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Inside

A publication of the Corporate Counsel Section
of the New York State Bar Association

Message from the Chair

To the Members of the Corporate Counsel Section:

As Chairperson of the Section, I would like to share with you some of the recent activities in which the Section has been engaged, as well as some upcoming events and points of Section interest.

This has been a very exciting year for us. As I described in our last issue of *Inside*, the Section co-sponsored a very successful Spring CLE Program with the Commercial and Federal Litigation Section at the Gideon Putnam Hotel in Saratoga Springs, New York. The Program examined how juries perceive corporations and how best to select a jury in a commercial case.

In September, the Section sponsored our first NYSBA "Corporate Counsel Institute," held at the Princeton Club in New York City. The Institute, which was sold out several weeks in advance, was combined with the Section's popular annual Ethics for Corporate Counsel Program, producing a comprehensive two-day curriculum covering multiple topics of particular interest to corporate counsel. Attendees obtained up to 14.5 CLE credits, including 4 credits in ethics. Due to the overwhelmingly positive feedback received, the Section is considering a second Institute. One of the attendees, Howard Shafer, describes the program's highlights in an article featured in this issue of *Inside*.

Looking ahead to the Annual Meeting on January 25, 2006, the Section is co-sponsoring a program with the International Law and Practice Section, entitled "NAFTA: Ten Years Later." The program will focus on three areas for review and discussion by panelists: (1) a current overview and status of NAFTA; (2) investor-state arbitrations under NAFTA; and (3) cross-border legal services in North America. Please visit our Section's website (http://www.nysba.org/corporate) in the months to come to view a program update.

During the Institute's luncheon reception, the Section announced the establishment of a new diversity internship program, named in honor of former state bar president Kenneth G. Standard. The diversity internships will begin in the summer of 2006. The Section's Internship Committee, headed by past Section Chair Barbara Levi, plans to recruit interns from a diverse group of law school candidates. Two internships are expected to be awarded for the first year from students who have successfully completed one year of law school at an accredited New York State school. For more information, please contact Barbara Levi at (201) 894-2766 or at Barbara.Levi@unilever.com.

Inside

NYSBA

Once again, this issue of *Inside* reflects the many areas of our members' interests. In addition to Howard Shafer's article on the Corporate Counsel Institute, we have included three other excellent articles on various practice areas, all of interest in some way to in-house generalists. The topics range from a review of Robert Haig's seminal compilation entitled *Commercial Litigation in New York State Courts* (2nd Ed.), to design of 401k employee benefit plans, and the recent SEC reform rules (effective December 2005) intended to simplify registration, communications and offering processes for issuers of securities.

I hope you enjoy this issue of *Inside*, and that through it, you become more involved in the activities of the Corporate Counsel Section. On behalf of the Executive Committee and officers of the Section, we encourage your interest and welcome your participation in the activities of the Section and look forward to meeting you at upcoming Section-sponsored events.

Mitchell F. Borger

Highlights from the First Corporate Counsel Institute

By Howard S. Shafer, Esq.

The Corporate Counsel Section held its Corporate Counsel Institute at the Princeton Club on September 22nd and 23rd, 2005. This was the first year it was held and it incorporated the popular "Ethics for Corporate Counsel" Program. Corporate Counsel from companies of all sizes attended. The topics included: The Use of In-House Alternative Dispute Resolution for Employment Law Issues; In-House Compliance Programs; Litigation and E-Discovery; Law Department Management; Intellectual Property; and Ethics for Corporate Counsel.

Workshops were also held on each of the subjects. Participants selected two workshops, and the ones I attended were: Employment Law, Overview for the Generalist; and Wage Hour Update: A Practical Approach to the New Fair Labor Standards Act. The other workshops were: Intellectual Property—Hot Topics in Copyrights and Hot Topics in Trademarks; Litigation/E-Discovery—Document Retention and Retrieval Programs and Developments in Technology to Enhance Storing and Retrieval of Electronic Data and Legal Developments in Electronic Discovery; Law Department Management—The Lawyer as Business Person/Management Solutions; In-House Compliance Programs—Responding to a Government Investigation; and In-House Compliance Programs—The Experience at American Express.

A diversity internship program for law students was named for attorney Kenneth G. Standard, Immediate Past President of the New York State Bar Association, and the Keynote Speaker was James G. Potter, Esq., Senior Vice President, General Counsel and Secretary of Del Monte Corporation. He spoke of the importance of promoting diversity in the legal profession and how Del Monte is helping to make a difference.

The topics were timely, interesting and well-presented. The bonus was 14.5 CLE credits. What follows are some highlights.

The Use of In-House Alternative Dispute Resolution for Employment Law Issues

Laura Giantris, Esq., of the Equal Employment Advisory Council, PC (EEAC), spoke about their ADR Project. That project allows companies to get together and share practices and techniques.

The EEAC surveyed member companies. The survey revealed that in-house ADR programs reduced litigation, costs and administrative agency charges. The companies surveyed included large companies in a wide variety of industries.

