dentons.com

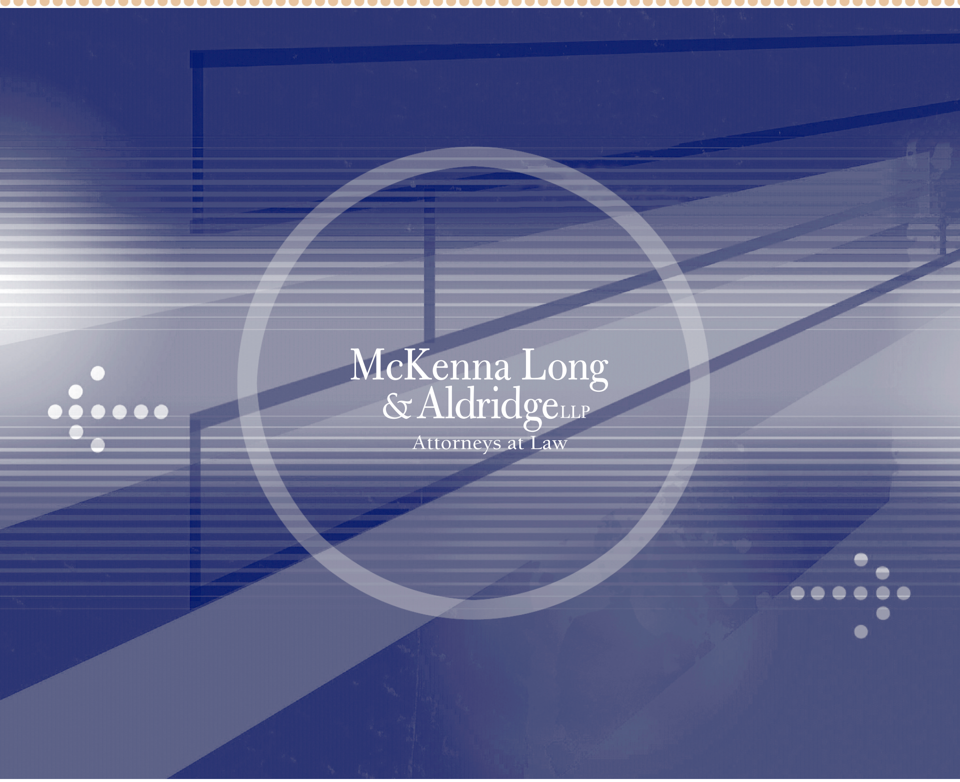
DENTONS

Insights and Commentary from Dentons

The combination of Dentons US and McKenna Long & Aldridge offers our clients access to 1,100 lawyers and professionals in 21 US locations. Clients inside the US benefit from unrivaled access to markets around the world, and international clients benefit from increased strength and reach across the US.

This document was authored by representatives of McKenna Long & Aldridge prior to our combination's launch and continues to be offered to provide our clients with the information they need to do business in an increasingly complex, interconnected and competitive marketplace.

CORPORATE GOVERNANCE
QUICK REFERENCE GUIDE



ATLANTA • BRUSSELS • DENVER • LOS ANGELES
PHILADELPHIA • SAN DIEGO • SAN FRANCISCO • WASHINGTON, DC

Introduction

This Quick Reference Guide began when our corporate lawyers organized themselves around the crisis emerging in late 2001 and the early jawboning responses of the stock exchanges, Securities and Exchange Commission, and other regulators. When the Sarbanes-Oxley Act was adopted in mid-2002, we created a more formal group, known internally as the Sarbanes Group, whose task was to master the changes and to educate the rest of us and our clients. The dust has now settled, at least somewhat. Most of the changes have been installed. Some are operating under transition rules and some have yet to become effective but their effective time has been established. A few are still in proposed form.

What remains, however, is the work we all must do – lawyers and clients – to absorb the plethora of changes – some extensive, some relatively minor – into the cultures of our organizations. This need led us to create the Guide. Its purpose is to have in one easily locatable binder the critical, often detailed components of the new compliance and governance environment.

We built this resource initially to use ourselves, and we have used it extensively over the past few months. A number of clients requested copies and so, in turn, we edited it for circulation. We invite your commentary. If there are additional topics you believe should be included, we would appreciate knowing that. Tell us experiences you think are indicative of material that is relevant to all companies. We anticipate the Guide will have a useful life of several years while we internalize the elements of this new operating environment.

We organized the Guide contextually, so you can readily access the material you need for answers in the same context in which the questions arise. We have also provided extensive cross-referencing where we believe important material may be located under more than one subject. For example, "independence" as a topic is important in many aspects of the operations of a board and its committees.

© McKenna Long & Aldridge LLP • June 2004

It is however, a concept that applies principally to the composition of the board itself. We have therefore presented the principal discussion of "independence" under the tab "Board Composition." So while each board committee is treated separately and aspects of "independence" unique to each committee are treated in the text for that committee, the subject of "independence" is cross-referenced to the section on boards. We have separately treated Nasdaq and New York Stock Exchange requirements where appropriate so that you can quickly find the information relevant to your question of the moment. Our aim has been to keep it simple and easy to use. There is no effort to provide legal interpretation – merely an effort to make it easy to find the answers to the questions we are asked and ask ourselves many times a day.

We chose the format deliberately. The Guide comes as a three-ring binder so that we can supply changed pages from time to time and supply additional subject matter sections as they become important. For example, we have included in a proposed form the proposed rules with respect to shareholder nominations for directors. When this rule is finalized we expect to replace that material.

In addition, we will be providing updates. These will come in two forms. We will forward electronic updates soon after changes occur. We will also periodically furnish hard copy pages which can be substituted for those in the Guide.

A word about the editorial group that assembled the Guide. They are a sizable group of very able associates of this firm, who have put in the extra time and hours required to keep ourselves and our clients current as these developments unfolded. They have been instrumental in preparing the series of advisories which we furnished during the course of the past two years, and they have taken direct responsibility for the content of the Guide. Theirs is the pinpoint expertise upon which we all rely.

© McKenna Long & Aldridge LLP • June 2004

We appreciate their efforts and have identified them as a group below. We have singled out the three principal editors whose extra efforts were exceptional, as were those of the reviewing partner-editor. We thank them all.

In addition, they are each separately identified to the subject matter topics for which they took particular responsibility. Should you have questions or suggestions, we of course urge you to contact the lawyer in our firm with whom you regularly raise relationship matters, and you may also wish to contact these individuals or the partners in our department who comprise the senior governance group.

Tom Wardell, Chair
Corporate Department
McKenna Long & Aldridge LLP
June 2004

ABOUT US

McKenna Long & Aldridge LLP is a full-service law firm of approximately 375 lawyers and public policy advisors. The firm provides business solutions in the areas of corporate law, government contracts, intellectual property and technology, complex litigation, public policy and regulatory affairs, real estate, environmental, energy and finance.

SUBSCRIPTION INFO

If you would like others to receive this Quick Reference Guide, please email their contact information to us at *cgguide@mckennalong.com*.

To change your address or to confirm that we have your email address for electronic updates, please email your contact info to *cgguide@mckennalong.com*.

If you would like to be removed from our Quick Reference Guide list, please email *cgguide@mckennalong.com*.

© McKenna Long & Aldridge LLP • June 2004

UPDATED 05/05

EDITORS:

Conrad Brooks
404.527.4972
cbrooks@mckennalong.com

Stacy Ingram
404.527.4647
singram@mckennalong.com

Andrew Surdykowski
404.527.8385
asurdykowski@mckennalong.com

REVIEWING PARTNER:

George Gaskin
404.527.8363
ggaskin@mckennalong.com

CONTRIBUTORS:

Valerie Barton
404.527.8326
vbarton@mckennalong.com

Joseph Blanco
404.527.4153
jblanco@mckennalong.com

David Brown
404.527.4927
dbrown@mckennalong.com

Clayton W. Coley
404.527.8365
ccoley@mckennalong.com

Monique McNeil
404.527.4644
mmcneil@mckennalong.com

Octavia Powers
404.527.8383
opowers@mckennalong.com

Melinda Renshaw
404.527.4195
mrenshaw@mckennalong.com

Trey Wainwright
404.527.4659
twainwright@mckennalong.com

SENIOR GOVERNANCE GROUP:

William L. Floyd
404.527.4010
wlf@mckennalong.com

R. William Ide, III
404.527.4650
bide@mckennalong.com

Clay Long
404.527.4050
clong@mckennalong.com

Michael Rosenzweig
404.527.4910
mrosenzweig@mckennalong.com

Tom Wardell
404.527.4990
twardell@mckennalong.com

BRUSSELS:

Richard R. Willis
32.2.278.12.64
rwillis@mckennalong.com

DENVER:

Raymond L. Friedlob
303.634.4324
rfriedlob@mckennalong.com

John W. Kellogg
303.634.4339
jkellogg@mckennalong.com

LOS ANGELES:

Dudley M. Lang
213.243.6144
dlang@mckennalong.com

WASHINGTON, DC

Kellie Newton
202.496.7193
knewton@mckennalong.com

The material contained in this Quick Reference Guide is for information only and does not constitute specific legal advice or opinions. Such advice and opinions are provided by the firm only upon engagement with respect to specific factual situations.
©2004 McKenna Long & Aldridge LLP.

Table of Contents

1 Board Composition and Governance

2 Audit Committee

3 Nominating/Corporate Governance Committee

4 Compensation Committee

5 Disclosure Controls and Procedures and Internal Control Over Financial Reporting

6 Governance Guidelines, Code of Ethics and Whistleblower Provisions

7 Use of Electronic Media/Web Sites

8 Use of Non-GAAP Financial Measures

9 Accelerated Filing Deadlines

10 MD&A Disclosures

11 Proxy Statements/Shareholder Communications

12 Shareholder Director Nominations

13 New Form 8-K Disclosure Requirements

14 Document Retention

15 Impact of Sentencing Guidelines/Corporate Compliance Programs

16 Foreign Private Issuers

© McKenna Long & Aldridge LLP • June 2004

Defined Terms

The following defined terms are used throughout this Corporate Governance Quick Reference Guide:

CEO
Chief Executive Officer

CFO
Chief Financial Officer

Exchange Act
Securities Exchange Act of 1934, as amended

GAAP
Generally Accepted Accounting Principles (U.S.)

IPO
Initial Public Offering

Nasdaq
The Nasdaq Stock Market, Inc.

NYSE
The New York Stock Exchange

PCAOB
Public Company Accounting Oversight Board

Sarbanes
The Sarbanes-Oxley Act of 2002

SEC
Securities and Exchange Commission

Securities Act
Securities Act of 1933, as amended

© McKenna Long & Aldridge LLP • June 2004

In November 2003, the SEC approved significant changes to the NYSE and Nasdaq listing standards that provide the basic governance requirements for companies listed on those respective markets. These listing standards, drafted in the aftermath of numerous scandals and in connection with the adoption and implementation of SOX, are designed to ensure the independence of directors of listed companies and to strengthen the companies corporate governance practices. While the standards have subsequently undergone several amendments, the basic impact remains the same.

The standards impact:

- Board composition
- Committee requirements
- Mandated policies and procedures

In late 2006, the SEC adopted additional requirements with respect to the determination of director independence and consolidated these requirements with other corporate governance disclosure requirements under new Item 407 of Regulation S-K.

NEW YORK STOCK EXCHANGE

Board Composition (Sections 303A.01-.02)

- A majority of the board must be independent and the company must identify which directors are independent and disclose the basis for that determination.
- Directors are required to meet subjective and objective measures of independence. The three-year look-back measurement period in the objective standards, which are listed below, is in effect as of November 4, 2004. 11/04
- No director qualifies as "independent" unless the board affirmatively determines that the director has no material relationship with the company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the listed company. The basis for determining that a relationship is not material must be disclosed in the company's annual proxy statement or, if the company does not file an annual proxy statement, in the company's Form 10-K. 11/04
- NYSE Objective Independence Standards – The following individuals are deemed not to be independent directors:

© McKenna Long & Aldridge LLP • August 2007

- ***The director is, or has been within the last three years, an employee of the listed company,*** or an immediate family member[1] is, or has been within the last three years, an executive officer, of the listed company (although employment as an interim Chairman or CEO or other executive officer does not disqualify a director from being independent).
- The director has ***received***, or has an immediate family member who has received, during any twelve-month period within the last three years, more than $100,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of ***deferred compensation*** for prior service (provided such compensation is not contingent in any way on continued service).
- The director or an immediate family member (a) is a current partner of a firm that is the company's internal or external auditor; (b) the director is a current employee of such a firm; (c) the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice; or (d) the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such a firm and personally worked on the listed company's audit within that time.

UPDATED 11/04

[1] *"Immediate family member" includes a person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters- in-law, brothers- and sisters-in-laws, and anyone (other than domestic employees) who shares such person's home.*

© McKenna Long & Aldridge LLP • August 2007

- The director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on that company's ***compensation committee***.
- The director is a current employee, or an immediate family member is a current executive officer, of a ***company that has made payments to, or received payments from,*** the listed company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of (a) $1 million or (b) 2% of such other company's consolidated gross revenues. (Contributions to tax-exempt organizations are not to be considered "payments" for purposes of this test, as long as certain disclosures are made in the company's annual proxy statement (or, if it does not file a proxy statement, its Form 10-K) regarding contributions to any such tax-exempt organization exceeding the foregoing amounts.)

- A director's ownership of even a significant amount of the company's stock, by itself, would ***not be viewed by the NYSE as a bar to an*** independence finding. The term "significant" has not been defined, but in the context of SEC releases, it is generally considered to be 10% or greater.
- Exceptions:
  - Controlled company (*i.e.*, when more than 50% of the voting power is held by an individual, a group or another company):
    - Controlled companies need ***not*** comply with provisions requiring a majority of independent directors.
    - If a controlled company chooses to take advantage of this exemption, then it must disclose in its annual proxy statement (or, if it does not file a proxy statement, its Form 10-K) that it is a controlled company and the basis for that determination. As a matter of practice, the board must make this determination.
  - IPO company:
    - Companies listing on the NYSE in connection with an IPO must have a majority-independent board within one year of listing.
  - Companies transferring from other markets:
    - A company listing on the NYSE upon transfer from another market will have one year from the date of transfer to comply with any

© McKenna Long & Aldridge LLP • August 2007

requirement to the extent the market on which it was listed did not have a substantially similar requirement. If the other market had a substantially similar requirement with a transition period for implementation that has not yet expired, the company will have the balance of that transition period to comply.

Committee Requirements (Sections 303A.04-.07)

- Audit committee (see "Audit Committee" section):
  - Membership – must have a minimum of three members, and all members must be independent directors
  - Must have a written charter
- Nominating/Governance committee (see "Nominating/Corporate Governance Committee" section):
  - Membership – no minimum number of members, but all members must be independent directors
  - Must have a written charter
- Compensation committee (see "Compensation Committee" section):
  - Membership – no minimum number of members, but all members must be independent directors
  - Must have a written charter
- Exceptions to independence requirements for IPO companies:
  - Companies listing on the NYSE in connection with an IPO must have:
    - One independent member on each committee listed above at the time of listing.
    - A majority of independent members on each committee listed above within 90 days of listing.
    - Fully independent committees within one year of listing.

© McKenna Long & Aldridge LLP • August 2007

Mandated Policies and Procedures (Sections 303A.03, 303A.09-.014)

- Executive sessions of ***non-management directors*** and of ***independent directors***:
  - Meetings – ***non-management*** directors must meet in regularly scheduled executive sessions without management.
    - Non-management directors are directors who are not executive officers, and include directors who are not independent due to material relationships, former status, family membership or otherwise.
    - If all non-management directors are not independent, then the independent directors should meet at least once annually.
  - ***Presiding non-management director*** – The company must disclose in its annual proxy statement (or, if it does not file one, its Form 10-K):
    - The procedure by which a presiding non-management director is selected for each executive session, ***or***
    - The name of the presiding non-management director, if only one director is chosen to preside at all such meetings.
- Communications by third parties with directors:
  - The company must:
    - Establish a method for interested parties to communicate directly with the presiding director or the non-management directors as a group, to make their concerns known to the non-management directors.
    - Disclose the method in its annual proxy statement or, if no proxy statement is filed, then in its Form 10-K.
  - For purposes of these communications, the company can utilize the same method it has established for complaint procedures (see "Governance Guidelines, Code of Ethics and Whistleblower Procedures" section).
- Corporate governance guidelines (see "Governance Guidelines, Code of Ethics and Whistleblower Procedures" section):
  - The board of directors must:
    - ***Adopt*** corporate governance guidelines

UPDATED 11/04

© McKenna Long & Aldridge LLP • August 2007

        - ***Disclose*** the guidelines on the company's web site

- Code of conduct (see "Governance Guidelines, Code of Ethics and Whistle-blower Procedures" section for more detail on the NYSE Code of Conduct requirements):
    - The board of directors must:
        - ***Adopt*** a code of business conduct and ethics applicable to all:
            - Directors
            - Officers, and
            - Employees
        - ***Disclose*** the code on the company's web site
    - Waivers of the code for ***officers*** and ***directors***:
        - Must be made by the board or by a board committee authorized by the board.
        - Must be disclosed promptly to shareholders, either on a Form 8-K (pursuant to SEC requirements) or on the company's web site.
- Listed companies must have and maintain a publicly accessible web site which must have printable versions of ***all*** of the following:
    - Corporate governance guidelines
    - Code of business conduct and ethics, and
    - Committee charters of most important committees (which means at least the audit, compensation and nominating committees)
- The company's annual proxy statement or ***Form 10-K*** must disclose ***all*** of the following:
    - State that these items are available on the company's web site.
    - Provide the address of the company's web site.
    - State that the same information is available to shareholders on request.
- Certification requirements:
    - The CEO must promptly notify the NYSE in writing after any executive officer of the company becomes aware of any material non-compliance with the NYSE corporate governance listing standards. See the "Form 8-K

© McKenna Long & Aldridge LLP • August 2007

Disclosure Requirements" section for corresponding SEC disclosure requirements under Item 3.01 of Form 8-K.

- The CEO must certify to the NYSE each year, on the CEO certification form provided by the NYSE, that he or she is not aware of any violation by the company of the NYSE governance listing standards, qualifying the certification to the extent necessary.
- The NYSE provides a form of certification, called a "Written Affirmation," that each listed company must submit annually to the NYSE addressing compliance with NYSE corporate governance listing standards. In addition, each listed company must submit an interim Written Affirmation each time a change occurs to the board or any of the audit, nominating/corporate governance or compensation committees. The annual and interim Written Affirmations must be in the form specified by the NYSE, which form can be found on the NYSE web site. 11/04
- NYSE may issue a public reprimand letter to any listed company, regardless of the type of security listed or country of incorporation, that it determines has violated a NYSE listing standard. For companies that repeatedly or flagrantly violate NYSE listing standards, suspension and delisting remain the ultimate penalties. 11/04

NASDAQ NATIONAL MARKET

ADDED 11/04

Board Composition (Rules 4350, 4200(a)(15))

- A majority of the board must be independent.
- Directors are required to meet objective measures of independence.
- In general, a director is not independent if the director was an officer of the company or a subsidiary or had another relationship which the board determines would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.
- A director's ownership of the company's stock, by itself, does ***not*** preclude a finding of independence.
- The company must disclose those directors determined to be independent in its annual proxy statement ***or***, if no proxy statement is filed, in its Form 10-K.
- Independent directors must have regularly scheduled meetings at which only independent directors are present.

- Nasdaq Objective Independence Standards – The following individuals are ***not*** deemed to be independent directors:
  - A director who is, or at any time during the past three years was, ***employed*** by the company or any of its parent or subsidiaries. Employment by a director as an executive officer on an interim basis lasting up to one year will not disqualify that director from being considered independent following such employment.
  - A director who accepted, or who has a family member[2] who accepted, any ***compensation from the company*** or any parent or subsidiary of the company, in excess of $100,000 during any period of 12 consecutive months within the three (3) years preceding the determination of independence.

11/04

    - Compensation does not include: (i) compensation for board or committee services; (ii) compensation paid to a family member[2] who is a non-executive employee of the company or a parent or subsidiary; (iii) benefits under a tax-qualified retirement plan or non-discretionary compensation; (iv) payments made in the ordinary course of providing business services (such as payments of interest or proceeds related to banking services, loans by a company that is a financial institution or payment of claims by a company that is an insurance company; (v) payments arising solely from investments in the company's securities; (vi) loans to executives permitted under Section 13(k) of the Exchange Act or (vii) compensation received by a director for former service as an interim officer, so long as that interim employment did not last longer than one year, although the board must consider whether that employment would interfere with the director's independent judgment.

ADDED 11/04

  - A director who is a ***family member***[2] of an individual who is, or at any time during the past three years was, ***employed*** by the company, or any parent or subsidiary of the company, ***as an executive officer***.
  - A director who is, or who has a family member[2] who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the ***company made***, or from which the ***company received***, ***payments*** for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or $200,000, whichever is more, other than (i) payments

© McKenna Long & Aldridge LLP • August 2007

arising solely from investments in the company's securities or (ii) payments under non-discretionary charitable contribution matching programs.

- A director of a listed company who is, or who has a family member[2] who is, employed as an executive officer of another entity, at any time during the past three years where any of the executive officers of the listed company serves on the ***compensation committee*** of such other entity; and
- A director who is, or who has a family member[2] who is, a current partner of the company's ***outside auditor*** (or was a partner or employee of the company's outside auditor and worked on the company's audit at any time during the past three years).

- Exceptions:
  - Controlled company (*i.e.*, when more than 50% of the company's voting power is held by an individual, group or another company):
    - Controlled companies need ***not*** comply with provisions requiring a majority of independent directors, but they must have regularly scheduled meetings at which only independent directors are present.
    - If a controlled company chooses to rely on this exemption, then it must disclose in its annual proxy statement (or, if it does not file a proxy statement, in its Form 10-K) that it is a controlled company and the basis for that determination. As a matter of practice, the board must make this determination.
  - Time for reestablishing compliance after vacancy or change in independent status of director:
    - If the company fails to comply with the independence requirement due to a vacancy, or a director ceases to be independent due to circumstances beyond the director's reasonable control, then the company must regain compliance with the independence requirement by the earlier of its next annual shareholders meetings or one year from the occurrence of the event that caused the compliance failure. If the annual shareholders meeting occurs no later than 180 days following the event that caused the compliance failure, then the company will have 180 days from that event to regain compliance. The company must inform Nasdaq of the non-compliance immediately upon learning of the event or circumstance that caused the non-

© McKenna Long & Aldridge LLP • August 2007

This page has intentionally been left blank.

compliance. See the "Form 8-K Disclosure Requirements" section for corresponding SEC disclosure requirements under Item 3.01 of Form 8-K.

- Newly listed companies:
  - Newly listed companies on Nasdaq must have a majority-independent board within one year of listing.
- Companies transferring from other markets:
  - A company transferring to Nasdaq from another market with substantially similar requirements will be afforded the balance of any grace period afforded by the other market. To the extent that the other market does not have a substantially similar requirement, the company will have one year from the date of listing on Nasdaq to comply.

Committee Requirements (Rule 4350)

- Audit committee (see "Audit Committee" section):
  - Membership – must have a minimum of three members, and all members must be independent directors
  - Must have a written charter
- Nominations committee (see "Nominating/Corporate Governance Committee" section):
  - Not required
  - Directors may be nominated ***either:***
    - By a nominations committee comprised solely of independent directors, ***or***
    - By a majority of the independent directors (with limited exceptions).
  - Must have a written charter or board resolution addressing the nomination process.
- Compensation Committee (see "Compensation Committee" section):
  - Not required
  - Nasdaq requires that the compensation of the CEO must be determined or recommended to the board for determination ***either:***

© McKenna Long & Aldridge LLP • August 2007

- By a compensation committee comprised solely of independent directors, ***or***
- By a majority of the independent directors.

- Exceptions to independence requirements for IPO companies:
  - Companies listing on Nasdaq in connection with an IPO must have:
    - One independent member on each committee listed above at the time of listing.
    - A majority of independent members on each committee listed above within 90 days of listing.
    - Fully independent committees within one year of listing.

Mandated Policies and Procedures (Rule 4350)

- Executive sessions of ***independent directors:***
  - Independent directors must hold regularly scheduled meetings at which only independent directors are present.
  - Controlled companies must hold executive sessions of independent directors even if the board is not majority independent.
- Code of conduct (see "Governance Guidelines, Code of Ethics and Whistle-blower Procedures" section):
  - The company must ***adopt*** (by board of directors approval) a code of conduct applicable to all:
    - Directors,
    - Officers, and
    - Employees
  - The code must be compliant with the code of ethics required by SOX and SEC rules adopted thereunder.
  - The code must be ***publicly available:***
    - As an exhibit to the company's Form 10-K, ***or***
    - On the company's web site.

© McKenna Long & Aldridge LLP • August 2007

- Waivers of the code for ***directors*** and ***executive officers*** must:
  - Be approved by the board, ***and***
  - For domestic companies, be disclosed on a Form 8-K within five business days of the waiver (see "Governance Guidelines, Code of Ethics and Whistleblower Procedures" section).
- The code must provide for an enforcement mechanism.

- Non-compliance with listing standards:
  - The company must give Nasdaq prompt notification after an executive officer becomes aware of any material non-compliance by the company with listing standards.
- Going concern audit opinion:
  - The company must issue a press release disclosing any audit opinions with going concern qualifications within seven days following the filing of the audit opinion in a public filing with the SEC.

SEC REGULATIONS

Item 407 of Regulation S-K

- Pursuant to Regulation S-K's new Item 407, a company must disclose, or incorporate by reference, in its Form 10-K each director and director nominee that is independent under the independence standards definitions applicable to the company:
  - For a listed company, the same definition used in the listing standards applicable to the company to determine whether a majority of the board of directors is independent, including any exemption to those requirements that are relied upon.
  - For an unlisted company, the definition used by any national securities exchange, using the same listing standards for all directors and committees, including any exemption to those requirements that are relied upon.
- If the company uses its own definitions, it must either indicate the availability of those definitions on the company's web site, including the company's web address, or make them available (at least every three fiscal

years, or in any year in which they are materially amended) in an appendix to the company's proxy statement or information statement.

- For each independent director, the company must disclose, by specific category or type, any transactions, relationships or arrangements not disclosed under related party transactions disclosure requirements (Item 404 of Regulation S-K) that were considered by the board in determining whether the director is independent.
- See the "Proxy Statements/Shareholder Communications" section for more information about the new Item 407 disclosures.

[1] *"Immediate family member" includes a person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters- in-law, brothers- and sisters-in-laws, and anyone (other than domestic employees) who shares such person's home.*

[2] *"Family member" is defined as a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.*

© McKenna Long & Aldridge LLP • August 2007

The largest impact of the SOX reforms was on audit committees. The audit committee's responsibilities have increased substantially, making sound procedures and documentation essential. The audit committee environment is defined both by the Exchange Act, as amended by SOX and the related regulations issued by the SEC, and by the principal stock exchanges. In late 2006, the SEC consolidated many of its disclosure obligations regarding audit committees with other corporate governance disclosures under new Item 407 of Regulation S-K.

SEC REQUIREMENTS FOR AUDIT COMMITTEES UNDER THE EXCHANGE ACT

Composition of the Audit Committee

- Independence:
  - Rule 10A-3 under the Exchange Act prohibits the listing of any security unless each member of the company's audit committee is "independent," or the company meets one of the Rule's exemptions from the independence requirements. The definition of independence as specified in Rule 10A-3 is more stringent than that applied by the exchanges (see "Board Composition and Governance" section) and has two principal components:
    - ***Director fees only; no advisory, consulting or compensatory fees.*** In order to be independent, an audit committee member must not accept, directly or indirectly, any consulting, advisory or other compensatory fees from the company or any of its subsidiaries, other than compensation for services as a director or a committee member. Compensatory fees do not include retirement plan compensation.
    - ***No affiliate status.*** An audit committee member is not permitted to be an "affiliated person" of the company or any of its subsidiaries, apart from serving as a director on the board or any board committee. The test for affiliation is being in control of, controlled by, or in common control with the company or others who together can determine the direction of the company. Note that a person will not be deemed to control the company if the person is not an executive officer of the company and is not the beneficial owner of more than 10% of any class of voting equity securities of the company. The definition of "affiliated person," however, is far-reaching. An executive officer, general partner or managing member of an affiliate (*e.g.*, a substantial

shareholder), or director who is also an employee of an affiliate, is him or herself considered an affiliated person of the listed company.

- There are limited exemptions for IPO companies, for audit committee members who sit on the board of both a listed company and an affiliate of the listed company, and for certain foreign private issuers (see Exchange Act Rule 10A-3(b)(1)(iv)).

- Audit committee financial expert:
  - The audit committee must either have an "audit committee financial expert" or, if not, the company must disclose in its annual proxy statement that it does not and the reasons why it does not. This disclosure requires a board determination that includes the board's reasoning for the determination.
  - This concept is not simple, although the universe of qualified individuals is relatively large:
    - An "audit committee financial expert" must have ***all*** of the following attributes:
      - An understanding of GAAP and financial statements.
      - An ability to assess the general application of GAAP in connection with accounting for estimates, accruals and reserves.
      - Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the company's financial statements, or experience actively supervising one or more persons engaged in such activities.
      - An understanding of internal control over financial reporting.
      - An understanding of audit committee functions.
    - To qualify, an individual must have acquired such attributes through ***any*** of the following:
      - Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions.

© McKenna Long & Aldridge LLP • August 2007

  - Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions.
  - Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements.
  - Other relevant experience, which must be briefly described in the company's Form 10-K if a person qualifies as an audit committee financial expert by means of this provision.
- The minutes of the board of directors' determination that an individual is an "audit committee financial expert" should reflect the board's consideration of these regulatory standards and the individual's expertise.

- With regard to who qualifies as an "audit committee financial expert," the SEC has stated that:
  - "[C]ertain individuals serving in governmental, self-regulatory and private-sector bodies overseeing the banking, insurance and securities industries work on issues related to financial statements on a regular basis. We believe that such experience can constitute a very useful background for an audit committee financial expert."
  - "[M]any people actively engaged in industries such as investment banking and venture capital investment have had significant direct and close exposure to, and experience with, financial statements and related processes. Similarly, professional financial analysts closely scrutinize financial statements on a regular basis. Indeed, all of these types of individuals often hold positions that require them to inspect financial statements with a healthy dose of skepticism. They therefore would be well prepared to diligently and zealously question management and the company's auditor about the company's financial statements," and thus hold the experience required to be an audit committee financial expert.

© McKenna Long & Aldridge LLP • August 2007

- In addition, the SEC has stated that an individual who has experience as a chief executive officer is not presumed to qualify as an audit committee financial expert. A CEO may qualify, however, if he or she actively participated in and contributed to the process, albeit at a supervisory level, of addressing the general types of issues regarding the preparation, auditing, analysis or evaluation of financial statements as those addressed by the person or persons being supervised.

Responsibilities of the Audit Committee

- Outside auditors:
  - Audit Services:
    - The audit committee must engage the company's independent auditors. The board should delegate this authority to the committee (either in the committee's charter and/or in a separate board resolution), and the audit committee should take responsibility for ***all*** of the following with respect to the auditors:
      - Appointment,
      - Compensation,
      - Retention, and
      - Oversight of the outside auditors (auditors report directly to the audit committee)
    - Approval must be explicit and must precede the engagement (see "Pre-approval" caption below).
  - Non-audit services:
    - Many non-audit services can destroy an auditors' independence. SOX and related SEC rules provide a list of specific non-audit services that independent auditors are prohibited from providing (see "Prohibited non-audit services" caption below).
    - Permitted non-audit services:
      - Permitted non-audit services are generally those that are not on the list of prohibited services below. The audit committee, however, should evaluate all non-audit services to ensure that they do not

impair the auditors' independence. The SEC has particularly stressed the need for careful review of any proposed tax services.

- The audit committee must approve permitted non-audit services. Approval must be explicit and must (with a limited *de minimis* exception) precede the engagement and commencement of services (see "Pre-approval" caption below).

- Prohibited non-audit services – the following non-audit services may not be performed by the company's independent auditors:
  - Bookkeeping or other services related to the accounting records or financial statements of the company.
  - Financial information systems design and implementation.
  - Appraisal or valuation services, fairness opinions, or contribution-in-kind reports.
  - Actuarial services.
  - Internal audit outsourcing services.
  - Management functions.
  - Human resources functions.
  - Acting as a broker-dealer or investment adviser, or providing investment banking services.
  - Legal services.
  - Expert services unrelated to the audit for the purpose of advocating the company's interests in litigation or regulatory or administrative investigations or proceedings.
  - Any other service that the PCAOB determines, by regulations, is impermissible.
    - In April 2006, the SEC approved PCAOB rules that state that an audit firm is not independent in the following circumstances:
    - If the audit firm provides a service or product to the company for a contingent fee or a commission, or receives from the company, directly or indirectly, a contingent fee or commission, at any time during the audit and professional engagement period (PCAOB Rule 3521).

