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**SEC I: SEC Issues Proposed Regulation NMS (National Market System) Seeking Public Comment**

U.S. Securities and Exchange Commission, [Proposed Rule: Regulation NMS](#), Release No. 34-49325 (Feb. 26, 2004) ([Click Here For PDF Version](#)).

U.S. Securities and Exchange Commission, [SEC To Publish Regulation NMS for Public Comment](#), News Release 2004-22 (Feb. 24, 2004).

On February 24, the Securities and Exchange Commission voted to publish for

public comment Regulation NMS (National Market System). The proposed rules address four "interrelated" areas that the Commission says are "designed to modernize the regulatory structure of the U.S. equity markets" by updating existing Exchange Act rules and consolidating them into a single regulation. The proposal addresses trade-throughs, intermarket access, sub-penny pricing and market data.

### **Trade-Throughs**

The proposal would create a "uniform trade-through rule for all market centers" based on the "fundamental principle of price priority". According to the SEC announcement of the proposal, it is intended to address "problems posted by the inherent difference in the nature of prices displayed by automated markets, which are immediately accessible, compared to prices displayed by manual markets, which are not."

The proposal would require SROs (as well as any market center that executes orders) to develop procedures "to prevent the execution of an order for national market system stocks at a price that is inferior to the best bid or offer displayed by another market center at the time of execution." Two exceptions would be: (1) an order that trades through a better-priced bid or offer on another market center if the person entering the order makes an informed decision affirmatively to opt out of the trade-through protections with "informed consent" required on an "order-by-order" basis; and (2) automated markets would be able to trade through a better displayed bid or offer on a non-automated market up to a de minimus amount of one to five cents, depending on the stock's price. The Commission warns that nothing about the proposal is intended to change a broker-dealer's existing duty to obtain best execution for customer orders.

### **Intermarket Access**

The proposal is intended to ensure non-discriminatory access at the best prices displayed by market centers without requiring "inflexible, 'hard' linkages such as

the Intermarket Trading System". According to the Commission, the proposal "would prohibit a market center from imposing unfairly discriminatory terms that prevent or inhibit any person from accessing its quotations indirectly through a member, customer, or subscriber."

In addition, to promote a common quoting convention, the proposed Regulation NMS would establish an access fee standard intended to "harmonize quotations and facilitate the ready comparison of quotes across the national market system." Specifically, according to the Commission, access fees would be capped at \$0.001 per share and the aggregation of this fee would be limited to no more than \$0.002 per share in any transaction.

The proposal also provides that each SRO must establish and enforce rules requiring its members to avoid -- and prohibiting them from engaging in a pattern or practice of -- locking or crossing the markets.

### **Sub-Penny Pricing**

The proposal would ban sub-penny pricing in most stocks. According to the Commission, "it would prohibit market participants from accepting, ranking or displaying orders, quotes, or indications of interest in a pricing increment finer than a penny in national market system stocks, other than those with a share price below \$1.00."

### **Market Data**

The Commission says that proposed Regulation NMS seeks "to better reward SROs for their contributions to public price discovery, as well as implement most of the [recommendations of the Commission's Advisory Committee on Market Information](#)." The proposal sets forth a new formula intended to divide market data revenues equally between trading and quoting activity "in order to reward markets that publish the best accessible quotes." Additionally, there are a number of "improvements" based on recommendations by the Advisory Committee on Market Information including broadening participation in plan

governance by creating advisory committees composed of non-SRO representatives representatives and authorizing market centers to distribute their own additional data, such as limit order books -- separately from other markets -- as well as establishing uniform standards for the terms of such distribution.

## **SEC II: SEC Proposes New Investment Company Act Rule 22c-2 Regarding Mandatory Redemption Fees for Mutual Fund Securities**

U.S. Securities and Exchange Commission, [SEC Proposes Mandatory Redemption Fees for Mutual Fund Securities](#), News Release 2004-23 (Feb. 25, 2004).

