Taming the Risk & Liability Beast

Webcast Presentation – February 2007

Presented by:
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About Brian Pastuszenski

Brian Pastuszenski, a senior partner in the national law firm of Goodwin Procter, LLP and co-chair of its Securities Litigation and SEC Enforcement practice, has achieved national prominence in the defense of securities class action and shareholder litigation matters and proceedings brought by the SEC and other regulatory organizations and in internal corporate investigations, corporate governance and compliance matters, merger and acquisition-related litigation, and the related insurance and indemnification issues that such matters involve.

Mr. Pastuszenski's practice is national in scope, and he spends a significant amount of his time advising senior management and boards of directors on how to minimize securities liability risks, and how best to manage crises when they occur. He has represented both United States and foreign-based issuers and their directors and officers in securities and corporate governance matters across the country, including matters in California, Colorado, Delaware, Illinois, Massachusetts, New York, Pennsylvania, Virginia, West Virginia, and Washington, D.C., among others. His clients have included manufacturers of computer hardware and software companies, semiconductor manufacturers, pharmaceutical and healthcare companies, an Internet portal company, a maker of special effects systems for the entertainment industry, venture capital firms, information technology providers, mutual funds, hedge funds, financial services companies and telecommunications products companies.

Mr. Pastuszenski recently tried a case in the Delaware Court of Chancery for an S&P 500 company in a matter involving allegations of breach of fiduciary duty arising from the granting of stock options. Mr., Pastuszenski also has represented numerous special board committees, publicly-traded companies, and individual officers and directors in connection with corporate internal investigations and shareholder derivative litigation concerning stock option matters.

Mr. Pastuszenski is also currently representing several public companies that have been sued in the IPO "allocation" class action litigation cases in federal court in New York City, which attack the way IPO underwriters allegedly allocated shares in "hot" IPOs to their customers. These cases constitute one of the largest securities class action litigations ever filed in the United States. Mr. Pastuszenski has also been appointed to serve on a committee of six law firms who represent issuer defendants in those cases.

Mr. Pastuszenski is past chair of the Business Litigation Committee of the Boston Bar Association. He has been selected as a national leader in his areas of expertise by Chambers USA: America's Leading Business Lawyers, Best Lawyers in America, and LawDragon. He was recently recognized by Boston Magazine as one of the Top 100 Lawyers in Massachusetts.

Mr. Pastuszenski is a summa cum laude graduate of Dartmouth College and received his J.D. (magna cum laude) from Cornell Law School, where he served as editor of the Cornell Law Review. Mr. Pastuszenski is admitted to the bar of the United States Supreme Court and other courts across the country.

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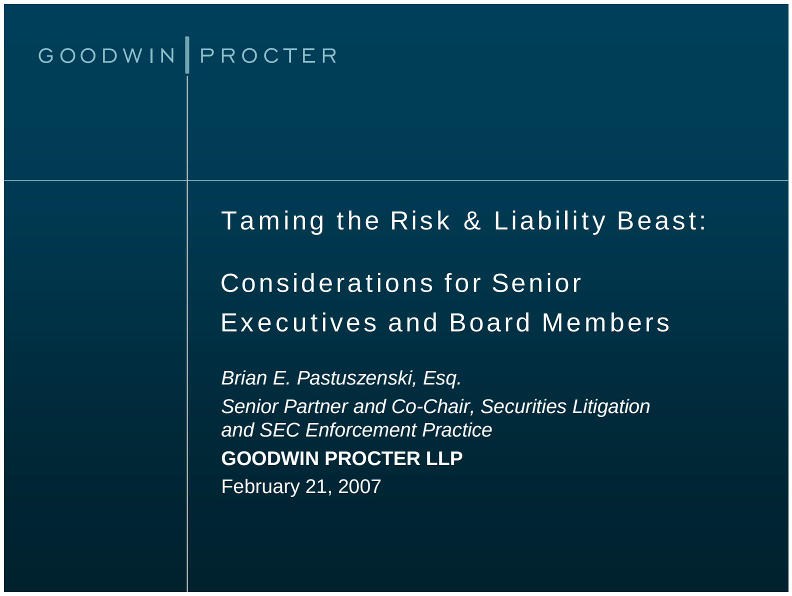
Table of Contents

Taming the Risk and Liability Beast



What I am going to cover today runs the gamut from issues that many of you are probably dealing with right now -- extremely hot, extremely media-grabbing or headline-grabbing matters – to other issues that have a more enduring importance. These are issues that go to the bedrock of what every company, large or small, ought to be paying attention to in terms of common sense, good corporate governance, and risk-mitigation and avoidance considerations and practices.

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Topics

I'm going to start by giving you a sense of what's going on right now in the litigation and liability landscape. We'll spend a few minutes looking at where we've been over the last few years, in particular the last 12 months, which has been a time of tremendous change.

I first want to spend some time on executive compensation issues, with a particular focus on stock options. This is something that many of my clients probably never want to hear anything more about, but nonetheless it's very important and very timely. Related to executive comp., I want to spend some time on 10b5-1 plans, of which I happen to be a major proponent, and which I view as a tremendous risk-mitigation tool.

I'm then going to shift to some issues that are of equal importance in the boardroom as well as in the management ranks, including diligence and corporate decision-making. My summary comments will include some discussion of personal indemnification and liability.

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Current Liability Landscape

Let's start off looking at the landscape. Everybody who reads the papers knows that the past several years since Sarbanes-Oxley have been a time of extraordinary aggressiveness on the part of the government, both from the perspective of the SEC, which has responsibility for enforcing the civil securities laws, as well the US and state Justice Departments, which have the duty of enforcing the laws criminally.

One unfortunate -- from my perspective -- consequence of the last few years is that much of what we see in the newspapers is being criminalized -- prosecuted criminally as well as civilly. We can debate for hours, no doubt, on whether some of that prosecution is warranted and some of it not, but the point is we have seen a tremendous period of aggressive, vigorous enforcement of the securities laws. At the same time, companies - I think the vast, vast majority of them -- are trying to do the right thing. Managements and boards are struggling with the weight of regulation, and many smaller public companies -- perhaps, many of the companies who are attending this Webcast today -- have come to question the wisdom and the benefits of being a public company, because of the burdens and the costs of compliance and regulation. Nonetheless, we still number in the several thousands companies listed on the various exchanges, despite the cost and despite the challenges.

One of those challenges, unfortunately, continues to be securities class action and related shareholder litigations. This is something that I spend much of my life as a professional dealing with. I defend these cases; more often than not, I win these cases. But from my clients' perspective I am a necessary evil, because these cases continue to haunt the business community -- they have for as many years as I've been in the business.

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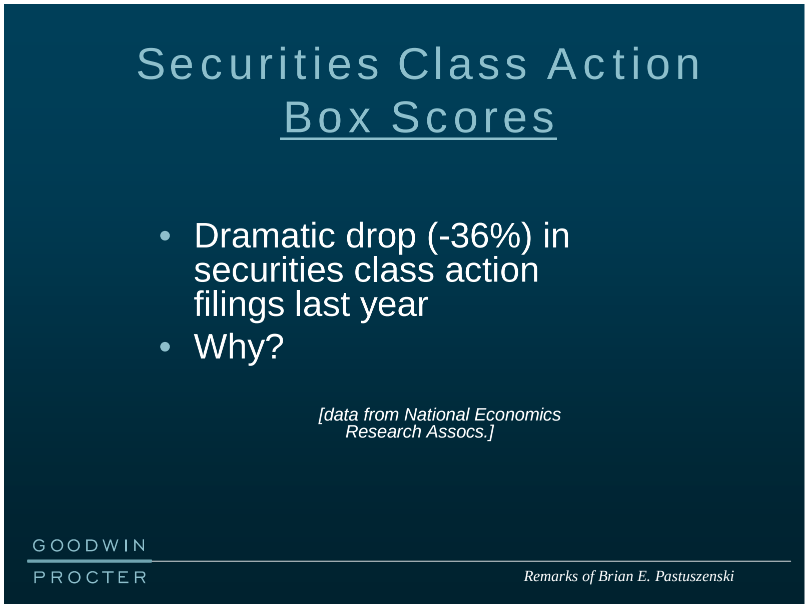
Securities Class Action: Box Scores



One thing happened last year, however, that has made a number of people stand up and take notice: there was a roughly 36% decline in the number of securities class action lawsuits filed in this country. That is not an insignificant drop. It brings to mind the one-time drop in securities class action filings that occurred immediately after the passage of the securities litigation reforms at the end of 1995 over President Clinton's veto. And as you might expect, both lawyers on the defense side, like myself, lawyers who end up advising boards and management, and plaintiff lawyers and academics on the other side, are scratching their heads and debating, "Why the drop? Why did we see a materially smaller number of securities cases filed last year?"

