CORPORATE & FINANCIAL WEEKLY DIGEST

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SEC/CORPORATE

SEC Schedules Open Meeting to Propose Rules on Financial Institution Incentive Compensation and Credit Ratings

On March 2, the Securities and Exchange Commission will hold an open meeting to discuss, among other matters, whether to propose rules to implement Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 956 requires that not later than nine months after enactment, the appropriate federal regulators jointly shall adopt regulations requiring "covered financial institutions" (as described below) with assets of $1 billion or greater to disclose incentive compensation to their appropriate federal regulator. Disclosure is required of all incentive-based compensation arrangements in sufficient detail for the regulator to determine if the arrangement with the executive officer, employee, director or principal shareholder is excessive or could lead to a material financial loss. Within the same time frame, federal regulators are also required to jointly prescribe regulations to prohibit any type of incentive-based compensation by "covered financial institutions" with assets of $1 billion or greater that is excessive or could lead to material financial loss. Covered financial institutions include depository institutions, depository institution holding companies, credit unions, registered broker-dealers and registered investment advisers.

The SEC will also consider whether to propose rule amendments that would implement Section 939A of the Dodd-Frank Act relating to references to credit ratings in filings under the Securities Act of 1933 and the Investment Company Act of 1940. Section 939A of the Dodd-Frank Act requires that the SEC: (1) review any regulation issued by it that requires the use of an assessment of the credit-worthiness of a security or money market instrument and any references to or requirements in its regulations regarding credit ratings, (2) modify any regulations to remove any reference to or requirement of reliance on credit ratings, and (3) substitute in its regulations a standard of credit-worthiness with alternative requirements.

See the February 11 edition of *Corporate and Financial Weekly Digest* for a discussion of currently proposed rules under Section 939A of the Dodd-Frank Act.

Read more.

LITIGATION

Manufacturer's Breach of Contract Claims Survive Improper Remedy Demand

The U.S. Court of Appeals for the Eighth Circuit reversed a trial court's dismissal of claims relating to a shipping dispute between a manufacturer and a distributor, holding that plaintiff's selection of an improper remedy in its demand for relief was not fatal to its claims.

Plaintiff, a Chinese manufacturer of organic insulin, entered into an agreement with the defendant, a Minnesota distributor. Under the agreement, the plaintiff was to send four shipments to the defendant. The defendant received and paid for the first shipment, but refused to pay for the second because of mold on its exterior. Plaintiff recalled the third and fourth shipments, and claims and cross-claims were filed. In plaintiff's breach of contract claim, it relied on the fact that all four shipments were delivered as specified in the purchase orders, and that defendant failed to pay for the last three shipments. The defendant moved to dismiss, arguing that a seller that recalls goods before they reach a buyer may not recover the contract price of retained goods even if there was a breach. The trial court dismissed the plaintiff's contract claims relating to shipments three and four.

The Eighth Circuit reversed. Although plaintiff's recall of shipments three and four may preclude recovery of their full contract price, if plaintiff "proves that [defendant] breached the contract as to shipments three and four, it is almost certain to be entitled to some monetary relief." Plaintiff's claims were not subject to dismissal merely because of its initial demand for the full price of the goods at issue. (*Dinxi Longhai Dairy, Ltd. v. Becwood Tech. Group LLC*, No. 10 Civ. 2612, 2011 WL 536490 (8th Cir. Feb. 17, 2011))

Shareholder Suit Dismissed for Insufficient Scienter Allegations

The U.S. Court of Appeals for the Eleventh Circuit affirmed the dismissal of a consolidated securities fraud action, holding that the complaint's scienter allegations did not meet the required heightened pleading standards.

Plaintiffs were shareholders in Technical Olympic USA, Inc. (TOUSA), and defendants were TOUSA executive officers. TOUSA entered into a significant joint venture acquisition funded in large part by a $675 million loan. TOUSA provided certain guarantees to the lenders. After the acquisition, TOUSA described the loan as "non-recourse" to TOUSA in Securities and Exchange Commission filings, press releases and analyst conference calls, and did not disclose the guarantees until March of 2006, after it had finalized the loan in August 2005. In November of 2006, TOUSA disclosed demand letters by the lenders under the guarantees. TOUSA's share price plummeted and it subsequently went bankrupt. Litigation followed.

Plaintiffs' securities fraud allegations focused on the characterization of the loan as non-recourse and the delayed disclosure of the guarantees. Affirming the trial court's dismissal of plaintiffs' claims, the Eleventh Circuit held that the "amended complaint fails to allege any direct evidence showing defendants acted with the requisite scienter." The complaint included no allegations that the defendants did not reasonably believe the loan to be non-recourse to TOUSA, no allegations that anyone ever questioned the non-recourse nature of the loan, no evidence that the defendants ever read the guarantees or believed more disclosures were required, thought any person at TOUSA was engaged in fraud, or had any other reason to believe the guarantees represented a material risk for TOUSA and its shareholders. Because the complaint rested only on speculative or conclusory allegations of scienter, the Eleventh Circuit found that the lower court properly dismissed the claims. (*Durgin, Briclayers & Trowel Trades Intl'l Pension Fund et al. v. Mon et al.*, No. 09 Civ. 15595, 2011 WL 573483 (11th Cir. Feb. 18, 2011))

ANTITRUST

Revisions to HSR Premerger Notification Form Expected Soon

The Federal Trade Commission (FTC) is expected to announce significant changes to the Hart-Scott-Rodino (HSR) Premerger Notification Rules, the Premerger Notification and Report Form, and the accompanying Instructions in the next several weeks. The changes, which may have been presaged by proposals issued by the FTC for public comment last August, may impose significant new reporting requirements on private equity and other funds, where one of a family of funds is making an HSR investment. The public will know which of the proposed changes were adopted when the FTC releases the new form.

Three of the proposed changes, if adopted, will have substantial impact on financial buyers and other acquirers who operate multiple funds or other investment vehicles. First, HSR filers who share common managers with other entities will need to provide information on the other commonly managed entities—defined as "associates" in the amended Rules—even though they are separately owned. Thus, funds that now share a common manager, or partnerships that share a common general partner, with the HSR filer will now be treated as "associates" of the filer, and the filer will need to disclose information about them.

Second, acquiring firms will need to disclose whether their "associates" (or businesses that are owned by the associates) receive revenues from the same line of business as the acquired firm. This will require that the filer inquire into the business holdings and revenue sources of its associated entities.

Third, acquiring firms will also need to disclose minority holdings (holdings of 5-50%) of their associates in entities that also drive revenues from the same industry as the acquired firm.

For financial investors, private equity, and families of funds, these proposed amendments to the HSR Rules are potentially quite significant. These changes will be addressed in a Katten Client Advisory shortly after the FTC's public announcement.

Click here to read the proposals issued by the FTC in August 2010.

For more information, contact:

SEC/CORPORATE		
Robert L. Kohl	212.940.6380	robert.kohl@kattenlaw.com
David A. Pentlow	212.940.6412	david.pentlow@kattenlaw.com
Robert J. Wild	312.902.5567	robert.wild@kattenlaw.com
LITIGATION		
Bruce M. Sabados	212.940.6369	bruce.sabados@kattenlaw.com
Brian Schmidt	212.940.8579	brian.schmidt@kattenlaw.com
ANTITRUST		
James J. Calder	212.940.6460	james.calder@kattenlaw.com
Laura Keidan Martin	312.902.5487	laura.martin@kattenlaw.com
David J. Gonen	202.625.3745	david.gonen@kattenlaw.com

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Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

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