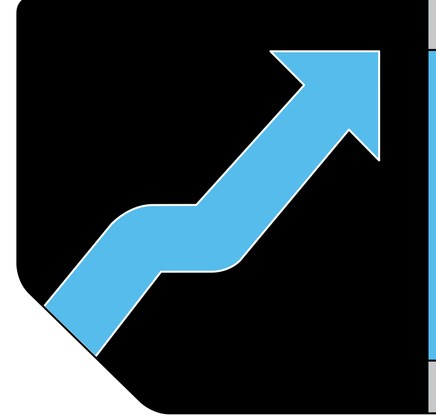
Snell & Wilmer L.L.P.



THE CORPORATE communicator

www.swlaw.com

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The 2009 Annual Meeting Season

contacts

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Dear Clients and Friends,

As always this time of year, we offer you this issue of Snell & Wilmer's Corporate Communicator to help you prepare for the upcoming annual report and proxy season. This issue highlights some of the considerations your company will need to focus on this annual meeting season. If you have any questions about the topics summarized in this issue, please do not hesitate to contact us.

Within this issue, we begin with a brief discussion on executive compensation disclosure rules as they remain an important topic for this annual meeting season in light of the recent economic crisis and the SEC's well-published messages that it will continue to focus on Compensation Discussion and Analysis ("CD&A"). We will also discuss how recent market and economic conditions will affect your disclosure in your Annual Report on Form 10-K. In particular, disclosures about risk management and liquidity and capital resources will take on heightened importance this year in light of the ongoing economic crisis and the risks and uncertainties it creates for all companies. Indeed, throughout this issue you will notice the recurring motif of the affect of the current economic climate and credit crunch on company practices and policies.

We also discuss other key issues facing public companies as they prepare their annual reports and proxy statements, including the latest developments surrounding:

- "say on pay";
- XBRL;
- e-proxy;
- fair value accounting;
- the new Smaller Reporting Company rules;
- the expiration of certain shelf registrations statements;
- International Financial Reporting Standards ("IFRS");
- earnings guidance;
- error corrections and stealth restatements;
- risk oversight;
- certain New York Stock Exchange and NASDAQ rule changes; and
- important developments from the SEC's Division of Enforcement.

During 2009, members of our Business & Finance group will continue to publish the Corporate Communicator, host business roundtables, participate in seminars that address key issues of concern to our clients, and sponsor conferences and other events targeted toward specific types of companies. First on the calendar is Snell & Wilmer's 2009 Public Company Roundtable on January 8, 2009. A copy of the invitation is included at the end of this publication.

Finally, we are also including in this issue a tombstone page that highlights selected deals that Snell & Wilmer's Business & Finance Group closed during a successful 2008. As always, we appreciate your relationship with Snell & Wilmer, and look forward to helping you make 2009 a successful year for your company as you navigate the challenging economic times that we all find ourselves in.

Very truly yours,
Snell & Wilmer L.L.P.
Business & Finance Group

Snell & Wilmer

RECENT BUSINESS & FINANCE TRANSACTIONS

Debt Offerings and Credit Agreements

$400 million
Secured Credit Facility

DriveTime
$385 million
Secured Credit Facility

DriveTime
$180 million
Loan Sale

DriveTime
$60 million
Securities Repurchase Credit Facility

DriveTime
$55 million
Junior Secured Debt

Meritage Homes
$500 million
Amended Revolving Credit Facility

$210 million
Receivables Securitization

$50 million
Revolving Credit Facility

$12 million
Secured Notes Restructuring

Mergers and Acquisitions

$4 billion
Renewable Energy Purchase and Sale Agreement with Arizona Solar One

$3.5 billion
Special Counsel in Sale to Roche Pharmaceuticals

Sale to Flowers Foods, Inc.

Sale to Caris Diagnostics

$50 million
Acquisition of California Division of Public Staffing Company

Sale to Elster, Inc.

$5 million
Sale to Global Med Technologies, Inc. (OTCBB: GLOB)

Sale to The Knot, Inc. (NASDAQ: KNOT)

Acquisition of Williams Foods, Inc.

$6.5 million
Sale of Business Unit to OneNeck IT Corporation

Asset Purchase of eBI Solution, LLC

Sale to Sonapar USA

Sale to Private Equity Fund (Heritage Partners) and Related Debt Recapitalization

$9 million
Sale to Inlign Capital

MAGNETEK
$1.3 million
Sale of Telecom Power Systems Division

Sale of Majority Ownership to Two Private Equity Groups

Sale to 3M

$3.3 million
Acquisition of Assets of Enrange LLC

The GROUNDSKEEPER
Purchase of Greater Texas Landscapes

$12 million
Acquisition of Tusonix Inc.

