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President Signs Dodd-Frank Bill into Law 1

Court Reinforces Work Product Doctrine 2

Advice to Boards and Controlling Shareholders of Delaware Corporation in Connection with Certain Going-Private Transactions 4

A Progress Report on the Convergence Plan 5

The Mattress Question 8
Technology's Impact on Financial Reporting

Reminder: Recently Amended Investment Adviser Custody Rule 9

Accounting Standards Update 11

TO OUR READERS

Welcome to the first edition of SEC Trends & Developments since Eisner LLP united with Amper, Politziner & Mattia, LLP to form EisnerAmper LLP. The reasons for the firms joining are the same as why we publish this and many other newsletters: to provide our clients and friends with the best possible services and resources we can. To find out more about the combination, visit www.eisneramper.com.

Eric Altstadter, *Managing Editor*

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President Signs Dodd-Frank Bill into Law

On Tuesday, July 20, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. The Dodd-Frank Act, with its impact on banks, investment advisors, and other consumer financial providers, will have at least an indirect effect on nearly every American. One little-heralded provision that will affect the largest number of public companies is an exemption from Section 404(b) of the Sarbanes-Oxley Act for non-accelerated and smaller reporting companies.

ANATOMY OF A BILL'S PASSAGE

The Dodd-Frank Act was first proposed by the House in December 2009 and passed later that month by a vote of 223 to 202. Taken up by the Senate in the spring of 2010, the Senate passed a version with substantial changes in May by a 59-39 margin, the minimum needed to avoid procedural hurdles which would have significantly delayed passage of the Bill, if not preventing its passage altogether. The House-Senate Conference on the Bill completed its work June 25, with the House passing the Bill 237-192 on June 30. The Senate passage of the Bill was expected shortly thereafter, but soon faced a number of hurdles.

The Senate's original 59 votes included abstention by two senators, including Senator Byrd, who passed away on June 28, potentially subjecting the Senate to

FROM THE BAR...

Advice to Boards and Controlling Shareholders of Delaware Corporations in Connection with Certain Going-Private Transactions

by Nancy D. Lieberman, Esq., Farrell Fritz, P.C.

Unilateral two-step freeze out transactions (going-private transactions in which a controlling shareholder unilaterally launches a first-step tender offer and commits to eliminate any remaining stockholders through a second-step short-form merger) have been subject to varying standards of review by the Chancery Court of the State of Delaware. There is no Delaware Supreme Court precedent addressing the standard of review in those transactions. Consequently, it has been difficult to advise directors regarding appropriate procedural safeguards in structuring controlling shareholder freeze-out transactions.

The Court of Chancery of the State of Delaware, however, recently paved the way for the Delaware Supreme Court to clarify which standard of review is appropriate. The Court granted an application for an interlocutory appeal in *In re CNX Corporation Shareholders Litigation*[1]. Until the Delaware Supreme Court issues a decision on the appeal, boards of directors and controlling shareholders are advised to consider the differences between the two current standards of review in structuring a unilateral two-step freeze out transaction.

CURRENT DIFFERING STANDARDS OF REVIEW

Delaware courts have been applying two different standards of review; the business judgment rule or the entire fairness test. **The business judgment rule** specifies that a court will not review the business decisions of directors who performed their duties in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the directors reasonably believe to be in the best interests of the corporation. Using this standard, a case against the board of directors will likely be dismissed at an earlier stage, thereby reducing litigation costs as well as the risk of an adverse decision.

The entire fairness test is a stricter standard of review and is factually intensive. It involves examining "when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained," as well as determining whether the transaction involved a fair price. This standard increases the cost of litigation and the risk of an adverse decision.

Some trial court decisions[2], including CNX Gas Corp., hold that the business judgment rule applies to a unilateral two-step freeze-out if it is (i) recommended by a duly empowered special committee of independent directors *and* (ii) "approved" by a majority of the minority shares. If both requirements are not met, the transaction will be reviewed under the entire fairness test, shifting the burden to the director/defendants to affirmatively prove the fairness of the transaction.

