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SEC Implements Sarbanes-Oxley Act Provisions and Accelerates Filing Deadlines for Forms 10-K and 10-Q

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Yesterday, the Securities and Exchange Commission adopted rules implementing the CEO/CFO certification of financial reports and accelerated reporting of changes in beneficial ownership provisions of the Sarbanes-Oxley Act of 2002 (which was signed into law on July 30, 2002) as well as rules accelerating the filing deadlines for Forms 10-K and 10-Q. The Sarbanes-Oxley Act required that the SEC enact rules implementing the Act's CEO/CFO certification requirements by August 29th; the changes made by the Act to the reporting of changes in beneficial ownership of issuer securities by the issuer's directors, officers and major shareholders would have become effective on August 29th whether or not the SEC made conforming changes to its Section 16 regulations.

CEO/CFO Certifications

In implementing Section 302 of the Sarbanes-Oxley Act, the SEC adopted new Rule 13a-14 with regard to CEO and CFO certifications for quarterly and annual reports.

Pursuant to this new Rule, CEO's and CFO's must certify in the report (as distinguished from certifications under Section 906 of the Act, which many issuers filed as "correspondence" with the report) that:

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

In addition, the certification must (i) confirm the certifying officers' responsibility for establishing and maintaining "disclosure controls and procedures" (described by the SEC as "a newly-defined term reflecting the concepts of controls and procedures related to disclosure"), (ii) confirm that the disclosure controls and procedures were designed by the certifying officers to ensure that material information is made known to them, (iii)

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confirm that the certifying officers have evaluated the effectiveness of the disclosure controls and procedures within 90 days of the date of the report, and (iv) present the conclusions of the certifying officers about the effectiveness of the disclosure controls and procedures based on that evaluation.

The principal executive and financial officers are also required to certify that they have disclosed to the company's auditors and audit committee (x) all significant deficiencies in the design or operation of internal controls (described by the SEC as "a pre-existing term relating to internal controls regarding financial reporting") which could adversely affect the issuer's ability to record, process, summarize and report financial data, and have identified to the issuer's auditors any material weaknesses in internal controls, and (y) any fraud (whether or not material) that involves management or other employees who have a significant role in the issuer's internal controls.

Finally, the certifying officers must state whether or not there were significant changes in the company's internal controls or other factors that could significantly affect internal controls "subsequent to the date of their evaluation", including corrective actions with regard to significant deficiencies and material weaknesses. This language is problematical, since the evaluation referred to is an evaluation of disclosure controls and procedures, which the SEC perceives as something different than an issuer's system of internal controls.

We have attached to this Alert a copy of the required certification. The SEC has mandated that issuers file the certification in the precise form set forth in the new Rule.

The new SEC rules did not harmonize the certification provisions of Section 302 of the Sarbanes-Oxley Act with those contained in Section 906 of the Act and an ambiguity continues to exist as to the implementation and potential enforcement of these separate certification requirements. The SEC made clear yesterday that the new rules have no application to the currently effective criminal law provisions of Section 906 of the Sarbanes-Oxley Act. The SEC noted that it is in discussions with the U.S. Department of Justice, but currently has nothing to report, and indicated that it may be difficult to develop a single certification which would satisfy the requirements of both Section 302 and Section 906 of the Act. We understand that the SEC's Office of General Counsel has not yet taken a position on this matter. As a result, unless the Sarbanes-Oxley Act is amended by Congress, or the DOJ provides guidance on this matter, the requirement of a separate certification under Section 906 remains in effect. We will keep you advised of any developments in this area.

Accelerated Reporting Deadlines for Forms 10-K and 10-Q

Earlier this year the SEC proposed accelerating the deadline for quarterly reports on Form 10-Q from 45 days to 30 days, and annual reports on Form 10-K from 90 days to 60 days. The SEC received hundreds of written comments on that proposal, many noting that the shortened reporting periods would be a tremendous burden on public companies and the accounting and legal professions, and could ultimately result in less accurate financial reporting. As adopted, the new regulations are slightly less burdensome than as originally proposed. However, given that the

Sarbanes-Oxley Act and other federal and state laws mandate that companies have extensive internal control procedures and that the Boards of Directors, audit committees, and CEOs and CFOs of public companies exercise extreme care and diligence when preparing and approving complex financial reports, meeting even these modified deadlines will be a significant challenge.

The new regulations adopted yesterday exempt certain small issuers from the accelerated reporting deadlines and are phased in over three years. Specifically:

- The new accelerated filing rules only affect U.S. public companies which (1) have previously filed at least one annual report; (2) have been reporting for at least 12 months; (3) have a public float of at least $75 million; and (4) are not eligible to use the SEC's special forms for small business issuers.

- The Form 10-Q deadline will ultimately be 35 days from the end of each of an issuer's first three fiscal quarters, phased in as follows:
  - o Year 1 -- 45 days (no change);
  - o Year 2 -- 40 days; and
  - o Year 3 -- 35 days.

