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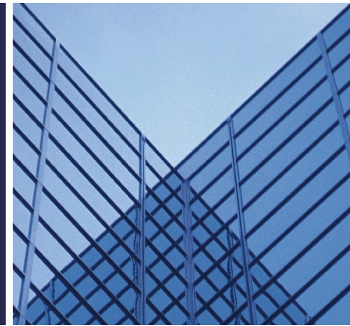
Corporate and Financial Weekly Digest



February 29, 2008

SEC/Corporate

NASDAQ Proposes Listing Standards for Special Purchase Acquisition Vehicles (SPACs)

On February 21, the Nasdaq Stock Market, Inc. proposed a rule change to the Securities and Exchange Commission which would permit the listing of companies, commonly known as special purpose acquisition vehicles (SPACs), whose business plan is to complete an initial public offering and engage in a merger or acquisition with one or more unidentified companies within a specific period of time. SPACs will be subject to both NASDAQ's initial listing requirements and additional requirements developed specifically for this entity.

The additional requirements include:

- Gross proceeds from the initial public offering must be deposited in an escrow account maintained by an insured depository institution as defined by the Federal Deposit Insurance Act or in a separate bank account established by a registered broker or dealer.

- Within 36 months of the effectiveness of its IPO registration statement, the company must complete one or more business combinations using aggregate cash consideration equal to at least 80% of the value of the escrow account at the time of the initial combination.

- So long as the company is in the acquisition stage, each business combination must be approved both by the company's shareholders and by a majority of the company's independent directors.

Following each business combination, the combined company must meet all of the requirements for initial listing.

http://www.complinet.com/file_store/pdf/rulebooks/NASDAQ_SR-NASDAQ-2008-013_Initial_Filing.pdf

Broker Dealer

FINRA Offers Guidance on ECN Trade Reporting

The Financial Industry Regulatory Authority (FINRA) issued a notice to address the issue of whether its trade reporting rules required submission of a clearing-only, "non-media report," to reflect the offsetting leg of a transaction matched by a firm operating as an electronic communication network (ECN). Although such reporting is currently permitted, the FINRA trade reporting rules do not at this time require submission of a non-tape report under these circumstances. However, FINRA noted that it intends to file a proposed rule

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change in the future to require non-media reports for offsetting transactions when necessary to identify a member firm that was a party to a trade and did not appear on the tape report.

http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p038015.pdf

FINRA Relief for Certain Record Retention Requirements

The Financial Industry Regulatory Authority (FINRA) announced record retention relief it secured for its member firms in connection with a no-action letter issued by the Security and Exchange Commission's Division of Trading and Markets. Under the terms of this letter, FINRA member firms will be able to rely on Web CRD, effective February 19, to satisfy record retention requirements with respect to the maintenance of certain Forms U4, U5 and BR filed in Web CRD. The relief does not extend to Form U4s and U5s that require signatures.

http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p038024.pdf

CBOE Proposes to Reduce Order Handling and Exposure Periods to One Second

The Chicago Board Options Exchange, Incorporated (CBOE) has proposed to reduce the order handling and exposure periods contained in its rules from three seconds to one second. Current CBOE Rules 6.45A and 6.45B mandate that an order entry firm is prohibited from executing an order where the firm represents itself as an agent with a facilitation or solicited order (Crossing Orders) using the Hybrid Trading System unless it first complies with a three second exposure requirement. During this three second exposure period for Crossing Orders, other CBOE members may enter orders to trade against the exposed order. CBOE's proposal would reduce this exposure period to one second.

CBOE believes that it is in the best interests of market participants to minimize the exposure period, as both the order being exposed and the participants responding thereto are subject to market risk during the exposure interval. Furthermore, CBOE maintains that the reduction in exposure time to one second will nevertheless allow for sufficient time to ensure effective interaction with orders.

https://www.cboe.org/publish/RuleFilingsSEC/SR-CBOE-2008-016.pdf

Phlx Proposes to List and Trade Jumbo Options

The Philadelphia Stock Exchange, Inc. (Phlx) has proposed to list and trade options on Exchange-Traded Fund Shares with a unit of trading of 1000 Exchange-Traded Fund Shares and on Trust Issued Receipts with a unit of trading of 1000 Trust Issued Receipts, in each case with a European-style exercise feature (collectively, Jumbo Options).

