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Corporate and Financial Weekly Digest

August 3, 2007

SEC/Corporate

Members of Advisory Committee on Improvements to Financial Reporting Announced

On July 31, Securities and Exchange Commission Chairman Christopher Cox announced the appointment of the members of the 17-person SEC Advisory Committee on Improvements to Financial Reporting. The committee was established last month and held its first meeting on August 2. The SEC announced that the "committee will examine the U.S. financial reporting system and provide recommendations about how to improve its usefulness for investors and reduce unnecessary complexity for U.S. companies," and cited investor concerns about the difficulty of understanding issuer financial reports and the prevalence of restatements (almost 10 percent of U.S. issuers restated prior financial reports in 2006) as evidence of difficulties in complying with current financial reporting requirements.

As part of its consideration of these issues, the committee will explore ways to use interactive data and the XBRL computer language for financial reporting. The committee includes representatives from a number of professional constituencies, including securities lawyers, audit committee members, auditors, pension funds, mutual funds, credit rating agencies, and various sizes of public companies.

http://www.sec.gov/news/digest/2007/dig073107.htm

Broker Dealer

FINRA Incorporates NYSE Rules in Connection with Regulatory Consolidation

The National Association of Securities Dealers (NASD) (now the Financial Industry Regulatory Authority (FINRA)) has incorporated certain rules of the New York Stock Exchange in connection with the consolidation of the member regulation operations of NASD and NYSE. The incorporated NYSE rules pertain to the regulation of NYSE member firm conduct and would apply solely to members of NYSE that are also members of FINRA. During an interim period prior to the approval of a consolidated FINRA rulebook, FINRA's rules consist of both the NASD manual and these incorporated NYSE rules. Therefore, no new rule requirements have been imposed upon member firms as a result of the regulatory consolidation – firms that were previously NASD-only firms continue to be subject to the NASD rules, NYSE-only firms continue to be subject to the NYSE rules, and dual NASD-NYSE members will continue to be subject to both NASD and the incorporated NYSE rules.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-14854.pdf

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Attorney Advertising

NYSE Creates Exemption from Rule 97 in Connection with Regulation NMS

The New York Stock Exchange has amended its Rule 97 to resolve a potential conflict between member firms' duties under that rule and their duties under Regulation NMS. NYSE Rule 97 prohibits member organizations that hold a long position in their proprietary account as a result of facilitating customer orders during the trading day from buying the same stock as principal on a "plus tick" during the last 20 minutes of trading if the purchase price would be higher than the lowest price at which it acquired the long position. The rule is intended to prevent member firms from driving up the price of the stock at the end of the trading day; however, it also may conflict with a member organization's duty under Regulation NMS to route proprietary intermarket sweep orders (ISOs) when facilitating a customer order that would trade through a protected bid or offer, as such ISOs might trade at a price that would violate Rule 97.

The amendments to Rule 97 create an exemption to permit member organizations to send buy ISOs to facilitate customer orders that would otherwise trade through a protected quotation during the last 20 minutes of trading, under the following circumstances: (i) the member organization has acquired its proprietary position as a result of a previous block facilitation for a customer; (ii) the facilitation trade to occur during the last 20 minutes of trading would trade through a better priced offer on another market, such that the member is obligated under Regulation NMS to send proprietary ISOs in order to facilitate the customer order; (iii) the customer has declined the better-priced ISO executions; and (iv) the better-priced away offers are such that Rule 97 otherwise would prohibit the firm from sending a proprietary buy order.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-13593.pdf

CBOE Extends Pilot Components of AIM

The Chicago Board Options Exchange (CBOE) has extended two pilot programs related to its Automated Improvement Mechanism (AIM) for an additional year. AIM will expose an agency order electronically to an auction to provide an opportunity for price improvement where a second order of the same size and on the opposite side of the market as the agency order is also submitted (which would otherwise stop the agency order at a given price). Two components of AIM – the lack of a minimum size requirement and the premature conclusion of an auction any time that there is a quote lock on CBOE under CBOE Rule 6.45A(d) – were approved on a pilot basis. These pilot programs have been extended until July 18, 2008.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-14311.pdf

Banking

2006 Small Business, Small Farm and Community Development Lending Data Released

On July 26, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision, through the Federal Financial Institutions Examination Council (the FFIEC), released data with respect to small business, small farm, and community development lending reported by certain commercial banks and savings institutions pursuant to the Community Reinvestment Act (CRA).

BANKING

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According to the Fact Sheet prepared by the FFIEC, "the small business and small farm lending data reported under the CRA regulations provide useful information about such lending...The CRA data include information on loans originated or purchased, but not on applications denied. The CRA data indicate whether a loan is extended to a borrower with annual revenues of $1 million or less, but they do not include demographic information about the applicant. The CRA data are aggregated into three loan-size categories and then reported at the census tract level, rather than loan-by-loan."

