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SEC/Corporate

Why Do Foreign Issuers Deregister?

In March 2007 the Securities and Exchange Commission adopted Rule 12h-6 under the Securities Exchange Act of 1934, revising the criteria for deregistration and termination of reporting obligations for foreign private issuers. Prior to the adoption of the new Rule, deregistration was difficult because the rules focused on the number of U.S. shareholders, regardless of how large their shareholdings were in relation to total shareholdings. Rule 12h-6 substituted a market-based test so that a foreign private issuer can qualify for deregistration if the average trading volume of the registered class of securities in the United States in the prior twelve-month period was no greater than 5% of the average trading volume of that class of securities on a worldwide basis for the same period. In addition, the foreign private issuer must have been in compliance with U.S. reporting requirements during the preceding twelve months; must have maintained a listing of that class of securities for at least the preceding twelve months on a foreign securities exchange that constitutes its primary trading market; and must not have sold securities in a registered offering during the twelve months preceding its deregistration.

The clamor for a more liberalized SEC rule arose primarily because of the concern of some foreign private issuers that compliance with U.S. disclosure requirements, and particularly with the requirements imposed by the Sarbanes-Oxley Act (SOX), was becoming increasingly costly.

A recent study published by Fisher College of Business of The Ohio State University examined 59 companies that utilized Rule 12h-6 to deregister equity securities and exit the U.S. markets. One of the objectives of the study was to examine whether SOX was a significant factor in the decision to deregister by determining whether the deregistering firms were adversely affected by SOX compared to other foreign firms listed on U.S. exchanges and, by examining stock price reaction to deregistering announcements and post-deregistering stock performance, to determine whether shareholders of deregistering companies benefited by deregistration.

The study concludes that, on average, there was no clear evidence that the 59 deregistering firms were more adversely affected by SOX than other foreign private issuers listed on U.S. exchanges. The study did determine that, on average, deregistering firms had poorer growth opportunities than other foreign firms with exchange listings and that these deregistering firms performed poorly prior to their deregistration announcements. Finally, the study found that deregistering firms did not benefit from their deregistration announcements and that to the extent stock price reaction was negative following a deregistration announcement, the negative reaction was greater for firms with higher growth potential. The authors of the study conclude that the "evidence supports the hypothesis that foreign firms list shares in the U.S. in order to raise capital at the lowest possible cost to finance growth opportunities and that, when those

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opportunities disappear, a listing becomes less valuable to corporate insiders so that firms are more likely to deregister and go home". The implication is that SOX is less a determining factor in foreign company deregistration than is company performance and prospects.

http://www.ssrn.com/abstract=1204442

Litigation

Choice of Forum Clause Prevented Plaintiffs' Assertion of Federal Claims

A federal district court granted defendants' motion to dismiss an action arising from plaintiffs' purchase of 100% of the stock in defendants' company. Plaintiffs asserted, among other things, claims under Section 10(b) of the Securities Exchange Act of 1934, alleging that defendants made materially false representations in order to induce plaintiffs to purchase their stock.

Defendants argued that the filing of the lawsuit in Cook County, where the federal courthouse for the Northern District of Illinois is located, violated the forum selection clause in the parties' stock purchase agreement, which specified that "exclusive jurisdiction" over all disputes arising out of or relating to the "[stock purchase] agreement and the other transaction documents" was to be in a court located in Lake County, Illinois. While Lake County is in the federal judicial district for the Northern District of Illinois, no federal courthouse is located in Lake County.

After determining that the forum selection clause in the stock purchase agreement governed, the court ruled that it was enforceable because it was not alleged to have resulted from fraud, undue influence or unequal bargaining power and did not contravene a strong public policy. The court noted that there was ample precedent supporting the dismissal of a federally filed case where the applicable forum selection clause specified a forum in which no federal courthouse was located.