- If the audit firm, or any affiliate of the audit firm, during the audit or professional engagement period, provides any non-audit service to the company relating to the marketing, planning or opining in favor of a tax treatment of, a transaction that is a confidential transaction (generally, a transaction offered to a company under conditions of confidentiality and for which the company pays the firm a fee) or falls within the category of aggressive tax position transactions, which generally consist of transactions initially recommended, directly or indirectly, by the audit firm and a significant purpose of which is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws (PCAOB Rule 3522). The latter transactions include the IRS's "listed transactions," which consist of transactions that are the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation or other form of published guidance as a listed transaction.
- If the audit firm, or any affiliate of the firm, during the audit and professional engagement period, provides any tax service to a person in a financial reporting oversight role at the audit client, or an immediate family member of such person, subject to certain exceptions (PCAOB Rule 3523). The term "financial reporting oversight role" means a role in which a person is in a position to or does exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

- Pre-approval:
  - Pre-approval may occur in one of two ways:
    - The audit committee may explicitly approve the particular engagement before the auditor is engaged to provide the audit or non-audit service; ***or***

- The engagement may be entered into pursuant to detailed pre-approval policies and procedures established by the audit committee, provided ***all*** of the following are true:
  - The policies and procedures are detailed as to the particular service.
  - The audit committee is informed of each service.
  - The policies and procedures do not permit delegation of the audit committee's responsibilities to management.

- Pre-approval may take the form of delegation to one audit committee member, provided the approval is reported to the audit committee at the next meeting of the audit committee.
- Pre-approval policies must be disclosed by the company in its Form 10-K and/or proxy statement (see "Proxy Statement/Shareholder Communications" section).
- *De minimis* exception to pre-approval requirements – only applies to permitted non-audit services, if ***all*** such services:
  - Do not aggregate to more than 5% of total revenues paid by the company to its auditors in the fiscal year in which services are provided.
  - Were not recognized as a non-audit service at the time of the engagement.
  - Are promptly brought to the attention of the audit committee and approved prior to the completion of the audit by the audit committee or one or more designated members of the audit committee.

- Other federal responsibilities:
  - The audit committee must:
    - Establish accounting/audit ***whistleblower procedures*** for:
      - The receipt, retention and treatment of complaints relating to accounting, internal accounting controls or auditing matters, ***and***
      - Confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.

© McKenna Long & Aldridge LLP • August 2007

- Have the authority to engage independent counsel and other advisors.
- Be provided with appropriate funding as determined by the audit committee for the payment of outside auditors and advisors engaged by the audit committee.

Disclosures

- In addition to the disclosures described above under the captions "Audit committee financial expert" and "Pre-approval," a company must disclose ***all*** of the following in its annual proxy statement:
  - The name of each committee member or, if there is no separately designated audit committee, the full board (while Item 401 of Regulation S-K technically permits disclosure of the identity in the Form 10-K directly or by incorporation by reference from the proxy statement, the practical effect is proxy statement disclosure).
  - The number of audit committee meetings held during the last fiscal year.
  - The functions performed by the committee.
  - Whether audit committee members are independent, using the definition of independence for audit committees included in the NYSE, Nasdaq or other listing standards applicable to the company (see "Board Composition and Governance" section).
  - Reliance on the limited exemptions described above under the caption "Independence," with an assessment of whether that reliance will materially affect the ability of the audit committee to act independently and to satisfy its requirements. This requirement is also one which is permitted to be reported in the Form 10-K or proxy statement, but practically would need to be in the proxy statement.
- Pursuant to Regulation S-K's new Item 407, a company must disclose in its annual proxy statement and its Form 10-K (usually through incorporation by reference):
  - Whether the audit committee has a charter, and if so, whether it is available to shareholders on the company's web site.

© McKenna Long & Aldridge LLP • August 2007

- If the charter is not available on the company's web site, a current copy of the charter (provided at least every three fiscal years, or in any year in which it is materially amended, as an appendix to the proxy statement) or a statement indicating in which prior proxy or information statement the charter was included. Note that NYSE listed companies must post the charter on their web site, as required by Section 303A.14 of the NYSE listing standards, even if they provide it as an appendix to the proxy statement.
- For a Form 10-K, proxy statement or information statement of a listed company, if an action is to be taken with respect to the election of directors and the company not relying on certain exemptions, whether the company has an audit committee that has been established in accordance with Section 3(a)(58)(A) of the Exchange Act or a committee performing a similar function, identifying in either case all committee members, or whether the entire board is acting as the company's audit committee.
- The disclosures described above under the caption "Audit committee financial expert."
- A report of the audit committee, over the names of each committee member, stating:
  - Whether the audit committee has reviewed and discussed the audited financial statements with management;
  - Whether the audit committee has reviewed and discussed with the independent auditors matters required to be discussed by the Statement on Auditing Standards No. 61, as amended, as adopted by PCAOB in Rule 3200T;
  - Whether the audit committee has reviewed the written disclosures and letter from the independent auditors required by Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees," as adopted by PCAOB Rule 3600T, and discussed with the independent auditors their independence; and
  - Whether, based on the above referenced reviews and discussions, the audit committee has recommended to the board of directors that the audited financial statements be included in the company's Form 10-K.

© McKenna Long & Aldridge LLP • August 2007

NEW YORK STOCK EXCHANGE REQUIREMENTS FOR AUDIT COMMITTEES
(Sections 303A.06-.07) (Additional to SEC Requirements)

Composition of the Audit Committee

- Number – the audit committee must consist of a minimum of three directors.
- Service on more than three public company audit committees requires a board determination that such service does not impair the member's ability to serve effectively on the listed company's audit committee. The company ***must disclose*** this determination in its annual proxy statement.
- All members must be independent:
  - Under the federal standard described above (*i.e.*, no advisory, consulting or compensatory fees and not an affiliated person), ***and***
  - Under the NYSE independent director standards as described in the "Board Composition and Governance" section.
- Exception when member ceases to be independent:
  - If a member of the audit committee ceases to be independent for reasons outside of the member's reasonable control, then the member may continue to serve on the audit committee until the earlier of the company's next annual meeting of shareholders or one year from the occurrence of the event that caused the member to no longer be independent.
- The company must provide notice to the NYSE of any event of non-compliance.
- Financial expertise/literacy:
  - Members must be financially literate, as determined by the board, or must become financially literate within a reasonable period of time following their appointment. "Financial literacy" has not been defined by the NYSE.
  - Financial expert – at least one member must possess accounting or related financial management expertise in the judgment of the board. A board may presume that a director who satisfies the definition of an

© McKenna Long & Aldridge LLP • August 2007

"audit committee financial expert," as described above under the caption "Audit committee financial expert," possesses the requisite accounting or related financial management expertise.

Purpose and Responsibilities of the Audit Committee

- The audit committee's purpose must be set forth in a ***written charter.*** The purpose must be, at a minimum, to:
  - Assist ***board oversight*** of ***all*** of the following:
    - Integrity of the company's financial statements
    - Compliance with legal and regulatory requirements
    - Outside auditors' qualifications and independence
    - Performance of the company's internal audit function and outside auditors
  - Prepare an audit committee ***report*** as required by the SEC in the annual proxy statement
- The ***charter*** must also contain the duties and responsibilities of the audit committee, which are, at a minimum:
  - Be responsible for the appointment, compensation, retention and oversight of the outside auditor.
  - At least annually, obtain and review a report by the company's independent auditor describing ***all*** of the following:
    - The audit firm's internal quality control procedures;
    - Any material issues raised by the most recent internal quality-control review, peer review or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, of the auditors' independent audits, and steps taken to deal with these issues; ***and***
    - Relationships between the independent auditor and the company to assess the independent auditor's independence.
  - Discuss the annual audited financial statements and quarterly financial statements with management and the independent auditors.

© McKenna Long & Aldridge LLP • August 2007

- Discuss the company's earnings press releases, financial information and earnings guidance provided to analysts and rating agencies.
- Discuss the company's risk assessment and risk management policies.
- Periodically meet separately with management, internal auditors and independent auditors.
- Review with the independent auditor any audit problems or difficulties and management's response to those problems.
- Establish procedures for each of the following:
  - The receipt, retention and treatment of complaints relating to accounting, internal accounting controls or auditing matters, ***and***
  - Confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.
- Have the authority to engage independent counsel and other advisors and be provided with appropriate funding, as determined by the audit committee, for the payment of independent auditors and other advisors engaged by the committee.
- Set clear hiring policies for employees or former employees of the independent auditors.
- Report regularly to the board of directors.
- Establish and follow a process for an annual performance evaluation of the audit committee.

- These duties are in addition to those "federal" duties with respect to pre-approval of audit and non-audit services described above under the caption "SEC Requirements for Audit Committees Under the Exchange Act – Responsibilities of the Audit Committee," which, for clarity and ease of administration should, as a matter of best practice, also be addressed in the audit committee charter.

Best Practice: As a matter of corporate law, the charter represents a delegation of authority by the board to the committee. The charter should be adopted by the entire board with language expressly delegating authority to carry out the responsibilities assigned to the committee, including frequency of reporting to the board.

© McKenna Long & Aldridge LLP • August 2007

Availability of Charter

- The company's ***web site*** must include the audit committee charter.
- The company's Form 10-K must state that the charter is available on its web site and in print to any shareholder that requests it.

NASDAQ REQUIREMENTS FOR AUDIT COMMITTEES

(Rule 4350(d)) (Additional to SEC Requirements)

Composition of the Audit Committee

- Number – the audit committee must consist of a minimum of three directors.
- All members must be independent:
  - Under the federal standards described above (*i.e.*, no advisory, consulting or compensatory fees and not an affiliated person), ***and***
  - Under Nasdaq independent director standards as described in the "Board Composition and Governance" section.
- Each audit committee member must not have participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years.
- Limited exception to the independence requirements:
  - One director who meets the federal standard for independence and is not a current officer or employee of the company, or a family member of an officer or employee, of the company, but is otherwise not independent under the Nasdaq listing standards, may serve on the committee and may be appointed to the audit committee if the board, under "exceptional and limited circumstances," determines this is required by the best interests of the company and its shareholders.
  - The company must disclose in its next proxy statement the nature of the member's relationship to the company and the reasons for the above determination.
  - This director cannot serve on the audit committee for more than ***two*** years and cannot be its chair.

© McKenna Long & Aldridge LLP • August 2007

- Additional exceptions:
  - If a committee member is no longer independent due to reasons beyond the member's reasonable control, then the audit committee member may remain on the audit committee until the earlier of the company's next annual meeting or one year from the occurrence of the event that caused the compliance failure.
  - If there is a vacancy on the audit committee and all remaining committee members are independent, the company will have until the earlier of the next annual meeting or one year from the occurrence of the event that caused the compliance failure, unless the annual meeting occurs no later than 180 days following such event, then the company will have 180 days from such event to regain compliance.
  - Nasdaq must be informed immediately upon company's learning of the event or circumstance that caused the compliance failure.

Responsibilities of the Audit Committee

- The committee must have a ***charter*** that contains, at a minimum, ***all*** of the following:
  - The scope of the committee's responsibilities, and how it carries out those responsibilities, including structure, processes and membership requirements.
  - The committee's responsibility for the appointment, compensation, retention and oversight of the outside auditor.
  - The committee's responsibility for ensuring receipt from the outside auditors of a written statement regarding the independence of the outside auditors, actively engaging in a dialogue with the auditors with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditors and taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor.
  - The committee's purpose of overseeing the company's accounting and financial reporting processes and the audits of the company's financial statements.

© McKenna Long & Aldridge LLP • August 2007

- The committee's responsibility to establish procedures for each of the following:
  - The receipt, retention and treatment of complaints relating to accounting, internal accounting controls or auditing matters, ***and***
  - Confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.
- The committee's authority to engage advisors and the provision by the company of appropriate funding, as determined by the committee, for the payment of those advisors.

- Audit committees for investment companies must also establish procedures for the confidential, anonymous submission by employees of the company, the investment adviser, administrator, principal underwriter or any other accounting related services provider of concerns regarding questionable accounting or auditing matters.
- These duties are in addition to those "federal" duties with respect to pre-approval of audit and non-audit services described above under the caption "SEC Requirements for Audit Committees Under the Exchange Act – Responsibilities of the Audit Committee," which, for clarity and ease of administration should, as a matter of best practice, also be addressed in the charter.

Best Practice: As a matter of corporate law, the charter represents a delegation of authority by the board to the committee. The charter should be adopted by the entire board with language expressly delegating authority to carry out the responsibilities assigned to the committee, including frequency of reporting to the board.

Related Parties/Conflict of Interest Transactions

- All related party transactions must be reviewed and approved by the audit committee or comparable independent body of the board. "Related party transaction" refers to transactions required to be disclosed under Item 404 of Regulation S-K (*i.e.*, transactions with management, certain business relationships, indebtedness of management and transactions with promoters).

© McKenna Long & Aldridge LLP • August 2007

Financial Literacy/Expertise

- Members must be able to read and understand fundamental financial statements at the time of their appointment, including a company's balance sheet, income statement and cash flow statement.
- Financial expert – at least one audit committee member must have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's "financial sophistication," including being or having been a CEO, CFO or other senior officer with financial oversight responsibilities. A director who qualifies federally as an "audit committee financial expert," as described above under the caption "SEC Requirements for Audit Committees Under the Exchange Act – Composition of the Audit Committee – Audit committee financial expert," is presumed to qualify as a financially sophisticated audit committee member.

© McKenna Long & Aldridge LLP • August 2007

Nominating/Corporate Governance Committee

Prior to the SEC's approval of the significant changes to the NYSE and Nasdaq listing standards on November 4, 2003, and its adoption of the final rules on "Disclosures Regarding Nominating Committee Functions" on November 24, 2003, neither nominating nor corporate governance committees were required under applicable rules and regulations.

NYSE

- Now requires listed companies to have a nominating/corporate governance committee.

Nasdaq

- Does not require a nominating or corporate governance committee.
- Does impose new requirements on how director nominees are selected.

SEC

- Prior to the adoption of the new standards, many companies employed nominating committees to aid in the selection of their directors. Their activities and functions were required to be discussed in the company's annual proxy statement. This requirement still applies.
- The new disclosure rules adopted on November 24, 2003 require that a company:
  - Must have established a nominating committee and must disclose that fact, ***or***
  - Must disclose the reasons why the company has determined that it is not necessary to establish such a committee.

NEW YORK STOCK EXCHANGE REQUIREMENTS FOR NOMINATING/ CORPORATE GOVERNANCE COMMITTEES (Section 303A(4))

Composition

- The nominating/corporate governance committee must be comprised solely of independent directors. (For a discussion of the requirements for "independence," see "Board Composition and Governance" section.)

© McKenna Long & Aldridge LLP • June 2004

Nominating/Corporate Governance Committee

Implementation — Transition

- Companies listed on the NYSE at November 4, 2003 must comply by the ***earlier*** of:
  - Their first annual meeting after January 15, 2004, ***or***
  - October 31, 2004.
- IPO company – Companies listing on the NYSE in connection with an IPO must have:
  - One independent member on the committee at the time of listing.
  - A majority of independent members on the committee within 90 days of listing.
  - A fully independent committee within one year of listing.
- Companies transferring from other markets:
  - A company listing on the NYSE upon transfer from another market will have 12 months from the date of transfer to comply with any requirements that are different from the requirements of the market from which it is transferring. The company will also be able to use any unexpired transition period for compliance with substantially similar requirements of the other market.

Charter

- The nominating/corporate governance committee must have a ***written charter.*** The charter must be available to the public on the company's web site.
- The written charter ***must*** address:
  - The committee's purpose and responsibilities, which must include, at a minimum, the responsibility to do ***all*** of the following:
    - Identify persons qualified to be board members, consistent with criteria approved by the board.
    - Select (or recommend that the board select) the director nominees for the next annual shareholders meeting.
    - Develop and recommend to the board a set of corporate governance guidelines applicable to the company.

    - Oversee the evaluation of the board and the company's management.
  - An annual performance evaluation of the activities of the nominating/corporate governance committee.
- NYSE's commentary to the rules provides that the written charter ***should*** include the following regarding the purpose and responsibilities of the committee:
  - Committee member qualifications
  - Committee member appointments and removals
  - Committee structure and operations (including authority to delegate to subcommittees)
  - The procedures by which the committee will report to the board
  - A grant to the committee of the sole authority to retain and terminate any third-party search firms used to identify director candidates, including negotiating the fees and retention terms

Best Practice: As a matter of corporate law, the charter represents a delegation of authority by the board to the committee. The charter should be adopted by the entire board with language expressly delegating authority to carry out the responsibilities assigned to the committee, including frequency of reporting to the board.

Exceptions

- A "controlled company" (*i.e.*, when more than 50% of the voting power is held by an individual, a group or another company) is not required to have a nominating/corporate governance committee.
  - If a controlled company chooses to rely upon this exemption, then it must disclose in its annual proxy statement (or Form 10-K, if no proxy statement is filed) that it is a "controlled company," the basis for that determination and that it is relying on the exemption. As a matter of practice, the board must make this determination.
- Companies that only list preferred or debt securities on the NYSE are not required to have a nominating/corporate governance committee.
- Special rules apply to certain foreign corporations.

© McKenna Long & Aldridge LLP • June 2004

Nominating/Corporate Governance Committee

NASDAQ REQUIREMENTS FOR NOMINATING DIRECTORS (Rule 4350(c))

Basic Requirements

- Nasdaq does not require that a company have a nominations committee.
- If a nominations committee is not utilized, the director nominees are required to be selected by a ***majority*** of the ***independent*** directors.
- The company must adopt a formal, written charter or board resolution, as applicable, addressing the nominations process and any related matters required under the federal securities laws.

Best Practice: As a matter of corporate law, the charter represents a delegation of authority by the board to the committee. The charter should be adopted by the entire board with language expressly delegating authority to carry out the responsibilities assigned to the committee, including frequency of reporting to the board.

- If a nominations committee is used:
  - The directors on the nominations committee must all be independent, except in the limited circumstance described immediately below.
  - If the nominations committee is comprised of at least three members, one non-independent director may serve on the nominations committee under "exceptional and limited circumstances" with the following limitations:
    - The director cannot be a current officer or employee of the company, or a family member of a current officer or employee.
    - The board determines that such individual's membership on the committee is required in the best interests of the company and its shareholders.
    - The nature of the relationship and the reasons for the board's determination ***must*** be disclosed in the next annual proxy statement (or, if the company does not file a proxy statement, in its Form 10-K).
    - A member appointed under this exception cannot serve on the committee longer than ***two*** years.

© McKenna Long & Aldridge LLP • June 2004

Implementation — Transition

- Companies (other than foreign private issuers and small business issuers) listed on Nasdaq at November 4, 2003 must comply by the ***earlier*** of:
  - The first annual meeting after January 15, 2004, ***or***
  - October 31, 2004.
- IPO company – Companies listing on Nasdaq in connection with an IPO must have:
  - One independent member on the committee at the time of listing.
  - A majority of independent members on the committee within 90 days of listing.
  - A fully independent committee within one year of listing (companies could instead rely on the majority of independent directors to nominate board members).
- Companies transferring from other markets:
  - A company listing on Nasdaq upon transfer from another market will have 12 months from the date of transfer to comply with any requirements that are different from the requirements of the market from which it is transferring. The company will also be able to use any unexpired grace period for compliance with substantially similar requirements of the other market.
- Listed companies that are foreign private issuers and small business issuers have until July 31, 2005 to comply.

Exceptions

- The nominating provisions do not apply in cases where the right to nominate a director belongs to a third party or the company is subject to a pre-November 4, 2003 binding obligation (*e.g.*, shareholders agreement or charter requirement) that requires an inconsistent nomination structure.
- A "controlled company" (*i.e.*, when more than 50% of the voting power is held by an individual, a group or another company) is exempt from the requirements for independence of members of the committee.

© McKenna Long & Aldridge LLP • June 2004

- If a controlled company chooses to rely upon this exemption, then it must disclose in its annual proxy statement (or Form 10-K, if no proxy statement is filed) that it is a "controlled company," the basis for that determination and that it is relying on the exemption. As a matter of practice, the board must make such a determination.

NEW SEC DISCLOSURE REQUIREMENTS REGARDING NOMINATING COMMITTEES

Implementation

- Companies must comply with the SEC's new disclosure requirements regarding nominating committees in any proxy statement or information statement that is first sent to shareholders after January 1, 2004. The new disclosure requirements are described in more detail in the "Proxy Statements/Shareholder Communications" section.

Basic Requirements

- The proxy statement must:
  - State that the company has a nominating committee, ***or***
  - Provide the reasons why the board has determined that a nominating committee is not necessary.
- The proxy statement must:
  - State the company's web site address at which the nominating committee's written charter is located, ***or***
  - Identify the proxy statement to which the charter is attached as an appendix (the charter must be included as an appendix to the proxy statement at least every ***three*** years if it is not provided by reference to the company's web site).[1]
- The proxy statement must disclose whether the members of the nominating committee meet the independence definition of the applicable exchange:
  - If the company is listed, then the exchange on which it is listed is the applicable exchange.

[1] *Note: NYSE listed companies must post the charter on their web site, even if they provide it as an appendix to the proxy statement.*

© McKenna Long & Aldridge LLP • June 2004

    - If the company is not listed, then it must choose one of the exchange's definitions of independence, disclose which definition is being employed, and consistently apply the definition.
- The proxy statement must:
    - Describe the policy of the company regarding the consideration of candidates nominated by shareholders, ***or***
    - State that the company does not have a policy regarding the consideration of candidates nominated by shareholders.
        - If the nominating committee will consider candidates recommended by shareholders, then the proxy statement must provide a description of the process that a shareholder must use to put forward the name of such a candidate.
- The proxy statement must describe any minimum qualifications for directors, as well as any specific qualities or skills that the shareholder believes are necessary for one or more of the company's directors.
- The proxy statement must describe the process for identifying and evaluating nominees for director (if the process for a shareholder candidate is different, then it must be stated as such).
- For all nominees approved for the proxy card who are not executive officers or directors of the company standing for reelection, a statement must be included as to which one or more of the following groups recommended the nominee:
    - Shareholder
    - Non-management director
    - CEO
    - Other executive officer
    - Third-party search firm
    - Other specified source
- The proxy statement must disclose the role of any third-party search firm in identifying nominees.

© McKenna Long & Aldridge LLP • June 2004

Nominating/Corporate Governance Committee

- The proxy statement must provide the names of any recommended nominee from a shareholder (or group of shareholders) that owned at least 5% of the company's stock for at least one year prior to the date of the recommendation, along with an indication as to whether the nominating committee (or the board) decided to nominate the candidate.
  - This proxy statement disclosure is only required if the company has the written consent of the applicable shareholder and the proposed nominee to be named in the proxy statement.
  - The proposed nominee must have been recommended at least 120 days before the mailing date of the company's proxy statement that related to the previous annual meeting for this disclosure requirement to apply.
  - The proposed rule requiring issuers to disclose the specific reasons for not nominating a candidate recommended by a shareholder was ***not*** adopted. In other words, an issuer is ***not*** required to disclose why an individual was not nominated.
  - ***NOTE:*** On October 14, 2003, the SEC proposed new rules, which would provide a process for shareholder nominations of directors. These rules have not yet been adopted, but they are summarized in the "Shareholder Director Nominations" section.

Joseph Blanco
Andrew Surdykowski

© McKenna Long & Aldridge LLP • June 2004

Prior to the SEC's approval of the significant changes to the NYSE and Nasdaq listing standards on November 4, 2003, there was no requirement for a public company to have a compensation committee. Nor was there any guidance from the NYSE or Nasdaq regarding the appropriate composition for a compensation committee if a company already had one in place. Even today, only the NYSE requires compensation committees.

PRIOR REGULATION — FEDERAL ONLY

Proxy Statement Disclosure

- Previously, the conduct of compensation committees was regulated only by Item 402(k) of Regulation S-K, which requires a company to include in its proxy statement a compensation committee report on executive compensation to be made over the name of each member of the company's compensation committee, other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors. This requirement still exists.

Rule 16b-3

- If a company's compensation committee is comprised solely of "non-employee directors," then the company may rely upon the Rule 16b-3 exemption from the short swing profit rules of Section 16(b) of the Exchange Act for equity awards granted by such committee, without having to obtain full board or shareholder approval of the grants. This exemption remains unaffected.
- The definition of "non-employee director" under Rule 16b-3 is also unaffected by the recent changes to the stock exchange standards of independence.

NEW YORK STOCK EXCHANGE REQUIREMENTS FOR COMPENSATION COMMITTEES (Section 303A(5))

Composition

- The compensation committee must be composed entirely of independent directors, effective with the earlier of (i) the company's first annual meeting after January 15, 2004 or (ii) October 31, 2004.

© McKenna Long & Aldridge LLP • June 2004

Implementation — Transition

- Companies listed on the NYSE at November 4, 2003 must comply by the ***earlier*** of:
  - Their first annual meeting after January 15, 2004, ***or***
  - October 31, 2004.
- IPO company – Companies listing on the NYSE in connection with an IPO must have:
  - One independent member on the committee at the time of listing.
  - A majority of independent members on the committee within 90 days of listing.
  - A fully independent committee within one year of listing.
- Companies transferring from other markets:
  - A company listing on the NYSE upon transfer from another market will have 12 months from the date of transfer to comply with any requirements that are different from the requirements of the market from which it is transferring. The company will also be able to use any unexpired transition period for compliance with substantially similar requirements of the other market.

Charter

- The compensation committee must have a ***written charter*** that is posted on the company's web site.
- The company's Form 10-K must state that:
  - The charter is available on the company's web site, ***and***
  - The charter is available in print to any shareholder who requests it.
- The charter must address:
  - The committee's purpose and responsibilities, which must include the responsibility to do ***all*** of the following, at a minimum:
    - Review and approve corporate goals and objectives relevant to the CEO's compensation.

© McKenna Long & Aldridge LLP • June 2004

- Evaluate the CEO's performance in light of these goals and objectives.
- Determine and approve the CEO's compensation level based upon this evaluation, either as a committee or together with the other independent directors (as directed by the board).
- Make recommendations to the board with respect to non-CEO executive officer compensation, incentive-compensation plans and equity-based plans that are subject to board approval. (This does not preclude the board from delegating its authority over such matters to the Compensation Committee.)
- Produce a compensation committee report on executive officer compensation as required by the SEC to be included in the company's annual proxy statement.

UPDATED 11/04

- An annual performance evaluation of the committee.

- The NYSE's commentary to the rules provides that as a matter of best practice companies also should consider addressing the following items in the charter:
  - Committee member qualifications
  - Committee member appointment and removal
  - Committee structure and operations (including authority to delegate to subcommittees)
  - Committee reporting to the board
- The NYSE's commentary to the rules also provides that where a compensation consultant is used to assist in the evaluation of director, CEO or executive officer compensation, the compensation committee charter should give the committee sole authority to retain and terminate the consulting firm, including sole authority to approve the firm's fees and other retention terms. 11/04

Best Practice: As a matter of corporate law, the charter represents a delegation of authority by the board to the committee. The charter should be adopted by the entire board with language expressly delegating authority to carry out the responsibilities assigned to the committee, including frequency of reporting to the board.

- The NYSE's commentary to the rules further provides that the full board is not prohibited from discussing the CEO's compensation.

- Controlled companies, limited partnerships, companies in bankruptcy and certain other entities are not required to have a compensation committee. Under NYSE rules, a "controlled company" is a company of which more than 50% of the voting power is held by an individual, a group or another company.
  - If a controlled company chooses to rely upon this exemption, then it must disclose in its annual proxy statement (or Form 10-K, if no proxy statement is filed) that it is a controlled company, the basis for that determination and the use of the exemption. As a matter of practice, the board must make this determination.

NASDAQ REQUIREMENTS REGARDING COMPENSATION (Rule 4350(c))

Basic Requirements

- Nasdaq does ***not*** require a compensation committee.
- Nasdaq rules require that:
  - CEO compensation must be determined or recommended to the board by ***either:***
    - A majority of the independent directors, ***or***
    - A committee comprised solely of independent directors.
  - The CEO may not be present during deliberation or voting in either case.
  - Compensation of all other executive officers ***must*** be determined in the same manner as CEO compensation, ***except*** that the CEO may be present.
- The requirements for determining compensation are effective with the earlier of (i) the company's first annual meeting after January 15, 2004 or (ii) October 31, 2004.
- Nasdaq does not require companies to adopt a written compensation committee charter. As a matter of best practice, however, Nasdaq-listed companies should consider doing so as a clear reflection of board delegation of authority and responsibilities to the committee.

© McKenna Long & Aldridge LLP • June 2004

Implementation — Transition

- Companies (other than foreign private issuers and small business issuers) listed on Nasdaq at November 4, 2003 must comply by the ***earlier*** of:
  - The first annual meeting after January 15, 2004, ***or***
  - October 31, 2004.
- IPO company – Companies listing on Nasdaq in connection with an IPO must have:
  - One independent member on the committee at the time of listing.
  - A majority of independent members on the committee within 90 days of listing.
  - A fully independent committee within one year of listing (companies could instead rely on the majority of independent directors to determine compensation matters).
- Companies transferring from other markets:
  - A company listing on Nasdaq upon transfer from another market will have 12 months from the date of transfer to comply with any requirements that are different from the requirements of the market from which it is transferring. The company will also be able to use any unexpired grace period for compliance with substantially similar requirements of the other market.
- Listed companies that are foreign private issuers and small business issuers have until July 31, 2005 to comply.

Exceptions

- If the company has a compensation committee and it is comprised of at least three members, one non-independent director may serve on the committee under "exceptional and limited circumstances" with the following limitations:
  - The director cannot be a current officer or employee of the company, or a family member of a current officer or employee.
  - The board determines that such individual's membership on the committee is required in the best interests of the company and its shareholders.

© McKenna Long & Aldridge LLP • June 2004

- The nature of the relationship and the reasons for the board's determination ***must*** be disclosed in the next annual proxy statement (or, if the company does not file a proxy statement, in its Form 10-K).
- A member appointed under this exception cannot serve on the committee longer than ***two*** years.

- "Controlled companies" are exempt from all of these requirements. A "controlled company" is a company of which more than 50% of the voting power is held by an individual, group or another company.
  - If a controlled company chooses to rely upon this exemption, then it must disclose in its annual proxy statement (or Form 10-K, if no proxy statement is filed) that it is a controlled company, the basis for that determination and the use of the exemption. As a matter of practice, the board must make such a determination.

Octavia Powers
Andrew Surdykowski

© McKenna Long & Aldridge LLP • June 2004

DISCLOSURE CONTROLS AND PROCEDURES

Definition of Disclosure Controls and Procedures

- Disclosure controls and procedures are designed to ensure that Exchange Act information is recorded, processed, summarized and reported in the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include (without limitation) controls and procedures designed to ensure that information is accumulated and communicated to the company's management, including the CEO and CFO, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Overlap with Internal Control Over Financial Reporting

- The SEC has stated that there is substantial overlap between disclosure controls and procedures and internal control over financial reporting (see "Internal Control Over Financial Reporting" caption below). In particular, those components of internal control over financial reporting that provide reasonable assurances that transactions are recorded as necessary to permit preparation of GAAP compliant financial statements ***are included*** in disclosure controls and procedures.
- Those components of internal control over financial reporting that are included in disclosure controls and procedures are subject to quarterly and annual evaluation to satisfy disclosure requirements and support the CEO's and CFO's Section 302 certification (see "Section 302 Certification" caption below).
- Management must disclose whether there were any changes to internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting. To make this disclosure, management must necessarily evaluate internal control over financial reporting on a ***quarterly*** basis to some extent. This evaluation will differ from the evaluation of internal control over financial reporting required for the Section 404 report in a company's Form 10-K.

© McKenna Long & Aldridge LLP • June 2004

Disclosure Controls Committee

- The regulatory requirement regarding disclosure controls does not specify how a company must design and use those controls. The SEC has recommended (and best practice has become) that a company create a committee to manage the flow of information, to evaluate information for materiality and to determine disclosure obligations on a timely basis (a "disclosure controls committee"). A disclosure controls committee also may be responsible for helping the CEO and CFO audit the disclosure controls and procedures process to ensure that it is working properly and for taking necessary action to improve the disclosure process.
- Committee Composition:
  - The SEC recommends that the disclosure controls committee should be comprised of the following officers, or officers performing similar functions:
    - Principal accounting officer or controller
    - General counsel or other senior legal official with responsibility for disclosure matters
    - Principal risk management officer
    - Chief investor relations officer (or an officer with equivalent responsibilities)
    - Such other officers or employees (including senior officers associated with business units and employees involved in the preparation of disclosure reports) as deemed appropriate by the company
  - The general counsel or other senior legal official on the committee should act as the chairperson of the committee, since disclosure is ultimately a legal decision.
  - A disclosure controls committee should have a charter outlining its responsibilities.