Finley Distributing Co., Inc.
Sale of Miller Beer Distributorship

Wholesale Floors, Inc.
Investment by Triangle Capital

Apogee USA LLC
Sale to Talex Development Group, LLC

Continental Residential Investments, LLC (dba Homesmart)
Acquisition of Dan Schwartz Realty, Inc.

eTelecare Global Solutions, Inc.
Formation of Joint Venture with Almori B PO Services

UCSC Ltd. Co.
Sale of Assets to Bay Systems North America LLC

TLC Casino Enterprises, Inc.
$28 million
Acquisition of Binion's Gambling Hall & Hotel

Adtron Corporation
$35 million
Sale to Smart Modular Technologies, Inc.

Venture Capital and Equity Transactions

Acquisition of Assets of Tattoos Manufacturing, Inc. and Related Senior and Mezzanine Financing

emerald Technology Ventures
$3 million
Investment in Series A-2 Convertible Preferred Stock of SDC Materials, Inc.

OrthoScan
$7.5 million
Private Placement of Series B Convertible Preferred Stock

PENINSULA EQUITY PARTNERS
$3 million
Series A-1 Investment in Response Analytics, Inc.

TELESPHERE
$11.4 million
Sale of Series B-1 Preferred Stock

Series A Financing

SpinFry, Inc.
$2.3 million
Series B Preferred Stock Finance

Diamondback Tactical
$4.2 million
Sale of Series B Convertible Preferred Stock and Warrants

Callaway Consumer Products, LLC
Private Placement of Series B Convertible Preferred Units

Xthetix, Inc.
Private Placement of Series A-1 Convertible Preferred Stock

Fund Formations

MarketplaceOne
Real Estate and Private Equity Opportunity Fund

TRAC Translational Accelerator Fund
$20 million
Life Sciences Fund

DENVER | LAS VEGAS | LOS CABOS | ORANGE COUNTY | **PHOENIX** | SALT LAKE CITY | TUCSON

Issues Affecting Your 2008 Annual Report and the Upcoming Proxy Season

by Jeffrey Beck, Franc Del Fosse and Travis Leach

Executive Compensation Disclosure

In some ways it seems like the executive compensation disclosure rules have been around for an eternity but, surprisingly, November only marked the two year anniversary of their effectiveness. In October 2008, John White, the Director of the Division of Corporation Finance of the United States Securities & Exchange Commission ("SEC"), gave remarks that reiterated the areas of focus for the SEC staff on executive compensation disclosure. While the takeaways from these remarks are consistent with prior advice given on the topic, we believe that it is germane to discuss this address as Mr. White's remarks look forward to the changing landscape for 2009 in light of current economic conditions.

Mr. White's remarks echo previous SEC guidance, which is that issuers need to improve Compensation Discussion and Analysis ("CD&A") disclosure by concentrating on:

Meaningful analysis
Companies need to focus on providing "meaningful analysis" on the "how" and "why" of specific executive compensation decisions. The CD&A is a principles-based discussion that requires companies to provide investors all the material information that is necessary to an understanding of the issuer's compensation policies and decisions with respect to named executive officers. For instance, this year, Mr. White made clear that companies will need to carefully consider if and how recent economic events impact their compensation program. Companies should also consider tailoring their disclosure in light of negative public sentiment to perceived exorbitant compensation. For example, justification/explanation of change-in-control arrangements.

Performance targets
Companies have wrestled with this topic over the past couple years and in its last thorough review of annual meeting proxy statements, the SEC staff indicated that they issued more comments regarding performance targets than any other disclosure topic. Given that the SEC seems to be trying to limit situations where companies do not disclose performance targets and investors are calling for transparency in this economic climate, the decision to not disclose your performance targets will require some forethought. Once a company determines performance targets are a material element of its compensation policies and decisions, then the company is required to disclose these performance targets *unless* it is able to demonstrate that disclosure of these targets would result in "competitive harm." Companies relying on the "competitive harm" exception may need to map out, in advance of filing their annual meeting proxy statement, their "competitive harm" arguments. If challenged by the SEC, companies will likely be required to demonstrate to the SEC staff that the disclosure of such targets will indeed cause competitive harm. The SEC has made clear that waiting until that time to formulate your rationale is not the best practice.

Other considerations
Mr. White's recent address asked companies to consider whether they have changed their processes and procedures for determining executive and director pay in light of recent economic and financial events. Companies should consider showcasing instances where compensation decisions aligned management's

interests with those interests of the rest of the employee base or the issuer's investors. Alternatively, in this current climate, if a company chooses to pay bonuses in situations where the company failed to achieve its performance targets, then a detailed discussion of that rationale is warranted.

There are still some companies that have yet to disclose their peer group used in compensation decisions, although given the SEC emphasis on this topic, the numbers are decreasing. To the extent a company uses comparative compensation information, disclosure should be provided in the CD&A as to the peer companies included in the issuer's peer group and how this information was used. In addition, companies should provide detail on how the company's compensation compares to such peer group.