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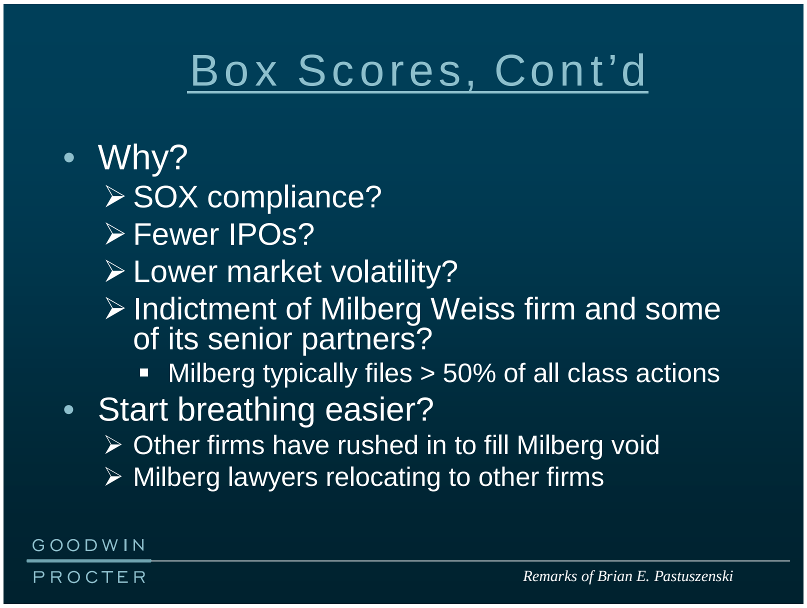

The reasons are many, potentially. One reason that some people have advanced is better compliance by companies through Sarbanes-Oxley and related laws. Another reason that some people have suggested is that, given where the markets have been moving, which is mostly sideways since the bursting of the bubble back in the 2000-2001 period, there are fewer IPOs and fewer targets for plaintiff lawyers to go after. That corresponds to lower market volatility, at least in the recent past.

One not-insignificant possible driver of the drop is the very public indictment of the Milberg Weiss firm and two of its very senior and very well known partners. This is a factor, I think, that is not to be underestimated. My crystal ball is no better than yours in terms of what accounts for the drop in securities class action cases recently, but historically, over the last several years, Milberg Weiss has filed more than 50% -- pushing 55% -- of all the securities class action cases brought in this country. It has seen a bloodletting, so to speak, over the last several months. Senior lawyers, junior lawyers, have decided to take their futures elsewhere, and have joined competing firms. The firm is still in existence, but it is a -- perhaps if I say "fraction of its former size" that would be an exaggeration, but it is substantially winnowed down from what it used to be. And time will only tell if that is the driver of the statistic or if there are other reasons.

One thing that I would say to you, however, even though my crystal ball is not perfectly clear, is that this is not a time to take a step back and breathe a sigh of relief. For every lawyer that leaves Milberg Weiss, a lawyer joins another firm that does the same thing. It's just like insurance -- you've heard the old saying that "insurance abhors a vacuum"? The same thing is true of plaintiff securities class action lawyers. They abhor a vacuum. And the slack created by Milberg Weiss' troubles is, I can assure you, being taken up by other firms as immediately as that slack appears.

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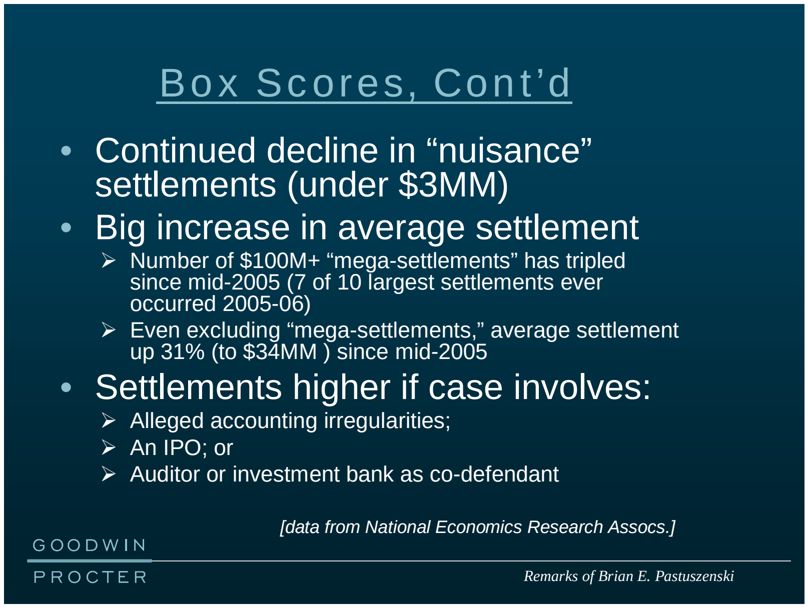

In addition to the drop-off in securities cases nationally, what we're seeing is an interesting and somewhat ironic development: the number of smaller settlements at $3 million and under has declined appreciably.

At the same time, the number of large settlements has increased, so that what we've seen since the middle of 2005 is that the average settlement has risen 31%, to almost $35 million. Now, that number does not include -- and this is an important fact -- does not include the mega-settlements. And, there have been a number of them in the last few years -- mega-settlements above $100 million. That $35 million figure -- $34 million figure -- does not include averaging of the huge settlements. If you include the huge settlements, like the WorldCom and Enron settlements, you get a substantially larger number. I've factored those out so as not to unfairly skew the figure. So that's a very significant number. And, if you're a public company in these markets the chance of getting sued in a securities case is not insignificant, and the average settlement of $34 million is nothing to sneeze at. This is why I intend to spend some time at the conclusion of my remarks talking about D&O insurance and indemnification.

It probably won't surprise you that the settlement amount you're likely to see in a case will be higher if you're being accused of accounting irregularities, particularly a financial accounting restatement or other kinds of irregularities -- revenue recognition, earnings misstatements, etc… If you've got those kinds of allegations in the lawsuit that's been filed against you, more often than not -- if it settles and doesn't get thrown out -- and by the way, when these cases get filed, my modus operandi is to try to get them thrown out because in my experience the vast majority are not well-taken and are not based on merit. But, if it does survive and does ultimately settle, the settlement is likely to be higher where there are accounting irregularities, where there was an IPO or public offering involved, or where you've got company and your public auditing firm or an investment bank is standing next to you as a codefendant. That will also drive the amount of the settlement up.

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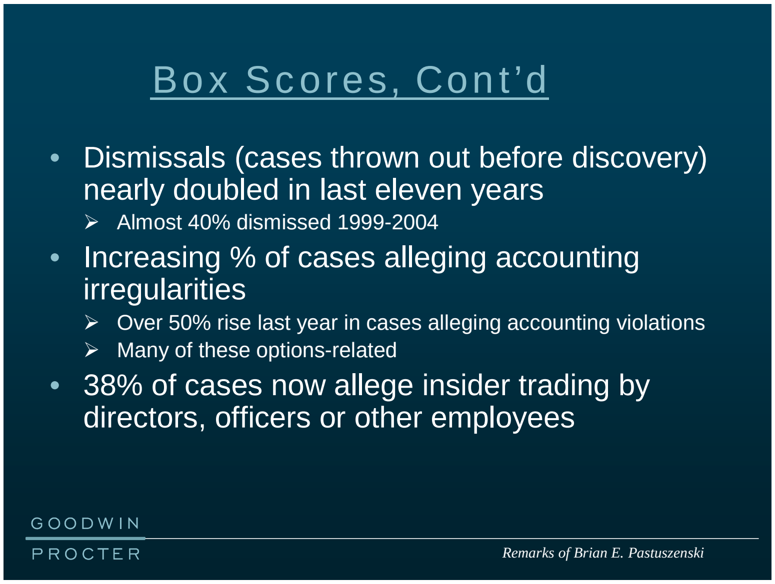

One silver lining in this picture is that the securities-law reforms that I mentioned, which were passed over Clinton's veto in 1995, have been having some beneficial impact for my clients and other companies in the business community. As a result of the laws becoming tougher, the number of cases that have been thrown out as lacking legal merit -- right at the offset, before they ever get into discovery -- has nearly doubled in the last 10 to 11 years. So if you look at the time period 1999 to 2004, which is the period for which I've got the most recent statistics, almost 40% of the securities cases filed in this country have been thrown out. And that is -- to me, somebody who is a defense lawyer and does this for a living -- that's a very gratifying figure.

At the same time, we've seen -- not surprisingly, given all the attention on revenue recognition and the attention on option accounting -- we've seen a huge increase in the number of cases alleging some kind of accounting irregularity. Over a 50% increase last year. That is to say, in calendar '06 in cases alleging accounting violations. And many of those are options-related.

Almost 40% of the cases now being filed allege some kind of trading by insiders on the basis of material, non-public information -- directors and officers. And the reason for that is not surprising. If you're a plaintiffs' lawyer and you're alleging fraud, you want to be able to tell a very compelling story of fraud to the judge so that the judge thinks twice before he or she grants my motion to have that case thrown out.

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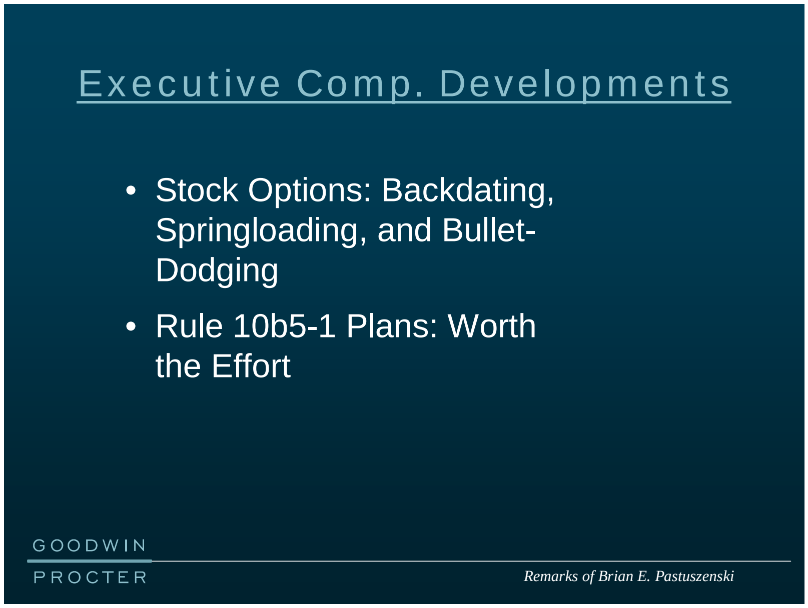
Executive Compensation Developments



Let me shift away from the liability landscape to something that, as I said at the beginning, is probably near and dear to the hearts of many of you -- and, I know, many of the companies that I have the pleasure of working with. And that is executive compensation, and specifically stock option-related issues. I'm not going to bore you with things you already know, but there are some important developments and, I think, some important considerations for all of us to be thinking about. Executive comp -- at least one aspect of it -- is the ability, at the appropriate time, to be able to get liquidity and to be able to sell stock, or exercise options and then sell stock. And in that regard, I want to spend some time talking about something that I think is becoming increasingly popular and increasingly used but is still, I think, an underappreciated liability-mitigation device. And that is the Rule 10b5-1 trading plan. So I want to spend some time on that.

