DAVIS POLK & WARDWELL

Corporate Regulatory Report

A Summary of Current Regulatory Developments Affecting Publicly Listed Companies

Contents

SEC Developments

SEC Amends "Best Price" Rule

On October 18, 2006, the SEC approved changes to its tender offer "best price" rule. The "best price" rule requires that all shareholders be paid the same price in a tender offer. The SEC has not yet published the final rule but according to the SEC's press release announcing the rule change, "the changes, which were made necessary by conflicting court interpretations, make clear that compensation for services that might be paid to a shareholder doesn't count as part of the price paid for his shares."

The amendments will be effective 30 days after their publication in the Federal Register.

For a copy of the SEC's press release announcing the amendment of the tender offer best price rule, see http://www.sec.gov/news/press/2006/2006-177.htm. For a copy of the Davis Polk Newsflash on the amendment click here.

SEC Announces Schedule for Action Regarding SOX 404, Deregistration, E-Proxy and Exchange Act Rule 14A-8 Proposals

On October 11, 2006, the SEC announced that it will consider, at an SEC open meeting to be held on Dec. 13, 2006, its proposals regarding Section 404 of the Sarbanes-Oxley Act and foreign private issuer deregistration, both of which will be addressed before year-end. Also at the meeting, the SEC will consider final rules regarding Internet availability of proxy materials and revisions to Exchange Act Rule 14a-8 regarding shareholder proposals.

The SEC's press release announcing its agenda for its meeting on December 13, 2006, is available at http://www.sec.gov/news/press/2006/2006-172.htm.

SEC Staff Members Discuss Various Matters at ABA Conference

On October 5, 2006, at the ABA conference "Live from the SEC - A Review of Recent Developments in International Securities Regulation and Enforcement," SEC staff members spoke on a variety of topics. Some of the issues and topics addressed by the SEC staff members are as follows.

SEC Developments (cont.)

Private Offering Reform. Although the SEC Division of Corporation Finance is interested in pursuing private offering reform, it is not on the Division's short-term agenda. Former Director of the Division, Alan Beller, had indicated that private offering reform was the next big project on the Division's agenda, but under the Division's new Director, John White, the SEC staff has shifted its focus to the new executive compensation rules, SOX 404 reform and the e-proxy proposal.

Deregistration Proposal. The SEC staff noted that they have received a lot of comments on the deregistration proposal but declined to reveal any detail regarding the contents of the final rule on deregistration.

Cross-Border Tender Offer Rules. According to the members of the SEC staff present at the conference, after several years of experience with the cross-border tender offer rules, the SEC staff has realized that certain revisions to the rules are needed. They plan to focus on these revisions now that the amendments to the tender offer best price rule have been approved. The SEC staff emphasized that they have given exemptive and no-action relief from the cross-border tender offer rules in the past and encouraged issuers and their counsel that are considering transactions impacted by the rules to contact the SEC staff to request some form of relief from the rules.

Waiver of Attorney-Client Privilege. The SEC staff believes a misconception exists that because the waiver of attorney-client privilege is one of the factors cited in the 2003 Thompson Memorandum, attorney-client privilege must be waived in order to demonstrate cooperation in connection with an SEC investigation. According to the conference participants, the waiver of privilege is not a requirement, it is only a factor to be considered. In addition, conference participants noted that a question exists as to whether management has the ability to waive the privilege. This may be a decision that should be made by the board of directors.

Accounting Convergence. The SEC staff reaffirmed their commitment to the timetable for and principles of the plan for international accounting convergence outlined in the SEC Staff Statement issued by Donald Nicolaisen, then SEC Chief Accountant, in April 2005. This Staff statement is available at http://www.sec.gov/news/speech/spch040605dtn.htm and is commonly referred to as "the Roadmap." According to the Roadmap, the goal of the SEC staff is to eventually recommend elimination of the current requirement that financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") be reconciled to U.S. GAAP. Before the SEC staff can make such a recommendation, however, it must have reviewed IFRS financial statements and accompanying U.S. GAAP reconciliations from a broad range of issuers and be comfortable that IFRS is being applied consistently and faithfully by issuers. The Roadmap suggests that the SEC staff will not be in a position to make such a recommendation prior to 2009.

