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Corporate and Financial Weekly Digest

Business/Financial News in Brief
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SEC/Corporate

SEC Advisory Committee Approves Recommendations Protecting Small Businesses

On April 20, the Securities and Exchange Commission's Advisory Committee on Smaller Public Companies approved its final report recommending that, unless and until an appropriate standard is adopted, the SEC should exempt small public companies from Section 404 of the Sarbanes-Oxley Act of 2002, subject to certain conditions. Herbert S. Wander, a partner at Katten Muchin Rosenman LLP, is Co-Chair of the Advisory Committee. The 21 members of the Advisory Committee voted unanimously to adopt the final report and transmit it to the SEC. The recommendations set forth in the final report were for the most part adopted unanimously, with only three members dissenting from the recommendation regarding the Section 404 exemption and one member abstaining from the vote regarding the scaling of securities regulation. In addition, many members of the Advisory Committee went on the record to express that, contrary to published reports by journalists, there are a number of investor representatives on the Advisory Committee.

In February, the Advisory Committee recommended an exemption from Section 404 compliance for microcap companies with less than $125 million in annual revenue and smallcap companies with less than $10 million in annual revenue unless and until the regulatory authorities devise a more cost-effective method for such small businesses to comply with the requirements. The Advisory Committee also recommended relief from the external auditor involvement in the Section 404 process for smallcap companies with less than $250 million but greater than $10 million in annual revenue.

The full text of the final report, which also includes separate statements submitted by members of the Advisory Committee briefly describing their reasons for disagreeing with specific recommendations, is available at http://www.sec.gov/info/smallbus/acspc/acspc-finalreport_discdraft_041806.pdf.

Backdating of Stock Options – Recent Company Responses to SEC Focus

The Securities and Exchange Commission's recent focus on the possible backdating of stock options by companies has caused heightened scrutiny over the timing of stock option awards. On April 17, chip maker Vitesse Semiconductor Corporation announced that it had placed three senior executives, including one of the company's co-founders, on administrative leave and that its board of directors had appointed a special committee of independent directors to conduct an internal investigation relating to past stock option grants, the timing of such grants and related accounting and documentation. In related news, UnitedHealth Group Incorporated has stated that it is conducting its own review of its stock grant practices after some recent negative publicity and a shareholder lawsuit. The lawsuit, filed in U.S. District Court in Minnesota on behalf of a shareholder, charges executives at the company with breaching their

fiduciary duty to shareholders by backdating option awards. The chairman and chief executive officer of UnitedHealth Group Incorporated has announced that he asked his board to forgo for the foreseeable future further equity-based grants or awards for the company's most senior and longest-tenured executives. In addition, Comverse Technology, Inc. announced that it would restate results back to 2001 following questions over whether stock option grant dates were inaccurately recorded.
http://today.reuters.com/business/newsarticle.aspx?type=ousiv&storyID=2006-04-19T204641Z_01_N19260447_RTRIDST_0_BUSINESSPRO-FINANCIAL-OPTIONS-DC.XML

http://www.knowledgemosaic.com/fpdb/NewsOpenFile.asp?FileName=200604191490.3_66bd000f311b0d86.htm&Subject=UnitedHealth+Chief+Seeks+End+To+Options%0D%0A&Publication=New+York+Times&NewsID=285074

http://www.latimes.com/business/la-fi-vitesse19apr19,1,3052639.story?ctrack=1&cset=true

Section 404 Compliance Burden Decreases for Larger Companies

According to a survey by CRA International commissioned by major accounting firms, the average cost of compliance with Section 404 of the Sarbanes-Oxley Act of 2002 has decreased as public companies become accustomed to its more stringent internal control requirements and develop more effective recordkeeping and compliance systems. Companies with over $700 million in market capitalization experienced a 44 percent drop in costs over the prior year. Companies with a market capitalization of between $75 million and $700 million experienced a 31 percent drop, with an average compliance cost of $860,000. The survey separated audit fees from Section 404 compliance costs.

In addition, Greg Bell, group vice president for CRA International, noted that fewer companies were reporting material weaknesses in internal control over financial reporting. A separate Compliance Week survey of the Annual Reports on Form 10-K of 289 companies for calendar year 2005 showed that only 2.1% of such companies disclosed material weaknesses in internal controls.
(*Securities Mosaic*, 4/18/06; *Compliance Week*, 4/11/06)

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Banking

Fed Makes Statistical Data Available Online

The Federal Reserve Board on Wednesday announced its new Data Download application, which provides interactive access to Federal Reserve statistical data in a variety of electronic formats. Data Download is the first application to allow custom data packages to be created in SDMX-ML, a technical statistical data standard that is gaining support among central banks and statistical agencies.

Data from the following four releases are now available: Industrial Production and Capacity Utilization (G.17), Flow of Funds Accounts of the United States (Z.1), Commercial Paper, and Selected Interest Rates (H.15). More releases will be added in the future. The application delivers customized data sets in machine-readable electronic formats (Excel, CSV, XML) or allows for quick downloading of formatted data packages.

The SDMX-ML technical standard was developed by the Statistical Data and Metadata Exchange (SDMX) initiative under the governance of the Bank for International Settlements, the European Central Bank, World Bank, International Monetary Fund, Eurostat, the United Nations, and the Organisation for Economic Co-operation and Development.

Data Download is available on the Board's web site at http://www.federalreserve.gov/datadownload.