© McKenna Long & Aldridge LLP • June 2004

- Disclosure Reporters:
  - To the extent responsibility has not been assigned through specific job descriptions, companies should divide and assign responsibility for gathering and qualifying the information required by the Form 10-K and for preparing the report. Those persons having responsibility for particular areas of the Form 10-K should retain that responsibility throughout the year (in this section of the Guide, each such person is referred to as a "disclosure reporter" and each disclosure reporter's area of responsibility, an "area").
  - Each disclosure reporter should report to the disclosure controls committee on an ongoing basis the following matters for his or her area:
    - Material deviation or change from the current public information with respect to the company
    - Changes in risks (or new risks) as they have been identified with respect to the disclosure reporter's area
    - Changes that may affect financial results in the disclosure reporter's area
    - A summary every 90 days of the previous three subjects
  - In practice, this means that a disclosure reporter will need to be aware of (if not involved in) the strategic planning functions of the company and will need to be informed of changes in the strategic goals of the company. It also means that each disclosure reporter will be responsible for supplying to the disclosure controls committee any change in the general information, risks or financial impact in his or her area.
  - Additionally, each quarter, in connection with the preparation of a Form 10-Q or Form 10-K, each disclosure reporter should report to the disclosure controls committee as to whether all information that should have been furnished to the committee was in fact furnished.

© McKenna Long & Aldridge LLP • June 2004

- Specific Committee Responsibilities:
  - Prepare and disseminate guidelines specifying the responsibilities and the lines of communication of committee members and employees involved in disclosure controls and procedures.
  - Prepare and disseminate to those involved in the disclosure process a timetable and checklist that assigns responsibility (based on an individual's experience and specific area of knowledge) for each aspect of the system of information management.
  - Compile a report directed to the CEO and CFO (and furnished to the company's auditors and audit committee) reviewing the matters processed during the preceding 90-day period.

Section 302 Certification

- The Section 302 certification has been codified as Exhibit 31 to each of Form 10-Q and Form 10-K, and must be ***filed*** with each of the company's Forms 10-Q and 10-K.
- It must be executed by the CEO and CFO.
- The certification must track the language below ***exactly***, with the limited exception noted in Footnote 1.

© McKenna Long & Aldridge LLP • June 2004

Form of Section 302 Certification

I, [identify the certifying individual], certify that:

1. I have reviewed this [specify report] of [identify registrant];
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods resented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) ***[and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f))]***[1] for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under their supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is make known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) ***[Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;]***[1]

[1] *Exception: These portions of the certification set forth in bracketed and bold text relating to internal control over financial reporting are subject to extended compliance periods established by the SEC. As a result, the bolded text need only be provided in the company's first Form 10-K that must include management's report on internal control over financial reporting and in all periodic reports filed thereafter. See "Internal Control Over Financial Reporting - Effective Dates" caption below for details regarding when this requirement becomes effective.*

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: ____________________

____
[Name]

____
[Title]

© McKenna Long & Aldridge LLP • June 2004

Section 906 Certification

- The Section 906 certification has been codified as Exhibit 32 to each of Form 10-Q and Form 10-K, and must be ***furnished*** with each of the company's Forms 10-Q and 10-K.
- No proscribed specific language has been stated, but the language should be in substantially the following form:

  In connection with the [Annual/Quarterly] Report of [insert company name] (the "Company") on Form [10-K/10-Q] for the period ended [insert date] as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, [insert name], [insert title] of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that [, ***to the best of my knowledge***][2]:

  (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

  (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

[2] *Note: Best practice is to include a knowledge qualification which permits consistency with the Section 302 certification discussed above.*

© McKenna Long & Aldridge LLP • June 2004

INTERNAL CONTROL OVER FINANCIAL REPORTING

Perhaps the most radical impact on companies of all of the changes mandated by Sarbanes will result from the imposition of extensive responsibilities on companies with respect to internal control over financial reporting. These responsibilities are still being developed. More substance will be forthcoming as the first reporting dates approach (first fiscal year ending on or after November 15, 2004 for accelerated filers and ending on or after July 15, 2005 for non-accelerated filers).

What is required?

- A report:
  - Annually in the Form 10-K
  - By the CEO and the CFO (or those fulfilling those roles), called "management" in this section and in the rules
  - Based on management's participation in the review process
- An attestation:
  - Annually in the Form 10-K
  - By the company's outside auditors
- An evaluation
  - By management
  - Quarterly
  - Of changes since the Form 10-K report

© McKenna Long & Aldridge LLP • June 2004

Definition of Internal Control Over Financial Reporting

- In the rule, "internal control over financial reporting" is defined as:
  - A process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that:
    - Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of assets of the company;
    - Provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the company are being made only in accordance with the authorizations of management and directors of the company; ***and***
    - Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Contents of Management's Annual Report

- Management's annual report must include:
  - A statement of ***management's responsibility*** for establishing and maintaining adequate internal control over financial reporting.
  - A statement identifying the ***framework*** used by management to evaluate the ***effectiveness*** of the company's internal control over financial reporting.
  - Management's ***assessment of the effectiveness*** of the company's internal control over financial reporting as of the end of the company's most recent fiscal year, including a statement as to whether the company's internal control over financial reporting is effective.

© McKenna Long & Aldridge LLP • June 2004

        - Note that a negative assurance to the effect that "nothing has come to the attention of management" is ***not*** acceptable.
    - Disclosure of any ***"material weakness"*** identified by management in the company's internal control over financial reporting.
        - If a material weakness has been identified, management may not conclude that the internal control over financial reporting is effective.
        - A "material weakness" exists when the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors or fraud in amounts that would be material relative to the financial statements being audited may occur and go undetected within a timely period by employees in the normal course of performing their assigned functions (Statement on Auditing Standards No. 60).
    - Confirmation that the registered public accounting firm that audited the financial statements has issued an ***attestation report*** (including required opinions) on management's assessment of the internal control over financial reporting. The company must also file the accounting firm's attestation report as part of its Form 10-K.

Framework Used By Management

- The rules do not mandate a particular framework for management to use to evaluate internal control over financial reporting. However, management must use a suitable, recognized control framework that has been adopted by a method following due process procedures, including the broad distribution of the framework for public comment (for example, the framework published by the Committee of Sponsoring Organizations ("COSO")).
- Such a framework:
    - Must be free from bias;
    - Must permit reasonably consistent qualitative and quantitative measurements of a company's internal control;
    - Must be sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of a company's internal control are not omitted; ***and***

- Must be relevant to an evaluation of internal control over financial reporting.

- The COSO framework in fact contemplates significantly more qualitative substance in the controls than the concept of "internal control over financial framework reporting" as adopted by the SEC.

Method of Evaluating Internal Control Over Financial Reporting

- The rules do not mandate specific methods or procedures for the evaluation of internal control over financial reporting; however, the adopting release states that ***inquiry alone*** will ***not*** provide an adequate basis for management's assessment.

- The assessment must be based on procedures sufficient to evaluate the design and to test the operating effectiveness of the controls, including ***all*** of the following:
  - Controls over initiating, recording, processing and reconciling account balances, classes of transactions and disclosure and related assertions in financial statements.
  - Controls related to the initiation and processing of non-routine and non-systematic transactions.
  - Controls related to the selection and application of appropriate accounting policies.
  - Controls related to the prevention, identification and detection of fraud.

- In addition, a company must retain ***evidence***, including documentation, of management's assessment of the effectiveness of internal control over financial reporting. This evidence should provide reasonable support:
  - For the evaluation of whether the control is designed to prevent or detect material misstatements or omissions;
  - For conclusions that tests were appropriately planned and performed; ***and***
  - That the results of the tests were appropriately considered.

Disclosure Controls and Procedures and Internal Control Over Financial Reporting

Location of Internal Control Report

- The SEC states that the report should be in close proximity to the corresponding attestation report by the company's independent auditor.
- The SEC expects many companies will choose to place it near MD&A or immediately preceding the financial statements.

Auditor Attestation and Independence Issues

- A company's Form 10-K must include an attestation report from the company's registered public accountant on management's assessment of internal control.
- The attestation report must:
  - Be dated, be signed manually and identify the period covered by the report.
  - Clearly state the auditor's opinion as to whether management's assessment of the effectiveness of the company's internal control is fairly stated in all material respects (or state why such an opinion cannot be given).
- Because the auditor must attest (and, as part of the attestation, opine) to management's assessment, management and the auditor will need to coordinate their processes for documenting and testing internal control.
  - Auditors may assist management in documenting internal control, but management must be actively involved in the process and cannot delegate its responsibility to the auditor.
  - Management's mere acceptance of final responsibility for documentation and testing performed by the auditor will not satisfy the auditor independence requirements.

© McKenna Long & Aldridge LLP • June 2004

Quarterly Evaluations of Material Changes

- In addition to its assessment of the effectiveness of internal control over financial reporting, management is required to evaluate any changes in the company's internal control over financial reporting that occur during a fiscal quarter and that have materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting.
- The company is required to disclose such changes in its quarterly reports on Form 10-Q.
- The company is not required to undertake a full evaluation of the effectiveness of its internal control over financial reporting on a quarterly basis. However, management will continue to be required to undertake a quarterly evaluation as to the effectiveness of disclosure controls and procedures (including some aspects of internal control – see "Disclosure Controls and Procedures" caption above).

Effective Dates

- These obligations become effective:
  - For "accelerated filers" (not including foreign private issuers), beginning with their first report on Form 10-K for fiscal years ending on or after November 15, 2004.
  - For most other issuers, beginning with their first report on Form 10-K for fiscal years ending on or after July 15, 2005.

Conrad Brooks

© McKenna Long & Aldridge LLP • June 2004

Governance Guidelines, Code of Ethics and Whistleblower Provisions

Included in the reforms mandated by Sarbanes and the changes to the NYSE and Nasdaq listing standards is the requirement that companies implement and disclose comprehensive policies regarding corporate governance, business conduct and whistleblowers.

These provisions are collected here in one section under the headings "Governance Guidelines," "Code of Ethics" and "Whistleblower Provisions."

GOVERNANCE GUIDELINES

Among the significant changes to the NYSE listing standards adopted on November 4, 2003 is a requirement that NYSE-listed companies establish a set of general governance principles, referred to as corporate governance guidelines. While no set of universal guidelines exists, any compilation should address key areas such as director qualifications and responsibilities, committee responsibilities and director compensation. Governance guidelines should be adopted by the board, disclosed to the public and reviewed periodically (*e.g.*, annually) to ensure their adequacy and effectiveness. Nasdaq has no requirement for corporate governance guidelines. However, emerging best practice suggests that ***all*** companies should establish governance guidelines, even companies that are not covered by the NYSE standards.

NYSE Requirements

- Described as "Corporate Governance Guidelines" in NYSE Rule 303A(9).
- The guidelines must be posted on the company's web site (charters of most important committees, *e.g.*, audit, compensation and nominating, must also be posted).
  - The company's Form 10-K must state that guidelines and charters are available on the company's web site and available in print to any shareholder who requests them.

© McKenna Long & Aldridge LLP • June 2004

- The guidelines must address:
  - Director qualification standards, which:
    - ***Must*** include independence requirements
    - ***May*** include other requirements such as tenure, retirement, succession and the number of boards upon which a director may sit
  - Director responsibilities (including basic duties and requirements for meeting attendance and advance review of materials)
  - Director access to management and, as necessary and appropriate, independent advisors
  - Director compensation:
    - Include general principles for determining the form and amount of compensation and for reviewing such principles
    - Consider limits on contributions to charities affiliated with directors and the company's policy with respect to consulting agreements with directors
  - Director orientation and continuing education
  - Management succession (succession planning should include policies and principles for CEO selection, performance review and succession in the event of emergency or retirement)
  - Annual performance evaluation of the board (self-evaluation required at least annually)

Nasdaq Requirements

- Not required at this time, although emerging best practice is for the board of a Nasdaq-listed company to adopt corporate governance guidelines analogous to those required by the NYSE.

© McKenna Long & Aldridge LLP • June 2004

CODE OF ETHICS

Sarbanes requires companies to disclose whether or not they have adopted a "code of ethics" that requires senior finance personnel to recognize and deal with ethical issues and conflicts of interest and to foster a culture of honesty and accountability. The Sarbanes code of ethics requirement technically applies only to "senior financial officers;" however, because the SEC, the NYSE and Nasdaq have all broadened this covered group, companies have generally chosen to prepare one code of ethics to satisfy all requirements and to cover all employees and directors.

SEC Requirements

- Adopted in January 2003 as Item 406 of Regulation S-K.
- The SEC requirements mandate ***disclosure***, not the adoption of a code.
- The disclosure requirements are effective for the first Form 10-K filed after July 15, 2003.
- The company's Form 10-K must state:
  - Whether the company has adopted a written code of ethics, and
  - If not, the reasons why it has not done so.
- "Code of ethics" is defined as standards reasonably designed to deter wrongdoing and to promote:
  - Honest and ethical conduct (including actual or apparent conflicts of interest)
  - Full, fair, accurate and timely disclosure in the company's periodic reports and other public communications
  - Compliance with applicable governmental laws, rules and regulations
  - Prompt internal reporting of violations of the code to appropriate persons identified in the code
  - Accountability for adherence to the code

© McKenna Long & Aldridge LLP • June 2004

- The code of ethics must apply at least to each of the following:
  - Principal executive officer
  - Principal financial officer
  - Principal accounting officer or controller
  - Persons performing similar functions
- The code of ethics must be disclosed by one of the following means:
  - As an exhibit to the company's Form 10-K
  - On the company's web site, with the web site address and the fact that the code is posted there stated in the Form 10-K
  - Through an undertaking in the Form 10-K to provide a copy to any person upon request at no charge
- Any ***waiver*** from compliance for the required officers listed above or any change to the code of ethics that applies to the required standards listed above must be disclosed by the company by one of the following means:
  - By filing a Form 8-K
  - By posting the information on the company's web site, but only if the company has disclosed its intent to disclose waivers and amendments in this manner in a previous Form 10-K
- Separate codes of ethics are allowed for different types of officers.
- The code of ethics ***may*** be a part of a broader document that addresses more topics or applies to more persons.

NYSE Requirements

- Adopted in November 2003 as Rule 303A(10)
- ***Requires*** listed companies to adopt a "code of business conduct and ethics" applicable to all of the following:
  - Directors
  - Officers
  - Employees

© McKenna Long & Aldridge LLP • June 2004

- Listed companies must have a code that complies with the NYSE rules by the ***earlier*** of:
  - The date of their first annual meeting of shareholders after January 15, 2004, ***or***
  - October 31, 2004.
- The code ***should*** include each of the following:
  - Prohibition against conflict of interest transactions and reporting procedures for potential conflicts
  - Prohibition against usurping corporate opportunities
  - Requirement regarding confidentiality of company and customer information
  - Policy requiring fair dealing with respect to customers, suppliers, competitors and employees
  - Policy regarding protection and proper use of company assets
  - Policy promoting compliance with laws, rules and regulations (including insider trading laws)
  - Procedures encouraging employees to report illegal and unethical behavior
- The code must be publicly disclosed on the company's web site.
- The company's Form 10-K must state that the code is available on its web site and in print to any shareholder who requests it.
- ***Waivers:***
  - Waivers from compliance for directors and executive officers must be made by the board or by a board committee.
  - The company must promptly ***disclose*** to shareholders any waiver of the code for directors or executive officers.
    - Disclosure should be made either on a Form 8-K (pursuant to SEC requirements) or on the company's web site.

Nasdaq Requirements

- Adopted in November 2003 as Rule 4350(n)
- ***Requires*** listed companies to adopt a "code of conduct" applicable to all of the following:
  - Directors
  - Officers
  - Employees
- The code must comply with the definition of "code of ethics" as described above under the caption "SEC Requirements."
- The code must include an enforcement mechanism ensuring all of the following:
  - Prompt and consistent enforcement
  - Protection against retaliation for reporting violations
  - Clear and objective standards for compliance
  - Fair process for determining violations
- The code must be "publicly available" (presumably on the company's web site) or available in print, although Nasdaq has not adopted a provision identifying conduct that constitutes public availability.
- ***Waivers:***
  - The board must approve any waivers from compliance with the code for directors or executive officers.
  - Domestic issuers must ***disclose*** waivers for directors or executive officers in a Form 8-K report filed within five business days.[1]

[1] *The new Form 8-K requirements that become effective on August 23, 2004 will shorten the Form 8-K filing deadlines to four business days; presumably, the Nasdaq requirements will either be amended or effectively shortened due to this change.*

© McKenna Long & Aldridge LLP • June 2004

WHISTLEBLOWER PROVISIONS

Sarbanes requires that companies provide a mechanism for employees to report potentially fraudulent activity. Sarbanes also provides an enforcement mechanism to prevent companies from retaliating against employees who report such information. Whistleblower provisions were not mandated prior to Sarbanes, although other statutes (such as Title VII and OSHA) provided employees with protection from retaliation for disclosure of improper conduct.

Requirements

- Set forth in Exchange Act Section 10A(m)(4) and SEC Rule 10A-3(b)(3), effective April 2003
- The company's ***audit committee*** must establish procedures for:
  - Receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, ***and***
  - Confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.
- The November 2003 changes to the NYSE and Nasdaq listing standards require the audit committee's written charter to address the responsibility for and authority with respect to these procedures.

Retaliation Provisions

- A company ***cannot retaliate*** against an employee for providing information or assisting in an investigation that the employee reasonably believes involves fraud or a violation of SEC rules and regulations or Federal laws relating to fraud against shareholders.
- The protected conduct is the provision of information by the employee to any of the following:
  - A federal regulatory or law enforcement agency
  - A member or a committee of Congress
  - A supervisor
  - Any person working for the employer who has authority to investigate and terminate the misconduct

© McKenna Long & Aldridge LLP • June 2004

- Liability for retaliation extends to the company and to any officer, employee, contractor, subcontractor or agent of the company who retaliates against an employee.
- An aggrieved employee may seek reinstatement, back pay and special damages.
- ***Criminal penalties*** may be imposed for retaliation, including fines and up to ten years' imprisonment.

Practical Considerations

- The audit committee is responsible for establishing procedures as to the matters discussed above, but the audit committee is not required to be the sole monitor of such procedures.
- Procedures can generally be monitored by others, including:
  - General counsel
  - Internal audit department
  - Compliance department
  - Ombudsman
- Third party vendors offer efficient and effective e-mail, hotline and post office box monitoring services using trained personnel.

Trey Wainwright
Stacy Ingram

© McKenna Long & Aldridge LLP • June 2004

USE OF ELECTRONIC MEDIA/WEB SITES

The federal rules regarding the use of electronic media have been relatively static since the SEC's May 4, 2000 interpretative release regarding Use of Electronic Media (Release No. 33-7856), which clarified its initial interpretative release on the subject published in October 1995 (Release No. 33-7233). However, there have been some material developments in state law since 2000 relating to the use of electronic media. Additionally, in connection with the adoption of Sarbanes, the SEC and stock exchanges have enacted rules regarding required web site postings.

- The use of electronic media is controlled by both federal and state law.
- Federal law primarily regulates a company's delivery to its shareholders of required securities-related documents (*e.g.*, registration statement, prospectus, proxy statement).
- State law primarily regulates a company's delivery of ***notices*** and a ***shareholder's*** electronic ***submission*** of certain documents (*e.g.*, vote, proxy, electronic signature).
- There is, however, considerable overlap of federal and state laws in this area.

DELIVERY OF DOCUMENTS TO SHAREHOLDERS

Federal

- A company generally may fulfill its delivery obligations under the federal securities laws with electronic transmissions (*i.e.*, posting the documents to its web site or electronically mailing the documents) so long as:
  - The recipients were specifically/directly notified of the availability of the electronic information.
  - The recipients had proper ***access*** to such information.
  - The company obtained evidence of ***delivery***.

- Evidence of ***delivery*** may be satisfied by obtaining satisfactory evidence of an "informed consent" from the recipients prior to delivery.
  - To be "informed," the shareholder must be made aware of ***all*** of the following:
    - The type of electronic medium to be used
    - The cost involved
    - The duration of the consent's effectiveness
  - Consent may be obtained in writing, electronically or by telephone (so long as a record of consent is retained).
  - Recipients may give a "global consent" to electronic delivery of all documents from all issuers (typically for broker-dealer accounts).
- Recipients must be able to ***easily access*** the transmitted documents (*i.e.*, the documents must be in a common format); PDF format is acceptable if:
  - The company informs recipients of the requirements necessary to access the documents, ***and***
  - Recipients are provided with the needed software and technical assistance free of charge.

Impact of State Law

- Shareholders' actions are also governed by the law of the company's state of incorporation. Therefore, in addition to complying with federal securities laws, a company must also comply with applicable state law, which also must permit electronic notice of shareholder meetings or other actions. In Delaware, electronic transmission of meeting notices is acceptable so long as the shareholder consented to the form of such electronic transmission.

Solicitation

- Electronic communication can also be utilized in the solicitation process, so long as the substance of the communication complies with federal securities laws.

© McKenna Long & Aldridge LLP • June 2004

- A company must avoid inadvertently including in its filings links to third party web sites that would have the effect of incorporating such sites into the company's filings.
  - A company may be liable for the content of third party web sites available through hyperlinks if the company was substantially involved in preparing the information ("entanglement theory") or if the company has "adopted" the information as its own.
  - Factors that will be considered to determine if the information is "adopted":
    - The context in which the hyperlink is presented (did the company expressly state or imply that the information on the third party's web site is accurate).
    - Whether the identity of the party presenting the information on the hyperlinked site is (or is not) clearly represented.
    - The degree to which the company selectively chose to make certain portions of the third party's web site available to the company's web site visitors.

SHAREHOLDER SUBMISSIONS

- Generally, the law of the state of the company's incorporation governs the validity of a shareholder's transmission of proxies, votes and electronic signatures to the company.
- Both the law of the company's state of incorporation and the company's corporate documents (articles of incorporation and/or bylaws) must allow for electronic voting and shareholder submissions.
- The majority of states allow some form of electronic submissions, ranging from telephonic to internet-based transmissions.
- Delaware allows voting/proxy submissions by internet and telephonic means as well as by traditional mailing.

© McKenna Long & Aldridge LLP • June 2004

- Delaware also permits companies to hold electronic-only shareholder meetings (as well as physical meetings with electronic participants) so long as the company has the ability to reasonably:
  - Verify the identities of the shareholders.
  - Verify the voting results.
  - Allow all remote participants to "attend" the meeting on a substantially concurrent basis.
  - Allow all remote participants to participate and vote despite their remote location.
- If it is uncertain whether electronic voting or transmissions are allowed in a state, an alternative is for a company to electronically submit the documents to the shareholder and request that the shareholder print out and mail back to the company a hard copy of the proxy card.

VOTING

- Although the SEC generally has held that electronic voting/proxy submission is primarily a state law matter, the SEC has given limited guidance with regard to disclosure of electronic voting. Specifically, the SEC has stated that if a company allows electronic voting:
  - The proxy statement should describe the voting procedures as well as the validity of the procedures under applicable state law – including highlighting any open issues relating to electronic voting under state law.
  - The proxy card should describe the voting procedures – unless the company is incorporated in Delaware (the SEC staff has stated that electronic voting in Delaware is sufficiently established).
  - If a proxy statement is selected for review by the SEC staff, the SEC may ask for a legal opinion regarding the validity of state proxy laws that are new, ambiguous or untested.
- Companies must be sure that the tabulation/verification agent has procedures in place that comply with state and federal authentication and security requirements.
- As of the beginning of 2004, approximately 20 states had adopted a version of the Uniform Electronic Transactions Act, which deems electronic signatures on documents (such as proxies) valid.

© McKenna Long & Aldridge LLP • June 2004

- Other states deem an electronic proxy valid if there is some reasonable indication that the execution of such proxy was authorized by the shareholder.
- Most state laws require that the company notify shareholders that the shareholders have the ability to revoke the electronically submitted proxy.
- Companies must retain records of electronic votes and submissions from shareholders received electronically for the time specified by state law (varying from two to seven years).

REQUIRED WEB SITE DISCLOSURES

Required SEC Reports

- Form 10-Ks, 10-Qs and 8-Ks (and any amendments):
  - A company that is an accelerated filer (see "Accelerated Filing Deadlines" section) must ***either***:
    - Make these reports available free of charge on or through the company's web site as soon as reasonably practicable after being filed with or furnished to the SEC (generally interpreted to be the same day) and disclose the availability of the reports and the web site address in its Form 10-K, ***or***
    - Disclose in its Form 10-K the reasons why these reports are not posted on the company's web site and whether the company will provide the reports free of charge on request.
  - In lieu of posting its reports directly on its web site:
    - A company may hyperlink to these reports via a third party service so long as the reports are made available within the appropriate time frame and access to the reports is made available free of charge, ***or***
    - A company may hyperlink directly to its reports on the SEC's EDGAR web site.
- The SEC encourages companies to provide on-going web site access to all of their reports and encourages that, at a minimum, companies provide web site access to their previous reports for at least a ***12-month*** period following the filing or furnishing of each report at an appropriately archived portion of their web sites.

© McKenna Long & Aldridge LLP • June 2004

Governance Documents

- Nasdaq-listed companies are required to post the following on their web sites and keep such information up-to-date:
    - ***Code of ethics*** for principal executive and senior financial officers
    - ***Nominating committee charter***
- NYSE-listed companies are required to post the following on their web sites and keep such information up-to-date:
    - ***Charters*** of the company's most important committees (including at least the audit, compensation and nominating committees)
    - ***Code of business conduct and ethics***
    - ***Corporate governance guidelines***

Non-GAAP Financial Measure (Regulation G only)

- If a non-GAAP financial measure is made public orally, telephonically, by webcast, by broadcast or by other similar means, a company may satisfy its requirement of presenting and reconciling the most directly comparable GAAP financial measure by posting such presentation and reconciliation on its web site (so long as a location of the web site is made public in the same presentation in which the non-GAAP financial measure is made public). (For a discussion of non-GAAP financial measures and Regulation G, see "Use of Non-GAAP Financial Measures" section.)

Director / Officer Securities Transactions

- A company must post on its web site all Section 16 reports by the end of the business day after filing such reports with the SEC.
- A company may satisfy the Section 16 requirements by hyperlinking directly to a list of the Section 16 reports maintained by a third-party service. The Section 16 reports must be available via a web page containing exclusively Section 16 reports for the company, they must be free of charge, and they must be made available within the appropriate time frame. The company may also satisfy the Section 16 requirements by hyperlinking directly to such reports on the SEC's EDGAR web site.

David Brown
Conrad Brooks

© McKenna Long & Aldridge LLP • June 2004

On March 28, 2003, the SEC's final rules pursuant to Section 401(b) of Sarbanes relating to the use of non-GAAP financial measures became effective.

- The rules established two new sets of regulations:
  - Regulation G governs public ***disclosures*** or public ***releases*** of material information that includes non-GAAP financial measures.
  - Amendments to Item 10 of Regulation S-K, which added Item 10(e), govern non-GAAP financial measures included in ***filings*** made with the SEC.

REGULATION G

- Regulation G applies to all public disclosures made on or after March 28, 2003 by any entity (other than a registered investment company) subject to the reporting requirements of Sections 13(a) or 15(d) of the Exchange Act.
- Regulation G is triggered whenever a company (or a person acting on behalf of the company) ***publicly discloses or releases*** any material information that includes a non-GAAP financial measure.
- A "non-GAAP financial measure" is defined as a numerical measure of a company's historical or future financial performance, financial position or cash flows that does ***either*** of the following:
  - Excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows, ***or***
  - Includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure calculated and presented in accordance with GAAP.
- The definition is intended to include all numerical measures that have the effect of depicting ***either*** of the following:
  - A measure of performance that is different from that presented in the financial statements, ***or***
  - A measure of liquidity that is different from cash flow or cash flow from operations computed in accordance with GAAP.

© McKenna Long & Aldridge LLP • June 2004

- Measures of ***operating performance or statistical measures*** that fall outside the definition are ***not*** non-GAAP financial measures. These include:
    - Operating and other statistical measures (unit sales, numbers of employees, numbers of subscribers, numbers of advertisers)
    - Ratios or statistical measures that are calculated using ***exclusively*** one or both of:
        - Financial measures calculated in accordance with GAAP
        - Operating measures or other measures that are not non-GAAP financial measures
- Regulation G prohibits a company from making public a non-GAAP financial measure that, taken together with the information accompanying that measure, contains an untrue statement of material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading. (Note: This is the basic Rule 10b-5 standard).
- Disclosure of any non-GAAP financial measure must also include ***both*** of the following:[1]
    - A presentation of the ***most directly comparable*** financial measure calculated and presented in accordance with GAAP, ***and***
    - A ***quantitative reconciliation*** (by schedule or any other clearly understandable method) of the differences between the non-GAAP financial measure and the most directly comparable GAAP measure.
- The "most directly comparable financial measure calculated and presented in accordance with GAAP" is not defined. The SEC has stated that:
    - A cash non-GAAP financial measure that measures cash or funds generated from operations should be balanced with disclosure of amounts from the statement of cash flows.
    - Non-GAAP financial measures that depict performance should be balanced with net income or income from continuing operations.

[1] *The statements regarding utility and other purposes for the non-GAAP financial measure described below in connection with Item 10(e) of Regulation S-K for SEC filings do **not** apply to disclosures under Regulation G.*

© McKenna Long & Aldridge LLP • June 2004

- Where the non-GAAP financial measure is a ratio, a reconciliation should be provided with regard to each non-GAAP financial measure used as a component in the calculation of such ratio, and the company must also present the comparable ratio as calculated using the most directly comparable GAAP financial measure.

- Dissemination:
  - If a non-GAAP financial measure is released ***orally, telephonically, by webcast, by broadcast or by other similar means,*** the company must post the information required by Regulation G on its web site and disclose the location and availability of the required information during such release.
- Noncompliance is a violation of the Exchange Act, and the company or any person acting on behalf of the company is subject to an enforcement action by the SEC.

AMENDMENT TO ITEM 10 OF REGULATION S-K

- The new requirements are found in Item 10(e), which applies only to filings with the SEC made after or for fiscal periods ending after March 28, 2003.
- Item 10(e) applies to the same categories of non-GAAP financial measures as covered by Regulation G (*i.e.*, the same definition applies).
- If a non-GAAP financial measure is included in a filing, the filing must also include ***all*** of the following:
  - A presentation, with equal or greater prominence, of the most directly comparable financial measure calculated and presented in accordance with GAAP.
  - A quantitative reconciliation (by schedule or other clearly understandable method) of the differences between the non-GAAP financial measure and the most directly comparable GAAP measure.

© McKenna Long & Aldridge LLP • June 2004

  - A statement disclosing the reasons why the company's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the company's financial condition and results of operations.[2]
  - To the extent material, a statement disclosing the additional purposes, if any, for which the company's management uses the non-GAAP financial measure that are not otherwise disclosed.[3]
- In addition, the following are expressly ***prohibited***:
  - Disclosures excluding charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, ***other than*** the measures EBIT and EBITDA.
  - Disclosures adjusting a non-GAAP performance measure to eliminate or smooth items identified as ***non-recurring***, infrequent or unusual, when ***either*** of the following is true:
    - The nature of the charge or gain is such that it is reasonably likely to recur within two years, ***or***
    - There was a similar charge or gain within the prior two years.
  - Presenting non-GAAP financial measures on the face of the company's financial statements prepared in accordance with GAAP or in the accompanying notes.
  - Presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X (for use generally following business combination transactions, significant acquisitions or dispositions and similar situations).
  - Using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

[2] *See Footnote 1.*

[3] *The statement of management regarding utility and other purposes is only required in filings subject to Item 10 and need not be addressed in disclosures that are only subject to Regulation G.*

© McKenna Long & Aldridge LLP • June 2004

MISCELLANY

- ***Excluded*** from Regulation G ***and*** from Item 10(e) are non-GAAP financial measures included in tender offer disclosures relating to a proposed business combination transaction (or the entities involved in the transaction) if the disclosures are contained in a communication that is subject to the SEC's communication rules applicable to business combinations (*i.e.*, Rule 425 under the Securities Act, Rule 14a-12 or Rule 14d-2(b) under the Exchange Act, or Item 1015 of Regulation M-A).
- The SEC cautions companies to consider whether a change in the method used to calculate or present a non-GAAP financial measure from one period to another, without a complete description of the change in the methodology, complies with the Regulation G general disclosure requirement. In general, this suggests a need for a thorough explanation, perhaps accompanied by additional schedules, to explain the transition to the new method and its effects.

