U.S. Securities and Exchange Commission Staff's Response to COSRA's Questionnaire on Corporate Governance[1]

Information presented as of March 2000.

Introduction: *Corporate governance practices in the United States are not regulated by any one particular statute but instead are affected by the governing instruments, the corporate law and the court decisions of each issuer's state of incorporation, and, in the case of many publicly-owned issuers, by the U.S. federal securities laws and requirements of the national securities markets. Matters governed by state law include the voting rights accorded to shareholders, the functions of the board, and the ability of board members and executives to enter into transactions with the company. State corporation laws vary among the 50 states. However, because many corporations choose to incorporate in Delaware, Delaware law can serve as a useful reference point for state corporate governance practices and may be referred to throughout this response.*

U.S. federal securities laws also affect corporate governance practices, primarily in the areas of disclosure and financial reporting, proxy voting, and the submission of shareholder proposals for consideration at shareholders' meetings. In addition, the national securities markets impact corporate governance practices through their requirements applicable to issuers of securities traded on their markets. Subject to applicable laws and regulations, corporations may establish their own governance practices in their corporate charters and bylaws.

I. DOMESTIC MARKET OVERVIEW

1. For each of the following types of investors, identify the approximate percentage of participation in your market, in terms of equity capitalization:

a) Controlling shareholders;
b) Institutional investors;
c) Domestic financial institutions;
d) Domestic non-financial institutions;
e) Other domestic investors; and
f) Foreign investors.

Answer:

[1] This document was prepared by staff of the U.S. Securities and Exchange Commission and does not necessarily reflect the views of the Commission itself. Information regarding state corporation law is based upon unofficial statutory sources and has not been independently verified.

No response is provided

2. Are there any entities in your jurisdiction that promote effective corporate governance, such as stock exchanges, business trade groups, professional associations, securities regulators, and others? If so, please briefly describe their objectives and activities, including any written corporate governance provisions.

Answer: Yes. All of the above entities in the United States have been involved in efforts to strengthen and improve corporate governance practices through a variety of actions. Recently, for example, the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD") sponsored a "blue ribbon" panel of experts from the business community, accounting profession and legal profession to consider how to improve the effectiveness of board of directors' audit committees in U.S. companies. In response to the report of this panel, the Securities and Exchange Commission ("Commission") recently adopted additional regulations designed to strengthen the effectiveness of the audit committee and to improve the reliability of the financial statements of public companies. The NYSE, the NASD and the American Stock Exchange ("AMEX") also adopted rule changes designed to increase the independence of the audit committee. Many other regulations and requirements of the Commission and the national securities markets are geared to enhancing corporate governance practices.

3. Are there special governance rules pertaining to particular types of companies, e.g., state-owned companies, banks, or investment funds?

Answer: The Investment Company Act of 1940 ("Investment Company Act") requires that independent directors constitute at least forty percent of a fund's board. These independent directors must be independent of the fund, its adviser and its principal underwriter. The Commission, Congress and courts view fund independent directors as "independent watchdogs" who serve to protect shareholder interests. Many Commission rules that provide exemptive relief from restrictions of the Investment Company Act specifically rely on the approval and oversight of fund independent directors.

In October 1999, the Commission proposed a comprehensive fund governance initiative. This proposal included a requirement that funds relying on certain exemptive rules have at least a majority of independent directors. The Commission requested comment on whether it should further require a two-thirds supermajority of independent directors. The Commission also proposed that the independent directors of funds relying on the exemptive rules select and nominate other independent directors. Rule 12b-1 under the Investment Company Act already requires funds that rely on that rule to have self-selecting and self-nominating independent directors. The Commission also proposed that any person who acts as legal counsel to independent directors of funds relying on the exemptive rules be an independent legal counsel. Finally, the Commission proposed a rule exempting funds from the requirement that shareholders ratify the selection of the fund's accountant at the next annual shareholders' meeting, if the fund's board establishes an audit committee entirely composed of independent directors. Final rules are expected some time in 2000.

Funds themselves also have focused on fund governance during the past year. In June 1999, the Investment Company Institute, a trade association, issued a fund governance "best practices report." While this report does not have the force of law, it has been influential in focusing funds on their governance practices.

Banks are subject to a variety of U.S. federal and state banking regulations, which are not within the jurisdiction of the SEC. Thus, no response is being provided with respect to banks.

II. THE RIGHTS OF SHAREHOLDERS

4. Describe the basic rights afforded to shareholders of public companies in your jurisdiction.

Answer: The rights of shareholders of U.S. public companies are generally established by the law of the state of incorporation. State laws vary, but they all provide shareholders of public corporations with certain basic rights. There is always at least one class of capital or common stock whose holders have voting rights. Generally, holders of all classes of stock have the right to obtain registration of their ownership in the company's registry of shareholders[2] and, absent any agreed to restrictions on transfers, to transfer their shares freely. Holders of capital or common stock also have the right to share in the residual net assets of the corporation through distributions upon liquidation of the corporation. In addition, the U.S. federal securities laws require public corporations to disclose material information about the corporation on a regular and timely basis. Shareholders may use the judicial system to protect their rights. See response to question 12.

5. Ownership Registration and Transfer of Shares:

a) How are shares registered and transferred?

Answer: Most corporate securities in the U.S. are issued in certificated form. For corporate equity securities, the shareholder registry is kept by the issuer or an agent of the issuer (called a "transfer agent") who affects transfers (reregistrations). Investors who elect to have their broker hold their securities in "street name" rather than holding them directly are recorded as the beneficial owners on the broker's records. The broker, in turn, deposits these holdings in a securities depository, normally the Depository Trust Company ("DTC"). Accordingly, for many security holdings, the holder of record in the shareholder registry is DTC's nominee, Cede & Co.

Generally, mutual funds do not issue certificates but keep shareholders' securities in book-entry form. Also, many corporate issuers, at the request of a shareholder, will keep the shareholder's securities in book-entry form. However, some states require corporations, including mutual funds, to issue a certificate upon request of a shareholder.

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[2] But see, response to question 5(c) for restrictions on transfers of securities that are issued in reliance upon certain limited offering exemptions from registration under the U.S. federal securities laws.

Exchange traded options are issued in dematerialized form (i.e., no paper contracts are issued) and held in book-entry form at the Options Clearing Corporation.

b) How are shares registered in your jurisdiction? Focus on the transparency and reliability of the registration mechanisms.

Answer: Typically, transfer agents stand between the issuer and shareholders to ensure that the shareholder registry is accurate. The transfer agent's functions include: (1) countersigning certificated securities upon issuance; (2) monitoring the issuance of securities with a view to preventing unauthorized issuance; (3) registering transfers of securities; (4) exchanging or converting securities; and (5) transferring ownership of securities by book-entry without physical issuance of securities certificates.

The Commission has issued rules that establish minimum performance standards for transfer agents including rules covering the cancellation of old certificates and recordkeeping rules. Transfer agents also are subject to inspection and examination by the Commission or federal banking regulators.

c) Are there any restrictions on the ability of shareholders to transfer shares? If so, what are they?

Answer: In general, Article 8 of the Uniform Commercial Code ("UCC") provides for free transferability of shares. Article 8 has been adopted into law in its most recently revised form by almost all of the states and is designed to address the possession and transfer of securities, both certificated and uncertificated. In order for restrictions on transfer to be enforceable under Article 8, the restrictions must appear or be referenced on the share certificates. Restrictions on transfers of securities that are not registered because they are issued in reliance upon certain limited offering exemptions under the U.S. federal securities laws also must conform to Article 8.

