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Corporate and Financial Weekly Digest

August 22, 2008

A Note from the Editor

In light of the Labor Day holiday, please note that *Corporate and Financial Weekly Digest* will not be published next Friday, August 29. The next issue will be distributed on September 5.

SEC/Corporate

SEC Announces Successor to Edgar Filing System

On August 19, the Securities and Exchange Commission announced that it will transition from the current EDGAR database to a new system called Interactive Data Electronic Applications (IDEA). The interactive data filings of reporting companies are expected to be available on the SEC website through IDEA beginning late this year.

The SEC began an interactive data pilot program in 2005 and concluded that interactive data would make financial reporting more useful to investors. While EDGAR allows investors to search for information on reporting companies one form at a time, IDEA will allow investors to search and collate information from thousands of reporting companies and forms at once through the use of interactive data that is formatted in eXtensible Business Reporting Language (XBRL). Interactive data uses computer "tags," which allow for identification of identical items in all reporting companies' financial disclosures. For example, each line item and number on income statements will be individually tagged using labels from a standard list, thereby allowing easy searching on the Internet and downloading into spreadsheets and databases, which will facilitate comparative analysis by investors and analysts.

The SEC's proposed schedule is expected to require companies with a worldwide public float over $5 billion to make financial disclosures using interactive data formatted in XBRL for filings that contain financial statements for periods ending on or after December 15, 2008. The proposed schedule would likely require the remaining companies to make financial disclosures using interactive data formatted in XBRL over the following two years.

As the SEC transitions from EDGAR to IDEA, investors will be able to benefit from interactive, IDEA-like features that the SEC says will be "grafted onto EDGAR in the short run." The EDGAR database will continue to be available as an archive of company filings even after EDGAR is phased out. Investors will also be able to take advantage of IDEA's advanced search capabilities during the transition period.

http://www.sec.gov/news/press/2008/2008-85.htm
http://www.sec.gov/news/press/2008/2008-179.htm
http://www.sec.gov/rules/proposed/2008/33-8924.pdf

SEC/CORPORATE

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Whistleblower Statute Requires Plaintiff to Explain Perceived Securities Law Violation

The Fourth Circuit affirmed a final order of the Administrative Review Board, finding that the termination of the former CFO of a public company did not violate the whistleblower protection provision of the Sarbanes-Oxley Act. The ex-CFO alleged that his termination stemmed from his repeated refusal to certify the company's quarterly reports filed with the SEC. He argued that the reports were based on fraudulent accounting practices that he had brought to the company's attention.

The Court noted that after the ex-CFO reported his concerns, he refused to meet with the board of directors to discuss them without his personal attorney present. After concluding that the ex-CFO's charges lacked merit, the company terminated him for refusing to explain his charges. Thereafter, the ex-CFO filed a complaint with the Department of Labor under the whistle-blowing provision of the Sarbanes-Oxley Act. Although an Administrative Law Judge concluded that the ex-CFO's rights were violated, the Administrative Review Board reversed, which led to the ex-CFO's appeal to the Fourth Circuit.

The Fourth Circuit found that an employee asserting a claim under Sarbanes-Oxley's whistleblower protection provision bears the initial burden of making a prima facie showing that he was retaliated against because he engaged in "protected activity." In order to meet this burden, the employee must show that he had both a subjective belief and an objectively reasonable belief that the conduct he "blew the whistle on" constituted a violation of one of the laws enumerated in the statute (e.g., the federal securities laws). After determining that the employee had failed to demonstrate an objectively reasonable belief that the company's accounting practices violated any federal securities law, the Court held that he could not make a prima facie showing that his activity was protected under the whistleblower protection provision and, accordingly, upheld the dismissal of the complaint. (*Welch v. Chao*, 2008 WL 2971800 (4th Cir. August 5, 2008))

Corrective Disclosure Must Provide New Facts or Fraud-Revealing Analysis

After a jury found that the defendant committed securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, a district court granted the defendant's motion for judgment as a matter of law. The plaintiffs alleged in their securities fraud class action lawsuit that the defendant corporation and two of its officers made material misstatements that caused the investors to suffer loss once the truth was disclosed. According to plaintiffs, the misstatements conflicted with findings in a report prepared by a governmental agency concerning the defendant company's business that the company was aware of but that had yet to be made public. Significantly, following the publication of nationwide news reports of the agency's findings, the market price of the company's stock did not change. Five days later, however, following the issuance of analyst reports that addressed the agency findings and downgraded the company's stock, the stock price dropped significantly. The jury found that the analyst reports were "corrective disclosures" that caused the investors' loss, thereby satisfying the "loss causation" element of plaintiffs' securities fraud claim.

