August 2005

DAVIS POLK & WARDWELL

Corporate Regulatory Report

A Summary of Current Regulatory Developments Affecting Publicly Listed Companies

Contents

SEC Developments

SEC Issues Final Rules that Clarify Section 16(b) Exemptions

On August 3, 2005, the SEC issued final rules to amend Rule 16b-3 and Rule 16b-7 of the Exchange Act to clarify the exemption of certain transactions from the private right of action to recover short-swing profit under Section 16(b). These rules address in particular the decision by the U.S. Court of Appeals for the Third Circuit in *Levy v. Sterling Holding Company, LLC* which held that neither Rule 16b-3 or Rule 16b-7 exempted directors' acquisitions of issuer securities in a reclassification undertaken by the issuer in preparation for an IPO, and therefore permitted the matching of those acquisitions for Section 16(b) profit recovery with the directors' sales within six months of the IPO. The SEC found that the court's decision in *Levy v. Sterling Holding Company, LLC* was contrary to its previous interpretations of Rules 16b-3 and 16b-7 in that it imposed additional conditions in order for reclassification transactions to be exempt from Section 16(b) short-swing profit recovery. In the amendments to Rules 16b-3 and Rule 16b-7, the SEC makes it clear that these additional conditions are not required for purposes of the Rule 16b-3 and Rule 16b-7 exemption from Section 16(b) short-swing profit recovery.

Additionally, the SEC amended Item 405 of Regulation S-K to delete the ability, on the part of the issuer, to presume that a Section 16 form it receives within three calendar days of the required filing date was filed with the SEC by the required filing date. The SEC thought that in light of the two-business day due date generally applicable to Form 4 and the requirements of mandatory EDGAR filing (and website posting), this presumption no longer is appropriate.

For a copy of the final rules see http://www.sec.gov/rules/final/33-8600.pdf.

New Check Box Required on Cover of Form 10-K, Form 10-Q and Form 20-F

The new shell company rules issued in July became effective on August 22, 2005. Under the new rules, all companies are required to include a new check box on the cover page of Form 10-K, Form 10-KSB, Form 10-Q, Form 10-QSB and Form 20-F. The new check box relates to whether the registrant is a "shell company" as defined in Rule 12b-2 under the Exchange Act. For a copy of the final release, which provides for the amendments see http://www.sec.gov/rules/final/33-8587.pdf.

SEC Enforcement Actions

United States District Court for the Southern District of New York Dismisses SEC Complaint Against Siebel Systems, Inc. for Violations of Regulation FD

The U.S. District Court for the Southern District of New York has dismissed the SEC's complaint against Siebel Systems, Inc. and two of its officers for violations of Regulation FD on the grounds that the statements that were the subject of the complaint, which were made by the CFO of Siebel Systems, Inc. at two private events, contained neither material nor non-public information. The District Court noted that it appeared that in forming its complaint, the SEC "had scrutinized, at an extremely heightened level" every particular word used in Siebel Systems' private and public statements and warned that such an approach would place "an unreasonable burden on a company's management and spokespersons to become linguistic experts, or otherwise live in fear of violating Regulation FD should the words they later use be interpreted by the SEC as connoting even the slightest variance from the company's public statements." For a copy of the DPW memo on the District Court's opinion, click here.

SEC Brings Action Against Former CEO and CFO of Kmart for Misleading MD&A Disclosure

On August 23, 2005, the SEC filed charges against the former Kmart CEO and CFO for providing materially false and misleading disclosure about the company's liquidity and related matters in the MD&A section of Kmart's Form 10-Q for the third quarter and nine months ended October 31, 2001, and in an earnings conference call with analysts and investors. The SEC alleges that, in the MD&A section of Kmart's Form 10-Q, the former Kmart CEO and CFO failed to disclose a massive inventory overbuy in the summer of 2001 and the impact it had on the company's liquidity. The MD&A disclosure attributed increases in inventory to "seasonal inventory fluctuations and actions taken to improve our overall in-stock position." The Commission alleges that this disclosure was materially misleading because, in reality, a significant portion of the inventory buildup was caused by a Kmart officer's reckless and unilateral purchase of $850 million of excess inventory. For a copy of the SEC's litigation release regarding the charges see http://www.sec.gov/litigation/litreleases/lr19344.htm. For a copy of the complaint see http://www.sec.gov/litigation/complaints/comp19344.pdf.

SEC Speaks

Christopher Cox Sworn in as 28th Chairman of SEC, Vows to be Investors' Advocate and to Advance Plain English Initiative

On August 3, 2005, Christopher Cox was sworn in as the 28th Chairman of the SEC. In a speech to the SEC staff on August 4, 2005, Mr. Cox spoke of the speculation as to whether he would be "business friendly" or "investor friendly" and stated that the interests of investors and businesses need not conflict. Mr. Cox further stated that the SEC will be the "investors' advocate" and that "if a business is investor friendly, the SEC will be friendly to it." Mr. Cox also focused on the plain English initiative begun by former Chairman Levitt and stated that he plans to focus on continuing to advance this "noble initiative." For a copy of Mr. Cox's speech see http://www.sec.gov/news/speech/spch080405cc.htm.

