

ABOUT DAVIDOFF MALITO & HUTCHER LLP

A Leading Full Service Corporate Law and Government Relations Firm with active practices in:

- Government Relations & Lobbying
- Corporate & Securities
- Mergers & Acquisitions
- Banking, Finance & Venture Capital
- Litigation
- Real Estate
- Land Use & Zoning
- Bankruptcy/Creditor's Rights
- Trusts & Estates
- Administrative Law
- Construction Law
- Computer & Internet Law
- Healthcare Law
- Labor & Employment Law

- Upcoming Events:*
- On **September 22, 2005**, our firm is sponsoring **Long Island Invest**, an annual conference which brings Wall Street exposure to Long Island public companies. The conference begins at 8:00 a.m. at the **Melville Marriott Hotel**. Our partner **Neil M. Kaufman** is a member of the advisory board of Long Island Invest, LLC.
 - On **September 29, 2005**, our firm is sponsoring the **2005 TEC Long Island Regional Member Meeting & Conference** at 11:00 a.m. at the **Hyatt Wind Watch Hotel & Conference Center** in **Hauppauge, New York**.
 - On **October 6, 2005**, **Neil M. Kaufman** will participate in a panel discussion at a conference regarding **Mergers & Acquisitions**, sponsored by **Salomon Smith Barney** and the **Geneva Companies**.

- Recent Events:*
- On **June 20, 2005**, **Michael Zapson** presented an **Update on Elder Law, Estate Taxes, Healthcare Proxies and Planning Tools** at the **Senior Care in Lynbrook, New York**.
 - On **June 9, 2005**, **Neil M. Kaufman** moderated a panel discussion on **Later Stage Venture Capital Financing** at the **2005 Long Island/NY Metro Capital Forum**, presented by the **Long Island Capital Alliance**.

For more information regarding any of these events, please contact Neil M. Kaufman at (516) 248-6400 or nmk@dmlegal.com.

The information contained herein is not to be construed as legal advice.

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CORPORATE CHRONICLE

DELAWARE BUSINESS JUDGMENT RULE PRESERVED

On August 9, 2005, the Delaware Court of Chancery issued its much-anticipated decision *In re Walt Disney Co. Derivative Litigation*, No. 15452 (Del. Ch. Aug. 9, 2005), holding that each director-defendant had fulfilled his or her fiduciary duties under the business judgment rule in relation to the hiring and termination of Michael Ovitz as Disney president. Although the plaintiffs in the case recently filed a notice of appeal with the Delaware Supreme Court, the case confirms for the time being that the Delaware business judgment rule is alive and well.

The business judgment rule is an evidentiary presumption that in making a business decision, the directors of a corporation acted on an informed basis in good faith and in the honest belief that the action was taken in the best interests of the corporation. Based upon this presumption, the Delaware courts generally will not examine a decision made by directors who:

- (a) are disinterested and independent, meaning free of any conflicts of interest and not engaged in self-dealing;
- (b) employ a reasonable decision-making process;
- (c) act on an informed basis for a valid business purpose;
- (d) do not abuse their discretion or act in a grossly negligent manner; and
- (e) act in good faith.

In a recent speech to the European Policy Forum, Delaware Court of Chancery Vice Chancellor Leo E. Strine, Jr., noted the following with respect to the Delaware business judgment rule:

“Delaware corporate law... invest[s] ... management with wide discretion to make business decisions and a wide choice of means to effect those decisions.... The so-called business judgment rule, which requires that the judiciary not second-guess business decisions made in good faith and with due care, even if they turn out badly, is also designed to protect the economic value served by centralized management. The rule does so by insulating managers from fear that pursuit of an

attractive, but risky, business venture will leave them liable to the stockholders if the venture fails.”

The *Disney* case related to the company’s aggregate severance payment of \$140 million, in the form of cash and stock options, to its former president, Michael Ovitz, who was employed by the company for approximately one year. The company’s directors, including members of the compensation committee, allegedly allowed the company’s chief executive officer, who was Mr. Ovitz’s long-time friend, to arrange such payment without proper investigation or decision making. The district court had refused to dismiss this case and indicated that the actions of the compensation committee may have been taken in bad faith in light of the alleged lack of time, attention and information relating to the approval. The Delaware Court of Chancery held that the directors, under the business judgment rule, did **not** breach their fiduciary duties or commit waste even though hiring Mr. Ovitz turned out to be a bad decision. The court stated, in part, that finding directors liable for informed decisions undertaken in good-faith that turn out to be bad would foster “decisions that minimize risk, not maximize value....”