Different ADR Alternatives were discussed. Lawyers from Federated Department Stores and Halliburton discussed programs with which they have had much success. The speakers agreed that limiting recoveries in in-house programs would jeopardize their enforceability and that programs should be employee-friendly.

In-House Compliance Programs

The Sarbanes-Oxley climate was discussed. The speakers agreed that an effective Corporate Compliance Program had to be risk-based, tailored to the specific business, supported from the top down and appropriately funded.

An effective compliance program requires that proper written policies and procedures be put into place. Once in place, it is imperative that they be enforced and that there be effective training programs, including multi-lingual programs, where necessary. Building a compliance program does not happen overnight, but requires a process. Doing a risk analysis and addressing the most significant risks first is a good start. Once in place, there should be a procedure to regularly review and update the program.

Litigation and E-Discovery

The importance of developing a good policy on retaining electronic information and involving IT in doing so was discussed. The use of form preservation notices in repeat kinds of litigation is helpful but there also needs to be a process for the ongoing preservation of records being created after the litigation hold is put into effect.

The issue of cost shifting for discovery compliance was discussed. When discussing e-discovery, the lawyer should be prepared to address the efforts and cost involved in compliance.

Reasonable steps must be taken to preserve records. What is reasonable becomes clearer as the likelihood of litigation becomes greater. What constitutes reasonable increases with the filing of discovery documents and the entry of a preservation order. Magistrate Judge Francis, IV, of the Southern District, emphasized that preservation is not production and that it is better to err on the side of over-preserving.

The best way to bring certainty to the e-discovery process is for outside counsel to be proactive in discussing with the adversary what discovery is needed and to have any stipulations "So Ordered" by the court. Even where negotiation is unsuccessful, voluntarily disclosing necessary information and informing the court of your efforts can work in your favor.

Law Department Management

The Law Department Management session addressed the in-house lawyer as business facilitator and e-billing and reporting metrics. James S. Wilber, of Altman Weil, Inc., discussed the Corporate Counsel as naysayer and stressed the importance of being a business facilitator when possible, rather than just saying no. Suggesting alternative solutions can go a long way. Matthew Gilles, Esq., and John Weber, Esq., of TyMetrix, Inc., demonstrated the benefits of tracking outside counsel billing with the company's software.

Intellectual Property

The Intellectual Property session came at the end of the first day and was appropriately light. Some important points were made regarding advertising concerns. Corporate Counsel should consider Trade Dress Infringement, Copyrights, Fair Use and Tarnishment or Trademark Dilution in reviewing advertising materials. Jacqueline Leimer, Esq., Chief Counsel, Global Trademarks for Kraft Foods, emphasized the importance of having good relationships with ad agency lawyers and placing responsibility for advertisements upon them.

Ethics for Corporate Counsel

The ethics portion of the Corporate Counsel Program focused on "up the ladder" reporting obligations of Corporate Counsel. Review of DR 5-109, entitled "Organization as Client," was suggested for guidance.

Through use of hypothetical examples taken from the insurance industry, the "up the ladder" reporting obligations were examined as the information available went from rumors about arguably related issues and products to similar issues and products involving other companies and beyond. The consensus was that as more concrete, reliable and related information became available, the "up the ladder" reporting obligation increased. John Villa, Esq., of Williams & Connolly LLP, emphasized the dangers involved in jumping into an investigation before one is necessary. Once started, stopping is not permitted until you have exhausted all areas of reasonable inquiry. He also questioned the usefulness of in-house investigations in some areas, since a finding of no wrongdoing would be subject to inquiry.

The Safe Harbor provision of DR 1-104, entitled "Responsibilities of a Partner or Supervisory Lawyer and Subordinate Lawyers," was discussed and participants were encouraged to read it. Lawyers were cautioned to make a note of "up the ladder" type conversations with senior lawyers. The realities of reporting obligations and business were noted, and a distinction was drawn between past conduct on the one hand and current and ongoing conduct on the other.

Another area which was discussed was the duty of the in-house lawyer to the client company and not to the individual employees. Corporate Counsel should be careful to make that distinction and to carefully scrutinize engaging in what may appear to be a simple legal matter for a company employee.

The complexities of entering into Joint Defense or Joint Litigation Agreements were also addressed. When people covered by the agreement become the subject of the investigation, it is very hard to "unscramble the egg." John Villa suggested that the trend is not to enter into such agreements.

The session ended with a good deal of attention being paid to Multi-Jurisdictional Practice. The issue is easier in states that have adopted Model Rule 5.5. However, attorneys were cautioned to be aware of the laws in the jurisdictions in which they are working and to consider becoming admitted in states where they perform a substantial amount of legal services. Andral N. Bratton, Esq., of the Departmental Disciplinary Committee of New York's Appellate Division, First Department, mentioned that courts place a lot of emphasis on physical location. But beware, Anthony E. Davis, Esq., of Hinshaw & Culbertson, LLP, briefed the participants on a case where action was taken by a state against lawyers who had never set foot in the jurisdiction.

