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SEC I: SEC Says It Has Complied with Court Order and Has Filed Report Regarding Mutual Fund Governance Rule

U. S. Securities and Exchange Commission, [SEC Complies With Court Order on Mutual Fund Governance Rule](#), News Release 2006-95 (June 13, 2006).

U. S. Securities and Exchange Commission, [Request for Additional Comment](#), Release No. IC-27395 (June 13, 2006).

[Letters In Response to Court Decision](#)

On April 7, 2006, the United States Circuit Court of Appeals for the District of

Columbia Circuit invalidated certain amendments adopted by the SEC to rules under the Investment Company Act of 1940 dealing with mutual fund governance issues. The amendments that were first proposed on January 15, 2004 provide that: (1) at least 75% of the members of mutual fund boards would have to be independent; and (2) such boards would have to be chaired by an independent director.

The Court held that the Commission failed to seek comment on the data used to estimate the costs of the amendments, but it suspended issuance of its mandate to give the SEC an opportunity to request further comment. The Commission issued a [release](#) soliciting such comment on June 13. The same day, the Commission filed a status report with the Court stating that it has complied with the Court's order by "soliciting comment on costs as well as 'any issue related to the underlying purpose of the independence requirements, which is the protection of funds and fund shareholders".

As of June 28, the Commission states that it has received thirteen comment letters. [They may be viewed here.](#)

SEC II: SEC Brings Its First Ever Enforcement Action Under the USA PATRIOT Act

U. S. Securities and Exchange Commission, [SEC Orders Crowell, Weedon to Comply with Anti-Money Laundering Law](#), News Release 2006-78 (May 22, 2006).

In the Matter of Crowell, Weedon & Co., Rel. No. 53847, [Order Instituting Cease-and-Desist Proceedings Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934](#) (May 22, 2006).

On May 22, the SEC announced that it has brought its first ever enforcement action under the USA PATRIOT Act against Crowell, Weedon & Co., a Los Angeles brokerage firm. The settled administrative proceeding resulted in

sanctions against the firm "for failing properly to document its customer identification program."

In its announcement, the Commission stated, in part, as follows:

"From October 2003 to at least late April 2004, Crowell, Weedon failed to document its actual customer identity verification procedures in its written customer identification program (CIP). During this period, the firm opened approximately 2,900 new accounts for customers. In verifying the identities of those customers, Crowell, Weedon simply relied on its registered representatives' attestations that they had personal knowledge of the customers opening the new accounts. This practice was not documented in the firm's written CIP.

Rather, Crowell, Weedon's written CIP specified that it would verify the identity of each new customer using certain non-documentary and documentary procedures, such as a public database search and reviewing a government issued identification."

The firm neither admitted nor denied the Commission's findings, but consented to the issuance of an order that it cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-8 thereunder.

RealCorporateLawyer.com is pleased to make memoranda on these developments available to its readers. *See:*

[The First PATRIOT Act Enforcement Action by the SEC Against a Broker-Dealer by Thacher Proffitt & Wood LLP](#) (June 2006).

[SEC Brings its First Ever Enforcement Action Under the USA PATRIOT Act Against Crowell, Weedon & Co. by Morrison Foerster](#) (May 2006).

SEC III: Stock Options Dating Investigations Grow

Media coverage of the stock options dating investigations seems to have reached a fevered pitch as dozens of companies are now being investigated by the SEC, the Department of Justice and the Internal Revenue Service. The issue, of course, is not merely one of alleged "backdating" from the actual grant date. Other possible scenarios may include: (1) instances where the date a board or committee decides to grant options is used as the date of the options although certain corporate formalities such as formal consents are not completed until a later date; (2) options granted to a person who agreed on a particular date to join the company but actually begins employment later; (3) options granted immediately prior to announcements of good news; (4) delaying option grants until immediately after announcements of bad news that depress the stock price; and (5) used of falsely backdated option exercise dates.

To make matters more interesting, on June 26 after giving a speech at Stanford University, SEC Chairman Christopher Cox reportedly told members of the media that "We expect to publish guidance this summer at the same time we vote on our final rules for executive compensation. The executive compensation rule will almost certainly contain some specific features dealing with options back-dating". RealCorporateLawyer.com is pleased to make memoranda on the stock options back-dating investigations available to its readers. To learn more, *see*:

[Tax Issues Arising Out of Stock Options Back-Dating Investigations from Morrison & Foerster](#) (Jun. 26, 2006).