INTERPRETIVE GUIDELINES / HIGHLIGHTS FROM SEC FREQUENTLY ASKED QUESTIONS RELEASE

The SEC's Division of Corporation Finance has released a series of frequently asked questions and answers concerning non-GAAP financial measures, which may be found at www.sec.gov/divisions/corpfin/faqs/nongaapfaq.htm, and highlights from which are listed below.

FAQ highlights

- Where a reconciliation is required in the context of a ***business combination***, and the most directly comparable measure is a pro-forma measure under Article 11 of Regulation S-X, that measure may be used in lieu of the GAAP measure.
- A ***registration statement*** (other than on Form S-8) that incorporates by reference a document containing a non-GAAP financial measure but not the required reconciliation (or other required disclosure) must include the reconciliation. This can be achieved by any of the following:

© McKenna Long & Aldridge LLP • June 2004

  - Amending the previous filing to include the reconciliation and incorporating the amendment
  - Including a section in the registration statement which contains the reconciliation
  - Filing a Form 8-K with the reconciliation and incorporating the Form 8-K

- The ***utility and purpose disclosures*** must be included in each Form 10-K that contains a non-GAAP financial measure (even if the same measure was included in the prior year's Form 10-K). However, the utility and purpose disclosures may be left out of a Form 10-Q or other report that contains non-GAAP financial measures if the disclosures were included in the company's most recent Form 10-K and do not require an update.
- The GAAP prohibition on presenting ***cash flow per share*** is maintained, and per share measures of liquidity continue to be prohibited.
- A ***non-GAAP liquidity measure*** must be accompanied by prominent presentation of the three major categories of the GAAP statement of cash flows (cash flows from operating activities, cash flows from investing activities and cash flows from financing activities).
- If ***"free cash flow"*** is shown, a clear description of its calculation must be given (as well as the requisite reconciliation and disclosure of all material limitations of the measure).
- The reconciliation for ***EBIT and EBITDA*** should be to net income, not operating income. Companies presenting EBIT and EBITDA as a performance measure must demonstrate the usefulness of such measures since they exclude recurring items.
- ***Forward-looking*** performance, financial position and liquidity non-GAAP measures do not need to be reconciled to the most directly comparable GAAP measure if such a GAAP measure is unavailable without unreasonable effort. However, the company must identify the unavailable information and that information's probable significance.

© McKenna Long & Aldridge LLP • June 2004

Transitional Interpretations of Limited Continuing Significance

- Any non-GAAP financial measure included in an ***amendment*** to a Form 10-K originally filed before March 28, 2003 must comply with the new rules, but the filer need not comply with the rules for any other portion of the Form 10-K. Nonetheless, the filer must consider whether the disclosure is misleading absent compliance with the new rules.
- A company need not remove a non-compliant non-GAAP measure posted on its ***web site*** before March 28, 2003, unless the measure is added to, amended or updated.
- An exception has been established pursuant to which the SEC will not object if a ***Form S-8*** does not provide a reconciliation of a non-GAAP financial measure included in a document filed before March 28, 2003 that is incorporated by reference in the Form S-8.
- A ***registration statement*** incorporating by reference an annual or quarterly report which contains a non-GAAP financial measure need not include a reconciliation if the non-GAAP financial measure related to a period ended prior to March 28, 2003.
- The SEC will not object if a non-compliant non-GAAP financial measure is included in a ***registration statement*** filed before March 28, 2003 and with respect to which a pre- or post-effective amendment is subsequently filed. Nonetheless, the filer must consider whether the disclosure is misleading absent compliance with the new rules. Any non-GAAP measure that is added to, amended or updated directly in the amendment must comply with the rules.

David Brown
Stacy Ingram
Conrad Brooks

FORM 10-K AND 10-Q

- Accelerated filing requirements for Form 10-Ks and Form 10-Qs apply generally to issuers eligible to register primary public offerings on Form S-3 under the Securities Act. An issuer will be subject to the shorter filing schedules if, at the end of its fiscal year ***all*** of the following are true:
  - The market value of its common equity securities held by unaffiliated persons is at least $75 million (measured as of the last business day of its most recently completed second fiscal quarter).
  - It has been required to file reports with the SEC for at least 12 months.
  - It has filed at least one Form 10-K with the SEC.
  - It is not eligible to use the SEC's forms for small business issuers (Form 10-KSB, Form 10-QSB).
- The accelerated filing deadlines for Form 10-Ks and Form 10-Qs originally had a three year phase-in period, with the accelerated deadlines fully in effect for all fiscal years ending on or after December 15, 2004. Subsequent to the adoption of the accelerated deadlines, the SEC adopted new requirements with respect to internal control over financial reporting, which were also scheduled to go into effect for all fiscal years ending on or after November 15, 2004 for accelerated filers. (See "Disclosure Controls and Procedures and Internal Control Over Financial Reporting" section.) To ensure that public companies were able to focus their efforts on complying with the new requirements regarding internal control over financial reporting, on November 17, 2004, the SEC issued a release adopting amendments to extend the interim deadlines for an additional year, postponing for one year the completion of the final phase-in of the accelerated filing deadlines for Form 10-Ks and Form 10-Qs. The tables below reflect the deadlines as adjusted for this postponement. ADDED 11/04
- Accelerated Filing Deadlines for Form 10-Ks and Form 10-Qs – General Rule:

For Fiscal Years Ending On or After:	Form 10-K Deadline:	Form 10-Q Deadline for the Following Three Quarters:
December 15, 2002	90 days after fiscal year end	45 days after fiscal quarter end
December 15, 2003	75 days after fiscal year end	40 days after fiscal quarter end
December 15, 2004	75 days after fiscal year end	40 days after fiscal quarter end
December 15, 2005 and after	60 days after fiscal year end	35 days after fiscal quarter end

11/04

© McKenna Long & Aldridge LLP • June 2004

Accelerated Filing Deadlines

- Actual filing deadlines for issuers with fiscal years ending December 31, 2003 and March 31, June 30, September 30, or December 31, 2004, 2005 and 2006:

For Companies with Fiscal Years Ending On:	Form 10-K Deadline:	Form 10-Q Deadline for the Following Three Quarters:		
		Q-1	Q-2	Q-3
December 31, 2003	March 15, 2004	May 10, 2004	August 9, 2004	November 9, 2004
March 31, 2004	June 14, 2004	August 9, 2004	November 9, 2004	February 9, 2005
June 30, 2004	September 13, 2004	November 9, 2004	February 9, 2005	May 10, 2005
September 30, 2004	December 14, 2004	February 9, 2005	May 10, 2005	August 9, 2005
December 31, 2004	March 16, 2005	May 10, 2005	August 9, 2005	November 9, 2005
March 31, 2005	June 14, 2005	August 9, 2005	November 9, 2005	February 9, 2006
June 30, 2005	September 13, 2005	November 9, 2005	February 9, 2006	May 10, 2006
September 30, 2005	December 14, 2005	February 9, 2006	May 10, 2006	August 9, 2006
December 31, 2005	March 1, 2006	May 5, 2006	August 4, 2006	November 6, 2006
March 31, 2006	May 30, 2006	August 4, 2006	November 6, 2006	February 5, 2007
June 30, 2006	August 29, 2006	November 6, 2006	February 5, 2007	May 7, 2007
September 30, 2006	November 29, 2006	February 5, 2007	May 7, 2007	August 6, 2007
December 31, 2006	March 1, 2007	May 7, 2007	August 6, 2007	November 5, 2007

- An accelerated filer must disclose in its Form 10-K:
  - Its web site address, if it has one.
  - Whether it makes available free of charge on or through its web site, if it has one, its Form 10-K, Form 10-Qs, Form 8-Ks and all amendments to those reports as soon as reasonably practicable (generally, the same day) after such material is filed with or furnished to the SEC.
  - If the company does not make its filings available in this manner:
    - The reasons it does not do so (including, where applicable, that it does not have a web site).
    - Whether the company voluntarily will provide electronic or paper copies of its filings free of charge upon request.

© McKenna Long & Aldridge LLP • June 2004

SECTION 16 REQUIREMENTS — FORMS 4 AND 5

- Directors, executive officers and 10% shareholders of reporting companies must file a Form 4 no later than ***two business days*** following the trade date of transactions in the equity securities of such companies.
- Most of the transactions between officers and directors and the company exempted from Section 16(b) short-swing profit recovery by Rule 16b-3 (*e.g.*, stock and option grants, option exercises, re-grants or repricings), which were previously reportable on Form 5 within 45 days of the end of the year in which the transaction occurred, must now be reported within ***two business days*** on Form 4 (Amended Rules 16a-3(f) and 16a-6(a)).
- If the conditions permitting small acquisitions (acquisitions in the aggregate not exceeding $10,000) to be reported on a deferred basis on Form 5 are no longer met, the small acquisition must be reported on a Form 4 within two business days (Amended Rule 16a-6(b)).
- Limited Exceptions:
  - Transactions pursuant to a 10b5-1 plan where a set transaction date is not provided in the plan.
  - "Discretionary transactions" pursuant to employee benefit plans where the insider does not select the date of execution. A "discretionary transaction" is a volitional transaction by the insider that involves an intra-plan transfer in a company's equity securities fund, or a cash distribution funded by a volitional disposition of the company's equity security.
  - For the two foregoing types of transactions, the "date of execution of the transaction" is deemed to be the date when the executing broker, dealer or plan administrator notifies the insider that the transaction was executed. The Form 4 must be filed before the end of the second business day following the actual date of this notice. If the notification date is later than the third business day following the trade date, the date of execution (and therefore the commencement of the two business day filing period) is deemed to be the third business day following the trade date of the transaction.

© McKenna Long & Aldridge LLP • June 2004

SECTION 16 REQUIREMENTS — FORM 3

- The filing deadline for Form 3 has not changed and is still within ten calendar days after the event pursuant to which a person becomes a reporting person (*i.e.*, an officer, director or 10% shareholder).

FORM 8-K

11/04

- Effective August 23, 2004, a number of additional events became reportable on Form 8-K, and all Form 8-K items must be filed within ***four business days*** (other than reports filed or furnished under Regulation FD, voluntary reports of significant "other events" and certain financial statements required to be filed as exhibits in connection with acquisitions). Please see the "New Form 8-K Disclosure Requirements" section for a discussion of the revised Form 8-K reporting requirements.

Stacy Ingram
Conrad Brooks

© McKenna Long & Aldridge LLP • June 2004

OVERVIEW

- Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") plays a critical role in assuring that public companies provide the investing public with full and frank disclosures regarding their operations and financial condition. Since the adoption of the federal securities laws in the early 1930's, the amount of disclosure required by the SEC has continually expanded. From the time of its addition as a disclosure item in 1980, MD&A has been the location for much of the expanded disclosure, and, due to the importance of the information MD&A contains, combined with its very broad requirements, it is expected to continue to expand and be the source of SEC pressure for additional disclosure. MD&A disclosure is governed by:
  - Specific rules, set forth in Item 303 of Regulation S-K.
  - SEC guidance in the form of interpretive releases, concept releases and published SEC commentary on actual filings.
- The general purpose of MD&A, as stated in Item 303(a) of Regulation S-K, is to provide readers with information "necessary to an understanding of [a company's] financial condition, changes in financial condition and results of operations."
- The MD&A requirements are intended to satisfy three principal objectives:
  - To provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management.
  - To enhance the overall financial disclosure and provide the context within which financial information should be analyzed.
  - To provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.

© McKenna Long & Aldridge LLP • June 2004

HISTORY OF MD&A

- 1980 – Item 303 of Regulation S-K was adopted with the present basic disclosure requirements for MD&A (SEC Release No. 33-6231).
- 1981 – The SEC published initial interpretive guidance for MD&A after its review of the early disclosures under the new requirements (SEC Release No. 33-6349).
- 1987 – The SEC sought public comment on the adequacy of MD&A and on proposed revisions submitted by members of the professional accounting community (SEC Release No. 33-6711). No new requirements resulted.
- 1989 – The SEC published an interpretive release that provided guidance in various areas, including required prospective information, analysis of long and short-term liquidity and capital resources, material changes in financial statement line items, required interim period disclosure, segment analysis, participation in high-yield financings, highly leveraged transactions or non-investment grade loans and investments, the effects of federal financial assistance upon the operations of financial institutions, and the disclosure of preliminary merger negotiations (SEC Release No. 33-6835).
- December 2001 – The SEC issued cautionary advice to companies regarding the need for greater investor awareness of the sensitivity of financial statements to the methods, assumptions and estimates underlying their preparation. This cautionary advice encouraged public companies to include in their MD&A full explanations of their "critical accounting policies," the judgments and uncertainties affecting the application of those policies and the likelihood that materially different amounts would be reported under different conditions or using different assumptions (SEC Release No. 33-8040).
- January 2002 – The SEC issued a statement providing explicit interpretive guidance on liquidity and capital resources (including off-balance sheet arrangements), trading activities involving non-exchange traded contracts accounted for at fair value, and relationships and transactions with persons or entities that derive benefits from their non-independent relationships with the company or the company's related parties (SEC Release No. 33-8056).

© McKenna Long & Aldridge LLP • June 2004

- May 2002 – The SEC proposed additional MD&A disclosure requirements, which remain under consideration, regarding the application of companies' critical accounting estimates (SEC Release No. 33-8098).
- January 2003 – The SEC adopted additional disclosure requirements in Item 303 of Regulation S-K regarding off-balance sheet arrangements and aggregate contractual obligations. The new rules require the disclosure of off-balance sheet arrangements in a designated section of MD&A and an overview of certain known contractual obligations in a tabular format. The new rules also supersede related guidance from the January 2002 release (SEC Release No. 33-8182).
- March 2003 – The SEC published a summary of the most frequent general areas of comment resulting from its review of the Form 10-Ks filed in 2002 by the Fortune 500 companies.
- December 2003 – The SEC published interpretive guidance on MD&A addressing the following four areas:
  - The overall presentation of MD&A
  - The focus and content of MD&A (including materiality, analysis, key performance measures and known material trends and uncertainties)
  - Disclosure regarding liquidity and capital resources
  - Disclosure regarding critical accounting estimates

  (SEC Release No. 33-8350)

© McKenna Long & Aldridge LLP • June 2004

MD&A Disclosures

The December 2003 release provides a useful framework for evaluating the current state of MD&A.

OVERALL PRESENTATION OF MD&A

- There are no specific rules for presentation of MD&A. The following ***guidance*** has been suggested in the SEC's releases:
  - Begin with a section that provides an executive-level overview to provide context for the remainder of the discussion.
    - Include the most important matters that management focuses on to evaluate financial condition and operating performance.
    - Do ***not*** simply repeat more detailed disclosure discussed later in MD&A.
    - Include economic or industry-wide factors relevant to the company.
    - Inform the reader about how the company earns revenues and income and generates cash.
    - To the extent necessary or useful, discuss the company's lines of business, location or locations of operations, and principal products and services (but an introduction should not merely duplicate disclosure in the Description of Business section of the report).
    - Provide insight into material opportunities, challenges and risks, such as those presented by known material trends and uncertainties, on which management is most focused for both the short- and long-term, as well as the actions they are taking to address these opportunities, challenges and risks.
  - With regard to material information, present disclosure so that the most important information is most prominent.
    - Use a layered approach, emphasizing the most important information and analysis. In a section with a detailed analysis, such as period to period analysis, begin with a statement of principal factors, trends or other matters that are discussed in more detail in the section.
    - Consider tabular presentation of relevant financial and other information.
    - Use headings.

© McKenna Long & Aldridge LLP • June 2004

- Avoid unnecessarily duplicative disclosure that can tend to overwhelm readers and act as an obstacle to identifying and understanding material matters.

FOCUS AND CONTENT

- Focus on material information and eliminate immaterial information that does not promote understanding of the company's financial condition, liquidity and capital resources, changes in financial condition and results of operations (both in the context of profit and loss and cash flows).
  - ***Required:*** MD&A must specifically focus on known material events and uncertainties that would cause reported financial information not to be necessarily indicative of future operating performance or of future financial condition.
  - ***Guidance:***
    - Remove unnecessary detail or duplicative or uninformative disclosure that obscures material information – avoid unnecessary information overload.
    - Evaluate issues presented in previous periods and consider reducing or omitting discussion of those that may no longer be material or helpful, or revise discussions where a revision would make the continuing relevance of an issue more apparent.

- ***Required:*** Segment information must be provided if necessary for an understanding of the company's business.
- ***Guidance:***
  - Segment discussion and analysis should be designed to avoid unnecessary duplication and immaterial detail that is not required and does not promote understanding of a company's overall financial condition and operating performance.
  - Improve the determination of company operating segments and refrain from inappropriate aggregation of segments.

© McKenna Long & Aldridge LLP • June 2004

- ***Required:*** Discussion of material changes from period to period in line items, to the extent necessary to understand the company's business.
  - Repetitious disclosure on a line by line basis is not required if the causes for change relate to numerous line items.
  - ***Amounts*** of changes from year to year that are readily computable from the financials do not need to be recited – the discussion must not merely repeat numerical data from the financials.
- ***Guidance:*** Avoid duplicative line item disclosure or disclosure of immaterial items.

- ***Required:*** Identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance.
  - Disclosure of a trend, demand, commitment, event or uncertainty is required unless a company is able to conclude either (i) that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or (ii) that a material effect on the company's liquidity, capital resources or results of operations is not reasonably likely to occur even if the trend, uncertainty or other event occurs or comes to fruition.
  - The company should make two assessments of any known trend, demand, commitment, event or uncertainty:
    - Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is ***not*** reasonably likely to occur, then no disclosure is required.
    - If management cannot make that determination, then it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the issuer's financial condition or results of operations is ***not*** reasonably likely to occur even if it does come to fruition.

© McKenna Long & Aldridge LLP • June 2004

- Focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of:
  - Matters that would have an impact on future operations and have not had an impact in the past.
  - Matters that have had an impact on reported operations in the past and are not expected to have an impact upon future operations.

- ***Guidance:***
  - Disclosure decisions concerning trends, demands, commitments, events and uncertainties generally should involve:
    - Consideration of financial, operational and other information known to the company. Consider all relevant information, even if that information is not required to be disclosed.
    - Identification, based on this information, of known trends and uncertainties.
    - Assessment of whether these trends and uncertainties will have, or are reasonably likely to have, a material impact on the company's liquidity, capital resources or results of operations.
  - Quantitative disclosure of the material effects of known material trends and uncertainties should be considered and may be required to the extent material if quantitative information is reasonably available.
- The disclosures required to address known material trends and uncertainties in the discussion and analysis should not be confused with optional forward-looking information. ***Not all forward-looking information falls within the realm of optional disclosure.***

© McKenna Long & Aldridge LLP • June 2004

- SEC ***guidance*** states that companies should identify and discuss key performance indicators that management uses to manage the business and that would be material to investors.
  - Provide both a short- and long-term analysis of the business.
  - Key variables may be financial measures or non-financial performance measures, including:
    - External or macro-economic matters as well as those specific to a company or industry.
    - Industry-specific measures, using common standards for the measures or, if no industry standard is available, providing an explanation of the calculation of the measure to promote comparability across companies within the industry.
    - Non-financial performance measures that are company-specific.

- Provide not only disclosure of information responsive to MD&A's requirements, but also an ***analysis*** that is responsive to those requirements that explains management's view of the implications and significance of that information and that satisfies the objectives of MD&A.
  - MD&A requires not only a "discussion" but also an "analysis" of known material trends, events, demands, commitments and uncertainties.
  - The analysis should reveal underlying material causes of the matters described.
  - Avoid boilerplate analysis.

LIQUIDITY AND CAPITAL RESOURCES

- ***Required***:
  - A company is required to include in MD&A the following information, to the extent material:
    - Historical information regarding sources of cash and capital expenditures
    - An evaluation of the amounts and certainty of cash flows

© McKenna Long & Aldridge LLP • June 2004

- The existence and timing of commitments for capital expenditures and other known and reasonably likely cash requirements
- Discussion and analysis of known trends and uncertainties
- A description of expected changes in the mix and relative cost of capital resources
- Indications of which balance sheet or income or cash flow items should be considered in assessing liquidity
- A discussion of prospective information regarding the company's sources of and needs for capital, except where otherwise clear from the discussion

- New Item 303(a)(5) of Regulation S-K, effective for filings containing financial statements for fiscal years ending on or after December 15, 2003, requires disclosure regarding the amounts of payments due under certain ***contractual obligations*** for specified time periods in a new tabular format.
  - The contractual obligations table must include all of the following, aggregated by type of obligation in the table:
    - Long-term debt obligations
    - Capital lease obligations
    - Purchase obligations
    - Other long-term liabilities reflected on a company's balance sheet under GAAP
  - The new table must be included in all Form 10-Ks, but the company only needs to describe in its Form 10-Qs material changes to the contractual obligations outside of the ordinary course of business that occurred in the quarter.

© McKenna Long & Aldridge LLP • June 2004

- ***Guidance:***
  - ***Cash Requirements***
    - In determining required or appropriate disclosure, companies should evaluate separately their ability to meet upcoming cash requirements over both the short- and long-term. Merely stating that a company has adequate resources to meet its short-term and/or long-term cash requirements is insufficient unless no additional detailed or nuanced information is material.
    - One starting point for a company's discussion and analysis of cash requirements is the tabular disclosure of contractual obligations (see above), supplemented with additional information that is material to an understanding of the company's cash requirements.
      - For example, if a company has incurred debt in material amounts, it should explain the reasons for incurring that debt and the use of the proceeds, and analyze how the incurrence of that debt fits into the overall business plan, in each case to the extent material.
      - Where debt has been incurred for general working capital purposes, the anticipated amount and timing of working capital needs should be discussed, to the extent material.
  - ***Sources and Uses of Cash***
    - Focus on the primary drivers of cash flows and other material factors necessary to an understanding of the company's cash flows and the indicative value of historical cash flows.
      - Address material changes in the underlying drivers (*e.g.*, cash receipts from the sale of goods and services and cash payments to acquire materials for manufacture or goods for resale), rather than merely describing items identified on the face of the statement of cash flows.
      - Consider whether, in order to make required disclosures, it is necessary to expand MD&A to address the cash requirements of and the cash provided by the company's reportable segments or other subdivisions of the business, including issues related to foreign subsidiaries, as well as the indicative nature of those results.

© McKenna Long & Aldridge LLP • June 2004

- For financing cash flows, a company should discuss and analyze, to the extent material:
  - Its external debt financing
  - Its use of off-balance sheet financing arrangements
  - Its issuance or purchase of derivative instruments linked to its stock
  - Its use of stock as a form of liquidity
  - The potential impact of known or reasonably likely changes in credit ratings or ratings outlook (or inability to achieve changes)
- Consider enhanced analysis and explanation of the sources and uses of cash and material changes in particular items underlying the major captions reported in the financial statements, rather than recitation of the items in the cash flow statements.
- Companies using the indirect method in preparing their cash flow statements should pay particular attention to disclosure and analysis of matters that are not readily apparent from their cash flow statements.

- ***Debt Instruments, Guarantees and Related Covenants***
  - Companies should consider whether enhanced disclosure on these items should be included in MD&A.
  - Companies that are, or are reasonably likely to be, in breach of these covenants must disclose material information about the breach and analyze the impact on the company if material. That analysis should include, as applicable and to the extent material:
    - The steps that the company is taking to avoid the breach.
    - The steps that the company intends to take to cure, obtain a waiver of or otherwise address the breach.
    - The impact or reasonably likely impact of the breach (including the effects of any cross-default or cross-acceleration or similar provisions) on financial condition or operating performance.
    - Alternate sources of funding to pay off resulting obligations or to replace funding.

© McKenna Long & Aldridge LLP • June 2004

- Companies should consider the impact of debt covenants on their ability to undertake additional debt or equity financing.
  - If these covenants limit, or are reasonably likely to limit, a company's ability to undertake financing to a material extent, then the company is required to discuss the covenants in question and the consequences of the limitation to the company's financial condition and operating performance.
  - Disclosure of alternate sources of funding and, to the extent material, the consequences (including but not limited to the cost) of accessing them should also be considered and may be required.
- Companies should also consider disclosure with respect to:
  - Provisions in agreements that could trigger a requirement for early payment, additional collateral support, changes in terms or modification of existing obligations (such as the failure to maintain certain financial ratios).
  - Circumstances that could impair a company's ability to raise financing or enter into certain transactions (such as the failure to maintain an investment grade credit rating or level of earnings).
  - Guarantees of debt or third-party commitments.
  - Written options on non-financial assets (*e.g.*, real estate puts).
  - Arrangements and other relationships with unconsolidated limited purpose entities.
  - Obligations and commitments to make future payments under contracts (such as debt and lease agreements) and under contingent commitments (such as debt guarantees).

- ***Cash Management***
  - MD&A should describe known material trends or uncertainties relating to the company's determinations of when and how to use cash resources to satisfy obligations and make other capital expenditures.

© McKenna Long & Aldridge LLP • June 2004

        - For example, a decision by a company in a highly capital-intensive business to spend significantly less on plant and equipment than it has historically spent may result in long-term effects that should be disclosed if material. Material effects could include more cash, less interest expense and lower depreciation, but higher future repair and maintenance expenses or a higher cost base than the company would otherwise have.

- ***Trading Activities*** (including non-exchange traded contracts accounted for at fair value)
    - Consider disclosure regarding:
        - Risk management activities undertaken in these trading activities.
        - Risks from changes to credit quality or from market fluctuations of assets underlying or linked to a particular commodity contract.

CRITICAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

- The disclosure in MD&A of critical accounting policies and critical accounting estimates has evolved solely from SEC guidance. Critical accounting policies differ from, but are related to, critical accounting estimates and assumptions. Critical accounting policies are the more general policies that a company uses to prepare its financial statements. Although the most critical of the accounting policies chosen by management will differ from company to company, and sometimes from industry to industry, the policies themselves are generally not company-specific. Estimates and assumptions, however, are more particular determinations that underlie a company's financial statements and its policies, and are more specific to the company and its operations. The SEC proposed rules regarding critical accounting policies in May 2002, but the rules have not yet been adopted.
- The Fortune 500 commentary encouraged expanded disclosure of critical accounting policies, as well as assumptions and estimates, particularly in the areas of revenue recognition, restructuring charges, impairments of long-lived assets, investments and goodwill, depreciation and amortization expenses, income tax liabilities, retirement and post-retirement liabilities, pension income and expense, environmental liabilities, repurchase obligations under repurchase commitments, stock-based compensation, insurance loss reserves and inventory reserves, and allowance for doubtful accounts.

© McKenna Long & Aldridge LLP • June 2004

  - With respect to revenue recognition, the SEC issued comments requesting expanded disclosure of revenue recognition accounting policies relating to software and multiple element arrangements (*i.e.*, providing software, hardware and services in one contract), deferred revenue, product return or price protection features, installation services, energy contracts (including disclosure of material terms), and pharmaceutical and retail returns, discounts and rebates.

- Once the company has determined what its critical accounting policies are, the company should:
  - Disclose its critical accounting policies.
  - Be able to defend the quality and reasonableness of selected critical accounting policies.
  - Include in MD&A a balanced and responsive explanation of:
    - The effects of the application of the critical accounting policies.
    - The judgments made in their application.
    - The likelihood of materially different reported results under different assumptions and conditions.
  - Consult with the SEC accounting staff if there is any uncertainty about the application of specific GAAP principles.
- Auditors' role: The independent auditors should satisfy themselves about the selection, application and disclosure of critical accounting policies, and should obtain an understanding of management's judgments in selecting and applying those policies.
- Audit committee's role: Prior to finalizing and filing a Form 10-K, the audit committee should review and discuss with senior management and outside auditors the selection, application and disclosure of critical accounting policies, estimates and assumptions.
- Companies should disclose accounting estimates or assumptions where:
  - The nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change.

© McKenna Long & Aldridge LLP • June 2004

- The impact of the estimates and assumptions on financial condition or operating performance is material.

- Companies should consider enhanced discussion and analysis of these critical accounting estimates and assumptions that:
  - ***Supplement, but do not duplicate,*** the description of accounting policies in the notes to the financial statements.
  - Provide greater insight into the quality and variability of information regarding financial condition and operating performance.
- A company should address specifically:
  - Why accounting estimates or assumptions bear the risk of change.
    - Is there an uncertainty attached to the estimate or assumption?
    - Is the estimate or assumption difficult to measure or value?
  - The questions that arise once the critical accounting estimate or assumption has been identified.
    - Analyze, to the extent material, factors such as:
      - How the company arrived at the estimate.
      - How accurate the estimate/assumption has been in the past.
      - How much the estimate/assumption has changed in the past.
      - Whether the estimate/assumption is reasonably likely to change in the future.
  - The estimates' and assumptions' specific sensitivity to change, based on other outcomes that are reasonably likely to occur and that would have a material effect, since the estimates/assumptions are based on matters that are highly uncertain.
- Companies should provide quantitative as well as qualitative disclosure when quantitative information is reasonably available and will provide material information for investors.

© McKenna Long & Aldridge LLP • June 2004

- For example, if reasonably likely changes in the long-term rate of return used in accounting for a company's pension plan would have a material effect on the financial condition or operating performance of the company, then the impact that could result given the range of reasonably likely outcomes should be disclosed and, because of the nature of estimates of long-term rates of return, quantified.

OFF-BALANCE SHEET TRANSACTIONS

- Effective for filings containing financial statements for fiscal years ending on or after June 15, 2003, MD&A must contain the disclosure regarding off-balance sheet transactions set forth in Item 303(a)(4) of Regulation S-K.
  - Off-balance sheet transactions include a company's relationship with unconsolidated entities or other persons that either have, or are reasonably likely to have, a material current or future effect on the issuer's financial condition, changes in financial condition, results of operations, liquidity, capital resources or significant components of revenues and expenses.
  - The main examples are:
    - Certain guarantee contracts.
    - Retained or contingent liabilities in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets.
    - Certain derivative instruments.
    - Material variable interests held by the company in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or that engages in leasing, hedging or research and development services with the company.
  - The disclosure of off-balance sheet arrangements must be presented in a separately captioned section of MD&A.
  - The disclosure must include, to the extent necessary to understand the off-balance sheet arrangements:
    - The nature and business purpose of the off-balance sheet arrangements.

© McKenna Long & Aldridge LLP • June 2004

- The importance of the off-balance sheet arrangements to the company's liquidity, capital resources, market risk, credit risk support or other benefits.
- The amounts of revenues, expenses and cash flows of the company arising from such arrangements; the nature and amounts of any interests retained, securities issued and other indebtedness incurred by the company in connection with such arrangements; and the nature and amounts of any other obligations or liabilities (including contingent obligations or liabilities) of the company arising from such arrangements that are or are reasonably likely to become material and the triggering events or circumstances that could cause them to arise.
- Any known event, demand, commitment, trend or uncertainty that will result in or is reasonably likely to result in the termination, or material reduction in availability to the company, of its off-balance sheet arrangements that provide material benefits to it, and the course of action that the company has taken or proposes to take in response to any such circumstances.

- Attention should also be paid to internal and external events that can trigger contingent liabilities and adverse factors such as credit rating downgrades.
- The company should aggregate off-balance sheet arrangements in groups or categories that provide material information in an efficient and understandable manner and should avoid repetition and disclosure of immaterial information.
  - Effects that are common or similar with respect to a number of off-balance sheet arrangements must be analyzed in the aggregate to the extent the aggregation increases understanding.
  - Distinctions in arrangements and their effects must be discussed to the extent the information is material, but the discussion should avoid repetition and disclosure of immaterial information.

© McKenna Long & Aldridge LLP • June 2004

MISCELLANEOUS MD&A DISCLOSURE ITEMS

- In its releases and commentary, the SEC has also suggested enhanced disclosure for the following items:
  - Effects of transactions with ***related parties*** and others with whom the company or its related parties have a less than arms-length relationship
    - Consider disclosure regarding:
      - The business purpose of the arrangement
      - Identification of the related parties
      - How transaction prices were determined by the parties
      - Any fairness evaluation conducted
      - Any on-going contractual or other commitments as a result of the arrangement
  - ***Restructuring Charges***
    - Expand disclosure in financial statements and MD&A to discuss:
      - Period by period analysis of restructuring charges
      - Events and decisions giving rise to the restructuring
      - Likely material effects of the restructuring plan on financial position, future operating results, liquidity and cash flows (including quantification and timing of these effects)
      - Nature, amount and description of each material component of restructuring charges
      - Material revisions to plans or timing, including reversals or adjustments of charges, and reasons for the revisions
  - ***Impairment Charges***
    - Provide better identification of material assets analyzed for impairment, including the events and decisions leading to an impairment charge and assumptions or estimates used in determining the charge.
    - More specifically, expand disclosure of impairment of long-lived assets, treatment of securities held for investment with significant unrealized losses for an extended period, and impairment of goodwill and other intangible assets.

