

## Corporate and Financial Weekly Digest

August 24, 2007

### A Note from the Editor

Please note that *Corporate and Financial Weekly Digest* will not be published next Friday, August 31, due to the Labor Day holiday. The next issue will be distributed on September 7.

Robert Kohl

### SEC/Corporate

#### SEC Committee Solicits Public Comments on Discussion Paper

On August 21, the Securities and Exchange Commission announced that the recently formed SEC Advisory Committee on Improvements to Financial Reporting was publicly soliciting comments on a draft discussion paper circulated by the Committee's chairman, Robert Pozen. The discussion paper provides a working outline, including a discussion of issues, views and potential consideration points, that the Committee may evaluate.

The paper describes the areas of inquiry mandated by the Committee's charter and sets forth the Committee's perception of the objectives of preparers, users and regulators of financial information. The paper also discusses the Committee's intention to form five subcommittees to aid in formulating its recommendations and exploring its mandated areas of inquiry:

- Substantive Complexity – this subcommittee will study causes and impacts of complexity on financial and reporting standards, including principles vs. rules-based standards, the inclusion of bright-line tests, exceptions and safe harbors, and the concerns of fair value measurement attributes and related earnings volatility.
- Standard Setting Process – this subcommittee will study the standard setting process and may consider the hierarchy of organizations that develop U.S. GAAP and their role in that process.
- Audit Process and Compliance – this subcommittee will study the current process of regulating compliance with the accounting and reporting standards and other factors that drive unnecessary complexity, the structuring of transactions to achieve an accounting result and whether there is a hesitance on the part of professionals to exercise professional judgment in the absence of detailed rules. It may consider financial restatements, the use of preparer and auditor judgment in reducing complexity, the role of the PCAOB and different SEC divisions, the behavior of audit firms and the sustainability of the audit profession.



### SEC/CORPORATE

*For more information, contact:*

Robert L. Kohl  
212.940.6380  
[robert.kohl@kattenlaw.com](mailto:robert.kohl@kattenlaw.com)

Mark A. Conley  
310.788.4690  
[mark.conley@kattenlaw.com](mailto:mark.conley@kattenlaw.com)

David Pentlow  
212.940.6412  
[david.pentlow@kattenlaw.com](mailto:david.pentlow@kattenlaw.com)

- Delivering Financial Information – this subcommittee will study the current system for delivering financial information to investors and accessing that information, and may consider the differing information needs of various investor groups, the tagging of information (such as the use of XBRL), the usefulness of press releases and website disclosure, and legal liabilities that may attach to different categories of information.
- International Coordination – this subcommittee will consider whether the growing use of international accounting standards has an impact on the relevant issues relating to complexity of U.S. accounting standards and the usefulness of the U.S. financial reporting system.

<http://www.sec.gov/rules/other/2007/33-8836.pdf>

## Broker Dealer

### AMEX Approved to Trade Binary Options on Equities and ETFs

The Securities and Exchange Commission recently approved the listing and trading of Fixed Return Options (FROs) by the American Stock Exchange LLC (Amex).

There will be two classes of FROs: Finish High pays \$100 if the underlying's volume weighted average price on the last day prior to expiration exceeds a stated price. Finish Low pays \$100 if the underlying's volume weighted average price on the last day prior to expiration is less than a stated price.

The initial listing criteria for FROs require that an individual stock or exchange traded fund (ETF) underlying an FRO: (i) an equity, but not an ETF, must have a market capitalization of at least \$40 billion; (ii) has minimum trading volume, in all markets in which the security trades, of at least one billion shares in the preceding 12 months; (iii) has a minimum average daily trading volume of four million shares; (iv) has a minimum average daily trading value of at least \$200 million during the previous six months; and (v) has a minimum market price per share of at least \$10, as measured by the closing price over the previous five consecutive business days preceding the date on which Amex submits a certificate to the Options Clearing Corporation for listing and trading.

To reduce concerns regarding potential price manipulation at expiration due to the "all-or-nothing" return provided by an FRO, Amex will settle FROs using an all-day volume weighted average price (VWAP) based on trading in the underlying security on the last trading day prior to expiration. Amex intends to publish and disseminate the current value of the VWAP calculation for FROs at least every 15 seconds throughout the last trading day prior to expiration.

