

Corporate and Financial Weekly Digest

Business/Financial News in Brief

August 18, 2006

SEC/Corporate

SEC Names Executive Director and Director of the Division of Market Regulation

On August 16, the Securities and Exchange Commission named Diego Tomás Ruiz as the SEC's Executive Director. As Executive Director, Mr. Ruiz will serve as the SEC's Chief Operating Officer, and will oversee the SEC's programs relating to budget planning and execution, preparation of the SEC's financial statements, human resources and employee relations, and administration of the SEC's facilities. For ten years, Mr. Ruiz served in a number of significant management positions for Univision Communications, Inc., a New York Stock Exchange-listed component of the S&P 500. In January, Mr. Ruiz left Univision to serve as Deputy Chief of the Office of Strategic Planning and Policy Analysis at the Federal Communications Commission. Mr. Ruiz is a graduate of the Harvard Business School, where he earned an M.B.A. degree, and the University of Virginia, from which he earned a B.A. in English Literature and History. Mr. Ruiz will begin his tenure at the SEC on August 21.

On August 14, the Securities and Exchange Commission named Erik R. Sirri as its Director of the Division of Market Regulation. As Director of the Division of Market Regulation, Dr. Sirri will be responsible for the regulation of broker-dealer firms, the stock exchanges, the National Association of Securities Dealers (NASD), the Municipal Securities Rulemaking Board (MSRB), and clearing and settlement agencies. Dr. Sirri, a Professor of Finance at Babson College, is currently a visiting scholar at Harvard Law School. From 1996 to 1999, Dr. Sirri served as Chief Economist for the SEC. From 1989 until 1995, Dr. Sirri served on the faculty of the Harvard Business School. Dr. Sirri has served as a member of the NASDAQ Stock Market Economic Advisory Board, as a Board Member of the Boston Options Exchange (Regulation), and as a Governor of the Boston Stock Exchange. Dr. Sirri holds a Ph.D. in Finance from the University of California, Los Angeles; an M.B.A. from the University of California, Irvine; and a B.S. in Astronomy from the California Institute of Technology. Dr. Sirri will begin his tenure with the SEC on September 12.

<http://www.sec.gov/news/press/2006/2006-141.htm>

<http://www.sec.gov/news/press/2006/2006-140.htm>

SEC Issues Request for Proposal for Software Development

On August 14, the Securities and Exchange Commission announced it had issued a Request for Proposal for the development of web-based analysis software that will enable investors and analysts to use interactive data encoded in the Extensible Business Reporting Language (XBRL) format. The software would enable investors and analysts to analyze mutual fund and corporate information. Interactive data has the potential to enable individual investors and investment professionals to quickly search for and

analyze any particular item of information from financial reports, such as individual line items from the financial statements; text-based information including accounting policies or mutual fund expenses; and also to easily compare retrieved information from company to company and industry to industry. Interactive data also can allow automatic, real-time delivery of SEC financial data directly to a person's desktop. The SEC launched its initiative for the use of interactive data in February 2005 and more than two dozen companies have joined the SEC's interactive data test group.

<http://www.sec.gov/news/press/2006/2006-139.htm>

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ERISA

Pension Bill Changing 25% Test Signed

Yesterday, President Bush signed the Pension Protection Act of 2006. The Pension Act makes significant changes throughout ERISA including changing the "25% test" for determining whether an entity is deemed to hold "plan assets" and adding a number of statutory prohibited transaction exemptions.

Although the Pension Act provides that the "25% test" remains at 25%, the test no longer includes "benefit plan investors" plans that are not subject to ERISA or Section 4975. This would exclude from the numerator, in the application of the test, governmental plans, foreign plans and many church plans.