© McKenna Long & Aldridge LLP • June 2004

- ***Pension Plans***
  - Expand disclosure of significant assumptions and estimates used to account for pension plans and how they were determined.
  - Address the effect pension plans had on results of operations, cash flow and liquidity, including the amount of expected pension returns included in earnings and the amount of cash outflows used to fund the plans.
  - Disclose any expected change in pension trends, and the reasonably likely impact.
  - Disclose the amount of current unrecognized losses on pension assets and the estimated effect of those losses on future pension expense.
  - Describe a sensitivity analysis that expresses potential change in expected pension returns resulting from hypothetical changes in assumptions and estimates.
- ***Environmental and Product Liability***
  - Increase disclosure on the nature of any loss contingency, the amount accrued, an estimate on the range of reasonably possible loss, significant assumptions underlying the accrual and the cost of litigation.
  - Particular focus in this area was directed at oil and gas, mining and manufacturing companies.

MORE RECENT DEVELOPMENTS IN MD&A DISCLOSURE

- Most recently, the NYSE amendments to its governance standards place responsibility for oversight of MD&A disclosures on the audit committee. The new rule requires that the audit committee of NYSE-listed companies:
  - Discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditors, including the company's disclosures under MD&A.
  - Discuss the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies.

Octavia Powers
Stacy Ingram

© McKenna Long & Aldridge LLP • June 2004

In January 2006, the SEC proposed new disclosure rules for executive and director compensation, related party transactions and corporate governance matters that affect proxy statement disclosure. The final rules were adopted by the SEC in July 2006 and were issued publicly in August 2006. On December 22, 2006, the SEC adopted additional immediately effective amendments to the final rules revising some of the new tabular disclosure requirements.

The 2006 amendments had the following impacts on proxy statements:

- Significantly revised and expanded executive and director compensation disclosures.
- Expanded the disclosure requirements with respect to director independence, and consolidated a number of prior rule changes to the disclosure requirements in proxy statements, adopted after SOX, under new Item 407 of Regulation S-K, which covers Corporate Governance disclosures. These prior rule changes included:
    - Expanded disclosure of nominating committee processes and methods for shareholders to communicate with the board of directors.
    - Enhanced disclosure of fees paid to and approval of services by the independent auditors.
    - Additional disclosure about board and committee independence and structure.
- Revised the related party transactions disclosure standard and added disclosure regarding approval processes for related party transactions.
- Revised the beneficial ownership disclosure requirements to add disclosure of pledged shares.
- Moved the stock performance graph disclosure from the proxy statement to the annual report to shareholders.

This section addresses proxy statement requirements with respect to corporate governance matters, related party transactions, and security ownership disclosures, in each case as revised by the 2006 amendments. Requirements under the 2006 amendments with respect to executive and director compensation disclosures in the proxy statement are discussed in detail in the "SEC Compensation Disclosure" section.

© McKenna Long & Aldridge LLP • August 2007

This section also addresses other recent rules changes that were not impacted by the 2006 amendments, including the requirement for an equity compensation plan table and stock exchange disclosure requirements adopted since 2003.

Compliance Dates

- Public companies are required to comply with the new disclosure requirements under the 2006 amendments in any proxy or information statement filed on or after December 15, 2006 that is required to include disclosure under Items 402 (compensation disclosures) and 404 (related party transaction disclosures) of Regulation S-K for fiscal years ending on or after December 15, 2006.

DISCLOSURES REGARDING THE BOARD OF DIRECTORS AND DIRECTOR INDEPENDENCE

Board of Directors Independence

- As part of the 2006 amendments, the SEC has consolidated its disclosure requirements on corporate governance issues, such as director independence and information regarding various committees of the board of directors, into new Item 407 of Regulation S-K.
- The new rules also expand disclosure requirements regarding director independence. The following disclosure is required for director independence:
    - Whether each director and director nominee is independent under the independence standards definitions applicable to the company:
        - A listed company must use the same definition used in the listing standards applicable to the company to determine whether a majority of the board of directors is independent, including any exemptions to those requirements that are relied upon.
        - An unlisted company can use the definition used by any national securities exchange, using the same listing standards for all directors and committees, including any exemptions to those requirements that are relied upon.
        - If the company uses its own definitions, it must either indicate the availability of those definitions on the company's web site, including the company's web address, or make them available (at least every

three fiscal years, or in any year in which they are materially amended) in an appendix to the company's proxy statement or information statement.

- If the independence standards applicable to the company contain independence requirements for committees of the board, identification of each director that is a member of the nominating, audit or compensation committee that is not independent under those committee independence standards.
- For each independent director, a description, by specific category or type, of any transaction, relationships or arrangements not disclosed as a related party transaction under Item 404 of Regulation S-K, that were considered by the board of directors when determining if applicable independence standards were satisfied.
- If a listed company is required under applicable listing standards to have a majority of independent directors, and is using an exemption from that requirement or from any committee member independence requirement, the company must disclose the exemption upon which it is relying and the basis for its conclusion that the exemption is applicable.
- The independence disclosures discussed above are required for any person who served as a director at any time during the last completed fiscal year.
- Disclosure of any audit, nominating and compensation committee members who are not independent.

■ Additional NYSE disclosure requirements:

- As described under the "Board Composition and Governance" section, Section 303A.02 of the NYSE listing standards states that a director does not qualify as independent unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). NYSE-listed companies must disclose this determination in their annual proxy statement in one of two ways:
    - The board can disclose the basis of its determination that a relationship is not material with respect to a particular director, or

© McKenna Long & Aldridge LLP • August 2007

- The board may adopt and disclose categorical standards to assist it in making these determinations of independence and make general disclosure if a director meets those standards.
  - If the board uses this second option, any determination of independence for a director who does not meet the categorical standards must be specifically explained.
  - In the event that a director with a business or other relationship that does not fit within the disclosed standards is determined to be independent, the board must disclose the basis for its determination in the manner described above.
- In connection with the requirement that non-management directors meet regularly in executive session without management, companies must disclose in the proxy statement the director chosen as the presiding director at these meetings or, alternatively, the procedure by which a presiding director is selected for each executive session.

- Additional Nasdaq disclosure requirements:
  - A Nasdaq-listed company is required to disclose in its annual proxy statement the directors which directors the board has determined to be independent under Rule 4200.

Board Meetings and Committees

- Item 407 of Regulation S-K includes a number of disclosure requirements about the board and its committees, in addition to the independence disclosures, that were previously located elsewhere in Regulation S-K. These require the company to do the following:
  - State the total number of meetings of the board of directors (including regularly scheduled and special meetings) that were held during the last full fiscal year.
  - Name each incumbent director who during the last full fiscal year attended fewer than 75% of the aggregate of:
    - The total number of meetings of the board of directors (held during the period for which he or she has been a director); ***and***
    - The total number of meetings held by all committees of the board on which he or she served (during the periods that he or she served).

© McKenna Long & Aldridge LLP • August 2007

- Describe the company's policy, if any, with regard to board members' attendance at annual meetings of security holders and state the number of board members who attended the prior year's annual meeting.
  - In lieu of describing in the proxy statement the company's policy regarding director attendance at annual meetings and the number of directors who attended the prior year's annual meeting, this information may instead be placed on the company's web site if the company discloses in its proxy statement the web site address where this information may be found.
- State whether or not the company has standing audit, nominating and compensation committees of the board, or committees performing similar functions.
  - If the company has these committees, however designated, the company must:
    - Identify each committee member.
    - State the number of committee meetings held by each committee during the last fiscal year.
    - Describe briefly the functions performed by each committee. This disclosure does not need to be provided to the extent it is duplicative of disclosure specifically required under Items 407 (c), (d) and (e) with respect to each of these committees, as discussed in more detail below.

NOMINATING GOVERNANCE COMMITTEE DISCLOSURES

- The nominating committee disclosure requirements were originally adopted by the SEC in November 2003 and became effective January 1, 2004. These requirements were subsequently consolidated into Item 407(c) of Regulation S-K.
- The required disclosures with respect to nominating committees must be provided in the proxy statement, except for changes in the nominating committee's policy with respect to shareholder nominations (which, as discussed below, must be disclosed in the Form 10-Q or 10-K for the period in which they occur).

© McKenna Long & Aldridge LLP • August 2007

- In addition to the basic description of the committee's functions, members and number of meetings, as discussed above under the caption "Disclosures Regarding the Board of Directors and Director Independence–Board Meetings and Committees," a public company must make the following disclosures:
  - Committee Status:
    - State whether the company has a standing nominating committee and, if not, state the basis for the board of director's view that it is appropriate for the company not to have such a committee and identify each director who participates in the consideration of director nominees.
    - For the purposes of the disclosure requirements described above, the term "nominating committee" refers not only to a specific nominating committee or a committee performing a similar function but also to groups of directors fulfilling the role of a nominating committee, or the entire board if it fulfills that role.
  - Charter:
    - State whether or not the nominating committee has a charter, and, if yes, state whether a current copy is available on the company's web site and the web site address.
    - If a current copy is not available on the web site, the charter must be included as an appendix to the proxy statement at least once every three fiscal years. In any year in which the charter is not included, the company must identify the prior fiscal year in which the charter was included.
  - Independence of Committee Members:
    - Disclose whether the members of the nominating committee are independent as defined in the listing standards applicable to the company (as discussed above under the caption "Disclosures Regarding the Board of Directors and Director Independence–Board of Directors Independence").
  - Candidates Recommended by Shareholders:
    - If the nominating committee has a policy with regard to the consideration of any director candidates recommended by shareholders,

© McKenna Long & Aldridge LLP • August 2007

describe the material elements of that policy, including, but not limited to, a statement as to whether the committee will consider director candidates recommended by shareholders.

- If the nominating committee does not have such a policy, state that fact and the basis for the board's view that it is appropriate for the company not to have such a policy.
- If the nominating committee will consider candidates recommended by shareholders, describe the procedures to be followed by shareholders in submitting recommendations.
- Companies must report any material changes to the procedures by which shareholders may recommend nominees to the board of directors in the company's Form 10-Q or Form 10-K filed for the period in which the material change occurs (see Part II, Item 5(b) of Form 10-Q, Part III, Item 10 or Form 10-Kand Item 407(c)(3) of Regulation S-K).
    - Adoption of these procedures, where the company previously disclosed that it did not have them, constitutes a material change requiring disclosure.
- If the nominating committee received, by a date not later than the 120th calendar day before the date of the company's proxy statement released to shareholders in connection with the previous year's annual meeting, a recommended nominee from a shareholder or group of shareholders that beneficially owned more than 5% of the company's voting common stock for at least one year as of the date the recommendation was made, identify the candidate and the shareholder or group that recommended the candidate and disclose whether the nominating committee chose to nominate the candidate.
    - No such identification or disclosure is required without the written consent of both the shareholder or group and the candidate.
    - Item 401(c)(2) of Regulation S-K contains specific instructions for calculating the percentage of securities and confirming the ownership of those securities, as well as calculating the timeframe for receipt of a nomination if the date of the previous year's meeting moves by more than 30 days.

© McKenna Long & Aldridge LLP • August 2007

- Qualifications of Directors/Evaluation of Candidates:
  - Describe any specific minimum qualifications that the nominating committee believes must be met by a nominee recommended by the committee and describe any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's directors to possess.
  - Describe the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by shareholders, and any differences in the manner in which the nominating committee evaluates shareholder nominees.
  - With regard to each nominee approved by the nominating committee for inclusion on the proxy card (other than nominees who are executive officers or who are directors standing for re-election), state which one or more of the following categories of persons or entities recommended the nominee: shareholder, non-management director, chief executive officer, other executive officer, third-party search firm or other specified source.
  - If the company pays a fee to any third party or parties to identify or evaluate, or assist in identifying or evaluating, potential nominees, disclose the function performed by each such third party.

- Additional Nasdaq requirements related to nominating committees:
  - As described in more detail under the "Nominating/Corporate Governance Committee" section, Nasdaq permits the board, under exceptional and limited circumstances and subject to certain conditions (including a limit on the time of service), to appoint one member to the nominating committee who is not independent, if the board determines that such individual's membership on the committee is required by the best interests of the company and its shareholders.
    - If the board makes this determination, it must disclose, in the proxy statement for the next annual meeting subsequent to the determination the nature of the relationship between the individual and the company and the reasons for the board's determination.

© McKenna Long & Aldridge LLP • August 2007

AUDIT COMMITTEE DISCLOSURES

- In addition to the basic description of the committee's functions, members and number of meetings, as discussed above under the caption "Disclosures Regarding the Board of Directors and Director Independence—Board Meetings and Committees," a public company must include in its proxy statement the following disclosures, now located in Item 407(d) of Regulation S-K, with respect to its audit committee:
  - Committee Status and Independence:
    - For any listed company, whether the company has a separately designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Exchange Act (see "Audit Committee" section), or a committee performing similar functions, as well as the identity of all of the committee members (Item 407(d) of Regulation S-K).
    - Whether the members of the audit committee are independent, as independence for audit committee members is defined in the listing standards applicable to the company (as discussed above under the caption "Disclosures Regarding the Board of Directors and Director Independence—Board of Directors Independence"). In addition, if the board determines in accordance with those listing standards to appoint a director to the audit committee who is not independent because of exceptional and limited circumstances, the company must disclose the nature of the relationship that makes the individual not independent and the reason for the board's determination.1
    - In addition, if a company is relying on one of the limited exceptions2 from the audit committee independence requirements (provided in Rule 10A-3(b)(1)(iv)), the company must disclose in its proxy statement (and in its Form 10-K) its reliance on that exemption, along with an assessment of whether the reliance will materially affect the ability of the audit committee to act independently and to satisfy its requirements (see Rule 10A-3(d)).
  - Charter:
    - State whether or not the audit committee has a charter, and, if yes, state whether a current copy is available on the company's web site and the web site address.

© McKenna Long & Aldridge LLP • August 2007

  - If a current copy is not available on the web site, the charter must be included as an appendix to the proxy statement at least once every three fiscal years or in any year in which it is materially amended. In any year in which the charter is not included, the company must identify the prior fiscal year in which the charter was included.
- Audit Committee Financial Expert Disclosure:
  - State whether the board of directors has determined that the company either:
    - Has at least one audit committee financial expert serving on its audit committee, or
    - Does not have an audit committee financial expert serving on its audit committee. (See the "Audit Committee" section for more information about audit committee financial experts.)
  - If the company discloses that it has an audit committee financial expert, it must also disclose the expert's name and whether he or she is independent, using the same definition of independence used for audit committee members in other required proxy statement disclosure.
  - If the company discloses that it does not have an audit committee financial expert, it must explain why it does not.
  - If the board determines that the company has more than one audit committee financial expert serving on its audit committee, the company may, but is not required to, disclose the names of those additional persons. If the company does so, it must indicate whether those additional persons are independent.
  - The disclosure regarding audit committee financial experts is required to be filed in the Form 10-K, but the SEC has indicated that companies may provide the disclosure in their proxy statement and incorporate it by reference into the Form 10-K.
- Audit Committee Report:
  - A report of the audit committee, over the names of each committee member, stating:

© McKenna Long & Aldridge LLP • August 2007

- Whether the audit committee has reviewed and discussed the audited financial statements with management;
- Whether the audit committee has reviewed and discussed with the independent auditors matters required to be discussed by the Statement on Auditing Standards No. 61, as amended, as adopted by PCAOB in Rule 3200T;
- Whether the audit committee has reviewed the written disclosures and letter from the independent auditors required by Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees," as adopted by PCAOB Rule 3600T, and discussed with the independent auditors their independence; and
- Whether, based on the above-referenced reviews and discussions, recommended to the board of directors that the audited financial statements be included in the company's Form 10-K.

- Additional NYSE disclosure requirements related to audit committees:
  - If a NYSE-listed company does not limit the number of audit committees on which a member of its audit committee may serve, then any member serving simultaneously on the audit committees of more than three public companies may only do so if the board determines that such service does not impair the member's ability to serve effectively on the company's audit committee, and the company discloses this determination in its annual proxy statement.
- Additional Nasdaq disclosure requirements related to audit committees:
  - As described in more detail under the "Audit Committee" section, Nasdaq permits the board, under exceptional and limited circumstances and subject to certain conditions, to appoint one member to the audit committee who is not independent, if the board determines that such individual's membership on the committee is required by the best interests of the company and its shareholders.
  - If the board makes this determination, it must disclose, in the proxy statement for the next annual meeting subsequent to the determination, the nature of the relationship between the individual and the company and the reasons for its determination.

© McKenna Long & Aldridge LLP • August 2007

COMPENSATION COMMITTEE DISCLOSURE

- The 2006 amendments expanded disclosure concerning the activities of the compensation committee of the board. In addition to the basic description of the committee's functions, members and number of meetings, as discussed above under the caption "Disclosures Regarding the Board of Directors and Director Independence—Board Meetings and Committees," a public company must include in its proxy statement the following disclosures, now located in Item 407(e) of Regulation S-K, with respect to its audit committee:
  - Committee Status:
    - State whether the company has a standing compensation committee (or committee performing similar functions) and, if not, state the basis for the board of director's view that it is appropriate for the company not to have such a committee and identify each director who participates in the consideration of executive and director compensation.
  - Charter:
    - State whether or not the compensation committee has a charter, and, if yes, state whether a current copy is available on the company's web site and the web site address.
    - If a current copy is not available on the web site, the charter must be included as an appendix to the proxy statement at least once every three fiscal years or in any year in which it is materially amended. In any year in which the charter is not included, the company must identify the prior fiscal year in which the charter was included.
  - Independence of Committee Members:
    - Disclose whether the members of the compensation committee are independent as defined in the listing standards applicable to the company (as discussed above under the caption "Disclosures Regarding the Board of Directors and Director Independence—Board of Directors Independence").
  - Committee Processes and Procedures:
    - A narrative description of the company's processes and procedures

for the consideration and determination of executive and director compensation, including:

- The committee's scope of authority;
- To what extent and to whom the committee may delegate its authority to determine or recommend the amount or form of executive and director compensation;
- The role of executive officers in determining the amount or form of executive and director compensation; and
- The identity and role of any compensation consultants or any other person in determining or recommending the amount or form of executive and director compensation, whether they are engaged directly by the compensation committee (or its equivalent), the nature and scope of their assignment, and the consultants' instructions concerning the performance of their duties under the engagement.

- Compensation Committee Interlocks and Insider Participation:
  - Under the caption "Compensation Committee Interlocks and Insider Participation", disclose:
    - Each member of the compensation committee (or its equivalent) during the last fiscal year, indicating each committee member who:
      - Was, during the fiscal year, an officer or employee of the company;
      - Was formerly an officer of the company; or
      - Had any relationship requiring a related party disclosure by the company. If such a relationship exists, the related disclosure must be included here as well.
    - Any of the following relationships existing during the last fiscal year and any related disclosure:
      - An executive officer of the company who was a member of another entity's compensation committee (or its equivalent), one of whose executive officers served on the company's compensation committee (or its equivalent).

© McKenna Long & Aldridge LLP • August 2007

- An executive officer of the company who was another entity's director, one of whose executive officers served on the company's compensation committee (or its equivalent).
- An executive officer of the company who was a member of another entity's compensation committee (or its equivalent), one of whose executive officers was one of the company's directors.

- Compensation Committee Report
  - Item 407(e)(5) contains the new streamlined version of the compensation committee report. The compensation committee report must now state whether:
    - The compensation committee has reviewed and discussed the CD&A with management, and
    - Based on the review and discussion, the compensation committee recommended to the board of directors that the CD&A be included in the company's Form 10-K, proxy statement or information statement.
  - The name of each member of the company's compensation committee (or other board committee performing equivalent function or, in the absence of any committee, the entire board) must appear below the report.
  - The information in the report is not deemed "soliciting material," or to be "filed" with the SEC, except to the extent the company specifically requests it be treated as soliciting material or specifically incorporated it by reference into a document filed under the Securities Act or Exchange Act.
    - The compensation committee report is, however, required also to be included in the Form 10-K, although it is deemed furnished, not filed. If the company elects to incorporate this information by reference from the proxy or information statement into its Form 10-K pursuant to General Instruction G(3) to Form 10-K, the disclosure will be deemed furnished in the Form 10-K and will not be deemed incorporated by reference into any filing under the Securities Act or Exchange Act as a result of furnishing the disclosure in this manner.

© McKenna Long & Aldridge LLP • August 2007

- The compensation committee report only has to be provided one time during any fiscal year.

- Additional Nasdaq requirements related to compensation committees:
  - As described in more detail under the "Compensation Committee" section, Nasdaq permits the board, under exceptional and limited circumstances and subject to certain conditions (including a limit on the time of service), to appoint one member to the compensation committee who is not independent, if the board determines that such individual's membership on the committee is required by the best interests of the company and its shareholders.
    - If the board makes this determination, it must disclose, in the proxy statement for the next annual meeting subsequent to the determination, the nature of the relationship between the individual and the company and the reasons for the board's determination.

DISCLOSURE REGARDING SHAREHOLDER COMMUNICATIONS WITH THE BOARD OF DIRECTORS

- The SEC adopted disclosure standards regarding shareholder communications with board members in connection with the 2003 adoption of the nominating committee disclosures described above. These requirements have now been consolidated into Item 407 of Regulation S-K as part of the 2006 amendments.
- Companies must disclose whether or not the board of directors provides a process for shareholders to send communications to the board and, if the company does not have such a process, state the basis of the board's view that it is appropriate for the company not to have such a process.
- If the company has such a process, the company must include a description of the manner in which shareholders can send communications to the board and, if applicable, to specified directors.
- If all shareholder communications are not sent directly to board members, the company must include a description of its process for determining which communications will be relayed to board members. This filtering process need not be disclosed if it is approved by a majority of the independent directors.

© McKenna Long & Aldridge LLP • August 2007

- In lieu of describing in the proxy statement the manner in which shareholders may communicate with board members and the manner in which the company determines which communications will be forwarded to board members, this information may instead be placed on the company's ***web site*** if the company discloses in its proxy statement the web site address where this information may be found.
- Communications from an officer or director of the company are not viewed as "shareholder communications." Communications from an employee or agent of the company are viewed as "shareholder communications" only if the communications are made solely in the employee's or agent's capacity as a shareholder.
- ***Note:*** Shareholder proposals submitted pursuant to Rule 14a-8 and communications made in connection with such proposals are not viewed as "shareholder communications" for the purposes of this requirement.

INDEPENDENT AUDITOR FEE DISCLOSURE

In connection with the auditor independence rules adopted by the SEC on January 22, 2003, the SEC also adopted expanded disclosure requirements for fees paid to the company's independent auditor.

- The company must include the disclosure in its Form 10-K and proxy statement, although it can be incorporated by reference into the Form 10-K from the proxy statement (Instruction G-3 of Form 10-K). The disclosure requirement is located in Item 9(e)(1) of Schedule 14A (and Item 14 of Form 10-K).
- The disclosure requirements require the company to make the following disclosures with respect to its "principal accountant":
  - Under the caption "Audit Fees," state the aggregate fees billed for each of the last ***two*** fiscal years for professional services rendered by the principal accountant for the audit of the company's annual financial statements and review of financial statements included in the company's Form 10-Q, or for services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years.
    - "Audit Fees" include fees for services necessary to perform an audit or review in accordance with generally accepted auditing standards,

© McKenna Long & Aldridge LLP • August 2007

as well as fees for services that normally would be provided by the accountant in connection with statutory and regulatory filings or engagements. This includes services that generally only the independent accountant reasonably can provide, such as comfort letters, statutory audits, attest services, consents and assistance with and review of documents filed with the SEC.

- Under the caption "Audit-Related Fees," state the aggregate fees billed in each of the last ***two*** fiscal years for assurance and related services by the principal accountant that are reasonably related to the performance of the audit or review of the company's financial statements and are not reported under the Audit Fees caption. The company must describe the nature of the services comprising the fees disclosed under this category.
  - "Audit-Related Fees" are fees for assurance and related services (*e.g.*, due diligence services) that traditionally are performed by the independent accountant. More specifically, these services would include, among others, employee benefit plan audits, due diligence related to mergers and acquisitions, accounting consultations and audits in connection with acquisitions, internal control reviews, attest services that are not required by statute or regulation and consultation concerning financial accounting and reporting standards.
- Under the caption "Tax Fees," state the aggregate fees billed in each of the last ***two*** fiscal years for professional services rendered by the principal accountant for tax compliance, tax advice and tax planning. The company must disclose the nature of the services comprising the fees disclosed under this category.
  - "Tax Fees" captures fees for all services performed by professional staff in the independent accountant's tax division except those services related to the audit. Typically, these fees would relate to tax compliance, tax planning and tax advice services. Tax compliance generally involves preparation of original and amended tax returns, claims for refund and tax payment-planning services. Tax planning and tax advice encompass a diverse range of services, including assistance with tax audits and appeals, tax advice related to mergers and acquisitions or employee benefit plans and requests for rulings or technical advice from taxing authorities.

© McKenna Long & Aldridge LLP • August 2007

- Under the caption "All Other Fees," state the aggregate fees billed in each of the last ***two*** fiscal years for products and services provided by the principal accountant other than those reported in the three categories above, as well as a description of the nature of the services comprising the fees disclosed under this category.
  - "All Other Fees" is a residual category for all other non-audit services.
- Describe the audit committee's ***preapproval policies*** and procedures for audit engagements and services adopted pursuant to the accounting rules (Rule 2-01(c)(7)(i) of Regulation S-X). (See the "Audit Committee" section for more information on audit committee preapproval policies and procedures.)
  - The company must provide clear, concise and understandable descriptions of these policies and procedures. Alternatively, the company may include a copy of the policies and procedures with the materials it delivers to shareholders and files with the SEC.
- State the percentage of services described in each of the last three categories of fees described above that were approved by the audit committee pursuant to the *de minimus* exception to the preapproval requirements.
- If greater than 50%, state the percentage of hours expended on the principal accountant's engagement to audit the company's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees.

© McKenna Long & Aldridge LLP • August 2007

EQUITY COMPENSATION PLAN TABLE

- In December 2001, the SEC adopted rules requiring greater disclosure of equity compensation plan information in proxy statements and Form 10-Ks. The rules are located in Item 201(d) of Regulation S-K.
- The disclosure is required in a company's ***proxy statement*** in any year in which it takes action with respect to any compensation plan (including both equity and non-equity plans). The information is also required in the company's ***Form 10-K***, although it can be incorporated by reference from the proxy statement pursuant to Instruction G-3 of Form 10-K. In years in which the table is not included in the proxy statement, it must be included in the Form 10-K.
- Companies must disclose, in the tabular format set forth below, information as of the end of the most recently completed fiscal year with respect to equity compensation plans of the company, aggregated by plans previously approved by shareholders and by plans not previously approved by shareholders.

Plan Category	**Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)**	**Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)**	**Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)**
Equity Compensation Plans Approved by Shareholders			
Equity Compensation Plans Not Approved by Shareholders			
Total			

- For each ***plan adopted without shareholder approval***, the company must describe briefly in narrative form the material features of the plan. If the company's financial statements contain this description, a cross-reference to the description in the financial statements is sufficient.

© McKenna Long & Aldridge LLP • August 2007

- The disclosure in the table must be provided with respect to any ***compensation plan*** and any ***individual compensation arrangement*** of the company (or parent, subsidiary or affiliate of the company) under which equity securities of the company are authorized for issuance to employees or non-employees (such as directors, consultants, advisors, vendors, customers, suppliers or lenders) in exchange for consideration in the form of goods or services as described in Statement of Financial Accounting Standards No. 123, *Accounting For Stock-Based Compensation*.
  - An individual compensation arrangement includes, but is not limited to, a written compensation contract within the meaning of "employee benefit plan," as defined in Rule 405 under the Securities Act, and a plan (whether or not set forth in a formal document) applicable to one person, as provided under Item 402(a)(6)(ii) of Regulation S-K). The company may aggregate information regarding individual compensation arrangements with the compensation plan information.
  - ***No disclosure is required*** with respect to any plan, contract or arrangement for the issuance of warrants or rights to all shareholders on a pro rata basis or any employee benefit plan that meets the qualification requirements of Section 401(a) of the Internal Revenue Code.
- The company may aggregate information regarding a compensation plan assumed in connection with a merger, consolidation or other acquisition transaction, pursuant to which the company may make subsequent grants or awards of equity securities, with the plan information required in the table. The company must disclose on an aggregated basis in a footnote to the table the information required in columns (a) and (b) with respect to any individual options, warrants or rights assumed in connection with a merger, consolidation or other acquisition transaction.
- To the extent that the number of securities remaining available for future issuance disclosed in column (c) of the table includes securities available for future issuance under any compensation plan or individual compensation arrangement, other than upon the exercise of an option, warrant or right, the company must disclose the number of securities and type of plan separately for each such plan in a footnote to the table.

© McKenna Long & Aldridge LLP • August 2007

- If an equity compensation plan contains a formula for calculating the number of securities available for issuance under the plan, including a formula that automatically increases the number of securities available for issuance by a percentage of the total number of outstanding securities of the company, a description of the formula must be disclosed in a footnote to the table.
- When a company is seeking shareholder approval to amend an existing plan, information about the securities previously authorized for issuance under the plan must be included in the table, but information about securities for which the company is seeking approval should not be included in the table. Similarly, if the company is seeking shareholder approval of a new plan, information about the securities authorized for issuance under the new plan should not be included in the table.

DISCLOSURE REQUIREMENTS FOR RELATED-PARTY TRANSACTIONS

- The SEC's 2006 amendments to the disclosure rules streamline related party disclosure requirements in the annual proxy statement and adopt a more "principles based" disclosure system.
- The company must disclose any transaction since the beginning of the last fiscal year in which the company was or is a participant involving an amount in excess of $120,000 (previously, the threshold was $60,000) in which any "related person" has or will have a direct or indirect material interest.
  - Note that disclosure has been expanded to include transactions where the company is a "participant" in the transaction, which is broader than the old rule which required disclosure of transactions where the company was a "party." The SEC release adopting this change states that its purpose was to clarify that being a "participant" includes situations where the company benefits from a transaction but is not technically a contractual "party" to the transaction. For example, the revised requirement would require disclosure if the company benefits from a transaction with a related party that the company has arranged and in which it participates, even if it is not a party to the contract.
- The disclosure required is similar to that under the previous rules, and includes the name of the person, the basis upon which the person is a "related person," his or her interest in the transaction, the approximate

© McKenna Long & Aldridge LLP • August 2007

dollar value involved in the transaction, and the approximate dollar value of the related person's interest.

- There is no longer a distinction made between indebtedness and other types of related party transactions. If the transaction involves indebtedness, the required disclosure must include the largest aggregate amount of principal outstanding since the beginning of the last fiscal year, the amount outstanding at the latest practicable date, the amount of principal and interest paid during the relevant period, and the rate of interest on the debt.
- "Related person" is defined as any of the following:
  - Executive officer of the company (at any time during the year).
  - Director of the company (at any time during the year) or nominee for director.
  - Greater than 5% shareholder.
  - An immediate family member of any of the above.
    - "Immediate family member" means spouse, child, stepchild, parent, stepparent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, sister-in-law and any other person sharing the household (other than an employee or tenant).
- Disclosure must be provided with respect to any person who was a "related person" at any time during the company's last fiscal year, even if not a "related person" at year end, except that a person will only be considered a "related person" based on stock ownership if the person met the 5% ownership threshold at year end.
- An indirect interest is not material if it results solely from a person's position as a director, less than 10% owner (together with all other persons listed above), or limited partner of the entity that enters into the transaction with the company.
- Under the old rules for directors, the requirements above were largely preempted by a test requiring disclosure of transactions with director-related entities where the amount exceeded 5% of gross revenue of the entity or the company. This test has now been eliminated, so that all director "related person transactions" are now subject to the disclosure requirements described above.

© McKenna Long & Aldridge LLP • August 2007

- In addition, companies are now required to describe their ***policies and procedures*** for review, approval or ratification of reportable related party transactions. This disclosure is required even if no related party transactions are reported.
  - Examples of the material features of policies and procedures may include, among other things:
    - The types of transactions that are covered by the policies and procedures.
    - The standards to be applied pursuant to the policies and procedures.
    - The persons or groups of persons on the board of directors or otherwise who are responsible for applying the policies and procedures.
    - A statement whether such policies and procedures are in writing and, if not, how the policies and procedures are evidenced.
  - Disclosure is also required of any related party transaction where the policies and procedures did not require review, approval or ratification or where the policies and procedures were not followed.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

- The following new disclosure items are required in annual proxy statements regarding security ownership:
  - Disclosure of the number of shares pledged as security by named executive officers, directors and director nominees.
  - Disclosure of beneficial ownership of directors' qualifying shares (previously, these were specifically exempted from disclosure).