The position limits for FROs will be 25,000 contracts on the same side of the market, and positions in FROs will not be aggregated with positions in other options on the same underlying stock or ETF for purposes of determining compliance with the position limits. FRO positions become reportable when an account establishes an aggregate position on the same side of the market of 200 contracts. A member, other than an Amex market maker, that maintains an FRO position in excess of 10,000 contracts on the same side of the market will have additional reporting requirements, including whether the position is hedged, a description of the hedge, and a description of the collateral. Amex is not proposing exercise limits for FROs.

Amex will use the same expiration cycle for FROs as it uses for traditional options, as well as the same strike price intervals. Symbols will be created for FROs that represent the underlying security, the fact that the option is an

## BROKER DEALER

*For more information, contact:*

James D. Van De Graaff  
312.902.5227  
[james.vandegraaff@kattenlaw.com](mailto:james.vandegraaff@kattenlaw.com)

Daren R. Domina  
212.940.6517  
[daren.domina@kattenlaw.com](mailto:daren.domina@kattenlaw.com)

Patricia L. Levy  
312.902.5322  
[patricia.levy@kattenlaw.com](mailto:patricia.levy@kattenlaw.com)

Morris N. Simkin  
212.940.8654  
[morris.simkin@kattenlaw.com](mailto:morris.simkin@kattenlaw.com)

Janet M. Angstadt  
312.902.5494  
[janet.langstadt@kattenlaw.com](mailto:janet.langstadt@kattenlaw.com)

FRO rather than a traditional put or call, the expiration date, strike price, and the exchange(s) trading the FRO.

<http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-16330.pdf>

## Banking

### **Revised Bank Secrecy Act/Anti-Money Laundering Examination Manual Released**

On August 24, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Conference of State Bank Supervisors, in collaboration with the Financial Crimes Enforcement Network (collectively, the Banking Agencies) released through the Federal Financial Institutions Examination Council (the FFIEC) a revised Bank Secrecy Act/Anti-Money Laundering Examination Manual (the Manual). Although changes were made throughout the Manual, significant updates were made in the following sections: customer due diligence, suspicious activity reporting, foreign correspondent account recordkeeping and due diligence, Office of Foreign Assets Control, correspondent accounts (foreign), electronic banking, trade finance, and non-bank financial institutions.

According to the press release, the revised manual "reflects the ongoing commitment of the federal and state banking agencies and Financial Crimes Enforcement Network to provide current and consistent guidance on risk-based policies, procedures, and processes for banking organizations to comply with the BSA and safeguard operations from money laundering and terrorist financing."

[www.ots.treas.gov](http://www.ots.treas.gov).

## Litigation

### **Derivative Claim Dismissed for Failure to Serve Demand**

Shareholder plaintiffs asserted derivative claims against the directors of Xethanol Corporation, an ethanol producer, alleging, among other things, that the directors breached their fiduciary duties by allowing the Company to misrepresent its ability to produce ethanol from non-traditional sources. Asserting that demand would have been futile, the shareholder plaintiffs commenced the derivative action without first making a demand on the Company's Board to bring suit on their behalf. The federal District Court for the Southern District of New York dismissed the case, holding that plaintiffs failed to allege with sufficient particularity the factual basis for failing to make a demand.

Plaintiffs claimed that the demand requirement was excused because a majority of the Board would have been incapable of exercising disinterested and independent judgment in response to such a demand. Rejecting this argument, the Court found that plaintiffs' conclusory allegations that Board members were not "disinterested and independent" were insufficiently particularized to demonstrate that a demand would have been futile. The Court held, among other things, that the mere fact that a director sat on the Board at the time of the alleged wrongdoing was insufficient to show that the director "face[d] a 'substantial likelihood' of personal liability that would prevent him from impartially considering a demand." (*In re Xethanol Corp. Derivative Litigation*, No. 06 Civ. 15536 (HB), 2007 WL 2331975 (S.D.N.Y. Aug. 16, 2007))

## BANKING

*For more information, contact:*

Jeff Werthan  
202.625.3569  
[jeff.werthan@kattenlaw.com](mailto:jeff.werthan@kattenlaw.com)

Christina J. Grigorian  
202.625.3541  
[christina.grigorian@kattenlaw.com](mailto:christina.grigorian@kattenlaw.com)

Adam Bolter  
202.625.3665  
[adam.bolter@kattenlaw.com](mailto:adam.bolter@kattenlaw.com)

