

DAVIS POLK & WARDWELL
Corporate Regulatory Report

A Summary of
Current Regulatory
Developments Affecting
Publicly Listed Companies

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SEC Developments

Technical Amendments to Securities Offering Reform Approved

On February 6, 2006, the SEC published final rules to clarify certain aspects of the Securities Offering Reform, including that:

- » Use by IPO companies of media free-writing prospectuses is permissible, even if the prospectus that is on file with the SEC does not contain a price range (which would typically only first be contained in the preliminary prospectus that is filed with the SEC immediately preceding the IPO road show). See the amendments to Rule 433(f) of the Securities Act of 1933.
- » Inclusion in a registration statement of an undertaking reflecting the SEC's position on indemnification for liabilities applies to registration statements that automatically go effective (in addition to registration statements for which acceleration of effectiveness is requested of the SEC). As a result of the SEC's amendments, WKSIs should now ensure that their automatic shelf registration statements include the appropriate Reg. S-K statement, within Part II of the registration statement, regarding the SEC's position on indemnification for liabilities under the Securities Act.

The amendments described above took effect on February 13, 2006. For a copy of the release, see <http://www.sec.gov/rules/final/33-8591a.pdf>. For the DPW Newsflash on this proposal, click [here](#).

Volunteer XBRL Program Deadline Extended to March 10

In response to requests for more time from potential participants, the SEC announced that the deadline for companies to volunteer for the XBRL test group has been extended until March 10, 2006. As originally announced in January 2006, companies volunteering for the program will receive expedited review of registration statements and annual reports. For a copy of the SEC's press release on this announcement, see <http://www.sec.gov/news/press/2006-20.htm>.

SEC Developments (cont.)

SOX 404 Roundtable Set for May 10

The SEC and the PCAOB will be sponsoring a roundtable May 10, 2006, at SEC headquarters in Washington, D.C., to discuss second-year experiences with SOX 404 requirements regarding internal control over financial reporting. In addition to the Roundtable, the SEC and the PCAOB are asking interested parties to submit written feedback on their SOX 404 experiences by May 1, 2006. For a copy of the press release on this development, see <http://www.sec.gov/news/press/2006-22.htm>.

SEC Revokes Registrations of 25 Delinquent Issuers

On February 15, 2006, the SEC ordered the revocation of the registrations of the securities of 25 issuers that had failed to comply with their periodic reporting obligations. The revocations are the largest single-day number of such orders issued by the SEC, and are part of the SEC Division of Corporation Finance's ongoing Delinquent Filings Program, which was instituted to encourage compliance with the SEC's periodic filing requirements. For a copy of the SEC's press release on this development, see <http://www.sec.gov/news/press/2006-21.htm>.

SEC Speaks

Cox Says Revenue Recognition and Taxes Cause the Most Material Weaknesses

In a February 9, 2006 speech, SEC Chairman Cox stated that revenue recognition is responsible for the most material weaknesses in internal controls. Second after that are material weaknesses related to accounting for the provision of income taxes. Nearly a third of the companies that have reported material weaknesses determined that at least one of such weaknesses is related to income taxes. Chairman Cox hopes that upcoming SEC initiatives, such as better use of plain English in SEC and accounting rules, will clarify requirements for companies so as to improve revenue recognition and tax reporting practices. For the speech, see <http://www.sec.gov/news/speech/spch020906cc.htm>.

Atkins Warns Against Premature Disclosure of SEC Settlements

In a February 16, 2006 speech, SEC Commissioner Atkins cautioned companies against prematurely disclosing settlements that are agreed with SEC staff, but yet to be approved by the Commission. In his view, too many companies err on the side of "extreme" caution by disclosing settlements before Commission approval. The SEC does not merely rubber-stamp staff settlement recommendations, and changes may be made such that early disclosure of the settlement may be materially misleading. Commissioner Atkins recognized that companies need more guidance in this area and hopes to address the following questions in the near future: (1) at what point is the existence of an SEC investigation a disclosable event under current rules and guidance; (2) should a Wells notice be a triggering event for disclosure; and (3) can a company choose to make an initial disclosure of an SEC investigation and in that disclosure state that no

SEC Speaks (cont.)

update will be made until there is a final resolution (for example, a Commission-approved settlement)? In the same speech, Commissioner Atkins also stated his desire to refocus enforcement on market manipulation schemes (including complicity between short sellers and plaintiffs lawyers to drive down stock price and “pump and dump”, “cybersmear” and “boiler room” schemes). Commissioner Atkins noted that the SEC may have allowed too much of their attention to be diverted to other “sexier” financial frauds” and away from these market manipulation schemes. For a copy of this speech, see <http://www.sec.gov/news/speech/spch021606psa.htm>.

