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SEC I: Lack of Guidance on SEC 17a-4 Designated Third Party Requirement for Electronic Storage of Broker-Dealer Records

Broker-Dealers and the hardware and software firms that they retain to assist them with electronic storage requirements increasingly are confronted with a lack of clear guidance from the Commission with regard to SEC 17a-4 Designated Third Party ("D3P") requirement for electronic storage of broker-dealer records. *See* 17 C.F.R. § 240.17a-4. SEC 17a-4(f)(3)(vii) requires, in effect, that if a broker-dealer uses electronic storage media as the exclusive means of storing some or all of its records for compliance purposes, then the broker-dealer shall arrange for "at least" one third party (the "D3P") who has access and the technological capability to download information from those records at the request of the staffs of the SEC, any self-regulatory organization of which the broker-dealer is a member, or any State securities regulator having jurisdiction

over the member. The section further requires that an "undertaking" signed by the D3P be filed with the designated examining authority for the broker-dealer. More particularly, the D3P section of SEC 17a-4 reads:

"For every member, broker, or dealer exclusively using electronic storage media for some or all of its record preservation under this section, at least one third party ('the undersigned'), *who has access to and the ability to download information* from the member's, broker's, or dealer's electronic storage media to any acceptable medium under this section, shall file with the designated examining authority for the member, broker, or dealer the following undertakings with respect to such records:

The undersigned hereby undertakes to furnish promptly to the U.S. Securities and Exchange Commission ('Commission'), its designees or representatives, any self-regulatory organization of which it is a member, or any State securities regulator having jurisdiction over the member, broker or dealer, upon reasonable request, such information as is deemed necessary by the staffs of the Commission, any self-regulatory organization of which it is a member, or any State securities regulator having jurisdiction over the member, broker or dealer to download information kept on the broker's or dealer's electronic storage media to any medium acceptable under Rule 17a-4.

Furthermore, the undersigned hereby undertakes to take reasonable steps to provide access to information contained on the broker's or dealer's

electronic storage media, including, as appropriate, arrangements for the downloading of any record required to be maintained and preserved by the broker or dealer pursuant to Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 in a format acceptable to the staffs of the Commission, any self-regulatory organization of which it is a member, or any State securities regulator having jurisdiction over the member, broker or dealer. Such arrangements will provide specifically that in the event of a failure on the part of a broker or dealer to download the record into a readable format and after reasonable notice to the broker or dealer, upon being provided with the appropriate electronic storage medium, the undersigned will undertake to do so, as the staffs of the Commission, any self-regulatory of which it is a member, or any State securities regulator having jurisdiction over the member, broker or dealer may request." [Emphasis added.]

The provision, to put it bluntly, is intended to ensure that if regulators who seek immediate access to a broker-dealer's electronic records conclude that the broker-dealer is being less than cooperative, they can turn to a third-party with the ability to provide access to the records. The principal difficulty with the D3P provision is that the Commission has provided little guidance regarding the meaning of "access to and the ability to download information". While a member of the Commission's Division of Market Regulation has told an industry conference that 17a-4(f)(3)(vii) does not require that the D3P physically control or possess the electronic records, the Commission has provided no other guidance in this regard. The concept of having "access to and the ability to download information" can be viewed along a spectrum from handing Commission staffers

a user manual for the software utilized by the broker-dealer to store records electronically to the other extreme whereby the D3P physically possesses the electronic records that can be searched and downloaded for the benefit of regulators upon their request.

Perhaps it should come as no surprise that a staff member of the Division of Market Regulation recently has suggested that the rule requires the D3P to provide assistance of a sort that is closer to the latter hypothetical rather than the former. While the Commission still does not maintain that the D3P must maintain physical possession of electronic records, the Division of Market Regulation indicated in a telephone call with the author that if the Commission calls upon such an undertaking, it expects the D3P to visit the premises of the broker-dealer with the Commission and to have available to it all the administrative tools, user names, passwords and the like necessary to allow it to access the storage system, search its contents effectively and download necessary information as requested by the regulators.

