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A transcript from our "**Shareholder Proposals: What to Expect in the 2003 Proxy Season**" program held on November 12th is available at <http://www.realcorporatelawyer.com/CLE/CLE11-12-02Transcript.html>.

SEC I: Proposed Rules on Attorney Responsibility Standards

In early November, the SEC proposed a controversial rule implementing Section 307 of the Sarbanes-Oxley regarding attorney responsibility standards. The proposed rule goes beyond the requirements of Section 307.

Who is Covered by the Proposed Rule - The term "attorney" would include anyone admitted, licensed or otherwise qualified to practice law in any jurisdiction (including foreign jurisdictions) - and would apply to both in-house and outside counsel. The proposal is so broad it would apply even if an "attorney" was not employed in a legal capacity. The proposed rule would apply to any attorney appearing and practicing before the SEC in any way, including any communications with the SEC on behalf of an issuer - and any conduct relating to the preparation of documents submitted to the SEC

(and would apply even when materials are not submitted to the SEC, if the attorney's advice causes the materials not to be submitted).

"Up-the-Ladder" Reporting - The proposed rule would impose an "up the ladder" reporting obligation if an attorney "reasonably believes" that a material violation of securities law or breach of fiduciary duty or similar violation has occurred, is occurring - or even "is about to occur." The attorney would be obligated to report evidence of such a violation or breach to the company's chief legal officer (or the CLO and CEO). If the CLO and CEO fail to "appropriately respond" to the evidence (or if the attorney determines that reporting to such officers would be futile due to their involvement in the perceived violation), the attorney would be required to report the evidence to the board, audit committee, or another independent board committee.

Reporting "Out" to the SEC - However, an attorney's obligation would not end with reporting "up-the-ladder." If the attorney believes that the board or board committee has not appropriately responded to evidence of an ongoing or potential violation that is likely to result in substantial injury to the financial interests or property of the company or investors, he or she must engage in a "noisy withdrawal." This means that outside counsel must withdraw from the representation; notify the SEC in writing of this withdrawal for "professional considerations"; and disaffirm any tainted documents filed with the SEC. For in-house lawyers, they need not resign - but must disaffirm any tainted documents filed with the SEC.

"QLCC" Alternative - As an alternative to "reporting out," the proposed rule would permit a company to create a Qualified Legal Compliance Committee ("QLCC"), comprised of one member of the company's audit committee and two or more other directors (all of whom must be independent). Reporting "up the ladder" would go directly to the QLCC, rather than to the CEO and CLO. The use of the QLCC alternative would relieve attorneys from the "noisy withdrawal" requirement. Upon receipt of evidence of a material violation or breach, the QLCC would be responsible for notifying the CEO and CLO, determining whether an investigation is warranted, directing any investigation, and devising remedial measures. If the company fails to appropriately implement remedial measures prescribed by the QLCC, each QLCC member would be required to "report out" to the SEC and disaffirm documents tainted by the misconduct.

The controversy over this proposal is highlighted by a November 25th letter sent by former SEC Commissioner Fleischman and other leading securities lawyers to the SEC. This letter is at <http://www.realcorporatelawyer.com/fleischman.doc>.

The SEC is required to adopt final rules implementing Section 307 no later than January 26, 2003. The proposing release is at <http://www.sec.gov/rules/proposed/33-8150.htm>.

SEC II: Regulation FD Enforcement Actions Announced

In late November, the SEC's Division of Enforcement fined one company \$250,000 and issued cease-and-desist orders to two others in the first enforcement actions under

Regulation FD. The SEC staff also issued a "Report of Investigation" to provide a warning in another case.

The Enforcement Division fined Siebel Corporation after an officer told attendees at an invitation-only investor conference that the company's business was improving. This was contrary to negative comments the officer made publicly a few weeks earlier. The company's stock rose more than 20% the day after the investor conference - and the SEC staff traced trades back to a number of attendees.

In the cease-and-desist actions, the Enforcement Division issued orders to Secure Computing Corp. and its CEO and Raytheon Co. and its CFO. In both cases, company officers disclosed the existence of material information to institutional investors before the companies publicly disclosed the information to all investors.