Workshop: Employment Law, Overview for the Generalist

Robert P. Joy, Esq., of Boston's Morgan, Brown & Joy, LLP, led the Employment Law for the Generalist workshop. Bob discussed the necessary aspects of a good employment law policy. Such a program should include:

- Fairness;
- Due Process;
- Consistency; and
- Written Substantiation.

In addition to specifically written employment policies, company handbooks should be checked for policies and practices which could be considered an implied-in-fact contract. Handbooks and manuals should include disclaimers stating that no contract is intended.

The importance of having a good defense to a wrongful termination claim, even in an employment-at-will state, was emphasized. If possible, Corporate Counsel should size up the decision-maker seeking advice on whether an employee can be terminated before the go ahead is given. That decision-maker will be your key witness. If the motion for summary judgment is denied, the jury will be evaluating your witness in looking to see that the company had a good reason for the termination and that the employee was treated fairly.

The session included many helpful hypothetical examples covering employee absence, discrimination, hiring and firing, references, wage and hour and National Labor Relations Act issues. The importance of considering the Family Medical Leave Act (FMLA) when dealing with absenteeism was stressed. Bob also pointed out the distinction between the reasonable accommodation required by the Americans with Disabilities Act and the interactive dialogue and reasonable accommodation required by the FMLA when an employee requests an accommodation.

The importance of conducting investigations on a need-to-know basis was also discussed. Corporate Counsel should be careful to ensure that this is done to shield companies from claims of defamation by employees.

Workshop: Wage Hour Update: A Practical Approach to the New Fair Labor Standards Act

Felice B. Ekelman, of Jackson Lewis, LLP, led the workshop on the changes to the Fair Labor Standards Act (FLSA), 29 C.F.R. 541. She reported that most FLSA work is now class or "collective" action and that the U.S. Department of Labor estimates that 70% of employers are not in compliance with the FLSA. Both the Department of Labor (DOL) website (http://www.dol.gov/) and the Jackson Lewis website (http://www.jacksonlewis.com/) have good primers on the changes.

Much of the discussion focused on the key exemptions for white collar employees. They include generally:

- Executive;
- Administrative;
- Learned Professionals (positions requiring advanced degrees or artistic skills);
- Computer Work; and
- Outside Sales.

The Motor Carrier Exemption is a special category which should be examined by every employer having drivers transport shipments and property.

The importance of looking past job titles and understanding job functions was stressed. Both the salary and the job functions must be examined to determine whether employees are exempt. The stakes are high. Penalties for non-compliance include three years back pay plus attorney's fees for willful FLSA violations. FLSA claims can only be resolved with Judicial or DOL supervision.

Also emphasized was the importance of fighting efforts to obtain class status. Arguments should be fashioned to dispute the allegations that the employees seeking to be included as putative opt-ins are similarly situated. Early discovery can be sought to defeat the broad definition of employees to be included in the notice.

Corporate Counsel must be aware of the pitfalls in misclassifying employees as exempt. Errors in classifying employees can result in penalties not just for that employee, but for all similar employees. Felice stressed that in order to avoid an encounter with the DOL's vigorous enforcement of the revised regulations for exempt employees, employers should act preventatively to develop positive solutions for compliance.

Internal FLSA audits will likely be discoverable, so they should be conducted discreetly using a small number of employees. She suggested steps that an employer could take to examine employee classification. They include dividing employees into the following three categories:

- Positions known to be exempt;
- Positions known to be non-exempt; and
- Positions in the gray area.

Titles of employees in the third category should be ignored and their job functions should be scrutinized to determine whether or not the employees are exempt. The importance of keeping time records for all employees in the event of an audit or challenge to classification was stressed. Mitchell F. Borger, Operating Vice President and Assistant General Counsel of Federated Department Stores and current Chair of the Corporate Counsel Section, mentioned that good communication with employees is important when undertaking a reclassification project. Once properly classified as exempt, employers must be careful not to take any action which would defeat the exempt status. Improperly deducting pay from employees can cause a loss of the exemption for other employees in the same job classification. While there is a Safe Harbor Provision for errors, employing it requires that the company have such a policy in place and that it be communicated to employees.

Lastly, working with the DOL in a "Compliance Partnership" to resolve the classification issue has its benefits. Based upon her experience in working with the DOL, Felice said that liquidated damages are not generally sought and that they will not ordinarily go back more than two years to recover back wages.

Other Workshops

Intellectual Property—Hot Topics in Copyrights was given by Barry I. Slotnick, Esq., of Loeb & Loeb, LLP. The material addressed copyright basics, transfers and licenses of copyrights, fair use, television formats and copyright protection.

Intellectual Property—Hot Topics in Trademarks was presented by Jacqueline Leimer, Esq., Chief Counsel, Global Trademarks for Kraft Foods. The topics included trademark basics, registration and protection, as well as advertising-related concerns.