Practical Tips: This, of course, raises a host of issues regarding the sorts of "sidebar" arrangements that may need to be made between the broker-dealer and the D3P. Thus, for example, there may need to be a letter agreement between them providing for such protections as: (1) a promise by the broker-dealer to provide access to its premises and systems in the event the regulators call upon an undertaking; (2) a promise by the broker-dealer to allow the D3P an opportunity to visit the facilities and test its access to the system periodically (e.g., once a year); (3) a promise by the broker-dealer to pay reasonable out-of-pocket costs (such as travel, hotel, food, etc.) in the event the D3P is called upon to discharge the undertaking; and (4) an indemnity by the broker-dealer in the event of a third-party claim arising from the D3P's access of the data and downloading of the data for the regulators as required under the undertaking.

SEC II: SEC Proposes Rule to Exempt Certain Thrift Institutions from Investment Adviser Requirements

U.S. Securities and Exchange Commission, [Proposed Rule: Certain Thrift Institutions Deemed Not To Be Investment Advisers](#) (Apr. 30, 2004).

U.S. Securities and Exchange Commission, [SEC Proposes Thrift Exception From Advisers Act, Comprehensive Disclosure Requirements for Asset Backed Securities](#) (Apr. 28, 2004).

Comments due on or before July 9, 2004.

On April 28, the U.S. Securities and Exchange Commission voted to propose a new rule under the Investment Advisers Act of 1940 that would address application of the Act to certain thrift institutions and a new rule under the Securities Exchange Act of 1934 addressing thrift institutions' collective trust funds. In effect, under the proposal, thrift institutions that provide investment advice in connection with certain trust department fiduciary services would be excepted from the '40 Act so long as the services are provided by the thrift solely in its capacity as trustee, executor, administrator or guardian in connection with customer accounts created and maintained for fiduciary purposes. Thrifts also would be excepted to the extent they provide such services to their collective trust funds excepted under the '40 Act. In addition, under proposed rule 12g-6, thrift institutions' collective trust funds would be exempt from the registration and reporting requirements of the Exchange Act just as is the case with thrift-sponsored common trust funds.

Thrifts that provide advisory services beyond the new exceptions would be required to continue to be registered with the Commission, but could apply the '40 Act only to accounts that fall outside the new exceptions.

SEC III: SEC Proposes Overhaul of the Registration, Disclosure and Reporting Requirements for Asset-Backed Securities

U.S. Securities and Exchange Commission, [Proposed Rule: Asset-Backed Securities](#), Release Nos. 33-8419, 34-49644 (Apr. 30, 2004).

U.S. Securities and Exchange Commission, [SEC Proposes Thrift Exception From Advisers Act, Comprehensive Disclosure Requirements for Asset Backed Securities; Adopts Supervision Programs for Broker-Dealers and Affiliates](#), News Release No. 2004-58 (Apr. 28, 2004).

After years of work, on April 28, the U.S. Securities and Exchange Commission voted to propose new and amended rules and forms intended to overhaul the registration, disclosure and reporting requirements for asset-backed securities under the Securities Act of 1933 and the Securities Exchange Act of 1934. The Commission seeks more disclosure intended to inform investors of the risks of such securities and to require more disclosure about their past performance. The proposals would:

Update and clarify the Securities Act registration requirements for offerings of asset-backed securities and include requirements for registration of asset-backed securities on Forms S-1 or S-3;

expanding the types of asset-backed securities that may conduct delayed primary offerings on Form S-3;

Consolidate and codify existing interpretive positions that allow modified Exchange Act reporting that the Commission says is more tailored and relevant to asset-backed securities;

Provide what the Commission describes as "tailored disclosure guidance and requirements for Securities Act and Exchange Act filings involving asset-backed securities; and

Streamline and codify existing interpretive positions that permit the use of written communications in a registered offering of asset-backed securities in addition to the statutory registration statement prospectus.

SEC IV: SEC Implements Mandatory Online Filing of Form ID

U.S. Securities and Exchange Commission, [Final Rule: Mandated Electronic Filing for Form ID](#), Release Nos. 33-8410, 34-49585, 35-27837, 39-2420, IC-26241 (Apr. 21, 2004).