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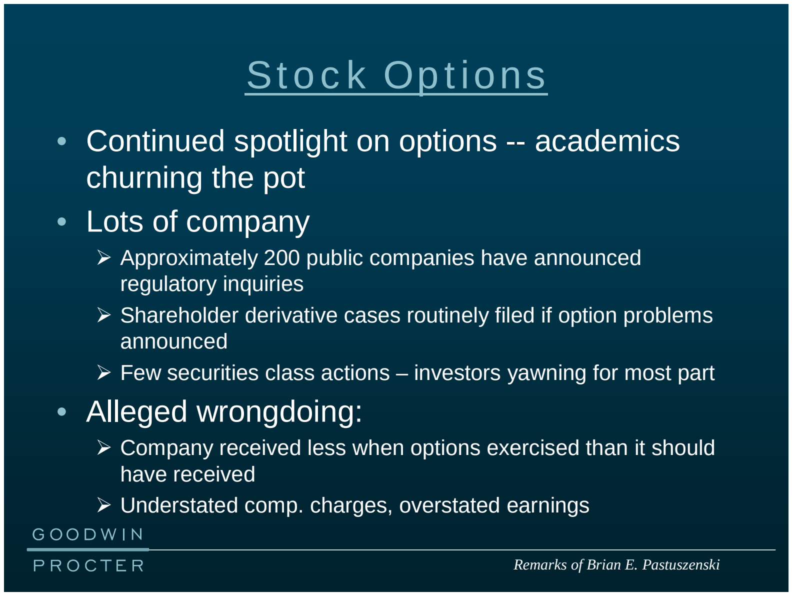
Stock Options



Stock options. A day does not go by that you can't pick up the Wall Street Journal or the Boston Globe or the LA Times and read an article about the latest company that has been embroiled in an options-related matter, whether an SEC investigation, a lawsuit, or an announcement that the company has delayed earnings in order to continue and complete an internal investigation. This began over a year ago, it continues to roll along, and a number of academics -- law school professors, professors of econometrics at various universities across the country -- have jumped into the fray and probably in no small part are contributing to this continuing to be a matter of attention in the media and a matter of attention for the regulators.

There are many, many companies that are dealing with this; over 200 public companies have announced regulatory inquiries or investigations of some sort. When a company announces some kind of options-related problem, there seems to be almost as a foregone conclusion that there will be some kind of shareholder litigation filed. I would say relatively few securities class action cases and relatively many shareholder derivative cases, cases brought ostensibly in the name of the company for harms allegedly caused to the company, and I think the reason for that is not too hard to figure out. If you look at most of the companies that have announced some kind of options-related issues, their stock prices have not, for the most part -- there are always exceptions -- moved materially. And that may be due to the fact that option-related issues are non-cash, they are non-operations-related; they certainly involve important accounting issues, but it appears that investors and the market as a whole have largely viewed the option-related problems as not affecting the fundamental viability of the business -- and that, of course, is to say where you've got problems that don't involve a complete overhaul of management or issues that really cause the viability of the company to be put into question.

When litigation is filed, the lawsuits contain all sorts of claims. But probably among the more common are claims that the company was underpaid. If you've got options that have been backdated -- that is to say, where the allegation is that the company or the board or management has picked a date for the grant that

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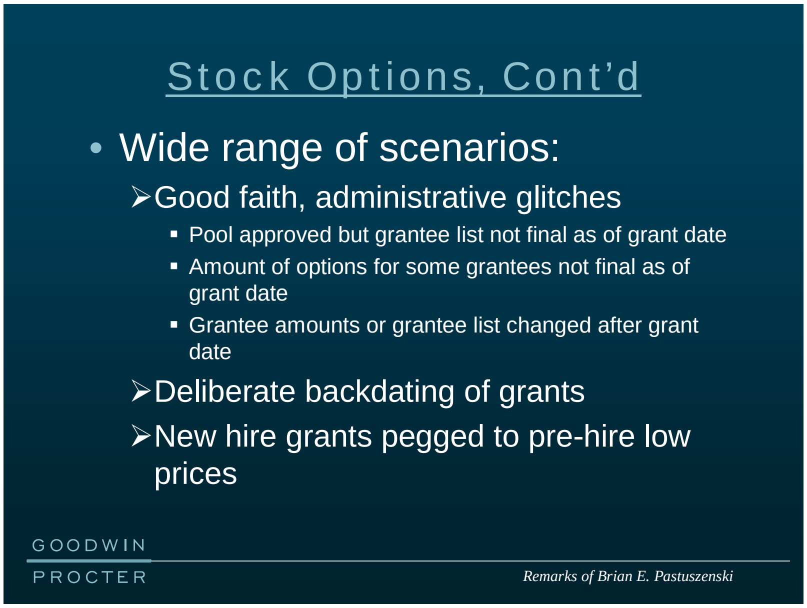
predates the actual date at which the grant occurred, thereby giving the grantees a lower price than they should have gotten, when those options are exercised, the company is actually getting paid less than it would have gotten paid had the grant date been measured appropriately. That's one flavor of claim; another flavor of allegation, of course, is that by backdating or by misdating the options the companies have understated compensation charges, which conversely have overstated earnings. Those are the claims you see in both the securities cases as well as in the shareholder derivative cases



As a matter of full disclosure, I will tell you that I have spent a not-insubstantial portion of the last year working with audit committees, representing special board committees, representing officers and directors and companies in a variety of stock option-related investigations, lawsuits, and internal reviews, across the country, for companies based from the West Coast to the East Coast to the South. And I can tell you that in many, many, many cases the issues involve good-faith administrative glitches, timing issues that have arisen for a variety of reasons, some of which may include the fact that, for certain grantees who were awarded options, the amount perhaps wasn't completely finalized at the time of the grant, or where there may have been some changes in the list of grantees after the grant date because some people might have been inadvertently omitted. We see many situations where there are honest-to-God accounting issues but they result from inadvertence or, as I said, administrative glitches.

There are certainly cases that have hit the headlines where, from all indications, there was intentional backdating of grants, where new hires were given grant dates that actually predated when they hit the payroll. We've also seen situations, again, in the papers and in the various regulatory matters that have been announced, where companies have been accused of timing grants either to immediately precede the issuance of positive corporate news or to come immediately after the announcement of negative news. In the former case, the value of the option's obviously rising; in the latter case, the value of the option is being enhanced as a

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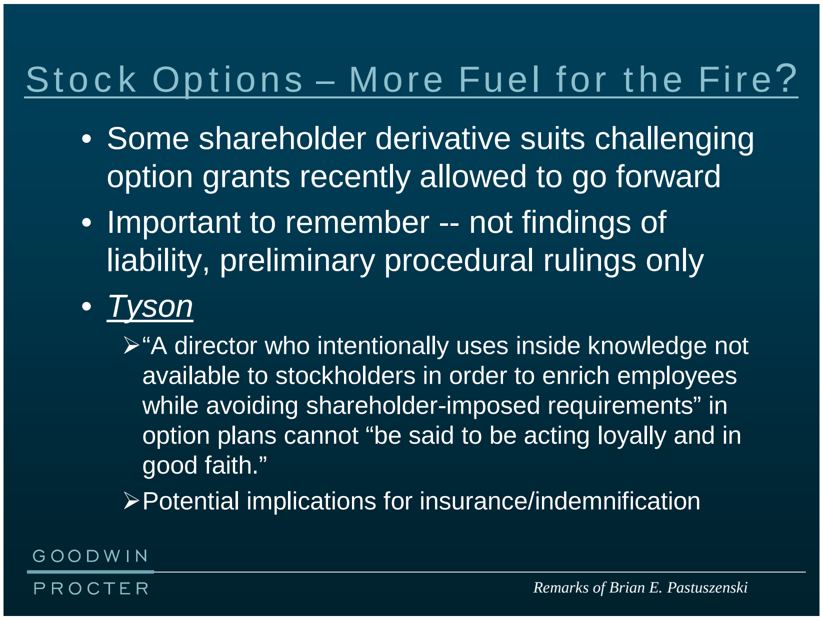
result of being granted at a time when the stock price has dipped because of negative corporate news.

Many of you may be aware of this, but there is not complete agreement even within the SEC regarding whether these practices -- "spring-loading" and "bullet-dodging" are the terms that have been coined to describe these two kinds of timing issues -- there's disagreement even within the SEC as to whether these practices are illegal. SEC Commissioner Atkins very publicly last summer made statements to the effect that in his view -- and, of course, he's only one of five commissioners -- in his view, these practices were not a violation of the securities laws. I will tell you, however, that in the last few weeks -- and I'm going to spend some time talking about this in a minute -- in the last few weeks, the Delaware court, specifically Chancellor Chandler of the Delaware Chancery Court, has issued two opinions that have, as a matter of state fiduciary duty law, taken the position that backdating and spring-loading -- if proved, if proved -- would constitute violations of a director's fiduciary duties.

Stock Options – More Fuel for the Fire?