Liquidity and Financial Resource Reporting in Annual Disclosure

As companies plan their upcoming disclosure in their Annual Report on Form 10-K, we believe that the current economic climate could impact disclosure on liquidity, risks, financings, and other areas. Following is a discussion of disclosure concepts that have been around for years but that need to be given careful consideration this year.

Risk factors
Companies should revisit their risk factor disclosure for the Form 10-K and consider both macro and company specific trends and uncertainties that are relevant in today's market conditions. In addition, companies should consider giving quarterly updates on risk factors where certain information may go stale from quarter to quarter. In this regard, companies should consider streamlining their risk factors to be more concise and limit the inclusion of operational and other data where it is not absolutely necessary for an understanding of the risk identified.

MD&A disclosure
Over the years, the SEC has provided several rounds of formal guidance on MD&A disclosure, the last of which was in December 2003. At that time, the SEC's guidance included significant new interpretations regarding MD&A disclosures with a view toward providing more insight, from management's perspective, into the company's past performance and future prospects. In light of the ongoing economic crisis, now is the time to take a fresh look at such guidance as the SEC staff continues to focus on this area and has made strong statements that companies should focus additional attention on its interpretive guidance when drafting MD&A.

In keeping with the SEC's theme of MD&A providing a view of a company "through the eyes of management," the SEC encourages early top-level involvement by management in identifying the key disclosure themes and items that should be included in MD&A. Boilerplate disclosure is never advisable, rather disclosures should be specifically tailored to the circumstances, trends, events and uncertainties that are truly driving the company's business. Put another way, disclosure on general economic or industry trends are only helpful as they are applied to the company, its financial condition and results of operations.

For example, MD&A should contain detailed disclosure regarding, among other things, key performance indicators, material trends and uncertainties and critical accounting estimates. This is management's chance to tell investors the full story about its year-end financial and operational data and what it means for the future.

Finally, this year's MD&A should include a meaningful discussion regarding liquidity and capital resources, including:

- sources of historical and current funding, cash and capital expenditures;
- pressure points on existing debt (potential events of default or covenant breaches and cross defaults);
- amounts and certainty of cash flows and the timing of commitments for cash expenditures and requirements;
- potential shrinking of available credit or calls for deposit of collateral; and
- changes in operating plans or capital expenditures or commitments in light of the economic climate.

"Say on Pay"

"Say on pay" of executive salaries has been become part of the national lexicon through constant press reporting. Institutional shareholders have proposed, at an increasing rate, "say on pay" votes at numerous companies including Exxon Mobil Corporation, General Motors, General Electric Company, and Wal-Mart Stores, Inc. Generally, "say on pay" proposals provide that, if adopted, an issuer's stockholders will be provided the opportunity to cast an annual (generally nonbinding) vote on whether or not a company's executive compensation package is reasonably tied to performance. While most of these proposals were ultimately rejected by stockholders, at least one report by RiskMetrics Group found that meaningful levels of stockholders supported the proposals (42.5% in 2007 and 43.1% in 2008.)

In addition, many commentators believe that the new Obama administration may focus its attention on passing "say on pay" legislation. In 2007, President-elect Obama, then a U.S. Senator, introduced the Shareholder Vote on Executive Compensation Act (the "Executive Compensation Act") in the U.S. Senate and U.S. Representative Barney Frank introduced an identical bill in the U.S. House of Representatives. Among other things, the Executive Compensation Act would amend the Securities Exchange Act of 1934 (the "Exchange Act") by requiring an annual, nonbinding shareholder vote on executive compensation and a shareholder vote on any compensation paid to executives as the result of a merger, acquisition, or asset sale. The Executive Compensation Act was passed by the U.S. House of Representatives, but remains in the U.S. Senate pending a vote.

XBRL

On December 17, 2008, the SEC adopted new rules requiring domestic and foreign companies that apply U.S. GAAP to their financial statements to provide the information in an interactive data format that uses eXtensible Business Reporting Language ("XBRL"). As adopted, the interactive data would be filed as an exhibit to a company's registration statements and periodic reports and would also be posted on its website.

Initially, XBRL would apply to filings containing financial statements for fiscal periods ending on or after June 15, 2009 by large accelerated filers that use U.S. GAAP and that have a worldwide public common equity float of over $5 billion. Use of XBRL would then be required on or after June 15, 2010, for all other domestic and foreign large accelerated filers that use U.S. GAAP and on or after June 15, 2011, for all other filers using U.S. GAAP, including smaller reporting companies and foreign private issuers that prepare their financial statements in accordance with IFRS.

e-proxy

Last year, in several publications, we discussed the SEC rules and regulations regarding the internet availability of proxy materials (the "e-proxy rules"). Effective July 1, 2007, companies can satisfy their proxy delivery requirements by (i) posting proxy materials, including annual reports, on their web site and (ii) mailing a notice to their stockholders advising them that the materials are available. In 2008, this process was voluntary for all issuers except "large accelerated filers."