The court also acknowledged the evolving nature of best practices reflecting the ideal norms of corporate governance and that a failure to satisfy these aspirational goals was not tantamount to a breach of fiduciary duties. In this regard, the court noted that fiduciary duties are relatively static, unlike best practices that may change from time to time. The decision, however, was by no means a complete vindication of the directors, as the court noted numerous embarrassing lapses, such as the CEO acting to hire without specific board authorization. The case also reminds us that management must play an active role in managing the company. In addition, directors should actively pursue and obtain information germane to their decision making and verify information when necessary. The court also noted the importance of

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well-prepared minutes reflecting the nature of the deliberation process. Finally, the court held that a determination as to whether directors have satisfied their fiduciary duties is done on a director-by-director basis instead of reviewing the actions of the board of directors as a whole.

FROM THE EDITOR

Dear clients and friends:

With the economy and markets continuing to thrive, our corporate practice at DM&H has continued to grow. A number of our clients have been or are involved in significant financing and merger & acquisition transactions.

We are happy to have added Christopher Seamster as a first year associate in our Long Island office. Chris previously worked for us as an intern and as a summer associate, and is a highly valued member of our corporate team. We are seeking to continue to expand our team by adding highly qualified mid-level corporate/securities associates.



Neil M. Kaufman,
Senior Partner,
Corporate & Securities
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METER TAMPERING

Consider this scenario. Your company receives three consecutive months of significantly higher electric bills. You've conscientiously paid your utility bills for the past ten years but are concerned that this time there may be an error so you call Con Edison and ask them to investigate. Shortly thereafter, Con Edison's representatives appear at your facility, state that your meter has been tampered with and advise you that you owe hundreds of thousands of dollars for unmetered service and that unless this amount is paid immediately, your electricity will be turned off.

Sound far-fetched? In fact, this is almost exactly the situation with which our client, the Ambulatory Surgery Center of Brooklyn LLC (the "Center"), was confronted. Con Edison contended that its representatives had tested and inspected the Center's meter and concluded that it had been tampered with and was allegedly under-recording electrical usage by approximately 30%. Shortly thereafter, Con Edison's representatives appeared at the Center, removed and disassembled the meter, and after performing a quick calculation, presented the Center with a bill in the amount of \$258,576 allegedly representing six years of unmetered electric service and late payment charges.¹ In addition, Con Edison stated that unless one-half of this amount was paid within two hours, the electricity would be turned off.

Rather than comply with this ultimatum, the Center filed a complaint with the New York State Public Service Commission ("PSC"), which stayed any further action by Con Edison. Thereafter, the Center requested that the meter be independently tested at Con Edison's certified meter testing facility at Van Dam Street, Queens. Significantly, this "authoritative" testing contradicted Con Edison's previous field test results and confirmed that the meter was recording accurately. Notwithstanding these results, however, Con Edison refused to withdraw its claim of unmetered service, asserting that it had physical evidence that the meter had been tampered with and the Center had failed to explain an increase in electrical usage after Con Edison replaced the meter.

The PSC rejected Con Edison's claim and directed that the utility cancel all unmetered service and late payment charges (see Ambulatory Surgery Center of Brooklyn LLC v. Con Edison, New York State Public Service Commission, Case No. 301211, decided Feb. 28, 2005). Needless to say, consumers should not be unfairly subjected to a claim of meter tampering when they lawfully exercise their right to challenge their utility bills. Fortunately, this decision confirms that Con Edison's actions are not immune from scrutiny and will not be upheld when they are shown to be clearly erroneous.

¹ Pursuant to the Public Service Commission's rules and regulations, six years is the maximum period in which Con Edison may assess unmetered service charges.

SEC ADOPTS NEW PUBLIC SHELL COMPANY RULES

On June 30, 2005, the SEC adopted new rules relating to public shell companies in an effort to prevent abusive practices. The new rules, which generally became effective on August 22, 2005:

- require a public shell company to report on Form 8-K events that cause it to stop being a shell company and to include in such 8-K substantially the same detailed information, including in the context of a reverse merger transaction, audited financial statements of an acquired private company and pro forma financial information, required in connection with an initial public offering or when a public company registers a class of its securities under the Securities Exchange Act of 1934;
- prohibit a public shell company from using Form S-8 until at least 60 days after it is no longer a shell company; and
- require every public company to check a box on the cover of their annual and quarterly reports to indicate whether or not it is a shell company.

