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Corporate and Financial Weekly Digest

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SEC/Corporate

Rule Amendments to Disclosure and Reporting Requirements for Small Companies Proposed

On July 5, the Securities and Exchange Commission issued proposed rule amendments relating to the disclosure and reporting requirements for small companies under the Securities Act of 1933 and the Securities Exchange Act of 1934. Many of the proposed rule amendments stem from the April 2006 recommendations of the Advisory Committee on Smaller Public Companies. The proposed rule amendments provide in part for the following:

- The categories of "small business issuer" and "non-accelerated filer" would be combined to form a new category "smaller reporting company". A "smaller reporting company" would be defined as an issuer with a public (non-affiliate) float of less than $75 million as of the last business day of the issuer's second fiscal quarter or an issuer which has no common equity public float or market price and which has reported annual revenues of less than $50 million in the most recently completed fiscal year for which audited financial statements are available. Foreign private issuers that meet the criteria for a "smaller reporting company" would be eligible to utilize the disclosure and reporting standards for a "smaller reporting company". Foreign private issuers who qualify would be able to choose to file pursuant to the requirements of Form S-1, Form S-3, Form S-4, Form 10-Q and Form 10-K or the "F" forms such as Form F-1, Form F-3, Form F-4 or Form 20-F.

- The substantive provisions of the current Regulation S-B would be integrated into Regulation S-K. For example:

    - A new Item 310 (Financial Statements of Smaller Reporting Companies) would be added to Regulation S-K to set forth the alternative requirements on form and content of financial statements for smaller companies that now appear in Item 310 of Regulation S-B. New Item 310 of Regulation S-K would base the requirements on form, content, and preparation of financial statements for smaller companies solely on generally accepted accounting principles (GAAP). It would not require smaller companies to conform their financial statements to Regulation S-X. Item 310 of Regulation S-B would allow smaller companies to provide an audited balance sheet for the latest fiscal year only and audited statements of income, cash flows, and changes in stockholders' equity for each of the latest two fiscal years only, rather than an audited balance sheet for the latest two fiscal years and audited statements of

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income, cash flows, and changes in stockholders' equity for each of the latest three fiscal years, as required in Regulation S-X.

- Items 301 (Selected Financial Data), 302 (Supplementary Financial Information) and 305 (Quantitative and Qualitative Disclosures about Market Risk) of Regulation S-K would be amended to provide that smaller reporting companies are not required to present the information required by these items.

- Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations) of Regulation S-K would be amended to permit only two years of analysis if the company is presenting only two years of financial statements instead of the three years of analysis required of larger companies as required in Regulation S-X.

- Item 402 (Executive Compensation) of Regulation S-K would be amended to provide for the alternative standards for smaller reporting companies for disclosure of compensation such as the exclusion of the Compensation Discussion and Analysis section, executive compensation disclosure for only three officers, and Summary Compensation Table disclosure for only two years.

- Item 404 (Transactions with Related Persons, Promoters and Certain Control Persons) of Regulation S-K would be amended to provide for alternative standards for disclosure of related person transactions.

- An issuer that qualifies as a smaller reporting company would be permitted to choose, on an item-by-item or "a la carte" basis, to comply with either the scaled disclosure requirements made available in Regulation S-K for smaller reporting companies or the disclosure requirements for other companies in Regulation S-K. A smaller reporting company would have the option to take advantage of the smaller reporting company requirements for one, some, all or none of the items, at its election, in any one filing, provided that, a smaller reporting company provide its financial statements on the basis of either Item 310 of Regulation S-K or Regulation S-X for an entire fiscal year.

- The Forms associated with Regulation S-B such as Forms 10-SB, 10-QSB, 10-KSB, SB-1 and SB-2 would be eliminated.

Comments to the proposed rule amendments should be received on or before 60 days after publication in the *Federal Register*.

http://www.sec.gov/rules/proposed/2007/33-8819.pdf

Registration Exemptions for Compensatory Stock Options Proposed

On July 5, the Securities and Exchange Commission proposed two exemptions from the registration requirements of Section 12(g) of the Securities Exchange Act of 1934, as amended, for compensatory employee stock options issued under employee stock option plans. The first exemption would apply to private, non-reporting issuers and the second to issuers that have registered under Section 12 of the Exchange Act the class of equity security underlying the exempted stock options. The exemptions from registration would apply to compensatory employee stock options issued under employee stock option plans that are limited to employees, directors,

consultants and advisors of the issuer, its parents and majority-owned subsidiaries of the issuer or its parents.