On February 25, the U.S. Securities and Exchange Commission voted to impose a two percent fee on the redemption proceeds of mutual fund securities redeemed within 5 days of their purchase. In any such case, the fund will retain the proceeds from the redemption fees. According to the Commission:

"The rule is designed to require short-term shareholders to reimburse the fund for the direct and indirect costs that the fund pays to redeem these investors' shares. In the past, these costs generally have been borne by the fund and its long-term shareholders. Thus the redemption fee would be a 'user fee' to reimburse the fund for the cost of accommodating frequent traders."

The proposed rule would require funds, in the case of shares held by financial intermediaries such as broker-dealers and retirement plans, to "obtain the information they need to assess the redemption fee, and to oversee the efforts of intermediaries to assess those fees and remit them to the fund."

The proposal apparently is more complex than might otherwise appear at first blush. First, it provides that funds must calculate the redemption fee on shares held the longest period of time first. Second, there is a de minimus exception providing that a fund *may* waive any redemption fee of \$50 or less. Third, the proposal contains an emergency exception that allows a shareholder to avoid

payment of a redemption fee in instances involving certain sorts of "unanticipated financial" emergencies.

The proposal does not apply to money market funds or exchange-traded funds. Nor would it apply "to mutual funds that encourage active trading and disclose to investors in the prospectus that such trading will likely impose costs on the fund."

### **SEC III: Commission Proposes Amendments to '40 Act Rule 12b-1 to Prohibit Directed Brokerage**

U.S. Securities and Exchange Commission, [Proposed Rule: Prohibition on the Use of Brokerage Commissions to Finance Distribution](#), Release No. IC-26356 (Feb. 24, 2004).

On February 24, the U.S. Securities and Exchange Commission proposed amendments to Rule 12b-1 under the '40 Act to prohibit funds from compensating a broker-dealer for promoting or selling fund shares by directing brokerage transactions to that broker. Additionally, the proposed amendments would prohibit step-out and similar arrangements designed to compensating selling brokers for selling fund shares.

Interestingly, the SEC seeks public comment on several specific questions on or before May 10. A few of these questions are:

- Are its concerns about the practice of using brokerage commissions to pay brokers for selling fund shares justified?
- Are there alternative measures it could take to address the use of brokerage commissions to finance distribution?
- Would brokerage commissions be reduced by eliminating the use of commissions to pay for distribution? Would there be greater competition in commission rates?
- If the SEC bans this practice, would the primary effect be to increase brokers' demands on advisers to make payments out of their assets -- i.e., revenue sharing? Is the SEC correct in its assumption that properly disclosed revenue sharing payments present more manageable conflicts for funds and broker-dealers?
- If such an assumption is correct, should the Commission take additional steps to address revenue sharing concerns?

### **SEC IV: SEC's Corporation Finance Division Issues Advisory Letter to**

## **Companies and Says Entire Oil & Gas Industry Should Consider It**

U.S. Securities and Exchange Commission Division of Corporation Finance, [Sample Letter Sent to Oil and Gas Producers](#) (Feb. 24, 2004).

On February 24 the Commission's Division of Corporation Finance announced that earlier that month it issued a guidance letter to registrants identified as being primarily engaged in the production of oil and gas. Significantly, however, the announcement further indicated that "All registrants with subsidiaries or operations engaged in the production of oil and gas should consider this letter in the preparation of their filings with the Commission."

The letter provides guidance regarding questions that have arisen concerning the required disclosures of FAS 69 with the more recent adoption of FASB Statement No. 143 (Accounting for Asset Retirement Obligations). According to the letter, the guidance is intended to clarify "how recognition of a liability for an asset retirement obligation and the related depreciation of the asset and accretion of the liability under FAS 143 impact the required disclosures under paragraphs 18 through 34 of FAS 69."

