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HRO Alert

The Sarbanes-Oxley Act of 2002

FINAL RULES: CODE OF ETHICS

On January 24, 2003, the SEC released final rules under the Sarbanes-Oxley Act of 2002 requiring public companies to make certain disclosures regarding their code of ethics.¹ Specifically, under the final rules, companies must disclose in their annual report whether they have adopted a code of ethics for their principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and, if not, why not. A company must also promptly disclose amendments to, and waivers from, the code of ethics relating to any of these officers.

These rules finalize and, in some cases, revise the SEC's proposed rules regarding codes of ethics, which were released on October 22, 2002.

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

SCOPE OF CODE OF ETHICS

The final rules define a code of ethics as written standards that are reasonably designed to deter wrongdoing and to promote:

- Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- Full, fair, accurate, timely and understandable disclosure in reports and documents that a company files with, or submits to, the SEC and in other public communications made by the company;
- Compliance with applicable laws, rules and regulations;
- The prompt internal reporting to an appropriate person or persons identified in the code of ethics of violations of the code (the SEC noted that such person(s) should not be involved in the matter giving rise to the violation and should have sufficient status within the company to engender respect for the code of ethics and the authority to deal adequately with the persons subject to the code); and
- Accountability for adherence to the code of ethics.

In the final rules, the SEC eliminated the component of the definition requiring the code of ethics to promote the avoidance of conflicts of interest, including disclosure to an appropriate person or persons identified in the code of any material transaction or relationship that reasonably could be expected to give rise to such a conflict. The SEC reasoned that the conduct addressed by this component already is addressed by the first prong of the definition, which requires honest and ethical conduct and the ethical handling of actual or apparent conflicts of interest.

¹ Note that these rules do not apply to asset-backed issuers, and that similar, though not identical, requirements apply to registered management investment companies.

The final rules do not prescribe any specific language that must be included in a code of ethics. Rather, the SEC believes that codes of ethics should vary from company to company, and that determinations relating to compliance procedures, as well as disciplinary measures for ethical breaches, are best left to the discretion of each company. The SEC added instructions to the final rules to clarify that a company may have separate codes of ethics for different types of officers and that the provisions of the code of ethics that address the elements listed in the definition and apply to the specified officers may be part of a broader code of ethics that addresses additional issues and applies to additional persons, such as all executive officers and directors of the company.

PUBLIC AVAILABILITY OF CODE OF ETHICS

Under the final rules, a company may choose between three alternative methods of making its code of ethics publicly available:

- The company may file a copy of its code of ethics that applies to the specified officers and addresses the specified elements as an exhibit to its annual report.
- The company may post the text of its code of ethics, or relevant portion thereof if the company has adopted a more encompassing code than required by the SEC, on its Internet website normally used for investor relations functions. If the company chooses this option, it must disclose its Internet address and intention to provide disclosure in this manner in its annual report. Companies should note that the New York Stock Exchange also has proposed rules which, if adopted, would require listed companies to adopt a code of ethics and post it on their Internet web site.
- The company may provide an undertaking in its annual report to provide a copy of its code of ethics to any person without charge upon request.

DISCLOSURES OF AMENDMENTS AND WAIVERS

Pursuant to the final rules, the SEC is adding a new Item 10 to the list of Form 8-K triggering events to require, within five business days,² disclosure of:

- The nature of any amendment to the company's code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions; and
- The nature of any waiver, including an implicit waiver, from a provision of the code of ethics granted by the company to one of the specified officers, the name of the person to whom the company granted the waiver and the date of the waiver.

The final rules include an instruction that a company need not disclose technical, administrative or other non-substantive amendments to the code of ethics. Furthermore, only amendments or waivers relating to the specified elements of the code of ethics and the specified officers must be disclosed. The SEC intends this clarification to allow and encourage companies to retain broad-based business codes.

² Note that the filing deadline originally proposed was two business days and that the SEC plans to consider whether to shorten the Item 10 disclosure deadline to two business days in connection with its final determination of other proposed accelerated 8-K filing deadlines. Also, note that foreign private issuers do not have to provide in a current report disclosure of any change to, or waiver from, the company's code of ethics for the specified officers. Instead, a foreign private issuer must disclose any change or waiver that has occurred during the past fiscal year in its annual report on Form 20-F.

As an alternative to reporting this information on Form 8-K, the final rules provide that a company may use its Internet website as a method of disseminating this disclosure, but only if it previously has disclosed in its most recently filed annual report its intention to disclose these events on its website and its website address. If a company elects to disclose this information on its website, it must do so within the same five business day period as required for a Form 8-K that includes this type of disclosure. In addition, the disclosure must remain available on the website for at least 12 months after the company initially posts the disclosure and the company must retain the disclosure for a period of not less than five years and make it available to the SEC or its staff upon request.

In response to commenters' requests for guidance, the final rules define the term "waiver" as the approval by the company of a material departure from a provision of the code of ethics. An "implicit waiver" is defined in the final rules as the company's failure to take action within a reasonable period of time regarding a material departure from a provision of the code of ethics that has been made known to an executive officer of the company.

If your company currently has a code of ethics, or chooses to adopt one in the future, it is important to ensure that it is workable within the final rules and that it can be followed within your organization. Your company should adopt realistic policies that do not require frequent amendments or waivers. Due to the requirement for public disclosure, frequent amendments to or waivers of the code of ethics may adversely affect a company's reputation in the marketplace.

NYSE/NASDAQ CODE OF ETHICS PROPOSALS

Both the New York Stock Exchange and Nasdaq have proposed rules requiring listed companies to adopt a code of ethics. These proposed rules would allow each listed company to determine for itself both the content of the code of ethics and appropriate sanctions for violations. These proposals, however, require the code of ethics to apply to all directors, officers and employees of the company and, in some cases, impose greater obligations on listed companies and eliminate some of the flexibility permitted by the SEC. Both the NYSE's rules and Nasdaq's rules will become effective six months after SEC approval, which currently is pending.

HOW HRO CAN HELP

These newly adopted rules will affect your company's disclosure and compliance practices. If you would like to discuss your disclosure obligations with respect to the final rules or a code of ethics that is appropriate for your company, we encourage you to contact any of the persons listed in the margin of the first page of this HRO Alert.

This HRO Alert is a periodic publication of Holme Roberts & Owen LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. Nor is it intended to address specific disclosure or compliance issues that may arise in particular circumstances or all of the provisions included in the newly adopted rules. The contents are intended for general informational purposes only, and you are urged to consult counsel concerning your own situation and any specific legal questions you may have. For further information regarding these rules, please contact any of the persons listed in the margin of the first page of this HRO Alert.

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