Many of you may be getting updates by email or in the mail from law firms describing these cases; perhaps you've gotten an update from my firm, Goodwin Procter, on this. They are two of the first decisions relating to stock option practices to come down in the wake of everything we've been reading for the last several months, almost a year now. It is important, as I describe these cases -- and I'm only going to describe them very briefly to you today, because this isn't a place to get into a long legal discussion -- but what's important to remember is that these cases involve preliminary procedural rulings by the court. These are not determinations that any of the directors or any of the managers involved violated the law in fact; these are simply determinations that the plaintiffs, in their complaints, have alleged enough to entitle them to take the next step in the lawsuit. So, with that context in mind, there are a couple of cases, one involving Tyson and one involving the Maxim Company, which is in the high-tech business. Each case involved allegations of option misconduct.

In the Tyson case, we had an allegation that the board was intentionally spring-loading grants -- that is to say, issuing grants immediately prior to the announcement of positive corporate news, thereby causing the price to go up and enhancing the value of the options for the grantee. In the slide you'll see a quote from the case where the court said, in essence, that a director who uses inside knowledge to enrich employees -- issuing options in violation of a plan that says the options have to be issued at fair market value -- cannot be said to be acting loyally and in good faith. If you cut through that legal verbiage, what it means is, if the plaintiffs prove that the board knowingly spring-loaded the grants in this case, there could potentially be liability. Assuming -- and there's a big assumption here, obviously, because we don't know what the facts will show -- but assuming that the plaintiffs could prove that, there could be potential implications if a court were ultimately to find after trial that the directors of a company had not acted in good faith -- had been disloyal, as a matter of proof and fact. That could have

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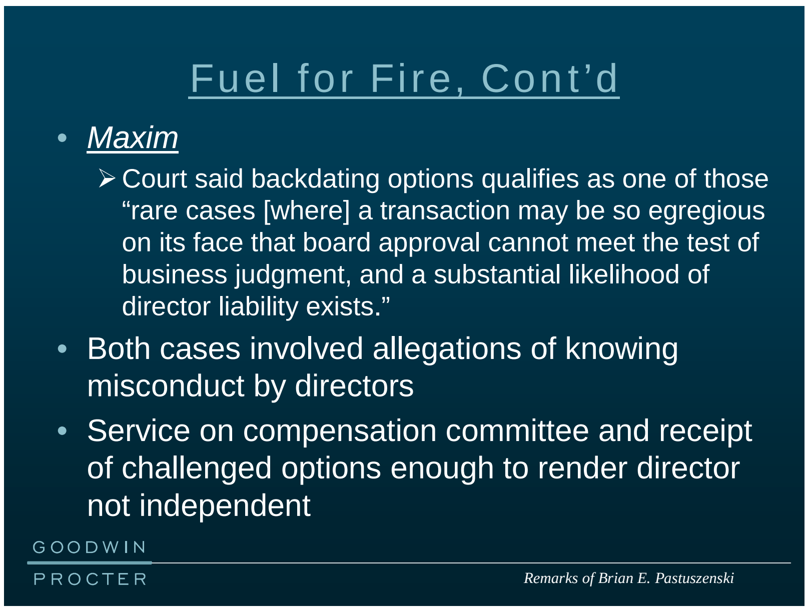
implications for whether those directors would be entitled to indemnification from the company or entitled to insurance. So this is not an insignificant ruling, but again it's a very preliminary one, and it is not the result of anyone having gone through a trial. One case I'm going to spend a couple of minutes talking about is the Disney case. Ultimately that case went all the way up to the Delaware Supreme Court and the Disney directors were found not to have violated any law. But that case went on for, I believe, almost 9 or 10 years, and everyone said everything that you could imagine about what might befall those directors before the ultimate curtain closed. So, again, it's a preliminary ruling, and it's important not to read too much into it.



The Maxim case involved a different type of alleged option practice. This was backdating; allegedly the defendants had deliberately gone back in time to pick a lower price for the grants than the price in effect in the market on the date of the grant. And the court said something very similar: that if such conduct could be proved, that would not meet the test of the Business Judgment Rule; that would not be entitled to deference from the court and there could be a substantial likelihood of director liability. So these cases have, I would say, shot a cannonball across the bow in the legal community. Lawyers like me are reading these cases and trying to understand what they mean and their implications, but you should be aware that the first couple of cases -- or among the first few cases to be filed -- have now been allowed, at least for the moment, to proceed to the next step.

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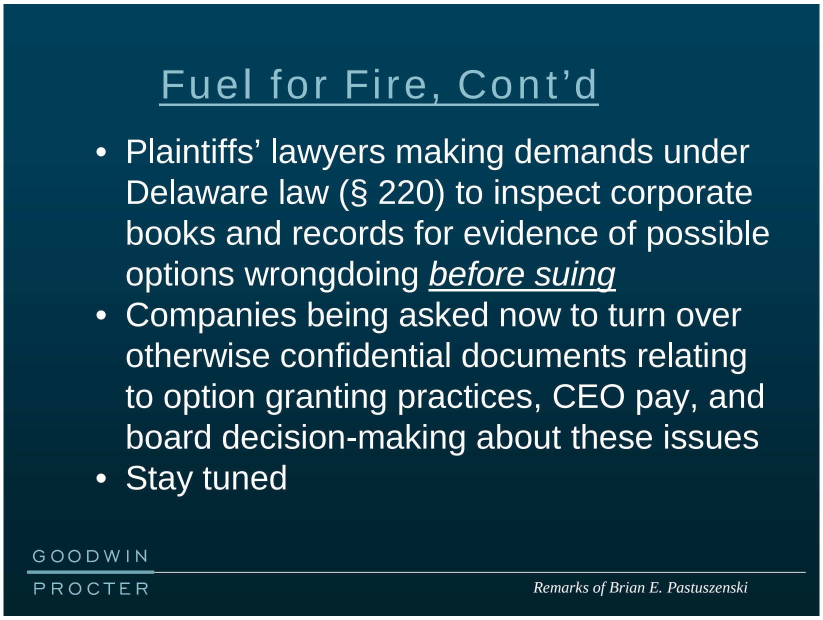

I’m going to spend a brief amount of time on a related development. Under Delaware law and the law of other states, it is possible even before filing a lawsuit for a plaintiff lawyer to try to get access to your corporation's books and records -- what would otherwise be confidential books and records -- provided that the plaintiff is a shareholder and meets certain requirements for having a valid purpose in seeking the records.

We are now seeing plaintiff lawyers seeking to get access to internal corporate records relating to option-grant practices, executive and board compensation, and related matters, in order to determine if there's a basis to file a shareholder lawsuit. Whether or not these cases are based on good arguments for such inspections or not is something that the courts are going to have to decide, but looking into my crystal ball I would expect we're going to see more of these kinds of proceedings under Delaware law or comparable law in other states.

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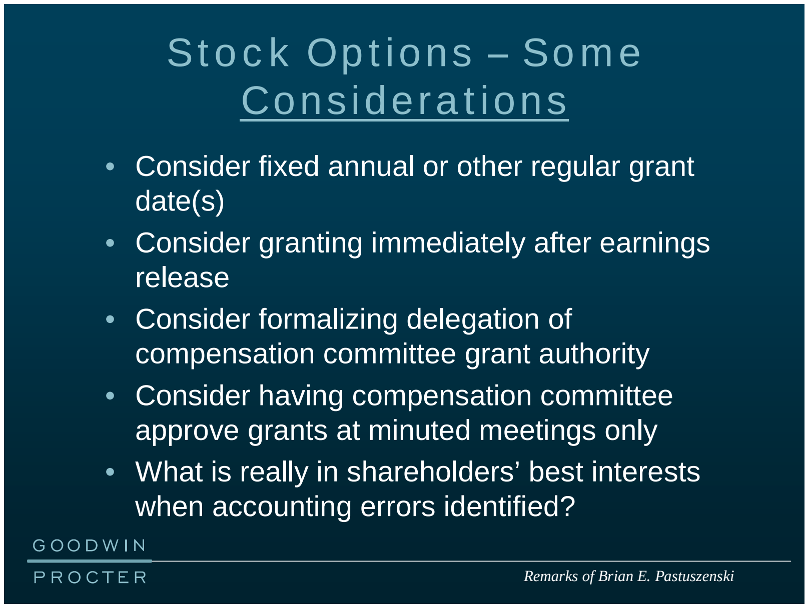
Stock Options – Some Considerations



I want to leave the stock option area with just a couple of considerations for you, as senior management and directors, to consider around the options area. Number one, as you're looking forward to what the company's option practices and procedures ought to be in the future, consider using a fixed grant date -- either annually or some other regular period -- on which the grants will occur. If they occur around the same time each year, it's much harder for those grants in hindsight to be challenged as having had their timing manipulated.

Secondly, consider granting options immediately after the announcement of quarterly earnings, at a time when the market essentially has the same information that the company does. The reason for this is it makes a challenge based on spring loading that much harder to make, and it's a much less risky time to grant options than it might otherwise be. Again, there are a variety of things companies can do, but this is a consideration that I suggest to you.

Another option is for companies that, for all practical purposes, have effectively delegated granting authority to management but where it has not actually been reduced to writing -- now would be an excellent time, if management has been given that authority de facto, to make it formal and put it in writing so there's no question that management has the ability, for certain types of employees and up to certain grant levels, to grant options without having to run through comp committee approval.

Consider having grants that are approved by the comp committee approved at minuted meetings, where you've got a record that the committee met on a certain day at a certain time and took a certain action, where attached to the minutes can be a list of the grantees and the grant amounts. Again, it removes many, many, many, if not all, of the questions around the option grant issue that we are all facing now and presumably will continue to face for quite some time.