An American-style option may be exercised at any time prior to its expiration whereas a European-style option may be exercised only on its expiration date. The purpose of the proposal is to expand options investors' choices by listing and trading option contracts on Jumbo Options. Jumbo Options will have the same terms as regular sized options except for the European-style exercise feature and the size of the trading units will be ten times larger.

Phlx believes that the Jumbo Options contracts will appeal to institutional and other large investors as the European-style exercise option will permit writers of Jumbo Options to more easily manage their risk because the options will not

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be exercised prior to their expiration date.

http://www.phlx.com/exchange/rulefilings/2008/SR-2008-11.pdf

Proposed Amendments to CBOE Rules Regarding Application of Participation Entitlements

The Chicago Board Options Exchange, Incorporated (CBOE) has filed a proposed rule change to amend its rules regarding the application of participation entitlements to orders executed electronically on the CBOE Hybrid Trading System (Hybrid System). Current CBOE Rules 6.45A and 6.45B govern priority and allocation of trades on the Hybrid System for equity options and index/ETF options, respectively. The first step in creating an allocation structure is to select a base matching algorithm. After a base matching algorithm is selected, the CBOE may utilize optional priority overlays that would be applied on a trade before the matching algorithm was used to allocate an order.

The proposed rule change would allow for more than one participation entitlement to be activated for an option class, including in different priority sequences, provided that no more than one entitlement could be applied on any given trade. Thus, the CBOE could set up an allocation structure that contemplates using both the Preferred Market-Maker entitlement and the Designated Primary Market-Makers or Lead Market-Makers entitlement with different priority positions.

http://www.sec.gov/rules/sro/cboe/2008/34-57332.pdf

ERISA

Supreme Court Holds That Individual Participants Can Seek Relief for Fiduciary Breach Under ERISA

Recently, the U.S. Supreme Court issued its decision in *LaRue v. DeWolff, Boberg & Associates, Inc*. (*LaRue*), which has significant implications for litigation involving plans subject to the Employee Retirement Income Security Act of 1974 (ERISA).

Mr. LaRue participated in a 401(k) defined contribution plan with participant-directed investments. He alleged that he made investment elections that were never carried out and, as a result, his account lost $150,000. He sued the plan fiduciaries, arguing that the failure to implement his instructions was a breach of fiduciary duty, and that his account should be made whole. The district court dismissed LaRue's claim on the basis that the relief he sought was unavailable under ERISA.

LaRue appealed, and argued that he was entitled to relief under ERISA § 502(a)(2), which permits a civil action by the Secretary of Labor or by a participant, beneficiary or fiduciary for "appropriate relief" for the breach under § 409 of ERISA.

The Court of Appeals rejected LaRue's arguments and upheld the district court's dismissal of his claim. The Supreme Court agreed to review the Court of Appeals decision.

The key issue in *LaRue* involves an earlier Supreme Court ERISA decision where a plaintiff received the benefits she sought under the plan, but there were delays in payment. She sued under § 502(a)(2) for damages based on the delay. The Court held that such damages were not available under § 502(a)(2) because that provision provided "remedies that would protect the entire plan, rather than with the rights of an individual beneficiary."

ERISA

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Massachusetts Mutual Life Ins. Co. v. Russell (*Russell*), 473 U.S. 134 (1985).

Since LaRue was seeking recovery that would only benefit his own account, the Court of Appeals, citing *Russell*, denied his claim because it did not benefit "the plan as a whole."

The opinion of the Supreme Court states that the fiduciary breach alleged by LaRue "falls squarely within" the category of fiduciary breaches covered by ERISA. Therefore, although § 502(a)(2) does not provide a remedy for individual relief, as distinct from plan relief, it does authorize recovery for fiduciary breaches that impair the value of plan assets allocated to a participant's individual account. Nothing in *LaRue*, however, appears to change the result in *Russell* to the extent that the earlier case holds that the kind of outside-the-plan damages sought by plaintiff there are not permitted under § 502(a)(2).

