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Katten Muchin Rosenman LLP

Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Provides Guidance on the Use of Company Websites

On July 30, the Securities and Exchange Commission voted unanimously to provide new guidance to public companies about how to comply with federal securities laws, particularly with respect to the Securities Exchange Act of 1934, while developing their websites to serve as effective means for disseminating important information to investors.

The guidance will be issued in the form of an interpretative release and will address four topics:

- How information on a company's website can be considered "public" for purposes of meeting the Regulation FD "public disclosure" requirement;
- The liability framework for information posted on company websites, including access to historical/archived data without it being considered reissued; hyper-linking to third parties without "adopting" the third-party information; providing summary information in the context of securities laws' antifraud provisions; and the content of interactive web sites such as company-sponsored blogs or electronic shareholder forums;
- The extent to which "disclosure controls and procedures" apply to information posted on a company website; and
- The format of information posted on a company's website, including the notion that the information need not be "printer-friendly."

The SEC's interpretative release will be posted on the SEC website shortly and will be immediately effective upon its publication in the Federal Register.

http://www.sec.gov/news/speech/2008/spch073008km.htm
http://www.sec.gov/news/press/2008/2008-158.htm

Litigation

Shareholders' Allegations Satisfied Scienter Pleading Requirements

In a putative securities fraud class action brought by shareholders against the company and its former CEO and CFO, defendants moved to dismiss on the grounds that, *inter alia*, plaintiffs failed to adequately plead scienter. After applying the *Tellabs* standard, *i.e.*, scienter element is met by alleging facts that give rise to an inference of scienter that is at least as likely as any opposing inference, the Court denied the motion, finding that the scienter of the CEO and CFO were sufficiently pled and that their acts were attributable to the company under agency law principles.

SEC/CORPORATE

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With respect to the former CEO, the Court held that the following allegations, among others, gave rise to a strong inference of scienter: (i) the company, with the CEO's knowledge, made statements and omissions with reckless, if not knowing, disregard for the truth; (ii) the company admitted that it had engaged in a backdating scheme of its stock options, which required it to restate its financials; (iii) the CEO was forced to resign; and (iv) the CEO repeatedly made false Sarbanes-Oxley certifications attesting to the adequacy of the company's internal controls, despite his knowledge of their flaws—including his undetected improper pledge of company stock as collateral for his margin account, which the Court found created an incentive for him to conceal problems at the company in order to avoid a stock price decline that could trigger a margin call.

Similarly, with respect to the former CFO, the Court ruled that plaintiffs had adequately pled her scienter through allegations that her conduct was "highly unreasonable" and "an extreme departure from the standards of ordinary care" with respect to dangers that were either known to her or so obvious that she must have been aware of them. As examples, the Court cited plaintiffs' allegations that the CFO repeatedly made Sarbanes-Oxley certifications even though she knew or was reckless in not knowing that the company's financial statements (i) were false and camouflaged 25 instances of options backdating, and (ii) were based upon faulty internal control processes. (*Hall v. The Children's Place Retail Stores, Inc.,* 2008 WL 2791526 (S.D.N.Y. July 18, 2008))

Shareholder Did Not Plead Fraud with Particularity or Adequately Allege Loss Causation

On September 20, 2005, the defendant company issued a press release announcing its agreement to enter into a reverse merger with another company. At the time of the announcement, the company had approximately 177 million shares of common stock issued and outstanding. On September 26, 2005, the company timely filed a Form 8-K with the SEC together with a complete copy of the Share Exchange Agreement. Among other things, the Share Exchange Agreement stated that, at the closing, the company's authorized and issued common stock would total 500 million shares.

Plaintiff, asserting claims under Section 10(b) of the Securities Exchange Act and Rule 10b-5, alleged that he purchased shares of the company's common stock from "approximately the end of September 2005 to November 4, 2005" in reliance on defendants' allegedly fraudulent misrepresentations. Specifically, plaintiff claimed that (i) at the time he purchased the shares, he did not know the company's issued and outstanding shares would be "significantly diluted" in connection with the reverse merger, (ii) this dilution caused the stock price to drop by 65%, and (iii) the dilution was not reported in any SEC filings and no advance notice of the merger or the dilution was provided to plaintiff or any other shareholder.

In dismissing the complaint, the Court held that plaintiff failed to plead fraud with particularity or to adequately allege loss causation. The Court ruled that "the fundamental problem" with plaintiff's fraud theory was that the company's press release stated that the merger would be accomplished through the issuance of additional shares and the Form 8-K disclosed all elements of the merger transaction, including that the company would be increasing its issued and outstanding shares to 500 million. The Court also rejected the plaintiff's assertion that defendants had a duty to disclose any information about the merger prior to reaching an agreement with the other company (which was the date of its press release).

