Katten Muchin Rosenman LLP

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SEC/Corporate

Statement of the SEC Concerning Financial Penalties

On January 4, the Securities and Exchange Commission announced the filing of two settled actions against corporate issuers, *SEC v. McAfee, Inc*. and *In the Matter of Applix, Inc*. In McAfee, the company will pay a $50 million civil money penalty; in the Matter of Applix, a penalty is not part of the settlement. In order to provide the maximum possible degree of clarity, consistency, and predictability in explaining the way that the SEC's corporate penalty authority will be exercised, the SEC issued a statement describing with particularity the framework for its penalty determinations in the above-referenced cases.

In reaching its decisions, the SEC considered the legislative histories of both the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 which gives the SEC authority generally to seek civil money penalties in enforcement cases and Section 308 of the Sarbanes-Oxley Act of 2002 which allows the SEC to take penalties paid by individuals and entities in enforcement actions and add them to disgorgement funds for the benefit of victims.

The SEC has concluded that it is a fundamental principle that corporate penalties are an essential part of an aggressive and comprehensive program to enforce the federal securities laws, and that the availability of a corporate penalty, as one of a range of remedies, contributes to the SEC's ability to achieve an appropriate level of deterrence through its decision in a particular case. With this principle in mind, the SEC's view of the appropriateness of a penalty on a corporation in a particular case, as distinct from the individuals who commit a securities law violation, turns principally on two considerations:

- the presence or absence of a direct benefit to the corporation as a result of the violation; and

- the degree to which the penalty will recompense or further harm the injured shareholders.

In addition to these two principal considerations, in its statement, the SEC lists several additional factors that are properly considered in determining whether to impose a penalty on a corporation such as the need for effective deterrence, the effect of penalties in encouraging the development of good compliance programs, fraudulent intent, the extent of harm to innocent third parties and unjust enrichment.

The full text of the SEC's press release is available at http://www.sec.gov/news/press/2006-4.htm.

Brian Cartwright Named SEC General Counsel

On January 3, the Securities and Exchange Commission announced that securities lawyer and former astrophysicist Brian G. Cartwright will join the SEC as its General Counsel. Mr. Cartwright will succeed Giovanni Prezioso, who was appointed in April 2002. Mr. Cartwright will join the SEC on January 23, 2006.

Mr. Cartwright, 58, is a partner in the international law firm of Latham & Watkins. Mr. Cartwright began his legal career in 1980 after earning a J.D. from Harvard Law School, where he was President of the Harvard Law Review and winner of the Sears Prize. He served as law clerk to Justice Sandra Day O'Connor of the United States Supreme Court, and prior to that, as law clerk to U.S. Court of Appeals Judge Malcolm R. Wilkey of the D.C. Circuit.
The full text of the SEC's press release is available at http://www.sec.gov/news/press/2006-1.htm

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Banking

Fed Announces Final Reg E Rules Governing Electronic Checks and Payroll Cards

The Federal Reserve Board on December 30 announced final amendments to Regulation E (Electronic Fund Transfer Act) that clarify the responsibilities of parties involved in electronic check conversion transactions. The rules require that consumers receive written notification in advance of these transactions. Additional revisions to the regulation's official staff commentary provide guidance on preauthorized transfers from consumers' accounts, error resolution, and disclosures at automated teller machines (ATMs).

In a separate action, the Board also amended Regulation E so that it covers payroll card accounts.

Among other things, the final rule provides that merchants and other payees that convert payments by check into electronic fund transfers must provide a notice to consumers to obtain consumer authorization for the electronic fund transfer. Merchants and other payees must also notify consumers that if a check is converted, funds may be debited from consumers' accounts as soon as the same day that payment is received, and the check will not be returned by their financial institution.

The final rule also revises the regulation's official staff commentary to clarify the error resolution obligations of financial institutions and to clarify the disclosure obligations of ATM operators with respect to fees imposed by the ATM operator on a consumer for initiating an electronic fund transfer or for a balance inquiry at an ATM.