Litigation/E-Discovery—Document Retention and Retrieval Programs and Developments in the Technology to Enhance Storing and Retrieval of Electronic Data was led by James L. Michalowicz, Litigation Program Manager for Tyco International (U.S.) Inc. and Charles A.B. Moore, Esq., Operating Vice President and Assistant General Counsel for Federated Department Stores, Inc. Legal Developments in Electronic Discovery was led by Steven C. Bennett, Esq., of Jones, Day, Reavis & Pogue, James L. Michalowicz and Frederick B. Warder, III, Esq., of Patterson, Belknap Webb & Tyler, LLP. The sessions expanded upon the issues raised in the general session and included specific examples of sanctionable misconduct.

Law Department Management—The Lawyer as Business Person/Management Solutions was given by James S. Wilber, Esq., of Altman Weil, Inc. The earlier session delved into the topics raised during the general session. The later session included a live demonstration of the TyMetrix litigation management program.

In-House Compliance Programs—Responding to a Government Investigation was led by John A. Mascarello, Esq., Counsel for The Bank of New York. The presentation included an introduction to the topic, as well as a discussion of the current environment of government investigations and practical suggestions for handling them.

In-House Compliance Programs—The Experience at American Express was presented by Kathryn S. Reimann, Senior Vice President and Chief Compliance Officer. The session developed issues raised during the general session and delved into the compliance experience at American Express.

Final Thoughts

This year's First Corporate Counsel Institute promises to be the start of a useful and popular program. The program was sold out early this year, and its popularity is sure to grow.

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Book Review by Michael Kreitman, Esq.

I have the pleasure of reviewing the Second Edition of *Commercial Litigation in New York State Courts*. For those not familiar with this work, the first edition, published in 1995, consists of three volumes and is widely recognized as a key reference tool on commercial litigation in New York State. This earlier work was written by a volunteer group of 63 New York attorneys and prominent judges, working under the leadership of Robert Haig of Kelley Drye & Warren LLP, who served as Editor-in-Chief.

The second edition is an expansion from the first edition, reflecting the significant changes in commercial litigation in New York State over the past nine years. Twenty-one new chapters have been added as well as updates and revisions to the chapters from the first edition. In total, 121 distinguished attorneys and judges volunteered their time to produce this work.

As with the earlier edition, the second edition is a comprehensive analysis of substantive and procedural issues in New York commercial litigation. But the Second Edition includes key developments in litigation that are of special concern to outside litigation counsel and in-house counsel alike, such as the chapter on "Electronic Discovery" that thoroughly reviews New York State law on this topic. Other topics include jurisdiction and venue, class action, and discovery and trial practice, as well as discussion about specific substantive areas such as sale of goods, agency and partnerships, right of privacy and commercial defamation.

Commercial Litigation in New York State Courts has unique value both for outside counsel and the in-house lawyer. This work provides information that is essential to the counseling roles that each plays and as such, it is a key reference tool to help manage client relationships.

For example, the "Case Evaluation" chapter treats a lawsuit as a business problem and identifies the many non-substantive issues that are of paramount importance to in-house counsel. This chapter talks about the importance of, and provides guidance on, (1) early and ongoing case assessment and steps to effectively accomplish this task, (2) identification of the client's business goals, (3) creating and regularly updating a cost-benefit analysis, (4) the appropriate time to consider mediation or some other alternative dispute resolution tools, and (5) preparing a decision tree analysis so litigation risks can be fully appreciated and an informed settlement decision made.

What really struck me about the "Case Evaluation" chapter is how accurately it captures factors that are important to the in-house lawyer managing litigation and the information that outside counsel is expected to provide. In fact, this chapter should be required reading for outside litigation counsel who want to understand how in-house counsel view litigation and the challenges faced by in-house counsel with business clients who may have difficulty separating emotions from objective business issues.

The "Litigation Management by Corporations" chapter also contains extremely practical guidance for the in-house lawyer involved in the complex roles of managing relationships with outside counsel, protecting the corporation from legal exposure and monitoring litigation fees to enhance shareholder value. It also advises outside counsel on factors that are of importance to in-house counsel and which will surely be the subject of discussion between lawyer and corporate client.

Accurately noting that the traditional relationship between corporate legal department and law firm has given way to new relationships, this chapter provides pointers on key aspects of litigation management. For example, the chapter discusses policies and procedures that corporations should have in place governing the selection of, and relationship with, outside counsel. It discusses the benefits of having an approved counsel list that notes the expertise of each firm and discusses how many law firms corporations should be actively using at any one time.

This chapter discusses the importance of evaluating outside counsel to ensure that cost-effective, quality services are being provided. This is achieved, in part, by setting corporate litigation goals, clearly communicating these goals to outside counsel and then evaluating outside counsel against these goals. Other methods to evaluate outside counsel are discussed such as doing a post mortem when a case is over and using a performance review method to evaluate individual lawyers.

