Katten
Katten Muchin Rosenman LLP

Corporate and Financial Weekly Digest

April 6, 2007

SEC/Corporate

Staff Recommendation for Working with the PCAOB on Section 404 Changes Approved

On April 4, in an unusual open meeting, the Securities and Exchange Commission approved four recommendations made by the SEC staff with respect to their work with Public Company Accounting Oversight Board to resolve the remaining issues on simplifying Section 404 of the Sarbanes-Oxley Act of 2002. This endorsement came after a previously scheduled meeting among the SEC's commissioners and the members of the PCAOB and was, according to SEC Chairman Cox, part of an effort to "keep us on track" in ongoing efforts to revise Section 404.
The SEC urged their staff to continue to work closely with the PCAOB and concentrate on four main areas:

- aligning the PCAOB's new auditing standard, referred to as AS-5, with the SEC's proposed new management guidance under Section 404;
- scaling the Section 404 audit to account for a company's size and circumstances;
- encouraging auditors to use professional judgment in the Section 404 process, particularly in using risk-assessment; and
- following a principles-based approach to determining when and to what extent an auditor can use the work of others.

The SEC and the PCAOB are under considerable pressure to make compliance with Section 404 more cost efficient for smaller companies and their investors and to implement the new audit standards and management guidance in time for 2007 financial statement audits.

The PCAOB audit standards must be approved by the SEC before they can take effect. The SEC expects the new Section 404 standards to be ready for its review by the end of May or early June, in time for the 2007 financial statement audits.

http://www.sec.gov/news/press/2007/2007-62.htm.

Recommendations on Private Securities Offering Reform Released

On March 22, the Business Law Section of the American Bar Association released a letter to the Director of the Division of Corporation Finance of the Securities and Exchange Commission setting forth a detailed set of recommendations for reform of private securities offerings. The letter includes a comprehensive historical narrative of statutory, regulatory and interpretive

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

Carolyn F. Loffredo
310.788.4585
carolyn.loffredo@kattenlaw.com

David A. Pentlow
212.940.6412
david.pentlow@kattenlaw.com

developments regarding private offering reform. The recommendations to the SEC included, among other things:

- Eliminate restrictions on activities, such as general solicitation and offers not followed by sales, that do not meaningfully contribute to investor protection and where modern technology precludes effective regulation, and replace them with restrictions on purchases;

- Clarify the integration doctrine and relax restrictions on private offering activity where a private offering and a public offering consummated in the same time period would each be permissible if considered separately;

- Amend Regulation D to, among other things, lift restrictions on general solicitation, allow control persons as well as issuers to rely on the safe harbor, and eliminate the notice of sale requirement;

- Amend Rule 144 to, among other things, reduce the holding period to six months (one year for 144(k)), eliminate manner of sale requirements, eliminate volume restrictions for non-affiliates and increase volume limitations for affiliates (at least for fixed income securities, as the volume limitations currently render Rule 144 of limited use for resales of such securities); and

- Amend Rule 144A to, among other things, eliminate the restriction on "offers", and substitute the concept of "qualified purchaser" under the Investment Company Act in place of the concept of "qualified institutional buyer".

The letter states that it views its recommendations as timely in light of the SEC's 2005 public offering reform package and the 2006 Final Report of the Advisory Committee on Smaller Public Companies.

http://www.abanet.org/buslaw/committees/CL410000pub/comments/20070322000000.pdf

Broker Dealer

Proposal for Consolidating NYSE and NASD Regulatory Organizations Published

The Securities and Exchange Commission has published for comment the proposal of the National Association of Securities Dealers, Inc. to consolidate into a new, yet to be named, self-regulatory organization (SRO) the regulatory functions of the NASD and the New York Stock Exchange. For the first three years, the new board will have 23 members: 11 public governors with no material business relationship with a broker-dealer or an SEC registered self-regulatory organization – 5 appointed by the NASD, 5 appointed by the NYSE, and one appointed by both the NASD and NYSE; 3 large firm governors – registered persons associated with firms that employ 500 or more registered persons, nominated by the NYSE and elected by members in that category who may also make nominations; one mid-size firm governor, registered with a firm that employs between 151 and 499 registered persons, nominated jointly by the NASD and NYSE and elected by members in that category who may also make nominations; 3 small firm governors - persons registered with a member employing 150 or fewer registered persons and elected by members in that category who may also make nominations; one governor associated with an NYSE floor member, appointed by the NYSE; one independent dealer/insurance affiliate governor appointed by the NASD; one investment company affiliate governor appointed by the NASD; the CEO of the SRO – Mary Schapiro; and the CEO of NYSE Regulation – Richard Ketchum.