In the Report of Investigation, the SEC said it had investigated Motorola because an officer called analysts to give them details that the public didn't have about the company's sales and orders. The Enforcement Division decided not to act because the officer inadvertently violated Regulation FD after receiving poor advice from an in-house lawyer.

The Commissioners split over these enforcement actions - Commissioners Atkins and Glassman voted against fining Siebel, arguing the penalty was inconsistent given that the other two companies weren't fined. Commissioner Campos voted against the cease-and-desist orders, arguing that they should have been fined instead. Chairman Pitt and Commissioner Goldschmid voted in favor of all the enforcement actions.

The SEC's press release regarding these enforcement actions is at <http://www.sec.gov/news/press/2002-169.htm>. The related litigation releases are at:

Siebel - <http://www.sec.gov/litigation/admin/34-46896.htm>

Secure Computing - <http://www.sec.gov/litigation/litreleases/lr17860.htm>

Raytheon - <http://www.sec.gov/litigation/admin/34-46897.htm>

Motorola - <http://www.sec.gov/litigation/admin/34-46895.htm>

SEC III: Staff Issues FAQs on Sarbanes-Oxley

Tucked away on the "Division of Corporation Finance" page, the SEC has posted "frequently asked questions" related to Sarbanes-Oxley. However, these FAQs don't address many of the most commonly questions asked - such as the various interpretive questions still open under Section 402 regarding prohibited loans.

The FAQs do address some helpful topics such as:

impact of Sarbanes-Oxley on "voluntary" filers (FAQs #1 and 9)
ways to address relatively novel certification situations (FAQs #10-16)
ramifications of filing a 10-Q and 10-K without a certification (FAQs #17-18)
how the SEC staff is defining "internal controls" until Section 404 rulemaking is final (FAQs #20-23)
ways to reduce the number of Form 4s by amending a deferred compensation plan (FAQ #26)

These FAQs are at <http://www.sec.gov/divisions/corpfin/faqs/soxact2002.htm>.

SEC IV: SEC Posts No-Action and Interpretive Letters for 2002

The SEC has begun posting no-action and interpretive letters on its web site! They go back as far as early 2002 - and are divided by subject matter, alphabetically, and chronologically. The SEC staff has indicated that it is unlikely that letters related to Rule 14a-8 (i.e. shareholder proposals) will be posted due to heavy volume of these letters processed in a relatively short period of time.

The letters are at <http://www.sec.gov/divisions/corpfin/cf-noaction.htm>.

SEC V: Auditor Independence Rules Proposed

In late November, the SEC proposed rules regarding auditor independence and workpaper retention requirements.

Regarding auditor independence, the SEC's proposed rules that would implement Sections 201-206 of Sarbanes-Oxley by addressing:

Mandatory partner rotation - Prohibiting partners on the audit engagement team from providing audit services to the company for more than 5 consecutive years - and from returning to provide audit services for the same company within 5 years. The SEC's proposal goes beyond what is required in Sarbanes-Oxley by applying this prohibition to all partners - not just the partners responsible for reviewing the audit. This could result in consolidation of smaller audit firms.

"Cooling-off" periods - Prohibiting accounting firms from auditing a company's financial statements if certain members of management had been members of the accounting firm's audit engagement team within the one-year period preceding the commencement of audit procedures.

Provision of non-audit services - Prohibiting services that would impair an accounting firm's independence. The types of prohibited services are based on the 9 non-audit services listed in Section 201.

Audit committee involvement - Requiring that the audit committee pre-approve all audit and non-audit services - and that the auditor report focus on certain matters for the audit committee, including addressing the company's "critical" accounting policies.

Proxy statement disclosure - Add one category to the table of audit and non-audit fees so that each table would address: "Audit Fees," "Audit-Related Fees," "Tax Fees," and "All Other Fees." In addition, the SEC proposed that the fee table would be expanded to include the two prior fiscal years - rather than the present requirement of only including fees from the most recent fiscal year.

Regarding workpaper retention, the SEC's proposed rules that would require auditors to retain specific information for 5 years after completing an audit or review of a company's financial statements. The proposed rules broadly define the documents to be retained by including any documents that may cast doubt on the auditor's conclusions - not just workpapers that support the auditor's conclusions.

