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Corporate and Financial Weekly Digest

February 23, 2007

SEC/Corporate

SEC Announces $700 Million Fee Cut

On February 16, Securities and Exchange Commission Chairman Christopher Cox announced that the SEC will significantly cut the fees charged to public companies and other issuers for securities transactions and registrations. Fees to register securities with the SEC will be reduced by 71.3%, and fees on securities transactions will be reduced by 50.2%. More specifically, effective February 20, the Section 6(b) fee rate applicable to the registration of securities, the 13(e) fee rate applicable to the repurchase of securities, and the Section 14(g) fee rate applicable to proxy solicitations and statements in corporate control transactions decreased to $30.70 per million dollars from the previous rate of $107.00 per million dollars.

In addition, effective March 17, the Section 31 fee rate applicable to securities transactions on the exchanges and over-the-counter markets will decrease to $15.30 per million dollars. Further, the SEC will determine no later than March 1, 2007, whether a mid-year adjustment to the Section 31 fee rate will be necessary. Also effective March 17, the Section 31 assessment on security futures transactions will decrease to $0.0042 per round turn transaction.

The SEC will announce new fee rates for fiscal 2008 no later than April 30, 2007. These fee rates will become effective October 1, 2007, or after the SEC's fiscal 2008 appropriation is enacted.

http://www.sec.gov/news/press/2007/2007-24.htm

Broker Dealer

NASD Files a Portfolio Margin Rule Change

On February 12, the National Association of Securities Dealers, Inc. filed with the Securities and Exchange Commission a rule change to amend Rule 2520 to permit members to extend initial and maintenance margin according to a prescribed portfolio margin methodology on a pilot basis. NASD also amended Rule 2860 to require that a disclosure statement and written acknowledgement for use with the proposed portfolio margin program be furnished to customers using a portfolio margin account. This rule change is substantially similar to the New York Stock Exchange and the Chicago Board Options Exchange portfolio margining rule amendments which were recently approved by the SEC (the NYSE and CBOE rule amendments were previously discussed in the December 15, 2006 edition of the *Corporate and Financial Weekly Digest*).

SEC/CORPORATE

For more information, contact:

Robert L. Kohl
212.940.6380
robert.kohl@kattenlaw.com

Mark A. Conley
310.788.4690
mark.conley@kattenlaw.com

Carolyn F. Loffredo
310.788.4585
carolyn.loffredo@kattenlaw.com

BROKER DEALER

For more information, contact:

James D. Van De Graaff
312.902.5227
james.vandegraaff@kattenlaw.com

Daren R. Domina
212.940.6517
daren.domina@kattenlaw.com

Patricia L. Levy
312.902.5322
patricia.levy@kattenlaw.com

Morris N. Simkin
212.940.8654
morris.simkin@kattenlaw.com

As proposed, Rule 2520 would, on a pilot basis starting on April 2, 2007, and ending July 31, 2007 allow members to elect to apply a portfolio margin methodology for initial and maintenance margin to all margin equity securities, listed options, security futures products, unlisted derivatives, warrants, index warrants and related instruments, provided that certain conditions are met.

In addition, a member that is a Futures Commission Merchant and is either a clearing member of a futures clearing organization or has an affiliate that is a clearing member of a futures clearing organization is permitted to combine an eligible participant's related instruments with listed index options, unlisted derivatives, options on exchange traded funds, index warrants and underlying instruments, and compute a margin requirement for such combined products on a portfolio margin basis.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_018677.pdf

CBOE Rule to Allow DPMs to Operate Remotely

On November 13, 2006, the Chicago Board Options Exchange, Incorporated filed with the Securities and Exchange Commission a proposed rule change to allow a Designated Primary Market-Maker (DPM) to operate remotely away from the CBOE trading floor. CBOE filed Amendment No. 1 to the proposed rule change on January 18 and, on February 12, the SEC published a notice to solicit comments on the proposed rule change.

Currently, all DPMs operate on the CBOE trading floor. The proposed rule change is intended to provide DPMs with the flexibility to operate on the CBOE trading floor (On-Floor DPM) or remotely away from the CBOE trading floor (Off-Floor DPM). A DPM would only be permitted to operate as an Off-Floor DPM in equity option classes traded on the CBOE's Hybrid Trading System. A CBOE committee will consider various factors specified in Rule 8.83(b) in determining whether to permit an On-Floor DPM to operate as an Off-Floor DPM.

http://www.sec.gov/rules/sro/cboe/2007/34-55275.pdf

Private Investment Funds

Principles Regarding Regulation of Private Pools Released

On February 22, the President's Working Group on Financial Markets (PWG) released a set of 10 principles and guidelines intended to guide the approach of U.S. financial regulators toward private pools of capital, such as hedge funds. The PWG, which includes key representatives from the Treasury Department, Federal Reserve Board, Securities and Exchange Commission and Commodity Futures Trading Commission, affirmed its view that private pools provide significant benefits to the financial markets and that the current regulatory structure for private pools has proven successful. The latest principles, the first statement by the PWG on private pool issues since 1999, concentrate on investor protection and systemic risk concerns, and include the following points:

- Market discipline by creditors, counterparties, and investors in private pools provides the most effective mechanism for limiting systemic risk—that is, the risk that losses by certain market participants might destabilize the broader financial system.