6. Participation and Voting in General Shareholder Meetings:

a) Are all shareholders furnished with information concerning the date, location and agenda of the meeting, as well as information regarding the issues to be decided at the meeting? If so, how far in advance of the meeting is the information provided to shareholders? Also, how much information is provided?

Answer: All shareholders who are shareholders of record on a given date (the "record date") and who are entitled to vote are required by state law to receive notice of shareholders' meetings. The record date is usually set by the board of directors according to the corporation's bylaws, subject to the parameters set forth in the applicable state law. The notice contains information with respect to the date, time and place of the meeting. If a special shareholders' meeting is being called, then the specific purpose of the meeting also must be disclosed. The amount of advance notice that must be given to shareholders is set by state statute. For example,

Section 222(b) of the Delaware General Corporation Law ("DGCL") requires that shareholders be given notice of each meeting not less than 10 nor more than 60 days before the meeting date. See response to question 11(b) below with respect to special shareholders' meetings.

If a class of securities of the company is registered under the Securities Exchange Act of 1934 ("Exchange Act"), the federal proxy and information statement rules will apply. If the company is soliciting proxies, it will be required to provide beneficial owners with a proxy statement that includes certain specified information, e.g., the revocability of the proxy, the identity of the persons making the solicitation, and the interest of certain persons in the matters to be acted upon at the meeting. For more information about the federal proxy and information statement rules, see response to question 6(c) below.

b) Do all shareholders have the right to ask questions of the board and to propose the inclusion of items in the agenda to a shareholder meeting? If so, under what circumstances?

Answer: The bylaws of most corporations typically designate the chairman of the board or president to serve as the chairman of the meeting. The chairman has wide latitude in conducting the meeting and is responsible for recognizing speakers and ruling on motions.

As a result of the federal proxy rules, the items to be discussed at the shareholders' meeting are generally known to shareholders before the meeting. Shareholders of public corporations whose securities are registered under the Exchange Act can propose items to be voted upon at the shareholders' meeting. Pursuant to Rule 14a-8 under the Exchange Act, a shareholder must own at least one percent or $2,000 in market value of securities entitled to be voted at the meeting and must have held the securities for at least one year before the shareholder may submit a proposal. Rule 14a-8 also includes strict requirements with respect to the appropriate notice that must be given to management of the corporation, the timeliness of the submission, and the number and length of the proposals that may be submitted. Rule 14a-8 also includes 13 exceptions pursuant to which management may exclude shareholder proposals from discussion at the meeting. Except for the shareholder proposal process, the U.S. federal securities laws do not regulate the ability of shareholders to ask questions or raise issues at a shareholders' meeting.

c) Are shareholders able to vote in person and in absentia? Please describe how it works. If allowed by local regulations, what are the requirements and formalities for proxy voting at a shareholder meeting? Are telephone and electronic voting permitted?

Answer: Shareholders are permitted under state law to vote in person or by proxy. For example, Section 212 of the DGCL explicitly permits shareholders to appoint a proxy by written authorization. Section 14 of the Exchange Act and the rules thereunder set forth the requirements for proxy solicitation. Any U.S. company that has securities registered under Section 12 of the Exchange Act must comply with the proxy rules if it is soliciting proxies. Before every shareholders' meeting, the company must send each of its shareholders a proxy statement containing certain specified information, along with a form of proxy on which shareholders can vote for or against each proposal that will be presented at the meeting. The

company must file copies of the proxy statement and form of proxy with the Commission. Also, if the proxies are being solicited for use at an annual meeting for the election of directors, an annual report that contains audited financial statements for, generally, the last three fiscal years must accompany or precede the proxy statement. In addition, if shares are registered in the names of brokers or nominees, the company must attempt to ascertain the beneficial ownership of those shares and furnish sufficient copies of the proxy statement and annual report for distribution to all beneficial owners. The company also must pay for the reasonable expenses of that distribution.

Even if a company is not soliciting proxies (e.g., insiders have sufficient votes to approve all matters to be voted upon at the meeting), the information statement rules under the Exchange Act require the company to distribute substantially the same information to shareholders in advance of the meeting as would have been required if proxies were solicited.

State law governs whether shareholders may vote by telephone or electronically. A handful of state statutes, including Delaware (see Section 212 of the DGCL), permit shareholders to appoint a proxy via electronic transmission. A few states also permit voting by telephone.

7. Fundamental Corporate Changes:

a) Fundamental corporate changes may include: amendments to statutes or governing documents of the company; the authorization of additional shares; and extraordinary transactions that in effect result in the sale of the company. Please describe any other corporate activities that would be considered fundamental corporate changes in your jurisdiction.

Answer: State statutes describe the types of corporate activities that are deemed fundamental corporate changes subject to shareholder approval. All of the corporate changes described above constitute fundamental corporate changes in the United States. In addition, the dissolution of a company and its merger or consolidation into another company are considered fundamental corporate changes. In some instances, a merger or acquisition in which the company is the surviving entity also will require shareholder approval. For example, the listing requirements of the NYSE require transactions that will result in a more than 20 percent increase in the company's outstanding shares to be submitted for shareholder approval.

b) Are shareholders sufficiently informed of fundamental corporate changes? If so, How? Before the change or after?

Answer: Generally, shareholders vote on any proposed activity that constitutes a fundamental corporate change under state law before the change can be implemented. State statutes require the company to send shareholders a notice that sets the time, date and place of the meeting and describes the item to be voted on. If the company's securities are registered under the Exchange Act, the proxy or information statement rules also would apply. In that case, shareholders would receive a proxy or information statement describing the proposed change.

Under some state statutes, such as Section 228 of the DGCL, fundamental corporate changes and other actions may be approved by written consent of the required majority of shareholders. If the consent process is used by a company with a class of securities registered under the Exchange Act, the Commission's information statement rules still would require that advance notice be given to shareholders.

c) Can shareholders participate in decisions with respect to fundamental corporate changes?

Answer: Yes.

i) How do shareholders get involved in decisions involving fundamental corporate changes?

Answer: Under state law, shareholders are entitled to vote upon fundamental corporate changes, as described above.

ii) Are special shareholder meetings held? If so, are special majorities required for shareholder approval of these fundamental corporate changes? If so, please indicate the types of special majorities that are required to approve the various fundamental corporate changes.

Answer: Generally, any matter that requires shareholder approval may be presented for approval at an annual meeting or at a special meeting. The minimum majority required to approve the fundamental corporate change by vote or written consent is also set forth by state statute. A higher majority may be required by a company's governing instruments. Generally, the majority required will not vary depending upon whether the votes are taken at an annual or special meeting or by written consent.

8. Acquisition of Corporate Control:

a) Are there any rules and procedures for shareholder involvement in the acquisition of corporate control or any extraordinary transactions, such as mergers and sales of substantial portions of corporate assets? If so, please describe.

Answer: Under state law, shareholder approval is required for extraordinary transactions such as mergers and sales of all or substantially all corporate assets. State statutes prescribe the procedures and disclosures required for shareholder approval of board resolutions to merge with another company or to sell substantially all of the company's assets. The federal proxy and information statement rules, which govern the timing, form and disclosures, also may apply. Under state law with respect to certain fundamental corporate changes, such as the merger of a company into another company, shareholders who do not vote for the transaction may be entitled to demand payment of the appraised value of their shares.

