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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Chairman Schapiro Previews Upcoming Agenda Items, Including Shareholder Access to Proxies and Enhanced Disclosure

In an April 6 speech at the "Council of Institutional Investors – Spring 2009 Meeting", Mary Schapiro, Chairman of the Securities and Exchange Commission, previewed a number of regulatory reform initiatives that the SEC will consider in upcoming months.

In May, the staff will consider a proposal regarding shareholder access to proxies with a view to ensuring that "a company's owners have a meaningful opportunity to nominate directors", according to Schapiro. Chairman Schapiro had previously directed the SEC's staff to draft proposals permitting shareholder access to issuers' proxy statements, as described in the March 20, 2009, edition of *Corporate and Financial Weekly Digest*. Schapiro indicated that the SEC would also review the staff's 2003 and 2007 proposals, as well as the potential impact of proposed changes to Delaware law, regarding proxy access (applicable changes in Delaware law are described in the March 20, 2009, edition of *Corporate and Financial Weekly Digest*). According to Chairman Schapiro, the SEC is reviewing the issue of shareholder access to proxies with "fresh eyes" and a view to ensuring that "any procedural requirements for access are rational, and not a means to thwart effective investor participation".

In June, the SEC will consider whether to "enhance" disclosure regarding director nominees' experience, qualifications and skills. Schapiro believes that the current rules, which require a brief disclosure of a candidate's business experience over the past five years, may be inadequate to enable shareholders to make informed voting decisions. Schapiro indicated that the SEC would also consider whether to require disclosure of the reasons for an issuer's choosing a particular leadership structure, such as an independent chairman of the board, a non-independent chairman or a combined CEO/Chairman.

Chairman Schapiro also suggested that the SEC would review existing compensation disclosure requirements and consider whether greater disclosure regarding companies' risk management policies (including in the context of setting compensation) may be necessary. In that regard, Chairman Schapiro noted her intention to "make sure shareholders fully understand how compensation structures and practices drive an executive's risk taking". Schapiro has asked the SEC's staff to develop a proposal to provide investors, and the market, with better insight into how companies and their boards address risk management. She also indicated that the SEC will consider whether greater disclosure should be required regarding a company's overall compensation approach, beyond decisions with respect to the highest paid

SEC/CORPORATE

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officers, and whether compensation consultant conflicts of interests should be disclosed.

http://sec.gov/news/speech/2009/spch040609mls.htm

Litigation

Seventh Circuit Affirms Dismissal of Securities Exchange Act, Section 14(a) Claim

The Seventh Circuit has upheld a lower court's dismissal of a claim under section 14(a) of the Securities Exchange Act, finding that plaintiff failed adequately to allege that there were misrepresentations in a proxy statement issued during a bidding war for a real estate investment trust.

Plaintiff, a shareholder of the investment trust, asserted a derivative claim against the trust's directors for violating section 14(a), which proscribes material misrepresentations or omissions in soliciting a shareholder's proxy vote. Plaintiff asserted that the proxy statements were misleading because defendants had recommended that shareholders accept a purchase offer which plaintiff alleged was less valuable than the competing bidder's offer. The court rejected plaintiff's argument, concluding that, even though defendants recommended a lower per-share offer which contained a breakup fee, it was superior to the competing bid which contained a stock component and was subject to shareholder approval. The court also rejected plaintiff's argument that the proxy solicitation which recommended the allegedly inferior offer was mailed to shareholders less than 14 days before the shareholder vote, finding that the Securities and Exchange Commission, not the court, should impose a notice rule if warranted. (*Beck v. Debrowski*, 2009 WL 723172 (7th Cir. March 20, 2009))

New York Federal Court Dismisses Section 10(b) Claim

A New York federal court dismissed a claim under Section 10(b) of the Securities Exchange Act because the court found defendants had no duty to disclose the allegedly omitted information.

Plaintiffs, investors in defendant Authentidate, a provider of electronic postmark services, alleged that the company and its directors failed to disclose that the company failed to meet certain performance metrics in its preferred provider agreement with the United States Postal Service. The court rejected each of plaintiffs' arguments that defendants had a duty to disclose their failure to meet the revenue metrics. First, the court found that Item 303 of Securities and Exchange Commission Regulation S-K, which requires that a registrant describe any known trends or uncertainties that have had a material impact on net sales or revenues, was irrelevant because plaintiffs failed to allege any facts making it plausible that the defendants' omissions misleadingly indicated a specific future result or financial condition. The court also found that defendant's February 2004 stock offering did not create a duty to disclose because defendant was not required to meet the revenue targets until months after the offering date. Finally, the court found that the factual allegations in the complaint did not demonstrate any prior statements which rendered the allegedly withheld information misleading. (*In re Authentidate Holding Corp. Securities Litigation*, 2009 WL 755360 (S.D.N.Y. March 23, 2009))

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Electronic Blue Sheet Submissions to Change Under Options Symbology Initiative

The Financial Industry Regulatory Authority (FINRA) has issued Regulatory Notice 09-18 to outline changes to Electronic Blue Sheet Submissions following implementations of the Option Symbology Initiative (OSI). In June 2008, the Options Clearing Corporation and its participant exchanges began implementing OSI in an effort to overhaul the existing method of identifying exchange-traded options contracts by replacing Options Price Reporting Authority codes and fractional strike price values with a new Symbology Key that will contain explicit expiration dates and decimal strike price values. Following implementation of the OSI, member firms must be able to support explicit options identifiers that will require a change to existing blue sheet layouts. The modified format may be used on a voluntary basis starting on April 30 and becomes mandatory on February 12, 2010. The notice reminds member firms that a failure to fill out blue sheet fields properly is a violation of FINRA Rule 8211 and/or FINRA Rule 8213.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118327.pdf