U.S. Securities and Exchange Commission, [Correction to Final Rule: Mandated Electronic Filing for Form ID](#), Release Nos. 33-8410, 34-49585, 35-27837, 39-2420, IC-26241 (Apr. 26, 2004).

U.S. Securities and Exchange Commission, [Mandated Electronic Filing of EDGAR Access Applications](#), News Release 2004-54 (Apr. 22, 2004).

[EDGARLink Filer Manual](#) (Vol. I) Rel. 8.7 (Effective Date: Apr. 26, 2004).

U.S. Securities and Exchange Commission, [EDGAR Release 8.7 Implemented!](#) (Apr. 26, 2004).

Effective April 26, the U.S. Securities and Exchanged Commission updated EDGAR primarily to support the mandatory electronic filing of Form ID, the application for access codes to file on EDGAR, via a new EDGAR Filer Management Web site. In connection with the update, the Commission released EDGARLink Filer Manual (Vol. I) Release 8.7.

Previously, Rule 10 of Regulation S-T required Forms ID to be filed on paper. The new rule not only mandates electronic filing, but also makes hardship exemptions unavailable to Forms ID. The Commission now requires that the form be supplemented with additional verification to help ensure the security of the system. Thus, Regulation S-T was amended to require applicants to "file in paper by fax within two business days before or after electronically filing Form ID

a notarized document, manually signed by the applicant over its typed signature, that includes the information contained in the Form ID filed or to be filed and confirms the authenticity of the Form ID." The Commission has stated that it eventually "will replace this procedure with a requirement that applicants used a certificate from a certification authority to authenticate their Form ID filings." Filers reportedly must fax a signed copy of the online version of the Form ID.

Practical Tips: The SEC still has not worked out all the kinks in its internal process yet and it seems to be taking longer to obtain codes than it did before. Filers planning to submit IPOs should apply for codes WELL in advance of their anticipated filing dates. They should check early to see if their Section 16 insiders have or need codes. For insiders who already have codes, they should connect with the IR Departments of the other companies as to which they are insiders to obtain the codes. For filers who have no codes, they should apply well before the S-1 goes effective. There also seems to be some confusion about the "notarized authenticating document". One way to satisfy the authenticating document requirement after electronic filing is to use a print-out of the Form ID application acknowledgement generated by the EDGAR Filer Management Web site. To use the printout to satisfy the requirement, the applicant must notarize the printout and add an authenticity confirming statement. Before faxing the printout, the applicant also should make illegible the passphrase that appears on it (as it should be kept highly confidential). Please note as well that the adopted amendment, unlike the initial proposal, also includes a requirement to place in the notarized authenticating document the accession number of the related electronic Form ID filing when electronic filing occurs first.

SEC V: SEC Proposes To Prohibit Use of Form S-8 by Shell Companies To Deter Fraud and Abuse

U.S. Securities and Exchange Commission, [Proposed Rule: Use of Form S-8 and Form 8-K by Shell Companies](#), Release Nos. 33-

8407, 34-49566 (Apr. 15, 2004).

On April 15, the Commission released the text of proposed rule amendments intended to minimize fraud and abuse in the securities markets through use of "shell companies". The Commission proposes to amend Form S-8 to prohibit use of the form by reporting shell companies. The Commission proposes to define a "shell company" as a company with no operations or nominal operations, and with no assets, nominal assets or assets consisting solely of cash and cash equivalents. In addition, the proposal would amend Form 8-K to require such a shell company, when reporting an event that "causes it to cease being a shell company," to file the same type of information with the Commission that it otherwise would be required to file if it registered a class of securities under the Exchange Act.

According to the Commission, the proposed rule and form amendments target two types of shell company transactions:

"The first type of transaction involves the use of Form S-8 registration statements by reporting shell companies to circumvent the registration and prospectus delivery requirements of the Securities Act. Form S-8 may be used only to register securities for offer and sale in connection with employee benefit plans. The use of Form S-8 by registrants to raise capital is prohibited. Some shell companies-which rarely have employees-have used Form S-8 registration statements improperly to register sales of securities that, while fashioned as sales under employee benefit plans, in fact are capital-raising transactions. . . .