In support of their motion to overturn the verdict, the defendant argued that the evidence did not support a finding of "loss causation" because, among other reasons, the analyst reports did not provide any new, "fraud-revealing analysis." Instead, the reports merely summarized past disclosures made through the nationwide news reports. The court agreed, noting that under the

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federal securities laws, fraud actions are available "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause." After finding that the original news reports acted as corrective disclosure for the defendant's alleged misstatements and that their disclosure did not impact the defendant's stock price, the court held that there was no evidence to support a finding of loss causation. Accordingly, the court overturned the jury verdict and granted the defendant judgment as a matter of law. (*In re Apollo Group, Inc. Securities Litigation*, 2008 WL 3072731 (D. Ariz. August 4, 2008))

Broker Dealer

SEC Approves BATS Exchange, Inc.

On August 18, the Securities and Exchange Commission approved the application of BATS Exchange, Inc. for registration as a national securities exchange. Both the corporate structure and the membership rules proposed by BATS were similar to those of other securities exchanges that have been privatized. Membership on BATS will be open to any registered broker or dealer that is a member of another registered national securities exchange or the Financial Industry Regulatory Authority (FINRA), or any natural person associated with such a registered broker or dealer. To remain eligible for membership in BATS, a broker or dealer must be a member of another Self-Regulatory Organization (SRO) at all times. Although BATS will be an SRO with all of the attendant regulatory obligations under the Securities Exchange Act of 1934, it has entered into agreements with FINRA under which FINRA will perform examination, enforcement and disciplinary functions on BATS' behalf.

BATS will operate a fully electronic order book, with members and entities that enter into sponsorship arrangements with members given access to the BATS system. Users will be able to electronically submit market and various types of limit orders to the exchange from remote locations. BATS plans to offer routing services to users through its affiliated broker-dealer, BATS Trading. BATS Trading will provide outbound routing of orders from the exchange to other trading centers, and will engage in no other activities unless approved by the SEC. BATS does not initially intend to list any securities. Members entering orders in the BATS system will be given an exception permitting a member of a national securities exchange to effect transactions on that exchange for its own account or accounts of associated persons. The SEC also approved BATS' request for an exemption from rule filing requirements in favor of incorporating by reference categories of FINRA rules that are not trading rules.

http://www.sec.gov/rules/other/2008/34-58375.pdf

NSCC & DTC Liberalize Standards to Admit Foreign Members

The Securities and Exchange Commission has approved policy statements of the National Securities Clearing Corporation (NSCC) and Depository Trust Company (DTC) to admit entities not subject to U.S. federal or state regulation. Both require that the applicant show that it meets the membership financial requirements by submitting audited financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP). If the financial statement is prepared in accordance with International Financial Reporting Standards, UK GAAP or Canadian GAAP it must show a premium of 1½ times the existing requirement. If the financial statement is prepared in accordance with European Union GAAP, other than UK GAAP, it must show a premium of 5 times the existing requirement. Financial statements prepared in accordance with any other GAAP must show a premium of 7 times the existing requirement. Both DTC and NSCC require the foreign entity to be subject to regulation in its home country and to be in good standing with its home country

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regulator. NSCC also requires that there be a Memorandum of Understanding between the SEC and the foreign entity's home country regulator.

In addition to requiring execution of the standard Membership Agreements, NSCC requires the foreign entity enter into a series of undertakings and agreements, including waiving immunity from NSCC's attachment of its assets in the U.S. Each foreign entity would submit an opinion of reputable foreign counsel confirming enforceability of NSCC's Policy Statement against the foreign entity in the courts of its home country or other jurisdictions where the foreign entity or its property may be found.

