

Corporate and Financial Weekly Digest

Business/Financial News in Brief
August 25, 2006

A Note from the Editor

The next issue of *Corporate and Financial Weekly Digest* will be distributed on September 8.

SEC/Corporate

SEC Division of Market Regulation Updates Frequently Asked Questions Regarding Regulation M

The Division of Market Regulation of the Securities and Exchange Commission recently updated Staff Legal Bulletin No. 9, a series of frequently asked questions regarding Regulation M originally issued in October 1999, adding two new questions and answers regarding concurrent distributions of the same securities and the beginning of a restricted period in connection with a third party proxy solicitation.

The new FAQ regarding concurrent distributions addresses different but concurrent distributions of the same securities, such as a common stock offering for cash conducted simultaneously with an offer of common stock to security holders of another company in connection with a merger or exchange offer. In such a concurrent distribution, absent additional factors, bona fide offers to purchase the common stock in the cash offering would not be an impermissible inducement with respect to the merger or exchange offer. However, a distribution may rise to the level of an impermissible inducement to purchase when a distribution participant engages in sales efforts that go beyond bona fide offers to sell or the solicitation of offers to buy the securities in distribution.

The new FAQ regarding commencement of a restricted period provides that in some cases a restricted period may be triggered under Rule 100 when a third party solicits proxies in opposition to a proposed merger on the basis of its proposed alternative to exchange its stock for the target company stock (an alternative stock transaction). Whether such a restricted period is triggered will depend on whether the alternative stock transaction is deemed to be a distribution under the three pronged test in Rule 100.

<http://www.sec.gov/interp/leg/mrslb9.htm>

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Broker Dealer

Regulation SHO Impacts Fails

The Office of Economic Analysis of the Securities and Exchange Commission published a study on the effect of Rule 203 of Regulation SHO on fails to deliver. Rule 203, among other things, requires a broker-dealer executing a short sale of an equity security to locate a source to borrow the subject security before executing the trade. The study compared fails for eight months before Regulation SHO became effective with fails for five months after effectiveness, and concluded: (i) fails declined by 34% after effectiveness; (ii) the average daily number of securities with aggregate fails of at least 10,000 shares declined by 6.5%; (iii) the average daily number of fails declined by 15.3%; and (iv) the average age of an outstanding fail declined by 15.3%.

<http://www.sec.gov/spotlight/failstodeliver082106.pdf>

NYSE Rule Authorizing Action for Failure to Testify or Produce Documents in Arbitrations is Effective

The Securities and Exchange Commission has approved an amendment to New York Stock Exchange Rule 619 clarifying that it is conduct inconsistent with just and equitable principles of trade for a responsible party to fail to appear or fail to produce any document in its possession or control as directed pursuant to the provisions of the NYSE Arbitration Rules. Rule 476(a)(6) authorizes an NYSE enforcement action against persons for conduct that is inconsistent with just and equitable principles of trade. This rule change exposes persons to enforcement action for failure to produce or testify when required to do so in an NYSE arbitration. No order from the arbitration panel is required for such enforcement action. Further, the enforcement action can be instituted while the arbitration is pending if the NYSE believes such action is warranted.

<http://www.sec.gov/rules/sro/nyse/2006/34-54320.pdf>

NASD Expands Automated Trade Reporting

Section 31 of the Securities Exchange Act of 1934, requires self regulatory-organizations to collect and pay to the Securities and Exchange Commission a transaction fee on all sales of securities executed in their marketplace. Currently existing rules of the NASD do not require automated reporting of odd-lot transactions, transactions at prices away from the current market prices and over-the-counter option exercises. Effective December 1, these trades will have to be reported to the NASD in an automated method. Reports may be made using the NASD's Trade Reporting Facility, OTC Reporting Facility or the Alternative Display Facility and must be submitted by 6:30 PM Eastern Time on the day of the trade. No system usage fee will be assessed for reporting such trades unless the entry is submitted for clearing, in which case the normal clearing related fee schedule will apply

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_017173.pdf

No-Action Letter Clarifies Statutory Disqualification

Section 3(a)(39) of the Securities Exchange Act of 1934, defines statutory disqualification, and Exchange Act Rule 19h-1 requires self-regulatory organizations to report to the Securities and Exchange Commission admission or continuance in membership of firms and individuals subject to a statutory disqualification. In a no-action letter to the New York Stock Exchange the staff of the SEC's Division of Market Regulation clarified this Exchange Act section and rule. A person is not subject to statutory disqualification when the time limitation of a bar or license revocation has expired, provided that: (i) application for re-entry is not required or has been granted, (ii) the bar or revocation has no continuing

effect, and (iii) the bar was not issued in connection with a final order based on a violation of laws or rules prohibiting fraudulent, manipulative or deceptive conduct. This also applies in the case of persons sanctioned on the basis of aiding and abetting violations. The staff granted no-action relief in the case of a person subject to statutory disqualification due to a finding of a willful violation (including willfully aiding and abetting a violation) of the Commodity Exchange Act or the rules thereunder, provided that the sanctions are no longer in effect, or a finding that the person failed reasonably to supervise another person with a view to preventing a violation of the CEA or the rules of the Municipal Securities Rulemaking Board, if the sanctions are no longer in effect.