PRIVATE INVESTMENT FUNDS

For more information, contact:

Bill Natbony
212.940.8930
william.natbony@kattenlaw.com

Dan Hunter
212.940.6783
daniel.hunter@kattenlaw.com

Janet R. Murtha
212.940.6469
janet.murtha@kattenlaw.com

Investor protection is addressed most effectively through a combination of market discipline and regulation limiting investment in private pools to more sophisticated investors.

- Concerns regarding the indirect exposure of less sophisticated investors to private pools via their holdings in pension funds or other pooled investment vehicles is best addressed through the practices of the fiduciaries managing those pooled investment vehicles.

- Managers of private pools should have information, valuation, and risk management systems meeting sound industry practices, allowing them to accurately provide material information to other market participants in a timely manner.

- Key creditors and counterparties to private pools should continue to develop and enhance risk management practices regarding the related credit exposure and the potential for changes in that exposure over time.

- Sufficient historical and current information should be available to enable a prospective investor to investigate the strategies, terms and conditions, and risk management capabilities of private pools and to evaluate the suitability of an investment in such pools for that investor.

http://www.treas.gov/press/releases/reports/principles.pdf

Banking

Insured Banks and Thrifts Report Record Earnings in 2006

Commercial banks and savings institutions insured by the Federal Deposit Insurance Corporation (FDIC) reported net income of $145.7 billion in 2006, eclipsing the previous record of $133.9 billion set in 2005. According the FDIC, the improvement in earnings can be attributed in part to strong growth in noninterest income at large banks, higher net interest income and lower expenses for bad loans. This is the sixth year in a row that industry earnings set a new record.

The industry's ROA of 1.28 percent in 2006 was slightly lower than the 1.30 percent in 2005. The average net interest margin -- the difference between the average interest income that institutions earn on their loans and other interest-bearing investments and the average interest expense they incur to fund those assets -- declined to an 18-year low of 3.31 percent in 2006 (from 3.52 percent in 2005). Rising short-term interest rates caused the difference between short-term and longer-term interest rates to narrow and even become negative at times in 2006.

Among the major findings:

- **Troubled residential mortgage loans increased during the fourth quarter.** Residential mortgage loans that were noncurrent (90 days or more past due or in nonaccrual status) increased by $3.1 billion (15.6 percent) during the fourth quarter. This increase followed a $974 million (5.2 percent) increase in the third quarter. Net charge-offs of residential mortgage loans totaled $888 million in the fourth quarter, a three-year high.

BANKING

For more information, contact:

Jeff Werthan
202.625.3569
jeff.werthan@kattenlaw.com

Christina J. Grigorian
202.625.3541
christina.grigorian@kattenlaw.com

Adam Bolter
202.625.3665
adam.bolter@kattenlaw.com

- **Industry earnings remained strong through the fourth quarter.** Insured institutions reported $35.7 billion in net income for the fourth quarter of 2006, an increase of $3.0 billion (9.3 percent) compared to the fourth quarter of 2005, when high losses in credit card portfolios held down industry earnings. The industry's performance was stronger than the reported income numbers indicate as restructurings at a few large institutions caused some fourth-quarter income and expense items to be understated.

- **Loan growth slowed in the fourth quarter, while deposit growth soared.** Total loans and leases increased by $66.1 billion in the fourth quarter, the smallest quarterly growth since the first quarter of 2002. Declining growth in residential mortgage loans and real estate construction and development loans accounted for a large part of the slowdown in lending growth. In contrast, total deposits grew by $247.2 billion during the quarter, the largest quarterly increase ever reported. The surge in deposit growth was aided by a record $90.2 billion increase in deposits in foreign offices, as well as by a $70.4 billion increase in savings and interest-bearing checking deposits, and a $56.6 billion increase in noninterest-bearing deposits.

- **Insured deposit growth continued to lower the Deposit Insurance Fund reserve ratio.** Estimated insured deposits grew by $53.8 billion in the fourth quarter, following a $60.6 billion increase in the third quarter. The effect of the growth in insured deposits on the ratio of the Deposit Insurance Fund (DIF) to insured deposits was the same in each quarter -- the DIF reserve ratio declined by one basis point in each of the last two quarters of 2006, ending the year at 1.21 percent.

http://www2.fdic.gov/qbp/index.asp

United Kingdom Developments

AIM Raises Standards for Nomads and Issuers

On February 20, the London Stock Exchange introduced, with immediate effect, a new rule book for Nominated Advisers (Nomads), amended the AIM Rules for Companies to require additional disclosures (*e.g.* requiring issuers to maintain a website containing key financial and other information, including the issuer's AIM admission document) and amended the AIM Appeals and Disciplinary Handbook to increase the range and size of penalties it can impose on issuers and Nomads.