Finally, there is a section in this chapter on managing litigation costs that addresses such items as alternative billing arrangements, case staffing, avoiding duplicative legal research, preparing a litigation budget, and corporate policies on disbursements that is a "must read" for the in-house lawyer who wants to control costs and expenses. In short, it stresses the importance of an open and comprehensive dialogue between outside and in-house counsel to explore the myriad of ways to manage litigation so as to produce good results at a cost-effective price tag.

There are also very informative chapters on substantive areas that in-house counsel will want to regularly consult when counseling business clients. For example, there is a "Construction Litigation" chapter that in-house counsel might refer to when counseling business clients on drafting construction contracts, handling disputes over contract terms, declaring a contractor in breach, or dealing with questions under the arcane New York lien law. The chapter on "Misappropriation of Trade Secrets" discusses steps a corporation may take to protect trade secrets and evaluate a lawsuit based on misappropriation of confidential information. The "Sale of Goods" chapter is instructive on such topics as rights, obligations and remedies in the event of a contract breach; information in-house counsel will want to review when charting a course of action with the business client embroiled in a contract dispute.

These and other chapters on "Agency," "Partnership," "Warranties," "Secured Transactions," "Franchising," and "Collections" all provide a valuable reference tool on substantive legal areas that in-house counsel is expected to know, or access quickly, in order to effectively counsel the business client.

In sum, *Commercial Litigation in New York State Courts* is an excellent reference tool for outside litigation counsel and in-house counsel. It provides both very thorough and detailed analysis on substantive and procedural aspects of New York law as well as useful information that is important to the relationships outside and in-house counsel have with each other and their business clients.

Designing a 401(k) Plan

By Steve Pomerantz, Ph.D.

The importance of a good 401(k) plan for employees cannot be understated. Not only is your employees' retirement plan an important part of their net worth and financial well-being, but a good plan can contribute significantly to company morale.

In devising a plan, there are two important issues to consider referred to as products and providers. In the products category, consideration is given to what types of investments should be offered to employees, while under the provider category, the issue to address is who does the actual investing.

Products

The most likely structure for investments is in a mutual fund format. Investors can benefit from professional management, and the economies of scale that may be present in a fund offer a great advantage. Retirement assets as a percentage of mutual fund holdings continue to grow. At the current time, over half of mutual fund assets are from some type of retirement option, be they IRA, 401(k) or some other defined contribution type of plan.

An important tenet of investing is portfolio diversification, so offering a wide enough array of choices is crucial. A plan should offer enough stock, bond and money market funds to allow investors to tailor their holdings to their own desired risk level. Too few funds will not allow adequate diversification, and too many will just cause great confusion.

Within the class of bond funds, investors should be able to choose from treasury-only options, which are the safest, to bond funds that invest in mortgage-backed and other asset-backed securities as well as corporate securities of both investment and non-investment grade.

The stock funds offered should allow ample room for diversification and as such should incorporate choices in both growth and core styles. Other ways to diversify would include investing in both large and small capitalization stocks as well as international equities. The international stock arena is further decomposed into either developed regions such as Europe and the Far East, or developing countries such as China or India.

A typical plan that offers ten funds will allow for ample diversification and for employees to choose the level of risk they are comfortable with.

An alternative to the types of funds discussed above are the class of lifecycle funds that are offered by many fund families. These funds will typically invest in several individual funds providing a pre-packaged diversified portfolio that suits an investor's risk tolerance. Typically these types of funds are targeted to a particular timeframe that they are to be held for, say 10, 20 or 30 years. Funds like this may alter their allocation over time to suit the aging population of its investors. For example a fund targeted for a 30-year holding period may initially have a very high weighting in equity, but will gradually shift its allocation to fixed income over time. Funds like these offer investors the convenience of not having to worry about re-allocating their assets as they age, but conversely the new allocations should be considered as investors make additional contributions to their retirement assets.

"Not only is your employees' retirement plan an important part of their net worth and financial well-being, but a good plan can contribute significantly to company morale."

Education is also a key part of any investment program and fund providers may offer seminars or other educational materials for employees. Important topics for employees to be introduced to include issues like:

- Costs—know what the annual fees are in your investment choices and how they will impact your long-term goals.
- Holding Periods—be aware of how long you intend to hold your portfolio so that your risk is appropriate. Too little risk can be as dangerous as too much risk.
- Rebalancing—don't forget about your portfolio. If you are not in a lifecycle or some other balanced fund, the risk level in your portfolio will migrate over time.

Providers

If you are not self-directing your investments, but using professional managers instead, the most important issue is to decide between active and passive management.

Passive managers invest the portfolio to track a particular index, be it stocks or bonds. As this style of investing is more administrative than advisory, the fees tend to be much lower. There are also index funds available for many asset classes and styles, so a diversified portfolio can easily be created and maintained.

"The biggest concern when hiring active managers is to determine whether or not they are worth the additional cost."