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The last issue I leave you with involves a difficult question: when accounting problems are detected, but there's no evidence of any sort of deliberate attempt to misstate financials or violate accounting or legal rules at companies, what should the board or the audit committee do? Where the practices are not intentional, what is the best thing for shareholders and the corporation? While it may be easy, in some sense, for the special committee or the audit committee to pull out the gun and aim it at the management that was in place during the period of time, I'd leave you with the question of whether that, at the end of the day, is ultimately in the best interests of the shareholder base and ultimately in the best interests of the corporation.

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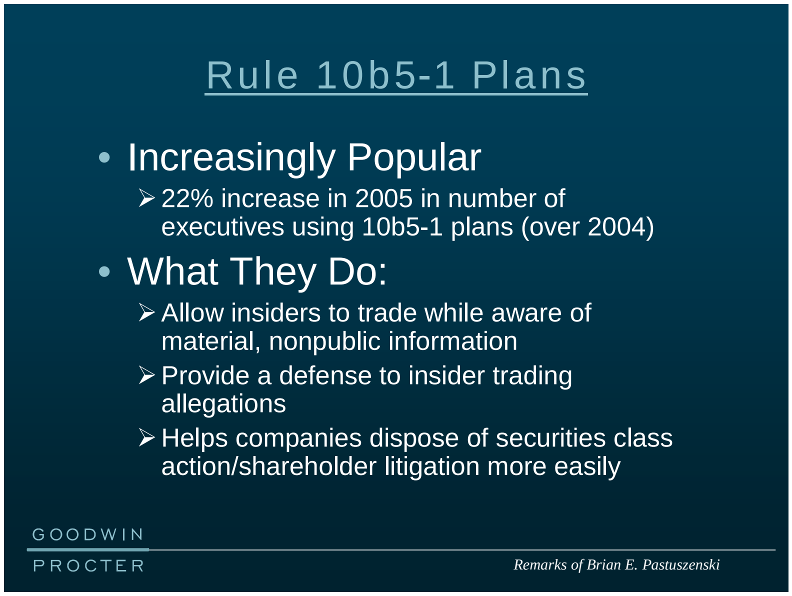
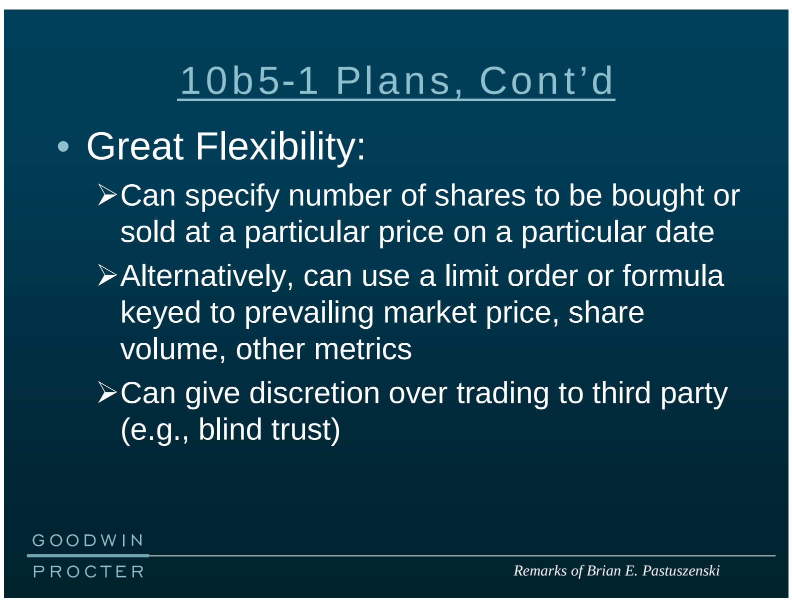
Rule 10b5-1 Plans



Let me shift now to a favorite topic of mine -- Rule 10b5-1. Rule 10b5-1, in a nutshell, gives you as a corporate officer or director the ability to sell or buy stock at a time when you might not otherwise be able to because you're aware of material, non-public information.



The key to the kingdom is that you create or set up a trading plan or a trading arrangement that provides for the sale or purchase of stock automatically, or you can give discretion over that to a third party, like a trustee or a broker or an advisor. But you must set one of these plans up at a time when you're not aware of material, non-public information.

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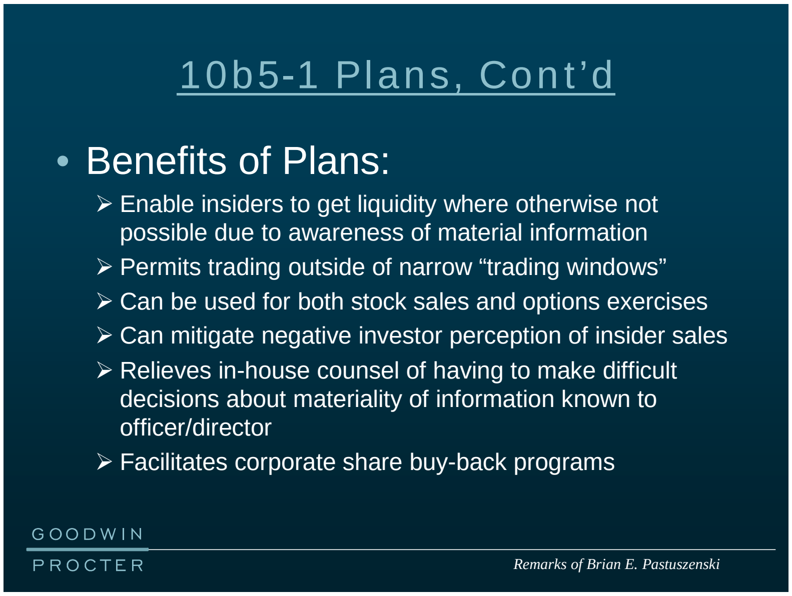

If you set one of these plans or arrangements up right, however, you have the ability to get liquidity, i.e. sell stock, at a time when your insider-trading plan or federal law may otherwise prohibit you from doing that. And if you're a company that's very acquisitive, if you're a company that has a volatile stock price, where something's always going on within the company -- that is to say, of a good nature -- important developments, important R&D developments, important clinical trials if you're in the biotech area -- you may find that you're never able to sell stock. And what the 10b5-1 mechanism permits you to do is to sell stock at a time when you might not otherwise be able to.

For a corporation, it also has a feature that facilitates the corporation's ability to do open-market repurchases of shares, at a time when otherwise it might not be possible because the corporation is aware of material, non-public information.

And it can also be used, not only for stock sales and purchases, but also for option exercises, which in the current environment is something that I think a lot of us would consider a fairly important consideration.

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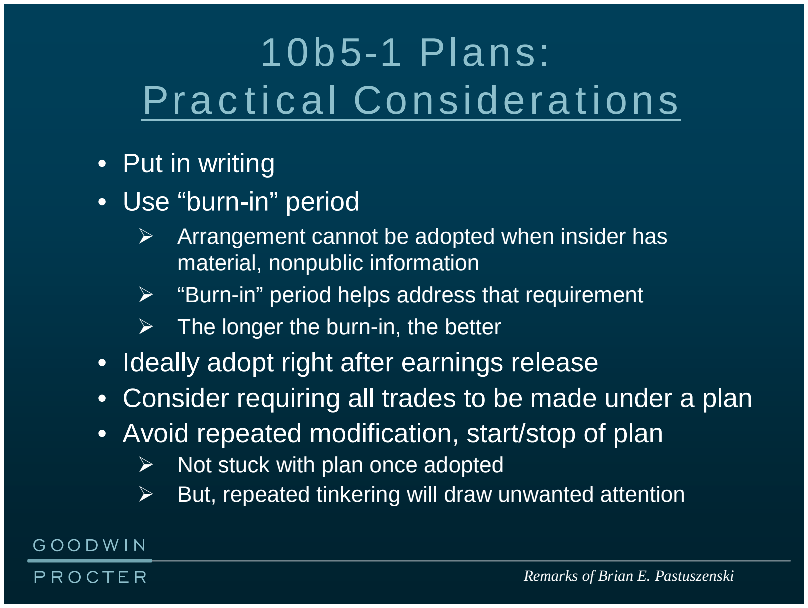
10b5-1 Plans: Practical Considerations



If you're going to do one of these plans, however, I'd strongly encourage you -- even though in certain situations it's not necessary -- strongly encourage you to put it in writing; I'd strongly encourage you to have what I refer to as a "burn-in period," which is a period of time after you enter into the plan where the first trade actually takes place -- 30, 60, 90 days. The longer the period of time, the better off you are, and the reason for this is, again, you must set it up at a time when you're not aware of material, non-public information. The later the first trade happens after you set it up, the less likely that any information in your head is likely to be material or, frankly, likely to even be relevant anymore.

The best time, from my perspective, to set one of these things up is right after your company releases earnings. Not surprisingly, I recommend that once you set one up, even though you can terminate it anytime -- you're not locked into these things; it's not like a shackle around your ankle -- but I don't recommend that you repeatedly start it, stop it, start it, stop it, or repeatedly modify it, because the more you do that, the more attention you're going to draw to the plan from a regulator, from a plaintiff's lawyer, from somebody whose attention you probably don't want.

