terms of the merger agreement, and nearly $125,000 on photocopying and related services. Most of that was spent "converting the document production from electronic to paper format," the court noted.

Fair Settlement. It said the parties do not dispute that because the lawsuit resulted in a "fair, reasonable, and adequate" settlement, the plaintiffs' lawyers are entitled to some award of fees and expenses. Moreover, the stipulation of settlement obligated Instinet—or Nasdaq—to pay an amount deemed "fair and reasonable" by the court. "Thus, the only dispute is over the amount that should be awarded."

The court said that in deciding how much to award, it must consider several factors, including:

- the benefits achieved by the settlement;
- the difficulty of the litigation and the efforts of counsel, including the stage of the proceedings at which the settlement was reached;
- "the contingent nature of the undertaking;" and
- "the standing and ability of counsel."

In this case, it said, the defendants focused their objections "on the modesty of the benefits achieved and the early stage at which the settlement was reached. They also argue that plaintiffs' counsel should not be rewarded for having inefficiently litigated the case."

Modest Benefits. The court agreed that the benefits achieved by the lawsuit, "although adequate to support the settlement of the claims asserted, are indeed modest." It also acknowledged "that this modest settlement was reached at an early stage of the litigation. . . . While the court does not penalize plaintiffs' counsel who achieve significant settlements early in litigation, it is also true that those who promptly recognize the inherent weakness of their claims and settle for modest gains should not expect to be rewarded with premium fee awards."

As to the time and expense incurred by plaintiffs' counsel, the court termed it "apparent that the plaintiffs undertook a massive document program in preparing for the preliminary injunction. As a result, they obtained several hundred thousand pages of production . . . and devoted a very large amount of time to review of these materials."

The court said it does not question "the *bona fides* of deciding to litigate in this fashion." However, it termed it "not unreasonable for the defendants to point out the obvious inefficiencies involved in this case, highlighted by the plaintiffs' decision to pay nearly $125,000 to convert documents produced in a digital format into a paper format." According to the court, using this approach "added both unnecessary expense and greatly increased the number of hours required to search and review the document production."

Finally, the court concluded that the "premium fee award" sought by plaintiffs' counsel is not justified by the "contingent nature" of their undertaking. "[W]here little is accomplished, the fact that the case was undertaken on a contingent fee basis militates in favor of awarding only a modest fee that reflects the value of the benefits achieved."

Counsel to the parties included the following attorneys, all of Wilmington, Del.: Pamela S. Tikellis, Chimicles & Tikellis; Seth D. Rigrodsky, Milberg, Weiss, Bershad & Schulman; Kenneth J. Nachbar, Morris, Nichols, Arsht & Tunnell; David C. McBride, Young, Conaway, Stargatt & Taylor; and Karen L. Valihura, Skadden, Arps, Slate, Meagher & Flom.

Internal Controls

Investor Community Representatives Attack Advisory Group Stance on Internal Controls

Several investor representatives in recent BNA interviews attacked what they see as moves spearheaded by a Securities and Exchange Commission advisory group to roll back key provisions of the Sarbanes-Oxley Act, in particular Section 404's requirements for reviewing and reporting on internal controls over public companies' financial reporting.

Representatives of the business community, particularly the banking industry, were more supportive of the advisory group's approach.

On Dec. 14, the SEC Advisory Committee on Smaller Public Companies approved five recommendations from its subcommittee on internal controls, including proposed exemptions for microcap companies from Section 404 reporting and for smaller public companies from Section 404 external audit requirements. Microcap companies would include those with less than $100 million-$125 million in market capitalization. Smaller public companies would be those with less than $700 million to $750 million market cap, or as much as 80 percent of all public companies.

The committee is expected to issue a report of its recommendations and solicit public comment on it during the week of Jan. 23 or the week of Jan. 30. The recommendations are due to be finalized by March, the month in which the panel's charter expires.

SEC Exemptive Authority Lacking? The SEC does not have the power to grant exemptions to microcap and smaller public companies from SOX requirements on reporting on internal controls—exemptions the SEC advisory committee is recommending, AFL-CIO Associate General Counsel Damon Silvers told BNA Jan. 9.

While Silvers suggested that the advisory group is seeking to "undermine" the law, he also said it is premature to address a court challenge in the event the SEC adopts the recommendations as rules. Separately, Barbara Roper, director of investor protection for the Consumer Federation of America, told BNA she generally agrees with Silvers's view.

Cynthia Richson, corporate governance officer for the Ohio Public Employees Retirement System, in a Dec. 29 interview called the SEC advisory committee's vote to roll back Section 404 for smaller companies "ridiculous" and "beyond disappointing."

"We're going so far backwards," Richson told BNA. "Why should only 20 percent of public companies be under the full Section 404 requirements," especially when the research of proxy advisory firm Glass Lewis & Co. LLC, for example, shows "we are starting to make good progress on cleaning up problems?" she asked.