The Pension Act also provides that "[a]n entity shall be considered to hold plan assets only to the extent of the percentage of equity interests held by benefit plan investors." This means that an investee fund would count a "plan asset" fund-of-funds as a "benefit plan investor" only to the extent of "benefit plan investor" participation in that plan asset fund-of-funds (e.g., if 50% of a fund-of-funds consists of ERISA/4975 money, then only 50% of that fund-of-funds' investment would count as a benefit plan investor when invested in an investee fund). The Pension Act also adds a number of statutory prohibited transaction exemptions, each with a significant number of conditions. It exempts (i) the provision of certain investment advice, (ii) block trading, (iii) foreign exchange transaction and (iv) cross trading, in each case provided the conditions are satisfied. These provisions generally became effective today.

The Katten Muchin Rosenman LLP Client Advisory on these changes may be viewed at;

<http://www.kattenlaw.com/publications/List.aspx?PublicationTypes=df5e0448-7387-4808-99ed-0c1e6c213614>

The Pension Protection Act of 2006 may be viewed at;

http://www.rules.house.gov/109_2nd/text/pensions_cr/HWC_373_xml.pdf

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Broker Dealer

Chicago Stock Exchange Proposal to Implement a New Trading Model

The Chicago Stock Exchange, Inc. has proposed rule changes to implement a new trading model that would allow participants to submit orders for immediate execution in a fully-automated, central matching system from any location. The new trading model is designed to comply with Regulation NMS and would

eliminate the Exchange's physical trading floor. The matching system would provide the only means for the display of orders and a central point for the execution of orders.

"Off-Exchange" order-sending firms that send orders to the matching system for execution would not be required to register with the Exchange to act in any specific capacity other than as trading participants. The Exchange would allow participant firms to register (i) to operate as proprietary market makers on the Exchange or (ii) to act as institutional brokers. Market makers could choose to post two-sided quotations and trade for their proprietary accounts. Any customer order would be accepted off the Exchange and a market maker could then choose whether or not to enter the order in the Exchange's matching system or submit the order to a different venue. In contrast, any customer orders accepted by institutional brokers would be deemed to be on the Exchange when accepted.

<http://www.sec.gov/rules/sro/chx/2006/34-54301.pdf>

NASD Proposes Amendments to Procedures for the Exercise of Options

The National Association of Securities Dealers, Inc. has proposed to amend Rule 2860(b)(23), which sets forth tendering procedures for the exercise of options, to: (i) simplify the manner in which a Contrary Exercise Advice (CEA) is submitted; (ii) extend by one hour the cut-off time by which members must submit CEA notices; and (3) add procedures for exercising a standardized equity option when a modified close of trading is announced. The proposal also consolidates all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) to eliminate duplication with Rule 11850, which also currently includes certain tendering procedures.

The proposed rule changes, which apply only to NASD members that are not also members of the exchange on which the option is listed and traded (so-called "access firms"), are meant to track recent changes to substantially similar rules of the options exchanges and, accordingly, to provide such firms with the same treatment as members of the options exchanges.

<http://www.sec.gov/rules/sro/nasd/2006/34-54313.pdf>

NASD Reminds Members of Obligations in Sales of Existing Variable Life Insurance Policies to Third Parties

The National Association of Securities Dealers, Inc. published Notice to Members 06-38 to remind member firms and their associated persons of their obligations in connection with recommending or facilitating a variable life settlement. A variable life settlement contract typically involves an owner of a variable life insurance policy, who no longer wants or can no longer afford the policy, selling the policy to a third party for less than the net death benefit, but more than the cash surrender value, based on a variety of factors, such as the insured's life expectancy and the nature and terms of the policy.

Because variable life insurance policies are securities, NASD requirements concerning, for example, suitability, due diligence, best execution, supervision and training, and compensation apply in connection with variable life settlements. Therefore, for example, before recommending any variable life settlement, an associated person must have a reasonable basis for believing that the transaction is suitable for the customer. There can be significant costs associated with such transactions and a variable life settlement is not necessarily suitable for a customer simply because the settlement price offered exceeds the policy's surrender value. The Notice to Members provides additional guidance concerning how member firms may satisfy their obligations in connection with these types of transactions.