STOCK PERFORMANCE GRAPH

- The 2006 amendments separate the stock performance graph from the executive compensation disclosure by moving the graph to Item 201(d) of Regulation S-K.
- The stock performance graph is only required to be included in annual reports to shareholders (required under Exchange Act Rule 14a-3) accompanying or preceding proxy statements for annual meetings at which directors will be elected.

© McKenna Long & Aldridge LLP • August 2007

- The SEC has clearly stated in it Compliance and Disclosure Interpretations under Item 201 of Regulation S-K that the performance graph is ***not*** required to be included in Form 10-K. Instruction 7 to Item 201(e) specifies that the performance graph need not be provided in any filings other than an annual report to security holders required by Exchange Act Rule 14a-3 or Exchange Act Rule 14c-3 that precedes or accompanies a company's proxy statement or information statement relating to an annual meeting of security holders at which directors are to be elected (or a special meeting or written consents in lieu of such meeting).
- A company ***cannot*** include the performance graph in its Form 10-K and omit the performance graph from its annual report to shareholders unless the company is using a "Form 10-K wrap" approach to satisfy the requirements of Rule 14a-3 or Rule 14c-3.
- A company can include the performance graph in the proxy statement, provided that the performance graph is ***also*** included in the annual report to shareholders that accompanies or precedes the proxy statement and therefore complies with Exchange Act Rules 14a-3 or 14c-3.

- The stock performance graph continues to be deemed furnished, not filed.

1. While Nasdaq listing standards provide for a narrow exceptional and limited circumstance exemption, the NYSE standards do not provide such an exemption.

2. These exceptions are for (a) newly public companies, (b) foreign private issuers and (c) a committee member who serves on the boards of both a public company and an affiliated entity but otherwise meets all of the independence requirements.

© McKenna Long & Aldridge LLP • August 2007

These proposed SEC rules have been the subject of much debate. They are very complex, and it appears unlikely that when adopted, they will be the same as proposed. However, the SEC has urged companies to voluntarily use the proposed rules as a "best practice," so we have included them for general information and reference.

General

- On October 8, 2003, the SEC published proposed rules that would, under certain circumstances, require companies to include in their proxy materials shareholder nominees for election as director. The initial comment period on the proposed rules closed December 22, 2003, and the SEC had indicated that it expected final rules to be adopted in February 2004. In March 2004, the SEC held a roundtable discussion on these rules and re-opened the comment period until March 31, 2004. Final rules have ***not*** yet been adopted.
- The new requirements would primarily be located in proposed Rule 14a-11 of the Exchange Act, although related changes to Schedule 13G and Rule 16a-1 of the Exchange Act have also been proposed.
- The limited access right provided by the proposed rules, which would not be available where shareholders are seeking control of a board of directors or election of a director with a financial relationship to the shareholder, would apply only in instances where criteria suggest that the company has been unresponsive to shareholder concerns as they relate to the proxy process, as indicated by certain "triggering events" detailed below.
- The requirements would apply to all companies that are subject to the Exchange Act proxy rules, but only if shareholders have an existing, applicable state law right to nominate a candidate for election as a director.
- The SEC has indicated that it is considering making the rule only applicable to companies that are accelerated filers.

© McKenna Long & Aldridge LLP • June 2004

Triggering Events

- The shareholder nomination procedure would only become operative for a company after the occurrence of one of the following three "triggering events":
  - Trigger one: At least one of the company's nominees for the board of directors receives "withhold" votes from more than 35% of the votes cast at an annual meeting of shareholders held after January 1, 2004. In the event of a contested election to which Exchange Act Rule 14a-12(c) applies or an election to which the proposed shareholder nomination procedure in proposed Rule 14a-11 applies, the withholding of more than 35% of the votes cast for a director will ***not*** be a triggering event.
  - Trigger two: A shareholder proposal (the so-called ***"direct access"*** proposal) submitted pursuant to the proxy rules (Rule 14a-8) providing that the company become subject to the proposed shareholder nomination procedure:
    - Was submitted for a vote of shareholders at an annual meeting held after January 1, 2004 by a shareholder or group of shareholders that held more than 1% of the company's voting securities for one year as of the date the proposal was submitted and that provided evidence of such holdings to the company, ***and***
    - That "direct access" proposal received more than 50% of the votes cast on that proposal at the meeting.
      - The SEC's proposing release indicated that this triggering event could begin to apply for annual meetings held in 2004 if share-holders submit direct access proposals to companies for their proxy statements for the 2004 annual meeting and provide sufficient evidence that they satisfy the 1% and one year thresholds when they submit their proposals.
  - Trigger three: If ***all*** of the following occur:
    - A shareholder proposal submitted pursuant to Rule 14a-8, other than a direct access shareholder proposal, was submitted for a vote of share-holders at an annual meeting by a shareholder or group of shareholders that held more than 1% of the company's voting securities for one year and that provided evidence of such holdings to the company.

© McKenna Long & Aldridge LLP • June 2004

- The shareholder proposal received more than 50% of the votes cast on that proposal.
- The board failed to implement the proposal by the 120th day prior to the date that the company mailed its proxy materials for the following year's annual meeting.
  - With respect to this third proposed triggering event, the SEC recognized that there are numerous implementation difficulties, including determining whether a proposal has actually been implemented and determining the necessary timing of such implementation, and has sought additional comment on this triggering event.
  - As with the second triggering event, the SEC recommended that companies identify any proposals submitted for the 2004 annual meeting that, if adopted, would result in a triggering event under the third proposed triggering event, provided that the proposing shareholder provides evidence to the company that the shareholder satisfies the more than 1% and one year thresholds when the shareholder submits the proposal.

- A proposed amendment to Rule 14a-5 would require the company, where a shareholder proposal is submitted by a more than 1% shareholder who has held the securities for at least one year, to advise shareholders of this fact in the proxy statement related to the meeting in which the shareholder proposal will be presented. The SEC release recommends that, pending final action on the proposed rules, companies make such an identification, if applicable, in their 2004 proxy statements to facilitate an informed shareholder vote with regard to proposals that could trigger the shareholder nomination procedure of proposed Rule 14a-11.
- Once a triggering event occurs, the shareholder nomination procedure would remain operative for any annual meetings or special meetings held during all of the following:
  - The remainder of the calendar year in which the triggering event occurs.
  - The calendar year following the calendar year in which the triggering event occurs.

© McKenna Long & Aldridge LLP • June 2004

- The portion of the second calendar year following the calendar year in which the triggering event occurs up to and including the annual meeting (or special meeting in lieu of an annual meeting) held during that second calendar year.

- To ensure that shareholders are aware when a nomination procedure triggering event has occurred, proposed Rule 14a-11 requires additional disclosures in the company's Form 10-Q or Form 10-K with regard to each of the following:
  - The company must disclose the shareholder vote with regard to any nomination procedure triggering event in the Form 10-Q for the period in which the matter was submitted to a vote of shareholders or, where the nomination procedure triggering event occurred during the fourth quarter of the fiscal year, in the Form 10-K.
  - The company must include in that Form 10-Q or Form 10-K information disclosing that the company is subject to the shareholder nomination procedure as a result of that vote, if applicable.

Eligible Shareholders

- To be eligible to submit a nomination under proposed Rule 14a-11, a shareholder or group of shareholders would be required to comply with ***all*** of the following:
  - Beneficially own, either individually or in the aggregate, more than 5% of the company's securities that are eligible to vote for the election of directors at the next annual meeting of shareholders (or a special meeting in lieu of annual meeting), with each of the securities used for purposes of calculating that ownership having been held continuously for at least two years as of the date of the nomination.
  - Intend to continue to own those securities through the date of the annual or special meeting.
  - Be eligible, as to the shareholder or each member of the group, to report beneficial ownership of those securities on Schedule 13G rather than Schedule 13D.

© McKenna Long & Aldridge LLP • June 2004

  - Have filed the Schedule 13G or an amendment to Schedule 13G reporting their beneficial ownership as a passive or institutional investor (or group) on the Schedule before or on the date of the submission of the nomination to the company. The Schedule must include a certification that the shareholder or group has held more than 5% of the subject securities for at least two years.

- The procedures in proposed Rule 14a-11 would not be available to a shareholder or group that is seeking control of the company. (Consequently, only Schedule 13G filers, who by the terms of the Schedule do not have a control intent, are permitted to use the procedures.) Existing procedures regarding contested elections of directors must be used in control contests.

Independence of Nominees

- The nominating shareholder or group must represent that the nominee meets the objective criteria for independence set forth in any applicable national securities exchange or national securities association rules. The nominee must only meet the general objective standards for independence, not the more stringent standards applicable to the audit committee, and would not need to meet any subjective elements of an independence standard.
- The nominee must also meet all of the following additional standards of independence from the shareholder or each member of the shareholder group that nominated that nominee:
  - If the nominating shareholder or any member of the nominating shareholder group is a natural person, the nominee may not be the nominating shareholder, a member of the nominating shareholder group or a member of the immediate family of either of the above.
  - If the nominating shareholder or any member of the nominating shareholder group is an entity, neither the nominee nor any immediate family member of the nominee may have been an employee of the nominating shareholder or any member of the nominating shareholder group during the then current or immediately preceding calendar year.

© McKenna Long & Aldridge LLP • June 2004

  - Neither the nominee nor any immediate family member of the nominee may have, during the year of nomination or the immediately preceding calendar year, accepted, directly or indirectly, any consulting, advisory or other compensatory fee from the nominating shareholder or any member of the nominating shareholder group or any affiliate of any such holder or member. Compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with that shareholder or any such member (provided that this compensation is not contingent in any way on continued service).
  - The nominee must not be an executive officer, director or a person fulfilling similar functions of the nominating shareholder or any member of the nominating shareholder group or an affiliate of the nominating shareholder or of any member of the nominating shareholder group.
  - The nominee may not control the nominating shareholder or any member of the nominating shareholder group.
- The nominating shareholder or each member of the nominating shareholder group must represent to the company that:
  - The nominee satisfies the applicable objective director independence standards.
  - Neither the nominee nor the nominating shareholder or any member of the nominating shareholder group has a direct or indirect agreement with the company regarding the nomination of the nominee.
- Proposed Rule 14a-11 would include an instruction making it clear that a nominating shareholder will not be deemed to be an affiliate of the company solely as a result of nominating a director or soliciting for the election of that director nominee or against a company nominee pursuant to the shareholder nomination procedure. In addition, where a shareholder nominee is elected, the nominating shareholder or nominating group would not be deemed to be an affiliate solely by virtue of having nominated that director under the proposed rules, as long as the shareholder or group does not have an agreement or relationship with that director otherwise than relating to the nomination.

© McKenna Long & Aldridge LLP • June 2004

Number of Shareholder Nominees

- The maximum number of nominees a company must include in the proxy statement under the proposed rules is as follows:
  - One nominee, if the total number of board members is eight or fewer
  - Two nominees, if the number of board members is greater than eight and less than 20
  - Three nominees, if the number of board members is 20 or more
- If the board is staggered, and the company has a director or directors currently serving who were elected as shareholder nominees with terms extending past the date of the shareholder meeting for which the company is soliciting proxies, then the company is only required to include shareholder nominees in the proxy statement up to the total number of shareholder-nominated directors, including both sitting directors and nominees, that would be required in the immediately preceding bullets.
- If more than one eligible shareholder or group nominates a person to the board pursuant to the proposed rule, the company must include the nominee or nominees, as applicable, of the shareholder or group with the largest beneficial ownership at the time of delivery of the shareholder's notice of intent to nominate a director pursuant to the rule.

Shareholder Notice of Nomination

- The nominating shareholder must provide notice to the company of its intent to require the company to include a nominee on the proxy card no later than 80 days before the date that the company mails its proxy materials for the annual meeting.
- The notice must include all of the following information:
  - A representation that the nominating shareholder or group is eligible to submit a nominee under the shareholder nomination procedure.
  - A statement that, to the knowledge of the nominating shareholder or group, the candidate's nomination or service on the board, if elected, would not violate controlling state law, federal law or listing standards (other than a standard relating to independence, which must be addressed in a separate representation).

© McKenna Long & Aldridge LLP • June 2004

Shareholder Director Nominations

*** PROPOSED RULE ONLY ***

- A representation that the nominee meets the objective independence criteria for the company.
- Representations regarding the absence of a prohibited relationship between the nominee and the nominating shareholder or nominating shareholder group.
- A representation that neither the nominee nor the nominating shareholder (or any member of the nominating shareholder group, if applicable) has a direct or indirect agreement with the company regarding the nomination of the nominee.
- A copy of the nominating shareholder's or nominating shareholder group's filed Schedule 13G indicating ownership of more than 5% of the appropriate class of the company's securities.
- A representation that the nominating shareholder or each member of the nominating shareholder group was eligible to report its security ownership on Schedule 13G in reliance on Rule 13d-1(b) or (c) of the Exchange Act.
- A representation that more than 5% of the appropriate class of the company's securities, as reflected in the Schedule 13G of the nominating shareholder or group, has been held continuously for at least two years and that the nominating shareholder or group intends to continue to own those securities through the date of the subject election of directors.
- A statement from the nominee that the nominee consents to be named in the company's proxy statement and to serve on the board if elected.
- Disclosure about the nominee that complies with the requirements of Item 7(a), (b) and (c) of Schedule 14A (generally, the nominee's biography, stock ownership, interest or involvement in any litigation involving the company and any related party transactions with the company) for inclusion in the company's proxy statement.

© McKenna Long & Aldridge LLP • June 2004

- In addition to the information listed above, include in the notice any of the following information that is not included in the Schedule 13G with regard to each nominating shareholder or member of a nominating shareholder group:
  - Name and business address.
  - Present principal occupation or employment and the name, principal business and address of any company or other organization which employs the nominating shareholder or group member.
  - The amount of each class of securities of the company that the individual owns beneficially, directly or indirectly, determined in accordance with Rule 13d-3 of the Exchange Act.
  - Whether or not, during the past ten years, the individual has been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) and, if so, the dates, the nature of the conviction, the name or other disposition of the case; and whether the individual has been involved in any other legal proceeding during the past five years, as specified in Item 401(f) of Regulation S-K.
  - The methods by which the nominating shareholder or group may solicit shareholders, including any web site address on which the nominating shareholder or group may publish soliciting materials.
- The nominating shareholder or group must also file the notice with the SEC. The notice is considered soliciting material and is subject to the anti-fraud provisions of the proxy rules (Rule 14a-9). The filing must be made no later than two business days after the notice is provided to the company.

Company Obligations if Shareholder Nomination Procedures Are Satisfied

- Once the company receives a nomination from a nominating shareholder or group, it must determine whether the shareholder or group has complied with proposed Rule 14a-11 and whether the nominee satisfies the requirements of the proposed procedure.

© McKenna Long & Aldridge LLP • June 2004

- If the requirements of the procedure are met, then the company must include information regarding the nominee in its proxy statement, including the web site address on which the nominating shareholder or group intends to solicit proxies in favor of the nominee, and the name of the nominee must be included on the proxy card. The information that must be included in the proxy statement includes certain required information from the shareholder notice to the company (see proposed Item 7(i) of Schedule 14A).
- If the company determines that it must include a shareholder nominee in its proxy statement, then it must advise the nominating shareholder or group of the determination and state whether the company intends to include in its proxy statement disclosure opposing the nominee and/or supporting company nominees.[1] If the company intends to include such a statement, then it must advise the nominating shareholder or group that it may submit its own statement in support of its nominee, not to exceed 500 words, and the date by which this statement must be provided to the company, which cannot be less than ten business days from the date of the company's notice to the shareholder.
- The nominating shareholder or group supporting statement is viewed as soliciting material and must be filed with the SEC by the shareholder or group in accordance with existing proxy rules (Rule 14a-11(f)(2)) and proposed proxy rules (Rule 14a-6(p)) on or about the date that the proxy statement is first released to shareholders.
- Both the company and the nominating shareholder or group can solicit proxies in favor of their nominees outside of the proxy statement, provided that such solicitations are made within the parameters of the applicable proxy rules.
- The company may identify any shareholder nominees as such on the proxy card, and may recommend that shareholders vote against or withhold votes from those nominees and in favor of management nominees on the form of proxy card. The company must otherwise present the nominees in an impartial manner on the card. The card may not give shareholders the option of voting for or withholding authority to vote for the company nominees as a group; each candidate must be voted on separately.

[1] *A mere recommendation to vote in favor of or withhold votes from specified candidates is not considered a company statement triggering the shareholder right to include a statement of support.*

© McKenna Long & Aldridge LLP • June 2004

Company Obligations if Shareholder Nomination Procedures Are *Not* Satisfied

- The company may exclude a shareholder nominee from the proxy materials if it determines that ***any*** of the following are true:
  - The shareholder nomination procedure in proposed Rule 14a-11 is not applicable to the company.
  - The nominating shareholder or group has not complied with the requirements of the procedure.
  - The nominee does not meet the requirements of the procedure.
  - Any representation required to be included in the notice to the company is false in any material respect.
  - The company has received more nominees than it is required to include and the nominating shareholder or group is not entitled to have its nominee included under these circumstances.
- If the company determines that the nominee need not be included, it must notify the nominating shareholder or group in writing no less than 30 calendar days before the date of the company's proxy statement released to shareholders in connection with the previous year's annual meeting. If the annual meeting date has been changed by more than 30 days, the notice must be provided a reasonable time before the company mails its proxy materials for the current year.
- The notice to the nominating shareholder must include all of the following information:
  - A description of the determination made by the company's board, including an affirmative statement of its determination not to include the specific nominee.
  - A discussion of the specific requirement or requirements of Rule 14a-11 that the company's board of directors has determined permit the company not to include the specific nominee.
  - A discussion of the specific basis for the belief of the company's board that the company is permitted not to include the specific nominee.
- The company must include in its proxy statement a statement that it has made such a determination, as well as disclosure relating to that determination that the company included in the notice to the shareholder.

© McKenna Long & Aldridge LLP • June 2004

Liability for Statements Regarding Shareholder Nominees and Incorporation by Reference

- The nominating shareholder or group will be liable for any false or misleading statements included in the notice it provides to the company, and the company is not responsible for this disclosure.
- Any information provided to the company in the shareholder notice and then included in the company's proxy materials would not be considered incorporated by reference into any of the company's filings unless the company determines to incorporate that information by reference specifically into that filing. If the company does so incorporate the information by reference, then that information is considered to be the company's disclosure, as the company's own statement, for purposes of the anti-fraud and civil liability provisions of the Securities Act or the Exchange Act, as applicable.

Exceptions from the Proxy Solicitation Rules for Limited Shareholder Communications

- To permit shareholders to engage in communications with other shareholders to form nominating shareholder groups, the proposed rules provide a limited exception to the proxy solicitation rules enabling shareholders to communicate for the limited purpose of forming such a group without filing and disseminating their own proxy statement. These exceptions would apply if:
  - The total number of persons solicited is not more than 30; ***or***
  - Each written communication includes no more than: (i) the statement of the shareholders' intent to form a nominating shareholder group to nominate a director under the proposed rule; (ii) the percentage of securities that the shareholder beneficially owns or the aggregate percentage owned by any group to which the shareholder belongs; and (iii) the means by which shareholders may contact the soliciting party; ***and***
  - Any soliciting material published, sent or given to shareholders in accordance with this item is filed with the SEC by the nominating shareholder or group, under the company's Exchange Act file number, no later than the date the material is first published, sent or given to shareholders.

© McKenna Long & Aldridge LLP • June 2004

- Solicitations by or on behalf of a nominating shareholder or group in support of a nominee placed on the company's proxy card in accordance with the proposed procedures would not subject the nominating shareholder or group to the requirements that it file its own proxy statement if:
  - The soliciting party does not, at any time during the solicitation, seek, directly or indirectly, either on its own or another's behalf, the power to act as proxy for a shareholder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization.
  - The written communication includes: (i) the identity of the nominating shareholder or group; (ii) a description of his, her or its direct or indirect interest, by shareholdings or otherwise, in the company; and (iii) a prominent legend in clear, plain language advising shareholders that the nominee is or will be included in the company's proxy statement and to read the proxy statement when it becomes available because it includes important information. The legend must also explain to shareholders that they can find the proxy statement, other soliciting material and any other relevant documents at no charge on the SEC web site.
  - Any soliciting material published, sent or given to shareholders are filed by the nominating shareholder or group with the SEC, under the company's Exchange Act file number, no later than the date the material is first published, sent or given to shareholders. Three copies of the material, at the same time, must be filed with, or mailed for filing to, each national securities exchange upon which any class of securities of the company is listed or registered.

Schedule 13G Amendments

- As indicated above, as proposed, the shareholder nomination procedures are to be available only to Schedule 13G filers. The SEC is proposing to add an instruction to Schedule 13G to make it clear that a beneficial owner who acquires or holds the company's securities in connection with a nomination, soliciting activities or the election of a nominee under proposed Rule 14a-11 will not be deemed to have a purpose or effect of changing or influencing the control of the company solely by virtue of making the nomination or engaging in these activities.

© McKenna Long & Aldridge LLP • June 2004

- Schedule 13G will also require the shareholder or group to certify that they have met the requirement of owning more than 5% of the company's securities for the minimum required time period of two years. If the shareholder or group has previously filed a Schedule 13G without that certification, it must amend the schedule to provide the required certification in order to make a nomination. Upon the termination of the nominating shareholder group, the group would file a final amendment to the Schedule 13G disclosing the termination of the group and of the group's filing obligation.

Impact on Section 16 Reporting Requirements

- The SEC has indicated that the formation of a group solely for the purposes of nominating a director pursuant to proposed Rule 14a-11, soliciting in connection with the election of that nominee or having a nominee elected as a director would not trigger a reporting requirement under Section 16. Rule 16a-1 is proposed to be amended to exclude such a group from the definition of a 10% owner.

Stacy Ingram

© McKenna Long & Aldridge LLP • June 2004

On March 16, 2004, the SEC released its final rule adopting amendments to Form 8-K, which have the effect of:

(1) Re-numbering and re-formatting Form 8-K

(2) Accelerating the filing deadline for Form 8-K disclosures

(3) Adding eight new significant events requiring disclosure on Form 8-K

(4) Moving two disclosure items from periodic reports to Form 8-K

(5) Expanding certain existing Form 8-K disclosure items

(6) Providing a limited safe harbor and carve out for late Form 8-K filings related to seven of the new disclosure items

The new Form 8-K requirements became effective on ***August 23, 2004***. At the end of this section is a complete list of Form 8-K items, revised to reflect the recent changes.

On November, 23, 2004, the SEC released Frequently Asked Questions, or FAQs, on the new Form 8-K requirements. Information from these FAQs is included below where appropriate, with a notation indicating the relevant question number from the FAQs. Copies of the full text of the FAQs can be found on the SEC's website at http://www.sec.gov/divisions/corpfin/form8kfaq.htm.

ADDED 03/05

ACCELERATION OF FILING DEADLINE

- The new Form 8-K requirements accelerate the filing deadline for Form 8-K disclosures to ***four business days*** following the event triggering disclosure for all items other than the following:
  - **Item 7.01** (Regulation FD Disclosure) – must be furnished within the timeframe required under the applicable circumstances under Rule 100 of Regulation FD (generally within one day).
  - **Item 8.01** (Other Events) – no deadline unless information is filed to comply with Regulation FD. Best Practice: file promptly following the event.
  - Financial statements of acquired businesses required to be filed as exhibits under **Item 9.01**. These financial statements may be filed by amendment not later than 71 calendar days after the date that the initial report on Form 8-K must be filed.

ADDED 03/05

- If the triggering event occurs within four business days before a company files a Form 10-Q or Form 10-K, the company may instead include the disclosure in Item 5 of Form 10-Q or Item 9B of Form 10-K, as appropriate. This does not apply to disclosure required by Items 4.01 (Changes in Registrant's Certifying Accountant) or 4.02 (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) of Form 8-K, which may only be disclosed on Form 8-K. In addition, amendments to previously filed Form 8-Ks must be filed on a Form 8-K/A. (FAQ #1)

NEW DISCLOSURE ITEMS

ADDED 03/05

The following is a list of the new events requiring disclosure on Form 8-K, with their item numbers. Please note that the final rule sets forth limited exceptions to these items, as well as specific information that must be disclosed. In addition, FAQ #2 notes that triggering events apply to companies and their subsidiaries (to the extent an event at the subsidiary level is material to the parent company), other than Items that obviously apply only at the parent company level, such as changes in directors and principal officers.

- **Item 1.01** – Entry into a ***material definitive agreement***, or a ***material amendment*** to such an agreement, ***not*** in the ordinary course of business.
  - The materiality standard for agreements that must be disclosed is the same as that used for determining which agreements must be filed as exhibits to Forms 10-K and 10-Q under Item 601(b)(10) of Regulation S-K.
  - A company is not required to file these agreements as exhibits to the Form 8-K (although they must be filed with the Form 10-Q or, if applicable, Form 10-K for the quarter in which they were entered); however, the SEC encourages filing where possible.
  - Required disclosure:
    - The date of the agreement or amendment
    - The identity of the parties
    - A brief description of any pre-existing material relationship with any of the parties
    - A brief description of the material terms and conditions

© McKenna Long & Aldridge LLP • June 2004

- If an agreement that was not material at the time a company entered into it becomes material at a later date, the company does not need to file a Form 8-K under Item 1.01, unless the agreement is material to the company at the time of an amendment to that agreement. The company will need to file the agreement as an exhibit to the Form 10-Q or Form 10-K relating to the reporting period in which the agreement became material if, at any time during that period, the agreement was material to the company. (FAQ #3)
- The SEC also provided the following information in its FAQs regarding agreements and arrangement relating to executive and director compensation:
  - ***Unwritten Agreements*** – Item 1.01 applies to both written and unwritten material definitive agreements. As noted in Telephone Interpretation I.85. in the Division of Corporation Finance's Manual of Publicly Available Telephone Interpretations (July 1997), if a company is party to an oral contract that would be required to be filed as an exhibit pursuant to Item 601(b)(10) of Regulation S-K if it were written, the company should provide a written description of the contract as an exhibit. (FAQ #5)
  - ***Director Compensation*** – If a "summary sheet" is given to directors that sets forth meeting fees and basic compensation information, and it memorializes or sets forth terms of what is in fact an agreement between the company and the director as to the compensation and other terms, it would be subject to Item 1.01 disclosure, as well as filing under Item 601(b)(10) of Regulation S-K. The Form 8-K describing the agreement should be filed within four business days after the agreement is entered into, rather than within four business days after the summary sheet is provided to the director. This is because Item 601(b)(10)(iii)(A) of Regulation S-K specifically indicates that any contract or compensatory plan with a director is material and must be filed, and if the plan or contract is not set forth in a formal document, then a written description must be filed. (FAQ #5)
  - ***Employment Agreements:***
    - If a company enters into an employment agreement with a director or an executive officer who is a "named executive officer," as defined in Item 402(a)(3) of Regulation S-K, or enters into any amendment of such agreement that is material to the company, then the

ADDED 03/05

company must file an Item 1.01 Form 8-K, unless the employment agreement or amendment is not required to be disclosed under the exceptions in Item 601(b)(10)(iii)(C) of Regulation S-K. Note that the company must also file an Item 5.02(c) Form 8-K (see below) if the officer is a newly appointed principal officer. (FAQ #6)

- If a company enters into an employment agreement with an executive officer who is not a named executive officer, the company must file an Item 1.01 Form 8-K if the employment agreement is not "immaterial in amount or significance" (see Item 601(b)(10)(iii)(A) of Regulation S-K), unless the agreement is not required to be disclosed under the exceptions in Item 601(b)(10)(iii)(C) of Regulation S-K. Whether an employment agreement with an executive officer is "immaterial in amount or significance" must be considered from the perspective of a reasonable investor and in light of established standards of materiality. Note that the company must also file an Item 5.02(c) Form 8-K (see below) if the officer is a newly appointed principal officer. (FAQ #7)

- ***Equity Compensation Plans:***
  - Except for a plan that may be excluded pursuant to Item 601(b)(10)(iii)(C) of Regulation S-K, adoption by a company's board of directors of an equity compensation plan in which named executive officers are eligible to participate requires an Item 1.01 Form 8-K. Where the company's board adopts a compensation plan, or a reportable plan amendment or stock option grant, subject to shareholder approval, the Item 1.01 Form 8-K is triggered upon receipt of shareholder approval. Note that Item 5.02 (see below) must be complied with if applicable. (FAQ #8)
  - If the following conditions are met, no Item 1.01 Form 8-K is required when the board of directors grants an equity award to a named executive officer, other executive officer or director:
    - The equity compensation plan has been previously disclosed in an Item 1.01 Form 8-K (if adopted after August 23, 2004) and previously filed;
    - For a plan that provides broad discretion as to the terms of its awards, each form of award agreement or notice used under the

© McKenna Long & Aldridge LLP • June 2004

plan for awards to directors or executive officers has been previously filed;

- The Item 1.01 Form 8-K filed pursuant to Item 1.01 to report adoption of the plan (or the filed plan itself or the form agreements/notices if adopted before August 23, 2004) discloses all material terms and conditions of the award, other than the identity of the recipient, the grant date, the number of securities covered by the award, the price(s) at which the recipient may acquire the securities, and the vesting schedule, and the grant is consistent with those material terms and conditions.

  This is based on Instruction 1 to Item 601(b)(10), which does not require the executive officer's or director's personal agreement to be filed as an exhibit unless disclosure of particular provisions in the personal agreement is necessary for an investor's understanding of that individual's compensation under the plan. (FAQ #9)

- If the company enters into or makes an award under the plan using an agreement (or an amended agreement) that is materially different from the material terms and conditions of the form of award agreement or notice that was previously disclosed in the Form 8-K announcing the adoption of the plan (or previously filed), an Item 1.01 Form 8-K must be filed to disclose the equity award. Note that Item 5.02 (see below) must be complied with if applicable. (FAQ #10)

- ***Cash Bonus Plans:***

  - If the board of directors of a company adopts a cash bonus plan under which named executive officers are eligible to participate, an Item 1.01 Form 8-K must be filed. The same position applies to the adoption of a cash bonus plan in which other executive officers are eligible to participate, unless the plan is immaterial in amount or significance. If the plan is adopted subject to obtaining shareholder approval, the receipt of the shareholder approval triggers the obligation to file the Form 8-K. (FAQ #12)

  - If the Form 8-K reporting the cash bonus plan's adoption did not disclose the specific performance goals and business criteria for a performance period (such as EBITDA, return on equity or other applicable measure), the company must file a subsequent Item 1.01

ADDED 03/05

ADDED 03/05

Form 8-K to disclose these measures when they are set by the board of directors. However, the company is not required to disclose target levels with respect to specific quantitative or qualitative performance related-factors, or factors or criteria involving confidential commercial or business information, if that disclosure would have an adverse effect on the company. This position is consistent with the treatment of similar information in the Compensation Committee Report on Executive Compensation required to be included in a company's annual proxy statement (see Instruction 2 to Item 402(k) of Regulation S-K). (FAQ #13)

- When a company pays out a cash award pursuant to a cash bonus plan for which Form 8-K disclosure previously was made, payment of the award does not require an Item 1.01 Form 8-K if the company pays out the cash award upon determining that the performance criteria have been satisfied. This is based on Instruction 1 to Item 601(b)(10) of Regulation S-K, which does not require the executive officer's personal agreement under the plan to be filed as an exhibit, unless disclosure of particular provisions in the personal agreement is necessary for an investor's understanding of that individual's compensation under the plan. Based on this Instruction, however, payment of a cash bonus must be disclosed in an Item 1.01 Form 8-K if the company exercised discretion to pay the bonus even though the specified performance criteria were not satisfied. (FAQ #14)

- **Item 1.02** – ***Termination*** of a ***material definitive agreement not*** in the ordinary course of business.
  - Required disclosure:
    - The date of termination.
    - The identity of the parties.
    - A brief description of any pre-existing material relationship with any of the parties.
    - A brief description of the material terms and conditions of the agreement.
    - A brief description of the material circumstances surrounding the termination.

© McKenna Long & Aldridge LLP • June 2004

- Any material early termination penalties incurred by the company.

- No disclosure is required:
  - If the termination/expiration of the agreement is by its terms or upon completion of all obligations thereunder.
  - During negotiations or discussions regarding termination.
  - If the company believes, in good faith, that the agreement has not been terminated, unless it has received a notice of termination.