If a company has a class of equity securities registered under the Exchange Act, the Commission's tender offer rules also would provide certain safeguards to the shareholders of a target company that is the subject of a tender offer. These include, for example, the requirement that all shareholders tendering shares have a right to receive the same price for their shares, and, in the event of an overtender, all shareholders have a right to have their shares purchased under pro ration procedures.

Even in circumstances where a change of control of a company with a class of equity securities registered under the Exchange Act takes place without triggering applicability of the proxy, information statement or tender offer rules, the Exchange Act requires that timely disclosure of the change in control be made to shareholders.

b) Are those rules and procedures, as well as any available recourse, disclosed to investors? How?

Answer: Shareholder authorization of extraordinary transactions usually occurs at a shareholders' meeting, for which a notice disclosing the time, date, place and items to be considered must be distributed to shareholders according to the applicable state statute. In addition, if the federal proxy or information statement rules apply, shareholders will be aware of the procedures and recourse available because of the disclosures contained in the proxy or information statement.

c) Are there any rules and procedures to provide assurance that these transactions occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class?

Answer: See response to question 8(a) above. In addition, the courts, corporate charters and state legislation provide protections to shareholders in the takeover context. In acquisitions for corporate control, the board of directors of the target company is charged with acting in the best interests of the company and its shareholders. However, if the directors have a genuine

conflict of interest or if the procedures used to effect the takeover are flawed, some courts will scrutinize the transaction using a higher fairness standard to review the directors' actions. Fairness requires a fair price and fair dealing (which encompasses an analysis of the structuring, negotiation, and manner by which approvals were obtained for the transaction). Many courts have assessed fairness by considering whether the board obtained fairness opinions from outside experts, such as investment bankers. In addition, many companies have charter provisions that restrict mergers with a large shareholder unless the acquirer pays a fair price and the shareholders approve the transaction with a supermajority vote. Many states also have fair price statutes, which are similar in purpose and effect to the corporate charter provisions. These statutes make it more difficult and expensive for bidders to eliminate minority shareholders.

In addition, when a tender offer is made for a class of equity securities registered under the Exchange Act, the directors of the target company have an obligation to advise shareholders whether and why they recommend that shareholders accept or reject the offer, or that they are making no recommendation.

d) Are anti-takeover devices permitted, and are these devices ever used to shield management from accountability?

Answer: Most states permit companies to adopt devices that make it more difficult for the company to be taken over. For example, these state laws permit boards to adopt poison pills without shareholder approval. Companies also may adopt charter amendments and advance notice bylaws as antitakeover devices. However, when adopting these devices, boards are required by many state statutes, as well as case law, to consider their fiduciary duties to shareholders. Recently, some states have adopted multiconstituency statutes that permit boards to consider the interests of other stakeholders, such as employees, customers, and suppliers. In some instances, boards have been criticized by commentators for relying on these statutes as a means of entrenching directors and management.

9. Are there any arrangements that might enable certain shareholders to obtain a level of control not proportionate to their equity ownership? Must these arrangements be disclosed?

Answer: Yes. It would be possible for agreements among shareholders to require some shareholders to vote their shares in accordance with the wishes of other shareholders. Also, companies may issue classes of equity securities with the same equity rights but with different voting rights. See response to question 10(c) below. The U.S. federal securities laws require disclosure of such arrangements.

III. THE EQUITABLE TREATMENT OF SHAREHOLDERS

10. Voting Rights:

a) Is more than one outstanding class of voting capital stock permitted?

Answer: State statutes generally permit the creation of different classes of voting capital stock. The terms of the different classes of stock and the voting rights accorded to each class are determined by the company and set forth in the company's articles of incorporation.

b) If voting preferred stock is permitted, do holders of this stock vote as a separate class and under what circumstances and on what matters?

Answer: The articles of incorporation for a company establish the voting rights that may apply to each class of shares issued by a company. Usually, each outstanding share of common stock is entitled to one vote on each matter to be voted on at a shareholders' meeting, although the articles of incorporation may specify otherwise. U.S. companies often issue preferred shares that give holders a priority with respect to receipt of dividends from the company but that often do not have voting rights. If the preferred shares do have voting rights, they often have lesser voting rights than the common shares, e.g., the shares carry no rights to vote for directors unless dividend payments have not been made for two years. Holders of voting preferred stock are entitled to vote as a separate class on any proposed changes that affect the terms, conditions and rights ascribed to that class, and on any other matters set forth in the company's articles of incorporation or bylaws.

c) If more than one class of voting common stock is permitted, do the voting rights differ among classes and, if so, under what circumstances and on what matters?

Answer: The company's articles of incorporation describe the classes of voting capital stock that can be created and the voting rights applicable to each class. The articles and state statute also may prescribe the types of matters each class of shares may vote on. It would be possible, for example, to have two classes of common stock, Class A and Class B, that are equal in all respects except that Class A shares are entitled on some or all matters to ten votes per share and Class B shares to one vote per share, with both classes voting as one class, except on matters that would affect the rights of a specific class.

d) Within any given class, do all shareholders have the same voting rights?

Answer: Generally, corporations must treat all shareholders of the same class of shares equally, and, within the same class, each share generally has the same voting rights.

e) Are all investors able to obtain information about the voting rights corresponding to all classes of shares before they purchase them? If so, how?

Answer: Yes, through disclosures made public in registration statements for public offerings, annual reports and/or proxy or information statements. This information is filed in electronic form through the Commission's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system. These filings are available to the public free of charge through the Commission's web site at <www.sec.gov>. Also, all filings with the Commission are available upon request through the Commission's Public Reference Branch. Foreign private issuers are not yet required to file on EDGAR, but paper copies of their filings can be obtained through the Commission's Public Reference Branch.

f) Are changes in the voting rights corresponding to a class of shares subject to the approval of shareholders? If so, are these changes subject to the approval of all shareholders or only to those holding shares of that particular class?

Answer: The provisions of the applicable state statute determine whether shareholder approval is required to permit changes to the voting rights of that class. For example, under Section 242 of the DGCL, the holders of the affected class are entitled to vote on such changes. As a general matter, changes in the voting rights of a class are subject to the approval of shareholders holding that class of shares.

g) Describe the manner in which votes can be cast by custodians or nominees. Is approval by the beneficial owner of the shares required?

Answer: In the United States, many shareholders hold their shares in "street name," the nominee name used by their brokers to register securities that they are holding for their customers. Under the U.S. proxy rules, companies are required to ascertain the beneficial ownership of securities held through brokers, banks and other nominees, and furnish sufficient copies of the proxy materials for distribution to these beneficial owners. The NYSE, other U.S. stock exchanges and the NASD require their member firms to transmit copies of all proxy materials that they receive to their beneficial owners. In the instructions that accompany the proxy materials, the broker or nominee must either request voting instructions, with a statement, where applicable, that if no instructions are received it may give a proxy in its own discretion, or inform the beneficial owner that he or she needs to complete the proxy form and forward it to the proxy solicitor.

11. Shareholder Meetings:

a) Describe the processes and procedures for public companies' shareholder meetings. Please indicate the applicable rules, regulations and local practices.

