DAVIS POLK & WARDWELL

Corporate Regulatory Report

A Summary of Current Regulatory Developments Affecting Publicly Listed Companies

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FASB Developments

FASB Proposes Disclosure of Funding Status of Pension Plans on Face of Financial Statements, Not in Notes

In a proposal issued March 31, FASB would require a company that sponsors defined benefit pension plans to report on the plan's current economic status (i.e., whether the plan is overfunded or underfunded) in its balance sheet, instead of as a reconciliation in the related notes. The proposal also would require the company to measure the plan assets and plan obligations as of the date of its balance sheet rather than as a measurement date that is up to three months before the end of its fiscal year. As currently proposed, the revised rules would apply beginning with fiscal years ending after December 15, 2006. For a copy of the FASB press release on this development, see http://www.fasb.org/news/nr033106.shtml. For a copy of the proposal itself, see http://www.fasb.org/draft/index.shtml.

SEC and PCAOB Developments

SEC Approves PCAOB Rules on Ethics, Independence, Tax Services and Contingent Fees

On April 19, 2006, the SEC approved the PCAOB's Proposed Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees, including the amendment filed by the PCAOB in March 2006 to delay implementation of certain of those rules. In its order approving the rules, the SEC urged the PCAOB to provide additional guidance regarding implementation.

These rules were originally adopted by the PCAOB in July 2005 and establish ethics and independence standards for public accounting firms. Under the rules, a registered public accounting firm will not be independent of an audit client if it enters into contingent fee arrangements with the client or provides tax services to certain members of management who serve in financial reporting oversight roles at the audit client or such management's immediate family members. The rules also prohibit a public accounting firm from providing any non-audit services to its audit clients related to the marketing, planning or opining-in-favor of the tax treatment of transactions that are confidential transactions under IRS regulations or transactions that would be considered aggressive tax position transactions. In addition, the rules require an outside auditor seeking pre-approval to perform tax services to pro-

SEC and PCAOB Developments (cont.)

vide the audit committee written documentation of the scope of the proposed tax service and the fee structure of the engagement, discuss with the audit committee the potential effects on the firm's independence of performance of the services and document the firm's discussion with the audit committee.

For a copy of the SEC order approving the rules see www.sec.gov/rules/pcaob/2006/34-53677.pdf. For a copy of the PCAOB press release which announces SEC approval of the rules and lists the effective date for each of the rules see www.pcaob.org/news_and_events/news/2006/04-21.aspx. The PCAOB rules as adopted and amended can be found on the PCAOB website at www.pcaob.org/rules/docket_017/index.aspx.

SEC to Issue Notices of Effectiveness via EDGAR

On April 24, 2006, the SEC announced that beginning on May 22, 2006, it will use the EDGAR system to issue notifications of effectiveness for Securities Act registration statements and post-effective amendments, other than those that become effective automatically by law. These notifications will be posted to the EDGAR system the morning after a filing is determined to be effective. The Divisions will no longer prepare and mail paper effectiveness orders associated with these filings. Registrants will continue to be notified promptly by telephone that their registration statements or post-effective amendments are effective. The SEC has also announced that after May 22, 2006, the Commission's website (http://www.sec.gov) will also present a list of filings declared effective on the previous business day. Consequently, for the first time, an interested person can search for a company's filings and be able to see when the staff declared a particular Securities Act registration statement effective.

For a copy of the SEC's press release announcing the issuance of effectiveness orders via EDGAR see http://www.sec.gov/news/press/2006/2006-61.htm.

SEC Speaks

John White, SEC Director of Corp. Fin., Tells Issuers What They "Need to Know" About Executive Compensation Disclosures

On April 3, 2006, in a speech before the Rock Center for Corporate Governance at the Stanford University Executive Compensation Conference, John White, SEC Director, Division of Corporation Finance, outlined what advice he would give issuers about executive compensation disclosures, in light of the SEC's recent proposals, if he were still in private practice. Director White suggested two action items that issuers can take now in order to avoid "unpleasant surprises" in the future. First, Director White noted that issuers should consider what executive compensation information would be required to be disclosed under the proposals and make sure that they know all such information, including information that has "been brought into sharper focus by the proposals." Second, Director White told issuers to "review and prepare to revise your disclosure controls and procedures so as to position your company to fully and faithfully comply with any new requirements." Director White went on to list several questions that issuers should

be asking themselves, noting that as an issuer finds the answers to many of these questions "your company, your board, and your compensation committee may not like what they see and may, perhaps, decide to make changes." For a copy of Director White's speech see http://www.sec.gov/news/speech/2006/spch040306jww.htm.