The court recognized that enforcement of the forum selection clause would prevent plaintiffs from pursuing their Section 10(b) claims because the Securities Exchange Act provides for exclusive federal court jurisdiction. It noted, however, that such a result also occurs in cases in which the agreements in issue contain exclusive foreign jurisdiction forum selection clauses, provided that the specified foreign forum provides claimants with sufficient remedies to vindicate their rights. Based upon such precedent, the court ruled that enforcement of the forum selection clause was appropriate because claims under the Illinois securities law and common law fraud were "more than adequate substitutes" for plaintiffs' federal securities claims. (*Spenta Enters., Ltd., et al. v. Coleman*, 2008 WL 2959935 (N.D. Ill. Aug. 4, 2008))

Circumstantial Evidence Was Sufficient to Establish Scienter

The Seventh Circuit affirmed a district court's grant of summary judgment in favor of the Securities and Exchange Commission and imposition of monetary penalties against two individual defendants in an SEC civil enforcement action. In the action, the SEC asserted that the defendants defrauded more than thirty investors out of millions of dollars by falsely representing to the investors that they would invest their funds in high-yield bank-issued securities not available or known to the general public.

Defendants argued that the district court's grant of summary judgment was in error, asserting that scienter, an element of the SEC's claim, involves a state of mind that can almost never be established at the summary judgment stage (and had not been established by the SEC). The Seventh Circuit disagreed.

LITIGATION

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Citing defendants' invocation of their Fifth Amendment right against self-incrimination, the Seventh Circuit noted that a consequence of defendants' decision not to testify in the case was that they offered no testimony to rebut the SEC's evidence that they had acted with scienter. Because of the "mountain of circumstantial evidence . . . that the SEC presented, evidence reinforced by the inference (permissible in a civil case) of guilt from their refusal to testify," the Seventh Circuit held that "no reasonable jury could doubt that they had acted with scienter." Accordingly, the Seventh Circuit affirmed the district court's grant of summary judgment to the SEC and its imposition of penalties against the defendants. (*SEC v. Lyttle*, 2008 WL 3114924 (7th Cir. Aug. 7, 2008))

Broker Dealer

SEC Requests Comment on Plan to Enhance Insider Trading Surveillance and Detection

The Securities and Exchange Commission published for comment an agreement between the Financial Industry Regulatory Authority (FINRA), NYSE Regulation, Inc. (NYSER) and ten U.S. securities exchanges pursuant to SEC Rule 17d-2, a rule that allows the SEC to approve plans for the allocation of regulatory responsibility among self-regulatory organizations. Under the agreement, each exchange gives responsibility for the detection of insider trading to FINRA for Amex, Chicago and NASDAQ-listed securities and to NYSER for New York Stock Exchange- and NYSE Arca-listed securities, no matter where trading occurs in the United States. Currently, each exchange conducts its own regulatory insider trading program and relies upon cooperation with other exchanges when potential insider trading is detected. The agreement was designed to improve detection of insider trading across the equities markets by centralizing surveillance, investigation, and enforcement.

http://www.sec.gov/news/press/2008/2008-174.htm

Modification of Nasdaq Rules Governing Market Maker Quotations

The NASDAQ Stock Market LLC (Nasdaq) filed with the Securities and Exchange Commission a proposed rule change to modify Chapter VII, Section 6 of the Nasdaq rules governing the requirements for market maker quotations on the NASDAQ Option Market (NOM). Because the proposed rule change was designated as a non-controversial rule change, it was deemed effective upon filing. The filing permits market makers to enter quotations for one or more contracts rather than requiring, as the previous rules did, that they enter quotations for 10 or more contracts in series in which they are registered. Nasdaq projects that modifying the quotations requirements will encourage more options trading firms to register as market makers on NOM and will therefore provide more liquidity to NOM participants. The NOM rules would continue to ensure that market makers actively quote. The filing is consistent with the current practice of the NYSE/Arca Exchange of permitting options market makers to enter quotations for one contract.

http://sec.gov/rules/sro/nasdaq/2008/34-58305.pdf

ISE Proposes Rule Changes Regarding Non-Customer Options Orders

On July 23, the International Securities Exchange (ISE) submitted a proposal to the Securities and Exchange Commission to amend the ISE rules regarding non-customer options orders. The ISE proposes to remove Rule 717(a), which prohibits members from entering (i) non-customer market orders and (ii) non-customer limit orders that cross the market and that cannot be executed within

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two minimum variations below the best bid or above the best offer. With the removal of other limitations on non-customer trading and advances in electronic options trading, such as improved intermarket linkage to provide trade-through protection, the ISE does not believe there is any reason to maintain the current restriction on non-customer market and marketable limit orders.