Answer: Most state statutes explicitly require, or at least assume, that an annual shareholders' meeting will be held. Typically at these meetings, the shareholders vote to elect directors, although other matters may be acted upon. The annual meeting date is usually set by

the corporation as authorized by state law and the company's governing instruments. In order for shareholder action at the meeting to be valid, companies must comply with applicable notice and quorum requirements. State statutes vary in the amount of notice that companies must give to their shareholders and in the quorum requirements. For example, Section 222(b) of the DGCL requires that shareholders be given notice of the date, time and place of each meeting not less than 10 nor more than 60 days before the meeting date. The DGCL looks to the corporation's articles of incorporation or bylaws to specify what constitutes a quorum, but it requires that a quorum constitute at least one-third of the shares entitled to vote at the meeting. The Delaware statute is typical in that it gives corporations certain latitude in setting their quorum requirements, subject to parameters set forth in the statute. All persons who are registered as shareholders on the record date are entitled to receive notice of the shareholders' meeting and to vote at the meeting.

b) What are the formal requirements for calling and conducting shareholder meetings? Are there different kinds of shareholder meetings?

Answer: Aside from the annual shareholders' meetings described in subpart (a) above, special shareholders' meetings also may be called by persons authorized to call such a meeting by state law, the corporation's articles of incorporation or the bylaws. These special meetings are held to consider the issue explicitly referred to in the notice for the meeting. Notice, record date and quorum requirements also apply to special shareholders' meetings.

c) Are companies permitted to require personal attendance or to charge fees to vote at a shareholder meeting?

Answer: No. State statutes permit shareholders to vote at shareholders' meetings either in person or by proxy. The right to vote shares of voting stock is viewed as an integral part of a shareholder's ownership rights.

d) Are shareholders able to request that the company or another body, such as a court, call a shareholder meeting in case the board of directors does not do it?

Answer: Most state statutes require that corporations hold an annual shareholders' meeting. If this meeting is not held or is not held in a timely manner, a shareholder often may obtain a judicial order compelling such a meeting to be held. For example, Section 211 of the DGCL explicitly permits a stockholder or director of a company to apply to the Delaware Court of Chancery to order such a meeting if a meeting has not been scheduled within 13 months after the last annual meeting or since the date of the corporation's organization.

e) Under what circumstances, if any, is it possible for shareholders to take binding action without a meeting? Are other shareholders informed of such actions?

Answer: Many state statutes permit shareholder action by written consent of a certain majority of the shareholders, rather than by shareholders' meeting. For example, Section 228 of

the DGCL permits shareholder action by written consent and requires that prompt notification of the corporate action taken be given to those shareholders who did not consent in writing.

12. Dispute Resolution:

a) What legal recourse is available to the shareholders if their rights are violated?

Answer: In the United States, shareholders may bring actions on behalf of themselves as individuals or as a class for injuries that they have suffered as a result of actions taken by the company, its officers or directors. Shareholders also can bring derivative suits as a means of sanctioning directors and officers who breach their fiduciary duties. In derivative suits, shareholders sue in the name of the corporation, and any damages that are recovered as a result of the suit are paid to the corporation.

b) Are there non-adversarial mechanisms to solve disputes between shareholders and the company or between themselves, e.g., commercial arbitration panels, stock exchange mediation, etc., or is civil litigation the only alternative?

Answer: Shareholders may voluntarily enter into commercial arbitration or other dispute resolution procedures with each other or with the company. However, shareholders cannot be required to waive any rights that they have against the company or its management under the U.S. federal securities laws.

13. Insider Trading:

a) Is insider trading prohibited? If so, are the prohibitions contained in the securities laws or under other types of statutes?

Answer: Yes, although there is no statutory definition of "insider trading," the SEC can bring insider trading actions under several provisions of the U.S. federal securities laws, as described below. Illegal insider trading generally refers to purchasing or selling securities while in possession of material non-public information concerning such securities, or tipping such information, where the trader or tipper breaches a fiduciary duty or a duty arising out of a relationship of trust or confidence. The law of insider trading has been largely defined by the courts.

b) What are the key provisions of the insider trading prohibitions?

Answer: Key provisions of the U.S. federal securities laws that may be used to prosecute insider trading include:

- Section 17(a) of the Securities Act of 1933 ("Securities Act") generally prohibits fraudulent practices in connection with the offer or sale of any security;

- Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, prohibit, among other things, any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of a security;

- Exchange Act Rule 14e-3, promulgated under Section 14(e) of the Exchange Act, prohibits any person from purchasing or selling securities while in possession of material nonpublic information relating to a tender offer in which the person knows or has reason to know the information is nonpublic and has been acquitted directly or indirectly from the (1) offering person, (2) the issuer of the securities sought or to be sought by such tender offer, or (3) any officer, director, partner, employee or any other person acting on behalf of such offering person or issuer.

Also, the Insider Trading Act of 1984 (ITSA), designed to enhance the deterrence of insider trading, permits the SEC to bring suit against anyone violating the Exchange Act, or rules thereunder, by "purchasing or selling a security while in possession of material nonpublic information." ITSA provides for penalties of up to three times the profits gained or loss avoided by the insider trading and authorizes a criminal penalty for insider trading of up to $100,000.

The Insider Trading and Securities Fraud Enforcement Act (ITSFEA) bolsters the ITSA by, among other things, permitting the payment of a bounty to private individuals who provide information leading to the imposition of a penalty in an insider trading case.

c) Who is subject to insider trading prohibitions?

Answer: The prohibitions described above can be applied to both regulated and non-regulated persons or entities.

d) How are these insider trading prohibitions enforced? Can actions be brought by civil, administrative and criminal authorities?

Answer: Insider trading violations may be prosecuted both civilly by the SEC and criminally by the U.S. Department of Justice. Typically, the SEC brings civil insider trading cases in U.S. federal district court. The SEC also can refer cases to criminal authorities. In addition, state authorities may bring actions for insider trading.

14. Conflicts of Interest:

a) Is self-dealing by the board and executives prohibited or subject to certain legal safeguards? Please explain.

Answer: Yes. State statutes and case law address interested party transactions involving the board and executive officers. Most state statutes permit transactions involving interested directors and officers provided that certain conditions are met. Section 144 of the DGCL is a typical example. Under Section 144, such a transaction is permitted if: (i) the material facts of the relationship or interest are disclosed to the board, and the transaction is approved by a

majority of the disinterested directors; (ii) the material facts of the relationship or interest are disclosed to the shareholders, and the transaction is approved by shareholders' vote; or (iii) the transaction is fair to the corporation at the time that it is approved by the board or shareholders. While directors and executives are not prohibited from self-dealing, they may not act in a manner that violates their fiduciary duty of loyalty to the corporation. Directors and officers may not take advantage of the corporation through unfair or fraudulent transactions. They also may not usurp for themselves a corporate opportunity that is available to the corporation.

The Investment Company Act also contains specific prohibitions on self-dealing.

b) Are members of the board and executives required to disclose any material interests in transactions or matters affecting the company? If so, please discuss how and when this information is made available to shareholders.

Answer: Yes. Directors and executive officers have a fiduciary duty to disclose to the board any material interest they may have in a transaction or other matter affecting the company. Also, as noted above, directors and executive officers may have to disclose material interests to shareholders. Companies subject to the disclosure requirements of the U.S. federal securities laws in turn must disclose these material interests in filings with the Commission.

i) Is the remuneration of directors and executives disclosed to investors?

Answer: Yes. In registration statements and annual reports or proxy or information statements filed with the Commission, U.S. companies are required to disclose the compensation paid to each of their directors, their chief executive officer, and their next four highly compensated executive officers. Foreign companies must disclose the aggregate amount of compensation that they paid to their directors and officers as a group in the registration statements and annual reports that they file with the Commission.

ii) Is the relationship between any of the directors and a controlling shareholder disclosed to investors?