Chairman Cox Outlines Key Initiatives on Improving Disclosure

In testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on April 25, 2006, Chairman Cox outlined the following four key initiatives to improve the quality and usefulness of disclosure for individual investors:

- Moving from boilerplate legalese to plain English in every document intended for retail consumption;
- Moving from long, hard-to-read disclosure documents to easy-to-navigate Web pages that let investors click through to find what they want (*e.g.*, use of XBRL);
- Reducing the complexity of accounting rules and regulations; and
- Focusing SEC anti-fraud efforts on scams that target older Americans.

One of the main focuses of Commissioner Cox's push for more plain-English disclosure is in the area of executive compensation, in particular the proposed new Compensation Discussion and Analysis section. In this Congressional testimony and in two other speeches in March and April, Commissioner Cox focused on the CD&A as a way of expanding compensation disclosure beyond disclosure of executive compensation levels and into the reasons behind the compensation decisions that an issuer makes. Noting that while it is not the SEC's role to dictate how much compensation is too much, Commissioner Cox stresses that the SEC does have the responsibility to ensure that disclosure surrounding executive compensation is clear and understandable to shareholders. For copies of Commissioner Cox's Congressional testimony, see http://www.sec.gov/news/testimony/ts042506cc.htm. For a copy of the two other referenced in which Commissioner Cox discussed compensation disclosure, see http://www.sec.gov/news/speech/spch033006cc.htm and http://www.sec.gov/news/speech/2006/spch040306cc.htm.

Commissioner Campos Suggests Multi-Pronged Approach to Dealing with Section 404 Issues for Non-Accelerated Filers

In a speech before the March 30, 2006, meeting of the IOSCO Standing Committee No. 1, SEC Commissioner Campos discussed the benefits and costs of compliance with Section 404 of the Sarbanes-Oxley Act and PCAOB Auditing Standard No. 2, particularly with respect to smaller companies. Commissioner Campos acknowledged that the costs of compliance are significant but expressed concern that exempting smaller public companies from all or some of Section 404 requirements, as has been recommended by the SEC's advisory committee on smaller public companies, would hurt "not only investors but also perhaps the smaller companies themselves." As an alternative, Commissioner Campos provided a three-pronged approach for dealing with Section 404 for non-accelerated filers. This multi-pronged approach would include the following:

SEC Speaks (cont.)

» *Pilot Program*. A small issuer pilot program could be conducted in 2006 which would allow small issuers and their auditors to share Section 404 experiences with other small issuers, the SEC, PCAOB and others before Section 404 compliance would be required for all non-accelerated filers.

» *Additional Guidance*. Commissioner Campos urged the PCAOB and SEC to provide greater guidance on (i) ways to narrow the scope of testing required under Auditing Standard No. 2, (ii) when an auditor can appropriately rely on company-level monitoring controls to make the audit process more cost-efficient and (iii) when outside auditors can rely on the work of others, such as internal auditors.

» *Delayed Implementation*. Commissioner Campos noted that he would support a further delay in compliance for non-accelerated filers for a period up to 18 months.

For a copy of Commissioner Campos' speech see www.sec.gov/news/speech/spch033006rcc.htm.

NYSE Developments

NYSE Spearheading Effort to Harmonize SRO Regulation

Richard G. Ketchum, chief regulatory officer of NYSE Regulation, has stated that the NYSE is working with the Securities Industry Association to harmonize its and other SRO's regulations to eliminate variances except where they are warranted due to, for instance, differences in membership or in the markets for which each organization is responsible. Mr. Ketchum stated that Mary Schapiro, NASD's Chairman and CEO elect, is also interested in participating in this effort. According to Mr. Ketchum, this harmonization project will involve the review of every NYSE rule against the comparable NASD rules, SEC rules and any other applicable standards by committees comprised of NYSE Regulation staff and senior compliance or legal persons from the securities industry, and will constitute a major project over the next six months. Mr. Ketchum notes that the NYSE would like to see all the recommendations ready by next March.