Each reporting commercial bank and savings institution has prepared an FFIEC disclosure statement on the reported 2006 data which is available on the FFIEC's website (www.ffiec.gov/cra).

http://www.ffiec.gov/hmcrpr/cra072607.htm.

Agencies Implement New Interlocks Rule

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the Agencies) have finalized an interim final rule implementing section 610 of the Financial Services Regulatory Relief Act (FSRRA). Section 610 of the FSRRA amended the Depository Institution Management Interlocks Act by raising the asset threshold of the small institution exception from $20 million to $50 million. More specifically, the amendment permits a management official of one depository institution to serve as a management official of another unaffiliated depository institution if both organizations have offices in the same metropolitan statistical area and one of the institutions has less than $50 million in total assets. The interim final rule was adopted with no changes and is effective July 16.

http://www.fdic.gov/regulations/laws/federal/2007/07finalAD13.pdf

United Kingdom Developments

FSA Publishes Further Listing Guidelines

On July 25, the Financial Services Authority published issue 16 of its *List!* newsletter. The latest issue includes feedback on (i) common issues with prospectuses, (ii) the application of the convertible bond exemption in the Prospectus Directive, (iii) retail debt cascades, (iv) summary content requirements for a prospectus, (v) debt issuance programs, (vi) comfort letters for schemes of arrangement, and (vii) issues with references to the Companies Act.

http://www.fsa.gov.uk/pubs/ukla/list_jul07.pdf

FSA Publishes Its Transaction Reporting User Pack

On July 30, the Financial Services Authority published its Transaction Reporting User Pack (TRUP).

The aim of the TRUP is to give detailed instructions and guidelines to help firms prepare for the new transaction reporting requirements contained in Chapter 17 of its Handbook Supervision Manual (SUP17) following the implementation of the EU Markets in Financial Instruments Directive (MiFID) on November 1.

http://www.fsa.gov.uk/pubs/other/trup.pdf

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FSA Confirms Position on Soft Commissions

In PS07/14 released on July 30 the Financial Services Authority (FSA) confirmed that although its current rules on the use of dealing commission by investment managers are more stringent than the provisions on inducements contained in Markets in Financial Instruments Directive, its rules (currently at COB 7.18) will be carried forward into the new FSA rulebook at COBS 11.6 substantially unchanged.

http://www.fsa.gov.uk/pubs/policy/ps07_14.pdf

FSA Issues New Enforcement Rule Book

On July 27, the Financial Services Authority (FSA) issued policy statement PS07/12 and announced the results of its review of its Enforcement and Decision Making Manuals. This review formed part of the FSA's work to simplify its Handbook of Rules and promotion of "better regulation." Specifically the FSA's goal has been to make the material with respect to enforcement clearer and easier to navigate. It has deleted the current ENF (enforcement) and DEC (decision making) manuals and replaced them with a new "Decision Procedure and Penalties Manual" (DEPP) manual and a new "Enforcement Guide" (EG) which will now form part of the Handbook. The changes include modifications of policy and procedure and consequent developments in enforcement policy.

http://www.fsa.gov.uk/pages/Library/Policy/Policy/2007/07_12.shtml

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Securities Fraud Claims Asserted by Foreign Purchasers' Dismissed

Plaintiffs sought to certify a class of purchasers of securities of an Italian company who asserted claims under the Securities Exchange Act after the company collapsed following the discovery of massive fraud. Some members of the putative class were United States-based and others were foreign. Defendants moved to dismiss the claims of the foreign purchasers, arguing that the federal securities laws did not apply to them. The United States District Court for the Southern District of New York agreed, ruling that the extraterritorial application of the federal securities was not warranted because the essential core of the alleged fraud occurred abroad and any activities that occurred within the United States were insubstantial and, at most, peripheral to the alleged fraud.

Because the federal securities laws are silent with respect to the scope of their extraterritorial application, where a foreign plaintiff seeks to invoke the federal securities laws in connection with a dispute that primarily involves foreign-based conduct, the Court must determine whether Congress would have wanted the resources of United States courts, rather than those of foreign countries, to be utilized. In the Second Circuit, this inquiry depends upon whether the wrongful conduct (i) occurred in the United States, or (ii) had a substantial effect in the United States, or upon its citizens.