The SEC is required to adopt final rules in these areas no later than January 26, 2003. The proposed rules regarding record retention are at <http://www.sec.gov/rules/proposed/33-8151.htm>. The proposing release regarding auditor independence is available at <http://www.sec.gov/rules/proposed/33-8154.htm>.

Proxy Season: Checklists to Consider

As many companies are faced with an unprecedented level of change for the upcoming proxy season, sample checklists can prove a big help to remember all of these changes.

Of course, these third-party checklists should serve as mere organizational reminders - as each company faces unique circumstances that require matters to be addressed that are not on these checklists.

For some sample checklists, see Wachtell Lipton's list of compliance reminders at <http://www.realcorporatelawyer.com/wachtellreminders.pdf> - as well as Snell & Wilmer's checklist at <http://www.realcorporatelawyer.com/Features/SnellWilmer-Checklist.pdf>. In addition, an updated summary of the Sarbanes-Oxley provisions is at http://www.realcorporatelawyer.com/Features/SnellWilmer-SOX_Summary.pdf.

Disclosure about "Disclosure Controls": What Was Done in 3rd Quarter

The latest wave of Form 10-Qs filed in mid-November was the first time that most companies provided disclosure regarding their disclosure controls under Item 4 of their 10-Qs. Here is an analysis of the different ways this disclosure was drafted:

Most companies provided simple disclosure merely parroting the certification requirements - and did not include any type of disclaimer. These companies stated: (1) that the CEO and CFO have evaluated the disclosure controls and procedures and have concluded that they are effective; and (2) that there were no significant changes in internal controls or other factors that could significantly affect such controls.

Some companies just took the approach of saying their controls were "effective" - but did not provide any statement or elaboration about what precisely was "effective." Of those who elaborated on "effectiveness," two approaches were followed. Some tracked the definition of "disclosure controls and procedures" set forth in Rule 13a-14(c), while others tracked the language describing what the certification is supposed to address as set forth in Rule 13a-14(b)(4)(i). The difference is significant, as the latter approach contains a materiality standard. The SEC suggests that the disclosure should be tailored to the particular company, so any of these approaches should be acceptable.

Several companies elected to include "cautionary language" or "reasonable assurances" about limitations as to the effectiveness of any system of controls. For example, Intel provided a lengthy qualifying statement, apparently drawn from the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and AICPA guidance, addressing possible limitations in the design and operation of control systems.

Cytec Industries used a disclaimer similar to Amazon's, stating, "The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote."

Safeway, Host Marriott, and Goodrich used something along these lines: "Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures which, by their nature, can provide only reasonable assurance regarding management's control objectives. The company also has investments in certain unconsolidated entities. As the company does not control or manage these entities, its disclosure controls and procedures with respect to such entities are necessarily more limited than those it maintains with respect to its consolidated subsidiaries."

Proctor & Gamble and Schick Technologies had fairly basic disclosure - but with the caveat that their disclosure control systems were functioning effectively to provide "reasonable assurance" that the company could meet its disclosure obligations.

A few others were unique. Yahoo, for example, stated, "In response to recent legislation

and proposed regulations, we reviewed our internal control structure and our disclosure controls and procedures. Although we believe our pre-existing disclosure controls and procedures were adequate to enable us to comply with our disclosure obligations, as a result of such review, we implemented minor changes, primarily to formalize and document procedures already in place. We also established a disclosure committee which consists of certain members of the company's senior management."

Gentex included a general forward-looking statement disclaimer (referring to risks and uncertainties described in the MD&A). And Exelon described a recent restatement and indicated that its officers had "directed that steps be taken to enhance the understanding and implementation of the company's controls and procedures." In addition, Exelon stated it "continually strives to improve its disclosure controls and procedures to enhance the quality of its financial reporting."

Critical Accounting Policy Disclosure: Don't Forget to Include It

At a late November meeting of the Federal Securities Regulation Subcommittee of the American Bar Association, Division of Corporation Finance Director Alan Beller stated that the proposed rulemaking regarding disclosure of critical accounting policies would not be final in time to be effective for the 2003 proxy season. As a result, Alan noted that companies should follow the SEC's cautionary advice on the topic from last December (see <http://www.sec.gov/rules/other/33-8040.htm>).

