Katten
Katten Muchin Rosenman LLP

Corporate and Financial Weekly Digest

April 11, 2008

SEC/Corporate

SEC Successful in Rare Application of Section 1103 of Sarbanes-Oxley Act

On April 9, the Securities and Exchange Commission announced the successful completion of its efforts to prevent a $29.5 million severance package from being paid to the former CEO of Gemstar-TV Guide International, Henry C. Yuen, who committed securities fraud prior to leaving Gemstar. The severance package, which was returned to the Company, had been held in an escrow account pursuant to Section 1103 of the Sarbanes-Oxley Act.

Section 1103 provides that "[w]henever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days." Section 1103 further provides that an extension of the 45 day period may be approved by the court until the conclusion of any legal proceedings.

In the Gemstar case, Mr. Yuen and Gemstar agreed to a $29.5 million severance agreement nearly simultaneously with Gemstar's public disclosure that it would need to restate its 2001 financial results, which would result in a material change to such results. The Commission immediately commenced a formal investigation and thereafter sought and received an order from the U.S. District Court pursuant to Section 1103 that froze Mr. Yuen's severance payment. After obtaining the order, the Commission sued Mr. Yuen in the District Court, which found in favor of the Commission on all claims. After an unsuccessful appeal by Mr. Yuen to the Ninth Circuit Court of Appeals, the District Court ordered the severance payment be returned to Gemstar.

Section 1103 was enacted in the wake of massive accounting scandals earlier in the decade to allow the Commission to freeze large, "extraordinary" payments to potential wrongdoers while the Commission investigated an issuer, so that the funds would not be unreachable by the time the Commission completed its inquiry and/or enforcement. The Gemstar case is one of the first instances of the Commission exercising its Section 1103 powers.

http://www.sec.gov/news/press/2008/2008-58.htm

SEC/CORPORATE

For more information, contact:

Robert L. Kohl
212.940.6380
robert.kohl@kattenlaw.com

Mark A. Conley
310.788.4690
mark.conley@kattenlaw.com

David S. Kravitz
212.940.6354
david.kravitz@kattenlaw.com

Court Grants Motion to Dismiss Section 10(b) Federal Securities Law Claim

The two individual defendants organized the plaintiff Republic Property Trust (REIT) and, as its Trustees, established subsidiary entities, including Republic Property Limited Partnership (RPLP). Thereafter, defendant Republic Properties Corporation (RPC), which was also controlled by the individual defendants, assigned to RPLP its contract (the Services Agreement) with the Community Redevelopment Agency of West Palm Beach, Florida (the Agency) in exchange for RPLP limited partnership units.

Shortly after RPC and RPLP entered into the assignment agreement, a West Palm Beach City Commissioner, a voting member of the Agency, was indicted. Unbeknownst to the investors in the REIT (other than the individual defendants), this Commissioner had received consulting payments from RPC for nearly two years. Although the Services Agreement required RPC to notify the Agency of any potential conflicts of interest, no notification of the consulting relationship had ever been given. The Agency terminated the Services Agreement shortly after learning of the consulting arrangement.

Plaintiffs brought this action seeking recovery for, among other things, securities fraud under Section 10(b) of the Securities Exchange Act. The Court granted defendants' motion to dismiss, ruling that the plaintiff could not demonstrate that the pleaded fraud occurred in connection with a sale of "securities."

The Court first ruled that limited partnership units can constitute investment contracts to which the federal securities laws apply provided that the person purchasing the units does so with the expectation that the partnership will be controlled by the efforts of others. However, when the sale of such units is part of a transaction that transfers control to the purchaser, it is considered "commercial" and "outside the ambit of the securities laws." Accordingly, because RPC exercised control over RPLP – because each entity had the same owners – the RPLP limited partnership units were not "securities" and the Securities Exchange Act claim could not succeed. (*Republic Property Trust v. Republic Properties Corp*., 2008 WL 835258 (D.D.C. March 31, 2008))

Court Partially Vacates Summary Judgment Ruling in Securities Fraud Case

The Securities and Exchange Commission asserted, among other things, that the individual defendants violated Section 10(b) of the Securities Exchange Act by making false and misleading statements to the public to influence the price of defendant Platforms Wireless's stock. In a prior order, the court granted summary judgment in favor of the SEC on most of its claims. However, the court permitted reargument after recognizing that it had wrongly applied an "objective recklessness" test, instead of a "deliberate recklessness" standard, in determining whether the SEC had established defendants' scienter. Under the "deliberate recklessness" standard the defendant must reflect some degree of intentional or conscious misconduct.