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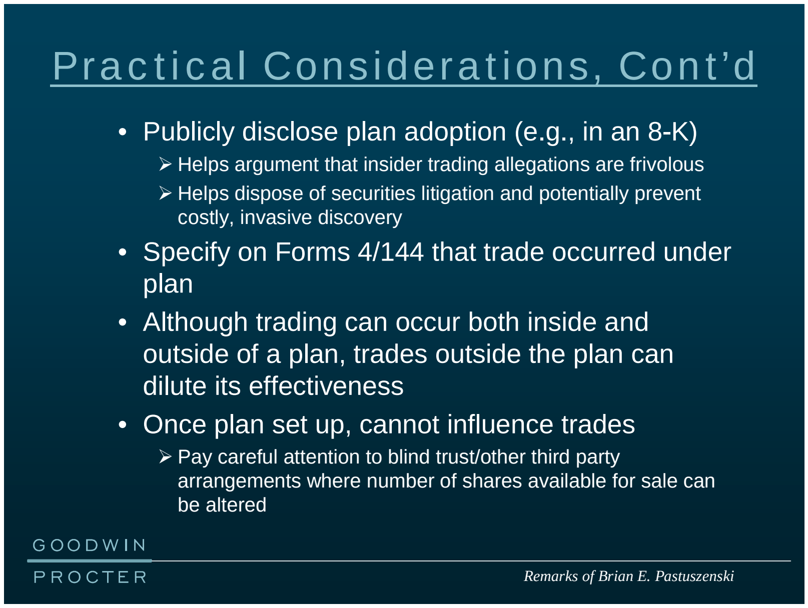

A couple of other things on these plans. As a defense lawyer, as a lawyer who is hired day-in and day-out to defend securities cases and shareholder cases, one of the things that you can do for me that helps me do my job better and more effectively for you, is, when you adopt a 10b5-1 plan, disclose it. You don't necessarily have to disclose all the details of it, but announce it to the world in some kind of public filing. Because when that plaintiff's lawyer alleges that your trade was on the basis of material, non-public information and violated the securities laws, I then have the ability to point the court to that public filing -- evidence that you did that trade under a plan that was put in place X number of months ago -- and argue that to allege that you traded on inside information is frivolous and not made in good faith. That makes me that much more likely to get that case thrown out or substantially truncated than I might otherwise be able to do.

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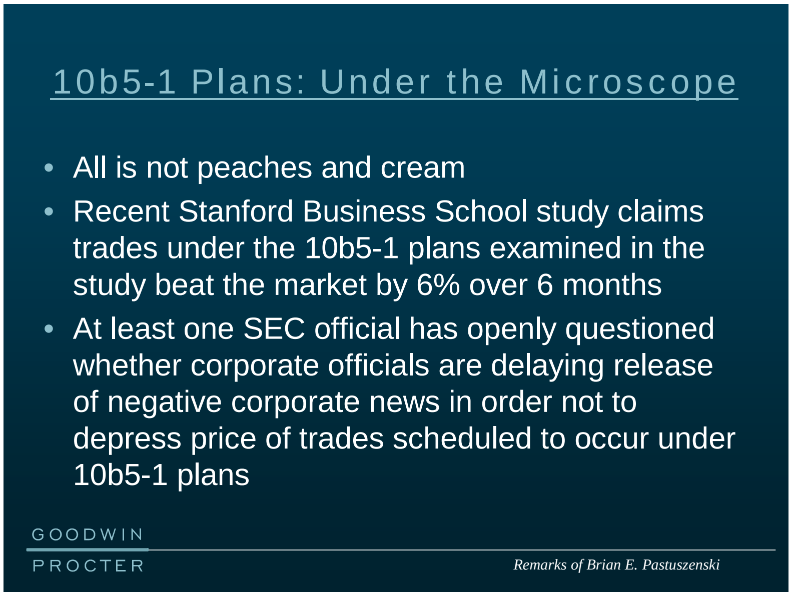
10b5-1 Plans: Under the Microscope



The last point I want to make goes back to this concept of, "Don't do things with your 10b5-1 plan that are going to draw attention to it". At least one SEC lawyer -- the one I'm thinking of was a regional SEC administrator out in the Midwest -- within the last year made the comment that he had become concerned that companies were using 10b5-1 plans in a manipulative way, that they were holding back on the release of important corporate news, negative news, in order to enable officers and directors to get their trades done under plans before the bad news hit. And this particular lawyer suggested that that could be, by itself, fraud and a manipulation. I mention it because that's something that we should all make sure we are never accused of doing.

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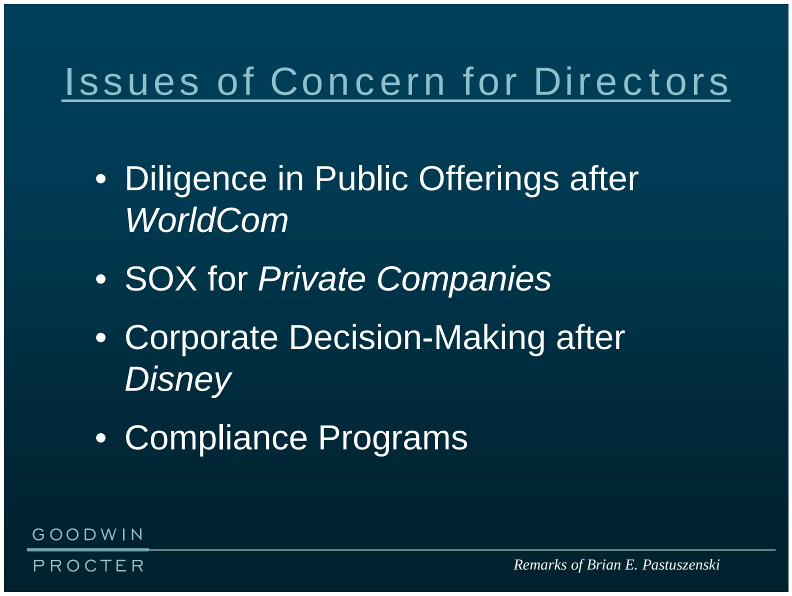
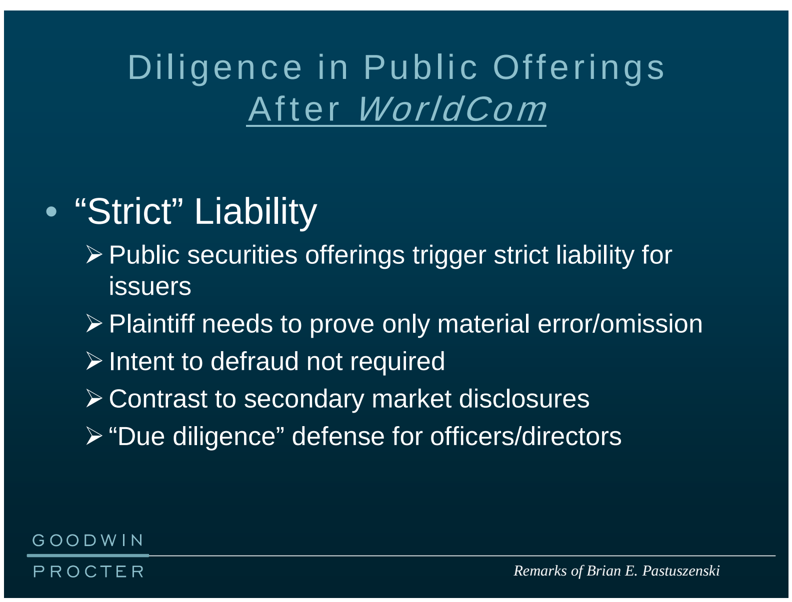
Issues of Concern for Directors



The next-to-last topic that I want to cover is diligence and compliance. Enron and WorldCom are hopefully fading into the distant past, but one important aspect of the WorldCom case in particular is that it involved the public offering of securities.

Diligence in Public Offerings



And when you offer securities to the public, there is strict liability -- meaning, as long as there is a misstatement and it's material, there is potential liability for the issuer.

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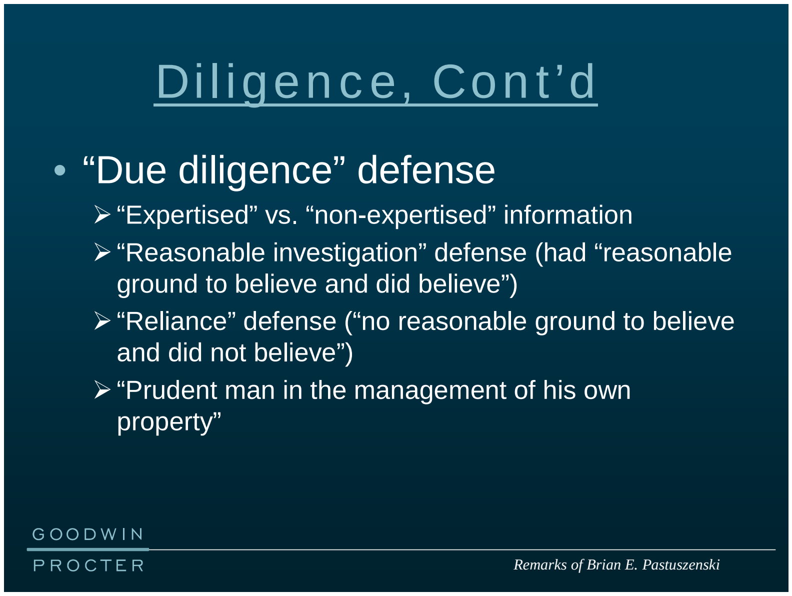
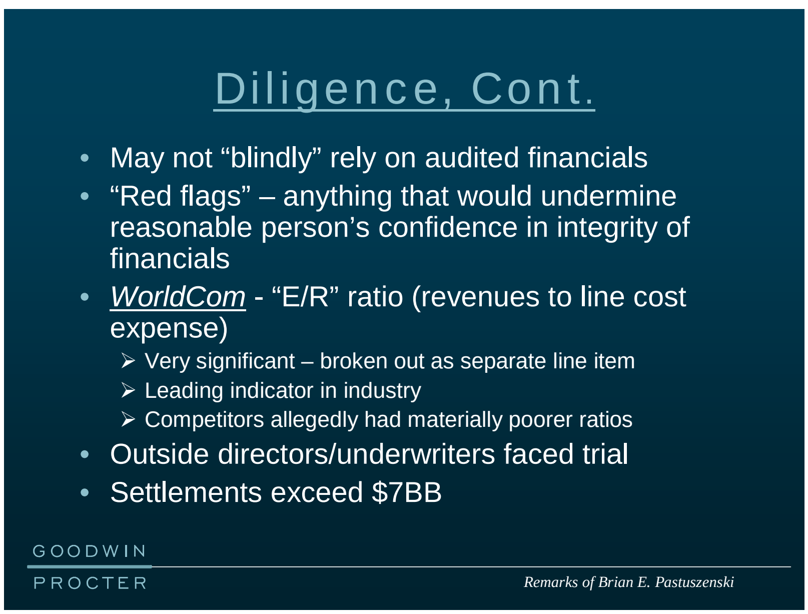


If you're a director, however, you have what's called the "due diligence defense": you can point to the fact that you asked questions, that you were diligent, that you did an appropriate investigation, that you discovered no problems, and therefore you should have no liability.