## LITIGATION

*For more information, contact:*

Steve Shiffman  
212.940.6785  
[steven.shiffman@kattenlaw.com](mailto:steven.shiffman@kattenlaw.com)

Daniel Edelson  
212.940.6576  
[daniel.edelson@kattenlaw.com](mailto:daniel.edelson@kattenlaw.com)

## **Shareholder Lacks Standing to Bring RICO Claim**

Plaintiff, a partnership that was a member of the Philadelphia Stock Exchange (the Exchange), commenced an action against several employees, directors and officers of the Exchange asserting claims under, among other things, the Racketeer Influenced and Corrupt Organizations Act (RICO 18 USC 1962 et al). The federal District Court for the Eastern District of Pennsylvania dismissed the complaint, holding that plaintiff lacked standing to assert its claims because it was not directly injured by the defendants' actions.

Plaintiff argued that defendants' conduct, which was alleged to include the waste and mismanagement of corporate assets, ultimately injured it and other members of the Exchange. Rejecting this argument, the Court found that although defendants' alleged acts may have harmed the Exchange, plaintiff could not adequately allege a direct injury to itself that was not a by-product of an injury to the Exchange. Because indirect or derivative injuries do not confer RICO standing, the Court dismissed the RICO claims with prejudice. (*Penn Mont Securities v. Frucher*, No. 05-CV-6686, 2007 WL 2343794 (E.D. Pa. Aug. 15, 2007))

## **CFTC**

### **CME Requests Exemption from FCM Registration on Behalf of CFETS**

The Commodity Futures Trading Commission has requested public comment on a Chicago Mercantile Exchange Inc. (CME) petition for exemptive relief on behalf of the China Foreign Exchange Trade System and National Interbank Funding Center (CFETS). CFETS is an affiliate of the People's Bank of China and operates an electronic system for trading in the inter-bank foreign exchange market in China. CME and CFETS have entered into an agreement under which CFETS will become a "super-clearing" member of CME authorized to clear foreign currency and interest rate futures transactions on behalf of CFETS members and their customers domiciled in China. As a clearing member of CME, CFETS would meet the definition of a futures commission merchant (FCM) under the Commodity Exchange Act and CFTC interpretative guidance. Under the CME's petition, CFETS (and its members) would be exempted from FCM registration but would be required to meet certain alternative financial, reporting and record keeping requirements.

<http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e7-16641a.pdf>

## **CFTC**

*For more information, contact:*

Kenneth Rosenzweig  
312.902.5381  
[kenneth.rosenzweig@kattenlaw.com](mailto:kenneth.rosenzweig@kattenlaw.com)

William Natbony  
212.940.8930  
[william.natbony@kattenlaw.com](mailto:william.natbony@kattenlaw.com)

Fred M. Santo  
212.940.8720  
[fred.santo@kattenlaw.com](mailto:fred.santo@kattenlaw.com)

Kevin Foley  
312.902.5372  
[kevin.foley@kattenlaw.com](mailto:kevin.foley@kattenlaw.com)

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# Katten

KattenMuchinRosenman LLP

[www.kattenlaw.com](http://www.kattenlaw.com)

**Charlotte**

401 S. Tryon Street  
Suite 2600  
Charlotte, NC 28202-1935  
704.444.2000 tel  
704.444.2050 fax

**Los Angeles**

2029 Century Park East  
Suite 2600  
Los Angeles, CA 90067-3012  
310.788.4400 tel  
310.788.4471 fax

**Chicago**

525 W. Monroe Street  
Chicago, IL 60661-3693  
312.902.5200 tel  
312.902.1061 fax

**New York**

575 Madison Avenue  
New York, NY 10022-2585  
212.940.8800 tel  
212.940.8776 fax

**Irving**

5215 N. O'Connor Boulevard  
Suite 200  
Irving, TX 75039-3732  
972.868.9058 tel  
972.868.9068 fax

**Palo Alto**

260 Sheridan Avenue  
Suite 450  
Palo Alto, CA 94306-2047  
650.330.3652 tel  
650.321.4746 fax

**London**

1-3 Frederick's Place  
Old Jewry  
London EC2R 8AE  
+44.20.7776.7620 tel  
+44.20.7776.7621 fax

**Washington, DC**

1025 Thomas Jefferson Street, NW  
East Lobby, Suite 700  
Washington, DC 20007-5201  
202.625.3500 tel  
202.298.7570 fax

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