### **SEC V: SEC Extends Compliance Dates for Internal Control Over Financial Reporting Requirements**

U.S. Securities and Exchange Commission, [Extension of Compliance Dates Regarding Internal Control Over Financial Reporting Requirements](#), News Release 2004-21 (Feb. 24, 2004).

U.S. Securities and Exchange Commission, [Final Rule: Management's Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Reports \(Extension of Compliance Dates\)](#), Release Nos. 33-8392, 34-49313, IC-26357 (Feb. 24, 2004).

On February 24, the Commission announced -- as widely expected -- that it has extended the compliance dates for the effectiveness of amendments to its rules under Section 404 of Sarbanes-Oxley. The amendments require a company to include in annual reports a report by management on the company's internal control over financial reporting and the accompanying auditor's report. According to the SEC's announcement:

Under the new compliance schedule, a company that is an 'accelerated filer' as defined in Exchange Act Rule 12b-2 (generally, a U.S. company that has equity market capitalization over \$75 million and has filed at least one annual report with the Commission), must begin to comply with these amendments for its first fiscal year ending on or after Nov. 15, 2004 (originally June 15, 2004). A non-accelerated filer must begin to comply with these requirements for its first fiscal year ending on or after July 15, 2005 (originally April 15, 2005). The Commission similarly has extended the compliance date for related requirements regarding evaluation of internal control over financial reporting and management certification requirements, including certification and related requirements applicable to registered investment companies. . . .

#### **SEC VI: SEC Issues Fee Rate Advisory #8 for Fiscal Year 2004**

U.S. Securities and Exchange Commission, [Fee Rate Advisory #8 for Fiscal Year 2004](#), News Release 2004-24 (Feb. 27, 2004).

The Commission issued Fee Rate Advisory #8 for Fiscal Year 2004 on February 27. The advisory provides that Effective April 1, 2004, the Section 31 transaction fee rate for fiscal 2004 will decrease from the current rate of \$39.00 per million to a revised rate of \$23.40 per million. This rate, the Commission noted, will not apply to the Section 31 assessment on security futures transactions, which will remain at the current rate of \$0.009 per round turn transaction.

## PCAOB I: On March 9 the PCAOB Will Consider Adopting Standard for Audits of Internal Control Over Financial Reporting

Public Company Accounting Oversight Board, [Board to Consider Adopting Standard for Audits of Internal Control Over Financial Reporting](#) (Feb. 24, 2004).

The Public Company Accounting Oversight Board has announced that on March 9 it will conduct an open meeting at which it will consider adopting an auditing standard for internal control over financial reporting. The auditing standard, "An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements" addresses the work that is required to audit internal control over financial reporting as well as the relationship of such an audit to the audit of the financial statements.

### **PRACTICAL GUIDANCE I: Correspondence with SEC is NOT "Confidential" - Keeping Communications With the SEC Confidential (Rule 83, SEC's Rules on Information and Requests)**

Since enactment of the Freedom of Information Act, any form of communication with the U.S. Securities and Exchange Commission has been at risk of being disclosed by the Commission publicly. With the recent [announcement by Global Securities Information, Inc. that it would begin offering as part of its LIVEDGAR service access to a massive collection of SEC comment letters and related response correspondence](#) this issue has come into sharp focus for many companies and their counsel.

Whenever a response to an SEC comment (or any other communication with the Commission for that matter) needs to include sensitive or confidential information, the company and its counsel may wish to consider protection of such information in either of two ways.

### **Confidential Treatment Under Rule 83 of the SEC's Rules on Information and Requests**

To make a confidential treatment request with respect to information included in a communication with, or supplemental information provided to, the SEC under Rule 83 of the SEC's Rules on Information and Requests, a company or its counsel must:

Electronically file the comment response letter or supplemental information with the confidential information redacted while marking each applicable page or portion of each page with the legend: "Confidential Treatment Requested by [Company Name]" and include an identifying number and / or code such as a so-called "Bates-stamped number".