<http://www.sec.gov/divisions/marketreg/mr-noaction/nyse080106.pdf>

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Banking

FDIC Requests Public Comment on Industrial Loan Companies

The Board of Directors of the Federal Deposit Insurance Corporation voted on August 17, to seek public comment on a wide-range of issues related to the chartering and supervision of industrial loan companies (ILCs). A six-month moratorium on ILC applications went into effect on July 28, which is set to expire on January 31, 2007.

The request for comment includes 12 specific questions, including those related to risks based upon ownership (e.g., a financial entity or commercial entity), features and aspects of an ILC that should affect the FDIC's review of such applications, competitive advantages inherent in the ILC structure, and tying concerns related to an ILC and its parent and affiliates.

According to the FDIC's accompanying press release, the agency believes that "public participation will provide valuable insight into the issues presented by recent trends and changes in the ILC industry, and will assist the FDIC in deciding how to respond to those issues."

Comments are due 45 days after publication in the *Federal Register*.

<http://www.fdic.gov/regulations/laws/federal/2006/06noticeILCcomments.html>

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Not for Profits

New Law Revises Tax Exempt Organization Tax Rules

The Pension Protection Act of 2006 signed on August 17, contains numerous changes to the tax law provisions affecting tax-exempt organizations, such as Section 501 (c)(3) organizations. Among the key provisions is a requirement that controlling organizations must report income from and loans to controlled

organizations as well as transfers between controlled and controlling organizations. This provision is effective for returns due (without regard to extensions) after the date of enactment.

Additionally, Section 501(c)(3) organizations must now disclose unrelated business income tax returns (Forms 990-T) and make them available for public inspection. This provision is effective for returns filed after the date of enactment.

Other changes to the tax laws affecting not for profit organizations and their contributors include:

- Private foundation and excess benefit penalty excise taxes are doubled.
- Donor advised funds, supporting organizations, and credit counseling organizations are subject to new requirements.
- Charitable contribution deductions for food, book, and certain conservation property are increased.
- Charitable contribution deductions for monetary donations, certain easements, taxidermy property, clothing and household goods, and certain other items are limited.
- Beginning in 2008, exempt organizations with gross receipts under \$25,000 must file an annual notice.

<http://www.irs.gov/charities/article/0,,id=161145,00.html>

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Litigation

District Court Finds Failure to Plead Damages Adequately Fatal to Securities Act Claim

Plaintiffs amended their securities fraud claim to allege that defendants were liable pursuant to Section 11 of the Securities Act in connection with a materially misleading registration statement. In dismissing the amended complaint, the Court noted, among other things, that there was no dispute that on the date that the original lawsuit was filed, the shares at issue were trading at a higher price than on the date that the shares were purchased. The Court explained that because plaintiffs could not allege any damage at the time the lawsuit was commenced, any subsequent fall in share prices was irrelevant for purposes of a Section 11 claim. (*Pierce v. Morris*, 4:03-CV-026-Y, 2006 WL 2370343 (N.D. Tex. Aug. 16, 2006))

Arbitration Clause not Waived Despite Failure to Assert it as Affirmative Defense

Plaintiff commenced an action against defendants asserting claims arising out of two loan agreements. Defendants answered the complaint, asserting a number of affirmative defenses, but failing to list arbitration as one of the affirmative defenses. Shortly after defendants answered, plaintiff moved for summary judgment. Defendants then moved to dismiss, arguing that plaintiff's claims were subject to a mandatory arbitration clause. Although defendants had failed to raise the arbitration clause as an affirmative defense, the Court held that defendants did not waive their right to enforce the arbitration clause. The Court explained that because plaintiff had not engaged in any discovery and had not been forced to contend with any other motions raised by defendants, plaintiff failed to demonstrate any significant prejudice if it were now compelled to seek relief through arbitration. (*Cathay Bank v. Inchon LLC*, No. 06-1971, 2006 WL 2355407 (D.N.J. Aug. 15, 2006))

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CFTC

CFTC Seeks Public Comment on Proposed Amendments to Advertising Regulations for CPOs, CTAs and Their Principals

The Commodity Futures Trading Commission published in the Federal Register proposed amendments to Regulation 4.41, which governs advertising by commodity pool operators (CPOs), commodity trading advisors (CTAs) and their principals. The proposed amendments are designed to prohibit CPOs, CTAs, and their principals from advertising in a false, deceptive or misleading manner by: (i) restricting the use of testimonials; (ii) clarifying the required placement of the prescribed simulated or hypothetical performance disclaimer; and (iii) making explicit that Regulation 4.41 extends to advertisement through electronic media. Interested parties may submit comments on the proposed amendments to the CFTC by September 22 .

<http://cftc.gov/foia/fedreg06/foi060823a.htm>

NFA Publishes New Investor Education Guide

National Futures Association has published a new investor education booklet entitled “Opportunity and Risk: An Educational Guide to Trading Futures and Options on Futures.” The booklet describes how futures and options on futures contracts are traded, explains the various ways investors can participate in the futures markets, and includes a glossary of terms. The booklet can be obtained free of charge on the NFA’s website via the link below or by calling the NFA’s Information Center at toll-free at (800) 621-3570.

<http://www.nfa.futures.org/investor/OppRisk/OppRisk.pdf>

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