Other cases, including *In re Siliconix, Inc. Shareholders Litigation*[3] hold that such freeze-out transactions will not be reviewed for entire fairness unless the offer is "structurally coercive" – meaning that the offer constitutes "a wrongful threat that has the effect of forcing stockholders to tender at the wrong price to avoid an even worse fate later on."[4]

Still other Court of Chancery decisions, including *In re Pure Resources, Inc., Shareholders Litigation*[5], hold that a unilateral two-step freeze-out will not be reviewed substantively if: (i) it is subject to a non-waivable majority of the minority tender condition; (ii) the controlling stockholder promises to consummate a prompt short-form merger at the same price if it obtains more than 90% of the shares; (iii) the controlling stockholder has made no retributive threats; and (iv) the independent directors on the target board have free rein and adequate time to react to the tender offer.

In addition to differing standards of review, the trial court decisions also conflict over the degree to which a unilateral two-step freeze-out is inherently coercive and the role of the board in the face of such a transaction.

SUGGESTIONS TO CONTROLLING SHAREHOLDERS AND DIRECTORS

Given the uncertainty of the current state of the law, directors and controlling shareholders should consider taking the most conservative approach while awaiting a decision from the Delaware Supreme Court. If a freeze-out transaction is recommended by a special committee of independent directors and approved by a majority of the minority shares, it will provide comfort that, if the test set forth in CNX Gas Corp. is applied, the transaction-related decisions of the board will be shielded from judicial scrutiny under the business judgment rule.

It is also advisable to consider the test established by *Pure Resources* (described above); this could avoid a substantive review of the terms of the transaction. However, controlling shareholders must weigh the benefits of the application of the business judgment rule or the lack of substantive review against potentially higher deal risk and costs resulting from the additional procedural protections.

The Delaware Supreme Court has not yet decided whether it will accept the interlocutory appeal. If it does accept, its decision will certainly affect the future of unilateral two-step freeze-out mergers. In the interim, directors and controlling shareholders are urged to consider the different standards of review in structuring the terms of any unilateral freeze-out transaction and the role of the board in such a transaction.

[1] In re CNX Gas Corp. S'holders Litig., C.A. No. 5377-VCL (Del. Ch. July 5, 2010).
[2] In re CNX Gas Corp. S'holders Litig., C.A. No. 5377-VCL (Del. Ch. July 5, 2010) and In re Cox Communications, Inc. S'holders Litig., 879 A.2d 604 (Del. Ch. 2005).
[3] 2001 WL 716787 (Del. Ch. 2001).
[4] CNX at *8, citing Siliconix at 438 n. 26.
[5] 808 A.2d 421 (Del. Ch. 2002).

From the Bar... is designed to present our readers with the views of counsel from outside EisnerAmper LLP. Please visit www.farellfritz.com for more information on Farell Fritz, P.C.

A Progress Report on the Convergence Plan

Overview of the Modified Strategy

On June 24, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) released a modified plan for their convergence effort. The revised plan outlined a new prioritization and target dates for projects that were previously documented in the 2006 Memorandum of Understanding (MoU) and other joint projects. The details of the Boards' modified strategy were also included in a progress report to the G20 leaders.

The original target completion date of June 2011 remains largely unchanged, but projects that are considered to be of lower priority will now be extended into the second half of 2011. In addition, the modified strategy also acknowledged changes in approach for certain projects. For Financial Instruments, the Boards plan to jointly consider the comment letters and other feedback in an effort to reconcile their differences and to foster improvements. For Consolidations, a revised strategy will focus on the consolidation of investment companies separately.

The table below highlights the new target dates for the priority projects and some other projects. For a complete discussion of the Boards' plan and timeline for all projects, the following is a link to their website: *http://www.ifrs.org/News/Announcements+and+Speeches/update+to+G20+on+modified+convergence+strategy.htm*

HIGHLIGHTS FROM THE EXPOSURE DRAFTS

On track with their proposed work plan, the FASB and IASB published a number of exposure drafts in the recent months. Some of the major proposed changes are highlighted below, and a complete list of the exposure drafts can be found on the FASB's website at www.fasb.org.

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Questions? Comments? Suggestions?

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