To effectuate these changes, Items 2.01 and 9.01 of Form 8-K have been amended and a new Item 5.06 has been added, effective on November 7, 2005.

INTERNAL REVENUE SERVICE
ISSUES GUIDANCE REGARDING
DISCLOSURE OF TAX
PENALTIES IN
FORMS 10-K AND 10-KSB

On August 12, 2005, the IRS issued rules implementing a disclosure requirement under the American Jobs Creation Act of 2004 that requires public companies generally to provide disclosure in their annual reports, under "Legal Proceedings," Item 103 of Regulations S-K and S-B, if they are required to pay a penalty to the IRS arising from their failure, or the failure of any entity required to be consolidated with them, to satisfy special tax return disclosure requirements in connection with certain transactions identified by the IRS as abusive or having a

CURRENT NEWS AND NOTES

U.S. Senate Confirms SEC
Chairman and Commissioners

On July 29, 2005, the United States Senate approved the nomination of Christopher Cox, a Republican, as Chairman of the Securities and Exchange Commission, and he was sworn in on August 3rd. On July 29th, the Senate also confirmed the nominations of Roel Campos and Annette Nazareth, both Democrats, as Commissioners. The other two Commissioners on the five-member SEC are Republicans.

SEC Charges an Issuer and its CEO
for Misleading Statements in a
Private Stock Offering

On August 24, 2005, the SEC charged a Nevada corporation and its chief executive officer with making false and misleading statements in a private placement memorandum offering 10,000,000 units at \$0.10 per unit. The SEC alleged that the issuer, among other things, made false and misleading statements about (a) revenues and assets that did not exist and (b) legal and accounting advisors that the issuer did not have. An administrative hearing regarding this matter is expected to be scheduled.

DM&H COMPANY SPOTLIGHT: PURITY PRODUCTS



Our client, Purity Products, is a leading high-end nutraceuticals company. Purity Products has formulated its products with the assistance of industry experts to include the right doses of vital ingredients that facilitate many healthy attributes.

These products are sold primarily through direct marketing channels. As a result of the efforts of owner Jahn Levin and his management team, Purity Products has achieved steady growth, with hundreds of thousands of satisfied customers, including your editor. For more information, you can call 1-800-718-2003 or visit www.purityproducts.com

We have enjoyed working with Purity Products in connection with acquisition, finance and real estate transactions, as well as on contractual and other matters. We look forward to continuing to assist Purity Products in achieving its goals.

significant tax avoidance purpose. A failure to disclose such information may result in a \$200,000 tax penalty under Section 6707A(e) of the Internal Revenue Code. The disclosure is generally required in the annual report for the year when the IRS demands payment of the penalty, and a failure to disclose in one year results in a continuing disclosure obligation in subsequent years until such disclosure is made. Each failure to disclose is treated as a separate violation that may result in a separate tax penalty for each failure.

SECURITIES ACT REFORM

On June 29, 2005, the Securities and Exchange Commission adopted a new set of rules revising different aspects of the Securities Act of 1933. The reform modernizes the communication, registration and offering processes by eliminating certain restrictions on registered securities offerings, allowing more communications before and during the registration period, and streamlining the shelf registration. The reforms will take effect on December 1, 2005 and will be more fully discussed in our next issue.

SECTION 16 AMENDMENTS

On August 3, 2005, the SEC adopted amendments to Rule 16b-3 and Rule 16b-7 of the Exchange Act. The SEC amended Rule 16b-3(d) and (e) to expressly provide that the exemption generally applies whether or not the transaction was for a compensatory or other particular purpose so long as (a) the transaction has been approved in advance by the full board or an authorized committee of the board comprised of non-employee directors, (b) the transaction has been approved or ratified by shareholders or (c) the securities acquired by the officer or director are held for six months. The SEC also amended Rule 16b-7, for the avoidance of doubt, to (a) replace "merger or consolidation" with "merger, reclassification or consolidation" and (b) clarify that the availability of the exemption is not dependent on any other condition than what is set forth in the rule.