

DAVIS POLK & WARDWELL
Corporate Regulatory Report

A Summary of
Current Regulatory
Developments Affecting
Publicly Listed Companies

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SEC Developments

SEC Announces Open Meeting to Consider Securities Offering Reform Proposal

The SEC has announced an open meeting on Wednesday, June 29, 2005, at 10:00 a.m. to consider the adoption of final rules related to the securities offering reforms, which were proposed in November 2004. The meeting will be available by audio webcast, and interested parties can connect to the webcast through <http://www.sec.gov/news/openmeetings.shtml>.

SEC Issues Report on Off-Balance Sheet Arrangements, Special Purpose Entities and Related Issues

On June 15th, the SEC released a Staff report prepared by the Office of the Chief Accountant, the Office of Economic Analysis and the Division of Corporation Finance on off-balance sheet arrangements, special purpose entities and related issues. The report was prepared pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002. The report describes the Staff's study, details its findings and provides recommendations, including reconsideration of:

- the accounting guidance for defined-benefit pension plans and other post-retirement benefit plans;
- the accounting guidance for leases; and
- the continued exploration of the feasibility of reporting all financial instruments at fair value.

In addition, the Staff recommends that the Financial Accounting Standards Board (FASB) continue its work on the accounting guidance that determines whether an issuer would consolidate other entities, including SPEs, in which the issuer has an ownership or other interest. See <http://www.sec.gov/news/studies/soxoffbalancerpt.pdf>.

SEC Provides Instructions on Searching Comment and Response Letters

The SEC has begun publicly releasing comment and response letters relating to filings made after August 1, 2004. These letters will be posted on the issuer's EDGAR site within 45 days after the conclusion of the

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review process. For information on how to search for EDGAR correspondence, see <http://www.sec.gov/answers/edgarletters.htm>.

SEC Issues Indication of Upcoming Proposals

The SEC published its semi-annual Regulatory Flexibility Agenda which provides an indication of the regulations they are considering proposing in the near future. The following items are on the agenda of the Division of Corporation Finance:

- Industry Guide 3 – statistical disclosure by bank holding companies
- Streamlining Rule 144
- Revision to Accelerated Filer definition
- Definition of securities “Held of Record”
- Termination of reporting obligations by Foreign Private Issuers under the Securities Exchange Act of 1934
- Lock-up agreements
- Equal treatment of security holders pursuant to Rules 14d-10 and 13e-4(f) under the Securities Exchange Act of 1934
- Proxy disclosure regarding executive compensation and related party transactions

See [http://ciir.cs.umass.edu/ua/Spring2005/agenda/SECURITIES_AND_EXCHANGE_COMM_ISSION_\(SEC\).html](http://ciir.cs.umass.edu/ua/Spring2005/agenda/SECURITIES_AND_EXCHANGE_COMM_ISSION_(SEC).html).

SEC ENFORCEMENT ACTIONS

SEC Brings Action Against Huntington Bancshares, Inc., its CEO, CFO and Former Controller for Accounting Misstatements Based on SAB 99 Analysis of Materiality

The SEC settled an enforcement action against Huntington Bancshares and individual officers for accounting misstatements, which allegedly enabled the company to meet or exceed analysts’ expectations and internal bonus targets. While the increases in operating earnings reported as a result of the improper accounting methods were quantitatively small in amount (3% change in EPS for fiscal 2001 and 5% change in EPS for fiscal 2002), the SEC cited SAB 99 for the importance of examining qualitative factors that may cause a misstatement of a quantitatively small amount to be material. In this case the SEC determined that those qualitative factors included the fact that the misstatement hid a failure to meet analysts’ consensus expectations and had the effect of increasing management’s compensation by satisfying requirements for the award of bonuses or other forms of incentive compensation.

A number of the misstatements were discussed during the company’s internal diligence and

SEC Enforcement Actions (cont.)

disclosure controls process for the CEO/CFO certifications included in the company's periodic reports, but management determined they were not material. The complaint also alleged violations of the certification requirements. Penalties include fines paid by the company, as well as each of the individuals, and disgorgement of bonuses. For a copy of the complaint, see <http://www.sec.gov/litigation/litreleases/lr19243.htm>.

SEC SPEAKS

Atkins, Glassman Continue to Voice Concerns About Certain SEC Actions

In a speech given on June 8th, Commissioner Atkins continued to voice his concerns over some of the SEC's recent regulatory actions and enforcement posture, particularly the use of corporate penalties. He also noted that he is sympathetic to companies' concerns over the SOX 404 process and believes that most of the concerns have been with PCAOB's Auditing Standard No. 2. He expressed the view that the SOX 404 process was too "granular", including that materiality determinations by accounting firms at the segment, interim financials level were "too deep in the weeds" and should instead be made "on an enterprise basis at the annual period level". Finally, with respect to options expensing, Commissioner Atkins stated his preference for a market-based options pricing model and that market participants and the SEC are working together to develop such a model. For the full speech, see <http://www.sec.gov/news/speech/spch060805psa.htm>.