Under *LaRue*, a suit for losses due to an alleged breach of fiduciary duty may now be brought under ERISA § 502(a)(2) without regard to whether the relief sought goes to the entire plan or only to certain accounts under the plan. As a result, plans and fiduciaries are likely to experience more litigation based on alleged fiduciary breaches. It would also appear that in a "stock drop" or "401(k) fees" class action, a defense that § 502(a)(2) relief is unavailable because the relief sought would go to individual participants' accounts, might be unsuccessful after *LaRue*.

http://www.supremecourtus.gov/opinions/07pdf/06-856.pdf

Client Alert on *LaRue* http://www.kattenlaw.com/

Banking

OTS Releases Report Describing Status of Thrift Industry

On February 20, the Office of Thrift Supervision (OTS) released its *Thrift Industry Highlights – Fourth Quarter 2007* report.

The report notes that the thrift industry posted a record loss of $5.24 billion for the fourth quarter of 2007. According to the report, about $4 billion of the overall loss resulted from "a write-down by a few thrifts in goodwill, necessary to recognize the reduced value of acquired assets." Another $2.2 billion loss was due to a restructuring charge by a single institution.

Among other findings, the report further notes the following: (i) during the fourth quarter of 2007, thrifts set aside $5.1 billion in loan loss provisions, or 1.35% of average assets; (ii) troubled assets were 1.65% of assets, up from 1.19% in the third quarter and 0.70% a year ago, (iii) total mortgage origination volume for the year was up 10% from 2006, but the fourth quarter was down 10% from the third quarter as existing and new home sales and refinance volumes declined; and (iv) the number of problem thrifts (those with composite examination ratings of 4 or 5) was up from 6 thrifts one year ago to 11 thrifts at the end of 2007.

http://www.ots.treas.gov/docs/7/778005.html

BANKING

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United Kingdom Developments

UK Launches Further Consultation on Funds of Alternative Investment Funds (FAIFs)

On February 22, the Financial Services Authority (FSA) published a further consultation (CP08/4) on establishing investment vehicles designed to allow

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UK retail consumers to invest in funds of hedge funds and other alternative investments funds.

The consultation paper proposes the introduction of retail-oriented Funds of Alternative Investment Funds (FAIFs) as part of the UK's regulated funds regime. The paper initiates a further round of consultation (following on from CP07/6 issued in the spring of 2007) on a number of issues raised by fund managers and interested parties during consultation such as whether the existing repayment standards for Non-UCITS Retail Schemes (NURS) need to be altered to take account of the time required for funds of funds to obtain valuations of assets held in underlying funds and allowing a FAIF (and NURS more generally) to act as "feeder funds" into one master fund. It is also proposed to address a current anomaly under which a NURS can invest in an offshore fund but not where that fund is a feeder fund investing solely in its master fund.

It is proposed to introduce FAIFs into the existing UK NURS regime by: (i) relaxing the existing NURS rules that restrict investment in unregulated collective investment schemes from 20% and allowing up to 100%; (ii) removing the prescription of the 15% rule that prohibits circularity of investment within NURS and to extend this to the UK Qualified Investor Scheme (QIS) regime; and (iii) applying due diligence criteria to investment managers where they invest more than 20% into any unregulated collective investment scheme.

The consultation closes on May 22.

www.fsa.gov.uk/pubs/cp/cp08_04.pdf

FSA Publishes Guidance on Passporting Under Prospectus Directive

On February 26, the Financial Services Authority (FSA) published a factsheet giving details of the passporting process it has adopted under the EU Prospectus Directive. The factsheet, which supersedes an earlier October 2006 edition, sets out procedures to be followed by issuers and their advisers when submitting passporting requests for a prospectus.

To obtain a passport from the FSA to circulate a prospectus in other EU Member States the issuer must submit a written request for an FSA certificate of approval, using a template request letter which can be found on the FSA's website. Almost all EU Member States will require translations of equity and retail debt prospectus Summaries. The only exceptions are Luxembourg, Austria and the Netherlands which will accept a Summary in English.