- The SEC's FAQs provided additional clarity on the disclosure implications of various ***notice and/or renewal provisions:***
  - If a material definitive agreement has an advance notice provision that requires 180 days advance notice to terminate, and the counterparty delivers to the company written advance notice of termination, an Item 1.02 Form 8-K is required even though the company intends to negotiate with the counterparty and believes in good faith that the agreement will ultimately not be terminated. (FAQ #15)
  - If a material definitive agreement has an automatic expiration date, but is continued for successive one-year terms until the next anniversary of that date unless one party sends a non-renewal notice during a specified window period before the automatic renewal, non-renewal of this type of agreement by sending the notice triggers Item 1.02 disclosure. The triggering event is the sending of the notice in the window period, not the termination of the agreement at the end of the term. However, automatic renewal in accordance with the terms of the agreement (in other words, where no non-renewal notice is sent) does not trigger the filing of an Item 1.01 Form 8-K. (FAQ #16)
  - A material definitive agreement expires on June 30. It provides that either party may renew the agreement for another one-year term ending on the following June 30th if it sends a renewal notice to the other party during January, and the other party does not affirmatively reject that notice in February. If neither party sends a renewal notice, and the agreement terminates on June 30th, no Item 1.02 Form 8-K filing is required. This would be a termination by the agreement's terms, which does not trigger an Item 1.02 Form 8-K. If one party sends a renewal notice that is not rejected, however, an

ADDED 03/05

© McKenna Long & Aldridge LLP • June 2004

ADDED 03/05

Item 1.01 Form 8-K is required. Such a filing would be triggered by the passage of the rejection deadline on February 28th, and not the sending of the renewal notice in January. (FAQ #17)

- **Item 2.03** – Creation of a ***material direct financial obligation*** or a material direct or contingent obligation under an ***off-balance sheet arrangement***.[1]
  - Material direct financial obligation includes a long-term debt obligation, a capital lease obligation, or an operating lease obligation, all as defined in Item 303(a) of Regulation S-K, or a short-term debt obligation that arises other than in the ordinary course of business.
  - ADDED 03/05 If a company issued long-term debt in a private placement and the debt is coming due, and the company replaces it or refunds it with another long-term debt issuance of the same principal amount and with similar terms in a private placement, depending on other facts and circumstances (including but not limited to factors such as current impact on covenants, liquidity and debt capacity and other debt requirements), a company may be able to conclude that a financial obligation in this situation is not material and no Form 8-K is required. Materiality is a facts and circumstances determination, and the company must consider not only the amount of the obligation, but also whether the financial obligation is a refinancing on similar terms. (FAQ #19)
  - Required disclosure:
    - The date on which the company becomes directly or contingently obligated
    - A brief description of the transaction or agreement
    - A brief description of the nature and amount of the obligation, including payment terms
    - The nature of any recourse provisions
    - The maximum potential amount of future payments
    - A brief description of the other material terms and conditions
  - Disclosure is required for a facility, program or similar arrangement that creates material direct financial obligations in connection with multiple transactions.

[1] *As defined in Item 303(a) of Regulation S-K.*

© McKenna Long & Aldridge LLP • June 2004

- Disclosure is required for a material obligation under an off-balance sheet arrangement whether or not the company is also a party to the transaction or agreement creating the contingent obligation.
- Instruction 2 to Item 2.03 states that if a company is not party to the transaction creating the contingent obligation arising under the off-balance sheet arrangement, the four business day period to file the Form 8-K begins on the "earlier of" (1) the fourth business day after the contingent obligation is created or arises, and (2) the day on which an executive officer becomes aware of the contingent obligation. Disclosure controls and procedures need to be put in place to ensure that executive officers become aware of this information (see "Disclosure Controls and Procedures" section). Instruction 2 to Item 2.03 provides for the additional four business days as a "grace" period given the nature of the requirement. (FAQ #18)

ADDED 03/05

- **Item 2.04** – Occurrence of a triggering event that ***accelerates or increases*** a material direct financial obligation or a material obligation under an off-balance sheet arrangement.
  - In addition to disclosure regarding the types of obligations described under Item 2.03, this item would include disclosure of an obligation arising out of an off-balance sheet item that is accounted for as a probable loss contingency (as defined under SFAS No. 5).
  - Triggering events include an event of default, event of acceleration or similar event which increases or accelerates the obligation or makes a contingent obligation arising out of an off-balance sheet arrangement become a direct financial obligation.
  - Required disclosure:
    - The date of the triggering event
    - A brief description of the agreement or transaction and the triggering event
    - The nature and amount of the obligation, as increased if applicable, and the applicable payment or acceleration terms
    - Any other material obligations that may arise, increase, be accelerated or become direct financial obligations as a result of the triggering event or the increase or acceleration of the obligation

© McKenna Long & Aldridge LLP • June 2004

- Disclosure is required for an off-balance sheet transaction whether or not the company is a party to the transaction or agreement under which the triggering event occurs.
- No disclosure is required:
  - Unless and until a triggering event has occurred in accordance with the terms of the relevant agreement, transaction or arrangement.
  - If the company believes, in good faith, that no triggering event has occurred, unless the company has received a notice of the occurrence of a triggering event.

ADDED 03/05

- If all facts necessary to an event triggering acceleration or increase in a direct financial obligation under an agreement have occurred, but the counterparty has not declared, or provided notice of, a default:
  - ***No*** Item 2.04 Form 8-K is required if, as is often the case, the agreement states that such declaration or notice is necessary prior to the increase or acceleration of the obligation under the agreement.
  - An Item 2.04 Form 8-K ***is*** required if the agreement provides that the increase or acceleration is triggered automatically on the occurrence of an event without declaration or notice. (FAQ #20)

- **Item 2.05** – Costs Associated with ***Exit or Disposal Activities***
  - Requires disclosure when the board of directors, a board committee, or an authorized officer or officers (if board action is not required) commits the company to an exit or disposal plan or otherwise disposes of a long-lived asset or terminates employees under a plan of termination described in paragraph 8 of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* under which material charges will be incurred under GAAP.

ADDED 03/05

  - Costs associated with an exit activity are not limited to those addressed in SFAS No. 146. SFAS 146 addresses certain costs associated with an exit activity. Paragraph 2 of SFAS 146 states that these costs include, but are not limited to, those costs addressed by the SFAS. Other costs that may need to be disclosed pursuant to Item 2.05 of Form 8-K are addressed by SFAS Nos. 87, 88, 106 and 112. (FAQ #21)
  - If a company, in connection with an exit activity, is terminating employees, it does not need to file the Form 8-K when the company commits to the plan. It can wait until it has informed its employees. Item 2.05 was

ADDED 03/05

intended to be generally consistent with SFAS 146, which states that if a company is terminating employees as part of a plan to exit an activity, it need not disclose the commitment to the plan until it has informed affected employees. See paragraphs 8, 20 and 21 of SFAS 146. (FAQ #22)

- Required disclosure:
  - The date of the commitment to the course of action
  - A description of the course of action
  - An estimate of the total amount or range of amounts expected to be incurred:
    - For each major type of cost associated with the course of action
    - In the aggregate for the course of action
  - An estimate of the amount or range of amounts of the charge that will result in future cash expenditures
- If at the time of filing the company is unable to make a good faith estimate of the amount of the charges, the Form 8-K must be amended to include the estimate within four business days after the company formulates an estimate.

- **Item 2.06** – ***Material Impairments***
  - Requires disclosure when a company's board of directors, a board committee, or an authorized officer or officers (if board action is not required) concludes that a material charge for impairment to one or more of its assets, including an impairment of securities or goodwill, is required under GAAP.
  - Required disclosure:
    - The date of the conclusion that a material charge is required
    - A description of the impaired asset or assets and the facts and circumstances leading to the impairment decision
    - An estimate of:
      - The amount or range of amounts of the impairment charge
      - The amount or range of amounts of the impairment charge that will result in future cash expenditures
  - No disclosure is required under this item if the conclusion regarding the

© McKenna Long & Aldridge LLP • June 2004

material charge is made in connection with the preparation, review or audit of financial statements at the end of a fiscal quarter or year and the disclosure is included in the Form 10-Q or Form 10-K for that quarter or year, respectively.

- **Item 3.01** – Notice of ***Delisting*** or ***Failure to Satisfy*** a Continued Listing Rule or Standard; ***Transfer*** of Listing
  - ***Receipt of a notice from*** the national securities exchange or national securities association that maintains the principal listing for any class of the company's common equity, indicating that a failure to satisfy a rule or standard for continued listing or delisting.
    - Required disclosure:
      - The date of receipt of the notice
      - The rule or standard for continued listing that the company fails, or has failed, to satisfy
      - Any action or response that, at the time of filing, the company has determined to take in response to the notice
  - ***Notification by the company to*** the exchange or association that the company is aware of any material noncompliance with a rule or standard for continued listing.
    - Required disclosure:
      - The date of the company's notice
      - The rule or standard for continued listing that the company fails, or has failed, to satisfy
      - Any action or response that, at the time of filing, the company has determined to take regarding its noncompliance
  - ***Receipt of a public reprimand letter*** or similar communication from the exchange or association indicating that the company has violated a rule or standard of the exchange or association.
    - Required disclosure:
      - The date of the letter
      - A summary of the contents of the letter

© McKenna Long & Aldridge LLP • June 2004

- ***Note:*** Disclosure is required for the three foregoing situations ***even if the company has the benefit of a grace period*** or similar extension period during which it may cure the deficiency.
- Definitive action by the company's board of directors, a board committee, or an authorized officer or officers (if board action is not required) to cause ***withdrawal, delisting or transfer*** of a class of its common equity from the exchange or association.
  - Required disclosure:
    - The date of the action
    - A description of the action taken
- Disclosure is ***not*** required where the delisting is a result of any one of the following:
  - The entire class of the security has been called for redemption, maturity or retirement and sufficient funds have been deposited with an agency authorized to make such payments.
  - The entire class of the security has been redeemed or paid at maturity or retirement.
  - The entire class of securities has been substituted for other securities and/or the right solely to receive an immediate cash payment.
  - All rights pertaining to the entire class of the security have been extinguished.

- **Item 4.02** – ***Non-Reliance*** on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review
  - Requires disclosure when the ***board of directors, a board committee, or an authorized officer or officers*** (if board action is not required) ***concludes*** that any of the company's previously issued financial statements covering one or more years or interim periods should no longer be relied upon because of an error in such financial statements as addressed in Accounting Principles Board Opinion No. 20.
    - Required disclosure:
      - The date of the conclusion
      - An identification of the financial statements and years or periods

© McKenna Long & Aldridge LLP • June 2004

covered that should no longer be relied

- A brief description of the facts underlying the conclusion
- A statement of whether the audit committee discussed the matter with the company's independent accountant

- Also requires disclosure if the company is ***advised by, or receives notice from, its independent accountant*** that disclosure should be made or action should be taken to prevent future reliance on a previously issued audit report or completed interim review related to previously issued financial statements.
  - Required disclosure:
    - The date on which the company was so advised or notified
    - Identification of the financial statements that should no longer be relied upon
    - A brief description of the information provided by the independent accountant
    - A statement of whether the audit committee discussed the matter with the independent accountant
  - The company must do each of the following:
    - Provide the independent accountant with a copy of the Form 8-K no later than the day it is filed with the SEC.
    - Request that the independent accountant furnish a letter addressed to the SEC stating whether the accountant agrees with the disclosure and, if not, stating the respects in which it does not agree.
    - Amend the Form 8-K to file the independent accountant's letter as an exhibit within two business days of receipt.

ADDED 03/05

- If a company has taken appropriate action to prevent reliance on the financial statements and has also filed an Item 4.02(a) Form 8-K, the company does not need to file a second Form 8-K under Item 4.02(b) if it is separately advised by, or receives notice from, its auditor that the auditor has reached the same conclusion, unless the auditor's conclusion relates to an error or matter different from that which triggered the company's filing under Item 4.02(a). (FAQ #23)

© McKenna Long & Aldridge LLP • June 2004

ITEMS MOVED FROM PERIODIC REPORTS TO FORM 8-K

In addition to the new items discussed above, the revised requirements moved to Form 8-K the following two items that were formerly required to be disclosed in Form 10-Q and Form 10-K:

- **Item 3.02** – ***Unregistered sales*** of the company's equity securities (formerly only required in Item 2(c) of Form 10-Q and Item 5(a) of Form 10-K)
  - Disclosure is required only if the unregistered equity securities sold in the aggregate since the company's last report (on Forms 8-K, 10-Q or 10-K, as applicable) constitute 1% or more of the company's outstanding securities of that class (5% for a small business issuer).
    - Includes issuances through conversion and similar transactions that meet the 1% and 5% thresholds.
  - The company must report any unreported unregistered sales (*i.e.*, sales below the threshold) on the next Form 10-Q or Form 10-K, as applicable, but issuances reported on Form 8-K do not need to be reported on the next Form 10-Q or Form 10-K.
  - Disclosure is triggered by entering into an agreement, whether or not subject to conditions, under which the equity securities are to be sold. If there is no such agreement, the company must provide the disclosure within four business days after the closing or settlement of the transaction or arrangement under which the equity securities are sold.
- **Item 3.03** – ***Material modifications*** to rights of security holders of any class of the company's registered securities (formerly required in Items 2(a) and (b) of Form 10-Q, which will be deleted effective August 23, 2004)
  - Requires a company to disclose material modifications to the rights of the holders of any class of the company's registered securities and to briefly describe the general effect of those modifications on the rights of security holders.
  - Disclosure is required even if the modification is disclosed in a proxy statement at the time that it is proposed.

EXPANSION OF EXISTING DISCLOSURE ITEMS

The SEC also amended two existing items to include additional disclosure events:

© McKenna Long & Aldridge LLP • June 2004

- **Item 5.02** – The departure of a director or principal officer, or the election or appointment of a director (other than at a meeting of shareholders) or principal officer (formerly Item 6)
  - "Principal officer" includes the company's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer and any person performing similar functions.
  - Former Item 6 of Form 8-K only required disclosure if a director departed as a result of a disagreement, provided a letter to the company describing the disagreement and then requested that the company publicly disclose the matter. The new disclosure requirements are much broader.
  - Item 5.02(a) - when a ***director resigns or refuses to stand for re-election due to a disagreement***, known to an executive officer of the company, on any matter relating to the company's operations, policies or practices, ***or is removed for cause***
    - Required disclosure:
      - The date of the director's resignation, refusal to stand for re-election or removal.
      - Any board committee on which the director served at the time of resignation, refusal to stand for re-election or removal.
      - A brief description of the circumstances of the disagreement.
    - The company must also do each of the following:
      - File as an exhibit a copy of any written correspondence from the director concerning the circumstances surrounding his or her resignation, refusal to stand for re-election or removal, regardless of whether the director requests such action.
      - Provide the director with a copy of the Form 8-K no later than the day that it is filed with the SEC.
      - Provide the director with the opportunity to furnish a letter addressed to the company stating whether he or she agrees with the Form 8-K disclosures and, if not, the respects in which he or she does not agree.
      - File any such letter as an exhibit by amendment to the previously filed Form 8-K within two business days after receipt.

UPDATED 03/05

© McKenna Long & Aldridge LLP • June 2004

- Item 502(b) – when a ***director retires, resigns, is removed or refuses to stand for re-election*** for any reason ***other than as a result of a disagreement or for cause*** or when a ***principal officer retires, resigns or is terminated***
  - Required disclosure:
    - The fact that the event has occurred.
    - The date of the event.
  - The obligation to file an Item 5.02(b) Form 8-K is triggered by a director's or officer's notice to the company of his or her decision to resign, retire, or not stand for re-election, whether or not that notice is written. The disclosure must specify the effective date of the resignation or retirement, or when the election in question will occur in the case of a refusal to stand for re-election. (FAQ #24)
  - No disclosure is required solely by reason of Item 5.02 of discussions or consideration of resignation, retirement or refusal to stand for re-election. Whether communications represent discussion or consideration, on the one hand, or notice of a decision, on the other hand, is a facts and circumstances determination. A company should ensure that it has appropriate disclosure controls and procedures to determine when a notice of resignation, retirement or refusal to stand has been communicated to the company. (FAQ #24)
  - If a company decides not to nominate a director for re-election at its next annual meeting, no Form 8-K is required. That situation is not covered under the phrase "is removed." However, if the director, upon receiving notice from the company that it does not intend to nominate him or her for re-election, then resigns his or her position as a director, then an Item 5.02 Form 8-K would be required. (FAQ #25)
  - If the director tells the company that he or she refuses to stand for re-election, a Form 8-K is required because the director has communicated a "refusal to stand for re-election," whether or not in response to an offer by the company to be nominated. (FAQ #25)
  - The adopting release for the new Form 8-K requirements did not include the proposed requirement that the company disclose the reasons for an officer's departure. However, a material definitive

UPDATED 03/05

agreement in the form of an employment contract may be terminated simultaneously with the officer's departure. This termination of a material agreement is required to be disclosed under Item 1.02. With respect to the Item 1.02 disclosure requirement regarding the "material circumstances surrounding the termination," it is sufficient for the company to state in its Item 1.02 disclosure that the contract was terminated in conjunction with the officer's departure. These positions under Items 1.02 and 5.02 do not, however, permit a company to avoid disclosing other "material circumstances" surrounding the termination, such as resulting termination, severance or other payments or other consequences. (FAQ #27)

- If a principal officer's duties and responsibilities as a principal officer are removed and reassigned to other personnel, but the person remains employed by the company and retains the title, the company must file an Item 5.02 Form 8-K to report the principal officer's termination. The term "termination" includes situations where an officer identified in Item 5.02 has been demoted or has had his or her duties and responsibilities removed such that he or she no longer functions in the position of that officer. (FAQ #29)

- Item 5.02(c) –when the issuer ***appoints new principal officers***
  - Required disclosure:
    - The officer's name and position.
    - The date of the appointment.
    - Information regarding the officer's background and related party transactions with the company.
    - A brief description of the material terms of any employment agreement.
  - A company can delay the Item 5.02(c) Form 8-K filing regarding appointment of a new principal officer until the day that it first makes a public announcement of the appointment, if the company intends to do so other than by means of a Form 8-K (for example, by a press release). (FAQ #26)
  - Similarly, the company may wait to disclose the entry into an employment agreement with the officer pursuant to Item 1.01 of Form 8-K until

the public announcement of the principal officer's appointment. In addition, if the principal officer were simultaneously appointed to the board of directors of the company, the company does not have to disclose that appointment pursuant to Item 5.02(d) (see below) until the public announcement of the principal officer's appointment. (FAQ #26)

- Even if the company does not consider its principal accounting officer an executive officer for purposes of Items 401 or 404 of Regulation S-K, the company must still make all of the disclosures required by Item 5.02(c) of Form 8-K for that officer. (FAQ #28)

- Item 5.02(d) – when a ***new director is elected*** to the board, except by shareholder vote at an annual or special meeting
  - Required disclosure:
    - The new director's name and the election date.
    - A brief description of any arrangement or understanding pursuant to which the new director was selected.
    - Any committees on which the new director will serve.
    - Information regarding the new director's related party transactions with the company.
  - If information regarding an employment contract, board committee appointment or related party transaction is not determined or is unavailable, the company must so state and must file an amendment to the Form 8-K with this information within four business days after it is determined or becomes available.

- **Item 5.03** – Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year (formerly Item 8)
  - Requires a company with a class of equity securities registered under Section 12 of the Exchange Act to disclose any ***amendment to its articles of incorporation or bylaws*** if the company did not propose the amendment in a previously filed proxy statement or information statement.
    - Required disclosure:
      - The effective date of the amendment
      - A description of the provision adopted or changed by amendment

UPDATED 03/05

© McKenna Long & Aldridge LLP • June 2004

ADDED 03/05

- If applicable, the previous provision
- Only the text of the amendment must be filed as an exhibit to the Form 8-K, with the fully restated articles of incorporation or bylaws filed as an exhibit to the next Form 10-Q or Form 10-K.
- The restatement of a company's articles of incorporation, without any substantive amendments to those articles (*i.e.*, a restatement that consolidates previous amendments without any substantive changes to the articles of incorporation), does not trigger a Form 8-K filing requirement. However, the SEC recommends that companies refile their complete articles of incorporation, if restated, in their next periodic report for ease of reference by investors. (FAQ #30)

- Requires a company to disclose any determination to ***change its fiscal year,*** by means other than a shareholder vote or an amendment to its articles of incorporation or bylaws.
  - Required disclosure:
    - The date of that determination
    - The date of the new fiscal year end
    - The form on which the report covering the transition period will be filed

SUBSTANTIALLY UNCHANGED ITEMS

The following items are substantially unchanged from their treatment in old Form 8-K, other than their new item number and some clarifying changes made by the SEC:

- **Item 1.03** – Bankruptcy or Receivership (formerly Item 3)
- **Item 2.01** – Completion of Acquisition or Disposition of Assets (formerly Item 2)
- **Item 2.02** – Results of Operations and Financial Condition (formerly Item 12)
- **Item 4.01** – Changes in Registrant's Certifying Accountant (formerly Item 4)
- **Item 5.01** – Changes in Control of the Registrant (formerly Item 1)

SAFE HARBOR AND FAILURE TO TIMELY FILE

- In connection with the additional disclosure requirements, the SEC has adopted a limited safe harbor.

© McKenna Long & Aldridge LLP • June 2004

- ***Failure to report*** any of the following items on Form 8-K will not be deemed a violation of Section 10(b) and Rule 10b-5 of the Exchange Act:
  - **Item 1.01** – Entry into a Material Definitive Agreement
  - **Item 1.02** – Termination of a Material Definitive Agreement
  - **Item 2.03** – Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant
  - **Item 2.04** – Triggering Events that Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement
  - **Item 2.05** – Costs Associated with Exit or Disposal Activities
  - **Item 2.06** – Material Impairments
  - **Item 4.02(a)** – Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review (in the case where a company makes the determination and does not receive a notice from its accountant)
- The safe harbor only extends until the due date of the Form 10-Q or Form 10-K, as applicable, for the period in which the Form 8-K should have been filed. Consequently, the disclosure must be made in that Form 10-Q (or 10-K) if the Form 8-K has not been filed, or the company will be subject to potential liability.
- ***Failure to timely file*** reports for these safe harbor items will not prevent the company from being eligible to register securities on Forms S-2 or S-3, or prevent security holders from relying on Rule 144 to resell securities. The company must be current in its Form 8-K filings, however, before it files a Form S-2 or S-3.
- The safe harbor does not apply to the remaining Form 8-K items.
- ***Material misstatements or omissions*** in any item reported on a Form 8-K will remain subject to Section 10(b) and Rule 10b-5 liability.

COMPLETE LIST OF FORM 8-K ITEMS

Section 1 – Registrant's Business and Operations

Item 1.01 – Entry into a Material Definitive Agreement

Item 1.02 – Termination of a Material Definitive Agreement

© McKenna Long & Aldridge LLP • June 2004

Item 1.03 – Bankruptcy or Receivership

Section 2 – Financial Information

Item 2.01 – Completion of Acquisition or Disposition of Assets

Item 2.02 – Results of Operations and Financial Condition

Item 2.03 – Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant

Item 2.04 – Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement

Item 2.05 – Costs Associated with Exit or Disposal Activities

Item 2.06 – Material Impairments

Section 3 – Securities and Trading Markets

Item 3.01 – Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing

Item 3.02 – Unregistered Sales of Equity Securities

Item 3.03 – Material Modifications to Rights of Security Holders

Section 4 – Matters Related to Accountants and Financial Statements

Item 4.01 – Changes in Registrant's Certifying Accountant

Item 4.02 – Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review

Section 5 – Corporate Governance and Management

Item 5.01 – Changes in Control of Registrant

Item 5.02 – Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers

Item 5.03 – Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year

Item 5.04 – Temporary Suspension of Trading Under Registrant's Employee Benefit Plans

Item 5.05 – Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics

© McKenna Long & Aldridge LLP • June 2004

Section 6 – [Reserved]

Section 7 – Regulation FD

Item 7.01 – Regulation FD Disclosure

Section 8 – Other Events

Item 8.01 – Other Events

Section 9 – Financial Statements and Exhibits

Item 9.01 – Financial Statements and Exhibits

David Brown
Stacy Ingram

© McKenna Long & Aldridge LLP • June 2004

As the Andersen and Morgan Stanley debacles demonstrate, document management is a critical issue in corporate America. Few business enterprises have developed and implemented adequately comprehensive document management policies that track, monitor and manage the vast amount of electronic and other documents and files that are resident in any given business environment. The ease of transmission across business, geographic, governmental and even personal boundaries further complicates the equation, challenging a compliance officer's efforts to create a comprehensive, but practical, business solution that conforms to the mandates of Sarbanes.

The development of a comprehensive, well-managed document management program begins with a thorough assessment of the existing policies under which documents are managed, both in hardcopy and in electronic media. To ensure compliance, an enterprise must develop a detailed profile of the communications pathways of its various businesses, both internally and externally, and must identify the information technology systems in use throughout the enterprise. The enterprise must also have a thorough understanding of the business activities that are subject to all forms of federal, state and local governmental regulations. Finally, during the assessment stage, upper-level management should consider and identify particular business activities that have the potential to create compliance issues or to create business and litigation risks.

After assessing its existing program and program needs, an enterprise must develop a comprehensive set of document management policies to control how and when documents are created, distributed, maintained, stored, retained, purged and finally destroyed. To best comply with the mandates of the Sentencing Guidelines, discussed below and in Chapter 15, upper management must also focus on document management policies and procedures, including a well-organized initial roll-out to all levels of employees, followed by the implementation of a systematic and routine plan for monitoring and enforcing the enterprise's document mandates. The purposes of this Chapter are:

- to discuss the legal framework surrounding document management policies;
- to provide basic guidelines for establishing an enterprise-specific document management policy;
- to analyze the impact of the Supreme Court decision in Andersen; and
- to analyze the potential impact of document management policies on litigation under the proposed amendments to the Federal Rules of Civil Procedure.

© McKenna Long & Aldridge LLP • December 2005

FEDERAL DOCUMENT MANAGEMENT REQUIREMENTS

A wide variety of federal statutes and regulations provide mandates relating to document management policies. While an exhaustive discussion of all applicable law and regulatory requirements is not possible due to the unique needs of each enterprise in its particular industry, the following highlights the critical issues facing business enterprises today.

The Sarbanes-Oxley Act of 2002

The Act explicitly addresses the retention and destruction of certain records, predominantly in the context of "obstruction of justice" concerns. The provisions of Sarbanes related to records retention and document destruction are as follows:

- ***Destroying, Altering or Falsifying Records in Federal Investigations and Bankruptcy***
  Section 1519 of Title 18 of the United States Code, which was effective July 30, 2002, provides that ***anyone*** who ***knowingly*** alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object ***with the intent to impede, obstruct, or influence*** the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, ***or in relation to or contemplation of any such matter or case***, shall be ***fined under this title, imprisoned for not more than 20 years, or both***.
- ***Retention of Company Audit Records***
  Section 1520 of Title 18 of the United States Code, which also was effective July 30, 2002, provides that ***any accountant*** who conducts an audit of an issuer of securities to which Section 10A(a) of the 1934 Act applies shall maintain all audit or review workpapers for a period of ***5 years*** from the end of the fiscal period in which the audit was concluded. This section also required the SEC to promulgate rules and regulations relating to the retention of relevant records, which are created in connection with an audit or review. These rules are discussed below under the caption "Securities and Exchange Commission Regulations." Any violation of Section 1520 can result in ***fines, imprisonment of not more than 10 years, or both***.

- ***PCAOB Standards Regarding Document Management***
  The PCAOB, which regulates the public accounting profession, establishes standards to be used in audits of public companies, inspects each registered accounting firm to assess compliance with Sarbanes, and investigates (and disciplines and sanctions, if appropriate) accounting firms and their associated persons for violations of the Act, the rules of the PCAOB, the federal securities laws dealing with accountants, the SEC's rules and "professional standards." The PCAOB established rules that, among other things, require each registered accounting firm to prepare and maintain for not less than ***7 years*** audit work papers and other information related to any audit report in sufficient detail to support the conclusions set forth in the report. Thus, registered accounting firms must retain their records 2 years beyond that required in the new Section 1520 in order to comply with the PCAOB. Please see also the section entitled "Securities and Exchange Commission Regulations" below pertaining to Rule 2-06 of Regulation S-X regarding the retention of accounting records.
- ***Strengthening Existing Obstruction of Justice Provisions***
  Section 1512 of Title 18 of the United States Code (the 2000 version of the statute under which Arthur Andersen LLP was indicted and convicted) was amended effective July 30, 2002 with the addition of the following provision: ***Whoever corruptly*** alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the ***intent*** to impair the object's integrity or availability for use in an ***official proceeding*** or otherwise obstructs, influences or impedes any ***official proceeding***, or attempts to do so will be ***fined or imprisoned for not more than 20 years, or both***.

Securities and Exchange Commission Regulations

Rule 2-06 of Regulation S-X addresses the retention of relevant records, which are created in connection with an audit or review. The SEC adopted Rule 2-06 of Regulation S-X to address the mandate in Section 1520 of Title 18 of the United States Code regarding document retention by auditors. The adopted regulation, which was effective March 3, 2003, establishes a ***seven-year retention period*** after an accountant concludes an audit or review for records relevant to the audit or review, including "***workpapers and other documents*** that form the basis of the audit or review, and memoranda, correspondence, communications, other documents and records (including electronic records), which: (1) are created, sent or received in connection with the audit or review, and (2) contain

UPDATED 12/05

© McKenna Long & Aldridge LLP • December 2005

ADDED 05/05 UPDATED 12/05

conclusions, opinions, analyses, or financial data related to the audit or review." 17 C.F.R. § 210.2-06. The rule requires that relevant documents be retained even if they contain information ***that is inconsistent with the auditor's final conclusions*** if it relates to a significant matter. Significance is determined based on "objective analysis of the facts and circumstances."

The retention period applies to issuers to which Section 10A(a) of the Exchange Act applies (*i.e.*, public companies) as well as to all registered investment companies. The SEC chose a seven-year retention period, rather than the five-year period prescribed by Sarbanes. This is in line with the seven-year period that Sarbanes required the PCAOB to mandate in its auditing standards. ***Compliance was required for audits and reviews completed on or after October 31, 2003***.

Industry-Specific Guidelines

UPDATED 12/05

In addition to Sarbanes and the SEC guidelines highlighted above, a number of other federal requirements affect document management policies for a variety of business enterprises and certain types of information. Examples of these requirements include:

- *Internal Revenue Service:* Regulations promulgated by the IRS require that tax records be retained for at least ***4 years*** after the date of filing the tax return, or until the date the tax is paid, whichever is later. ***However***, records must be maintained and made available to the IRS for inspection for as long as they are or might be "material," even if this period exceeds four years. Tax returns may be subject to audit for as long as ***6 years*** after the filing date.
- *Occupational Health and Safety Administration:* OSHA regulations mandate that certain types of businesses keep logs summarizing certain occupational injuries or illnesses. These logs must be retained for ***5 years*** following the end of the calendar year covered by the records.
- *Intellectual Property:* Because patents are issued based upon the "first to invent or discover" rather than the "first to file" a patent application, adequate records retention is vital to secure a patent. In the trademark arena, registrants must generally file continuing use affidavits between the ***5th and 6th*** year after initial registration. Records must be maintained to track this time frame accurately.
- In addition to the above, a multitude of other document management considerations exist, including mandates under the *Employee Retirement*

© McKenna Long & Aldridge LLP • December 2005

Income Security Act (ERISA), the *Fair Labor Standards Act*, the *Toxic Substances Control Act*, the *Consumer Product Safety Act*, various import/export legislation and many others.

STATE LAW CONSIDERATIONS

In addition to the many federal requirements for document management policies, there are also state law requirements. These most frequently concern health care and employment records. Some states, however, have document retention laws concerning broader areas of business. For example, both Georgia and Texas have statutes that provide for the retention of certain business records.

ADDED 05/05

IMPACT OF REVISED FEDERAL SENTENCING GUIDELINES

The Federal Sentencing Guidelines (the "Sentencing Guidelines") set forth a framework for determining the appropriate sentencing range for individuals or organizations convicted of a federal offense. The Sentencing Guidelines are administered by the Federal Sentencing Commission (the "Sentencing Commission"), which is charged with reviewing and amending the Sentencing Guidelines when necessary.