Under Section 12(g) of the Exchange Act, an issuer with 500 or more holders of record of a class of equity securities and assets in excess of $10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration. Stock options are a separate class of equity securities for purposes of the Exchange Act and there is currently no exemption from registration for compensatory employee stock options.

The first of the proposed exemptions would apply to issuers without a class of securities registered under Section 12 of the Exchange Act and not otherwise subject to the reporting requirements of Section 15(d) of the Exchange Act where all of the following conditions are present:

- eligible optionholders are limited to employees, directors, consultants and advisors of the issuer;
- transferability of compensatory employee stock options, shares received, or to be received, on exercise of those options, and shares of the same class as those underlying those options by optionholders and holders of shares received on exercise of the options is restricted; and
- risk and financial information is provided to optionholders and holders of shares received on exercise of those options that is of the type that would be required under Rule 701 of the Securities Act of 1933, as amended, if securities sold in reliance on Rule 701 exceeded $5 million in a 12-month period.
- The proposed exemption would not extend to the class of securities underlying the compensatory stock options.

The exemption from registration applicable to Exchange Act reporting issuers would be available only where the options were issued pursuant to a written compensatory stock option plan and the class of persons eligible to receive or hold the options is limited to those participants permitted under Rule 701. The proposed exemption would not include any information conditions, other than those arising from the registration of the class of equity securities underlying the options.

Comments to the proposed rule are due by September 10.

http://www.sec.gov/rules/proposed/2007/34-56010.pdf.

Broker Dealer

Regulation NMS Pilot Stocks Phase Date

July 9 was the "Pilot Stocks Phase Date" for purposes of Regulation NMS. This date marks the beginning of full industry compliance with Regulation NMS Rules 610 and 611 with respect to a pilot group of 250 NMS stocks.

http://www.sec.gov/divisions/marketreg/nmsfaq060807.htm

Amendments to NYSE Rule 92 Approved

The Securities and Exchange Commission has approved amendments to NYSE Rule 92, which generally prohibits NYSE members from trading on a proprietary basis ahead of or along with customer orders executable at the same price. The amendments create an exception to this prohibition, modeled

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after the NASD's so-called "Manning Rule," which permits members to trade ahead of a customer under certain circumstances for the purpose of facilitating the execution, on a riskless principal basis, of one or more other customer orders.

The amendments also eliminate the requirement to obtain order-by-order consent for permissible trades along with a customer's order, instead permitting blanket consent with appropriate disclosure. Finally, the amendments create an exemption from Rule 92 that allows members facilitating a customer order to route intermarket sweep orders (which might otherwise violate Rule 92 by trading ahead of or along with open customer orders) consistent with their Regulation NMS obligations without violating Rule 92, if certain conditions are met.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-13497.pdf

NYSE Arca Removes LMM Requirements for Certain Options Classes

The Securities and Exchange Commission approved rule changes proposed by NYSE Arca to allow NYSE Arca to trade certain highly liquid, highly active options classes without designating a Lead Market Maker (LMM) in such options classes. Prior to the rule change, NYSE Arca rules required that an LMM be assigned to every options class. The amended rules provide that a Market Maker may be designated on a rotating basis as the responsible Intermarket Linkage Market Maker to fulfill certain duties that would otherwise be performed by the LMM with respect to the Intermarket Options Linkage (such as routing Principal Acting as Agent Orders to another exchange).

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-13311.pdf

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E88525731000058DFBA/$FILE/Microsoft%20Word%20-%20Document%20in%2007-68.pdf

CBOE to Trade Corporate Debt Securities Options

The Securities and Exchange Commission has issued an order approving a rule change proposed by the Chicago Board Options Exchange Incorporated (CBOE) to list and trade options on corporate debt securities (CDSOs), thus providing an exchange-traded equivalent to the over-the-counter market in CDSOs. According to CBOE, the main advantages of exchange-listed as opposed to over-the-counter CDSOs would be greater contract term standardization and resulting liquidity, reduced counterparty credit risk, and increased transparency due to data provided by CBOE.

The initial listing standards for a CDSO include (i) original public sale of the underlying corporate debt security (CDS) in a principal amount of at least $250 million, (ii) trading volume of the CDS over the preceding 6 months of at least $100 million in notional value, (iii) minimum aggregate par value or "float" of the CDS of at least $200 million, (iv) at least 360 holders of the CDS, (v) at least one class of common or preferred equity securities of the issuer of the CDS (or its parent) registered under Section 12(b) of the Securities Exchange Act of 1934, and other requirements.