NYSE Developments

NYSE Representative Speaks on Corporate Governance Issues and Upcoming Regulatory Developments

At a July 27, 2005 meeting at DPW, a representative of the NYSE's Office of the General Counsel provided an update on corporate governance issues. Some of the items discussed by the NYSE representative are as follows:

• *NYSE Requirement to Distribute Annual Reports to Shareholders (Section 203.01).* The NYSE anticipates that this requirement will be eliminated sometime in the near future. The NYSE expects to move towards an "access equals delivery" model under which SEC filings provide shareholders with the necessary disclosure.

• *Disclosure Regarding Director Independence (Commentary to Section 303A.02(a)).* The NYSE representative stated that the NYSE feels that companies need to provide more specific proxy disclosure regarding any categorical standards adopted and other factors considered by the board in determining a director's independence or lack thereof. The NYSE representative emphasized that if a company has adopted categorical standards regarding director independence, it must discuss those standards in the proxy statement; a reference to a website or other method of incorporation by reference is not sufficient. In addition, any relationship that the board considers in determining a director's independence (even if the board determines that the relationship is immaterial) must be specifically disclosed, unless it is otherwise covered by a categorical standard. Lastly, if a director is party to a related party or other transaction that is required to be disclosed under Item 404 of Regulation S-K, that particular transaction must also be specifically addressed in the company's discussion of that director's independence. The NYSE expects to publish rules that clarify these requirements shortly.

NYSE Developments (cont.)

• *Communications with and Executive Sessions of Non-management Directors (Commentary to Section 303A.03).* The NYSE representative said that while non-management directors may themselves establish standards for the sorting and handling of communications to them, companies cannot, without guidance from non-management directors, decide to limit the types of communications sent to the non-management directors. The NYSE representative further stated that the requirement for a company to schedule executive sessions for the non-management directors is satisfied even if such executive sessions are attended by independent directors only. This is contrary to advice previously provided by the NYSE that suggested that such sessions might not meet the requirement.

• *Interpretations of Rule 10A-3 Audit Committee Requirements (Section 303A.06).* The NYSE representative stated that the NYSE doesn't have the authority to interpret SEC Rule 10A-3 and forwards all Rule 10A-3 interpretative questions it receives to the SEC Division of Corporation Finance. As a result, the NYSE may take longer to respond to these types of questions and the NYSE therefore encourages listed companies and their advisors to contact the SEC Division of Corporation Finance directly with any Rule 10A-3 interpretative issues. The NYSE has asked the SEC Division of Corporation Finance to publish these determinations in the form of telephone interpretations since these interpretations are not currently publicly available.

The NYSE representative also mentioned that the SEC Division of Corporation Finance has interpreted Rule 10A-3's requirement that an independent audit committee member can not have accepted directly or indirectly any consulting, advisory or other compensatory fee from the issuer or any subsidiary thereof to include sums paid by a company to a law firm in which the spouse of an audit committee member is a partner.

Other Developments and DPW Memos

Other Developments

IRS Requires Disclosure of Certain Tax Shelter Penalties in Form 10-K

The IRS has published guidance relating to the required Form 10-K disclosure of certain penalties imposed under Section 6707A(e) of the Internal Revenue Code, which was recently enacted as part of the American Jobs Creation Act of 2004. Tax-related penalties covered by this guidance include penalties imposed for failure to report a "listed transaction," the 30-percent accuracy-related penalty for certain understatements involving reportable transactions (*i.e.*, cases in which the relevant facts affecting the tax treatment of the item were not adequately reported) and the 40-percent accuracy-related penalty for gross valuation misstatements under certain circumstances. The IRS guidance clarifies how the required disclosure regarding the imposition of any of the covered penalties must be made. Disclosure must be made in Item 3 (Legal Proceedings) of the Form 10-K filed with the SEC that relates to the fiscal year in which the IRS sends a notice and demand for payment of the penalty and must

Other Developments (cont.)

include (1) the amount of the penalty, (2) whether the penalty has been paid in full, (3) the Code section and subparagraph under which the penalty was determined, and (4) a description of the penalty. An additional penalty, which itself must be disclosed in Form 10-K, may be imposed for each failure to disclose a penalty as described above. For a link to the IRS Revenue Procedure setting forth these requirements see http://www.irs.gov/irb/2005-33_IRB/ar14.html.

Other DPW Memos

For a copy of the DPW memo on the final rules published by the SEC with respect to securities offering reforms, click here.

For a copy of the DPW memo on the decision in the *In re Walt Disney Co. Derivative Litigation*, click here.

Contacts

If you have questions about any of the developments covered in this report, please call your regular Davis Polk contact or:

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