The final rule addressing electronic check conversion and other matters will take effect thirty days after the date of publication in the Federal Register, which is expected soon. The mandatory compliance date is January 1, 2007.

In addition to the final rule on electronic check conversion services, the Board adopted a separate interim final rule on payroll card accounts to provide that payroll card accounts established for the purpose of providing salary, wages, or other employee compensation on a recurring basis are accounts covered by

Regulation E. The interim final rule grants flexibility to financial institutions that must provide account transaction information to payroll card users.

The amendments to address payroll cards are being issued as interim final rules so that interested parties may comment on the new requirements. The Board requests comment within sixty days after publication in the Federal Register.
http://www.federalreserve.gov/BoardDocs/Press/bcreg/2005/20051230/attachment.pdf
http://www.federalreserve.gov/BoardDocs/Press/bcreg/2005/20051230/attachment2.pdf

Federal Banking Agencies Propose Guidance on Non-Traditional Mortgage Products

On December 20, the federal financial regulatory agencies proposed guidance on residential mortgage products that allow borrowers to defer repayment of principal and sometimes interest.

These nontraditional mortgage products include "interest-only" mortgage loans where a borrower pays no principal for the first few years of the loan and "payment option" adjustable-rate mortgages where a borrower has flexible payment options, including the potential for negative amortization. Institutions are combining these mortgages with other practices, such as making simultaneous second-lien mortgages and allowing reduced documentation in evaluating an applicant's creditworthiness.

The agencies expressed concern that these practices can present risks that institutions must appropriately manage. They are also concerned that these products and practices are being offered to a wider spectrum of borrowers, including subprime borrowers and others who may not otherwise qualify for more traditional mortgage loans or who may not fully understand the associated risks of nontraditional mortgages.

The proposed guidance states that management should:

- Assess a borrower's ability to repay the loan, including any balances added through negative amortization, at the fully indexed rate that would apply after the introductory period. The agencies recognize that this requirement differs from underwriting standards at some institutions and are specifically requesting comment on this aspect of the guidance;

- Recognize that certain nontraditional mortgage loans are untested in a stressed environment and warrant strong risk management standards as well as appropriate capital and loan loss reserves; and

- Ensure that borrowers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice.

Comment has been requested on the guidance, particularly on the section regarding comprehensive debt service qualification standards.
http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20051220/attachment.pdf

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Broker Dealer

SEC Won't Sue Putnam Fiduciary Trust Company

On January 3, the Securities and Exchange Commission announced it was suing six former employees of Putnam Fiduciary Trust Company (Putnam), but was not suing Putnam itself. The suit arose out of a one-day delay in January 2001 in investing the defined benefit plan contribution of Cardinal Health, Inc. (Cardinal). As a result of the delay, Cardinal's plan lost $4 million in earnings. Putnam was the trustee of Cardinal's plan. The six individuals covered up the delay and resulting loss until January 2004, when another Putnam employee saw an e-mail exchange relating to the cover-up. The SEC said it was not suing Putnam because of its extraordinary cooperation in the investigation, including prompt self-reporting, conducting an independent internal investigation, sharing the results of that investigation with regulators, not asserting any attorney-client or attorney work product privileges, terminating or otherwise disciplining the wrongdoers, providing full restitution to Cardinal's plan, paying for the attorneys and consultants for Cardinal's plan and implementing new controls designed to prevent the recurrence of the fraudulent conduct.
http://www.sec.gov/litigation/litreleases/lr19517.htm

Family Investment Companies Seek Exemption from Limitations on Performance Fees

The Securities and Exchange Commission has given notice of an application for exemption from the limitations on performance fees under Section 205 of the Investment Advisers Act of 1940 (the Advisers Act). The applications were filed by Greenhouse Associates, LLC and Superior Partners, LP. The managing members of Greenhouse and the managing general partners of Superior are qualified clients under Advisers Act Rule 205-3. However, some of the members of Greenhouse and some of the limited partners of Superior are not qualified clients. The two family investment vehicles will invest in hedge funds that charge performance fees, and the family funds would not be qualified clients because of the equity ownership of interests in the family funds by persons that are not qualified clients. The companies request an exemption under Advisers Act Section 205(e) to permit the family funds to invest in hedge funds that charge a performance fee. The application notes that, in addition to being qualified clients and having strong financial management backgrounds, the managing members and the general partners have strong familial relationships with those investors that are not qualified clients. If no comments are filed by January 20, 2006 an order of exemption will be granted.
http://a257.g.akamaitech.net/7/257/2422/01jan2061800/edocket.access.gpo.gov/2006/pdf/E5-8246.pdf