Answer: In the registration statements and in the annual reports or proxy or information statements filed with the Commission, companies are required to describe any family relationships as well as any arrangements that exist between any of their directors or executive officers, and any other person pursuant to which they were selected as a director or executive officer.

iii) Are officers, directors and owners of a certain amount or percentage of shares required to disclose their holdings and trading activities?

Answer: Yes, U.S. companies are required to disclose in their annual reports, proxy or information statements and in their registration statements the identity and amount of shares held by any beneficial owner of more than 5% of any class of the company's voting securities, as well as the amount of shares held by each director and executive officer. Foreign companies must

disclose in their annual reports and registration statements the identity of any person who owns more than 10% of any class of the company's voting securities, as well as the total amount of any class of the company's voting securities that are owned by the officers and directors as a group. Also, owners of more than 5% of any class of equity securities that is registered under the Exchange Act must disclose their holdings to the company, as well as file a statement with the Commission. In addition, Section 16(a) of the Exchange Act requires any person who is the beneficial owner of more than 10% of any class of equity security that is registered under the Exchange Act, as well as the officers and directors of such company, to file a report with the Commission indicating the amount of all equity securities of that company owned by such person. Any changes in that ownership must be reported to the Commission within 10 days after the end of the calendar month in which the change occurred.

There is also a separate provision of the Exchange Act, Section 16(b), that provides that any officer, director or more than 10 % holder of the securities of a company with a class of securities registered under the Exchange Act, who purchases and sells or sells and purchases any securities of the company within a period of six months, shall remit any profits from such transaction to the company. In the event that such profits are not remitted and the company does not demand that the profits be remitted, any shareholder of the company may initiate a lawsuit to recover the profits for the company.

IV. THE ROLE OF STAKEHOLDERS

15. Can a stakeholder (employees, creditors and suppliers) participate in corporate governance, e.g., employee representation on boards, employee stock ownership plans, creditors involvement via insolvency proceedings?

Answer: Stakeholders in a U.S. company may participate in corporate governance as shareholders (e.g., employee stock ownership plans) and through service as directors.

16. Where stakeholder interests are protected by law (e.g., labor law, contract law, insolvency law), do stakeholders have the opportunity to obtain effective redress for violation of their rights?

Answer: Yes. In the United States, the rights of stakeholders are established by a variety of laws, such as labor law, contract law and insolvency law. If their rights as established by these laws are violated, stakeholders can obtain effective redress through the courts and, in some cases, administrative agencies.

V. DISCLOSURE AND TRANSPARENCY

17. Indicate which of the following items is subject to disclosure, as well as to whom the disclosure is made. Please discuss how and when this information is made available to shareholders.

a) The financial and operating results of the company;

b) Company objectives;
c) Major share ownership and voting rights;
d) Members of the board and key executives, and their remuneration;
e) Material foreseeable risk factors;
f) Material issues regarding employees and other stakeholders; and
g) Governance structures and policies.

Answer: All of the information identified above must be disclosed by public companies in the registration statements that they file with the Commission when making a public offering of securities in the U.S. markets. Substantially the same disclosure is required in periodic SEC reports and proxy or information statements, except that the reporting requirements for U.S. companies do not include a separate general risk factors section. Financial and operating results and material events are also disclosed in periodic filings. Copies of all such filings are available to the public by request through the Commission's Public Reference Branch and are also available to the public through the Commission's web site at <www.sec.gov>.

18. Financial Statements and Audits:

a) Are financial statements prepared, audited and presented in accordance with high quality, internationally acceptable standards of accounting and auditing? Are comparable high quality, internationally acceptable standards applicable to non-financial disclosure?

Answer: Yes, companies that file registration statements with the Commission must provide financial statements that have been prepared, audited and presented according to high quality, internationally acceptable standards of accounting and auditing. All U.S. companies must file financial statements that comply with U.S. generally accepted accounting principles ("U.S. GAAP"). Foreign private issuers must include audited financial statements that are prepared either in accordance with U.S. GAAP or pursuant to a comprehensive body of accounting principles with a reconciliation to U.S. GAAP. In addition, any financial statements that are required to be audited must be audited according to U.S. generally accepted auditing standards ("U.S. GAAS").

Companies also are required to provide disclosure of material non-financial information. Beginning on September 30, 2000, foreign private issuers that file registration statements with the Commission will be required to comply with the core set of disclosure standards that were endorsed by the International Organization of Securities Commissions ("IOSCO") in 1998 for the non-financial statement sections of a disclosure document. IOSCO's standards represent a strong international consensus on fundamental disclosure topics, and can be used to produce offering and listing documents that will contain the same high level of information that the Commission has traditionally required. U.S. companies that provide non-financial disclosure must comply with U.S. standards, which meet or exceed the IOSCO standards.

b) Is the audit conducted by an independent auditor in order to provide an external and

objective assurance on the way in which financial statements have been prepared and presented?

Answer: Yes. The fact and appearance of independence of auditors, who audit the financial statements included in filings with the Commission, is crucial to the credibility of financial reporting and, in turn, the capital formation process. In today's securities market, where investors generally do not have an opportunity to inspect a public company's books or query management on financial matters, investors look to the independent auditors to perform those functions on their behalf. The independent auditor's objective review of issuers' financial statements provides investors with some assurances about the reliability of those statements and encourages investment in the securities of public issuers. The Commission's independence requirements are designed to ensure that the interests of investors are paramount to auditors in the performance of their professional responsibilities.

i) How are the external auditors appointed and removed?

Answer: The Investment Company Act of 1940 requires that the appointment of auditors of registered investment companies be approved by a majority of non-interested directors of the investment company and by shareholders. Auditors of registered investment companies also are subject to removal by majority vote of the shareholders. Presently, there are no other Commission requirements that independent auditors be hired or monitored by the board of directors or stakeholders. The hiring and monitoring of auditors is governed by the state law in which the company is incorporated and, as applicable, by the membership requirements of a securities market on which a company's securities are listed.

In public companies, audit committees generally bear responsibility for the appointment and removal of auditors. The U.S. stock exchanges and national securities markets vary in terms of whether they require listed companies to have audit committees and, if they do, the extent to which such committees must be comprised of solely independent directors. Recently, in response to recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, the NYSE, the AMEX and the NASD adopted rule changes that:

- define "independence" more rigorously for audit committee members;
- require audit committees to include at least three members and be comprised solely of "independent" directors who are financially literate;
- require companies to adopt written charters for their audit committees; and
- require at least one member of the audit committee to have accounting or financial management expertise.

The SEC also recently required new proxy statement disclosures including, among other things, requiring that:

- companies provide in their proxy statements a report from the audit committee that discloses whether the audit committee reviewed and discussed certain matters with management and the auditors, and whether anything came to the attention of audit

committee members that caused them to believe that the audited financial statements contain any materially misleading statements or omit any material information;

- companies disclose in their proxy statements whether the audit committee has a written charter, and file a copy of their charter every three years; and
- companies whose securities are listed on the NYSE or AMEX or are quoted on Nasdaq disclose certain information about any audit committee member who is not "independent" within their proposed definition. (All other companies must disclose, if they have an audit committee, whether the members are "independent" based on the definition proposed by the self regulatory organizations.)

ii) Are there any regulations that establish auditing standards and ensure auditors' independence and responsible professional conduct?