CDSOs will be European-style and physically settled, and their option premium will be quoted in points each equal to $1,000. The position limits established by CBOE will be tiered so that all positions, if exercised, would not exceed 10% of the total float of the underlying bond (the lowest CBOE position limit for equity options is 19.28% of the minimum float of the underlying equity

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security—a difference which CBOE believes is justified by the differences in liquidity between the equity and debt markets). The CDSOs will be subject to margin requirements (both initial and maintenance margin), determined through CBOE's formula for all other option classes but adjusted for market factors specific to the debt rating and type of underlying CDS. CBOE's surveillance plan for CDSO trading includes monitoring for insider trading, mini-manipulation, manipulation, frontrunning, and capping and pegging.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-13275.pdf

Investment Companies and Investment Advisers

Private Fund Antifraud Rule Under the Investment Advisers Act Adopted

On July 11, the Securities and Exchange Commission adopted Rule 206(4)-8 under the Investment Advisers Act. The rule will make it a fraudulent, deceptive, or manipulative act, practice, or course of business for an investment adviser to a pooled investment vehicle to make false or misleading statements to, or otherwise to defraud, investors or prospective investors in that pool. A pooled investment vehicle includes any investment company and any company that would be an investment company but for the exclusions in Section 3(c)(1) or 3(c)(7) of the Investment Company Act.

The new antifraud rule applies to all investment advisers to pooled investment vehicles (e.g., hedge funds, private equity funds, venture capital funds, and mutual funds) regardless of whether the adviser is registered under the Advisers Act. The new rule will apply to all communications with investors, including periodic reports, and not just to communications in connection with the purchase or sale of a security, as would be the case under Securities Exchange Act Rule 10b-5. However, the rule does not provide for a private right of action.

The new rule is largely in response to uncertainty created by the decision of the D.C. Court of Appeals in *Goldstein v. SEC*. In that case, the Court held that an adviser's client is the fund itself, not the individual investors.

The new rule will take effect 30 days after its publication in the *Federal Register*.

http://sec.gov/news/press/2007/2007-133.htm

Banking

Proposed Revisions to Interagency CRA Questions and Answers Released

On July 11, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision (collectively, the Banking Agencies) issued for public comment new and revised interagency questions related to the Community Reinvestment Act (CRA).
According to the accompanying press release, the "majority of the proposed revisions clarify existing questions and answers, improve readability, or adopt current terminology. Many of the proposed revisions update existing guidance to reflect terminology changes made by the Office of Management and Budget and the US Census Bureau or to reflect changes in the agencies' CRA regulations."

Comments are due September 10.

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http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070711/default.htm

United Kingdom Developments

FSA Reverses Proposed Amendments to UK Listing Rules

On June 29, the UK Financial Services Authority (FSA) announced the results of its feedback and further consultation on Listing Review for Investment Entities in consultation paper CP07/12. The details of the proposal for the revised Listing Rules for Investment Entities comprised a withdrawal of a prior proposal that would have permitted close ended funds incorporated outside the UK to obtain a London listing by complying with lower level requirements than for UK investment funds.

The FSA has announced that it will amend the section of its listing rules applicable to investment funds to make London listings more attractive to alternative investment funds. Proposed changes include (i) permitting listing of feeder funds, (ii) relaxing requirements for investment manager experience and (iii) modifying requirements for an independent board of directors.

http://www.fsa.gov.uk/pubs/cp/cp07_12.pdf

JMLSG Consults on Changes to Anti-Money Laundering Guidance

On June 29, the Joint Money Laundering Steering Group (JMLSG) announced that it is consulting on proposed amendments to its risk-based anti-money laundering guidance to reflect the UK Money Laundering Regulations 2007. The amendments, once confirmed and approved by HM Treasury, will update the JMLSG's guidance to include the 2007 Regulations which will implement the EU Third Money Laundering Directive.

Comments are invited by September 7.

http://www.jmlsg.org.uk/bba/jsp/polopoly.jsp?d=751&a=9852

FSA Announces New Market Abuse Strategy

The Financial Services Authority (FSA) announced its new Market Abuse Strategy on July 2. The Regulator first emphasised the need to prevent misuse of inside information and other forms of market abuse, focusing on the need for firms' senior management to take an active role in achieving this and the FSA's enforcement strategy against errant firms.