The take-away of WorldCom that I want to remind you about, and that I remind audiences like you about all the time – is that "diligence" means "diligence"; it means something other than blindly relying on what, if you're a director, management has said, and in the case of financial statements that have been audited, on what the auditors seem to be saying.

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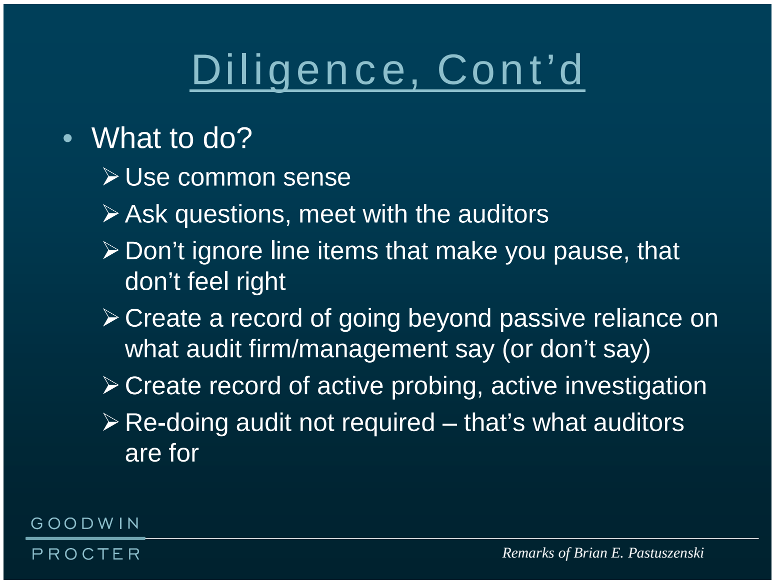

My recommendation to you here in the context of a public offering is create a record that you've asked questions, that you've been diligent, that you've done more than passively rely. If you do that, and if there is ever a problem that arises after that offering, you will have put yourself into a much better position from a liability standpoint than you would otherwise be in. You don't need to redo the auditors' audit; that's what auditors get paid for. But I strongly recommend you create a record of good and active questioning.

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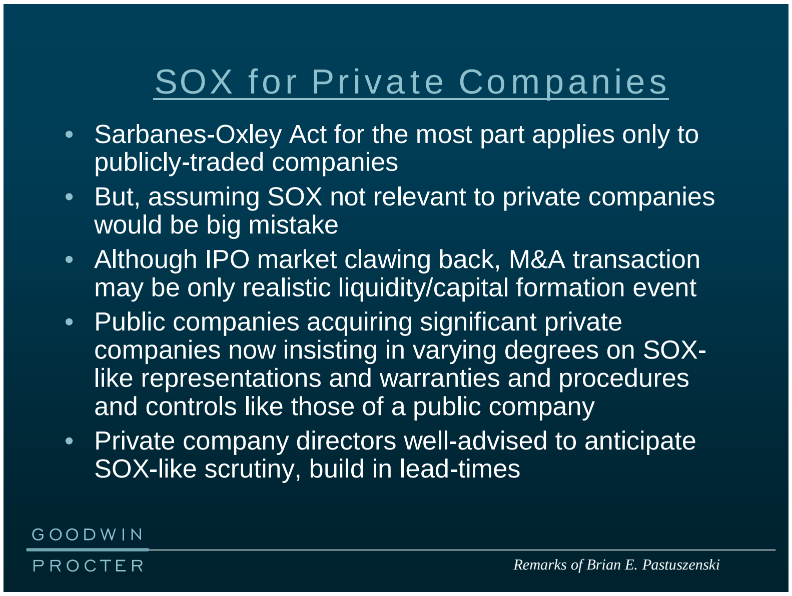
SOx for Private Companies



All I'm going to say on this topic is that private companies are increasingly being looked to, in the same way that public companies are, to make representations and warranties in the context of M&A transactions. If you're a director of a private company looking to do an M&A or financing transaction, the earlier you realize that you may be asked to make reps and warranties like a public company if you do a deal with a public company, the sooner you can put the goals and the processes in place that you're going to need to in order to make those reps and warranties.

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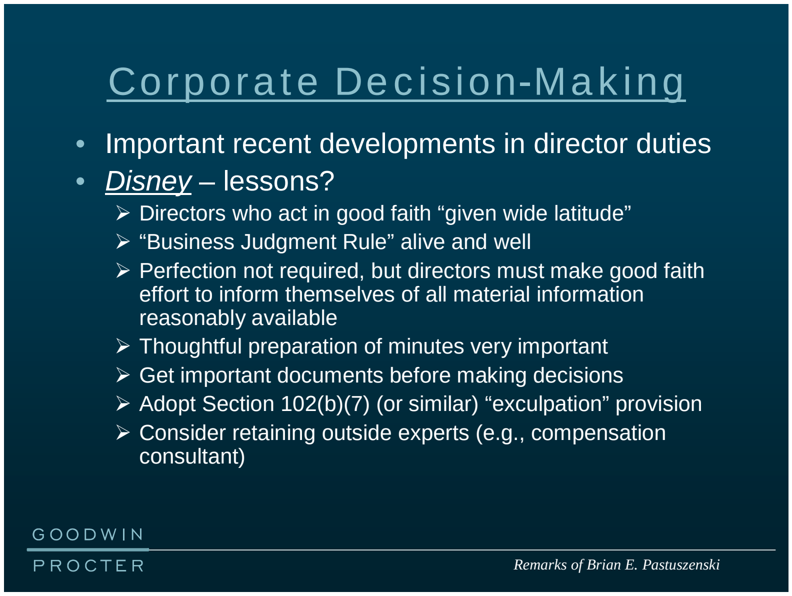
Corporate Decision-Making



My last two topics are corporate decision-making and insurance and indemnification. I can wrap everything in these slides around decision-making into the following couple of words: "good faith and diligence." Good faith is essentially where Delaware law has come out as a result of the ten-year-long litigation in Disney. The court there said that under Delaware law, which is pretty much the bellwether for fiduciary duty law in this country, a director who acts in good faith and makes a good faith effort to inform him- or herself of the important facts relevant to a corporate decision will be protected from liability. That is ultimately the take-away of Disney.

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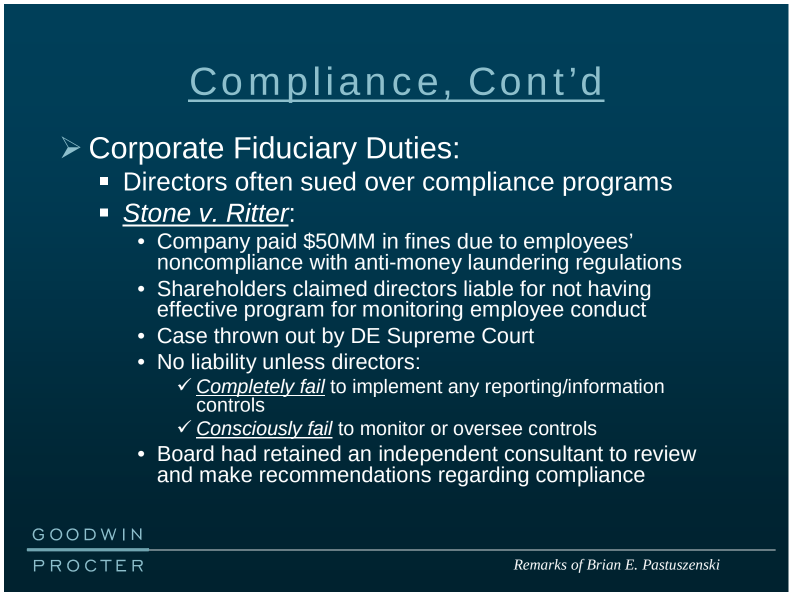
Compliance



It is also the take-away of another case, the Stone v. Ritter case, a very recent Delaware case involving an accusation that a board of directors had not done an appropriate job putting an effective compliance program in place. This company ended up spending $50 million in fines and penalties because of its employees' non-compliance with anti-money-laundering and suspicious activity rules. At the end of the day, those directors did not have liability. And the reason, the court said, was because there was evidence that they'd acted in good faith, and the court said the only time that a director will have liability in connection with a compliance program is where either there's been a complete and utter failure to even attempt to put one in place or, secondly, you've got one in place and you completely ignore it. That's a very high hurdle for a plaintiff, but that's not to say that we, as directors and officers, ought to sit back and assume that we don't have exposure, because there is exposure. But again, if you create a record of diligence and you use care and just a little amount of caution and foresight, there is a tremendous amount of protection under Delaware law that will be available for you.