DTC will not require special financial controls beyond its net debit cap, collateral monitor and other risk management controls applicable to all members. DTC will require the foreign entity to provide sufficient information to permit DTC to evaluate any anti-money laundering risk it may pose.

http://edocket.access.gpo.gov/2008/pdf/E8-19128.pdf
http://edocket.access.gpo.gov/2008/pdf/E8-19133.pdf

Structured Finance and Securitization

Foreclosure Reduction Legislation Enacted by North Carolina Governor

On August 18, North Carolina's governor signed three housing bills into law in conjunction with his Emergency Foreclosure Reduction Program. Subprime legislation *HB 2623* mandates at least 45 days' notice be given to homeowners and the North Carolina Banking Commissioner prior to foreclosure, and allows the Banking Commissioner to impose a 30-day delay on foreclosure proceedings in certain circumstances. The governor also signed *HB 2188*, effective October 1, which prohibits lenders from offering and brokers from receiving compensation based on loan interest rates, and *HB 2463*, effective January 1, 2009, which requires all loan servicers in North Carolina to register and report to the Banking Commissioner.

http://www.ncleg.net/Sessions/2007/Bills/House/HTML/H2623v6.html
http://www.ncleg.net/Sessions/2007/Bills/House/HTML/H2188v5.html
http://www.ncga.state.nc.us/Sessions/2007/Bills/House/HTML/H2463v7.html
http://www.governor.state.nc.us/News/PressReleases/Default.asp

CFTC

CFTC and SEC Asked to Lower Customer Margin Requirements

OneChicago, LLC (OCX) has petitioned the Commodity Futures Trading Commission and the Securities and Exchange Commission to amend CFTC Rule 41.45(b) and SEC Rule 403(b) by reducing from 20% to 15% the minimum customer margin required to trade single stock futures and other security futures products. Section 7(c)(2) of the Securities Exchange Act of 1934 requires that the customer margin requirements for security futures be consistent with those for comparable exchange-traded securities options. OCX pointed to the SEC's approval, on December 12, 2006, of a rule change by the Chicago Board Options Exchange that permits broker-dealers to calculate customer margin requirements on a portfolio basis, effectively reducing to 15% the margin required on listed equity options. OCX's request seeks to reduce the margin requirement for customers carrying security futures in futures accounts regulated by the CFTC to the same 15% level.

http://www.sec.gov/rules/petitions/2008/petn4-565.pdf

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CFTC Allows U.S. Trading of Eurex Futures Contracts on Security Indices

On August 18, the Commodity Futures Trading Commission's Office of General Counsel issued a no-action letter allowing the offer and sale in the U.S. of the SLI Swiss Leader Index, Swiss Market Index Midcap, Dow Jones Euro STOXX Select Dividend 30 Stock Index and TecDAX Index futures contracts that are traded on Eurex Deutschland.

http://www.cftc.gov/stellent/groups/public/@lrlettergeneral/documents/letter/08-13.pdf

Banking

FDIC Implements Loan Modification Program for IndyMac Federal Mortgages

On August 20, Federal Deposit Insurance Corporation (FDIC) Chair Sheila Bair announced that IndyMac Federal Bank, FSB will begin to systematically modify troubled mortgages. IndyMac Bank, FSB was closed by the Office of Thrift Supervision on July 11 and the FDIC was thereafter appointed as receiver. On the same day, the FDIC was named as conservator for the newly formed IndyMac Federal Bank, FSB.

Under the program, "eligible mortgages would be modified into sustainable mortgages permanently capped at the current Freddie Mac survey rate for conforming mortgages. Modifications would be designed to achieve sustainable payments at a 38% DTI ratio of principal, interest, taxes and insurance." Such payments would be achieved by adopting a combination of interest rate deductions, extended amortization, and principal forbearance.

According to the related press release, IndyMac Federal will "only make modification offers to borrowers where doing so will achieve an improved value for IndyMac Federal or for investors in securitized or whole loans. Modification offers will be provided consistent with agreements governing servicing for loans serviced by IndyMac Federal for others." The press release further states that IndyMac Federal will send an estimated 4,000 modification proposals to borrowers this week and thousands of additional proposals in the coming weeks.

http://www.fdic.gov/news/news/press/2008/pr08067.html

BANKING

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