Saying that the SEC staff "lives by the Roadmap," the SEC staff noted that it is too soon to make a blanket statement about what they like and dislike about IFRS. The SEC staff has provided comments to individual issuers that have filed statements in IFRS but they have not yet developed a plan for commenting on IFRS generally.

SEC Developments (cont.)

Internet Publicity Relating to Offshore Offerings. In response to a question regarding the SEC's views on the use of the Internet in offshore offerings, the SEC staff said that they have not received a lot of questions on this subject recently but they still feel that the SEC Statement Regarding the Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore issued in 1998 works fairly well. The 1998 SEC release is available at http://www.sec.gov/rules/interp/33-7516.htm.

Recent Disclosure Changes Affecting FPIs. The SEC staff urged foreign private issuers to note the changes to the Form 20-F exhibit requirements as a result of the new executive compensation and related party rules. Under the new rules, foreign private issuers will be required to file an employment or compensatory plan with management or directors (or portion of such plan) only when the foreign private issuer either is required to publicly file the plan (or portion of it) in its home country or if the foreign private issuer has otherwise publicly disclosed the plan. The SEC staff members believe that this amendment should be viewed favorably by foreign private issuers because the public filing of management employment agreements as an exhibit to Form 20-F will mirror the public availability of those agreements under home country requirements.

Impact of Proposed NYSE/Euronext Merger. In order to address concerns surrounding the proposed merger of the NYSE and Euronext, the SEC staff again affirmed that joint ownership or affiliation of the NYSE and Euronext markets alone would not lead to regulation from one jurisdiction (such as SOX) becoming applicable in the other. The SEC staff also affirmed their belief in local regulation of local markets. They urged those interested in the impact of the proposed NYSE/Euronext merger to refer to the SEC press releases and fact sheet on the subject which are available at http://www.sec.gov/news/press/2006/2006-165.htm and http://www.sec.gov/news/press/2006/2006-96.htm.

SEC Speaks

Annette Nazareth Says SOX 404 Worthwhile but Needs "Fine Tuning"

On October 12, 2006, in a speech to the ALI-ABA Sarbanes-Oxley Institute, Commissioner Annette Nazareth expressed the view that overall SOX 404 is "a sound addition to our federal securities laws." Ms. Nazareth also noted that she does not agree with those who say that SOX 404 has weakened the competitiveness of the U.S. markets. As such, Ms. Nazareth said that she does not support a SOX 404 exemption for smaller companies but acknowledged that some "fine-tuning" of SOX 404 is needed. Ms. Nazareth then reviewed the SEC's recent initiatives in this regard, including the SEC's anticipated SOX 404 guidance. In discussing this anticipated guidance, Ms. Nazareth noted that she expects that "any guidance that we issue would be just that – guidance – that would be available to assist companies but not dictate any particular method that must be followed." She also noted that the guidance "will be based on principles that allow for flexibility according to the particular facts and circumstances faced by an issuer."

A copy of Ms. Nazareth's speech is available at http://www.sec.gov/news/speech/2006/spch101206aln.htm.

SEC Speaks (cont.)

John White Urges CFOs to Update Disclosure Controls and Procedures Early

In a speech on October 3, 2006, before the CFO Executive Board, John White, Director of the SEC Division of Corporation Finance, provided an overview of the new executive compensation and related party rules. Mr. White then went on to discuss the "process" associated with the new rules and told the CFO attendees that in his mind "a company needs to be reviewing and, where necessary, revamping its disclosure controls and procedures" in order to make sure that those disclosure controls and procedures are "up to the task" of compliance with respect to the new rules. Mr. White urged CFOs to get started on the update process if they have not already because it could take a considerable amount of time, particularly because the process needs to cover information from the start of the current fiscal year as all of such information will be required to be disclosed in the next proxy. Mr. White went on to note that due to the specific facts and circumstances inherent in each company, he could not provide specific examples of what types of updates might be needed to a company's disclosure controls and procedures as a result of the new executive compensation rules. He did urge all CFOs, however, to be actively involved in the disclosure controls and procedures update and to make sure that their "team is thinking outside the box." He further stated that "because of the new requirements in the executive compensation arena, you may need to include more people, different people who have never been involved in your public company disclosures in the past" and "set up new processes and circuits for gathering, compiling and analyzing information even before making disclosure determinations." He also urged the attendees to "remember that the universe of people at the company for whom disclosures may be required has been expanded in many cases."