Upon reconsideration, the court held that it had incorrectly granted summary judgment on several claims. For example, while the Court had concluded under the misapplied "objective recklessness" standard that an individual's public statement that the value of a contract was $330 million—without disclosing that under the terms of the contract its value could be half that amount—satisfied the scienter element, it found that under the "deliberate recklessness" test that there was a material issue of fact on scienter because the SEC had not presented any evidence that the defendant knew that the

LITIGATION

For more information, contact:

Alan R. Friedman
212.940.8516
alan.friedman@kattenlaw.com

Vikas Khanna
212.940.6427
vikas.khanna@kattenlaw.com

contract was subject to downward negotiation. (*SEC v. Platforms Wireless International, Corp.*, 2008 WL 904903 (S.D. Cal. April 3, 2008))

Broker Dealer

FINRA Issues Notice Regarding Unauthorized Proprietary Trading

The Financial Industry Regulatory Authority (FINRA) issued a Notice highlighting prudent risk management practices relating to preventing and detecting unauthorized proprietary trading. FINRA put out the guidance after soliciting input from a range of member firms regarding their internal controls in this area in response to a number of high profile cases involving allegations of unauthorized "rogue" trading. Although the Notice described procedures FINRA believed were sound practices in this area, the Notice was not intended to create a safe harbor from regulatory exposure but rather to act as an aid for member firms undertaking internal reviews of the adequacy of their current risk controls.

http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p038276.pdf

FINRA Adopts Exemption for Foreign Research Analysts

The Financial Industry Regulatory Authority announced amendments to NASD Rule 1050 and NYSE Rule 344 to codify an exemption from the Research Analyst Qualification Examination for certain research analysts employed by a member firm's foreign affiliate who contribute to the preparation of "globally branded" or foreign affiliate research reports. The rule changes replace an existing exemption that was more limited in scope. The exemption will be available provided that certain supervisory, disclosure and recordkeeping requirements are also satisfied.

http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p038272.pdf

Proposed ISE Rule Change Relating to the Exposure of Public Customer Orders

The International Securities Exchange, LLC (ISE) has filed with the Securities and Exchange Commission a proposed rule change proposing to expose public customer orders that are not executable on the ISE before sending an order through the intermarket linkage system (a Linkage Order) on behalf of the public customer. Under the current procedure, if the primary market maker (PMM) does not execute the public customer order, it sends a Linkage Order(s) to a competing exchange(s) even though there may be other ISE market makers who would be willing to execute the public customer order at the better price. Additionally, a PMM is charged the other exchange's execution fee.

Under the proposed rule change, before the PMM sends a Linkage Order, the public customer order will be exposed at the national best bid or offer (NBBO) for a period established by the ISE not to exceed one second. During the exposure period, ISE market makers may enter responses up to the size of the order being exposed in the regular trading increment applicable to the option. If at the end of the exposure period, the order is executable at the then-current NBBO and the ISE is not the then-current NBBO, the order will be executed against responses that equal or better the then-current NBBO. If, after an order is exposed, the order cannot be executed in full on the ISE at the then-current NBBO or better, and it is marketable against the then-current NBBO, the PMM will send a Linkage Order on the customer's behalf for the balance of the order as provided in the ISE Rule 803(c)(2)(ii). If the balance of the order is not

BROKER DEALER

For more information, contact:

James D. Van De Graaff
312.902.5227
james.vandegraaff@kattenlaw.com

Daren R. Domina
212.940.6517
daren.domina@kattenlaw.com

Patricia L. Levy
312.902.5322
patricia.levy@kattenlaw.com

Morris N. Simkin
212.940.8654
morris.simkin@kattenlaw.com

Janet M. Angstadt
312.902.5494
janet.angstadt@kattenlaw.com

Ross Pazzol
312.902.5554
ross.pazzol@kattenlaw.com

Lance A. Zinman
312.902.5212
lance.zinman@kattenlaw.com

marketable against the then-current NBBO, it will be placed on the ISE book.

http://sec.gov/rules/sro/ise/2008/34-57551.pdf

AMEX Proposes Delta Hedging Exemption from Equity Options Position Limits

The American Stock Exchange LLC has filed with the Securities and Exchange Commission a proposed rule change to amend Amex Rule 904 to establish a delta hedging exemption from equity options position limits. The new exemption will be available, subject to certain conditions, to Amex members and certain of their affiliates that are delta neutral under a "Permitted Pricing Model." Moreover, the exemption would only apply to equity options, such as stock options and options on Exchange Traded Fund shares.