Linda Quinn, Otilie Jarmel and Claire Horgan of Shearman & Sterling recently surveyed how the Fortune 100 has provided critical accounting policy disclosures - this survey is available at <http://www.realcorporatelawyer.com/pdfs/ssfortune100.pdf>

Executive Compensation: Ripe for Reform

On November 20th, we held a teleconference program regarding "Executive Compensation: Ripe for Reform?" The panelists included **Carolyn Brancato**, Director, Global Corporate Governance Research Center, The Conference Board; **Charles Elson**, Professor/Chair, Univ. of Delaware's Center for Corporate Governance; **Pat McGurn**, Director of Corporate Programs, Institutional Shareholder Services **David Swinford**, Partner, Pearl Meyers & Partners; and **Marc Trevino**, Partner, Sullivan & Cromwell.

The following are some of the many highlights of the program:

Based on a recent survey of portfolio managers and analysts, about 73% of them

said that they support options expensing.

Performance shares mixed with a few options are the "up and coming" method of compensation.

Don't think there's been any impact on the notion that director ownership is unnecessary. However, there is heightened attention to the long-time caveat that you can't sell it while you're a director.

The last five or six years have seen more and more compensation paid in stock. It will switch back a little to more and more in cash. So you'll see the balance shift, but that's okay, directors still have a fair amount of stock.

If directors need to sell, they should make some sort of advance sale notice in a regular manner for those selling for estate planning purposes and so on.

As for committee fees, some argue that it will increase the liability for those directors that receive some sort of disparate pay. On the other hand, the market will likely dictate what audit committee members get, especially the financial experts.

If you pay directors for their time, rather than their differential responsibilities, that is the way to avoid giving them greater liability exposure.

The key is to pay each committee chair a larger amount and then pay more meeting fees.

So if every company discloses that they don't have anyone that qualifies under the rules as a "financial expert," that means that the rules were drawn up just much, much too narrowly.

As more companies truly meet the definition of having a majority of independent or outside directors, then we will see compensation committees move up in size to probably about five. Five people gives you an opportunity to ensure that you've got a sitting CEO from another organization on your committee.

The compensation committee is sort of the heart of the corporate governance structure of the company.

The compensation committee should retain and hire outside consultants who advise it. And those consultants should report only to the committee.

The full transcript will be available sometime in early December on <http://www.realcorporatelawyer.com>.

Shareholder Proposals: What to Expect in 2003 Proxy Season

As the 2003 proxy season approaches, it is becoming clear that uneasy shareholders are submitting more shareholder proposals than ever before. One company reports that it already has received 36 proposals - double what is believed to be the prior record for a single company.

On November 12th, we held a teleconference program regarding "Shareholder Proposals: What to Expect in the 2003 Proxy Season." The following are some of the many highlights of the program:

Marty Dunn Deputy Director, SEC's Division of Corporation Finance

This year, the staff is going to try to have 11 lower level examiners and five reviewers. The hope there is that the five reviewers can turn things around faster and we can cut down on our turnaround time.

While an appeal to the Commission of the National Semiconductor no-action letter involving an options expensing proposal is pending (on (i)(7) grounds), the staff will follow the approach it started with a request that came to us from Mercury Computing - we advised them that we were not in a position to take a view as to their position regarding whether or not to include the proposal until the Commission responds to the appeal.

Last year, we told everybody that if there were a lot of problems within the (i)(3) area relating to a proposal - rather than requiring revisions of each sentence - we would allow the entire proposal to be excluded. We didn't follow through on that last year because we didn't think it was fair on such short notice to do that to proponents. Now, folks who repeatedly abuse this will find out that we don't think it's the best use of everybody's time.

If you haven't read Staff Legal Bulletin #14, you're simply not representing your client responsibly.

Beth Young, Corporate governance consultant

Most proponents are not waiting to hear about the National Semiconductor appeal before they submit options expensing proposals. From what I'm hearing, these proposals may number over a hundred as there are groups of proponents who are doing large numbers of them.