[Backdating of Stock Options by Thacher Proffitt & Wood LLP](#) (Jun. 2006).

["Options Backdating" Issues Heat Up by Morgan Lewis](#) (Jun. 1, 2006).

[The Next Big Scandal? Stock Option Practices Under Scrutiny by Covington & Burling](#) (May 26, 2006).

[Stock Options Back-Dating Investigations by Morrison Foerster](#)

(May 2006).

SRO I: NYSE Releases Report and Recommendations of the Proxy Working Group

New York Stock Exchange, [Report and Recommendations of the Proxy Working Group to the New York Stock Exchange](#) (Jun. 5, 2006).

On June 5, the New York Stock Exchange released a preliminary report and recommendations prepared by the Proxy Working Group it created last year. The report seems to focus principally on Rules 452 and 465. With respect to Rule 452 (broker proxy voting), the report recommends: (1) the NYSE should amend the rule to make election of directors a "non-routine" matter; (2) the NYSE should take a leading role in efforts to educate investors about the proxy voting system; (3) the NYSE should support efforts to improve the ability of issuers to communicate with beneficial owners; and (4) the NYSE should continue to evaluate the effectiveness and necessity of broker discretionary voting following the amendment of Rule 452 to make the election of directors a "non-routine" matter.

With respect to Rule 465 (reimbursement of broker proxy distribution expenses), the report recommends: (1) the NYSE should engage an independent third party to analyze and make recommendations regarding the structure and amount of fees paid pursuant to Rule 465; and (2) the NYSE should consider commissioning an economic study of the existing payment and mailing system to determine its utility given changes in technology.

In addition, the report recommends that the NYSE should ask the SEC to study the role of groups making voting decisions over shares they do not own or in which they do not have an economic interest.

SRO II: NASDAQ Stock Market's Proposal to Modify Cure Period Following Loss

of Independent Director or Audit Committee Member Released by SEC

U.S. Securities and Exchange Commission, [The NASDAQ Stock Market LLC; Notice of Filing of a Proposed Rule Change to Modify the Cure Period Available to an Issuer that Loses an Independent Director or Audit Committee Member](#), Release No. 34-53941 (Jun. 5, 2006).

On June 5, the SEC released for public comment The NASDAQ Stock Market's proposal to modify the cure period available to an issuer that loses an independent director or audit committee member leading to the issuer's inability to comply with NASDAQ's requirements that a majority of the board must consist of independent directors and at least three independent directors must sit on the audit committee.

The proposal is to permit an issuer at least 180 days from the date it first fails to comply with the independent director or independent audit committee member requirements.

LITIGATION I: U.S. Court of Appeals for D.C. Circuit Rejects SEC's Rules Regulating Hedge Funds

Phillip Goldstein, et al. v. SEC, [Opinion](#), No. 04-1434 (D.C. Cir. Jun. 23, 2006).

U.S. Securities and Exchange Commission, [Statement of Chairman Cox Concerning the Decision of the U.S. Court of Appeals in Phillip Goldstein, et al. v. Securities and Exchange Commission](#), News Release 2006-101 (Jun. 23, 2006).

U.S. Securities and Exchange Commission, [Final Rule: Registration Under the Advisers Act of Certain Hedge Fund Advisers](#), Release No. IA-2333 (Dec. 2, 2004) ([Federal Register PDF](#)).

U.S. Securities and Exchange Commission, [Dissent of Commissioners Cynthia A. Glassman and Paul S. Atkins to the Registration Under the Advisers Act of Certain Hedge Fund Advisers](#) (Dec. 2, 2004).