In addition to the removal of Rule 717(a), the ISE also proposes to amend its rules to clarify that market makers may enter market orders and fill-or-kill orders in the options classes to which they are appointed, as the ISE believes that allowing its market makers to utilize these orders types is consistent with its practice of not allowing market makers to have both standing limit orders and quotes in the same options class.

Because the proposal was filed as a non-controversial rule change, it was effective upon filing with the SEC but does not become operative for 30 days after the filing date.

http://www.sec.gov/rules/sro/ise/2008/34-58237.pdf

FINRA, NYSE and CBOE Propose to Make Permanent Their Respective Portfolio Margin Pilot Programs

The Financial Industry Regulatory Authority (FINRA), the New York Stock Exchange LLC (NYSE) and the Chicago Board Options Exchange (CBOE) have filed a proposed rule change with the Securities and Exchange Commission with regard to their respective portfolio margin programs (the Program). The proposal is immediately effective and makes permanent the pilot portfolio margin program (the Pilot Program) that certain self-regulatory organizations (SROs) implemented approximately 18 months ago. The Program, which is substantively similar across the SROs, permits members to margin certain products according to a prescribed portfolio margin methodology. FINRA, NYSE and CBOE stated that they have not encountered any problems or difficulties since implementing the Pilot Program. Moreover, each believed that the Program better aligns margin requirements with the actual risk of hedged products and promotes greater reasonableness, accuracy and efficiency with respect to margin requirements.

http://www.sec.gov/rules/sro/cboe/2008/34-58243.pdf
http://www.sec.gov/rules/sro/nyse/2008/34-58269.pdf
http://www.sec.gov/rules/sro/finra/2008/34-58251.pdf

Structured Finance and Securitization

Rep. Scott Garrett Introduces the Equal Treatment For Covered Bonds Act

On July 30, Rep. Scott Garrett (R-New Jersey) introduced the Equal Treatment for Covered Bonds Act. According to Garrett, the legislation is designed to help facilitate a robust covered bonds market in the United States and to add liquidity and certainty to the nation's housing market. Rep. Garrett supports Treasury Secretary Henry Paulson and the Federal Deposit Insurance Corporation (FDIC) on their proposals for covered bond regulation, but believes the proposed Equal Treatment for Covered Bonds Act would go further.

According to Garrett, covered bonds as debt instruments are broad enough in scope and magnitude to warrant being authorized and codified as federal legislation. He argues that establishing a statute will lend the added benefit of legislative review, rather than leaving policy open to changes made by a simple motion of the FDIC board. Statutory language, Garrett said, would

STRUCTURED FINANCE AND SECURITIZATION

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provide more certainty than a regulatory change, and such certainty could promote lower transaction costs.

In addition, Garrett suggests that with definitive legal certainty, spreads would be narrower, which would encourage more institutions to enter the covered bonds marketplace. So far, the country's four largest banks have all pledged their support of Paulson's covered bond proposal, but they have yet to put forth any specific plans for bond issuance.

Garrett's legislation amends the Federal Deposit Act by providing covered bonds with the same treatment that is given to other qualified financial contracts. The Act sets the minimum term of maturity for a covered bond at one year but does not set a maximum maturity term. It also adds a clause ensuring that a bank failure will not impair the value of the covered bonds, and it gives joint rulemaking authority for any new covered bond regulations to the Treasury Secretary, Federal Reserve, Office of the Comptroller of the Currency, Office of Thrift Supervision, and FDIC.

http://garrett.house.gov/News/DocumentSingle.aspx?DocumentID=99123
http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h6659ih.txt.pdf

Freddie Mac to Stop Purchasing Subprime Home Loans

On August 12, Freddie Mac announced via a bulletin on its website that, beginning September 1, it will stop purchasing mortgage loans in New York that fall within the state's definition of “subprime home loans” in a subprime lending reform bill. On August 5, New York Governor David A. Paterson signed the bill into law and said it will help protect New York homeowners from losing their homes and mandates reforms to avoid a similar housing crisis in New York State in the future.