A copy of Mr. White's speech is available at http://www.sec.gov/news/speech/2006/spch100306jww.htm.

NYSE Developments

NYSE Files Broker Non-Vote Proposal with SEC

On October 24, 2006, the NYSE filed a proposal with the SEC to eliminate broker discretionary voting for the election of directors. Currently, NYSE Rule 452 allows brokers to vote on "routine" proposals on behalf of the beneficial owner of a security if the beneficial owner has not provided specific voting instructions to the broker at least 10 days before a scheduled meeting. Under the NYSE's proposal, director elections would no longer be considered a "routine" proposal thus brokers would no longer be able to vote in such elections.

If the current form of the proposal is approved, it would be applicable to proxy voting for shareholder meetings held on or after January 1, 2008, except to the extent that a meeting was originally scheduled to be held in 2007 but was adjourned to 2008.

The proposal is subject to publication and approval by the SEC. The proposal also contemplates a public comment period. The proposal is available at http://apps.nyse.com/commdata/pub19b4.nsf/docs/A2CC4C6807081506852572110058 9E90/$FILE/NYSE-2006-92.pdf.

NYSE Developments (cont.)

SEC Publishes NYSE Amendment to Eliminate Treasury Share Exception

On October 5, 2006, the SEC published the NYSE proposal to eliminate the treasury share exception from its rules requiring shareholder approval of certain stock issuances. Currently, under Rule 312.03 of the Listed Company Manual, although the issuance of new shares is subject to shareholder approval in certain circumstances, the issuances of shares from treasury generally are *not* subject to shareholder approval.

The NYSE has modified the published proposal from its original filing to provide for a transition period to the new rule. Under the published proposal, the existing treasury share exception would continue to be available for companies that have entered into a binding contract with respect to the issuance of common stock prior to October 24, 2006 (five business days after the SEC published notice of the proposed rule change in the Federal Register).

The NYSE rule filing also proposes amendments to Section 312.04 of the NYSE Listed Company Manual, which amplifies and interprets the operative provisions of Section 312.03. The published proposal differs from the NYSE's original proposal in that it defines "market value" as used in Rule 312.03 as the official closing price on the NYSE as reported on the Consolidated Tape immediately preceding the entering into of a binding agreement to issue the securities. The NYSE has previously allowed issuers to define market value in the context of Section 312.03 as either the last reported sale price on the trading date prior to the date that the issuer entered into a definitive agreement to issue the securities *or* by reference to average price over a period of time not to exceed 10 trading days prior to the date of the issuance.

The NYSE also proposes to amend Section 312.03(b) so that it covers issuances that are part of a "a series of related transactions" and to amend Section 703.01(A) of the Listed Company Manual to require companies issuing shares from treasury in a transaction or series of related transactions to notify the NYSE in writing in advance of the issuance, indicating whether shareholder approval is required.

The SEC's publication of the proposed rule change is available at http://www.sec.gov/rules/sro/nyse/2006/34-54579.pdf. The proposed rule filing is subject to SEC approval and a comment period that ends on November 6, 2006.

NASDAQ Developments

SEC Approves Changes to NASDAQ Director Independence Standards and NASDAQ Proposes Additional Changes

The SEC has approved certain amendments to the NASDAQ's director independence standards that were published by the SEC in August. Although the amendments became effective upon SEC approval, the NASDAQ has implemented a transition period pursuant to which any director that would be considered independent under the rules existing prior to the implementation of the rule change, but that would no longer be deemed independent under the new rules, is permitted to continue to serve on the issuer's Board of Directors as an independent director until no later than January 4, 2007.

NASDAQ Developments (cont.)

Under the amended rules, the definition of independent director in NASDAQ Rule 4200(a)(15)(B) has been modified to provide that a finding of independence is precluded if a director accepts any *compensation* in excess of a specified threshold amount from the company or its affiliates during any consecutive 12-month period within the three years prior to the independence determination. Under the pre-amended rule, a director's independence was evaluated based on *payments* accepted from the company or its affiliates. The NASDAQ has implemented this change in order to narrow the scope of the rule. Previously, the NASDAQ staff had been confronted with several examples of payments that were unlikely to taint a director's independence. The NASDAQ interpretative material continues to provide specific examples of compensation that preclude a director's independence.