On June 23, the United States Court of Appeals for the District of Columbia Circuit released its decision in Phillip Goldstein, et al. v. Securities and Exchange Commission. In what was viewed by many as a rather stunning setback for the Commission, the Court struck down the Commission's so-called "Hedge Fund Rule". Essentially the petition for review before the Court asserted that the regulation improperly equated "client" with "investor" as a way to subject to regulation hedge fund advisory firms that were previously exempt from registration because they had "fewer than fifteen clients". The Court agreed, holding the rule to be arbitrary and, thus, vacating the rule. The Court wrote:

"The Commission reasons that because hedge funds are now national in scope, treating the entity as a single client for the purpose of the exemption would frustrate Congress's policy. If Congress did intend the exemption to prevent regulation only of small-scale operations -- a policy goal that is clear from neither the statute's text nor its legislative history -- the Commission's rule bears no rational relationship to achieving that goal. The number of investors in a hedge fund -- the 'clients' according to the Commission's rule -- reveals nothing about the scale or scope of the fund's activities. It is the volume of assets under management or the extent of indebtedness of a hedge fund or other such financial metrics that determines a fund's importance to national markets. One might say that if Congress meant to exclude regulation of small operations, it chose a very odd way of accomplishing its objective - by excluding investment companies with one hundred or fewer investors and investment advisers

having fewer than fifteen clients. But the *Hedge Fund Rule* only exacerbates whatever problems one might perceive in Congress's method for determining who to regulate. The Commission's rule creates a situation in which funds with one hundred or fewer investors are exempt from the more demanding Investment Company Act, but those with fifteen or more investors trigger registration under the Advisers Act. This is an arbitrary rule."

The day the court issued its opinion, the Commission issued a "Statement of Chairman Cox" saying that he has instructed the staff to analyze the decision and provide a list of alternatives available to the Commission. The statement noted that "The SEC takes seriously its responsibility to make rules in accordance with our governing laws" and further noted that the Commission will "continue to work with the other members of the President's Working Group on Financial Markets, including the Treasury, the CFTC, and the Federal Reserve, to evaluate both the systemic market risks and retail investment issues associated with the growing presence of hedge funds in the world's capital markets".

LITIGATION II: Federal Court Holds that Prosecutors Violated Rights of Former KPMG Partners by Pressuring Firm Not To Pay Their Defense Costs

United States v. Jeffrey Stein, et al., [Opinion](#), No. S1 05 Crim. 0888 (LAK) (S.D.N.Y., Jun. 26, 2006).

On June 26, the United States District Court for the Southern District of New York issued a significant opinion in *United States v. Jeffrey Stein, et al.* In it, the Court held that the government violated former KPMG partners' Fifth Amendment substantive due process rights and their Sixth Amendment right to counsel by causing KPMG to cut off payment of legal fees and other defense costs upon their indictment in the KPMG tax shelter investigation. According to the Court, "KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these

defendants' legal expenses."

The decision would certainly seem to suggest that the Justice Department must reconsider its internal policies regarding the criteria it uses in deciding whether to prosecute corporations under federal law for alleged criminal conduct. These criteria are reflected in the so-called Thompson Memorandum which the Court analyzed in great detail in its opinion.

The decision is considered a stunning setback to the government and may have an impact on a host of pending investigations.

LITIGATION III: Delaware Supreme Court Affirms Court of Chancery's Decision Dismissing Shareholder Claims Challenging Board's Decision Regarding Michael Ovitz Severance

The Walt Disney Company Derivative Litigation, C.A. No. 15452,
[Opinion](#) (Del., June 8, 2006).

On June 8, the Delaware Supreme Court issued its long-awaited opinion in The Walt Disney Company Derivative Litigation. The Court ruled that members of the Walt Disney board did not breach their fiduciary duty in connection with the hiring or firing of Michael Ovitz as president of the company. According to the Court, the directors were protected by the business judgment rule since the actions of the Board's compensation committee in approving the terms that governed Ovitz's employment did not constitute conscious dereliction of duty that might support a finding of bad faith against the directors.

RealCorporateLawyer.com is pleased to make available a [memorandum discussing the decision](#) prepared by Wachtell, Lipton, Rosen & Katz. As that memo notes:

"The Delaware Supreme Court's opinion closes a potentially worrisome chapter in the ongoing development of fiduciary duty law with a note that should be comforting to those concerned about the potential spill-over of the oft-rancorous corporate governance

debates into the realm of legal rule and liability standards: that the Delaware courts remain steadfast in drawing the necessary distinctions between 'best practices' and liability-producing behavior, and in eschewing what may sometimes seem the popular fix in favor of the well-tested legal doctrines that have encouraged risk-taking and creation of stockholder value. The opinion likewise reflects that the Delaware courts recognize the reality that the corporate boardroom is at times not a perfect laboratory or even a law school classroom."