PCAOB Developments

Auditing Standard No. 4 Approved

On February 6, 2006, the SEC approved PCAOB Auditing Standard No. 4 (relating to requirements that apply when an auditor is engaged to report on whether a previously reported material weakness in internal control over financial reporting continues to exist). For a copy of the SEC’s adopting release, see <http://www.sec.gov/rules/pcaob/34-53227.pdf>. For a copy of AS No. 4, see http://pcaobus.org/Rules/Docket_018/Form_19b-4_Elimination_of_Material_Weakness.pdf.

2006 PCAOB Inspections to Begin; Reports on 2004 Inspections to Be Released

In a speech on February 10, 2006, acting PCAOB Chairman Bill Gradison discussed the PCAOB’s 2006 inspections of audit firms. According to Chairman Gradison, this year’s inspections will focus on whether firms have gained efficiencies in implementing PCAOB’s guidance on SOX 404 and addressed quality control deficiencies identified in prior-year inspections. Chairman Gradison also said that in the next few months, the PCAOB will publish reports on the 2004 inspections that, while preserving the confidentiality of issuers and audit firms, will “provide a baseline against which future inspection findings can be compared, providing an opportunity not only to observe where quality control weaknesses have been identified, but also, in years to come, to judge whether progress is being made in achieving the board’s statutory mission to oversee the auditors of public companies.” For the speech, see http://pcaobus.org/News_and_Events/Events/2006/Speech/02-10_Gradison.aspx.

FASB Developments

FASB and IASB Issue Memo of Understanding on Convergence of Accounting Standards

On February 27, 2006, FASB and IASB issued a memorandum of understanding setting forth a work plan for the convergence of IFRS and U.S. accounting standards. The boards' short term goal is to decide whether differences in certain identified areas (such as impairment, income tax, subsequent event, joint venture and segment reporting) should be eliminated and, if so, to complete or substantially complete work in those areas by 2008. The boards also agreed that instead of trying to eliminate differences between standards that are both in need of significant improvement, they will focus on developing better common standards. For a copy of the press release on this development and a copy of the memorandum of understanding, see <http://www.fasb.org/news/nr022706.shtml>.

NASD Developments

NASD Proposes to File Section 12(b) Registrations for its Listed Companies

On February 23, 2006, the NASD filed a proposal with the SEC pursuant to which NASDAQ-listed companies would give permission for NASDAQ to file Section 12(b) registrations of their securities on their behalf. This proposal is intended to smooth the conversion of the NASDAQ to a national stock exchange. Without this proposal, NASDAQ's approximately 3,200 listed companies would be required separately to register their securities under Section 12(b). Companies who do not wish NASDAQ to undertake such filings on their behalf may opt-out of the program. NASDAQ proposes that these rules take effect immediately upon the close of the comment period and requests that the SEC accelerate approval. For a copy of the proposal, see <http://www.sec.gov/rules/sro/nasd/34-53362.pdf>.

Clarifying Amendments to Fairness Opinion Proposal Filed

The NASD has filed with the SEC Amendment No. 2 to its fairness opinion proposal (proposed Rule 2290). The amendment consists of the following two clarifying changes:

- » In connection with the proposed requirement for a member to disclose whether they have independently verified company-supplied information that formed a basis for the member's fairness opinion (paragraph (a)(4)), the NASD is clarifying that such disclosure must specify on a *category-by-category* basis whether such information was verified.
- » The NASD is also clarifying that the written fairness opinion procedures that the proposed rule would require members to develop must address the appropriateness of the use of particular valuation analyses *given the type of company or transaction that is the subject of the fairness opinion*.

NASD Developments (cont.)

The filing indicates that it was submitted to the SEC on January 25, 2006, although it is unclear when the NASD made the filing public on its website. Neither the NASD nor the SEC has indicated when these rules would be published for comment or finalized. For a copy of Amendment No. 2, see http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_015890.

Other Developments and DPW Memos

Enhanced Standards for Phase I Environmental Audits

In November 2005, ASTM published new standards for Phase I environmental audits. Although the application of these new standards for the purposes of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) is not effective until November 1, 2006, companies may wish to begin following such standards now notwithstanding the added expense and time that may be involved. For a DPW memo with more in-depth analysis on this development, click [here](#).

SEC Proposal on Exec. Comp. Disclosure

For a copy of the DPW memo on the SEC's proposal to change executive compensation and certain other corporate governance disclosure, click [here](#).

The Securities Offering Reform's Effect on OTC Derivative Transactions

The Securities Offering Reform has significantly simplified capital raising for companies, including equity capital raising through the execution of over-the-counter equity derivative transactions. A recent article by DPW partner, James T. Rothwell, and senior lawyers from Banc of America Securities addresses the impact of the new rules on equity capital raising through OTC derivative transactions. For a copy of the article, please click [here](#).

Contacts

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