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

Mr. Ketchum will be the non-executive chairman of the SRO. A Lead Governor will be appointed by the board after consultation with the CEO to act as chair when the CEO and non-executive chairman are recused and to chair executive sessions of the board. The CEO, non-executive chairman and Lead Governor can call board meetings and place items on the board agenda. The transition board will have an NASD group committee, NYSE group committee, small firm governor committee, large firm governor committee, an executive committee of 5 to 8 members including Ms. Schapiro and Mr. Ketchum, and Audit, Finance and Nominating Committees.

After three years, Mr. Ketchum will cease serving on the board, and the board will be reduced to 22 members comprised as described above. The NASD group committee and the NYSE group committee will cease to exist.

During and after the transition period members of the SRO will only be allowed to vote for the large firm, intermediate firm and small firm governors, depending upon the member's classification and not for any other governors.

http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_018866.pdf

New York Court of Appeals Holds Notes are a UCC Security

Norton McNaughton, Inc. bought two companies from four family member shareholders. Part of the consideration was eight subordinated promissory notes as to which, upon default, the payee could elect to receive cash or stock. The notes contained a Securities Act of 1933 notice restricting transfer other than pursuant to a registration statement or an opinion of company counsel that the transfer was exempt from registration. The note holders orally agreed to sell seven of the notes at 50% of their face amount. However, before closing on the sale they learned that Norton McNaughton was being bought, and that the buyer would pay the full amount of the notes. They then refused to consummate the sale.

This suit followed in the U.S. District Court for breach of contract. The Second Circuit referred to the New York Court of Appeals the question whether the notes were a security under Article 8 of the Uniform Commercial Code (UCC). If they were, an oral contract of sale was enforceable. Otherwise, UCC Section 1-206(1) would require a written contract for the sale of personal property in excess of $5,000.

In a 5-2 opinion, the Court held the notes were securities as defined in UCC Section 8-102(a)(15). The Court's majority applied the three part test of that section:

- Are the notes represented by a certificate and any transfer registered upon books maintained for that purpose by or on behalf of the company (transferability test);

- Were the notes part of or by their term divisible into a class or series (divisibility test); and

- Were the notes of a type traded in the market or a medium for investment that provided it is a security under Article 8 (functional test).

The majority and minority agreed that the notes met the divisibility and functional tests. The majority held that if the notes were sold and the new owner presented them to the company, the UCC and the Securities Act legend contemplated transferability. It was not necessary for the issuer to maintain or to create books to register the transfer at the time of issuance as long as it may do so at some point in time – e.g., upon sale, so that the issuer would record the new payee.

The dissent pointed out that a security under the UCC is not defined the same as a security under the federal securities laws, but said the notes failed the transferability test because no transfer register ever existed, and noted the distinction between a transfer of a security where the transferor has no liability for the default of the issuer and an endorsement of a negotiable instrument where the endorser retains liability for default by the issuer.

http://www.courts.state.ny.us/ctapps/decisions/apr07/38opn07.pdf

NASD Form U-5 Statements Ruled Absolutely Privileged from a Defamation Claim

In a 4-2 opinion (Chief Judge Kaye not participating), the New York Court of Appeals answered a certified question from the Second Circuit U.S. Court of Appeals that statements made by an employer on an NASD termination notice are subject to an absolute privilege rather than a qualified privilege in a suit for defamation. An absolute privilege immunizes a communicant from liability in a defamation action. Communications that are protected by a qualified privilege are not actionable unless a plaintiff can demonstrate that the declarant made the statement with malice.

NASD requires a firm to file a form U-5 within 30 days of termination and to state the reasons for termination. The majority noted that (i) the filing of a Form U-5 is mandatory, (ii) the NASD is a quasi-governmental entity standing in the shoes of the SEC, (iii) the NASD investigates Form U-5s to determine if the registered person violated the Federal securities laws or NASD rules, and (iv) Form U-5 notices are often the first indication the NASD receives of possible misconduct by a registered person, and found the Form U-5 to be subject to an absolute privilege.