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Insurance, Indemnification, and Personal Liability

Before I end my remarks, we'll cover the slides dealing with insurance and indemnification. This is obviously an extremely important topic, because it hits all of us personally: insurance, indemnification, and personal liability.

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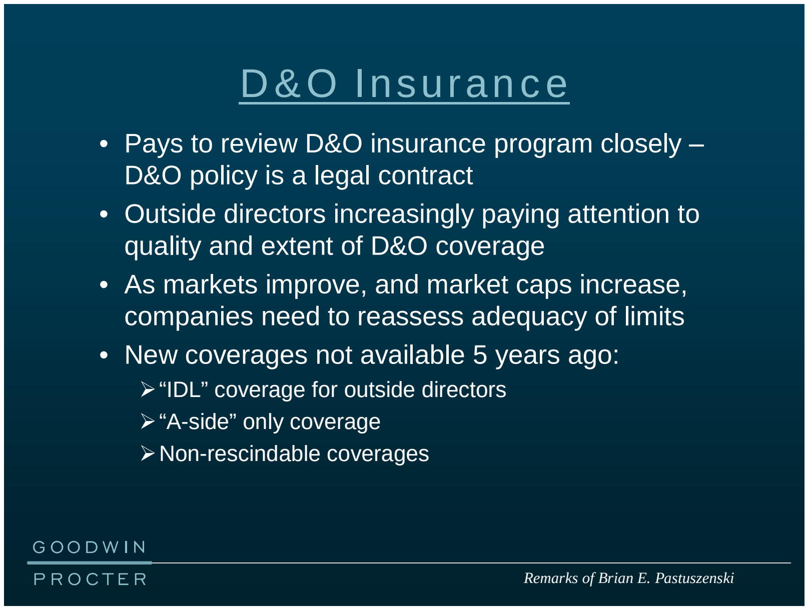
D & O Insurance



Insurance is something that fundamentally is a legal contract. In fact, here at Goodwin Procter we have an insurance group that does nothing other than help public companies, private companies, venture capital funds, private equity funds, better manage their risk exposure. Part of what we do is we help put insurance in place and help negotiate insurance policies, which are effectively contracts.

As market caps increase, the need to make sure that all of our companies have adequate insurance in place is extremely important. I strongly recommend that you consult with an expert -- it doesn't have to be my firm, though we'd be very happy to help -- but with an expert that can walk you through what you have, where it may be adequate, where it may not be so adequate, and where you might be able to improve it.

And I will tell you, for those of you who are members of management -- and you've probably already seen this from your own boards -- directors, independent directors, have become extremely interested in the kind of coverage they have, not only in the dollar amount, but the features. They’re a very, very savvy group of individuals, and they're asking some pretty tough questions of management, so it’s another reason to really look closely at what you have and whether it's the best bang for the buck.

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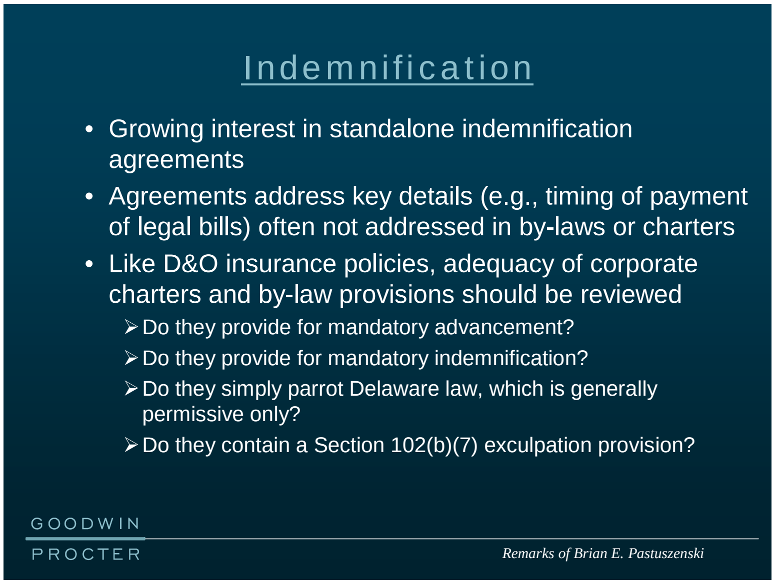
Indemnification



Indemnification is another topic that senior management and directors are well advised to pay attention to. Corporate bylaws and corporate charters all provide indemnification of some sort or another, but many of them don't dot the i's and cross the t's in as friendly and as favorable a way as indemnification agreements do. I'm finding an increasingly large number of the directors that I represent want to have standalone indemnification agreements to deal with some of the issues, like how quickly my lawyer's legal bills get paid when there's a problem, issues that aren't dealt with in many cases by bylaws and charters, and this is an extremely important thing to pay attention to.

One thing that I would recommend all of you do, if you don't already have one, is to think about whether you should have in your charter what's called an exculpation provision, which essentially is a provision that says, in the event of a lawsuit, your directors cannot be held liable for a basically good-faith screw-up. Many companies have them, but many companies don't have them as well. The ones that don't at least should be thinking about it.

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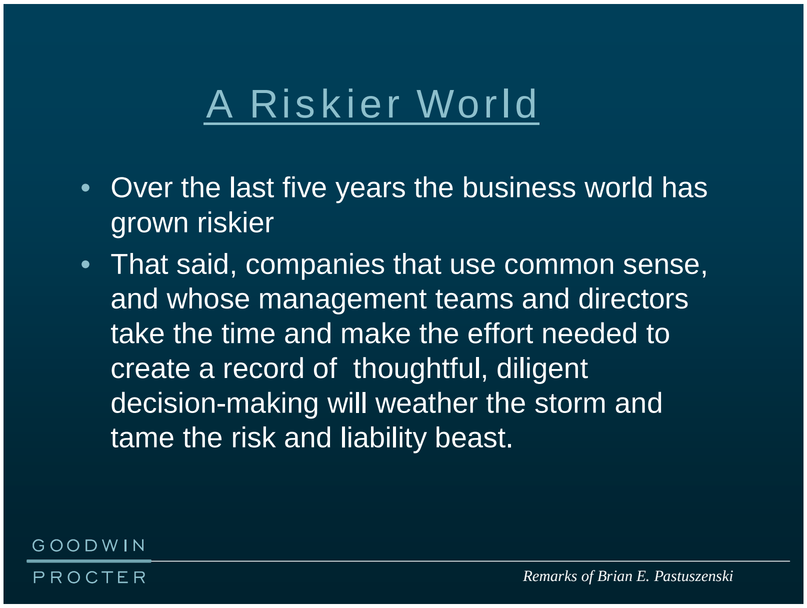
A Riskier World



And last but not least, I want to leave you with this thought: it's a very risky world that we have the benefit or the pleasure of dealing with. It's gotten riskier since Sarbanes-Oxley; it's gotten riskier in the last ten years since securities reforms were put in place; and despite the 36% drop-off in securities class action filings last year, this particular cynical defense lawyer thinks that that's a temporary blip.

But this is not a reason to panic, and it's not a reason to despair, because with a little amount -- or maybe a moderate amount -- of care and time and diligence, you can protect yourself in a very meaningful way. And hopefully, if I've communicated anything to you today, I've left you with a couple of things -- not necessarily silver bullets, but at least a couple of considerations that are worth some thought.

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Q & A

Robert O'Connor:

This first question is very specific: given the importance of Delaware as a state for major corporate incorporation, are the rulings of the Chancery Court on spring-loading and bullet-dodging likely to carry major weight with other legal jurisdictions?

Brian Pastuszenski:

The answer to the question fundamentally is: Delaware is an important jurisdiction; it's where most companies in this country are incorporated; and yes, the courts of other states look to what Delaware does as a barometer. So I would agree that judges in cases in other states are going to be looking to these rulings. But again, at the end of the day, everything turns on the facts, and what's alleged in these complaints may be very different from what ultimately is proved at trial, which is precisely what happened in the Disney case. If you read the complaint in the Disney case, many people thought that the Disney board ought to be taken out into a field and shot. At the end of the day, after trial, a very different set of facts got proved than what had been alleged.

Robert O'Connor:

Final questions: Some people asked questions about where all this is headed over the next few years? Perhaps you can comment with respect to the Sarbanes-Oxley legislation and compare it as a solution to a problem to what might be ahead for the stock options situation?

Brian Pastuszenski:

Let me say about the stock option situation that what the market does is one thing; there's no question that companies have an obligation to accurately report revenues and earnings. And whether a company has an accounting problem because of an administrative glitch or a company has an accounting problem because of something else, in order for the public markets to work in this country the way they're supposed to work, that presumes accurate financial reporting. But if you look at what's happened in the vast majority of cases, investors and the market have not viewed the options issues with a reaction that's produced significant drops in stock prices upon the announcement of option-related issues.

Looking forward into the future in terms of Sarbanes-Oxley and related issues, I think we've got currently a chairman of the SEC who is attempting to look at the regulatory framework in place now and that's been in place since 2002 and is trying to evaluate and assess whether, as currently written, it is working and it is sensible. I think there's willingness on the part of the current administration within the SEC to reflect on that and step back and see whether certain changes might be appropriate. That's certainly something, I think, that the current chair of the SEC has made clear.

I don't know what will befall the business community after the current options situation has been resolved. We've seen over the last several years a spate of revenue recognition restatements; we've seen options; in the mutual-fund context, we've seen the market-timing phenomenon and all those lawsuits. Knowing what my crystal ball has shown me over the last 25 years, there will no doubt be something else. I can't predict what it is today, but, you know, I have, I guess, some abiding hope that the business community will be able to work through it and that at the end of the day, as I think has been the case after each one of these phenomena before, it will fundamentally be stronger and we will all have learned.

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