- The Form 10-K deadline will ultimately be 60 days from the end of an issuer's fiscal year, phased in as follows:
  - o Year 1 -- 90 days (no change);
  - o Year 2 -- 75 days; and
  - o Year 3 -- 60 days.

- The first reductions in the filing period (Year 2 - 40 days for Form 10-Q and 75 days for Form 10-K) would take effect for fiscal years ended on or after December 15, 2003. Thus, for calendar year companies, this Rule will first apply to the 10-K for the year ending December 31, 2003.

Beginning with the Form 10-K filed for the fiscal year ending on or after December 15, 2002, a company subject to accelerated filing must disclose in its Form 10-K whether it makes its periodic and current reports (Forms 8-K, 10-Q and 10-K) available, free of charge, on its Web site as soon as reasonably practicable after filing with the SEC.

Accelerated Reporting of Changes in Beneficial Ownership (Section 16 Reporting)

Section 403(a) of the Sarbanes-Oxley Act amended Section 16(a) of the Securities Exchange Act to require that all persons subject to Section 16(a) - officers, directors and 10% shareholders of a public company - report on Form 4 changes in their beneficial ownership of the company's securities within two business days of the date of execution of the transfer, beginning with transactions on and after August 29, 2002.

The SEC issued new rules yesterday to conform its Section 16 regulations to the requirements of Section 403(a) of the Sarbanes-Oxley Act. Under the new rules, all transactions that are reportable

on Form 4 are now reportable within two business-days of the execution of such transactions, instead of within 10 days after the end of the calendar month during which the transaction took place. Further, the new rules provide that stock option grants, awards, discretionary transactions and certain other transactions previously reported on an annual basis on Form 5 are now subject to the two business-day reporting requirement. This means that for transactions effected, for example, any time on Tuesday, a Form 4 would need to be filed by the close of business on Thursday.

The SEC's Section 16 rules, however, continue to allow for (1) deferred reporting on Form 5 for bona fide gifts and inheritances and (2) for the exemption from Section 16 reporting for the reinvestment of dividends or interest pursuant to broad-based dividend or interest reinvestment plans and transactions in certain tax-conditioned benefit plans, such as employee stock purchase plans (ESPPs).

The new rules also provide for two exceptions from the two business-day filing requirement. The first is for transactions under a contract, plan or arrangement that satisfies SEC Rule 10b5-1(c) - a safe harbor from insider trading - where the reporting person does not select the date of execution. In this case, the date of execution of the trade is deemed to be the date when the executing broker, dealer or plan administrator notifies the reporting person of the execution of the trade, so long as the notification date is not later than the third business day following the trade. Similarly, for a discretionary employee benefit plan transaction where the reporting person does not select the date of execution, the date on which the plan administrator notifies the reporting person that the transaction has been executed is the deemed date of execution, again so long as the notification date is not later than the third business day following the trade. In both cases, the two business-day filing requirement would then run from the deemed date of execution. For example, if a transaction under a 10b5-1(c) plan was effected by a broker on Monday (and the reporting person did not select the date of execution), but notice was not given to the reporting person until Wednesday, the reporting person would have until the close of business on Friday to file her Form 4 (two business days from Wednesday, the deemed date of execution). It will be incumbent upon officers and directors who utilize 10b5-1(c) arrangements and who have investments made in company stock pursuant to employee benefit plans to make sure that their brokers, dealers and plan administrators report transactions to them promptly, since the rules merely provide a maximum of a three business-day additional grace period.

In issuing these new rules, the SEC reiterated that the Sarbanes-Oxley Act mandates that, no later than July 30, 2003, the SEC require that beneficial ownership reports be filed electronically with the SEC and posted on the SEC's and the issuer's websites. We join the SEC in encouraging all reporting persons to obtain EDGAR filing codes as soon as possible and to file electronically now. Filing via EDGAR is advisable because electronic filing provides instant delivery of the report to the SEC, rather than losing a day while the report is sent by overnight courier. It is also advisable that reporting persons give a power of attorney to a designated filing person (such as an in-house or

outside counsel) in case the reporting person is not available to sign the beneficial ownership report. The new rules continue to require issuers to include disclosures about late filings in their proxy statements. Additionally, late filings can result in enforcement actions.

Further Rulemaking Expected

Provisions of the Sarbanes-Oxley Act require the SEC to enact additional regulations on or before January 26, 2003, although we believe that the SEC will issue final rules with respect to those matters before the end of this year. Further, we expect that the SEC and the self-regulatory organizations (Nasdaq and the New York Stock Exchange, among others) will seek to develop sets of coordinated corporate governance rules for the continued listing of public companies on the major exchanges.

For more information about the new SEC rules or other corporate governance reform measures, please contact Peter H. Ehrenberg, Esq., Member of the Firm and Chair of Lowenstein Sandler's Corporate Department and its M&A and Corporate Finance Practice Group, or Anthony O. Pergola, Esq., Counsel, Jeffrey M. Shapiro, Esq., Counsel, Steven J. Tsimbinos, Esq., Counsel, or Douglas N. Bernstein, Esq., Associate, each a member of the M&A and Corporate Finance Practice Group, at 973.597.2500.