Silvers noted that SOX Section 404 requires the SEC to prescribe rules mandating that management report on internal controls, and that a public accounting firm attest to the reports. Details of how the attestations are done are left up to the Public Company Accounting Oversight Board, he said. In Section 405, Congress

specified that nothing in Section 404 shall apply to an investment company.

Significantly, Silvers said, Sections 404 and 405 are not amendments to the 1934 Securities Exchange Act, as some other Sarbanes-Oxley provisions are. They are "simply stand alone" and the SEC was not given exemptive authority with respect to these sections in the way that it has exemptive authority under the 1934 Act, Silvers said.

"We are extremely supportive of what the advisory committee, at least preliminarily, will be recommending."

SARAH MILLER
AMERICAN BANKERS ASSOCIATION

However, Christopher Cole, regulatory counsel for the Independent Community Bankers Association, told BNA Jan. 9 that ICBA strongly supports the advisory committee's preliminary recommendations. He observed that the advisory committee is proceeding with the idea that this can be done through regulation without legislation.

"I believe that is the case, that the SEC can make these changes without any legislation," Cole said. "If the commission accepts those recommendations and that legal position, I don't see any reason right now that we would need to have any legislative fix for [Section] 404."

Similarly, Sarah Miller, chief regulatory counsel for the American Bankers Association, told BNA Jan. 9, "We are extremely supportive of what the advisory committee, at least preliminarily, will be recommending." She called the two contemplated exemptive provisions "excellent proposals."

Herbert Wander, the chairman of the SEC advisory panel on small companies and a corporate governance and securities lawyer with Katten Muchin Zavis Rosenman in Chicago, could not be reached for comment.

Publicly Traded Banks. Cole and Miller each said that if SEC were to implement the preliminary recommendations of the advisory committee, as much as 90 percent of publicly traded banks would either be wholly exempt from 404 or exempt from the outside audit requirement, "404 lite."Cole said that if the SEC does not act to exempt microcap and smaller public companies, as the advisory committee is preliminarily recommending, "[w]e're hoping that the House Small Business Committee will take up the issue legislatively."

Meanwhile, investor advocate Roper emphasized that Sarbanes-Oxley "clearly states that there's to be an annual certification and an annual audit, and it's not subject to interpretation or SEC exemption."

Roper commented that the language of Section 404 is "not particularly ambiguous." However, she said SEC "asserts that it always has exemptive authority. I think you're definitely looking at another situation in which the SEC could be sued."

The agency has been sued in the past year over its rules on the registration of hedge fund advisers, mutual fund governance, and exemptions from the 1940 Investment Advisers Act for broker-dealers rendering investment advice. There has been no decision yet in any of the three cases.

Silvers pointed out that Kurt Schact, executive director of the CFA Centre for Financial Market Integrity and a member of the SEC advisory committee, wrote a dissent to the internal controls subcommittee's recommendation of exemptions in which he suggested that the SEC may lack legal authority to implement broad exemptions to Sarbanes-Oxley Section 404.

Alternative Discussed. Like Schact, Silvers and Roper both advocated an alternative approach—that the SEC develop a Section 404 cost-effective standard tailored to smaller public companies. The committee preliminarily adopted the recommendation of this alternative. Roper acknowledged, "It's absolutely true that you can't take a system that's built around big companies and slam it onto small companies and hope it fits."

Silvers told BNA, "The SEC doesn't have the power to do the things the [advisory committee] is advising them to do. The commission doesn't have the power to exempt anybody from 404. It doesn't have the power to create a '404-lite' that doesn't involve an audit by an outside auditor. . . . It is consistent with the generally intellectually light tone of their deliberations that they would come out with recommendations that are . . . contrary to the law."

"We went from reform to repeal with lightning speed," Roper commented. She suggested that the Section 404 issue "will move primarily on a regulatory front."

In part because of the exigencies that propelled Sarbanes-Oxley into law, Roper said she does not believe Congress is "committed to the protection the law provides."

Section 404 is also vulnerable to regulatory change, she said, because the law's sponsors—Sen. Paul Sarbanes (D-Md.) and Rep. Michael Oxley (R-Ohio)—have announced they will retire at the end of this session of Congress. "Most people would prefer to do this by regulation rather than legislation, because legislation is a more dangerous and public process. The regulatory process is much easier to control," Roper said.

No Bill Yet. No legislation to repeal Section 404 has yet been introduced. Nonetheless, Rep. Tom Feeney (R-Fla.), a member of the House Financial Services Committee, has been engaging in an effort to gather input through "listening sessions," an aide told BNA Jan. 10. These forums, which have been organized by various groups, began a few months ago, the aide said, adding that Feeney's outreach effort is ongoing. The aide told BNA, "People want to talk about it and we're happy to listen to them."

Other lawmakers have lent an ear to small businesses upset over the impact of Section 404. For example, representatives of the banking, biotech, electronics, and venture capital industries, among others, participated in a roundtable with Democratic members of the House Small Business Committee in late October.