Initial Results of Project to Improve Financial Privacy Notices for Consumers Released

On March 31, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Trade Commission, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Securities and Exchange Commission released a report entitled *Evolution of a Prototype Financial Privacy Notice* authored by the Kleimann Communication Group. The report was commissioned by the federal agencies as part of their effort to develop improved financial privacy notices.

The release of the report marked the conclusion of the first phase of the agencies' efforts to "explore alternatives for financial privacy notices that would be easier for consumers to read, understand and use than many of the notices consumers currently receive from financial institutions." According to survey data gathered by the report's authors, many consumers neither read nor understand the notices financial institutions provide under the current regulations and feel overwhelmed by complex financial information.

Included in the report is a prototype simplified privacy notice.

A second phase of the project will be contracted separately and will involve the "interviewing of a much larger group of consumers throughout the United States to measure the effectiveness of the prototype and other examples of notices."
http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060331/default.htm

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Broker Dealer

Nasdaq Files Proposed Rule Changes to Integrate Execution Systems

The NASDAQ Stock Market LLC recently filed with the Securities and Exchange Commission proposed rule changes designed to integrate the three execution systems (the Nasdaq Market Center (formerly SuperMontage), Brut ECN and INET ECN) currently operated by Nasdaq. The result would be a single matching system, instead of three, governed by a single set of rules and subject to a single fee schedule. The proposed rules also are designed to ensure compliance with Regulation NMS (for example, the rules incorporate the SEC Division of Market Regulation's proposed uniform rule on locked and crossed markets for self-regulatory organizations subject to Regulation NMS) and to facilitate operation by Nasdaq as an exchange (for example, Nasdaq will maintain a single two-sided quotation, rather than its members being obligated individually to maintain two-sided quotes and Nasdaq, and not its members, will be responsible for trade-through compliance, opening the system to full participation by order entry firms). Comments to the proposed rules must be submitted on or before May 5, 2006.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/06-3341.pdf

Nasdaq and NASD File Plan Allocating Regulatory Responsibilities

The NASDAQ Stock Market LLC and the National Association of Securities Dealers, Inc. filed with the Securities and Exchange Commission a proposed plan for allocating regulatory responsibilities for firms that are common members of Nasdaq and NASD. Under the plan, the NASD would assume responsibility for overseeing and enforcing common members' compliance with certain specified Nasdaq rules that are identical to, or substantially similar to, certain NASD rules. All comments concerning the proposed plan must be submitted on or before May 8, 2006.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-5693.pdf

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Litigation

One-Sided Arbitration Agreement Unenforceable by any Party

An arbitration agreement between plaintiff and its employees provided that claims initiated by employees, but not those that the employer initiated, were subject to mandatory arbitration. After the employer filed a federal action, certain individual defendants, its former employees, moved to stay and to compel arbitration, arguing that because one-sided arbitration agreements are unconscionable and not enforceable as written, the court should "remedy" the situation by requiring the employer to arbitrate the claims at issue against them. Holding that the agreement as written was unconscionable in mandating arbitration of claims by employees but not those by their employer, the Court nevertheless denied the employees' motion to compel arbitration, determining instead that the agreement's unconscionability rendered it unenforceable by any party. (*First National Bank of Arizona v Kislak National Bank*, 2006 WL 988254 (D. Ariz. April 13, 2006))

Plaintiff may Choose to Arbitrate or Litigate at its "Sole Discretion"

An arbitration clause provided that "any and all dispute(s), at the sole discretion [of plaintiff company], shall be decided by arbitration." After plaintiff filed an action against it, defendant sought to compel arbitration, arguing that the phrase "at the sole discretion" should be interpreted to entitle plaintiff to determine whether a dispute existed and not whether disputes that did exist would be litigated or arbitrated. In denying defendant's motion, the Court, among other things, held defendant's interpretation of the phrase "at the sole discretion" to be illogical and that, properly interpreted, that phrase provided plaintiff with discretion to choose to litigate or to arbitrate disputes as it saw fit. (*Albert M. Higley Company v. N/S Corporation*, 2006 WL 985753 (6th Cir. April 17, 2006))

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CFTC

CFTC Revises Its Policy Regarding the Listing of New Futures and Option Contracts by Foreign Exchanges

The Commodity Futures Trading Commission has revised the procedures pursuant to which foreign exchanges that have received no-action relief authorizing them to provide direct access to their automated trading systems from locations in the U.S. may list new contracts for trading. Formerly, an exchange could list a new contract for trading by filing notice with the Commission one business day prior to listing. Under the revised procedures, which are effectively immediately, an exchange must provide the Division of Market Oversight at least 10 business days notice prior to listing new futures and options contracts. The exchange may list the contract for trading at the end of the 10 business day notification period, unless Commission staff notifies the exchange that additional time is needed to complete a review of any regulatory issues pertinent to the new contract, including the need for enhanced market surveillance or additional information sharing.

In its notification, an exchange is required to submit only a copy of the initial terms and conditions of any additional contracts and a certification that it is in compliance with the terms and conditions of its no-action letter and that the additional contracts will be traded in accordance with those terms and conditions. The notification procedure does not apply to futures and option contracts that are covered by section 2(a)(1)(C)(ii) of the Commodity Exchange Act -- i.e., broad based stock index contracts. Exchanges continue to be required to seek and receive written supplemental no-action relief from Commission staff prior to offering these contracts through U.S.-located trading systems.
http://www.cftc.gov/opa/press06/opa5175-06.htm

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