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Litigation

Sarbanes-Oxley's Extension of Limitations Period Not Retroactive

Under The Sarbanes-Oxley Act (SOX), the limitations period applicable to private claims under the federal securities laws was extended to the earlier of two years after discovery or five years after the events at issue for all actions "commenced on or after" July 30, 2002. In 2003, plaintiffs filed unrelated actions arising from events that took place in 2001, arguing that their claims were not barred by the shorter pre-SOX limitations period because the actions were filed after the SOX effective date which had the effect of reviving the claims at issue. Affirming the dismissal of the actions, the Third Circuit held that "there is no clear evidence that Congress intended [Sarbanes-Oxley] to revive previously expired claims." (*Lieberman v. Cambridge Partners, L.L.C.*, No. 04-3079, 04-3869, 2005 WL 3527013 (3d Cir. Dec. 27, 2005))

Contract Enforceable Where No Evidence of Impossibility of Performance

To raise capital, Continental and defendants entered into an equity finance agreement under which defendants agreed to purchase up to $20 million of Continental common stock over three years. Although Continental delivered one million shares upon execution of the agreement, it was unable to fulfill the requirements for filing an Securities and Exchange Commission registration statement and, as a result, it failed to perform its remaining obligations under the agreement. According to Continental, its inability to perform was caused by the fact that it could not comply with applicable SEC regulations in order to file a registration statement. On cross motions for summary judgment, the court rejected Continental's arguments, noting that it had offered no evidence of any SEC regulation prohibiting registration of its stock. The court dismissed Continental's claims and granted judgment to defendants on their counterclaims, requiring Continental to pay defendants a commitment fee. (*Continental Energy Corp. v. Cornell Capital Partners, L.P.*, No 04 Civ. 260GEL, 2005 WL 3543972 (S.D.N.Y. Dec. 28, 2005))

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CFTC

FinCEN Announces Foreign Correspondent Due Diligence Rules

The U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) has adopted regulations pursuant to Section 312 of the USA PATRIOT Act. The new rules require securities broker-dealers, futures commission merchants, introducing brokers, mutual funds and banks and trust companies perform due diligence and, in some cases, enhanced due diligence, with regard to accounts established or maintained for "foreign financial institutions." A foreign financial institution includes any foreign organized entity that would be a bank, broker-dealer, futures commission merchant, introducing broker or mutual fund if it were organized and situated in the United States.

Covered financial institutions that have a foreign correspondent account are required to establish risk-based policies, procedures and controls that are reasonably designed to enable it to detect and report, on an ongoing basis, known or suspected money laundering activities in a correspondent account managed, maintained, administered or established by a foreign financial institution. These policies and procedures are to assess the money laundering risk presented by the correspondent account based on relevant factors, including: (i) the nature of the foreign financial institution's business and the markets it serves; (ii) the type, purpose and anticipated activity of the correspondent account; (iii) the nature and duration of the relationship between the covered financial institution and the foreign financial institution; (iv) the anti-money laundering and supervisory regimes of the jurisdiction(s) that chartered or licensed the foreign financial institution and its owner(s); and (v) information known or reasonably available to the covered financial institution about the foreign financial institution's anti-money laundering record. A covered financial institution additionally is required to conduct periodic reviews of the correspondent account's activity that are sufficient to determine consistency with the information obtained about the type, purpose, and anticipated activity of the account.

The final rule takes effect on April 4, 2006 for new accounts opened on or after that date by U.S. financial institutions and October 2, 2006 for existing accounts.
http://www.fincen.gov/section312.html

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