Yes.

Auditing Standards

The Commission has authority to set auditing standards but has chosen to rely on the private sector for leadership in developing and maintaining those standards. The Auditing Standards Board ("ASB") is the senior technical body on auditing matters of the American Institute of Independent Certified Public Accountants ("AICPA").

Auditing standards and procedures promulgated by the ASB: (i) define the nature and extent of the auditor's responsibilities; (ii) provide guidance to the auditor in carrying out his duties, enabling him to express an opinion on the reliability of the representations on which he is reporting; (iii) make special provisions, where appropriate, to meet the needs of small enterprises; and (iv) have regard to the costs that they impose on society in relation to the benefits reasonably expected to be derived from the audit function.

Independence Regulations

U.S. federal securities laws underscore the crucial function of independent auditors in protecting public investors by requiring that "independent" accountants certify financial statements filed with the Commission. Accordingly, the Commission, as set forth in Rule 2-01 of Regulation S-X and section 600 of the Codification of Financial Reporting Policies, views both the fact and appearance of independence as essential in order that the public may view the audit process as a wholly unbiased review of management's presentation of the corporate financial picture. In addition, auditors of U.S. companies generally are required to be independent, in fact and appearance, of the entities that they audit in accordance with U.S. GAAS.

Auditors of public companies are subject to the requirements of Rule 2-01 of Regulation S-X. Rule 2-01(b) stipulates that: "[t]he Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent. For example, an accountant will

be considered not independent with respect to any person or any of its parents, its subsidiaries, or other affiliates (1) in which, during the period of his professional engagement to examine the financial statements being reported on or at the date of his report, he, his firm, or a member of his firm had, or was committed to acquire, any direct financial interest or any material indirect financial interest; (2) with which, during the period of his financial engagement to examine the financial statements being reported on, at the date of his report or during the period covered by the financial statements, he, his firm, or a member of his firm was connected as a promoter, underwriter, voting trustee, director, officer, or employee. A firm's independence will not be deemed to be affected adversely where a former officer or employee of a particular person is employed by or becomes a partner, shareholder or other principal in the firm and such individual has completely disassociated himself from the person and its affiliates and does not participate in auditing financial statements of the person or its affiliates covering any period of his employment by the person."

The independence requirements specified in Rule 2-01(b) are supplemented by Rule 2-01(c), which indicates that "[i]n determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission."

The Commission also provides guidance regarding independence through interpretations related to a specific set of facts and circumstances. These interpretations have been published in section 600 of the AICPA's Codification of Financial Reporting Policies.

Mechanisms to Ensure Compliance

Statement on Quality Control Standards ("QC") promulgated by the AICPA requires that policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence (QC Section 10.07). Compliance with professional standards adopted by the AICPA is accomplished through the peer review mechanism, the ethics division, and the Quality Control Inquiry Committee ("QCIC") established by the AICPA.

The AICPA's SEC Practice Section requires that firms that audit public companies submit to peer reviews by other auditing firms. Such peer reviews are to be conducted at intervals no longer than once every three years. The peer reviewer is required to review the firm's quality control for the accounting and auditing practice; test the firm's compliance with that quality control system; and opine as to whether the firm's quality control system met the quality control standards of the AICPA and was being complied with during the year to provide the firm with reasonable assurance of conforming with professional standards and AICPA membership requirements. The ethics division of the AICPA reviews issues of ethics/independence referred to it by government agencies, the public and others. The QCIC reviews all litigation involving accounting firms in order to ascertain whether such litigation resulted from a quality control problem within a particular firm.

The Public Oversight Board ("POB") performs oversight of the peer review process and QCIC. The POB is an organization that is independent of the AICPA (except for funding). The staff of the

Commission works closely with the POB in reviewing peer reviews and the QCIC as part of the Commission staff's oversight of the accounting profession.

Section 10A of the Exchange Act requires auditors to report the discovery of fraudulent financial reporting and other illegal acts to the company's audit committee or board of directors in the absence of an audit committee. If, thereafter, the auditor determines that the company's management is not taking appropriate remedial action with respect to the illegal act, the illegal act has a material effect on the financial statements of the company, and management's failure to take remedial action is reasonably expected to warrant departure from a standard form audit report or resignation of the auditors, the auditor must, as soon as practicable, report its conclusion to the company's board of directors. If the company's board of directors does not inform the SEC of such matter on a nonpublic basis within one business day after receipt of the auditor's report, the auditor is required to notify the SEC regarding the matter on a nonpublic basis within one business day of its failure to receive notice that the company has taken the required action.

iii) How is auditor's independence defined?

Answer: The U.S. federal securities laws reflect the importance of independent audits by requiring or permitting the Commission to require that financial statements filed with the Commission by public companies, investment companies, broker/dealers, public utilities, investment advisers, and others be certified (or audited) by independent public accountants, and by granting the Commission the authority to define the term "independent." The Commission has stated that an auditor is deemed to be independent if he or she is independent in fact and if he or she appears to be independent. He or she must act in an unbiased and objective manner and he or she must be free of any financial interest, which would create the perception that he or she may not be independent.

Further, Congress, the Commission, the U.S. Supreme Court, and the accounting profession historically have stressed the need for auditors not only to be independent but also to avoid circumstances that may impair reasonable investors' perceptions of auditors as independent from their audit clients.

19. Describe the channels through which relevant information is disseminated to users, e.g., filing of reports via electronic filing and data retrieval systems, disclosure of material information via the Internet?

Answer: All U.S. companies file all of their registration statements, annual reports and proxy and information statements through the Commission's EDGAR system. All filings on EDGAR are immediately available to the public through the Commission's web site at <www.sec.gov>. Also, filings with the Commission are available upon request through the Commission's Public Reference Branch. Foreign private issuers are not yet required to file disclosure documents with the Commission on EDGAR, although they may do so on a voluntary basis. Most foreign private issuers submit their documents in paper form, and copies of these documents are available to the public through the Commission's Public Reference Branch.

20. Comment on aspects in your current disclosure regime that you would like to see reformed, indicating whether there is any support for such reforms internally and the main barriers that you see for implementing change.

Answer: The Commission has become concerned recently about the practice of earnings management whereby, for example, companies attempt to avoid disclosure of adverse changes in operating results by deferring on capitalizing expenses or by drawing upon previously established revenues that should have been reflected in prior years' earnings. Some companies are resorting to earnings management out of concern that the price of their stock may drop if they report corporate earnings that are less than what is predicted by analysts. As a result of concerns expressed by Commission Chairman Arthur Levitt, the NYSE and the NASD sponsored a "blue ribbon" panel to consider ways to strengthen the effectiveness of audit committees in U.S. companies. The panel was composed of leaders from the accounting profession, the legal profession and the business community. In February of 1999, the panel published its conclusions in the Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. Based on the recommendations in this report, in December of 1999, the Commission adopted new rules and amendments to current rules that are designed to enhance the reliability and credibility of financial statements of public companies. A U.S. company's independent auditors are now required to review the company's financial information prior to the filing of the company's quarterly Exchange Act reports with the Commission. In addition, companies are required to include in their proxy statements certain disclosures about their audit committees and reports from their audit committees that contain certain disclosures.

VI. THE RESPONSIBILITIES OF THE BOARD

21. <u>Structure of the Board:</u>

a) Who nominates, elects and removes the members of the board?