In speeches by the current FSA director of enforcement on June 29 and the departing FSA chief executive on July 2, both mentioned the importance of the FSA being granted the power to offer immunity or plea bargains in exchange for agreements to give evidence.

The FSA called on all firms, whether regulated or not, to strengthen their controls. The FSA's markets division is drawing up a statement of good practice to improve standards among non-FSA regulated firms. The FSA has approached the Solicitors Regulation Authority about possible changes to the new Solicitors Code of Conduct as part of its drive to clamp down on insider trading.

The remainder of the new strategy was announced in one of the FSA's newsletters; its Markets Division Market Watch newsletter on market conduct in which detailed good practices and appropriate high level policies and procedures for regulated firms were described. These included:

UK DEVELOPMENTS

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- firms being less complacent about the effectiveness of their existing internal procedures;
- documented policies understood by all relevant staff;
- effective information barriers; and
- IT controls to limit access to inside information.

Significantly in light of a number of other recent reports there was no focus on particular market participants: hedge funds, private equity funds and prime brokers were not specifically mentioned or targeted.

http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0629_mc.shtml

http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0702_jt.shtml

http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter21.pdf

FSA Launches Discussion on MTF Trading Oversight

Following proposals by HM Treasury in February 2007 to modernize stamp duty relief on the trading of shares, the Financial Services Authority (FSA) published a discussion paper on July 5 to consider potential issues raised by FSA's oversight of markets for multilateral trading facilities (MTFs).

HM Treasury is extending tax relief available for intermediaries trading shares admitted to a regulated market, including over-the-counter (OTC) trades. The tax relief aims to ensure a single sale is not subject to multiple charges. HM Treasury is also considering extending the relief beyond regulated markets to shares trading on MTFs.

The discussion paper invites comments by September 7.

http://www.fsa.gov.uk/pubs/discussion/dp07_03.pdf

FSA Publishes Quarterly Consultation

On July 6, the Financial Services Authority (FSA) published its 13th quarterly consultation (CP07/13) with various proposals to amend the FSA Handbook's glossary of definitions, Insurance Prudential Sourcebooks, Fees Manual, Market Conduct sourcebook and New Collective Investment Schemes sourcebook.

The quarterly consultation includes proposed clarifications on the application of FSA's Code of Market Conduct to block trades and proposals to allow non-UCITS retail schemes (i.e. funds outside the EU undertakings for collective investments in transferable securities directives) to hold real estate assets through a special purpose vehicle and clarifications on payments to third parties out of scheme property.

http://www.fsa.gov.uk/pubs/cp/cp07_13.pdf

EU Developments

Undertakings for Collective Investment in Transferable Securities Amending Directive Announced

An amending directive was published on July 10, dealing with consequential amendments as a result of the EU's adoption of a new "comitology" procedure in 2006. The new procedure increases the European Parliament's rights of oversight of implementing measures and gives the European Parliament the right to exercise scrutiny of draft implementing measures, and also extends the grounds on which the European Parliament may oppose a draft measure or may propose amendments.

http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2007-0299+0+DOC+XML+V0//EN&language=EN

Questionnaire on Rating of Structured Finance Instruments Published

On June 22, the European Committee of European Securities Regulators (CESR) published a questionnaire on the rating of structured finance instruments as part of CESR's review of the extent that credit ratings agencies are applying the International Organization of Securities Commissions (IOSCO) Code of Conduct Fundamentals for Credit Rating Agencies. CESR has previously advised the European Commission not to formally regulate credit rating agencies.

The deadline for comments is July 31.

http://www.cesr-eu.org/popup2.php?id=4675

Commission Steps Up Pressure on Member States to Implement MiFID

On June 27, the European Commission formally requested 24 EU Member States to write into national law the Markets in Financial Instruments Directive (MiFID) within two months. The deadline for this was January 31, 2007, but only the UK met that date and only Ireland and Romania have joined the UK since January in fully transposing MiFID into national law. The transposition deadline was intended to give the EU financial services firms affected by MiFID provisions nine months prior to November 1, 2007, when MiFID comes into effect, to make the necessary changes to systems, documents and procedures.