Submit in a paper filing to the SEC a copy of the complete comment response letter or supplemental information without the confidential information redacted;

Submit to the Commission in a paper filing a letter requesting confidential treatment under Rule 83 and identifying the specific information for which confidential treatment is requested including a reference to the identifying number and code of the page(s).

Send a copy of the request for confidential treatment (but NOT the underlying documents for which confidential treatment is requested) by mail to the Office of Freedom of Information and Privacy Act Operations with the legend "FOIA Confidential Treatment Request" prominently displayed at the top of the first page of the written request. This must include the name, address and telephone number of the person requesting confidential treatment.

Significantly, the Director of the SEC's Division of Corporation Finance recently indicated that the SEC Staff will not honor so-called "blanket requests" for Rule 83 Confidential Treatment covering the contents of all correspondence between the SEC and the issuer.

### **Paper Filings of Supplemental Information**

In the case of supplemental information submitted to the SEC, a company should consider the possibility of submitting the information to the SEC in a paper filing instead of an electronic filing and request that the SEC return such materials following its review. Under Exchange Act Rule 12b-4 and Securities Act Rule 418(b), the Commission should -- at the company's request -- return to the company any supplemental information provided by the company so long as the company's request is made when the information is furnished to the Staff, the return of the information is "consistent with the protection of investors" and

"consistent with FOIA" and the information is not filed electronically.

## **PRACTICAL GUIDANCE II: Courtesy of RealCorporateLawyer.com**

RealCorporateLawyer.com works hard to provide its readers with free access to a very large collection of law firm memoranda providing practical guidance on current hot topics. Readers are encouraged to visit the frequently-updated "Special Features" area of the home page for such current memoranda, as well as the [SEC Reform Portal](#) containing hundreds of other such memoranda. In the last 30 days, RealCorporateLawyer -- a free service -- has provided its readers with easy access to the following memoranda:

[Sarbanes-Oxley, SEC and NYSE Corporate Governance rules and Proposals Summary from Bryan Cave LLP \(02/27/04\)](#)      [Urgent Notice for Non-EU Issuers of Securities from Elexica \(Simmons & Simmons\) \(02/18/04\)](#)

[Sarbanes-Oxley, SEC and Nasdaq Corporate Governance Rules and Proposals Summary from Bryan Cave LLP \(02/27/04\)](#)      [EU: Directive on Cross-Border Mergers from Elexica \(Simmons & Simmons\) \(02/18/04\)](#)

[Reports to Government Investigators of Audit Committee Findings May Be Discoverable by Plaintiffs in Shareholder Lawsuits from Wachtell, Lipton, Rosen, and Katz \(02/27/04\)](#)      [Consultation on Director and Auditor Liability from Elexica \(Simmons & Simmons\) \(02/18/04\)](#)

[SEC Delays Implementation Date of Internal Control Report Requirement for Many Public Companies from Morrison & Foerster \(02/27/04\)](#)      [Market Abuse Directive: First Implementing Measures Adopted from Elexica \(Simmons & Simmons\) \(02/18/04\)](#)

[Alert for US Issuers: Last Minute Reminders for Preparing Your Annual Report on Form 10-K from White & Case LLP \(02/26/04\)](#)      [Another Call for Disclosure by Public Companies of Business in Terrorist-Supporting States from Covington and Burling \(02/18/04\)](#)

[SEC Extends the Compliance Dates for Internal Control Attestation Requirements Sarbanes-Oxley Section 404 from Arnall Golden & Gregory \(02/26/04\)](#)      [SEC Issues Interpretive Guidance on MD&A from Sullivan and Worcester \(02/17/04\)](#)

[M&A Notes from Kirkland & Ellis \(Exculpatory Charter Provisions\) \(02/26/04\)](#)      [What Public Companies Need to Know About This Year's Annual Reports and Proxy Statements from Sullivan and Worcester \(02/17/04\)](#)