Starting January 1, 2009, compliance with the e-proxy rules is required for all companies commencing a solicitation of proxies (except those solicitations involving business combination transaction).

Generally speaking, these "mandatory" regulations provide companies two alternatives to comply with the e-proxy rules. A company may adopt either (i) the "notice only" process, which takes full advantage of the electronic-delivery/ internet-availability model; or (ii) the "full set delivery" alternative, which entails both posting proxy materials on the internet (with notification) and also sending a full set of proxy materials to stockholders. The "full set delivery" alternative closely resembles what most companies have done prior to 2009. In other words, if an issuer wishes to continue the status quo and furnish a full set of proxy materials in paper to stockholders, the mandatory rules require only that the company: (1) post those proxy materials on an internet web site (other than the SEC's EDGAR website), and (2) include a "Notice of Internet Availability of Proxy Materials" with their physically delivered materials or incorporate such notice information into its current proxy statement and proxy card.

California law amendment

Last year, we also discussed the fact that companies incorporated in California or that have their principal executive offices in California (or customarily hold meetings of their board of directors in California) ("California issuers") should be aware of a wrinkle in California law that prevented such California companies from taking full advantage of the e-proxy regulations. This issue has been remedied by an amendment to California law. Prior to this amendment, California law required a California company to mail a hard copy of its annual report to each of its shareholders unless the company had received consent from the shareholder to deliver the annual report in electronic form. This consent requirement effectively prevented California companies from utilizing the "notice only" model described above. In July 2008, the California legislature amended California Corporations Code § 1501(a) and eliminated the requirement of shareholder consent when companies that have outstanding securities registered under the Exchange Act comply with the e-proxy rules. However, California companies utilizing the "notice only" model should also ensure that they are complying with California Corporations Code § 601 physical notice requirement of shareholders' meetings by incorporating the requirements from § 601 into their "Notice of Internet Availability" as required by the e-proxy rules.

Fair Value Disclosure

Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements*" (SFAS 157) defines fair value and establishes a three-tier measurement hierarchy and provides for enhanced disclosures about fair value. At the current time, SFAS 157 generally only applies to financial assets and liabilities.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The SFAS 157 fair value measurement standards are based on a three level hierarchy system depending on how the inputs used to measure fair value are observed (or not observed).

- Level 1 inputs are quoted prices in active markets for *identical* assets or liabilities
- Level 2 inputs are inputs other than Level 1 quoted prices that are directly or indirectly observable (for example, quoted prices for *similar* assets or liabilities)
- Level 3 inputs are "unobservable inputs"—which are inputs reflecting an entity's own assumptions about what the market would use to price the asset or liability

In March 2008, the SEC Staff sent to public financial companies so-called "Dear CFO" letters. These letters set forth the SEC Staff's views about SFAS 157 disclosures and the SEC has indicated that the disclosure principles in those letters can be applied to any company, regardless of industry. In the letters, the SEC Staff highlighted important disclosure considerations that companies should consider, particularly with respect to Level 3 unobservable inputs. Disclosures about Level 3 inputs are particularly challenging because of the significant judgment that must be applied in using unobservable inputs and the effect that such estimates can have on a company's results of operations, liquidity and capital resources. For example, where the fair value determined by the company falls within a broad range.

As companies prepare the MD&A sections of their 2008 annual reports, they should keep in mind the SEC Staff's guidance in the Dear CFO letters, such as:

- how fair value was determined and how changes in those values impacted or could impact the company's results of operations, liquidity and capital resources;
- the amount of assets and liabilities measured using significant Level 3 unobservable inputs;
- the amount and reason for material changes in Level 3 assets and liabilities resulting from transfers from or into Level 1 or Level 2 of the hierarchy;
- where a material amount of assets or liabilities are transferred to Level 3 during the year, a discussion of the significant inputs that are no longer considered observable and information about related gains or losses;
- for Level 3 assets and liabilities, a discussion about material gains or losses (realized or unrealized) affecting the company's results of operations, liquidity or financial resources, the reason for any material decline or increase in fair value and whether the company believes the calculated fair values will diverge materially from the amounts that will be realized at settlement or maturity (and a basis for those views);
- a general description of the company's valuation techniques or models and any material changes made to those techniques or models during the period;
- a discussion of the methods used to validate the techniques or models; and
- sensitivity analysis-type disclosures to provide a sense of how the fair value estimates could potentially change as significant inputs vary.

Fair value disclosures continue to be scrutinized as the seizure of the credit markets has resulted in some instances in the disappearance of active markets, which means that some measurements are

no longer eligible for Level 1 (and, in some cases, even for Level 2) measurement in the hierarchy.

While a complete and in-depth discussion of SFAS 157 is beyond the scope of this article, companies should be mindful that fair value disclosure is not meant just for the financial statement footnotes. Fair value disclosure needs to be considered in other areas of the Form 10-K, such as critical accounting estimates, market risks, risk factors and liquidity, and capital resources.