The rule changes also codify certain interpretations of the independence rules and 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).

Separately, the NASDAQ has submitted a proposed rule change to the SEC which would raise to $120,000 the amount of compensation that a director or immediate family member could receive from an issuer while still being considered independent. NASDAQ's current rules generally preclude a director from being considered independent if the director has received more than $60,000 in compensation from the issuer. This proposed increase in the NASDAQ's threshold replicates the recent increase in the related party transaction disclosure threshold in Regulation S-K, Item 404 under the SEC's new executive compensation rules.

The proposed rule change is subject to publication and approval by the SEC and contemplates a comment period. The proposed rule change is available at http://nasdaq.complinet.com/file_store/pdf/rulebooks/SR-NASDAQ-2006-041.pdf.

FASB Developments

FASB Issues Separate Proposed Staff Positions on Accounting for Registration Rights and EPS

On October 20, 2006, the FASB issued a proposed FASB Staff Position ("FSP") regarding an issuer's accounting for registration rights payment arrangements. This proposed FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration rights payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument

or other agreement, would be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*. The proposed FSP also confirms that a financial instrument subject to a registration rights payment arrangement would be accounted for in accordance with other applicable generally accepted accounting principles without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. Comments are due on this proposed FSP by December 4, 2006. The proposed FSP is available at http://www.fasb.org/fasb_staff_positions/prop_fsp_eitf00-19-b.pdf.

Separately, on October 20, 2006, the FASB issued a proposed FSP that addresses whether instruments granted in share-based payment transactions may be participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing basic earnings per share (EPS) pursuant to the two-class method described in paragraphs 60 and 61 of FASB Statement No. 128, *Earnings per Share*. Comments are due on this FSP by December 19, 2006. The proposed FSP is available at http://www.fasb.org/fasb_staff_positions/prop_fsp_eitf03-6-a.pdf.

FASB Issues FAS 158 Relating to Accounting for Defined Benefit Pension and Other Postretirement Plans

On September 29, 2006, the FASB issued Statement of Financial Accounting Standards No. 158 "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*" ("FAS 158"), which requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Generally, funded status is measured as the difference between plan assets at fair value (with limited exceptions) and the benefit obligation. Companies with publicly traded equity securities are required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006 – December 31, 2006, for calendar year companies.

The initial recognition amount will vary but for many companies may be material. Calendar year end companies should review whether they have any minimum net worth or shareholders' equity requirements in credit agreements, indentures or otherwise that may need to be amended or waived prior to December 31st to either adjust minimum levels or exclude the impact of FAS 158.

A copy of the FASB Summary of Statement 158 is available at http://www.fasb.org/st/summary/stsum158.shtml. A copy of FASB Statement 158 is available at http://www.fasb.org/pdf/fas158.pdf.

Other Developments and DPW Memos

Delaware Court Circumscribes Stockholder Right to Inspect Corporate Books and Records

In recent years, activist stockholders have used Section 220 of the Delaware Corporate Code (Inspection of Books and Records) to gain access to a corporation's books and records for an increasingly broad range of purposes. Although the Delaware courts have facilitated this access in the past by broadly interpreting the proper purposes for shareholder access under Section 220, the Delaware Chancery Court recently broke with this trend and upheld a corporation's right to deny a shareholder access to the corporation's books and records.

In *Polygon v. West Corporation* (Del. Ch. Oct. 12, 2006), an arbitrage hedge fund purchased stock in West Corporation ("West") shortly after West's announcement that it would be going private. The hedge fund then requested access to West's books and records in order to determine whether to seek appraisal rights in connection with the going-private transaction. The court held that West was justified in denying access to the hedge fund because, although the determination of appraisal rights was a proper purpose for inspecting the books and records, all of the information the hedge fund needed to make such a determination was already available in the company's public filings. The court also rejected the hedge fund's argument that it needed access to the corporation's books and records to investigate a potential breach of the board's fiduciary duties in connection with the going-private transaction because the hedge fund had purchased its shares only after the transaction was announced. For a copy of the Davis Polk Newsflash on this decision click here.

Contacts

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