April 8, 2011

BROKER DEALER

SEC Announces Filing of Proposed Limit Up-Limit Down Requirements

On April 5, the Securities and Exchange Commission announced that the national securities exchanges and the Financial Industry Regulatory Authority filed proposals to establish "limit up-limit down" requirements (Limit Rules) to address extraordinary market volatility in the U.S. equity markets. The Limit Rules would replace the existing single stock circuit breaker pilot program established in response to the market events of May 6, 2010.

The proposed Limit Rules would prevent trades in listed equity securities from occurring outside set price ranges (i.e., a certain percentage above and below the average price of a security over the preceding five minutes). The following percentage limits would apply:

1) 5% for stocks subject to the current circuit breaker pilot (i.e., stocks in the S&P 500 Index, the Russell 1000 Index and certain exchange-traded funds);
2) 10% for stocks not currently subject to the circuit breaker pilot; and
3) double the applicable percentage during opening and closing periods.

Moreover, the proposed Limit Rules would pause trading in a particular stock for five minutes if trading is unable to occur within the acceptable price range for more than 15 seconds.

The national exchanges and FINRA have requested that the SEC approve the proposed Limit Rules as a one-year pilot program.

To read the SEC release, click here.

CFTC

CFTC Open Meeting Regarding Proposed Dodd-Frank Rules

The Commodity Futures Trading Commission announced that it will hold an open meeting on the thirteenth series of rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act on April 12. At the meeting, the CFTC will consider, among other things, proposed rulemakings regarding the imposition of margin requirements for uncleared swaps on swap dealers and major swap participants.

Information about the meeting is available here.

LITIGATION

Fifth Circuit Holds That Fiduciary Obligations to General Partner Can Extend to Partnership

The U.S. Court of Appeals for the Fifth Circuit held that a corporate fiduciary who exercises substantial control over a limited partnership managed by a corporation can owe fiduciary obligations to the partnership itself.

David Harwood was a Director and the Chief Operating Officer of B&W Finance Co., Inc., which was the sole general partner of FNFS, Ltd., a limited partnership engaged in consumer lending operations. Mr. Harwood, who managed B&W's daily affairs, exercised substantial control over FNFS, and withdrew more than $800,000 of FNFS funds as personal loans that he allegedly neglected to properly record. The B&W board terminated Mr. Harwood, who filed for Chapter 7 bankruptcy, and B&W challenged Mr. Harwood's ability to discharge his debts to FNFS because he accrued this debt through defalcation while acting as a fiduciary.

The bankruptcy court ruled the debts were not dischargeable and Mr. Harwood appealed. He argued that while he owed a duty to B&W as an officer and director, this duty did not transfer to FNFS, the limited partnership managed by B&W. The Fifth Circuit disagreed, ruling that the status of a fiduciary was based on the trust conferred on Mr. Harwood and the control he exercised over FNFS. Accordingly, his debts to the partnership were not dischargeable. (*In re Harwood,* No. 10–40406, 2011 WL 1239810 (5th Cir. April 5, 2011))

Revision of Earnings Due to Overbilling Supports Fraud Claims

Allegations that a medical device manufacturer knowingly overbilled insurance companies and reported these unrecoverable accounts as income were sufficient to support security fraud claims.

According to plaintiffs, Zynex Inc. deliberately overbilled insurance companies and reported this inflated income on its financial statements even though top officers knew that the company would not be able to collect this amount. Zynex announced on April 1, 2009, that it was revising its financial reports for the first three quarters of 2008, telling investors that the reduction in earnings was based on "provider discounts" that should have been recognized during that period. Zynex's stock price dropped 56% following the announcement, and plaintiffs sued the company and two officers for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder.

The defendants moved to dismiss, arguing that plaintiffs' allegations at most showed that accounting mistakes occurred, and that the alleged over-billing did not give rise to a strong inference that the company intended to mislead investors. The U.S. District Court for the District of Colorado disagreed, holding that the alleged insistence of Zynex officers to continue the practice of overbilling—despite being aware that collection was impossible—demonstrated an intent to deceive. The Court also noted that the amount of the earnings reduction was "substantial," which also supported the federal fraud claims. (*Mishkin v. Zynex Inc.,* Civil Action No. 09–cv–00780–REB–KLM, 2011 WL 1158715 (D. Colo.))

BANKING

Federal Reserve Proposes to Repeal Regulation Q Pursuant to Dodd-Frank Act

The Federal Reserve Board on April 6 requested comment on a proposed rule to repeal the Board's Regulation Q, which prohibits the payment of interest on demand deposits by institutions that are member banks of the Federal Reserve System. The proposed rule would implement Section 627 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which repeals Section 19(i) of the Federal Reserve Act in its entirety effective July 21. The repeal of that section of the Federal Reserve Act on that date eliminates the statutory authority under which the Board established Regulation Q. The proposed rule would also repeal the Board's published interpretation of Regulation Q and would remove references to Regulation Q found in the Board's other regulations, interpretations and commentary. The Board is seeking comment on whether the repeal of Regulation Q, currently set forth at 12 CFR 217.101, is expected to have implications for balance sheets and income of depository institutions, short-term funding markets such as the overnight federal funds market, the demand for interest-bearing demand deposits, and competitive burden on smaller depository institutions. Some bankers feel that their banks will be compelled to offer accounts that pay interest or lose corporate business, which would either crimp margins or eliminate a source of deposit liabilities.

Technically, the proposal would affect only member banks of the Federal Reserve System. However, other banking agencies are expected to follow suit with similar actions that would apply to their regulatees, regardless of size, that hold demand deposits. The proposal would permit, but not require, member banks to pay interest on demand deposits maintained at those institutions. As such, the Board expects that the proposal would have a positive impact on such entities because it would eliminate an obsolete regulatory provision and because member banks are not obligated to offer interest-bearing demand deposits following the repeal of Regulation Q. The Board promulgated Regulation Q on August 29, 1933, to implement Section 19(i) of the Act. In the past, Regulation Q also contained provisions implementing then-current statutory provisions regulating the rates of interest payable on various types of interest-bearing deposits. The Depository Institutions Deregulation Act of 1982 phased out these statutory interest rate limitations effective in March 1986. After that time, Regulation Q consisted primarily or exclusively of provisions related to implementing Section 19(i)'s prohibition of the payment of interest on demand deposits by member banks.

Read more.

For more information, contact:

FINANCIAL SERVICES

Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Guy C. Dempsey, Jr.	212.940.8593	guy.dempsey@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Maureen C. Guilfoile	312.902.5425	maureen.guilfoile@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Joseph Iskowitz	212.940.6351	joseph.iskowitz@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com

LITIGATION

William M. Regan	212.940.6541	william.regan@kattenlaw.com
Gregory C. Johnson	212.940.6599	gregory.johnson@kattenlaw.com

BANKING

Jeffrey M. Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Christina Grigorian	202.625.3541	christina.grigorian@kattenlaw.com

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

Published for clients as a source of information. The material contained herein is not to be construed as legal advice or opinion.

CIRCULAR 230 DISCLOSURE: Pursuant to regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

©2011 Katten Muchin Rosenman LLP. All rights reserved.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).

London affiliate: Katten Muchin Rosenman UK LLP.