Answer: See response to question 21(a)(ii) below. In addition, under the Exchange Act, the Commission is authorized to seek a court order prohibiting, conditionally or unconditionally, for such period of time as the court shall determine, any person who violated the antifraud provisions of Section 10(b) of the Exchange Act or the rules or regulations thereunder, from acting as an officer or director of any company that is required to file reports under the Exchange Act if the person's conduct demonstrates substantial unfitness to serve as an officer or director.

i) Do shareholders have cumulative voting rights? If so, please describe.

Answer: In the United States, most state statutes permit cumulative voting if the company elects to provide for it in its governing instruments. For example, Section 214 of the DGCL and Section 618 of the New York Business Corporation Law permit cumulative voting. A minority of states, such as California Corporation Code (Section 708), require companies to provide shareholders with cumulative voting rights. Most companies that are not required to provide for

cumulative voting do not elect to do so voluntarily. The objection to cumulative voting is that it could permit a significant block of minority shareholders to elect their own nominee to the board who may represent the interests of the group electing him or her, rather than to shareholders generally, thereby resulting in a splintered board of directors.

ii) How are vacancies on the board filled?

Answer: Directors vacate their position on the board if their term of appointment has expired, they resign or they are removed by shareholders. Most state statutes permit directors to be removed for cause, although some states, such as Delaware, also permit shareholders to remove directors of non-classified boards without cause, as well.

When a vacancy occurs on the board between annual meetings, the vacancy is normally filled by vote of the board of directors, and the new director stands for reelection at the later of the next annual meeting or when his or her term expires and his or her successor is elected.

iii) Are the election and identity of the members of the board disclosed to the securities regulator and the stock exchange, and is this information publicly available? If so, how?

Answer: Yes. All public companies that report to the Commission must identify their directors and executive officers and their term of office in registration statements and in annual reports or proxy or information statements that they file with the Commission and the stock exchange or the Nasdaq Stock Market, if their shares are listed or quoted on stock markets. In addition, public companies must describe any arrangements that exist between a director or executive officer and any other person pursuant to which he was selected as a director or executive officer. Copies of all registration statements and annual reports that are filed with the Commission are available to the public through the Commission's web site at <www.sec.gov> or by request through the Commission's Public Reference Branch.

b) What are the requirements for serving as a member of the board?

i) Can foreigners or non-residents be board members?

<u>Answer:</u> Most state statutes permit the company itself to set forth qualifications for directors in their articles of incorporation or bylaws. Generally, companies do not prohibit foreigners from serving as board members.

ii) What are the prohibitions on being a board member?

<u>Answer:</u> The qualifications for board membership are set forth in a company's articles of incorporation or bylaws. State statutes tend to prescribe few restrictions on who can serve as a board member. For instance, Section 141 of the DGCL only mandates that "[d]irectors need not be stockholders unless so required by the certificate of incorporation or bylaws. The certificate of incorporation or bylaws may prescribe other qualifications for directors." Some companies elect to impose maximum age limits.

iii) What is the maximum term of office for members of the board? Are classes of board members permitted? If so, describe the circumstances and rights of each class.

<u>Answer:</u> The actual structure of the board depends on the requirements of state law and the company's articles of incorporation and bylaws. Directors generally serve one-year terms with the potential for re-election. Most state statutes also permit classified boards, in which directors serve for several years, but with terms that expire on a staggered basis. For example, in a classified board that is composed of six directors, two of the directors' terms may expire in each of the next three years (<u>see</u> e.g., DGCL, Section 141(d)).

iv) Are there any legal provisions requiring independent members of the board? If so, how is "independent" defined?

<u>Answer:</u> For information on independence requirements for directors of registered investment companies, see response to question 3 above. State law generally does not contain any requirements for independent members. However, public companies that list their securities on U.S. stock exchanges or the Nasdaq Stock Market must comply with the independent director requirements of those markets' listing standards. The NYSE, the AMEX and the NASD impose independence requirements. See response to question 18(b)(i) above.

c) Are members of the board compensated? If so, how and subject to what approvals?

<u>Answer:</u> Many state statutes permit directors to set their own compensation. For instance, Section 141(h) of the DGCL permits directors to set their own compensation unless restricted by the corporation's certificate of incorporation or bylaws. Directors usually receive an annual fee or a per meeting fee plus expenses for their service on the board. Some public corporations have stock option plans for directors. However, the directors' ability to set their own fees is not

unlimited. State common law and statutes provide certain limitations. Directors owe their corporations and shareholders a fiduciary duty of loyalty, which prohibits them from taking advantage of their beneficiaries by fraudulent or overreaching transactions. This duty prohibits them from abusing their beneficiaries when they have a conflict of interest. Many state statutes also contain restrictions on abusive self-dealing by directors. See response to question 14(a) above.

d) Describe the typical structure and functioning of the board, e.g., calling of the meetings, quorum, majorities, other formal requirements.

Answer: Most actions by the board are taken by majority vote at formally noticed meetings. The corporation's bylaws indicate the type of notice that must be provided for these meetings, as well as the quorum. Each director has one vote and is not allowed to vote by proxy. The results of the board meeting are recorded in the minutes of those meetings. Most states also have adopted statutes that permit directors to act without a meeting by giving their unanimous written consent to the proposed corporate action. Some states statutes, such as the DGCL, also permit directors to participate in meetings via telephone conference call.

22. Functioning of the Board:

a) Describe the key functions of the board. In particular, please indicate whether the board is responsible for the following functions:

i) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

ii) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning;

iii) Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.

iv) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

v) Ensuring integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.

vi) Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.

vii) ***Overseeing the process of disclosure and communications.***

Answer: Although the actual responsibilities of each board may differ according to the applicable state statute and to the articles of incorporation and bylaws for each company, boards in the United States perform essentially all of the functions described above. The degree of active involvement in monitoring and oversight may vary. Many of the functions may be delegated to board committees. As the different items above indicate, boards are expected to manage the business of the corporation.

b) ***What standards must the board follow when it makes decisions on corporate issues? What duties do board members owe to the company and its shareholders, e.g., loyalty, due care, forgoing corporate opportunities?***

Answer: State law sets forth the standards for appropriate board behavior. Under state law, directors of a corporation are deemed to owe their corporations a fiduciary duty of care. They must exercise the degree of skill, diligence and care that a reasonably prudent person would exercise in similar circumstances. However, the business judgment rule, which has evolved through state court decisions, qualifies this duty somewhat by protecting the decisions of directors under certain circumstances. See response to question 22(b)(iv) below.

Also, Section 102(b)(7) of the DGCL permits a corporation to include in its certificate of incorporation a provision that eliminates or limits the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty, provided that such provision should not eliminate or limit the liability of a director: (i) for breach of the duty of loyalty; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) for unlawful payment of dividends on stock repurchases or redemptions; or (iv) for any transaction from which the director derived a personal benefit. The effect of this provision is that proof of gross negligence rather than ordinary negligence may be required to establish a director's breach of fiduciary duty.