The new rule book *AIM Rules for Nominated Advisers* includes provisions which codify and expand a Nomad's role and responsibilities on matters including due diligence responsibilities with respect to issuers. It sets out in detail the tasks which the Nomad must carry out in order to meet its responsibilities to confirm to the exchange that a company is appropriate to be listed and to ensure that it is able to maintain ongoing compliance with AIM Rules.

www.londonstockexchange.com/aim/rulechanges2007

UK DEVELOPMENTS

For more information, contact:

Martin Cornish
44.20.7776. 7622
martin.cornish@kattenlaw.co.uk

Edward Black
44.20.7776.7624
edward.black@kattenlaw.co.uk

Litigation

Section 11 Claim Rejected Where Commitment to Invest Preceded Registration Statement

On a matter of first impression, the U.S. Court of Appeals for the Eleventh Circuit held that sophisticated investors involved in an arms-length merger transaction may not recover under Section 11 of the Securities Act of 1933 where they made a legally binding investment commitment months before an allegedly defective registration statement was issued. The plaintiffs, shareholders of the merger target corporation, signed stockholder agreements in which they irrevocably agreed to vote their shares in favor of the merger.

Two months later the acquirer issued its registration statement for the merger, which was followed by the requisite shareholder approval of the merger. Just months thereafter, the acquirer announced revenue shortfalls, which caused a sharp stock price decline. Plaintiffs sued, alleging the registration statement misrepresented the acquiring company's financial condition.

While recognizing that Section 11 claims brought within one year of issuance of a registration statement ordinarily include a presumption of reliance on the statement, the Court ruled that applying such a presumption here was "illogical" and unwarranted, finding that there was no basis to presume that the plaintiffs relied upon alleged misrepresentations in the registration statement since it did not exist at the time they irrevocably committed to invest. Rather, based upon an extension of the "so-called 'commitment theory'" courts use to determine the commencement of the statute of limitations in Rule 10b-5 claims, the Court ruled that the plaintiffs had made a "binding commitment decision" and "effectively 'purchased' their [stock]" months before the registration statement was filed. Accordingly, the Court dismissed the Section 11 claim. (*APA Excelsior III L.P. v. Premiere Technologies, Inc.*, 2007 WL 286258 (11th Cir. Feb. 2, 2007))

"Storm Warnings" Triggered Running of Statute of Limitations

Former employees of a private company that merged with defendant company brought securities fraud claims under § 10(b) of the Securities and Exchange Act and Rule 10b-5 against defendant company and its principals after steep share value declines followed certain company statements, announcements and filings between February 2001 and January 2005. Defendants moved to dismiss, arguing that the statute of limitations had long ago expired.

The Court first noted that, in 2001, the applicable statute of limitations was either one year from the date of discovery or three years from the date of the fraud. The Court then addressed whether, as defendants argued, the one year prong applied because plaintiffs had been placed on "inquiry notice."

The court ruled that a plaintiff is charged with the duty to exercise reasonable diligence in determining whether a potential claim exists "[w]hen the circumstances would suggest to an investor of ordinary intelligence the probability that she has been defrauded." Defendants argued that several such circumstances, known as "storm warnings," existed. Defendants first argued that the company's announcement on February 15, 2001 that its growth would be less robust than projected and the widespread media reporting of that announcement were "storm warnings."

The Court disagreed, noting that neither the announcements nor the media reports suggested any fraud. However, the Court agreed that plaintiffs' duty of inquiry – and, thus, the one year statute of limitations

LITIGATION

For more information, contact:

Alan Friedman
212.940.8516
alan.friedman@kattenlaw.com

Bonnie L. Chmil
212.940.6415
bonnie.chmil@kattenlaw.com

prong – was triggered by the filing of securities fraud class actions against the defendant company in February 2001. Although the class periods in those actions commenced two months after plaintiffs received their stock in the merger, the fraud allegations asserted by the plaintiffs and in the class actions were so similar as to put plaintiffs on inquiry notice. (*Domenikos v. Roth*, 2007 WL 221418 (S.D.N.Y. Jan. 26, 2007))

Antitrust

New HSR Thresholds Announced

The Federal Trade Commission recently announced changes to the thresholds governing premerger notification filings that must be made under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR). Effective February 21, the various HSR notification thresholds rose to reflect inflation. As a result, transaction valued at less than $59.8 million will no longer require HSR filings. The thresholds used to apply the "size of person" test have increased as well. In order to satisfy the "size of person" test under the new thresholds, one party must have net sales or total assets of at least $12 million and the other party must have net sales or total assets of at least $119.6 million.

http://ftc.gov/os/2007/01/P859910RevisedSection7AClaytonAct2007.pdf

Katten

Katten Muchin Rosenman LLP

www.kattenlaw.com

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

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

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

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

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

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

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

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

ANTITRUST

For more information, contact:

James J. Calder
212.940.6460
james.calder@kattenlaw.com

Laura Keidan Martin
312.902.5487
laura.martin@kattenlaw.com

Jeffrey Patt
312.902.5604
jeffrey.patt@kattenlaw.com

David Stoner
212.940.6493
david.stoner@kattenlaw.com