Under the new law, investors, including loan buyers like Freddie Mac and Fannie Mae, are held accountable for mortgage fraud, which Freddie Mac says it has no way of policing or preventing. The bill establishes a borrower ability-to-pay standard that is determined based on lenders' “reasonable and good faith determination.” It also lays out requirements for brokers to act in borrowers' best interests, and mandates all local mortgage servicers to register with the state's banking department.

One of the reforms outlined by the new legislation is the classification of mortgage fraud as a crime under the state's penal code, making it easier for prosecutors to pursue criminal cases and convictions. According to the Governor's office, as the magnitude of the fraud increases, so would the criminal penalty. The provisions are intended to establish strong consumer protections for subprime loans and to implement minimum underwriting standards that protect borrowers.

http://www.ny.gov/governor/press/press_0805081.html
http://www.freddiemac.com/sell/guide/bulletins/pdf/bll081208.pdf

CFTC

FTC Issues Notice of Proposed Rulemaking Regarding Petroleum Market Manipulation

On August 13, the Federal Trade Commission (FTC) issued a Notice of Proposed Rulemaking to seek public comment on its proposed rule prohibiting market manipulation in the petroleum markets. The new FTC Notice follows an Advance Notice of Proposed Rulemaking issued in May. The proposed rule, which is intended to implement Section 811 of the Energy Independence and

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Security Act of 2007, employs a liability scheme modeled after Securities and Exchange Commission Rule 10b-5 and would prohibit manipulative practices in connection with the purchase of crude oil, gasoline or petroleum distillates at wholesale.

In its Notice, the FTC rejected arguments raised by several futures industry commenters that the proposed rule should be amended to limit or eliminate its application to futures trading activities already regulated by the Commodity Futures Trading Commission. The FTC asserted that CFTC jurisdiction over futures market manipulation is not exclusive and that the adoption of rules "to give full effect to all statutory schemes that may address the conduct at issue" is appropriate, notwithstanding the possibility of regulatory overlap with the CFTC.

The comment period for the proposed rule closes on September 18.

http://www.ftc.gov/opa/2008/08/nprm.shtm
http://www.ftc.gov/os/2008/08/P082900nprm.pdf

CFTC Creates Forex Enforcement Task Force

The Commodity Futures Trading Commission has created a special task force within the Division of Enforcement to focus on fraud in the off-exchange retail foreign currency ("forex") market. The new task force, the creation of which coincides with recent legislation enhancing CFTC jurisdiction over forex transactions, will work in conjunction with other federal and state regulators to investigate and litigate cases of forex fraud.

http://www.cftc.gov/newsroom/enforcementpressreleases/2008/pr5530-08.html

Banking

Federal Reserve Revises Fee Schedule and Payment Conditions Under Regulation S

On August 13, the Federal Reserve Board proposed amendments to Regulation S, which implements the Right to Financial Privacy Act (RFPA). Regulation S sets the rates and conditions under which a government agency must reimburse a financial institution for costs incurred in producing customer financial records under RFPA. The changes are being proposed to reflect more accurately the costs of producing electronically stored information.

The amendments include (i) updating the fees for which a financial institution may seek reimbursement, (ii) replacing prior "per diskette" charges with a "per electronic production" flat fee, and (iii) prohibiting reimbursement on a per-page basis for printing electronically stored information. The proposed rules require that certain costs (e.g., photocopying) will only be reimbursable if the institution has reproduced records that are not maintained electronically or where the government authority has requested specifically that such documents be produced in hardcopy. The proposed amendments also provide for an automated mechanism to update periodically the labor rates using Bureau of Labor Statistics.

Comments must be submitted on or before September 29.

http://www.federalreserve.gov/newsevents/press/other/other20080813a1.pdf

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