Katten Muchin Rosenman LLP

# Corporate and Financial Weekly Digest

Business/Financial News in Brief
**February 10, 2006**

## SEC/Corporate

### SEC Approves PCAOB Auditing Standard No. 4

On February 6, the Securities and Exchange Commission issued an order approving the Public Company Accounting Oversight Board's Auditing Standard No. 4, which establishes requirements and provides directions that apply when an auditor is engaged to report on whether a previously reported material weakness in internal control over financial reporting continues to exist.

The new standard provides that such an engagement is voluntary in nature at the election of management, and may be performed as of any reasonable date selected by management. The auditor may report on the remediation of one or more material weaknesses as part of a single engagement, and the engagement need not be performed in conjunction with an audit or review of the company's financial statements. In order to perform such an engagement, the auditor must receive a written report from management that contains several elements, including a statement from management that the identified material weakness no longer exists as of the date specified by management. If the auditor determines that the material weakness continues to exist, the company may re-address remediation efforts and re-engage the auditor to opine on whether the material weakness continues to exist.

To facilitate implementation of the standard, the SEC order directed the PCAOB to issue within 90 days a clear and concise outline of the affirmative audit steps set forth in the standard.
http://www.sec.gov/rules/pcaob/34-53227.pdf

### SEC Issues Technical Amendments to Securities Act Reform

On February 7, the Securities and Exchange Commission issued a release containing technical amendments to its Securities Act Reform, including, among other things, amendments that provide for the inclusion of new language in Item 512(h) of Regulation S-K, which requires an issuer to include a statement regarding the SEC's position on indemnification for liabilities under the Securities Act in registration statements in which acceleration is requested or in registration statements filed on Form S-8. Absent such corrections, the amendments to Rule 462 of the Securities Act providing that automatic shelf registration statements go effective immediately would inadvertently have allowed a well-known seasoned issuer to file an automatic shelf registration statement without including a statement of the Commission's position on indemnification in its undertakings. The technical amendment makes it clear that Item 512(h)

will apply to registration statements that go effective immediately pursuant to Rule 462 (e) and (f).
http://www.sec.gov/rules/final/33-8591a.pdf

**SEC Chairman Cox Names John White to be the Commission's Next Director of the Division of Corporation Finance**

On February 8, Securities and Exchange Commission Chairman Cox announced that John W. White would join the SEC on March 20 as its next Director of the Division of Corporation Finance. Mr. White is currently a partner at the law firm of Cravath, Swaine & Moore LLP, where he has represented public companies and their financial advisors.

According to the SEC's release, Mr. White is expected to work to improve financial reporting as well as to further the SEC's interests in pursuing international convergence of accounting and financial disclosure standards, to expand the use of interactive data to make financial reports more useful and to find and develop additional ways in which technology may improve the accessibility and utility of public disclosures and other information for investors. Mr. White is expected to initially focus on the SEC's consideration of proposed rules to improve disclosure of executive compensation, to rationalize the rules by which foreign companies may exit U.S. markets and to enhance the corporate proxy process for shareholders through the Internet.
http://www.sec.gov/news/press/2006-18.htm

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## Banking

**Federal Banking Agencies Release New Guidance on External Auditor Limitation of Liability Provisions**

On February 3, the federal banking regulators released an interagency advisory on limitation of liability provisions in agreements between banking institutions and their external auditors. The advisory's provisions will be immediately effective with respect to audit engagement letters signed after publication of the advisory in the *Federal Register*, but does not apply to those signed before such publication. The banking agencies did, however, "encourage" financial institutions with multi-year audit engagement letters to amend such letters to be consistent with the newly released guidance for periods ending in 2007 or later.

The advisory, entitled *The Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters*, states that the federal banking agencies "believe that when financial institutions agree to limit their external auditors' liability, either in provisions in engagement letters or in provisions that accompany alternative dispute resolution (ADR) agreements, such provisions may weaken the external auditors' objectivity, impartiality and performance." The advisory further states that the regulators believe that the inclusion of such limitations on liability may "reduce the reliability of audits and therefore raise safety and soundness concerns."

According to the advisory, financial institutions should not enter into external audit engagement letters that "incorporate unsafe and unsound limitation of liability provisions with respect to audits of financial statements and internal control over financial reporting." According to the advisory, unsafe and unsound

liability provisions would include those that (1) indemnify the external auditor against claims made by third parties (including punitive damages); (2) hold harmless or release the external auditor from liability for claims or potential claims that might be asserted by the client financial institution; or (3) limit the remedies available to the client financial institution. A financial institution's ability to waive its right to seek punitive damages against an external auditor was not deemed to be unsafe and unsound.
http://www.ots.treas.gov/docs/7/776003.html

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## Broker Dealer

### NYSE Warns about Gambling on Premises

The New York Stock Exchange, Inc. has issued Member Education Bulletin No. 2006-4. It warns that members, member organizations and their employees that promote or participate in unlawful gambling activities on premises under the NYSE's control are subject to disciplinary action under NYSE Rule 476. The Bulletin states that a gambling activity is unlawful when there is payment of any remuneration, tips or gratuities pursuant to any custom, practice or understanding, whether written or unwritten, explicit or implicit, to one who advances the gambling activity.
http://apps.nyse.com/commdata/PubeduMemos.nsf/AllPublishedMEBMemosNyseCom/85256F340070DCAD852571070074CF62/$FILE/Microsoft Word - Document in 2006-4.pdf