Amex members and non-member affiliates relying on the exemption would be required to ensure that the Permitted Pricing Model applies to all positions in, or relating to, the security underlying the relevant options position that are owned or controlled by the members or its affiliates, unless certain other conditions are met.

http://sec.gov/rules/sro/amex/2008/34-57502.pdf

BSE Proposes Delta Hedging Exemption from Equity Options Position and Exercise Limits

The Boston Stock Exchange, Inc. has filed with the Securities and Exchange Commission a proposal to amend the rules of the Boston Options Exchange (BOX) to create a new exemption from equity options position and exercise limits for positions held by BOX Participants under the BOX Rules. The purpose of the rule change is to permit expanded hedge positions pursuant to a delta hedge exemption from equity options position limits in Section 7 of Chapter III of the BOX Rules. The exemption will be available to BOX Participants and certain of their affiliates that are delta neutral under a "Permitted Pricing Model." Moreover, the exemption will only apply to equity stock options and options on exchange-traded funds.

BOX Participants and their affiliates will be required to ensure the Permitted Pricing Model is applied to all positions in or relating to the security underlying the relevant options position that are owned or controlled by the BOX Participant or its affiliates, unless certain other conditions are met.

http://sec.gov/rules/sro/bse/2008/34-57503.pdf

CFTC

CFTC Amends Regulations for Registered Entities and Exempt Commercial Markets

Effective as of February 14, the Commodity Futures Trading Commission amended several regulations pertinent to registered entities, including contract markets and derivatives clearing organizations, and exempt commercial markets (ECMs). The amendments include, among other matters, (i) a delegation to the Director of the Division of Enforcement of the CFTC's authority to issue special calls to ECMs, (ii) revision of the CFTC's rules governing the submission of rules by registered entities to permit an emergency to be declared by persons other than the registered entity's governing board, and (iii) a requirement that rules and new products that are

CFTC

For more information, contact:

Kenneth Rosenzweig
312.902.5381
kenneth.rosenzweig@kattenlaw.com

Fred M. Santo
212.940.8720
fred.santo@kattenlaw.com

Kevin Foley
312.902.5372
kevin.foley@kattenlaw.com

Lance A. Zinman
312.902.5212
lance.zinman@kattenlaw.com

self-certified by a registered entity be submitted one full "Commission business day" in advance of their implementation.

http://a257.g.akamaitech.net/7/257/2422/01jan20081800/edocket.access.gpo.gov/2008/E8-2580.htm

Banking

Federal Reserve Approves Application Related to Energy Management and Tolling

On March 27, the Board of Governors of the Federal Reserve System (the Federal Reserve) announced its approval of an application by the Royal Bank of Scotland Group (Royal Bank) to engage in physical commodity trading and to provide energy management services. These activities were previously found by the Federal Reserve to be activities that are complementary to the financial activity of engaging as principal in commodity derivatives transactions and, with respect to the energy management services, also "complementary to providing financial and investment advisory services for derivatives transactions."

In addition to these activities, Royal Bank also applied for permission to engage, through a joint venture, in physically settled energy tolling by entering into tolling agreements with power plant owners. (Generally, energy tolling agreements allow a toller to pay an energy plant owner for its fixed costs in exchange for a specific percentage of the plant's power output with the plant owner retaining control of the physical plant and assets.) Royal Bank asserted that such an activity is complementary to the financial activity of engaging as principal in commodity derivatives transactions. The Federal Reserve, which had not previously considered whether "energy tolling" was complementary to a financial activity, agreed to permit such activities in certain circumstances, finding that such activity would assist Royal Bank in managing its own commodities risks.

http://www.federalreserve.gov/newsevents/press/orders/orders20080327b1.pdf

United Kingdom Developments

FSA Fines Stockbroker for Poor Sales Practices

On April 2, the Financial Services Authority (FSA) announced that it had fined Mansion House Securities Limited (Mansion House) £122,500 ($242,150) for giving customers unsuitable and inaccurate advice and using inappropriate sales practices when selling higher risk shares.

Mansion House's failings came to light after the FSA reviewed 30 investment recommendations relating to higher risk shares, made by Mansion House between May 2006 and January 2007. The review also showed that Mansion House had not set up adequate compliance procedures and that it had failed to ensure that its staff were properly trained.