The second type of reporting shell company transaction we address in the proposed rules involves the use of Form 8-K to report 'reverse merger' and other transactions in which a reporting shell company combines with a formerly private operating business, with

the surviving entity becoming a reporting company in the business formerly conducted by the private business."

SEC VI: SEC General Counsel Speaks on Commission's Regulation of Lawyers Under Section 307 of Sarbanes-Oxley

U.S. Securities and Exchange Commission, [Speech by SEC Staff: Remarks Before the American Bar Association Section of Business Law 2004 Spring Meeting by Giovanni P. Prezioso](#) (Apr. 3, 2004).

On April 3, SEC General Counsel Giovanni P. Prezioso spoke before the American Bar Association Section of Business Law. He spoke on the topic of the Commission's regulation of lawyers under Section 307 of the Sarbanes-Oxley Act. In his remarks, Mr. Prezioso sidestepped the issue of the Commission's early proposal to require attorneys to disclose directly to the Commission in certain circumstances misconduct by a public company. Rather, the focus of his remarks revolved around the "permissive disclosure" provisions of the applicable rules.

In his remarks, Mr. Prezioso argued that the Commission's rules in this regard arise from "well-established principles" that prohibit attorneys from participating in illegal conduct detrimental to the interests of a corporate client and that obligate lawyers to put the interests of their "corporate clients, and thereby investors," ahead of the interests of the individual officers and directors. Using what he described as a simplified version of a true story, Mr. Prezioso discussed State law rules of professional responsibility and the support they provide for the Commission's decision to implement the up-the-ladder reporting rules. He noted, however:

"But what happens if reporting 'up the ladder' doesn't stop the fraud? How should a lawyer fulfill the duty to serve the interests of the client organization if the officers and directors are betraying

those interests? One potential approach is for the lawyer to 'report out' the violation to the Commission or another authority -- an approach that is permitted in some circumstances in the vast majority of states and is now permitted under the ABA's Model Rules.

Under the ABA's Model Rule, adopted last summer, a lawyer may in some cases reveal confidential information relating to his representation to the extent necessary to prevent substantial injury to an organization, if the highest authorities in the organization fail to address a clear violation of law. The ABA's formulation of its model rule differs somewhat from the Commission's permissive disclosure rule. It addresses, however, a similar -- and limited -- set of circumstances: not 'ratting out' a client simply to reveal past misconduct, but rather disclosing information to prevent or remedy substantial harm to the organization that may result from serious violations of law."

In further defending the Commission's permissive disclosure rules, Mr. Prezioso argued that principles of agency and fiduciary duties support the rules as well. He noted that in most cases, "a lawyer will be acting as an agent of a corporate client and, as such, has a fiduciary duty to act in the interests of the corporation." Additionally, he argued that such a lawyer "will also generally have a responsibility not to assist any other agents or fiduciaries, such as officers and directors, in betraying the interests of the corporation."

Finally, Mr. Prezioso argued that lawyers themselves must comply with the federal securities laws and that the provisions prohibiting persons from aiding and abetting violations of the securities laws may come into play. While providing a passing nod to the 1994 decision by the Supreme Court of the United States in the *Central Bank* case, Mr. Prezioso added that while aiding and abetting liability "has not been in the forefront of lawyers' minds . . . the

Commission retains the authority to bring enforcement actions against those who aid and abet violations of the Exchange Act. And I want to assure you, in the eyes of the Commission enforcement staff, aiding and abetting liability is alive and well."

SEC VII: SEC Bars Ernst & Young from Accepting New Public Company Clients for Six Months, Then Issues "Further Guidance"

In the Matter of Ernst & Young LLP, Admin. File No. 3-10933, [Initial Decision](#) (Apr. 16, 2004).