PRACTICAL GUIDANCE: Courtesy of RealCorporateLawyer.com

RealCorporateLawyer.com provides 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 "Emerging Legal Issues" area of the home page for such current memoranda, as well as the [Expert Analysis: SEC Reform Portal](#) section containing hundreds of other such memoranda. Recent additions include:

<p>Tax Issues Arising Out of Stock Options Back-Dating Investigations from Morrison & Foerster. (6/26/06)</p>	<p>NYSE Issues Report on Proxy Voting Process: Election of Directors May Become “Non-Routine” Matter from Alston & Bird LLP (6/9/06)</p>
<p>“Gun-Jumping”: How Parties To An Acquisition Can Avoid Illegal Pre-Closing Coordination Activities from Snell & Wilmer L.L.P. 6/26/06</p>	<p>Client Bulletin: Backdating of Stock Options from Thacher Proffitt & Wood LLP. (6/5/06)</p>
<p>Nasdaq Proposes to Extend Cure Period Available for Loss of Independence By a Director from Alston & Bird LLP. (6/26/06)</p>	<p>“Options Backdating” Issues Heat Up from Morgan, Lewis & Bockius LLP. (6/2/06)</p>
<p>Considering Director Independence from Covington & Burling (6/19/06)</p>	<p>Nasdaq Exchange Registration, Member and Issuer Transition Issues from Morgan, Lewis & Bockius LLP (6/1/06)</p>

<p><u>Taking Stock of the Securities Transfer Act from Stikeman Elliott LLP.</u> (6/16/06)</p>	<p><u>The Next Big Scandal? Stock Option Practices Under Scrutiny from Covington & Burling.</u> (5/31/06)</p>
<p><u>Delaware Supreme Court Affirms Disney Case: the Business Judgment Rule Prevails from Wachtell, Lipton, Rosen & Katz</u> (6/13/06)</p>	<p><u>SEC Brings its First Ever Enforcement Action Under the USA PATRIOT Act Against Crowell, Weedon & Co. from Morrison & Foerster LLP.</u> (5/25/06)</p>
<p><u>Majority Voting -- A Look Back at the 2006 Proxy Season from Wachtell, Lipton, Rosen & Katz</u> (6/13/06)</p>	<p><u>Stock Options Back-Dating Investigations from Morrison & Foerster LLP.</u> (5/24/06)</p>
<p><u>The First Patriot Act Enforcement Action By The SEC Against A Broker-Dealer from Thacher Proffitt & Wood LLP.</u> (6/12/06)</p>	

Please don't forget that RR Donnelley has released the latest supplement to its widely-acclaimed SEC Handbook. The full-text searchable supplement is available via RealCorporateLawyer.com and is entitled "[SEC Handbook Supplement: Securities Act of 1933 Offering Reform Final Rules - 17 CFR Parts 200, 228, 229, et al. Effective Date: December 1, 2005](#)". The [Table of Contents](#) for the detailed and exceptionally rich primer on the recently adopted Securities Offering Final Rules shows how detailed and substantial the treatment of the subject is in this 142-page Supplement.

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

On June 26, D2C Solutions announced that former SEC Chief Accountant **Don Nicolaisen**, has accepted a position on its Board of Advisors. *See* [D2C Solutions, Former SEC Chief Accountant Joins D2C Solutions' Board of Advisors](#), PRNewswire (June 26, 2006).

On June 20, Yorkville Advisors announced that former SEC branch chief **Eric Hansen** has joined the firm as Senior Legal Counsel. *See* [Yorkville Advisors Hire Former SEC Branch Chief](#) (June 20, 2006).

On June 19, the SEC announced that Federal Reserve Board Governor **Mark W. Olson** has been appointed Chairman of the five-member Public Company Accounting Oversight Board until 2010. *See* U.S. Securities and Exchange Commission, [Federal Reserve Governor Mark W. Olson Named to Chair Public Company Accounting Oversight Board](#), News Release 2006-97 (June 19, 2006). The same day the Commission announced that founding PCAOB member Kayla Gillan has been reappointed to the Board. *See* U.S. Securities and Exchange Commission, [Public Company Accounting Oversight Board Incumbent Kayla J. Gillan Reappointed to Second Term](#), News Release 2006-98 (June 19, 2006). The SEC also announced on June 6 that **Susan Ferris Wyderko**, Director of the Office of Investor Education and Assistance, will leave the Commission to become Executive Director of the Independent Mutual Fund Directors Forum, a non-profit organization dedicated to improving mutual fund governance. *See* U.S. Securities and Exchange Commission, [Susan Ferris Wyderko, Director of the Office of Investor Education and Assistance, to Leave Commission](#), News Release 2006-88 (June 6, 2006).