Alternatively, active managers tend to take significant bets versus their benchmarks and may produce superior returns. (Inferior returns are possible too!) This style of management requires a lot of technological and investment know-how and employs more staff to implement the process. For this reason, active managers tend to be more expensive.

The biggest concern when hiring active managers is to determine whether or not they are worth the additional cost. It is important to measure the performance of managers on a net-of-fees basis. There is no advantage to hiring an active manager who does better than an objective benchmark only to deliver lower returns after the fees are deducted.

When hiring an active manager, it is important to monitor their returns versus these respective benchmarks to make sure that they are worth the additional cost. Part of the due diligence process of hiring an active manager should include developing expectations of how they will perform. It is not realistic to expect that active managers will always do better than their benchmark, but at least you should have a sense of how often they will under-perform and by how much. There are many statistical measures that are used to monitor performance and to verify that the returns and risks realized are within your expectations. There are also metrics that measure the consistency of managers' performance which is helpful in developing the confidence that they are on the right path. Any active managers should be required to periodically provide this type of analysis.

And finally, do not be afraid to terminate managers if their results do not meet your expectations.

Steve Pomerantz LLC provides economic consulting in the areas of securities valuation, investment suitability and investment management performance. Steve can be reached at 609.921.7545 or steve@steve-pomerantz.com.

Correction

The following was omitted from the Fall 2005 edition of *Inside*: Laurence B. Beckler primarily practices corporate law, focusing on general business and commercial matters. Mr. Beckler primarily represents mid-market businesses in the full range of business issues. In particular, the firm's current activities include forming business entities, negotiating transactional and license agreements and advising on mergers and acquisitions. Mr. Beckler also advises on intellectual property, advertising and new media issues. He can be reached at 575 Madison Avenue, New York, NY 10022 and at larry@becklerlaw.com.

SEC Adopts Significant Securities Offering Reforms

By Thomas More Griffin, Esq. and Brian DiBenedetto, Esq.

Recently, the Securities and Exchange Commission ("SEC") adopted a set of groundbreaking rules intended to simplify registration, communications and offering processes for issuers of securities. The rules, originally proposed last November in SEC Release No. 33-8501, were adopted without substantial change by the SEC on June 29, 2005 in Release No. 33-8591 and will become effective in early December, 2005 (the "Rules").

Categorization of Issuers

In the Rules, the SEC divides issuers into four distinct categories:

- *Non-Reporting Issuer.* An issuer that is not required to file periodic reports with the SEC pursuant to the Securities Exchange Act of 1934 (the "Exchange Act").
- *Unseasoned Issuer.* An issuer that is required to file periodic reports with the SEC, but is not eligible to use Form S-3 or Form F-3 in connection with a primary offering of its securities.
- *Seasoned Issuer.* A reporting issuer that is permitted to use Form S-3 or Form F-3 for a primary offering of its securities.
- *Well-Known Seasoned Issuer ("WKSI")*. A seasoned issuer that either (1) has outstanding a minimum $700 million of worldwide common equity market capitalization held by non-affiliates, or (2) within the past three years, has issued at least $1 billion aggregate principal amount of non-convertible securities, other than common equity, in primary offerings for cash registered under the Securities Act of 1933 (the "Securities Act").

Communications Relating to Registered Securities Offerings

Generally, the SEC restricts the types of offering communications that issuers, underwriters and other offering participants may use prior to and during a registered public offering. The form and severity of the restriction is dependent upon the timing of the communication. The SEC commonly refers to violations of these restrictions as "gun-jumping." The Rules significantly expand the scope of permissible offering communications in light of modern communications technologies.

Treatment of Electronic Communications

Intending to encompass new technologies, the Rules make it clear that all electronic communications (other than telephone and other live, in real-time communications to a live audience) are "graphic" and, therefore, written communications that are free writing prospectuses (see Free Writing Prospectus below).

Safe Harbors for Ongoing Communications During an Offering

The Rules implement two non-exclusive safe harbors from the gun-jumping provisions for continuing ongoing business communications.

Safe Harbor for Reporting Issuers

The first safe harbor permits *reporting issuers* to continue to publish or disseminate *regularly released factual business and forward-looking information* at any time, including during the period surrounding a registered offering. For purposes of this safe harbor, *"factual business information"* means (1) factual information about the issuer, its business or financial developments, or other aspects of its business, (2) advertisements of, or other information about, the issuer's products or services, and (3) dividend notices, and *"forward looking information"* means (a) projections of the issuer's revenues, income, earnings per share, capital expenditures, dividends, capital structure, or other financial items, (b) statements about the issuer management's plans and objectives for future operations, (c) statements about the issuer's future economic performance, and (d) assumptions underlying or relating to any of the foregoing information.

Safe Harbor for Non-Reporting Issuers

The second safe harbor permits *non-reporting issuers* to continue to publish or disseminate regularly released *factual business information* (which is not forward-looking), excluding dividend notices, that is intended for use by persons other than in their capacity as investors or potential investors, such as customers and suppliers; however, the safe harbor also requires that the same issuer employees or agents who historically have been responsible for providing the information continue to communicate the information provided in reliance on this safe harbor.

