

DAVIS POLK & WARDWELL
Corporate Regulatory Report

A Summary of
Current Regulatory
Developments Affecting
Publicly Listed Companies

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SEC Developments

SEC Publishes Final Exec. Comp. Disclosure Rules

On August 11, 2006, the SEC published final rules to revise the requirements for disclosure of executive compensation in proxy statements, registration statements and other SEC filings. The new disclosure rules will apply to proxy statements for any fiscal year ended after December 15, 2006, which will be the proxy filed in early 2007 for most calendar year-end companies. The new rules were adopted substantially as proposed with the exception of the elimination of the so-called “Katie Couric” clause. This controversial clause (a requirement to disclose the compensation of up to three employees whose compensation exceeds that of the named executive officers) is being re-proposed for comment. In its new iteration, the requirement will apply only to large accelerated filers and will specifically exclude athletes, entertainers and other employees who have no policy-making authority at the company or any of its major units. For a copy of the final rule release, see <http://www.sec.gov/rules/final/2006/33-8732.pdf>. For a copy of the DPW memo on this development, [click here](#).

SEC Extends SOX 404 Deadlines for Foreign Private Issuers; Proposes Extension for Newly Public and Smaller Companies

On August 9, 2006, the SEC extended by another year the deadline for accelerated (but not large accelerated) foreign private issuers (FPIs) to comply with the portion of Section 404 of the Sarbanes-Oxley Act of 2002 (SOX 404) that requires a company to provide an auditor’s attestation report on internal control over financial reporting. Accelerated FPIs must still begin including a management’s report on internal controls in their annual reports for any fiscal year ending on or after July 15, 2006, but may wait until their annual reports for their first fiscal year ending on or after July 15, 2007, to provide the auditor’s attestation report on internal controls. The deadline for SOX 404 compliance by large accelerated FPIs has not changed, and they are required to include both a management report on internal control and an auditor’s attestation report on internal control in their annual report for any fiscal year ending on or after July 15, 2006. For a copy of the SEC’s final rule containing this extension see <http://www.sec.gov/rules/final/2006/33-8730a.pdf>.

In a concurrently issued, but separate release, the SEC is proposing a transition period for newly public companies before they become subject to the SOX 404

SEC Developments (cont.)

requirements. Under the SEC's proposed rule, a company that becomes subject to the Exchange Act reporting requirements as a result of an IPO or a registered exchange offer or by listing on a U.S. exchange for the first time, would not need to comply with the SOX 404 requirements in the first annual report that it files with the SEC. Rather, the company would begin to comply with these requirements in the second annual report that it files with the SEC. The SEC is also proposing to extend the SOX 404 compliance deadlines for non-accelerated filers (both domestic and FPIs). Under the proposal, a non-accelerated filer would not be required to provide management's report on internal control until it files an annual report for a fiscal year ending on or after December 15, 2007. An auditor's attestation report on internal control would not be required until a non-accelerated filer files an annual report for a fiscal year ending on or after December 15, 2008. For a copy of the SEC's proposal regarding the extension of SOX 404 compliance dates for newly public companies and non-accelerated filers, see <http://www.sec.gov/rules/proposed/2006/33-8731.pdf>.

SEC and CESR Publish Joint Work Plan Regarding Application of IFRS and GAAP

On August 2, 2006, the SEC and the Committee of European Securities Regulators (CESR) published a joint work plan, which will guide the SEC and CESR as they continue their dialogue on the application of IFRS and GAAP in the United States and the European Union. The three key issues covered by the work plan are:

- » Implementation of IFRS and U.S. GAAP by internationally active issuers;
- » Modernization of financial reporting and disclosure; and
- » Discussion of risk management practices.

The work plan includes a description of the goal of each project and the next steps to be taken.

The SEC's press release regarding the work plan, is available at <http://www.sec.gov/news/press/2006/2006-130.htm>.

SEC Speaks

Roel Campos on How to Be an Effective Director

At a speech on August 15, 2006, Commissioner Roel Campos gave directors some advice on how to carry out their responsibilities, including the following:

- » The SEC continues to adhere to the traditional business judgment rule (that the SEC will not second guess the board's decision if the board acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation). The suggestion that the expansion of directors' duties following the adoption of the Sarbanes-Oxley Act leads to correspondingly

SEC Speaks (cont.)

new or increased standards of personal liability is unwarranted. However, Commissioner Campos emphasized that directors must be involved in order to act in good faith. According to Commissioner Campos, “Directors cannot have a good faith belief that an audit committee of a multi-billion dollar multi-national corporation that meets for an hour quarterly . . . devoted enough time and attention to oversight.”

- » Further to the above point, Commissioner Campos says that “Passivity is not an option. . . . Directors’ should be intimately involved in representing shareholder interests.” To this end, Commissioner Campos advises directors to keep an open mind when confronted by large shareholders. Of course, a board may react negatively to a shareholder activist proposal if the board believes that the company has a “cogent long-term strategy” and that the shareholder is merely pumping up the stock for the short run.
- » Commissioner Campos also strongly supports majority voting for directors as another method of giving voice to shareholders. He urges companies to adopt bylaw or charter amendments that require majority voting.
- » On options backdating, Commissioner Campos advises directors not to (i) “use ‘as of’ dates unless you have carefully thought about the consequences and have explicit approval from legal counsel that it is acceptable,” and (ii) “assign critical board functions to ‘committees of one,’ unless you’re extremely careful to adopt procedures to ensure that there are appropriate checks and balances in place.”