Smaller Reporting Company Rules

As summarized in the March 2008 issue of our Corporate Communicator, on December 19, 2007, the SEC issued final rules amending and streamlining the reporting requirements for small public companies. The new rules were effective February 4, 2008 and:

- created a new category of filer, the "smaller reporting company," which replaced the "small business issuer" category;
- expanded the availability of scaled disclosure requirements to filers with a public float of less than $75 million (or where no public float or market price exists, less than $50 million in annual revenue);
- moved the Regulation S-B reporting requirements to Regulation S-K and eliminated Regulation S-B and its various reporting forms;
- allowed small reporting companies to choose the scaled reporting requirements on an á la carte basis; and
- allowed foreign companies to file as a smaller reporting company.

Last year, companies that qualified as a "small business issuer" under Regulation S-B had the option to file their annual report for the fiscal year ending on or after December 15, 2007 on Form 10-KSB, using Regulation S-B; however, those companies were required to file their next quarterly reports on Form 10-Q and annual reports on Form 10-K. Accordingly, this year all companies that may have previously qualified as a "small business issuer" under Regulation S-B must file their annual reports on Form 10-K using the scaled Regulation S-K reporting requirements.

Extension of deadline for auditor attestation report
On June 20, 2008, the SEC adopted the proposed amendment to the temporary rules it issued on December 15, 2006. Under the adopted amendments, a non-accelerated filer does not need to provide the auditor's attestation report until fiscal years ending on or after December 15, 2009. As a result, all non-accelerated filers are required to provide:

- management's report on internal controls for fiscal years ending after December 15, 2007; and
- the auditor's attestation report in the annual report filed for fiscal years ending on or after December 15, 2009.

Odds and Ends

by Jeffrey Beck, Franc Del Fosse and Travis Leach

Shelf Registration Expiration

On November 30, 2008, the first shelf registration statements filed under the Securities Offering Reform began to expire. Below we briefly discuss the types of shelfs that may have expired and what should be done.

Under the groundbreaking Securities Offering Reform certain shelf registration statements automatically expire after three years. Generally, shelf registration statements that become effective on or after December 1, 2005 expire three years from their effective date. Companies are required to file a new registration statement prior to the applicable expiration dates (post-effective amendments to extend expiring shelf registration statements are not permitted). Accordingly, companies should examine whether they will need to file replacement registration statements so they can continue to do shelf take downs.

This expiration could be unfortunate for a company whose stock price has dropped significantly due to recent economic and market conditions. These companies may have lost their well-known seasoned-issuer ("WKSI") status due to stock price decline (need a public float at or above $700 million). By losing WKSI status, a company would not be able to take advantage of the important automatic shelf registration benefits. The three-year expiration provision does not apply to registration statements on Form S-8 registering securities sold pursuant to an employee benefit plan, among others.

What Should be Done? Companies with effective shelf registration statements should review their registration statements and filings to determine if they have any registration statements that would be subject to these three-year expiration provisions and what the applicable expiration dates are.

IFRS Roadmap

On November 14, 2008, the SEC published a *proposed* roadmap to requiring U.S. filers to prepare financial statements on the basis of International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). This means that the SEC is now throwing its influence behind the notion that the best platform for an international, unified standard of accounting is IFRS. Over 100 countries currently require or allow for the use of IFRS for their domestic companies, including all the members of the European Union.

The IASB and U.S. Financial Accounting Standards Board have been coordinating for several years to converge the standards existing in IFRS and U.S. GAAP. The goal is comparability between U.S. and non-U.S. companies. The SEC's roadmap contemplates that the SEC will determine in 2011 whether it is in the public interest and would enhance investor protection to require that U.S. public companies adopt IFRS beginning in 2014 and outlines the possibility that certain companies could voluntarily adopt IFRS beginning in 2010. In addition, the SEC is considering allowing the 20 largest companies (as determined by market capitalization) in each industry in which IFRS is the most common basis of financial reporting to report under IFRS voluntarily beginning with fiscal years ending on or after December 15, 2009.

Considerations Relating to Ending Earnings Guidance

The practice of providing the "street" quarterly earnings guidance is a decreasing trend. The rationales given for discontinuing earnings guidance include: (i) a perceived lack of benefit when compared to increased scrutiny and risk (e.g., securities litigation); (ii) according to at least one study, there is some empirical data to support that eliminating estimates results in less volatile stock returns and another widely-cited study concluded that there was no evidence that guidance improved shareholder return, (iii) a short-term emphasis on guidance attracts transient investors and prevents shareholders and management from concentrating on long-term strategies and operating goals, and (iv) the practice provides too many distractions for management and requires expending considerable resources. Proponents of continuing earnings

guidance argue that ultimately this practice requires management to show transparency, accountability, discipline and an ability to properly forecast a business they should be in control of. Proponents of continuing earnings guidance also argue that there is evidence to suggest that ceasing to provide guidance is viewed negatively by the market and has been shown by at least one study to result in the underperformance of stock price.