The dissent noted the rare instances where an absolute privilege has been afforded. It noted that other states have granted Form U-5 a qualified privilege. The dissent felt that serious personal and financial interests of the employer are at stake and acknowledged use by some firms of false Form U-5 reports to retaliate against a departing employee would be protected against by granting a qualified privilege requiring the plaintiff to prove that the statement was motivated by malice.

http://www.courts.state.ny.us/ctapps/decisions/mar07/23opn07.pdf

Advisers Act Rule Exempting Fee Based Brokerage Accounts Vacated

In a 2 to 1 decision, in *Financial Planning Association v. Securities and Exchange Commission*, the D.C. Circuit Court of Appeals vacated Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (Advisers Act and Rule). The Rule excluded from the definition of investment adviser broker-dealers receiving fee-based compensation as a fixed amount or percentage of assets in an account for execution, clearance, settlement, custody and provision of research reports. The Rule also excluded from the definition broker-dealers that charged customers different fees for brokerage services - e.g., a full service account versus a discount brokerage account. The Rule also excluded broker dealers exercising temporary discretion over an account.

The Rule was adopted under Adviser Act, Section 202(a)(11) (F) ((now 202(a)(11)(G)) that authorizes the Securities and Exchange Commission to exempt from the definition of investment adviser "such other persons not within the intent of this paragraph …" The Court noted the exemption from the definition in Section 202(a)(11)(C) for broker-dealers who perform research and advisory services solely incidental to the conduct of their business and who receive no special compensation therefor. The court held that this specific exclusion precludes the SEC from adopting a rule under Section 202(a)(F) (now 202(a)(11)(G)), expanding or going beyond Section 202(a)(11)(C) in the case of broker-dealers.

Unless the SEC appeals the decision or requests reconsideration the mandate ordering the opinion into effect will be issued about May 14.

http://pacer.cadc.uscourts.gov/docs/common/opinions/200703/04-1242a.pdf

Banking

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

Banking Agencies Propose Revised Examination Schedule

On April 3, 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 proposed interim rules expanding the range of small institutions eligible for an extended 18-month on-site examination cycle. The proposed interim rules allow well-capitalized and well-managed banks and savings associations with up to $500 million in total assets and a composite CAMELS rating of 1 or 2 to qualify for an 18-month (versus the current 12-month) on-site examination cycle. Notably, until passage of the Financial Services Regulatory Relief Act of 2006, only institutions with less than $250 million in total assets could qualify for an extended 18-month on-site examination cycle.

According to the accompanying announcement, the Banking Agencies believe that this change will allow them to "better focus their supervisory resources on those institutions that may present capital, managerial, or other issues of supervisory concern, while concomitantly reducing the regulatory burden on small, well-capitalized and well-managed institutions."

Comment will be sought for 30 days after publication in the Federal Register.

http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070403/attachment.pdf

United Kingdom Developments

UK DEVELOPMENTS

For more information, contact:

Martin Cornish
44.20.7776. 7622
martin.cornish@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

FSA Leaves Directive-Minimum Listing Door Open

The UK Financial Services Authority (FSA) announced on April 4 that it will keep its current simplified regime for secondary listings of funds until the first quarter of 2008 before moving to a single regime which will be super-equivalent to the EU Prospectus Directive's minimum requirements.
The FSA received a large number of responses from investors, practitioners, listed companies and trade bodies to its second consultation on proposed changes to the UK listing rules for investment entities (CP06/21) which closed on February 28. Respondents to the consultation were in broad agreement that the FSA should make the UK listing regime more attractive for less traditional funds. The FSA will publish a detailed feedback statement in June.

The FSA intend to proceed on the basis of a single platform for all listed closed-ended investment funds, irrespective of domicile. A further consultation paper will be issued in June proposing implementing measures and examining further de-regulatory measures that may enhance the international attractiveness of the UK listing regime for investment entities, while maintaining appropriate protections.

http://www.fsa.gov.uk/pages/Library/Communication/Statements/2007/investment_entities_update.shtml

UK Chancellor Names President of Financial Action Task Force

UK Chancellor Gordon Brown announced on April 4 that he has appointed James Sassoon as the president of the Financial Action Task Force (FATF) for a 12-month period from July 2007 to June 2008. Mr. Sassoon is currently the UK Treasury Department's representative for the promotion of the City of London.