Mansion House agreed to settle at an early stage of the investigation and is appointing an independent party to assess its systems and sale practices and to determine any appropriate compensation for customers.

www.fsa.gov.uk/pages/Library/Communication/PR/2008/031.shtml

The Future of EU Regulation

On April 4, the Financial Services Authority (FSA) published its *International Regulatory Outlook*, setting out developments in international financial services

BANKING

For more information, contact:

Jeff Werthan
202.625.3569
jeff.werthan@kattenlaw.com

Christina J. Grigorian
202.625.3541
christina.grigorian@kattenlaw.com

Adam Bolter
202.625.3665
adam.bolter@kattenlaw.com

UK DEVELOPMENTS

For more information, contact:

Martin Cornish
44.20.7776.7622
martin.cornish@kattenlaw.co.uk

Sam Tyfield
44.20.7776.7640
sam.tyfield@kattenlaw.co.uk

Edward Black
44.20.7776.7624
edward.black@kattenlaw.co.uk

Sean Donovan-Smith
44.20.7776.7625
sean.donovan-smith@kattenlaw.co.uk

policy. The publication included updates on key legislative measures, interviews with FSA staff, an overview of global standard-setting bodies and commentary on the future evolution of EU regulation.

It is the FSA's view that the EU single market in financial services must be supported by regulatory cooperation in order to provide consistent investor protection. Although financial services regulation is typically directed at the national objectives of each EU Member State, there is a growing body of EU-wide legislation currently coordinated by three regulatory committees: the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR).

As a result of questions being raised about the effectiveness of these committees, a meeting of EU finance ministers in December 2007 set out a number of possible areas for further consideration. These included undertaking a review of the regulators' powers and their use, creating an EU mandate for national supervisors and implementing common operational guidelines for the operation of colleges of EU supervisors.

The FSA considers that the current arrangements represent a solid basis on which to build and achieve EU regulatory convergence. It is the FSA's view that, in assessing regulatory convergence, it is much more important to focus on outcomes than on the details of implementation.

http://www.fsa.gov.uk/pubs/iro/apr_2008.pdf

Third Party Administrator Fined for Customer Document Failings

On April 9, the Financial Services Authority (FSA) fined third party administration firm Liberata Financial Services Limited (Liberata) £525,000 ($1.03 million) for failures in its systems and controls for producing and issuing documents to life and pensions policyholders.

Liberata's failings resulted in 30,000 policyholders not receiving information. Of these, 161 suffered financial loss totaling £17,584 ($34,800).

The FSA found that Liberata had acted recklessly in failing to heed internal warnings that documents were not being produced. Since the failures were identified, Liberata has made changes to its senior management and appointed external consultants to help review its document production system and identify documentation which was not produced. Liberata has also compensated the policyholders who suffered financial loss as a result of its failings.

Liberata agreed to settle at an early stage of the FSA's investigation and thereby qualified for a 30% discount of the original fine of £750,000 ($1.5 million).

www.fsa.gov.uk/pubs/final/Liberata.pdf

EU Developments

CRD Changes Proposed

In a speech to the European Parliament's committee on economic and monetary affairs delivered on April 1, Charlie McCreevy, the European Commissioner for Internal Market and Services, announced the following proposed amendments to the EU Capital Requirements Directive (CRD).

Proposals for changes to the CRD included:

EU DEVELOPMENTS

For more information, contact:

Martin Cornish
44.20.7776.7622
martin.cornish@kattenlaw.co.uk

Sam Tyfield
44.20.7776.7640
sam.tyfield@kattenlaw.co.uk

- new rules to limit the risk stemming from large exposures,
- a harmonization of the definition of hybrid capital,
- capital requirements for default risk in the trading book,
- a definition of the significance of risk transfer,
- technical changes to the securitization framework, and
- a series of changes to ease the administrative burden.

The proposals were characterized by Commissioner McCreevy as a targeted revision of certain aspects of the CRD based on a recognition of the need to reinforce the prudential framework and risk management in the banking sector.

http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/162&format=HTML&aged=0&language=EN&guiLanguage=en

* Click here to access the *Corporate and Financial Weekly Digest* archive.

Edward Black
44.20.7776.7624
edward.black@kattenlaw.co.uk

Sean Donovan-Smith
44.20.7776.7625
sean.donovan-smith@kattenlaw.co.uk