NASD/NASDAQ Developments

SEC Publishes NASDAQ Proposal to Eliminate Annual Meeting Requirement for Non-Equity Issuers

On March 30, 2006, the SEC published a proposed change to NASDAQ's annual shareholder meeting requirement under Rule 4350(e), such that:

» Only issuers of voting and non-voting common and voting preferred stock and their equivalents would be required to hold an annual shareholder meeting. This change would codify NASDAQ's current practice of not requiring annual shareholder meetings for issuers that list only securities whose holders do not directly participate as equity holders and do not vote in the election of directors;

NASD/NASDAQ Developments (cont.)

» Issuers will no longer be required to provide notice of their annual meetings to Nasdaq; and

» An issuer will be required to hold its annual shareholder meeting within one year of its fiscal-year end.

The proposal was originally submitted by the NASDAQ in June 2005 and amended in December 2005. The comment period ends April 27, 2006. For a copy of the rule proposal, see http://www.sec.gov/rules/sro/nasd/2006/34-53578.pdf.

SEC Publishes for Comment NASD's Proposal on Fairness Opinions

On April 4, 2006, the SEC published for comment the NASD's proposal to establish new Rule 2290, which would require certain disclosures and procedures for the issuance of fairness opinions by NASD member firms. This proposal dates back to November 2004 when the NASD issued a notice-to-members seeking comment on possible rules in this area (see http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012249). The NASD then submitted the actual rule proposal to the SEC in June 2005, which was amended in November 2005 and January and March 2006, before publication by the SEC.

For a copy of the rule proposal as published by the SEC, see http://www.sec.gov/rules/sro/nasd/2006/34-53598.pdf . For prior versions of the rule, including the amendments, see http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_014559.

NASD Creates Higher Tier Global Select Market

On April 17, 2006, the NASD filed a proposal to rename the Nasdaq National Market the Nasdaq Global Market and to create the Nasdaq Global Select Market, a new segment within the Nasdaq Global Market with higher listing standards. The Nasdaq Global Select Market will be launched on July 1, 2006. Those companies currently listed on the Nasdaq National Market that qualify for listing on the Global Select Market will automatically be assigned to that tier. Following this initial upgrade of companies into the Global Select tier, Nasdaq will provide an annual review of its listed companies and automatically upgrade those that meet the higher listing criteria. Companies may, however, apply for an upgrade at any such time as they qualify. Because these rules are deemed not controversial, they became effective immediately upon filing with the SEC. The Nasdaq originally announced the creation of this new market tier in February 2006. For a copy of the NASD rule filing, see http://www.nasdaq.com/about/SR-NASDAQ-2006-007_Rule_Filing.pdf.

Other Developments

DOJ Fines QUALCOMM and Flarion Technologies $1.8 million Total for Gun Jumping in Violation of HSR Act

On April 13, 2006, the Department of Justice announced a settlement with QUALCOMM and Flarion Technologies for alleged violations of the pre-merger waiting period requirements of the Hart-Scott-Rodino Act. During the HSR waiting period, merging companies are prohibited from consummating the merger and must operate independently of one another. The DOJ alleged that (i) certain covenants in the merger agreement (e.g., provisions requiring Flarion to seek QUALCOMM consent before undertaking certain routine business activities, such as entering into IP license agreements and presenting business proposals to customers) and (ii) Flarion's seeking of QUALCOMM consent before undertaking other routine activities, such as hiring consultants and employees and providing certain customer discounts, although not required by the merger agreement, together constituted illegal "gun-jumping" activity that violated the HSR Act. As part of the settlement, the parties were ordered jointly and severally to pay a $1.8 million fine. For a copy of the DOJ press release on this development, see http://www.usdoj.gov/opa/pr/2006/April/06_at_220.html. For a copy of the DPW memo on this and other antitrust developments, click here.

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