Meanwhile, the regulatory process proceeds. Silvers told BNA that the AFL-CIO plans to write a letter detailing its concerns about the SEC's authority in this area in response to the advisory committee's report. In addition, he said, the organization will set forth the substantive reasons why the exemption and "404-lite" would be "a terrible idea."

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Working With Accounting Firms. According to Silvers, "There is ample room to pursue"—as former SEC Chairman William Donaldson and former PCAOB Chairman William McDonough did—"a course of action [in which the] PCAOB [would] work with accounting firms to impress upon them that Sarbanes-Oxley is not the 'Bleed-the-Public-Company Act of 2002.' " Auditors need to be reasonable under Section 404, Silvers said, adding that "there are a number of ways by which to manage 404."

Silvers argued that even if the kind of relief being recommended by the advisory committee were legal, the case has not been made for it. For companies with public float under $75 million, the level of their Section 404 compliance costs is still unknown. For companies with public float over $75 million, the compliance costs from the first year under the SEC rules were expected to be high, while the costs of the second year are not yet tallied, Silvers urged.

One of the few investor representatives on the advisory panel, Schact in a Dec. 14 news release said CFA's "biggest concern" is that the recommendations give "a flat-out exemption" for "what effectively will be more than 80 percent of the public companies in this country." He said, "[S]mall public companies need checks and balances over financial reporting. They consistently have more misstatements and restatements of financial information, nearly twice the rate of large firms, according to one report."

Long-Standing Requirement. Similarly, Roper commented, "We've had a requirement that companies have effective internal controls for 30 years, and they did nothing about it in all too many cases." SEC statistics from the first year of Section 404 reporting, she said, showed that in some 15 percent of cases, the companies "had to report material weaknesses.

"[T]he message conveyed to me is that their internal controls are in an absolutely appalling state. We have a bunch of small companies that can't begin to meet the responsibilities that go hand-in-hand with raising money from the public."

BARBARA ROPER
CONSUMER FEDERATION OF AMERICA

"You've finally got something on the books that makes the requirement to have internal controls more than an empty gesture and you're talking about rolling it back for as many as 80 percent of companies," Roper said.

"Unless the Democrats on the commission develop some backbone and unless [SEC Chairman] Chris Cox lives up to his promise to have the SEC serve as the investors advocate, [smaller public companies] have victory within their grasp, and it's amazing," Roper said.

In a separate Jan. 3 interview, Roper told BNA smaller companies are talking about internal control issues and sending the message that the requirements are unreasonable, but "the message conveyed to me is that their internal controls are in an absolutely appalling state. We have a bunch of small companies that can't begin to meet the responsibilities that go hand-in-hand with raising money from the public," she said.

According to Roper, the developments of this advisory committee lend support to the notion that the SEC advisory committee system itself is open to question. Essentially, she said in the later BNA interview, "you get people in a room who share the same basic philosophy and they come out with a broad proposal, with a wish list," and this becomes influential in the SEC's decision-making.

BY RACHEL MCTAGUE AND ALISON CARPENTER

Civil Penalties

Securities Lawyers Find SEC Statement On Corporate Penalties Clearly Beneficial

Several securities lawyers told BNA Jan. 5 that the framework provided by a new Securities and Exchange Commission policy statement on corporate fines and penalties is clearly beneficial, but they differed on how much the statement represents a change from current practice and on whether the magnitude of corporate penalties will be affected.

SEC Chairman Christopher Cox announced the new policy statement, which lays out principles and factors the SEC will consider in deciding whether to impose penalty on a corporation accused of securities law violations (4 CARE 4, 1/6/2006). SEC Commissioner Paul Atkins had raised questions about whether large corporate penalties are appropriate when shareholders have already suffered from corporate managers' wrongdoing.

David M. Becker, a partner at Cleary Gottlieb Steen & Hamilton LLP in Washington and a former SEC general counsel, told BNA Jan. 5, "I think its a good thing that they've come out with a policy. It's going to stimulate a lot of public debate and that's a very healthy thing. I don't think, in the short term, it's going to have much impact on the direction of the commission. I think it's fully consistent with [the agency's] enforcement practices over the past couple of years." The former SEC official also said he does not think there is "any backtracking" on the level of penalties.

Good Citizenship. Becker said he thinks there will be much public discussion about the import of the sentence under the "cooperation" factor in the statement that reads, "When securities law violations are discovered, it is incumbent upon management to report them to the Commission and to other appropriate law enforcement authorities." "[P]eople will be talking about that, wondering what the word 'incumbent' is," Becker said. He said that he hopes and expects that the SEC staff interprets "incumbent" to mean something along the lines of "obligations of good citizenship, as opposed to a legal duty."

Further, Becker said he does not believe the commission intends to change its current position that "while you may get credit for cooperation, you don't get penalized if you don't self-report." He also said that he thinks concerns that the same wrongful conduct at two different companies will result in different treatment simply