NYSE Delays Operative Date for Riskless Principal Transactions Reporting Requirements

NYSE Regulation has issued Information Memo 09-15 to inform members that the operative date of riskless principal reporting requirements under NYSE Rule 92(c)(3) has been delayed from March 31 to July 31. The New York Stock Exchange filed with the Securities and Exchange Commission for this extension to permit NYSE Regulation time to review with the Financial Industry Regulatory Authority (FINRA) both Rule 92 and FINRA's Manning Rule for the purpose of harmonizing those rules. As part of the proposed harmonized approach to customer order protection, NYSE Regulation and FINRA are reviewing whether it is advisable to alter or otherwise adjust the reporting standard for riskless principal transactions. Until further notice, the use of the "R" account type indicator and NYSE's Front End Systematic Capture database and batch-file reporting requirements for riskless principal transactions are not being implemented and are on hold pending review.

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E885257584006E926D/$FILE/Microsoft%20Word%20-%20Document%20in%2009-15.pdf

Options Exchanges File Plan Regarding Options Order Protection and Locked/Crossed Markets

On March 30, the Securities and Exchange Commission published for comment a proposed plan by the options exchanges that would replace the current intermarket linkage plan. Under the existing intermarket linkage plan, the Options Clearing Corporation (OCC) operates a stand-alone system on behalf of all of the options exchanges. The new plan moves away from a "system-based" approach to a "rules-based" approach that would require neither a central linkage system nor a complex set of operating rules.

Order Protection. Similar to Regulation NMS, which applies to the equities markets, the new plan would rely on a rules-based price protection system to protect against "trade-throughs." Each exchange participating in the new plan would be required to adopt rules reasonably designed to prevent trade-throughs in eligible options classes.

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Exceptions from Trade-Through Prohibition. The new plan provides exceptions from the prohibition against trade-throughs for certain transactions that are similar to the exceptions under Regulation NMS. Of particular importance is the exception for Intermarket Sweep Orders, which permits a participant to access a quote that is inferior to the national best bid or offer as long as orders are sent simultaneously to trade against all protected quotations.

Locked and Crossed Markets. The new plan would require participants to adopt rules that (i) require members to take reasonable measures to avoid displaying locked and crossed markets; (ii) are reasonably designed to ensure the reconciliation of locked and crossed markets; and (iii) prohibit members from engaging in a pattern or practice of displaying locked and crossed markets.

Methods for Compliance. Under the new plan, a participant has two alternatives for compliance: a participant may utilize private order routing arrangements (like Regulation NMS) or use the central system operated by the OCC.

Comments are due on or before April 23.

http://www.sec.gov/rules/sro/nms/2009/34-59647.pdf

SEC Votes to Seek Comment on Five Alternative Short Sale Rule Proposals

A Katten *Client Advisory* on the topic is available here.

Private Investment Funds

Suits Filed in Connection with Madoff Feeder Funds

On April 6, New York State Attorney General Andrew Cuomo filed suit against Gabriel Capital Corporation (GCC) and its principal, J. Ezra Merkin, in connection with investments by GCC-advised hedge funds with Bernard Madoff. Among the many allegations in the complaint, the complaint alleges that by failing to perform adequate due diligence on Madoff's operations and ignoring certain warning signs of fraud, Mr. Merkin breached his fiduciary duties to fund investors and "caused representations he made to investors concerning his ongoing due diligence and oversight of outside money managers to be false and misleading." The complaint also alleges that Mr. Merkin breached fiduciary duties to nonprofit organizations for which he served on investment committees or as investment advisor, by failing to disclose his conflicts of interest in connection with investments made by these organizations.

Attorney General Cuomo's suit is one of a number of lawsuits against GCC, and against other advisors of "feeder funds" (conduits for investment) associated with Bernard Madoff, including various lawsuits by private investors and a complaint filed by Massachusetts' primary securities regulator.

http://www.oag.state.ny.us/media_center/2009/apr/pdfs/merkin%20summons%20complaint.pdf%20-%20Adobe%20Acrobat%20Professional.pdf

CFTC

CFTC Establishes Risk Management Advisory Committee

On April 8, the Commodity Futures Trading Commission announced that it has formed a Risk Management Advisory Committee to serve as a forum for discussion on emerging risk management issues among the CFTC, market

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CFTC

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participants, regulators and other interested persons. The CFTC will use the Committee's reports and recommendations in evaluating legislative and regulatory issues that fall within the CFTC's statutory responsibilities.

http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e9-7939a.pdf

Banking

OCC and OTS Release Quarterly Mortgage Metric Report

On April 3, the Office of the Comptroller of the Currency and the Office of Thrift Supervision jointly released their quarterly report on first lien mortgage performance for the fourth quarter of 2008. The report covers mortgages serviced by nine large banks and four thrifts, constituting approximately two-thirds of all outstanding mortgages in the country.

According to the report, at the end of the year, just under 90% of mortgages were performing, compared with 93% at the end of September 2008. The report also states that the biggest percentage jump with respect to a decline in credit quality was in prime mortgages, which are typically the lowest risk category and account for nearly two-thirds of all mortgages serviced by the reporting institutions.

With respect to modified mortgages, the report states that the re-default rate on such mortgages was high and rising during the first three quarters of 2008. The report does not set forth definitive reasons as to why the re-default rates remain so high, although it notes that it could be from the "worsening economy, excessive borrower leverage, or poor initial underwriting." Finally, the report notes that re-default rates were consistently lower for modifications that resulted in lower monthly payments.

http://www.occ.treas.gov/ftp/release/2009-37.htm

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