30-Day Bright-Line Exclusion from Gun-Jumping Provisions

As a means of preventing unnecessary limitations on issuer communications, the Rules provide a bright-line time period, ending 30 days prior to filing a registration statement, during which issuers may communicate without violating the gun-jumping provisions, provided several conditions are met.

Permitted Pre-Filing Offers for WKSIs

In addition to being able to utilize the 30-day bright-line exemption available to all issuers, WKSIs are permitted to engage in unrestricted oral and written offers (whether by the issuer or on its behalf) within the 30-day period prior to the filing of a registration statement, without violating the gun-jumping provisions. These communications, while exempt from the gun-jumping provisions, still are subject to Regulation FD and applicable liability standards, and the anti-fraud provisions of the federal securities laws also continue to govern such communications.

"According to the SEC, a 'free writing prospectus' includes any written communication that constitutes an offer to sell or a solicitation of an offer to buy securities that are or will be the subject of a registration statement and that is not otherwise a prospectus."

A written offer made under this proposed exemption would be considered a "free writing prospectus" and would have to include a legend and, subject to certain exemptions, be filed promptly upon the issuer filing its registration statement. Any written communication used for these purposes is subject to the same cure and record retention provisions applicable to free writing prospectuses used after a registration statement is filed.

Expansion of Rule 134 Post-Filing Communications

Rule 134 provides a safe harbor from the gun-jumping provisions for limited public notices about an offering made after the filing of a registration statement. The Rules contain amendments to Rule 134 that provide for a limited expansion of the information permitted in the notice about the issuer and the registered offering.

Free Writing Prospectus

Overview

The Rules as adopted permit written communications that constitute offers, including electronic communications, outside the statutory prospectus beyond those previously permissible under the Securities Act, if certain conditions are met. Any such written offer outside of the statutory prospectus will be classified as a "free writing prospectus."

"Free Writing Prospectus" Defined

According to the SEC, a "free writing prospectus" includes any written communication that constitutes an offer to sell or a solicitation of an offer to buy securities that are or will be the subject of a registration statement and that is not otherwise a prospectus. Although a free writing prospectus would not be filed as part of a registration statement, it still will be considered to relate to the public offering of securities.

Availability of the Free Writing Prospectus

The use of a free writing prospectus by any person participating in the offer and sale of securities would be conditioned on the availability of the issuer's most recently filed statutory prospectus (other than a summary prospectus) satisfying the requirements of the Securities Act and, in certain cases, on prior or concurrent delivery of the issuer's most recently filed statutory prospectus.

The permitted use of a free writing prospectus is governed by the categorization of the issuer. A free writing prospectus can be used by a WKSI at any time. Non-reporting issuers and seasoned and unseasoned issuers may only use a free writing prospectus subsequent to the filing of a registration statement.

Seasoned issuers and WKSIs need not deliver the most recent statutory prospectus to recipients of a free writing prospectus. Instead, they must include a legend on the free writing prospectus that informs the recipient of the filing of a registration statement and the URL for the SEC's website where the recipient can access or hyperlink to the preliminary or base prospectus, as well as the toll-free telephone number through which the statutory prospectus may be requested.

The Rules make clear that information included in a free writing prospectus yet omitted from a registration statement prospectus will not, solely by virtue of inclusion of the information in a free writing prospectus, be considered an omission of material information required to be disclosed in the registration statement. In addition, the Rules allow users to cure unintentional or immaterial failures to include the specified legend in any free writing prospectus, as long as a good faith and reasonable effort is used to rectify the omission. A similar cure provision applies where a user fails to file a free writing prospectus.

Electronic Road Shows

Traditionally, issuers and underwriters conducted live presentations, known as "road shows," to market their securities offerings to the public. Due to advances in electronic media, today's road shows often are conducted or re-transmitted over the Internet or other electronic media, in some instances to broader audiences.

Generally, the Rules provide that electronic communications, including electronic road shows (i.e., road shows transmitted electronically by the Internet, videos, e-mail, CD-ROM or any other medium), are graphic communications that fall within the definition of written communication and, therefore, are considered free writing prospectuses (but, generally, are exempt from the free writing prospectus filing requirements). However, a live real-time road show, to a live audience, that is transmitted graphically will not be a graphic communication, and therefore not a written communication, or a free writing prospectus. Communications (such as slides or visual aids) that are provided only as part of a road show and simultaneously therewith are deemed to be part of the road show.

Websites

The Rules make clear that the offer of an issuer's securities on its website or hyperlinked to a third party website from the issuer's website, will be considered a written offer of securities and unless otherwise exempt, will be a free writing prospectus. Nonetheless, an exemption exists for historical information. Specifically, historical information posted on an issuer's website will not be deemed to be a current offer of securities and, therefore, a free writing prospectus, if it is: (1) separately identified as such, and (2) located in a separate section of the issuer's website that contains historical information.