The second category - in some cases being submitted hand in hand with options expensing - is performance-based stock options. In the past, these proposals have done pretty well (with shareholder votes up into the high 30s and low 40s percentage-wise).

The third category of compensation proposals - which would be a pretty new proposal - is holding periods and other mechanisms to focus on long-term ownership by executives.

Nell Minow, Editor, The Corporate Library

We just posted a report by Beth Young on our Web site about related transactions where we documented things like the Chief Operating Officer's brother who was hired by a vendor to negotiate their relationship with the company.

We are releasing a product at the end of this month that's had a lot of interest regarding interlocking directors. We've got 20,000 directors in our database and this software will show basically the first, second and third degree lines of connections between all of them.

As for corporate governance guidelines, we will be publishing all of them and comparing them - and everybody who cheats off of someone else's paper and publishes

whatever their lawyer sends them is going to look very bad.

John Wilcox, Vice Chairman, Georgeson Shareholder

The NYSE's proposed listing requirements requiring shareholder approval for all equity compensation plans and eliminating the discretionary broker vote is going to have a very big impact on companies because options plans have always been a major repeat item.

One of the important factors that will come into play - even more strongly than in the past - is the importance of the overhang in the calculation of dilution.

Figuring out who your owners are, looking very carefully at your institutional shareholders and looking at their voting records is critical.

The full transcript of the program is available at

<http://www.realcorporatelawyer.com/CLE/CLE11-12-02Transcript.html>.

International: Impact of Sarbanes-Oxley on Non-U.S. Companies

On November 25th, we held a teleconference program regarding "Impact of Sarbanes-Oxley on Non-U.S. Companies." The panelists included **Paul Dudek**, Chief, Office of International Corporation Finance, U.S. Securities & Exchange Commission; **Ed Greene**, Partner, Cleary, Gottlieb Steen & Hamilton; **Paul Kumleben**, Partner, Davis Polk & Wardwell; and **Linda Quinn**, Partner, Shearman & Sterling.

The following are some of the many highlights of the program:

SEC's current role - You can see a real effort by the SEC to craft the application of Sarbanes-Oxley to foreign companies in a way that complies with the letter and the spirit of the law - and yet addresses the specific situation for foreign companies.

CEO/CFO Certifications - For foreign private issuers is that this certification is only required in the context of the Annual Report on Form 20-F. It is not required for the interim reports on Form 6-K. These are not periodic reports filed with the SEC that contain financial statements.

Disclosure Controls & Procedures - It is important to note that these disclosure controls and procedures are required to be in place before the Form 6-Ks are filed and even though there's no mandatory certification when these 6-Ks are filed, foreign private issuers still have to have the appropriate procedures in place. This would include what each foreign private issuer is doing under their home country disclosures practices and procedures as well as their existing SEC ones.

Consequences of Certifications - There has been some concern by foreign private issuers as to whether this certification is designed to change the liability that they would have with respect to the financial statements that are otherwise filed with the SEC. I think the Commission has tried to assure people that this was not the intention -

that there is no change or increase in liability. On the other hand, I suspect that with the signatures, it makes it more likely than not that if there was a proceeding involving restated financials, the individual might initially be named by the SEC, subject to an ability to show that he or she acted improperly.

Prohibited Loans - There are some interesting interpretative questions that come up for issuers because the statute bars loans to directors and executive officer.

"Executive officer" is defined under the Act and is not necessarily someone who solely sits on the top board. In addition, the 20-F that foreign private issuers file requires them to identify senior management, which is different from the use of the terms "directors" and "executive officers". So, most companies should review and take a view on what kind of people would be covered by this section.

Disgorgements and Restatements - First, it's the obligation on the individuals to basically give back the money. No enforcement mechanism is specified in the Act. Secondly, the misconduct doesn't necessarily have to be the misconduct of the individuals involved, if there were otherwise misconduct leading to the restatement of the financial statement. Third, in some jurisdictions, it's not permissible to recoup from employees, without their consent, amounts paid by way of bonus or other incentive compensation, raising questions as to whether companies would be advised to consider changing the terms of employment to specify how this might be enforced.

Audit Committees - The first is that the audit committee is to have full power to hire, oversee and set the compensation for auditors that are retained by an issuer. That, first, directly conflicts with the rules in some jurisdictions that auditors can only be appointed by shareholders.