The FATF was established by the G7 in 1989 and is an inter-governmental body which develops and promotes national and international policies to combat money laundering and terrorist financing. It currently has 33 members.

http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2007/press_43_07.cfm

Litigation

LITIGATION

For more information, contact:

Alan Friedman
212.940.8516
alan.friedman@kattenlaw.com

Julia Chung
212.940.6394
julia.chung@kattenlaw.com

Motion to Dismiss Claims Against Former Officers and Directors Denied

The District Court sustained claims of breach of fiduciary duty, fraud and deepening insolvency asserted by the successor-in-interest to the Committee of Unsecured Creditors of DVI, a defunct company, against DVI's former officers and directors. The complaint alleged, among other things, that, to maintain operations and the appearance of solvency, the defendants caused DVI to repurchase delinquent loans and leases without receiving commensurate value, to transfer funds within DVI's subsidiaries and among select borrowers to disguise underperforming accounts and to invest substantial amounts of money in ill-performing markets and non-core businesses. The complaint further alleged that the defendants misrepresented DVI's creditworthiness to lenders and disregarded numerous warnings and "red flags" from DVI's outside auditor and the Securities and Exchange Commission.

The Court denied defendants' motion to dismiss the plaintiff's claims and, in so doing, rejected multiple arguments raised by the defendants including that their actions were valid and protected exercises of business judgment. After noting that the business judgment rule creates a rebuttable presumption that actions of the Board of Directors are entitled to deference, the Court ruled that the presumption is overcome at the pleading stage if the complaint "pleads particularized facts sufficient to raise a reason to doubt that the [challenged] action was taken in good faith or on an informed basis." Here, the Court found the numerous specific allegations of wrongdoing by the defendants to readily suffice in raising doubts as to whether the defendants had acted in good faith when engaging in the various actions that preceded DVI's inability to repay its creditors and its filing for bankruptcy. (*Buckley v. O'Hanlon*, 2007 WL 956947 (D. Del. Mar. 28, 2007))

CFTC

CFTC

For more information, contact:

Kenneth Rosenzweig
312.902.5381
kenneth.rosenzweig@kattenlaw.com

CFTC Proposes Codification of Foreign Broker Exemption

The Commodities Futures Trading Commission has proposed amendments to its rules that would codify the "foreign broker exemption" previously established in a series of releases and interpretations by the CFTC and its staff. The proposed rule amendments would exempt from futures commission merchant (FCM) registration any person whose customers are located outside the U.S., provided that person confines its commodity interest activities to areas outside of the U.S. and has all trades made on a U.S. exchange cleared through a registered FCM.

The comment period for the proposed amendments closes on May 2.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/07-1522.pdf

William Natbony
212.940.8930
william.natbony@kattenlaw.com

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

Kevin Foley
312.902.5372
kevin.foley@kattenlaw.com

Katten

Katten Muchin Rosenman LLP

www.kattenlaw.com

Charlotte
401 S. Tryon Street
Suite 2600
Charlotte, NC 28202-1935
704.444.2000 tel
704.444.2050 fax

Chicago
525 W. Monroe Street
Chicago, IL 60661-3693
312.902.5200 tel
312.902.1061 fax

Irving
5215 N. O'Connor Boulevard
Suite 200
Irving, TX 75039-3732
972.868.9058 tel
972.868.9068 fax

London
1-3 Frederick's Place
Old Jewry
London EC2R 8AE
+44.20.7776.7620 tel
+44.20.7776.7621 fax

Los Angeles
2029 Century Park East
Suite 2600
Los Angeles, CA 90067-3012
310.788.4400 tel
310.788.4471 fax

New York
575 Madison Avenue
New York, NY 10022-2585
212.940.8800 tel
212.940.8776 fax

Palo Alto
260 Sheridan Avenue
Suite 450
Palo Alto, CA 94306-2047
650.330.3652 tel
650.321.4746 fax

Washington, DC
1025 Thomas Jefferson Street, NW
East Lobby, Suite 700
Washington, DC 20007-5201
202.625.3500 tel
202.298.7570 fax

Katten Muchin Rosenman LLP is a Limited Liability Partnership including Professional Corporations. London Affiliate: Katten Muchin Rosenman Cornish LLP.