The Court's ruling with respect to the failings of plaintiff's loss causation allegations was equally decisive. After noting that this element requires that the subject of the allegedly fraudulent statement be the cause of the actual loss

suffered, the Court stated that it is “entirely unclear” from the complaint when plaintiff suffered his alleged loss and whether it was causally related to the allegedly fraudulent failure to disclose that the company would be issuing additional shares. Moreover, and contrary to plaintiff’s assertion that the issuance of the common stock caused the stock price to drop by 65%, the Court found that the company’s stock price increased after the merger announcement and disclosure of the issuance of additional shares and continued to trade at a higher price following the issuance of the shares. (*Chien v. Skystar Bio Pharmaceutical Co.,* 2008 WL 2790005 (D. Conn. July 17, 2008))

Broker Dealer

BSE Proposes Rule Change Relative To SROP And CROP Designations

The Boston Stock Exchange (BSE) filed rule changes to amend certain rules that govern members’ conduct in doing business with the public. The amendments would eliminate a current BSE requirement that a member qualified to do a public customer business in options must designate specific individuals to act as a Senior Registered Options Principal and as a Compliance Registered Options Principal. Under the proposed changes, members would be required to integrate the responsibility for supervision of their public customer options business into their overall supervisory and compliance programs. The rule changes conform BSE rules to those of the Financial Industry Regulatory Authority and the other options exchanges.

http://www.sec.gov/rules/sro/bse/2008/34-58221.pdf

NASDAQ OMX Group Acquires Philadelphia Stock Exchange

On July 24, the NASDAQ OMX Group completed its acquisition of the Philadelphia Stock Exchange, renaming it NASDAQ OMX PHLX. The NASDAQ OMX Group reported that this acquisition positioned it to operate the third largest options market in the U.S., with NASDAQ OMX PHLX offering two market models: electronic and hybrid floor-based options trading. The NASDAQ OMX Group also reported that between these two market models, it would have a combined share of 17% of the U.S. equities options market.

http://ir.nasdaqomx.com/releasedetail.cfm?ReleaseID=324143

Approval of ISE Proposed Rule Change to Reduce Order Handling and Exposure Periods

The Securities and Exchange Commission has granted accelerated approval to the proposed rule change to reduce the order handling and exposure periods contained in International Securities Exchange (ISE) Rules 716 (Block Trades), 717 (Limitations on Orders), 723 (Price Improvement Mechanism for Crossing Transactions) and 811 (Directed Orders) from three seconds to one second. A summary of the proposed rule change was previously reported in the July 11, 2008 edition of *Corporate and Financial Weekly Digest*.

http://www.sec.gov/rules/sro/ise/2008/34-58224.pdf

FINRA Proposes to Amend NASD IM-1013-1 Concerning Member Firms That Obtain Membership by Waiving In

The Financial Industry Regulatory Authority, Inc. (FINRA) (f/k/a/ National Association of Securities Dealers, Inc. (NASD)) filed with the Securities and Exchange Commission a proposed rule change with respect to NASD IM-1013-1. The proposal is aimed at addressing the applicability of the consolidated FINRA Rules to member firms of the New York Stock Exchange

BROKER DEALER

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LLC that became members of FINRA pursuant to the waive-in process set forth in IM-1013-1.

Subsequent to NYSE amending its rules to require FINRA membership as a condition of being an NYSE member organization, FINRA incorporated into its existing rulebook NYSE Rules pertaining to member firm conduct. To simplify the mandatory dual-membership process, FINRA adopted NASD IM-1013-1 to enable eligible NYSE member organizations to become FINRA members through an expedited waive-in process. Accordingly, certain NYSE firms were eligible to automatically become FINRA members.