### SEC Commissioner Nazareth Discusses Bond Market Liquidity

Commissioner Annette Nazareth of the Securities and Exchange Commission spoke on February 7 before The Bond Market Association Legal and Compliance Conference in New York City. She noted that the Trade Reporting and Compliance Engine (TRACE) of the National Association of Securities Dealers, Inc. requires that reports of trades in corporate bonds be sent to the NASD within 15 minutes of execution and those reports are immediately disseminated by TRACE. On an average day some 22,000 transactions representing some $18 billion are reported. The Real-Time Transaction Reporting System (RTRS) operated by the Municipal Securities Rulemaking Board similarly requires reports of trades in municipal bonds, other than new issues and variable rate issues, within 15 minutes of execution and prompt dissemination by RTRS. The SEC's Office of Economic Analysis estimates that as a result of these trade reporting systems transaction costs in bonds have decreased some five basis points. A third party study of institutional bond trading in corporate bonds estimates that trade execution costs in TRACE eligible bonds have dropped by 50 percent.

An NASD March 2005 proposed interpretation on permissible mark-ups for transactions in non-municipal bonds is currently being worked on by the SEC staff. Included in this proposal are disclosures for the trade confirmation. These disclosures would include, in the case of principal trades, a statement that the price paid or received includes a payment to the broker-dealer. The credit rating, cash flow and yield to maturity or call, whichever is worse, would have to be included. Ms. Nazareth advised that an NASD proposal to enhance corporate debt confirmation disclosure would be published for comment, and urged the audience to consider and support these proposals.

Ms. Nazareth also acknowledged the criticisms of The Interagency Statement on Sound Practices Concerning Complex Structured Finance Activities (Release No. 34-49695) published by the SEC and the federal bank regulatory agencies in May, 2004. She agreed that the criticisms that it was too prescriptive

and not flexible enough to accommodate various business models were appropriate. A revised proposal with a brief comment period will be forthcoming shortly.
http://www.sec.gov/news/speech/spch020706aln.htm

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## Litigation

### Court Denies Motion to Stay Order Requiring Production to SEC

In seeking to stay an order requiring it to produce documents to the Securities and Exchange Commission, defendant argued, among other things, that compliance with the order would subject it to civil and criminal liability under Bermuda law. Considering the same factors applicable to a motion for a preliminary injunction – (1) irreparable harm; (2) likelihood of success on the merits; (3) balance of hardships; and (4) the public interest – the court reaffirmed prior orders refusing to issue a stay. In doing so, it noted that a recent decision where the Bermuda Supreme Court held that defendant's compliance with the SEC subpoena would not subject it to liability in Bermuda. (*Securities and Exchange Commission v. Lines Overseas Management*, 2006 WL 241229 (D.D.C. Feb. 1, 2006))

### Statutory Limitation on Lead Plaintiffs Inapplicable to Class Representatives

The "Institutional Investment Group," which previously had been appointed as lead plaintiff in an action against a pharmaceutical company for violations of the federal securities laws, sought class certification. The company opposed their motion, characterizing the three separate investment funds comprising the Group as professional plaintiffs that, individually, had served as class representatives in numerous other actions. In its view, the Private Securities Litigation Reform Act's limitation on a party's acting as lead plaintiff in more than five actions in any three year period required denial of the motion of the Group to serve as class representative in this action. The court rejected defendant's argument, holding that each fund's prior service as a class representative did not preclude the Group's collective appointment as lead plaintiff. (*In re Vicuron Pharmaceuticals, Inc. Securities Litigation*, 2006 WL 241472 (E.D. Pa. Feb. 1, 2006))

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## CFTC

### CFTC Extends Relief Granted to NYMEX Floor Members

The Commodity Futures Trading Commission has extended for a further six months the relief originally granted in a February 4, 2003 order to floor brokers and floor traders (floor members) of the New York Mercantile Exchange (NYMEX). NYMEX floor members, when acting for their own accounts, are permitted to continue to enter into certain specified over-the-counter (OTC) transactions in exempt commodities, exempt from all but certain requirements of the Commodity Exchange Act. In order to participate, the NYMEX floor member must have its OTC trades guaranteed and cleared by a NYMEX

clearing member that is registered with the CFTC as a futures commission merchant and that meets certain minimum working capital requirements. Although this order applies only to NYMEX and NYMEX members, the CFTC indicated that it was prepared to provide substantially similar relief to other designated contract markets and members of designated contract markets.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-1777.pdf

**CFTC Exempts Tokyo Commodity Exchange Member Firms from Foreign Futures and Option Rules**

The Commodity Futures Trading Commission has granted an exemption to firms designated by the Tokyo Commodity Exchange (TOCOM) from the application of certain of the CFTC's foreign futures and option rules based on substituted compliance with certain comparable regulatory and self-regulatory requirements of a foreign regulatory authority consistent with conditions specified by the CFTC. The relief granted is limited to brokerage activities undertaken on behalf of customers located in the U.S. with respect to transactions made on or subject to the regulations of TOCOM for products that customers located in the U.S. may permissibly trade.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-1776.pdf

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