In deciding whether to eliminate earnings guidance, the following should be considered:

- *Carefully choose the timing and nature of ending earnings guidance.* One reason that the discontinuation of earnings guidance is viewed as negatively affecting stock price is because there is a perception that companies end the practice when they are underperforming. If possible, it may make sense to discontinue the practice when it does not coincide with an underperforming period or at least at the conclusion of a fiscal year. Companies announcing the discontinuance of earnings guidance should be aware of Regulation FD and other regulatory issues.

- *Provide alternative information.* Management should consider being prepared to produce new "long term value-driven" information to the market to combat the perception that ending earnings guidance is effectively eliminating transparency. Keep in mind that analysts may continue to forecast absent management's participation which could lead to estimates which are substantially out of line with management's expectations. By providing helpful information such as operating data or cost estimates, management can mitigate unruly analyst expectations and convey transparency. Companies should also use this step as an opportunity to evaluate communications with investors and possibly increase the frequency of discussing strategies and key developments.

- *Adopt shareholder friendly initiatives.* Another way to allay investors concerns regarding the discontinuance of earnings guidance might be to couple the discontinuance with shareholder friendly initiatives such as "clawbacks" or "say on pay" provisions on executive compensation, mandatory stock ownership policies for management and directors, and other initiatives that may be perceived as aligning the interests of management with shareholders and increasing accountability of management and the board.

Error Corrections and Stealth Restatements

Look for new guidance in 2009 on how errors are corrected and the types of disclosures that should be made about such corrections.

In August 2008, the Advisory Committee on Improvements to Financial Reporting delivered its final report to the SEC. The guiding purpose of the report was to provide specific recommendations as to how to reduce unnecessary complexity in the United States financial reporting system.

Among the many recommendations made in the final report, the Committee concluded some restatements in the last few years may have resulted from an overly broad application of materiality concepts. The Committee concluded that a bright line test for materiality (for example 5%) was not appropriate and that the total mix of information should be considered, including qualitative and quantitative factors. The Committee recommended in its final report that the SEC or FASB provide supplemental guidance about determining the materiality of errors in financial statements.

With respect to how errors should be corrected, the Committee reached two important conclusions:

- All errors should be corrected, unless they are clearly insignificant. Oftentimes immaterial errors are not corrected and the Committee believes this practice can lead to the accumulation of errors that become material in a future period.

- Only those errors in historical statements that are material to the prior periods should be corrected through a restatement of prior period financial statements. All other errors should be corrected in the period in which the error is identified. The Committee acknowledges that this conclusion is not consistent with SAB 108. SAB 108 requires the correction of errors that are immaterial to prior periods through a restatement of the prior financial statements if correction of the error in the current period would be material to the current period.

The Committee also recommended that the SEC clarify that prior reports may not need to be amended where the company will be filing a report in the near future and that report will contain all of the financial statements that must be restated to correct an error.

Finally, the Committee issued two recommendations concerning "stealth restatements."

- The Committee recommended that the SEC revise its Form 8-K rules to make clear that a Form 8-K needs to be filed for *all* determinations of non-reliance. The Form 8-K rules concerning restatements and non-reliance on financial statements (Item 4.02) remain a source of frustration for companies in determining when a state of non-reliance exists absent a formal notification from the auditors. It remains unclear whether the Committee's recommendations directly address this problem.

- The Committee recommended that the SEC or the FASB issue guidance advising companies to continue to disclose financial and other information (including information about the restatement itself) during the period of time between entering a state of non-reliance (the "dark period") and the time the company returns to current status (upon the filing of all necessary restated financial statements).

Risk Oversight and the Board of Directors

In light of the current economic climate, boards of directors should understand that directors have the responsibility for the general risk oversight role. While acting in a risk oversight role, it is not necessarily required that a board become actively engaged in day to day risk management. Rather, boards should consider performing the following tasks in overseeing the risk management process:

- establish a detailed risk management policy for the company, which should include, among other things, procedures, training, board and committee composition, and communication;

- establish a committee or subcommittee with the primary responsibility of overseeing the company's risk management;

- conduct regular risk evaluations to ensure the effectiveness of the risk tolerance and management; and

- establish period risk reports to be presented to the full board (or the appropriate committee) for review and consideration.

Finally, we recommend that boards become familiar with the particular risks facing their companies so that any actions taken by a board in a risk oversight role properly account for the specific risks of a company. In attempting to identify a company's risks, we recommend that directors carefully review the risk factors and forward-looking statements set forth in a company's public SEC filings or audit reports. Such risks commonly include one or more of the following:

- financial risks (for example, large amounts of cash deposited with financial institutions, lending relationships with troubled banks, investments in auction rate securities or mortgage-backed securities);
- natural disasters or terrorist attacks;
- product liability or other litigation risks;
- environmental;
- insurance;
- intellectual property;
- information technology; and
- employment practices.