Retention of Workpapers - The Act would anticipate, not only that U.S. firms be registered with the new oversight board, but any foreign auditing firm that either signs an opinion that is filed with a document, filed with the SEC or participates in an audit (such that the reporting account relies upon the work of the foreign private auditor), that auditor will be deemed to have consented to make workpapers available and will be deemed to have consented to the jurisdiction of U.S. courts in trying to enforce access to those workpapers. That clearly will conflict with laws in local jurisdictions with respect to access and divulging of workpapers without the clients' consent to regulators. The European union has opened up a dialogue with the SEC with respect to this provision. It will be some time in the future before we see how it's resolved, because this is also one of the provisions in the Act that explicitly contemplates some form, but perhaps some exempted relief will be forthcoming as it has raised difficult and interesting questions.

Attorney Responsibility Standards - It's important to note that the proposed rules apply to foreign lawyers as well as U.S. lawyers - and "lawyer" means lawyers who are licensed. Does "similar laws" include foreign securities laws and foreign corporate law concepts? I think it's an extraordinary action by the Commission to propose such a far reaching rule (leaving aside the issues for domestic companies) with respect to the foreign legal community where the ethics rules, where the licensing rules are particularly unexplored by the Commission in this proposal. Also, as the Commission itself notes, how this would fit into corporate governance structures for foreign private issuers is not terribly clear.

The full transcript will be available sometime in early December on

<http://www.realcorporatelawyer.com>.

Corporate Governance: NACD's Blue Ribbon Commission Report on Risk Oversight

In mid-November, the National Association of Corporate Directors issued its latest Blue Ribbon Commission report entitled "Risk Oversight: Board Lessons For Turbulent Times" The report explains why boards must be involved in risk oversight, how they can oversee risk management -including detection of material risks - and how the board's leadership role changes when crises occur.

The report identifies a number of key board practices that are central to the effective practice of risk oversight, including:

Independent board leadership - The Blue Ribbon Commission found that effective corporate governance requires leadership by a non-executive board member who is either the chairman or a leader by any denomination, such as chairman of an independent governance committee. This independent director plays a central role in ensuring that directors and board committees receive the information they need to make sound oversight decisions.

Director continuity versus resignation during a crisis - Crisis situations place significant burdens of time and effort on directors, but the Blue Ribbon Commission emphasizes the value that some board continuity has in a time of crisis. The report provides decision-making guidance for directors and the conditions and circumstances that may warrant action.

The report also provides practical tools for implementing risk oversight processes and procedures at the board level, including a list of red flags for financial fraud, case studies and lessons learned. To obtain a copy of the report, see <http://www.nacdonline.org/publications/pubDetails.asp?pubID=204>.

Comings and Goings: Who's Doing What and Where

At the SEC, Chairman Harvey Pitt has resigned but still is serving in that capacity until a successor is named. The Chairman's **Chief of Staff, Mark Radke**, announced his return to the private sector.

Chief Accountant Bob Herdman also resigned and has left the Commission. **Deputy**

Chief Accountant Jackson Day was named Acting Chief Accountant.

Long-time journalist **Herb Perone** was hired as Deputy Director of the Office of Public Affairs. **William Baker III**, Associate Director of the Division of Enforcement, has announced that he will leave the SEC to go the private sector (but has not yet announced where).

In **Corp Fin**, former Special Counsel **Knute Salhus** has agreed to join Wilmer, Cutler & Pickering as a Partner in New York City.

Events CalendarUpcoming events of interest include:

Northwestern Law's "41st Annual Corporate Counsel Institute," San Francisco, December 5-6

Glasser's Institute of Directors Conference on Corporate Responsibility, London, December 5

National Association of Corporate Directors' "Role of the Governance Committee: Raising The Bar," Washington DC, December 10

PLI's "London Institute," London, December 9-10

Glasser's "24th Annual Institute on Proxy Statements, Periodic Reports, and Critical Disclosure Issues," San Francisco, December 9-10, New York City, December 11-12

Northwestern Law's "30th Annual Securities Regulation Institute," San Diego, January 29-31

Input, Please

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