Jeffrey Risinger, the SEC's Director of Human Resources, was selected as the Agency's Acting Executive Director as indicated in an announcement released by the Commission on June 5. *See* U.S. Securities and Exchange Commission, [Jeffrey Risinger Designated Acting Executive Director](#), News Release 2006-87 (June 5, 2006).

Also on June 5 the Commission announced that **Andrew N. Vollmer**, who had been a partner with Wilmer Cutler Pickering Hale and Dorr LLP, will serve as the agency's Deputy General Counsel. *See* U.S. Securities and Exchange Commission, [Andrew Vollmer Named SEC Deputy General Counsel](#), News Release 2006-86 (June 5, 2006).

What Are the Commissioners Saying?

On June 22, SEC Chairman **Christopher Cox** delivered Remarks at the Harvard Business School Global Leadership Forum, Washington, DC regarding ["Cross-Border Exchange Mergers in the Context of Global Trade"](#) Commissioner

Annette L. Nazareth delivered "[Remarks Before the NYSE Regulation Second Annual Securities Conference](#)" on June 20. SEC Commissioner **Paul S. Atkins** delivered "[Remarks Before the French Association of Corporate Governance](#)" on June 15. Commissioner **Roel C. Campos** delivered "[Remarks Before the SIA Hedge Funds & Alternative Investments Conference](#)" on June 14. Commissioner Atkins also spoke on June 14, delivering "[Remarks Before the Mutual Fund Directors Forum Members Roundtable with SEC Staff](#)". SEC Chairman Cox delivered "[Videotaped Remarks at the Annual Meeting National Investor Relations Institute](#)" on June 9 and, on June 8, delivered an "[Address to the New York Financial Writers Association](#)". Commissioner Campos spoke on June 8 before IOSCO's 31st Annual Conference regarding "[Bond Markets -- Should Their Transparency be Enhanced?](#)" SEC Commissioner Cynthia A. Glassman spoke on June 8 regarding "[Complexity in Financial Reporting and Disclosure Regulation](#)". SEC Commissioner Atkins delivered "[Remarks at the International Law Association Biannual Conference](#)" on June 7. The same day, SEC Chairman Cox delivered "[Remarks at the American Securitization Forum](#)" and Commissioner Nazareth spoke regarding "[Lifting the Veil - Investment Industry Trading Practices and Best Execution Workshop](#)" at the Mutual Fund Directors Forum. On May 30, Chairman Cox spoke regarding "[The Interactive Data Revolution: Improved Disclosure for Investors, Less Expensive Reporting for Companies](#)". Nearly a week earlier, on May 24, Commissioner Nazareth delivered "[Remarks Before the Securities Industry Association Market Structure Conference](#)". On May 23, Chairman Cox delivered "[Remarks at Joint News Conference with OFHEO](#)". Commissioner Glassman spoke on May 19 before the Bond Market Association regarding "[The Continuing Evolution of the Bond Market and Other Observations](#)". Commissioner Nazareth spoke the same day, delivering "[Remarks Before the 38th Annual Rocky Mountain Securities Conference](#)" and spoke on May 18 as well, delivering "[Remarks Before the NASD Spring Securities Conference](#)".

What Are the Commission Staffers Saying?

On June 20, the SEC's Director of OCIE, **Lori A. Richards**, spoke regarding "[Transparency in Regulatory Examinations](#)". On June 8, the SEC's Acting Chief Accountant, **Scott A. Taub**, spoke at the Leventhal School of Accounting during the SEC and Financial Reporting Institute on June 8 regarding "[The Future of Financial Reporting](#)". Two days before that, he spoke before the SEC Historical Society Annual Meeting regarding "[Looking Forward and Back at Financial Reporting](#)". **John White**, Director of the SEC's Division of Corporation Finance, spoke on May 25 regarding "[Section 404: The Need for Input](#)". On May 23 **Linda Chatman Thomsen**, the SEC's Director of the Division of Enforcement, delivered a "[Statement Regarding Fannie Mae](#)".

Input, Please

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