NASDAQ and NYSE Updates

NASDAQ Suspension of Minimum Bid Price
In October 2008, the NASDAQ Stock Market LLC ("NASDAQ") temporarily suspended NASDAQ's continued listing requirements related to bid price and market value of publicly held shares. Due to a recent extension, this suspension ends April 20, 2009, unless NASDAQ decides to further extend the suspension. NASDAQ's rule requires that a company's listed securities maintain a $1 per share minimum closing bid price. If the company's securities fall below that threshold for a period of 30 consecutive business days (with a 180-day grace period to regain compliance) then the securities are subject to delisting. The decision to implement this temporary suspension resulted from the volatility in the markets and NASDAQ conveyed that it believes the precipitous decline in trading prices on NASDAQ was resulting from general economic conditions rather than investor concerns regarding the underlying business model or prospects of these affected companies. Indeed, NASDAQ indicated that the number of securities trading below $1 on NASDAQ had increased from 64 at September 30, 2007 to 227 on September 30, 2008 and to 344 on October 9, 2008, with an additional 300 NASDAQ-listed securities trading between $1 and $2. In connection with its recent extension of the suspension, NASDAQ indicated that since the suspension was implemented in October the number of securities trading below $1 and between $1 and $2 has increased. The New York Stock Exchange (the "NYSE") has not taken similar steps with respect to its comparable listing requirement (although the NYSE Staff has indicated that they had considered the issue). The NYSE noted that the number of its listed companies falling below the $1 threshold has increased but is still proportionally small.

NASDAQ Amends Delinquent Filer Rules
In an effort to respond to the difficulty companies have in complying with increasingly complex compliance and accounting standards, NASDAQ recently amended its process for handling issuers delinquent in filing their periodic reports. In the past, under NASDAQ's delisting rules, companies received a delisting letter from NASDAQ immediately upon missing a filing due date. NASDAQ amended its rules to grant delinquent filers an extension of 60 calendar days from receipt of a notice of delinquency from NASDAQ to submit a plan which would include, among other things, the reasons for the late filing and other identified information related to restoring compliance and the company's history of

compliance. NASDAQ staff may grant a company up to 180 calendar days to regain compliance and satisfy its filing requirements. This rule change brings NASDAQ's process in line with the NYSE's existing rules that provide delinquent companies with a cure period to comply with filing requirements, although NASDAQ's rules provide a cure period for late quarterly filings but NYSE rules do not.

Amendments to NYSE Independence Standards
The NYSE has amended the following corporate governance standards related to director independence:

- Relating to director compensation, Section 303A.02(b)(ii) has been amended to provide that if a director or his or her immediate family member has received, during any 12-month period within the prior three years, more than $120,000 in direct compensation from the issuer, subject to limited exceptions, such director would be precluded from being independent. The increased dollar amount from $100,000 to $120,000 brings the NYSE rule in line with the existing dollar threshold under Item 404 of Regulation S-K with respect to related party transactions.

- Director's family members who are considered affiliated with an auditing firm of the listed company were narrowed, which creates more likelihood of a favorable independence determination. This change makes NYSE's rule more consistent with NASDAQ's.

New SEC Enforcement Manual

by Dan Goldfine

For decades, the SEC preached transparency but was less than transparent when it came to its own enforcement standards. Companies and lawyers were relegated to picking-apart speeches, decisions and informal statements by Commission staff and the appointed Commissioners to decipher enforcement standards. In October 2008, the SEC took a step towards transparency by issuing a 122-page Enforcement Manual or the "Red Book."

A number of important issues are addressed (as well as many pedestrian issues) in the Enforcement Manual. These include:

- the interrelationship between waiving attorney-client privilege and garnering credit for fully cooperating with the staff of the SEC's Division of Enforcement;

- implications arising from simultaneous investigations by the SEC and a self-regulatory organization such as NASDAQ;

- implications arising from simultaneous investigations by the SEC and the Department of Justice through a grand jury;

- SEC staff's expectations as to subpoena compliance;

- access to the SEC's investigative files upon receipt of a Wells Notice (i.e., notice from the SEC staff of an imminent enforcement action).

- "best practices" for elevating a challenge to a SEC staff's enforcement decision to SEC management;

- process for obtaining immunity from criminal prosecution from the SEC; and
- policy for the issuance of "no-action" letters.

Below we address two of these issues in detail: (1) waiver of the attorney-client privilege and (2) simultaneous investigations by the SEC and a self-regulatory organization such as NYSE.

Waiver of Attorney-Client Privilege
Like the Department of Justice, the SEC had been embarking for about a decade on a policy of threatening to deny credit for cooperation if companies did not waive attorney-client privilege. This had the practical effect – particularly, in the risk-averse environment of special committee investigations – of forcing companies to waive the attorney-client privilege in many circumstances when it was not otherwise in the interest of the companies or their shareholders to do so. Basically, everyone (Congress, business groups, the private bar, some federal courts), except enforcement agencies, believed that the policy to force a waiver to obtain credit for cooperation was wrong. The SEC now agrees.