The proposed rule change will reflect FINRA's position that NYSE firms which obtain FINRA membership pursuant to the waive-in process should be subject to all consolidated FINRA Rules. The proposal is particularly important because all existing NYSE Rules applicable to those NYSE firms which waive into FINRA membership are scheduled to be eliminated from the FINRA/NYSE consolidated rulebook, which would ultimately result in a gap in regulation for such NYSE firms. Thus, the proposal would amend IM-1013-1 to specify that the waive-in firms would be subject to FINRA's By-Laws and Schedules to its By-Laws.

http://www.sec.gov/rules/sro/finra/2008/34-58206.pdf

Structured Finance and Securitization

President Bush Signs Into Law "Housing and Economy Recovery Act of 2008"

On July 30, President Bush signed into law H.R. 3221, the "Housing and Economic Recovery Act of 2008" (Housing Act). The Housing Act establishes a new regulator to oversee Fannie Mae, Freddie Mac ("GSEs") and the Federal Home Loan Banks; authorizes the Treasury Department to buy stock or debt in those GSEs; reforms the regulatory supervision of the GSEs; creates the "Hope for Homeowners" FHA program to encourage refinancing of mortgages of at-risk borrowers living in their own homes; establishes a permanent Housing Trust Fund and Capital Magnet Fund to increase the supply of affordable housing; provides $4 billion in emergency assistance to states and cities for the redevelopment of abandoned and foreclosed homes; and contains housing-related tax incentives and other tax provisions.

Katten Muchin Rosenman LLP is preparing a *Client Advisory* providing further details on the Housing Act.

http://www.house.gov/apps/list/press/financialsvcs_dem/detailed_summary_of_hr_3221.pdf
http://www.americansecuritization.com/uploadedFiles/HR3221.pdf

House Financial Services Committee Approves "Municipal Bond Fairness Act"

On July 30, the House Financial Services Committee approved H.R. 6308, the "Municipal Bond Fairness Act." The bill would require nationally recognized statistical rating organizations (NRSROs) to "define clearly any rating symbol used by that organization" and "to apply such rating symbol in a consistent manner for all types of securities and money market instruments to which that symbol is assigned." The bill responds to concerns raised by the Securities and Exchange Commission's recently proposed new rule, Rule 17g-7, which would require NRSROs to either publish a report describing how the credit rating procedures for structured finance products differ from those of other types of rated instruments, or, as an alternative, would require NRSROs to use different rating symbols for structured finance products than those used for

STRUCTURED FINANCE AND SECURITIZATION

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other types of rated debt securities.

http://www.opencongress.org/bill/110-h6308/text

Treasury Department Publishes Best Practices Guide for U.S. Residential Covered Bonds

On July 28, the Treasury Department published a Best Practices Guide for U.S. Residential Covered Bonds. The Best Practices Guide follows and serves as a complement to the FDIC's Final Covered Bond Policy Statement dated July 15. The Best Practices Guide aims to present a "standardized model for Covered Bonds issued in the United States in the absence of dedicated legislation." For a Covered Bond to be consistent with the Best Practices template, the program's documentation must comply with a number of criteria, including:

- the maturity for the Covered Bonds must be between one and thirty years;
- the collateral must be performing, first-lien, one-to-four family residential mortgages, underwritten at the fully-indexed rate, with documented income, with a maximum LTV of 80%, and that are not negative-amortization loans;
- there must be a minimum of 5% overcollateralization; and
- the Covered Bonds may account for no more than 4% of an issuer's liability after issuance.

http://www.treas.gov/press/releases/reports/USCoveredBondBestPractices.pdf

CFTC

CFTC Signs off on FSA Supervision of OTC Clearing on U.S. Exempt Commercial Market

On July 23, the Commodity Futures Trading Commission issued an order pursuant to Section 409(b)(3) of the Federal Deposit Insurance Corporation Improvement Act, determining that the supervision by the UK Financial Services Authority (FSA) of the clearing of over-the-counter instruments by ICE Clear Europe Limited (ICE Clear Europe) satisfies appropriate standards. In reaching its determination, the CFTC considered several factors, including the UK legal and regulatory regime applicable to ICE Clear Europe, the FSA's authority to enforce compliance with the applicable law, and the ability and willingness of the FSA to share information and otherwise cooperate with the CFTC.

http://edocket.access.gpo.gov/2008/E8-17357.htm

NFA Proposes Increase to Net Capital Requirements for Forex Dealer Members

The Executive Committee of the National Futures Association (NFA) has recommended amending the NFA Financial Requirements for Forex Dealer Members to bring them in line with the increased adjusted net capital requirements of the Commodity Futures Trading Commission Reauthorization Act of 2008. The revisions contemplate that NFA Forex Dealer Members will be required to have an adjusted net capital of $10 million by October 31, $15 million by January 17, 2009, and $20 million by May 16, 2009. The Executive Committee is also recommending that Section 12 of its Financial Requirements be amended to provide that a Forex Dealer Member that chooses to collect from its customers less than the security deposits prescribed in Section 12