In the Matter of Ernst & Young LLP, Admin. File No. 3-10933, [Order Granting Motion for Expedited Entry of Final Order and Notice that Initial Decision Has Become Final](#) (Apr. 26, 2004).

[Letter from Donald T. Nicolaisen, Office of the Chief Accountant, to Mr. James Turley \(CEO of Ernst & Young LLP\) Regarding the Initial Decision In the Matter of Ernst & Young LLP, April 16, 2004](#) (Apr. 27, 2004).

On April 26, the SEC issued an order of finality rendering final an April 16 decision by an administrative law judge barring Ernst & Young LLP from accepting new public company clients for six months. The issue before the administrative law judge was whether E&Y was independent "in fact and appearance" when it audited PeopleSoft's financial statements for fiscal years 1994 through 1999 in view of "business relationships with PeopleSoft, involving EY's consulting group". The administrative law judge concluded that in connection with the engagements, E&Y violated the Commission's rules on auditor independence. The order further included cease-and-desist provisions as well as provisions requiring disgorgement of \$1.7 million (reportedly the amount of its fees).

In a highly unusual follow-up to the matter, on April 27, the SEC's Office of the

Chief Accountant made publicly available a letter it issued to E&Y's CEO providing "further guidance" on the order entered against E&Y, apparently in response to questions received from registrants and from E&Y. The letter stated that the purpose of the six-month bar "is to obtain the remedial effect of the suspension as to E&Y, without unduly burdening registrants from a financial or operational standpoint". The letter provided guidance on such issues as the cut-off date for when a party would or would not be considered to be a pre-existing E&Y client (April 16, the date of the administrative law judge's decision) and examples of scenarios that the Commission would not deem to involve "new Commission registrant audit clients" under the terms of the ALJ's decision.

PRACTICAL GUIDANCE: Courtesy of RealCorporateLawyer.com

Every day 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 just the last few weeks, RealCorporateLawyer -- a free service -- has provided its readers with easy access to the following memoranda:

Morrison & Foerster, [SEC Adopts Quarterly Disclosures for Issuer Stock Repurchases and Modifies Rule 10b-18 Safe Harbor Conditions](#) (Apr. 19, 2004) Paul Weiss, [SEC Proposes Accommodations to Address First-Time Application of IFRS for Foreign Issuers](#) (Apr. 8, 2004)
Nixon Peabody, [SEC Investigations: How Much Cooperation is Enough?](#) (04/08/2004) Paul Weiss, [Update: Rule 12g3-2\(b\) Exemption from SEC Reporting](#) (Apr. 8, 2004).

In addition to all of this, RealCorporateLawyer.com updates its FAQs on important issues. This month the [Rule 10b5-1 FAQs](#) have been updated.

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

On May 3, the Commission announced the appointment of **Nancy M. Morris** as an Attorney-Fellow for a two-year term. Ms. Morris formerly served as Vice President and Associate Legal Counsel of T. Rowe Price Associates, Inc. in

Baltimore. See U.S. Securities and Exchange Commission, [Nancy Morris Named Attorney-Fellow in the Division of Investment Management](#), News Release 2004-60 (May 3, 2004).

On April 29, the New York Stock Exchange announced that it has appointed **Margaret Tutwiler** as Executive Vice President for Communications and Government Relations effective July 12. Currently Ms. Tutwiler serves as U.S. Undersecretary of State for Public Diplomacy and Public Affairs. See New York Stock Exchange, [NYSE Appoints Margaret Tutwiler as Executive Vice President; Ambassador Tutwiler is U.S. Undersecretary of State for Public Diplomacy and Public Affairs](#) (Apr. 29, 2004).

William Lenox was appointed as the SEC's Ethics Counsel in charge of the Commission's Ethics Office on April 26. He will also serve as the Commission's Designated Agency Ethics Official. See U.S. Securities and Exchange Commission, [William Lenox Named Ethics Counsel](#), News Release 2004-57 (Apr. 26, 2004).