The Court first ruled that the second of these tests, the "effects test," had no bearing on the motion because the defendants only moved to dismiss claims asserted by foreign purchasers. The Court then determined that the plaintiffs' allegations also failed to satisfy the requirements of the "conduct test." Under the "conduct test," the extraterritorial application of federal securities laws is appropriate if "culpable conduct" in furtherance of the fraud is alleged to have occurred in the United States. Because the alleged fraud – the company's issuance of duplicate receivables to different entities for the same goods – occurred entirely in Italy and because none of the United

States-based conduct was necessary for the fraud to occur, the Court ruled that it was too peripheral to support the foreign purchasers' claims. (*In re Parmalat Securities Litigation*, No. 04 MD 1653(LAK), 2007 WL 2120279 (S.D.N.Y. July 24, 2007))

Securities Fraud Claims Dismissed Because Defendant Had No Duty to Disclose

The seller of a convertible note sued the issuer-purchaser under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, claiming that the issuer committed fraud by repurchasing the note at a negotiated discount price without revealing its plan to raise funds through a new private placement to fund the redemption of all outstanding convertible notes at a premium price. The defendant moved to dismiss, arguing that (i) the undisclosed information was not material because it was contingent on the company's ability to successfully conclude the private placement, and (ii) because it had no duty to disclose the omitted information to the plaintiff.

The court first ruled that the omitted information was material, finding that it was something that a reasonable investor would have wanted to know: "It is unlikely that an investor seeking to liquidate [convertible notes] would be uninterested" in the company's plans relating to its potential re-purchase of the convertible notes at a premium.

Notwithstanding this ruling, the court proceeded to dismiss the plaintiff's claims, ruling that the issuer owed no duty of disclosure to the convertible noteholder-seller. While recognizing that a fiduciary relationship triggers a duty of disclosure, the Court ruled that no such duty arose from the convertible noteholder – issuer relationship. Despite there being no direct New York precedent, the Court drew support for its ruling from the well-settled rule that corporations owe no fiduciary duty to their unsecured creditors (including debt security holders) and from cases from other jurisdictions, including Delaware, rejecting the argument that a fiduciary relationship triggering a duty to disclose exists between a convertible noteholder and the issuer of the note. (*Alexandra Global Master Fund, Ltd. v. IKON Office Solutions, Inc.*, No. 06 Civ. 5383(JGK), 2007 WL 2077153 (S.D.N.Y. July 20, 2007))

CFTC

CFTC Announces Hearing to Examine Trading on Exchanges and ECMs

The Commodity Futures Trading Commission has announced that it will hold a hearing on September 18 to examine the oversight of trading on regulated futures exchanges and exempt commercial markets (ECMs). Members of the energy trading community, financial services trade associations and energy consumer groups will testify at the hearing. The CFTC hearing will focus on a number of issues, including:

- the tiered regulatory approach of the Commodity Futures Modernization Act of 2000 and whether this risk-based model is beneficial;
- the similarities and differences between ECMs and regulated exchanges;
- the associated regulatory risks of each market category;
- the types of regulatory or legislative changes that might be appropriate to address such identified risks; and

CFTC

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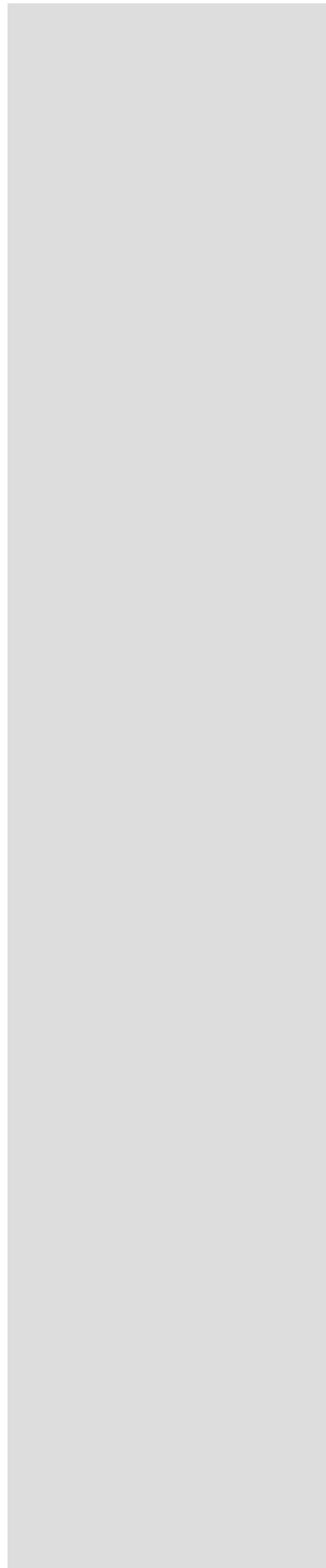
- the impact that regulatory or legislative changes might have on the U.S. futures industry and the global competitiveness of the U.S. financial industry in general.

http://www.cftc.gov/opa/press07/opa5368-07.htm



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