In Sarbanes, Congress directed the Sentencing Commission to review and amend the Sentencing Guidelines to ensure that they sufficiently deter and punish corporate, securities and accounting fraud crimes, as well as the destruction of evidence relating to these offenses. The Sentencing Commission did so, in the 2003 Amendments and the 2004 Amendments, which are described in Chapter 15. Organizational compliance and risk assessment programs are valuable to mitigate possible criminal penalties under the Sentencing Guidelines and also to establish a reputation for sound governance practices to an enterprise's many audiences, including the financial markets. An effective document management policy is an important part of an effective compliance program and of a continuing program of risk assessment.

UPDATED 12/05

DOCUMENT MANAGEMENT POLICY CONSIDERATIONS

The following outlines certain considerations to be addressed when designing a document management policy.

The Purpose and Goals of a Document Retention Policy

Conducting business requires the retention of certain information. However, it is unreasonable and inefficient for a company to retain all information created in

© McKenna Long & Aldridge LLP • December 2005

the scope of its business. An enterprise's document management policy should address the need to dispose of information once a document no longer has a business purpose and the mandated retention period for legal and regulatory purposes has expired.

The purposes and goals of a comprehensive document management policy include:

- to maintain complete and accurate business records;
- to ensure compliance with all federal, state, local and other applicable legal and regulatory requirements regarding document management and retention;
- to define responsibility for maintaining specific categories of documents;
- to identify and store documents in a cost-efficient manner that increases the availability of information and facilitates easy and inexpensive retrieval of documents, when necessary;
- to maintain an efficient, cost-effective and autonomous program for the routine, periodic destruction of unneeded documents in the normal course of business;
- to provide instructions for the mandatory preservation of documents and/or the suspension of their destruction in the event of litigation or other legal or regulatory events; and
- to protect the privacy and security of an enterprise's business records by safeguarding and protecting the same from unauthorized access, from being removed from the enterprise business premises or from being lost, damaged or destroyed prematurely or improperly.

Assessment and Development of Scope

The creation of an effective document management policy begins with a thorough assessment of the existing processes for the creation, storage and destruction of documents and information for each operating unit of the business. This assessment stage includes the identification of:

- The lines of communication throughout the business and its operating units;
- Information technology systems deployed throughout the business enterprise;

© McKenna Long & Aldridge LLP • December 2005

- The impact of federal, state and local government regulation and compliance issues; and
- Specific business and litigation risks.

Document Creation and Distribution

An effective document management policy should state at the outset the policy and procedures governing the purposeful creation of documents. In other words, employees should consider the document's use and how best to limit the document's distribution PRIOR to creating the document.

Culling of Files

While certain statutory and regulatory requirements mandate retention of certain documents, it is neither feasible nor necessary to maintain certain other documents indefinitely, and some documents should not be maintained at all if they have no business purpose. Employees should be instructed to destroy on a routine and systematic basis those documents that are not subject to any legal retention requirement and that have no legitimate business purpose.

Consistent Application of the Policy

One of the major pitfalls in the Andersen case was Andersen's failure to consistently apply its own document management policy. Every corporate manager is responsible for consistently monitoring and tracking compliance with a document management policy to ensure that records are consistently and periodically purged and that the records retained are the records that satisfy the business objectives of the enterprise. Periodic audits may also help ensure compliance with the policy.

Electronic Records

Much of corporate America's records are now kept in electronic format. While it is generally good policy to purge certain electronic records of emails and other electronic files and to archive other such information in accordance with the enterprise's document management policy, it should be emphasized that, ***until the hard drive is destroyed***, it is often possible to restore information that was thought to have been previously eliminated. Accordingly, an adequate document management policy may need to include the regular destruction and replacement of computer hard drives.

UPDATED 12/05

© McKenna Long & Aldridge LLP • December 2005

UPDATED 12/05

Attorney-Client Privilege

The attorney-client privilege protects from disclosure the contents of communications between a client and its lawyer (and the lawyer's agents) in the context of receiving legal advice. Communications satisfying this standard cannot be revealed absent permission or waiver by the client, but the privilege is limited to *communications*, meaning it does not grant the client the ability to shelter itself by making its attorney the custodian of all of the client's records. Despite this caveat, it may be possible to structure certain projects as legal engagements in order to extend the attorney-client privilege to circumstances where it might not otherwise apply. Adequate planning at the outset of such a project and prior to the creation of certain records enable companies to take full advantage of the strongest defensive position available.

In light of the numerous and complex issues discussed above, it is impossible to provide a comprehensive "one size fits all" document management policy. Before the creation of such a policy, an enterprise should perform an assessment of the types of information to be handled and the industry-specific guidelines set forth in various statutory and regulatory authorities. A proper document management policy should be tailored based on these considerations, and the enterprise should consistently follow, monitor, enforce and audit the policy once implemented.

ADDED 08/05

THE IMPACT OF THE SUPREME COURT'S REVERSAL OF ANDERSEN

As a practical matter, the U.S. Supreme Court's narrowly-framed decision to reverse the Andersen conviction has little to no impact on our view of how an enterprise should structure, monitor and enforce its document management policy. Even if the bar to criminal prosecution for obstruction of justice has arguably been raised, the associated potential for civil liability remains a very real concern for all forms of business enterprises, mitigating against any changes in current policies and procedures.

The Supreme Court reversed Andersen's conviction because the District Court's jury instructions did not convey the requisite consciousness of wrongdoing required to convict under the 2000 version of Section 1512(b)(2)(A) and (B) of Title 18 of the United States Code, which governs witness tampering. At that time, Section 1512(b) punished for

> ***knowingly*** ... ***corruptly persuad[ing]*** another person ... with intent to ... cause or induce any person to (A) ... withhold a record ...

© McKenna Long & Aldridge LLP • June 2004

> from an official proceeding; [or] (B) alter, destroy, mutilate, or conceal an object with intent to impair the object's integrity or availability for use in an official proceeding ....

The Supreme Court relied upon the natural meaning of "knowingly ... corruptly" to interpret the statute, associating "knowingly" with awareness, understanding or consciousness and "corruptly" with wrongful, immoral, depraved or evil. Joining the meaning of these terms together, the Supreme Court determined that only the actions of persuaders who are conscious of their wrongdoing rise to the level of culpability required to impose criminal liability under the statute.

Significantly, the Supreme Court also found the jury instructions to be infirm because the wording led the jury to believe that it did not have to find a ***causal nexus*** between the persuasion to destroy documents and a particular official proceeding. As articulated by the Supreme Court, "[a] 'knowingly ... corrup[t] persuade[r]' ***cannot*** be someone who persuades others to shred documents under a document retention policy when he does not have in contemplation any particular official proceeding in which those documents might be material." The official proceeding must at least be foreseeable.

The Supreme Court's interpretation of these two key elements will be critical to future decisions under Section 1512(b), which was amended by the Act effective July 30, 2002. The revised statute criminalizes the actions of any person who "corruptly alters, destroys, mutilates, or conceals a record ... with the intent to impair the object's integrity or availability for use in an official proceeding or otherwise obstructs, influences or impedes any official proceeding...." The amendments will likely be impacted in light of the following aspects of Andersen:

- Although the term "knowingly" has been omitted, the Supreme Court's decision mandates a finding of dishonesty or corruptness to ensure that innocent persuasion falls outside the boundaries of the statute; the Court stressed a standard that requires "consciousness of wrongdoing" in applying Section 1512(b), a requirement that would be equally applicable, under the Court's reasoning, to the amended Section 1512(b).
- In addition, the Court stressed the need for a particular official proceeding to be on the horizon. Accordingly, if the "persuader" encouraging compliance with a corporation's existing document management policy is completely unaware of any official proceeding looming on the horizon,

ADDED 08/05

> it appears unlikely that such person could be properly convicted under Section 1512(b).

There is support in the decision for the use of document management policies. Chief Justice William Rehnquist, writing for the unanimous Supreme Court in Andersen, noted that document retention policies, "which are created in part to keep certain information from getting into the hands of others, including the Government, are common in business." The Court further noted, ***"[i]t is, of course, not wrongful for a manager to instruct his employees to comply with a valid document retention policy under ordinary circumstances."*** A well-conceived and consistently-enforced document management policy remains, therefore, the best defense to any charge of obstruction of justice under the Act or during the course of litigation.

ELECTRONIC DISCOVERY: THE IMPACT OF DOCUMENT MANAGEMENT POLICIES DURING LITIGATION

ADDED 08/05

Electronic discovery refers to the discovery of electronic documents and data, including email, web pages, word processing files, computer databases and virtually anything else stored on a computer or in an electronic file format. The same rules of civil procedure that govern paper discovery also apply to electronic discovery.

As discussed above, absent litigation, or a document retention obligation imposed by statute or regulation, systematic deletion of electronic data following an enterprise's approved document management policy is acceptable. An enterprise's document management policy should not, however, be designed to encourage (or perceived to encourage) the "cleansing" of files or the elimination of documents that may be harmful to the enterprise's interest with respect to threatened or pending litigation or other official proceeding. It is critical that an enterprise anticipate the circumstances that would trigger the suspension of normal document destruction procedures and incorporate a plan for managing this event – often described as a ***"litigation hold"*** - into its day-to-day document management policy.

The duty to preserve documents by implementing a "litigation hold" arises when there is actual or reasonably anticipated litigation or an investigation by a government agency. Once a duty to preserve arises, an enterprise should develop and implement a document preservation plan that:

- is tailored to requirements of the matter;

© McKenna Long & Aldridge LLP • June 2004

- applies only during the life of the matter;
- is effectively communicated to all document custodians; and
- requires only ***relevant*** records to be preserved – not ***all*** records.

As a general rule, a "litigation hold" does not apply to inaccessible backup tapes maintained for disaster recovery purposes, but would apply to backup tapes that are used in the normal course of business for information retrieval. Parties are only required to exert reasonable efforts to identify and produce relevant and reasonably available information. It is recommended that the "litigation hold" announcement be sent to the appropriate internal personnel, including information technology managers and/or supervisors, and periodically reissued throughout the course of the litigation or investigation matter.

During discovery, the party responding to a discovery request will generally bear the reasonable costs of retrieving and reviewing electronic data for production, unless such information is not reasonably available in the ordinary course of business. In recent federal cases, courts have relied upon certain factors to determine if cost-shifting would be appropriate if the party responding to a discovery requests determines that the electronic data requested is not reasonably accessible:

- The extent to which the specific request is tailored to discover relevant information;
- The availability of the information from other sources;
- The total cost of production versus the amount in controversy;
- The total cost of production versus the resources available to each party;
- The relative ability of each party to control costs and its incentive to do so;
- The importance of the issues at stake in the litigation; and
- the relative benefits of obtaining the information.

ADDED 08/05

The limits and processes involved in discovery of electronic documents continue to evolve. The standards described above reflect the impact or anticipated impact of the proposed amendments to the Federal Rules of Civil Procedure (presently anticipated to be effective December 1, 2006) as well as the so-called "Sedona Guidelines," which represents a set of best practices developed by a group of interested parties. We must expect that these standards and best practices will continue to develop as information technology continues to develop.

ADDED 12/05

ADDED 08/05

Zubulake v. UBS Warburg, 217 F.R.D. 309 (S.D.N.Y. 2003). An enterprise may be subject to judicial sanctions in the event a court determines that there was (1) a knowing, willful or reckless failure to preserve and produce and (2) a reasonable probability that the loss of the evidence has materially prejudiced the opposing party. Possible sanctions include monetary fines, exclusion of evidence or testimony, adverse inference jury instruction and default judgment.

© McKenna Long & Aldridge LLP • December 2005

INTRODUCTION

Among the more serious consequences of the intensified emphasis on corporate governance are the increased standards of conduct imposed upon individuals in criminal statutes, and the stronger sanctions imposed by both the new statutes and the revised sentencing guidelines for violations of those standards of conduct.

In 2004, the Federal Sentencing Guidelines, in particular those guidelines setting forth the requirements for effective corporate compliance programs, were amended to provide for higher standards of conduct for corporations and their officers, directors, and senior management. Although the U.S. Supreme Court has since held that the Federal Sentencing Guidelines are merely advisory, these Guidelines still provide a "best practices" standard by which a company's compliance programs can and may be judged. Included in these best practices are adequate document management policies, which are discussed in detail in "The Corporate Document Management Policy" section. While these compliance standards originate in this context of criminal law, the framework is one which, if implemented, is responsive to much criticism leveled at corporate compliance practices by institutional shareholders and shareholder watchdog groups.

ADDED 04/05

This section has been organized under the following headings:

- Basic Structure of the Federal Sentencing Guidelines
- Constitutionality of the Sentencing Guidelines
- Changes to the Sentencing Guidelines Based on SOX
- Corporate Compliance Programs

Basic Structure of the Federal Sentencing Guidelines

- The Federal Sentencing Guidelines (the "Sentencing Guidelines") set forth a framework for determining the appropriate sentencing range for individuals convicted of a federal offense. The Sentencing Guidelines are administered by the Federal Sentencing Commission (the "Sentencing Commission"). The Sentencing Commission is charged with reviewing and amending the Sentencing Guidelines when necessary.
- Under the Sentencing Guidelines, a federal sentence is based on two factors:
  - The crime's offense level:

ADDED 04/05

© McKenna Long & Aldridge LLP • August 2007

- An offense level is calculated based upon the general underlying offense (known as the ***base offense level***) and specific characteristics of the defendant's crime (known as ***enhancements***, ***upward departures***, or ***downward departures***) (U.S.S.G. § 1B1.1).
- The base offense level and any enhancements or departures are added together for a total offense level.
- The higher the total offense level, the longer a defendant's sentence.
- In fraud cases, a key factor of an offense level is the amount of loss, in dollars, caused by the crime. The greater the amount of loss, the higher a crime's offense level (U.S.S.G. § 2B1.1).

- The defendant's criminal history category:
  - A defendant's criminal history is based on the defendant's prior criminal record (U.S.S.G. §§ 1B1.1(f), 4A1.1).

- Once a defendant's total offense level and criminal history are determined, a sentencing range is calculated from a table in the Sentencing Guidelines, which cross-references offense levels with criminal history categories. A defendant receives a sentence within the calculated sentencing range, unless the range is greater than the statutory maximum sentence for the offense.

ADDED 04/05

Constitutionality of the Sentencing Guidelines

- In 2004, in Blakely v. Washington, 124 S.Ct. 2531 (2004), the U.S. Supreme Court held that the State of Washington's sentencing guidelines violated the Sixth Amendment because they allowed the imposition of a sentence using judicial fact finding, as opposed to a sentence based on facts determined by a jury or admitted by a defendant. Although the Blakely decision did not specifically address the constitutionality of the Federal Sentencing Guidelines, the decision called into doubt the validity of these Guidelines, where sentencing decisions such as the application of enhancements and upward departures were based on facts not determined by a jury beyond a reasonable doubt or admitted by a defendant.
- Subsequently, in 2005, in a joint ruling on two appeals, United States v. Booker and United States v. Fanfan, 125 S.Ct. 738 (2005), the U.S. Supreme Court held that the Federal Sentencing Guidelines violate the Sixth Amendment and, therefore, are unconstitutional, because they allow a judge, as

opposed to a jury, to make factual findings that form the basis for sentencing enhancements.

- The Booker decision was a two-part ruling:
  - In the first part of the decision, the Court held that any fact (other than a prior conviction), which is necessary to support a sentence exceeding the maximum allowed based on the facts established by a plea of guilty or a jury verdict, must be admitted by the defendant or proved to a jury beyond a reasonable doubt.
  - In the second part of the decision, a different majority held that the Sentencing Guidelines were not defunct; rather, the Sentencing Guidelines now are advisory. Although federal courts are not bound by the Sentencing Guidelines, trial courts must consult them during sentencing. Appellate courts then will determine whether sentences are reasonable. In the second part of the decision, the Supreme Court also noted that Congress was capable of devising and installing a new federal sentencing system that is compatible with the Constitution.

ADDED 04/05

Although the Sentencing Guidelines now are only advisory, federal judges still will consult and use the Sentencing Guidelines to determine a defendant's sentence, up to a statutorily-mandated maximum sentence. Many of these maximum sentences were increased based on SOX. Accordingly, the Sentencing Guidelines, in particular the amendments to the Sentencing Guidelines discussed below, provide corporations and their directors, officers, and senior management with a useful framework for corporate compliance programs.

Changes to the Sentencing Guidelines Based on SOX

- As described above under the caption "Changes Enacted Through Sarbanes and Implementing Regulations" in "The Corporate Document Management Policy" section, Congress, in SOX, amended numerous federal statutes to create new crimes relating to corporate, accounting and securities fraud. Congress also directed the Sentencing Commission to review and amend the Sentencing Guidelines to ensure that they sufficiently deter and punish both corporate, securities and accounting fraud crimes, as well as the destruction of evidence relating to these offenses. 04/05

© McKenna Long & Aldridge LLP • August 2007

- In response, the Sentencing Commission adopted emergency amendments to the Sentencing Guidelines on January 8, 2003. The Sentencing Commission then permanently expanded and re-adopted these amendments on May 1, 2003 (the "2003 Amendments"). The 2003 Amendments became effective on November 1, 2003.
- The 2003 Amendments made the following changes to the Sentencing Guidelines:
  - ***Increased the penalties for fraud offenses if the offense carries a maximum term of imprisonment of 20 years or more.***
    - U.S.S.G. § 2B1.1 governs fraud offenses.
    - Section 2B1.1 includes fraud offenses such as wire fraud and mail fraud.
    - The 2003 Amendments raise from level 6 to level 7 the base offense level for fraud offenses with a maximum sentence of 20 years or more.
    - The availability of a probation-only sentence for a fraud offense is limited to an offense committed by a defendant with a prior criminal history in the lowest level and with a loss amount of $10,000 or less.
  - ***Increased the penalties for fraud crimes where the amount of loss was catastrophic.***
    - The base offense level for fraud incrementally increases based upon the amount of loss, in dollars, caused by the crime (U.S.S.G. § 2B1.1(b)(1)).
    - Previously, the highest loss level for fraud was $100 million dollars, resulting in a base offense level of 26.
    - The 2003 Amendments created additional loss levels for losses that exceed $200 million dollars (new base offense level of 28) and $400 million dollars (new base offense level of 30).
    - To determine the amount of loss, courts now may consider ***any reduction in the value of equity securities or other corporate assets*** that resulted from the fraud offense (U.S.S.G. § 2B1.1, cmt. n.3(C)).

© McKenna Long & Aldridge LLP • August 2007

- ***Increased the penalties for crimes where the number of victims is significantly greater than 50.***
  - Under U.S.S.G. § 2B1.1(b)(2), a sentence can be enhanced based upon the number of victims involved in the offense.
  - Previously, a defendant received a two-level enhancement where the offense involved more than ten, but fewer than 50, victims, and a four-level enhancement where the offense involved more than 50 victims.
  - Section 2B1.1(b)(2) now provides for a six-level enhancement if the offense involves 250 or more victims.
- ***Increased the penalties for securities and accounting fraud offenses or offenses that endanger the solvency or financial security of a substantial number of victims.***
  - Previously, U.S.S.G. § 2B1.1(b)(12)(B) provided for a four-level sentence enhancement and a minimum offense level of 24, if the offense substantially jeopardized the safety and soundness of a financial institution.
  - Now, § 2B1.1(b)(12)(B) provides for a four-level enhancement and a minimum offense level of 24, if the offense:
    - Substantially jeopardized the safety and soundness of a financial institution (U.S.S.G. § 2B1.1(b)(12)(B)(i)), ***or***
    - Endangered the solvency or financial security of any company that, at any time during the offense, was a publicly traded company or had 1,000 or more employees (U.S.S.G. § 2B1.1(b)(12)(B)(ii)), ***or***
    - Substantially endangered the solvency or financial security of 100 or more victims (U.S.S.G. § 2B1.1(b)(12)(B)(iii)).

© McKenna Long & Aldridge LLP • August 2007

- To determine whether to apply the financial institution enhancement under § 2B1.1(b)(12)(B)(i), a court may consider the following non-exhaustive list of factors:
  - References to insolvency
  - Substantial reduction of benefits to pensioners and insureds
  - An inability to refund fully any deposit, payment or investment on demand

  U.S.S.G. § 2B1.1(b)(12)(B), cmt. n.11(A).
- Factors that a court may consider in applying the public company enhancement under § 2B1.1(b)(12)(B)(ii) include, but are not limited to:
  - Any references to insolvency
  - Filing for bankruptcy
  - A substantial reduction in the company's stock value
  - A substantial reduction in the company's workforce

  U.S.S.G. § 2B1.1(b)(12)(B), cmt. n.11(B)(ii).
- The new enhancement applies cumulatively with the enhancement in § 2B1.1(b)(2), which is based solely upon the number of victims, although the cumulative impact is limited under § 2B1.1(b)(12)(C).

- ***Increased the penalties for the violation of securities or commodities laws where the defendant holds certain positions within the company.***
  - Under U.S.S.G. § 2B1.1(b)(14)(A), a four-level sentence enhancement is now available if the offense violates securities laws and, at the time of the offense, the defendant was any of the following:
    - An officer or director of a publicly-traded company
    - A registered broker or dealer
    - A person associated with a broker or dealer
    - An investment adviser
    - A person associated with an investment advisor

© McKenna Long & Aldridge LLP • August 2007

- Under U.S.S.G. § 2B1.1(b)(14)(B), a four-level enhancement is available if the offense violates commodities laws, and, at the time of the offense, the defendant was any of the following:
  - An officer or director of a futures commission merchant or an introducing broker
  - A commodities trading advisor
  - A commodity pool operator
- Securities and commodities enhancements do not apply cumulatively with an enhancement for the abuse of a position of trust under U.S.S.G. § 3B1.3.
- Securities and commodities enhancements apply regardless of whether the defendant was convicted under a specific securities fraud or commodities fraud statute or under a general fraud statute, such as the federal mail fraud statute.

◆ ***Increased the penalties for obstruction of justice.***

- The 2003 Amendments modified both the obstruction of justice base offense level and the obstruction of justice sentence enhancement in U.S.S.G. § 2J1.2.
- The base offense level for obstruction of justice offense increased from 12 to 14 (U.S.S.G. § 2J1.2(a)).
- A two-level obstruction of justice enhancement now exists under U.S.S.G. § 2J1.2(b) for offenses:
  - Involving the destruction, alteration or fabrication of a substantial number of records, documents or tangible objects, or
  - Involving the selection of any essential or especially probative record, document or tangible object to destroy or alter, or
  - That were otherwise extensive in scope, planning or preparation.
- The 2003 Amendments provide for a new upward departure for obstruction of justice offenses that involve extreme acts of violence (U.S.S.G. § 2J1.2, cmt. n.4).

© McKenna Long & Aldridge LLP • August 2007

- ***Increased the penalties for perjury.***
  - The base offense level for perjury under U.S.S.G. § 2J1.3 increased from 12 to 14.
- ***Addressed sentencing for new offenses created under SOX.***
  - The new offense of destruction of corporate audit records (18 U.S.C. § 1520) is referenced in U.S.S.G. § 2E5.3, cmt.
  - A statutory maximum penalty of ten years' imprisonment applies to the knowing and willful violation of document maintenance requirements set forth in § 1520 or in rules or regulations adopted by the SEC.
  - If a defendant destroys corporate audit records in violation of § 1520 in an effort to obstruct justice, courts must apply U.S.S.G. § 2J1.2, which provides for offense levels and enhancements for fraud and obstruction of justice.
  - Additional new offenses created by SOX, to which the Sentencing Guidelines now apply, are set forth in Appendix A to the Sentencing Guidelines.
- Clarified sentencing for contempt.
  - U.S.S.G. § 2J1.1, as amended, provides that the fraud guideline, § 2B1.1, is the most analogous guideline for a case involving a violation of a judicial order enjoining fraudulent behavior (U.S.S.G. § 2J1.1, cmt. n.2).

ADDED 04/05

Corporate Compliance Programs

- ***Overview.***
  - There is no question that a viable complete Corporate Compliance Program has become a plus with institutional shareholders and share-holder watchdog groups in addition to the media and state and federal regulators. The Sentencing Guidelines include a seven-point outline of a Compliance Program within the context of criminal law. (See "Seven Minimum Requirements for an Effective Compliance Program" in this section.) This Program, if instituted, provides mitigation for corporate conduct that might otherwise result in heavier sentences. It is easy to dismiss the relevance of the Corporate Compliance Program frame-work embedded in the Sentencing Guidelines because its relevance appears limited to the context of sentences for criminal conduct. Most

© McKenna Long & Aldridge LLP • August 2007

companies, other than perhaps government contractors, may quite justifiably think this has limited value since their own conduct rarely abuts statutes with criminal penalties.

- A more careful look, however, suggests that the Compliance Program framework embedded in the Sentencing Guidelines provides a straightforward way of measuring a corporate Compliance Program, specifically as a means to identify weaknesses in a Compliance Program and to structure corrective action.
- The relevant standard, whether to measure an existing program or to install a new program consists of a few straightforward concepts, although implementation may in some cases be extensive:
  - The Company must conduct an audit with either internal or external resources of its existing Compliance Program;
  - Based on the audit results, it must build a scope of change and implementation.
  - A good Corporate Compliance Program:
    - Consists of a series of policies and codes of conduct addressing personal behavior required to comply with applicable laws and regulations and company standards;
    - Must have a system of evaluating conformance;
    - Must be accompanied by orientation and, on a regular basis, training and reaffirmation (whether by signature of employees or some other means)
    - Must incorporate a process for identifying, surfacing and communicating violations to those who can remedy those violations; and
    - Must be supported visibly by managers "at the top."

- These programs, and such an initiative, will echo as well as blunt much of the shareholder and regulatory criticism of corporate behavior over the past several years.

ADDED 04/05

© McKenna Long & Aldridge LLP • August 2007

Impact of Sentencing Guidelines/ Corporate Compliance Programs

Corporate Compliance Programs Under the Organizational Sentencing Guidelines

- The "Organizational Guidelines" are found in Chapter Eight of the Sentencing Guidelines.
  - A company generally can be held criminally liable whenever an employee of the company commits an act within the scope of his or her employment, even if the employee acted contrary to company policy and instructions.
  - Under the Organizational Guidelines, a convicted company may be subject to:
    - Mandatory restitution (U.S.S.G. §§ 8A1.2(a), 8B1.1).
    - Issuance of public notices of conviction (U.S.S.G. §§ 8A1.2(a), 8B1.4).
    - Monetary fines (U.S.S.G. § 8A1.2(b)).
    - Probationary sentences of up to five years (U.S.S.G. §§ 8A1.2(c), 8D1.1, 8D1.2).
    - Community service (U.S.S.G. §§ 8A1.2(a), 8B1.3).
    - Forfeiture (U.S.S.G. §§ 8A1.2(d) 8E1.2).
    - Other remedial measures (U.S.S.G. §§ 8A1.2(a), 8B1.2).
- The current Organizational Guidelines provide that the ***existence of an internal, "effective" compliance program is a mitigating factor that may justify a significant reduction in applicable fines or penalties*** (U.S.S.G. § 8C2.5(f)).

2004 Amendments to Organizational Guidelines

- In 2004, the Organizational Guidelines were amended to toughen the criteria for effective corporate compliance programs (the "Compliance Amendments").
  - The Compliance Amendments make the following changes to the Organizational Guidelines:
    - Retain an effective corporate compliance program as a mitigating factor for fines (U.S.S.G. § 8C2.5(f) (as amended)).

© McKenna Long & Aldridge LLP • August 2007

- Expand the scope of an effec tive compliance program to include violations of "any law, whether criminal or noncriminal (including a regulation), for which the organization is, or would be, liable" (U.S.S.G. § 8B2.1, cmt. n.1).
- Set forth seven minimum steps for an effective compliance program (see "Seven Minimum Requirements for an Effective Compliance Program" caption below) (U.S.S.G. §§ 2B2.1(6)(1)-(7)).
- Require directors and executives to take an active leadership role in developing and operating compliance programs.
- Allow the implementation of a compliance program to be a condition of probation.
- Retain the requirement that a company exercise due diligence to prevent and detect violations of law.
- Require a company to promote a culture that encourages compliance with the law.
- Provide additional guidance for implementing compliance programs.

- ***Seven Minimum Requirements for an Effective Compliance Program***

1. ***"Compliance standards and procedures"*** to prevent and detect violations of law.
   - Compliance standards and procedures are "standards of conduct and internal control systems reasonably capable of reducing the likelihood of violations of law" (U.S.S.G. § 8B2.1, cmt. n.1).
2. ***Assignment of direct/overall leadership*** of a compliance program to specific individuals in company leadership.
   - Company leadership consists of:
     - High-level personnel of the company,
     - High-level personnel of a unit of the company, ***or***
     - Personnel with substantial authority.
   - Adequate resources and authority must be given to carry out responsibility for the program.
   - The head of the compliance program must report to the board of

© McKenna Long & Aldridge LLP • August 2007

directors (or an appropriate subgroup) regarding the implementation and effectiveness of the program.

- Although specific individuals must have direct responsibility for a compliance program, all individuals within the company leadership must:
  - Know about the contents and operation of the program,
  - Perform assigned duties with due diligence, ***and***
  - Promote a company culture that encourages a commitment to compliance.

3. ***Reasonable efforts to exclude*** from management and positions with substantial authority ***individuals*** whom the company knew, or should have known through the exercise of due diligence, have a ***history of engaging in violations*** of law or other conduct inconsistent with an effective compliance program.
4. ***Compliance training,*** including training for ***all*** of the following:
   - Members of the board of directors or the highest governing body,
   - Company leadership,
   - Company employees, ***and***
   - Company agents, where appropriate.
5. ***Reasonable steps*** to:
   - ***Ensure that the program is being followed***, including monitoring and auditing systems that are designed to detect violations of law.
   - ***Evaluate periodically*** the effectiveness of the company's program.
   - ***Have a system for reporting potential or actual violations*** of law that is:
     - For use by employees and agents,
     - Without fear of retaliation, ***and***
     - Available anonymously.
6. ***Consistent promotion and enforcement of the program.***
   - Use incentives to encourage compliance.

© McKenna Long & Aldridge LLP • August 2007

- Use disciplinary measures for engaging in or failing to take reasonable steps to prevent or detect violations of law.

7. When a ***violation of law occurs***, take reasonable steps to:
    - Respond appropriately to the violation,
    - Prevent future violations, ***and***
    - Modify the compliance program, if necessary, to prevent future violations.

- ***Required Risk Assessment***
    - In addition to meeting the seven minimum requirements for a compliance program, a company also must conduct ongoing assessments to identify any risk of violations of law (U.S.S.G. § 8B2.1(c)).
    - The company must design, implement or modify each of the seven minimum requirements for a compliance program to reduce the risk of violations of law.
    - The assessment must look at:
        - The nature and seriousness of violations of law, ***and***
        - The likelihood that certain violations of law may occur because of the nature of the company's business.
    - If a substantial risk of violations of law exists, the company must take reasonable steps to prevent and detect those types of violations.
    - Actions taken to implement a compliance plan must be prioritized in light of the risks identified in this assessment.

- ***Self-Reporting of Violations of Law***
    - Self-reporting is still a factor that may justify a reduction in a company's applicable fines or penalties (U.S.S.G. § 8C2.5(g)).
    - Reduction in fines or penalties depends upon the level of self-reporting.
    - General requirements for self-reporting:
        - Must occur prior to an imminent threat of disclosure or government investigation,

© McKenna Long & Aldridge LLP • August 2007

Impact of Sentencing Guidelines/ Corporate Compliance Programs

- Must occur within a reasonably prompt time after becoming aware of the offense,
- Must be made to the appropriate governmental authorities,
- The company must fully cooperate in the investigation, ***and***
- The company must demonstrate recognition and acceptance of responsibility for its conduct.

  U.S.S.G. § 8C2.5(g).

- Lower reductions in fines and penalties are available for merely cooperating with an investigation or accepting responsibility, without self-reporting.

- ***Effect of Self-Reporting on Attorney-Client Privilege***
  - In 2006, the U.S. Sentencing Commission voted unanimously to eliminate language from the Federal Sentencing Guidelines which would impact the sentencing of organizations. Specifically, the amendment removes the privilege waiver sentence under Guideline provision 8C2.5, Application Note 12, which provided "[w]aiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score under subdivisions (1) and (2) of subsection (g) unless such waiver is necessary in order to provide timely and through disclosure of all pertinent information known to the organization." The amendment was prompted by criticisms from the American Bar Association and other legal organizations and professionals who argued that the language had the effect of pressuring organizations to waive attorney client privilege and attorney work product protection. The amendment took effect in November 2006.

- ***Criminal Offenses by High-Level Personnel***
  - A company is not precluded from receiving compliance program credit if high-level personnel participate in the offense.
  - Participation in, condoning of or willful ignorance of an offense results in a rebuttable presumption that no effective compliance program existed (U.S.S.G. § 8C2.5(f)(3)).

© McKenna Long & Aldridge LLP • August 2007