On April 26, the SEC announced the appointment of **Peter H. Bresnan** as an Associate Director in the Division of Enforcement. He reportedly will serve as a senior official in the Division of Enforcement and will assist in planning and directing the Commission's investigations and other enforcement efforts. Since November 2001, Mr. Bresnan served as the Deputy Chief Litigation Counsel in the Division of Enforcement. See U.S. Securities and Exchange Commission, [Peter Bresnan Named Associate Director of the Division of Enforcement](#), News Release 2004-56 (Apr. 26, 2004).

The Office of the Chief Accountant of the SEC announced on April 23 that **Jonathan Glover** and **Audrey Gramling** have been selected as Academic Accounting Fellows for one year terms scheduled to begin in August. Jonathan Glover is a Professor of Accounting in the Graduate School of Industrial Administration at the Carnegie Mellon University. Audrey Gramling is an Assistant Professor of Accountancy in the School of Accountancy at Georgia State University. See U.S. Securities and Exchange Commission, [Jonathan](#)

[Glover and Audrey Gramling Have Been Named Academic Accounting Fellows, Office of the Chief Accountant](#), News Release 2004-55 (Apr. 23, 2004).

The New York Stock Exchange announced on April 12 that **Amy S. Butte**, Executive Vice President - Corporate Finance, has assumed the role of Chief Financial Officer effective immediately. She succeeds **Keith R. Helsby**. See New York Stock Exchange, [Amy S. Butte Named Chief Financial Officer, NYSE](#) (Apr. 12, 2004).

On April 8, the Public Company Accounting Oversight Board announced that **Sara Bridwell** has joined the Board's staff as its Director of Human Resources. She previously served in the Human Resources Department of PricewaterhouseCoopers. See Public Company Accounting Oversight Board, [Board Hires Director of Human Resources](#) (Apr. 8, 2004).

The New York Stock Exchange announced on April 7 that it has appointed **Andrew T. Brandman** as Vice President, Financial Process Transformation. He "will be charged with identifying and implementing business process and technology solutions related to the NYSE's financial strategy." See New York Stock Exchange, [NYSE Appoints Andrew T. Brandman as Vice President, Financial Process Transformation](#) (Apr. 7, 2004).

On April 6, the New York Stock Exchange announced that its Board of Directors has approved the appointment of **Carly Fiorina** (Chairman and CEO of Hewlett-Packard) and **Jeffrey W. Greenberg** (Chairman and CEO of Marsh & McLennan) as members of the NYSE's Board of Executives, an advisory panel made up of NYSE constituents. See New York Stock Exchange, [NYSE Appoints Two Members to Board of Executives](#) (Apr. 6, 2004).

What Are the Commissioners Saying? SEC Chairman **William H. Donaldson** delivered an "[Opening Statement at April 28, 2004 Open Meeting](#)" regarding asset-backed securities, among other things. Chairman Donaldson also delivered "[Remarks Before the Investment Counsel Association of America](#)" on April 22 regarding various initiatives of the Commission's Divisions. On April 21, Chairman Donaldson delivered an "[Opening Statement at the Regulation NMS](#)

[Hearing](#)". Similarly, Chairman Donaldson delivered "[Introductory Remarks at April 13, 2004 Open Meeting](#)" regarding use of Forms S-8 and 8-K by shell companies, among other topics.

What Are the Commission Staffers Saying? On April 29, **Stephen M. Cutler** spoke at the [24th Annual Ray Garrett Jr. Corporate & Securities Law Institute](#). He spoke on the Commission's "penalty authority". OCIE Director **Lori A. Richards** spoke April 14, 2004 at the NRS Annual Spring Compliance Conference on "[The Need for More Proactive Risk Assessment](#)." During the open Commission meeting on April 13, **Paul F. Roye** spoke on "[Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings](#)". On April 3, SEC General Counsel **Giovanni P. Prezioso** delivered "[Remarks before the American Bar Association Section of Business Law 2004 Spring Meeting](#)" regarding the regulation of lawyers under Section 307 of the Sarbanes-Oxley Act. On April 2, Paul F. Roye delivered "[Remarks Before the 2004 New Directors Workshop](#)" regarding "Mutual Fund Scandals: Lessons for Fund Directors".

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