Directors also have a fiduciary duty of loyalty to the corporation. This means that directors may not take advantage of the corporation through unfair or fraudulent transactions. This duty is especially relevant in situations in which a director may have a conflict of interest with the corporation. In addition, directors have a fiduciary duty not to usurp for themselves a corporate opportunity that is available to the corporation. State courts have interpreted corporate opportunities to include any business opportunity in which the corporation has an interest or expectancy, or which is essential to it. Other courts have used a more expansive definition of corporate opportunity that includes almost any business opportunity that is within the corporation's line of business.

i) ***Are there any sanctions applicable to the members of the board for a breach in the performance of their duties? If so, please enumerate them, indicating the remedies for violations.***

Answer: In the United States, shareholders' derivative suits are a common means of sanctioning directors who breach their fiduciary duties. In this type of suit, shareholders sue in the name of the corporation, and any damages that are recovered as a result of the suit are paid to the corporation. For instance, a shareholders' derivative suit can be used to bring an action against a director for breaching his fiduciary duty not to usurp a corporate opportunity. If successful, the corporation would recover the asset or business project in question from the director or the profits that he made. Shareholders also may bring actions on behalf of themselves as individuals or as a class for injuries that they have suffered as a result of actions taken by corporate fiduciaries. In those actions, any damages recovered go to the shareholders who brought the suit, rather than to the corporation.

In addition, if the corporation has filed a registration statement with the Commission to raise capital in the U.S. securities markets, and the registration statement contains materially false or misleading statements or omits statements necessary to render the statement not materially misleading, the Commission also may bring an action against the directors and against the officers who signed the registration statement. In the most egregious cases, the Commission can seek to bar individuals from serving as officers or directors of public companies.

ii) ***Do shareholders have any legal recourse available to them to make members of the board accountable for any breach of their duties?***

Answer: See response to question 22(b)(i) above with respect to shareholder suits, both individual and class actions, and shareholders' derivative actions.

iii) ***Is the board permitted to obtain and rely upon disinterested professional advice - from accountants, investment advisers, appraisers - in order to determine whether a transaction is proper and fair to the company and shareholders?***

Answer: Yes.

iv) ***Are decisions by the board entitled to a presumption of "business judgment," which shields the decisions from shareholder challenge? If so, under what circumstances and conditions?***

Answer: In the United States, the "business judgment rule" has evolved through state court decisions to protect the decisions of directors from challenge by shareholders or the courts. The rule presumes that in making a business decision, the directors act on an informed basis, in good faith and in the belief that the action is in the company's best interests. However, certain important exceptions to this rule exist. If a director's judgment is tainted by fraud or conflict of interest, many courts have concluded that this judgment is not protected by the rule because the director is trying to further his own personal interests. This implicitly acknowledges the

important role that shareholders' suits play in supplementing the enforcement actions taken by the government.

c) What duties does the board owe to shareholders where it makes a decision that may affect different shareholder groups differently?

Answer: The board has a duty to treat all shareholders fairly and not to favor the interests of one group of shareholders, such as controlling shareholders, over other shareholders.

23. Board Independence

a) Are there any requirements that the board assign non-executive board members capable of exercising independent judgment to tasks where there is a potential conflict of interest? If so, under what circumstances?

Answer: For information on independence requirements for directors of registered investment companies, see response to question 3 above. State statutes permit boards to delegate some of their duties to committees. As a matter of practice, many boards appoint a committee of disinterested directors as a means of avoiding potential shareholder suits where a demand is first required to be made on the board of directors to remedy the matter in dispute. Independent directors help to ensure that the board of directors fulfills its objective oversight role and holds management accountable to shareholders. Boards typically delegate their oversight function over the financial reporting process to an audit committee. Although the requirements as to audit committee structure or function, including independence in audit committee membership, may be set by state corporation statutes, little guidance on audit committee structure or function is provided by state corporate law. The listing standards of the primary U.S. stock exchanges require companies to have an audit committee. See response to question 18(b)(i) above.

As a result of the report by the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, the Commission adopted rules in December of 1999 to improve the independence and effectiveness of audit committees. See response to question 20 above.

b) Can specific committees be created within the board? If so, describe their composition and responsibilities. Are there any requirements that some committees be composed solely, or at least primarily, of independent board members?

Answer: State law provides that the board may delegate certain of its duties to committees. The bylaws for each company usually set forth board-authorized committees. Their duties may be established in the bylaws or by board resolutions. Often, boards of public companies delegate their responsibilities with respect to oversight, remuneration of officers and directors, and nomination of directors to committees. Many corporations also have executive committees of directors. See response to question 25 below. As indicated above, the board may delegate its oversight function over the financial reporting process to an audit committee. Typically, state statutes do not provide much guidance on the composition or function of these committees. Each

company may set up its own guidelines with respect to these issues in its bylaws or articles of incorporation.

State laws typically do not require independent board members on committees or on the board itself. However, the NYSE, AMEX and Nasdaq listing standards for domestic issuers require an audit committee, of at least three members, comprised solely of independent directors. See question 18(b)(i) above. Also see response to question 3 above for independence requirements for directors of registered investment companies.

c) Are there any limitations on the number of board positions that an individual can hold?

Answer: In the United States, there are no formal limitations on the number of board memberships that an individual can hold. However, board members have fiduciary obligations to the company and may be held accountable under state law if they fail to perform their duties to shareholders adequately. Although no formal limitations may restrict board memberships held by an individual, legal and ethical considerations may encourage individuals to limit themselves to the number of board memberships at which they can maintain the confidence of shareholders. Companies subject to Exchange Act disclosure requirements also are required to disclose all other Exchange Act reporting companies on which their directors also serve as directors.

24. Describe how and when board members can gain access to relevant information necessary to make decisions on corporate issues.

Answer: Board members must have access to accurate and relevant information on a timely basis to perform their duties. Members of the board who are also executives of the company have the most accessibility to vital information as a result of their position in the company. However, independent directors also can obtain information if they have access to key managers in the company and if they can rely on independent external advice. Directors often receive information about the company from documents and presentations that are put together by executive officers of the company. In the business combination context, the board of directors of the target company typically appoints outside experts, such as independent counsel and investment bankers, to assist them in assessing a proposed bid. These experts provide advice on significant aspects of the business combination, such as the fairness of the consideration.

VII. THE RESPONSIBILITIES OF THE SUPERVISORY BOARD

25. Does the corporate law of your jurisdiction require a supervisory board or person that is separate from the board of directors? Is such a supervisory board permitted?

Answer: In the United States, companies have a unitary, rather than two-tiered, board structure. Executives of the company, as well as independent members who do not have a separate relationship with the company, are appointed to the same board. This board is charged with monitoring management.

The structure of the board is regulated at the state, rather than national, level by state corporate statutes. Additional requirements may be set forth in each company's bylaws and articles of incorporation. The DGCL, for example, contains requirements as to the minimum number of directors that must be appointed, the number of directors that may constitute a quorum, the structure of board committees and other issues that affect the operation of the board. Although the statute itself does not contain prohibitions against the formation of a two-tiered board, companies in the United States historically have established a single, unitary board.

26. If so, please indicate the following:

a) Substantial differences between the supervisory board and the board of directors, the shareholders meetings and the auditor;

b) Supervisory board's duties and powers that overlap with those of the board of directors, the shareholders meetings and the auditor;

c) Is the relationship between any of the members of the supervisory board and the independent accountant certifying the corporations' financial statements disclosed to investors? Are such relationships prohibited?

Answer: U.S. companies follow a unitary board structure and do not have a supervisory board. The supervisory board in the two-tiered board system has similar functions to the single board in the U.S. system. Many public companies in the U.S. establish an executive committee of the board of directors. For example, under Section 141(c) of the DGCL, "[a]ny such committee to the extent provided in the resolution of the board of directors, or in the by-laws of the corporation, shall have and may exercise all the powers and authority of board of directors in the management of the business and affairs of the corporation," subject to certain exceptions expressly stated in Section 141(c).