For a copy of the full speech, see <http://www.sec.gov/news/speech/2006/spch081506rcc.htm>.

NASDAQ Developments

SEC Publishes NASDAQ Proposed Amendments to Director Independence Standards

The SEC has published a NASDAQ proposed rule change which would clarify the NASDAQ corporate governance rules regarding director independence and more closely conform the NASDAQ requirements to the NYSE’s director independence requirements. An earlier version of this proposed rule change was originally filed with the SEC by the NASD in August 2005 but the proposal was never published by the SEC for comment. Substantively, the original NASD proposal and the NASDAQ proposal published by the SEC are very similar, although there are some minor changes.

Under the proposed rule changes, the definition of independent director in NASDAQ Rule 4200(a)(15)(B) would be modified to provide that a finding of independence is precluded if a director accepts any *compensation* from the company or its affiliates in excess of \$60,000 during any consecutive 12-month period within the 3 years prior to the independence determination. Under the existing rule, a director’s independence is evaluated based on *payments* accepted from the company or its affiliates. The proposal seems to suggest that this is a narrowing of the rule since the NASDAQ staff has been confronted with several examples of payments that do not fall within the original intent of the rule and are unlikely

NASDAQ Developments (cont.)

to taint a director's independence. The interpretative material for the rule would also continue to provide specific examples of compensation that would preclude a director's independence, such as contributions to the political campaign of a director or family member.

The proposed rule change would also modify the interpretative material to NASDAQ Rule 4200(a)(15) regarding director independence to provide that a director that serves as a compensated officer of a company on an interim basis is not precluded from subsequently being considered independent solely as a result of that service. The service as an interim officer, however, must be limited to not more than one year and the board must still determine on its own—without regard to the “bright-line” test—that the individual that served as an interim officer should be considered independent. In addition, if while acting as an interim officer the director participated in the preparation of the company's financial statements, the director would be precluded from serving on the Audit Committee for three years under NASDAQ Rule 4350(d)(2)(A)(iii).

The proposals would also clarify that references to “the company” in NASDAQ Rule 4200(a)(15) include any parent or subsidiary of the listed company.

Lastly, the proposals would clarify that the Exchange Act Rule 10A-3(c)(2) exception to the audit committee requirements for certain issuers that have a listed parent is also applicable to the NASDAQ's audit committee requirements.

The proposed rule change is subject to approval by the SEC and a 21-day comment period that will begin upon publication in the Federal Register. The NASDAQ plans to implement the proposed rule change upon SEC approval. Once the rule change is implemented, any director that would be considered independent under the rules existing prior to the rule change, but that would no longer be deemed independent under the new rules, would be permitted to continue to serve on the issuer's Board of Directors as an independent director until no later than 90 days after the approval of the rule change.

The proposed rule change is available at <http://www.sec.gov/rules/sro/nasdaq/2006/34-54333.pdf>.

NASDAQ Operates as an Exchange; SEC No-Action Relief to Allow EDGAR Filings to Satisfy NASDAQ Filing Requirements

On August 1, 2006, the NASDAQ officially commenced operation as an exchange. In connection with NASDAQ's transition to an exchange, the SEC Division of Market Regulation and the SEC Division of Corporation Finance issued a no-action letter that permits listed companies to satisfy their obligations to provide the NASDAQ copies of most of their 1933 and 1934 Act filings through their EDGAR filings. A link to the no-action letter is <http://www.sec.gov/divisions/marketreg/mr-noaction/nasdaq080106.htm>.

NYSE Developments

NYSE Proposes to Reduce Distribution Requirements to 400 Round-Lot U.S. Holders

The NYSE has filed a proposed rule change with the SEC to reduce its distribution requirements under Section 102.01A of the Listed Company Manual from 2,000 to 400 round-lot U.S. holders for companies listing in connection with an IPO, transfer or quotation. As amended, Section 102.01A would allow foreign private issuers listing from North America the option of counting all North American holders toward the 400 round lot U.S. holder threshold.

The SEC has not yet published this proposed rule change but the text of the rule change requests that the SEC waive the normal notice period and delayed operative date requirement so that the rule change would take effect as of the filing date.

The text of the rule change is available at [http://apps.nyse.com/commdata/pub19b4.nsf/docs/03789196762A2D82852571CE0075EA50/\\$FILE/NYSE-2006-64.pdf](http://apps.nyse.com/commdata/pub19b4.nsf/docs/03789196762A2D82852571CE0075EA50/$FILE/NYSE-2006-64.pdf) and a copy of the first amendment to this proposed rule change is available at [http://apps.nyse.com/commdata/pub19b4.nsf/docs/2687DCA2ACACDEC2852571D100728776/\\$FILE/NYSE-2006-64%20A-1.pdf](http://apps.nyse.com/commdata/pub19b4.nsf/docs/2687DCA2ACACDEC2852571D100728776/$FILE/NYSE-2006-64%20A-1.pdf).

The NYSE also currently has in effect a pilot program that established a 400 round-lot holder requirement for companies listing following emergence from bankruptcy or which are affiliated with listed companies. The NYSE has filed a separate rule change with the SEC to make these changes permanent.

Contacts

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