[SEC Issues Additional Guidance Regarding MD&A from Kirkland & Ellis LLP \(02/25/04\)](#)

[Update for Form 20-F Filers from Paul, Weiss, Rifkind, Wharton & Garrison LLP \(02/13/04\)](#)

[ISS Study Finds Companies with Stronger Takeover Defenses Outperform Other Companies from Wachtell, Lipton, Rosen, and Katz \(02/25/04\)](#)

[The SEC's New MD&A Interpretive Release from Covington & Burling \(02/13/04\)](#)

[SEC and FDA Announce New Referral Program from Covington and Burling \(02/24/04\)](#)

[2004 Annual Update for Form 10-K and Proxy Statement Preparation from Mayer, Brown, Rowe & Maw LLP \(02/09/04\)](#)

[New Obligations - 2004 Proxy Season NYSE and Nasdaq Listed Companies from Vedder, Price, Kaufman & Kammholz P.C. \(02/19/04\)](#)

[SEC Issues Further Guidance on MD&A from Paul, Weiss, Rifkind, Wharton & Garrison \(02/02/04\)](#)

In addition to all of this, the [FAQs on Foreign Issuers & Compliance With Sarbanes-Oxley](#) were updated during the month! Plus, the transcript to RR Donnelley's February 19, **Preparing the MD&A in a New Environment Teleconference** is now [available](#) on [RealCorporateLawyer.com](#).

#### **COMINGS AND GOINGS: Who's Doing and Saying What and Where?**

On February 26, Professor **Joel Seligman** (noted securities law scholar and author of the newly-revised *The Transformation of Wall Street*) gave an online "Fireside Chat" sponsored by the Securities and Exchange Commission Historical Society. An audio archive of the Fireside Chat is available online. [Click here to access the archive.](#)

On February 19, the Financial Accounting Foundation reappointed **Edward W. Trott** (FASB Board Member) and **Paul R. Reilly** (GASB Board Member) to their respective boards effective July 1, 2004. The reappointments were made by the Foundation's Board of Trustees, which has oversight responsibility for the Financial Accounting Standards Board and the Governmental Accounting Standards Board. See Financial Accounting Standards Board, [Financial Accounting Foundation Reappoints Edward W. Trott, FASB Board Member, and Paul R. Reilly, GASB Board Member](#), News Release (Feb. 19, 2004).

On February 12, the American Stock Exchange named **Fred Yager**, formerly President and Founder of the World News & Information Network, as its Senior Vice President of Corporate Communications. Mr. Yager previously had held positions with Merrill Lynch, Fox Television, CBS News and Associated Press. See American Stock Exchange, [American Stock Exchange Names Fred Yager Senior Vice President](#), Corporate Communications, News Release (Feb. 12, 2004).

On February 11, the Financial Accounting Foundation announced that **Robert H. Attmore**, a former Deputy State Comptroller in the New York State Comptroller's Office, has been elected Chairman of the Governmental Accounting Standards Board effective July 1, 2004. Mr. Attmore will succeed **Tom L. Allen** who has served as GASB Chairman commencing in 1995. See Financial Accounting Standards Board, [Robert H. Attmore Elected Chairman of the Governmental Accounting Standards Board](#), News Release (Feb. 11, 2004).

On February 9 the *New York Law Journal* reported that Duke University School of Law professor **Francis McGovern** has been named fund administrator for the \$1.4 billion settlement between the SEC and the country's largest brokerage firms regarding allegedly biased research. See Tom Perrotta, [Law Professor Tapped as Administrator of SEC Settlement](#), N.Y. Lawyer (Feb. 9, 2004) (reprinted from *New York Law Journal*).