Separately, the NASD indicated in the Notice to Members that depending on the circumstances, the sale and marketing of interests in life insurance policies (variable or not) for investment purposes may trigger

broker-dealer registration requirements and promised to continue to monitor this development and provide further guidance as necessary.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_017131.pdf

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Banking

Fed Sets New TILA Fee-Based Trigger

On August 9, the Federal Reserve Board published its annual adjustment of the dollar amount that triggers additional disclosure requirements under the Truth in Lending Act for home mortgage loans that bear rates or fees above a certain amount.

The dollar amount of the fee-based trigger has been adjusted to \$547 for 2007 based on the annual percentage change reflected in the Consumer Price Index that was in effect on June 1.

The adjustment is effective January 1, 2007.

The Home Ownership and Equity Protection Act of 1994 restricts credit terms such as balloon payments and requires additional disclosures when total points and fees payable by the consumer exceed the fee-based trigger (initially set at \$400 and adjusted annually) or 8 percent of the total loan amount, whichever is larger.

<http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060809/default.htm>

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Litigation

Securities Fraud Claims Based on Company's Restatement Sufficient to Withstand Dismissal

A district court in Texas refused to dismiss a securities class action lawsuit against Key Energy, an onshore well service company, and two of its officers, but granted a motion to dismiss the action against two other individual defendants. Plaintiffs asserted claims based on violations of §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 arising from defendants' alleged overstatement of the company's financial results through various improper accounting practices which led to an announcement of a restatement. In denying the company's and two officers' motion to dismiss, the Court found that the defendants' announcement of the need to restate earnings supported an allegation of falsity. The Court further found that the announcement that the company would write down 22% of the value of its fixed assets met the materiality pleading requirement. Finally, the Court found that defendants' need to file a restatement where it would write down such a large portion of the company's assets, and the termination of the company's CEO by the board, amounted to strong evidence of scienter. The Court granted the

motion to dismiss of the other two officers because plaintiffs had failed to plead facts specifically tying those defendants to the fraud. (*Kaltman v. Key Energy Services Inc.*, No. MO-04-CV-082, 2006 WL 2346423 (W.D. Tex. August 11, 2006))

“Director by Designation” May Be Subject to Section 16(b)

Plaintiff brought claims for disgorgement of short swing profits under Section 16(b) of the Securities Exchange Act of 1934, which prohibits insiders, such as directors, from profiting on short swing trades. The lower court granted defendant’s motion to dismiss because Rule 16b-3(d), the exemption to Rule 16(b) which allows insider transactions if approved by the board of directors of the company, applied. On appeal, Plaintiff argued that the Securities and Exchange Commission lacked authority to promulgate Rule 16b-3(d) and that the rule was contrary to 16(b). The Ninth Circuit found that the SEC had the authority to promulgate the rule and that it was not, as plaintiff asserted, “arbitrary and capricious.” However, the Ninth Circuit remanded for further findings as to whether the exception applied to the facts at issue. (*Dreiling v. American Express Co.*, No. 04-35715, 2006 WL 2337451 (9th Cir. Aug. 14, 2006))

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CFTC

CFTC Allows the Sydney Futures Exchange’s 1-Day Option Contract Based on the CBOT Mini-Sized Dow Futures Contract to be Offered and Sold in the United States

The Commodity Futures Trading Commission issued a No-Action Letter to the Sydney Futures Exchange on August 8 that authorizes the offer and sale in the United States of the SFE’s 1-Day Option Contract based on the Chicago Board of Trade Mini-Sized Dow Futures Contract . The 1-Day Option Contract uses the daily settlement price of the CBOT Mini-Sized Dow Futures Contract, which is based on the Dow Jones Industrial Average Index, for cash settlement.

<http://www.cftc.gov/files/opa/opasydneyfuturesexchangenactionletter06-17.pdf>

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