Media Publications

When an issuer or offering participant provides (oral or written) information to the media about the issuer or an offering that constitutes an offer, and where the media publication of that information is an offer by the issuer or offering participant, such publication will be considered a free writing prospectus of the issuer or offering participant.

If the issuer or offering participant prepares, pays or provides consideration for, or uses or refers to a published article, television or radio broadcast, or advertisement, the issuer or offering participant will have to satisfy the conditions to the use of any other free writing prospectus. As applied, non-reporting and unseasoned issuers would have to proceed or accompany the communication with a statutory prospectus, while for seasoned issuers (excluding WKSIs), a registration statement (including a statutory prospectus) would have to be on file with the SEC. However, if the media publication is prepared and published or broadcast by persons in the media that are unaffiliated with the issuer or offering participants, and the publication is not paid for by the issuer or offering participants, a prospectus would not have to precede or accompany the media communication, provided that (except in the case of a WKSI) a registration statement (including a statutory prospectus) is on file with the SEC.

Where a media publication must be filed with the SEC, such requirement may be satisfied by filing: (1) the media publication, (2) all of the information provided to the media in lieu of the publication, or (3) a transcript of the interview or similar materials that the issuer or other offering participant provided to the media, assuming that all the information provided is filed.

Liability Issues

Timing of Information

The SEC provides in the Rules that the time at which an investor becomes committed to purchase securities is the appropriate time to apply the liability standards of Section 12(a)(2) and Section 17(a)(2) of the Securities Act. In accordance with this framework, a determination of liability does not take into account information conveyed to a purchaser only after the time of sale, including information contained in any final prospectus, prospectus supplement, or Exchange Act filing that is filed or delivered subsequent to the time of sale, where the information is not otherwise conveyed at or prior to that time.

Section 11 Liability

Notwithstanding the liability timing modifications discussed above, the Rules provide that a prospectus or prospectus supplement that is part of a registration statement filed after the time of the contract of sale will be deemed to be part of and included in a registration statement for purposes of liability under Section 11 of the Securities Act at the time of effectiveness, which may be at or before the time of the contract of sale. Accordingly, the class of investors that may have a claim under Section 11 and Section 12(a)(2) may be different.

Modifications to Registration Procedures

Clarification of Means for Adding Information to a Shelf Prospectus

The Rules now permit information omitted from a base shelf prospectus to be contained in either a prospectus supplement, post-effective amendment or, where permitted, the issuer's Exchange Act reports (not solely its periodic reports).

Automatic Shelf Registration for WKSIs

The Rules contain a more flexible form of shelf registration for WKSIs, which provides for:

- automatic effectiveness upon filing (without SEC staff review);
- additional classes of securities and majority-owned subsidiaries may be added as registrants after the automatic shelf registration statement becomes effective; and
- filing fees may be paid at any time in advance of a takedown (i.e., on a "pay-as-you-go" basis).

> *"The arrival of December will bring the most significant registered offering reforms in years."*

Incorporation by Reference on Form S-1 and F-1

Under the rules, reporting issuers that are current with their reporting obligations under the Exchange Act and have filed at least one annual report now may incorporate by reference into Form S-1 or Form F-1 information from their previously filed Exchange Act reports and documents, provided the incorporated reports or materials are made available on the issuer's website. Incorporation by reference still remains prohibited for Exchange Act reports and materials filed after the registration statement is effective (i.e., "forward incorporation by reference"). Nonetheless, the change makes Form S-2 and Form F-2 superfluous and, therefore, they have been rescinded.

Prospectus Delivery Reforms

The Rules eliminate the prior requirement that a final prospectus be delivered to investors. Instead, the Rules adopt an "access equals delivery" model, which provides that a final prospectus is deemed to precede or accompany a security for sale as long as the final prospectus is filed or the issuer will make a good faith and reasonable effort to file it within the time frame required by Rule 424 of the Securities Act.

Additional Exchange Act Disclosures

Risk Factors

The Rules amend Form 10-K and Form 10 to require the disclosure of risk factors of the same type required by Item 503(c) of Regulation S-K.

Unresolved Staff Comments

Under the Rules, accelerated filers and WKSIs must disclose, in their annual reports on Form 10-K or Form 20-F, written comments from SEC staff made in connection with a review of the issuer's Exchange Act reports that meet certain conditions.

Conclusion

The arrival of December will bring the most significant registered offering reforms in years. Gun-jumping restrictions will be significantly relaxed, while the free writing prospectus will greatly expand communications between issuers and investors during the offering process. WKSIs will be most significantly affected, enjoying unprecedented freedom from SEC oversight. Without question the Rules will be thoroughly reviewed and new issues concerning their implementation will arise. Accordingly, the ongoing implementation and application of the Rules should be closely watched to see how far-reaching their reforms will extend.

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