On February 6, the American Institute of Certified Public Accountants announced that the AICPA Board has voted to extend **Barry Melancon's** term as President and CEO of the AICPA for an additional five years. Prior to joining the AICPA, Melancon served as Executive Director of the Society of Louisiana CPAs and began his accounting career at the firm of Bergeron & Company in Louisiana. See American Institute of Certified Public Accountants, [AICPA Board Approves Third Term for President and CEO Barry C. Melancon](#), News Release (Feb. 6, 2004).

**What Are the Commissioners Saying?** SEC Chairman **William H. Donaldson** delivered an Opening Statement at the February 25 open meeting on the topic of

["Mandatory Redemption Fees"](#). He also delivered a statement on the ["Regulation NMS Proposal"](#). SEC Commissioner **Cynthia A. Glassman** spoke at the 26th Annual Conference on Securities Regulation and Business Law Problems on February 20 regarding ["Board Independence and the Evolving Role of Directors"](#). Commissioner **Glassman** also delivered remarks at the Eighth Annual Conference on the Practical Implications of SEC Regulation Outside the United States regarding [methods for instilling ethical procedures and preventing fraud through strong compliance](#). SEC Chairman **William H. Donaldson** delivered an ["Introductory Statement at February 11, 2004, Open Meeting"](#) regarding initiatives aimed at protecting mutual fund investors. Commissioner **Cynthia A. Glassman** spoke on February 3 at the Legal & Compliance Conference sponsored by the Bond Market Association regarding [enforcement activities by the SEC staff and implementation of new rules under the Sarbanes-Oxley Act](#).

**What Are the Commission Staffers Saying?** On February 25, **Paul F. Roye** (Director of the Division of Investment Management) delivered an opening statement at the Commission's open meeting regarding ["Mandatory Redemption Fees"](#). **Mr. Roye**, on February 23, also delivered ["Remarks Before the National Investment Company Service Association's 22nd Annual Conference & Expo"](#) regarding the role of fund service providers and lessons for fund service providers. On February 19, **Stephen M. Cutler** (Director of the Division of Enforcement) delivered a ["Statement Regarding SEC Action Against Ex-Enron Officer Jeffrey K. Skilling"](#). On February 11, the SEC's Chief Accountant, **Donald T. Nicolaisen**, delivered ["Remarks at the Tax Council Institute Conference on the Corporate Tax Practice: Responding to the New Challenges of a Changing Landscape"](#). Also on February 11, **Stephen M. Cutler** delivered ["Remarks Before the District of Columbia Bar Association"](#) regarding inter-SEC "cross-pollination" to handle corporate fraud. On February 4, **Mary Ann Gadziala** (Associate Director, Office of Compliance Inspections and Examinations, N.Y.) spoke regarding ["The Vital Role of Effective Comprehensive Compliance Controls at](#)

[Broker-Dealers](#)" at the Bond Market Association's Ninth Annual Legal and Compliance Conference. On February 2, Giovanni Prezioso (General Counsel, New York, NY) delivered "[Remarks Before the Bond Market Association's Ninth Annual Legal and Compliance Conference](#)".

January 27, **Paul F. Roye** (Director of the Division of Investment Management) delivered "[Remarks Before the Understanding Securities Products of Insurance Companies - 2004 Conference](#)" before a Practising Law Institute audience in New York City. On January 14, **Linda C. Thomsen** (Deputy Director of the Division of Enforcement) delivered a "[Press Statement Regarding Settlement in SEC v. Andrew S. Fastow](#)". On January 14, **Paul F. Roye** also delivered a "[Statement at the SEC Open Meeting](#)" regarding proposed rules regarding governance of mutual funds. At the same meeting, **Annette Nazareth** (Director of the Division of Market Regulation) delivered a "[Statement at the SEC Open Meeting](#)" regarding proposed rules concerning mutual funds. On January 8, **Paul F. Roye** spoke before the Mutual Fund Directors Forum in Washington, D.C. regarding "[Enhancing the Fund Director's Tool Box](#)".

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