CFTC

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must consistently maintain capital in excess of 150% (as opposed to 200%) of the required adjusted net capital. The anticipated effective date of the revisions is October 31, pending CFTC approval.

http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=2165

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BANKING

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Federal Reserve Announces Extensions of Liquidity Facilities

The Federal Reserve (Fed), on July 30, in conjunction with the European Central Bank (ECB) and the Swiss National Bank (SNB), announced several steps to enhance the effectiveness of its existing liquidity facilities. These actions are described in more detail below:

Extension of the PDCF and TSLF
In light of "continued fragile circumstances in financial markets," the Fed extended the Primary Dealer Credit Facility (PDCF) through January 30, 2009, and the Fed and the Federal Open Market Committee (FOMC) have extended the Term Securities Lending Facility (TSLF) through that same date. These facilities would be withdrawn should the Fed determine that conditions in financial markets are no longer "unusual and exigent." The PDCF provides discount window loans to primary dealers, collateralized by investment-grade securities. The interest rate charged is the primary credit rate (discount rate) of the Federal Reserve Bank of New York (FRB of NY). Under the TSLF, the FRB of NY conducts weekly auctions of 28-day loans of Treasury securities to primary dealers. Loans under the TSLF are collateralized by a range of government and private securities.

Auctions of TSLF Options
The FOMC has authorized the FRB of NY to auction options for primary dealers to borrow Treasury securities from the TSLF. Such options will be offered for exercise in advance of periods that are typically characterized by elevated stress in financial markets, such as quarter ends. Under the options program, up to $50 billion of draws on the TSLF using options may be outstanding at any time. This amount is in addition to the $200 billion of Treasury securities that may be offered through the regular TSLF auctions. Draws on the TSLF through exercise of these options may be collateralized by the full range of TSLF Schedule 2 collateral.

Eighty-four-day Term Auction Facility Loans
Beginning on August 11, 84-day Term Auction Facility (TAF) loans will be auctioned as well as 28-day TAF funds. Specifically, bi-weekly auctions will be conducted, alternating between auctions of $75 billion of 28-day credit and auctions of $25 billion of 84-day credit. Currently, the Fed auctions $75 billion of 28-day funds every two weeks. During a transition period, the amount of 28-day credit being auctioned will be reduced to keep the amount of TAF credit outstanding at $150 billion. A schedule of TAF auctions and applicable terms and conditions can be found at the Federal Reserve website.

Increase in Swap Line with European Central Bank
The ECB and the SNB will also make 84-day funds, as well as 28-day funds, available at their dollar auctions. The FOMC has authorized an increase in its dollar swap line with the ECB in order to accommodate a temporary increase in the ECB's dollar auctions as the ECB shifts some of its auctions to 84-day terms. The size of the SNB's swap line remains at $12 billion. These swap lines are authorized through January 30, 2009. See the ECB website and the SNB website.

http://www.federalreserve.gov/newsevents/press/monetary/20080730a.htm

UK Developments

BVCA Publishes Guidance for Private Equity Firms on FSA Regulatory Reporting

On July 24, the British Venture Capital Association (BVCA) published two legal bulletins to help private equity firms understand the new regulatory capital reporting requirements due to be introduced by the UK Financial Services Authority (FSA) with effect from September. The requirements are set out in SUP 16.12 of the FSA's Rules. The bulletins provide an overview of the changes to the FSA's regulatory capital reporting regime related to private equity firms that are not subject to the EU Markets in Financial Instruments Directive and private equity firms that are categorized as "Exempt CAD firms."

www.bvca.co.uk/doc.php?id=913
www.bvca.co.uk/doc.php?id=914

FSA Commences Several Criminal Prosecutions for Insider Dealing

On July 24, Malcolm Calvert, a former partner at a major London stockbroker, was charged with 12 separate offenses of insider dealing in breach of Section 52 of the Criminal Justice Act 1993. Mr. Calvert pleaded not guilty and the proceedings were adjourned until September.

On July 28, the regulator filed an indictment against Matthew Uberoi and Neel Uberoi charging 17 counts of insider dealing in relation to trading over a four-month period in 2006. The following day, the UK Financial Services Authority (FSA) arrested eight individuals suspected of insider dealing and executed related search warrants across London and the Southeast of England in connection with a major ongoing investigation. Among those arrested were junior support personnel at two investment banks.

Prior to the three cases mentioned, the FSA had only commenced a single criminal insider dealing prosecution since being given the power to do so in 2001.

www.fsa.gov.uk/pages/Library/Communication/PR/2008/078.shtml

UK DEVELOPMENTS

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