Section 4.3 of the SEC Enforcement Manual states that both entities and individuals can provide significant cooperation by disclosing relevant information, which "need not include a waiver of privilege to be an effective form of cooperation, as long as all relevant facts are disclosed." Moreover, during internal investigations, in which a company's lawyers typically interview employees and sometimes prepare interview memoranda, the Manual asserts that the notes and memoranda of those interviews may be privileged and directs the SEC staff not to "ask a party to waive the attorney-client or work product privileges." It explains that the waiver of privilege "is not a prerequisite to obtaining credit for cooperation," and a "party's decision to assert a legitimate privilege will not negatively affect their claim to credit for cooperation." It is anticipated that this change – along with similar policy changes at the Department of Justice – will substantially reduce the frequency of waivers of attorney-client privilege.

Simultaneous investigations
The SEC Enforcement Manual addresses the issue of when a private actor, such as the NYSE or a company, becomes a "state actor" for determining whether an employee has a Fifth Amendment right to refuse to answer questions from an exchange or other private actors (including his own employer). *See U.S. v. Stein*, 541 F.3d 130 (2d Cir. 2008) (DOJ turned KPMG, the company under investigation, into a state actor for purposes of the Fifth Amendment). The Manual advises staff attorneys on how to avoid the issues arising out of the state actor doctrine. First, Section 3.1.4 of the Manual explains the elements of the "state actor" doctrine, according to which, state action will be imputed to a private entity if (1) the private entity willfully engages in joint action with state officials; or (2) state officials coercively influence or significantly encourage a private entity to engage in a given course of conduct. Second, it then advises that to prevent a finding that state action is imputed to a private entity, "[i]n fact and appearance, the SEC and the private entity's investigations should be parallel and should not be conducted jointly. Staff should make investigative decisions independent of any parallel investigation that is being conducted by a private entity." As has been in the past, good lawyering should permit an exchange to investigate purported wrongdoing adequately without increasing the risk of SEC enforcement and criminal prosecution of key employees. Like with the change of the "waiver for cooperation" policy, the clear division between, for example, a NYSE inquiry and the SEC investigation will further

reduce unjustified and inadvertent waivers of attorney-client privilege.

In sum, the SEC Enforcement Manual is a serious step in the right direction in lifting the veil of secrecy over SEC enforcement policy.

Snell & Wilmer's First Annual Public Company Roundtable

January 8, 2009. The Roundtable will address topics of interest to public and "pre-public" companies, including executive compensation and MD&A disclosure considerations in light of the recent economic turmoil, SEC enforcement developments, NYSE and Nasdaq developments as well as our thoughts on things to look for in 2009.

Denver • Tabor Center, 1200 Seventeenth St., Suite 1900 8:30-9:00 a.m. Registration and Breakfast • 9:00-10:30 a.m. Roundtable Discussion. **RSVP** by January 5 to Jan Place at 303.634.2059 or jplace@swlaw.com. Underground parking available.

Las Vegas • 3883 Howard Hughes Pkwy., Suite 1100. 7:30-8:00 a.m. Registration and Breakfast • 8:00-9:30 a.m. Roundtable Discussion. **RSVP** by January 5 to Kari Baker at 702.784.5200 or kbaker@swlaw.com. Complimentary parking available in visitors section in the parking garage next to the building.

Orange County • 600 Anton Blvd., Suite 1400. 7:30-8:00 a.m. Registration and Breakfast • 8:00-9:30 a.m. Roundtable Discussion. **RSVP** by January 5 to Christy Blackwell at 714.427.7000 or cblackwell@swlaw.com. Validated parking available in parking structure in front of building.

Phoenix • One Arizona Center, 400 E. Van Buren, Suite 1900. 8:30-9:00 a.m. Registration and Breakfast • 9:00-10:30 a.m. Roundtable Discussion. **RSVP** by January 5 to the rsvp line at 602.382.6599 or rsvp@swlaw.com. Validated parking available in the parking garage at 5th Street and Fillmore.

Salt Lake City • Beneficial Tower, 15 West South Temple, Suite 1200. 8:30-9:00 a.m. Registration and Breakfast • 9:00-10:30 a.m. Roundtable Discussion. **RSVP** by January 5 to Jennifer Sinquefield at 801.257.1994 or jsinquefield@swlaw.com. Parking available in the Joseph Smith Memorial Building (enter JSMB off of South Temple).

Tucson • One South Church Avenue, Suite 1500. 8:30-9:00 a.m. Registration and Breakfast • 9:00-10:30 a.m. Roundtable Discussion. **RSVP** by January 5 to Sara Monreal at 520.882.1355 or smonreal@swlaw.com. Validated parking available underneath building.

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