In a separate June 15th speech, Commissioner Glassman echoed Commissioner Atkins' concerns about the imposition of corporate penalties where the shareholders have not otherwise benefited from the wrongdoing. For the full speech, see <http://www.sec.gov/news/speech/spch061505cag.htm>.

Linda Thomsen Discusses SEC Enforcement Process

Linda Thomsen, the director of the SEC Division of Enforcement, recently discussed the SEC enforcement process, including the "two fundamental things [in law enforcement] – one, make people and institutions understand, feel, believe that if they violate the law, we will be there; and two, we need to impose sanctions that people and institutions will work hard to avoid". With respect to penalties, she noted that while the SEC has sought and obtained stiffer sanctions against wrongdoers in recent years, the "gross misconduct we have seen merited nothing less." The speech also discussed the SEC's Wells process. See <http://www.sec.gov/news/speech/spch062105lct.htm>.

NASD DEVELOPMENTS

NASD Issues Proposal Regarding Fairness Opinions

The NASD has filed with the SEC a proposal to establish new NASD Rule 2290 to address disclosures and procedures concerning the issuance of fairness opinions issued by their member firms. The proposed rule sets forth the requirement for an NASD member to disclose in any fairness opinion that will be included in a proxy statement: whether it has acted as a financial advisor to any transaction that is the subject of the fairness opinion; if applicable, that it will receive certain compensation contingent upon the successful completion of the transaction; certain material relationships with the parties involved in the transaction covered by the opinion; whether information that formed a substantial basis of the opinion was supplied by the company and has been independently verified by the member and whether the opinion was approved or issued by a fairness committee. In addition, NASD members must have procedures that address the process by which a fairness opinion was approved the firm. For the rule proposal, see http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_014559.

NASDAQ Proposes Interim Filings for Foreign Private Issuers

NASDAQ has proposed that all of its listed foreign private issuers be required to provide in a press release, which would also be submitted on a Form 6-K, an interim balance sheet and income statement as of the end of its second quarter no later than six months following the end of an issuer's second quarter. The information must be presented in English but does not have to be reconciled to U.S. GAAP. The rules would be effective for interim periods ending after January 1, 2006. See <http://www.sec.gov/rules/sro/nasd/34-51905.pdf>.

NYSE DEVELOPMENTS

SEC Approves NYSE Procedures for Companies Failing to Meet Annual Filing Requirements

Under new Paragraph 802.01E of the Listed Company Manual, the NYSE sets forth procedures to be followed by a company that has failed to file its annual report on Form 10-K, 20-F or 40-F by the later of (a) the date that the annual report was required to be filed or (b) if a Form 12b-25 was timely filed, the extended filing due date for the annual report. The specified procedures include, among other things, notice to the NYSE of the status of the annual report filing, issuance of a press release disclosing the status of the filing, monitoring of the company by the NYSE until the annual report is filed and suspension and delisting procedures if such annual report is not eventually filed in a manner satisfactory to the NYSE. These procedures are effective immediately for companies that were already late in filing their annual reports as of June 2, 2005. See <http://www.sec.gov/rules/sro/nyse/34-51777.pdf>.

FASB DEVELOPMENTS

FASB Chairman Discusses Current Complexity in Accounting Rules

In a recent speech FASB Chairman Robert Herz discussed the current complex system of accounting literature, which U.S. GAAP standards include over 2000 individual pronouncements issued by various bodies and organizations in a variety of forms, and efforts at simplification. See http://www.fasb.org/SEC_FRI_24th_Conference.pdf.

OTHER DEVELOPMENTS

ABA Committee Issues Discussion Paper on Majority Voting of Directors

The Committee on Corporate Laws of the Section of Business Law of the American Bar Association has undertaken an analysis of possible changes to the Model Business Corporation Act relating to voting for directors of public corporation. The Discussion Paper sets forth various issues identified by the Committee relating to shareholder voting for the election of directors as well as possible changes to the Model Act that could be considered and the potential consequences of those changes. The purpose of the Discussion Paper is to elicit from interested persons focused input and suggestions of alternative courses of action. See <http://www.abanet.org/buslaw/committees/CL270000pub/materials/20050621000000.pdf>.

U.S. Treasury Secretary Discusses U.S.-EU Cooperation and IFRS Convergence with US GAAP

U.S. Treasury Secretary John Snow addressed U.S.-EU financial cooperation in the financial markets and regulation, including the trend toward convergence and the “roadmap” for the United States to accept IFRS standards. He stated that “the ball is in Europe’s court to make this a reality.” See <http://www.ustreas.gov/press/releases/js2494.htm>.

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