The European Commission has previously sent letters to these Member States seeking explanations for the delays in MiFID implementation. The formal requests are part of the second stage of the EU's infringement procedure. If there is no satisfactory reply within two months, the European Commission can refer the matter to the European Court of Justice.

http://www.europa.eu/rapid/pressReleasesAction.do?reference=IP/07/911&format=HTML&aged=0&language=EN&guiLanguage=en

Litigation

Vertical Price Restraints Are No Longer *Per Se* Illegal

In *Leegin Creative Leather Products v. PSKS, Inc.*, the United States Supreme Court, reversing a century old rule, held that it is no longer *per se* illegal for a manufacturer to establish vertical minimum resale price maintenance arrangements with retailers of its products.

EU DEVELOPMENTS

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The plaintiff-retailer in *Leegin* argued that the defendant-manufacturer's establishment of a policy of refusing to sell its goods to retailers who discounted them below levels set by the manufacturer was *per se* illegal under § 1 of the Sherman Act. Relying on long-standing precedent, the District Court agreed and, accordingly, did not permit evidence of any procompetitive effects of the defendant's policy. The plaintiff was awarded a multimillion dollar judgment, which was affirmed on appeal.

The Supreme Court, in a 5 to 4 decision, ruled that *per se* rules should only be applied with respect to restraints that "always or almost always" tend to restrain competition. Because the Court concluded that vertical minimum resale price agreements do not have such an anticompetitive effect, it held that application of a *per se* rule was not appropriate. Among other things, the Court found that the economic literature was "replete" with procompetitive justifications for resale price maintenance agreements and that such agreements could, among other things, promote interbrand competition, facilitate market entry for new competitors, and incentivize retailers to provide enhanced services to support sales of goods to which such agreements apply.

While recognizing that vertical price restraints also could have anticompetitive effects, especially when imposed by market-powerful manufacturers or when foisted upon a manufacturer by retailers, the Court determined that, under the "rule of reason" test, courts were well equipped to prohibit vertical resale price maintenance agreements that impose unreasonable restraints on competition. (*Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, ___ S.Ct. ___, 2007 WL 1835892 (June 28, 2007))

Plaintiff Did Not Plead Securities Fraud Claim with Scienter

In one of the first decisions to apply the Supreme Court's *Tellabs, Inc. v. Makor Issues & Right, Ltd.* decision, a Missouri district court dismissed a securities fraud class action lawsuit filed against a corporation and its management. The complaint alleged that the defendants made multiple false statements that artificially inflated the defendant company's stock price and that the stock price fell by nearly 50% when a corrective disclosure was made just weeks following the allegedly false statements.

The court first held that the plaintiffs failed to sufficiently plead that the allegedly false statements (regarding the corporation's anticipated earnings and expected performance) were false at the time they were made. Because the statements were based on estimates that were made in accordance with the Company's established methodology for making such estimates and were approved by the company's internal and external actuaries, the court ruled that they were not false when made.

The court also ruled that the plaintiffs failed to adequately plead scienter. Applying the standard established in *Tellabs,* the court ruled that the plaintiffs were required to plead facts that gave rise to an inference of scienter at least as compelling as any opposing inference of nonfraudulent intent. The plaintiffs sought to meet this burden by, among other things, alleging that both the CEO and CFO engaged in insider stock sales while the allegedly false statements remained uncorrected. However, the Court found this basis to be insufficient because the plaintiffs failed to allege any facts showing that such sales were "unusual."

While the Court was "sympathetic" to plaintiffs' additional argument that the proximity of the alleged misrepresentations and "subsequent revelation of the truth" suggested that defendants knew the statements were false, it ruled that this "possibility" fell short of meeting the PSLRA's requirement that plaintiffs articulate "facts" supporting a strong inference of scienter in order to withstand a motion to dismiss. (*Elam v. Neidorff*, 2007 WL 1880747 (E.D. Mo. June 29, 2007))

CFTC

Rule Requiring Online Annual Review of Registration Information Adopted

The Commodity Futures Trading Commission has amended CFTC Rule 3.10 to require each registered futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator and leverage transaction merchant to complete online annual reviews and updates of the information maintained by the National Futures Association relating to the registrant. The amended rules become effective on August 1, 2007. Under the amended rule, any failure to make a required update within 30 days of the date established by NFA for completion would be deemed to be a request for withdrawal from registration. The rule change does not alter a firm's continuing obligation under Regulation 3.31(a)(1) to promptly correct any deficiency or inaccuracy in its NFA registration file.

http://www.cftc.gov/foia/fedreg07/foi070702a.htm

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