Passporting a prospectus approved by another EU Member State into the UK requires the issuer to contact its home state regulator which approved its prospectus and for that regulator to submit to the FSA an electronic version of the approved prospectus and a translation of the Summary into English when required by the FSA.

http://www.fsa.gov.uk/pubs/ukla/factsheet4.pdf

EU Developments

EU Proposes Sovereign Wealth Fund Code of Conduct

On February 27, the European Commission proposed a common EU approach to increasing the transparency, predictability and accountability of sovereign wealth funds. The common approach is intended to strengthen the European Union's voice in international discussions on establishing a code of conduct which would include standards in areas of transparency and governance, with

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the overall aim of maintaining an open investment environment.

The proposals are based on five principles: (i) commitment to an open investment environment both in the EU and elsewhere; (ii) support of multilateral work in international organizations such as the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development (OECD); (iii) use of existing instruments at EU and individual Member State level; (iv) respect of EU obligations and international commitments; and (v) proportionality and transparency.

ec.europa.eu/internal_market/finances/docs/sovereign_en.pdf

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§12(a)(2) Claim Dismissed: Alleged Misrepresentations Did Not Relate to Prospectus

A federal district court dismissed plaintiffs' claim under §12(a)(2) of the Securities Act of 1933. Plaintiffs, a group of hedge funds, purchased stock of defendant Health Grades, Inc. directly from defendant Essex Woodland Health Ventures, which owned 30% of Health Grade. Principals of Health Grade assisted Essex in its sales efforts. Plaintiffs alleged, among other things, that defendants violated §12(a)(2) by making material omissions and misrepresentations regarding the status of an important contract between Health Grade and a third party in order to induce plaintiffs to purchase the stock.

The Court ruled that §12(a)(2) claims can survive only if the alleged misrepresentations are contained in or relate directly to a prospectus. Although the plaintiffs conceded that the prospectus did not include any misrepresentations, they argued that the alleged oral misrepresentations related to their decision to purchase the stock and, thus, to the Health Grade prospectus provided to them in connection with their purchase of the stock.

The Court rejected the argument on two grounds. First, it found that the alleged misrepresentations solely concerned the status of Health Grade's contract with the third party and did not relate to the prospectus itself. Second, because the stock sales were made to institutional investors, rather than the public at large, the Court ruled that there was no obligation for defendants to issue a prospectus to plaintiffs in connection with the sale. While noting that Health Grade's prospectus was included in the sales offering documents provided to plaintiffs, the Court deemed this irrelevant, ruling that plaintiffs did not allege that Essex was obligated to issue a prospectus and that Essex had not issued one. (*Gotham Holdings, L.P. v. Health Grades, Inc*., 2008 WL 449689 (S.D.N.Y. Feb. 15, 2008))

Court Denies Motion to Dismiss Rule 10b-5 Claim

Plaintiffs, who had entered into a Merger Agreement with defendant, sued defendant for, among other things, violating §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Because plaintiffs and defendant operated casinos, the merger was subject to governmental approval. Defendant represented in the Merger Agreement that no government investigations of its business existed and that its directors and owners were complying with all applicable gaming laws. It also agreed to promptly notify plaintiffs if its representations became untrue.

Plaintiffs sought to extend the closing date specified in the Merger Agreement because it did not anticipate receiving the requisite governmental approvals by such date. Defendant agreed to the extension in exchange for plaintiffs' agreement to immediately pay defendant a $5 million non-refundable deposit.

After defendant refused plaintiffs' request for a second extension, because the requisite government approvals still had not been received, plaintiffs sued, alleging that defendant deliberately failed to disclose that at the time of the extension the Illinois Gaming Commission was investigating one of defendant's director-stockholders for, among other things, alleged ties to organized crime.

Defendant moved to dismiss the federal securities law claim, arguing that plaintiffs failed adequately to allege the scienter and causation elements of the claim. The Court disagreed. The Court found that the complaint created the requisite cogent and compelling inference of scienter by alleging that (i) when defendant agreed to extend the closing date it knew of the Illinois Gaming Commission's investigation, (ii) defendant knew that some of its representations in the Merger Agreement were false at the time of the extension agreement, and (iii) defendant purposely did not correct the earlier, now false, statements in order to induce plaintiff to pay it $5 million and, avoid having plaintiffs "walk away from the faltering deal." The Court found the "loss causation" element to be sufficiently pled based upon plaintiffs' allegation that defendant's failure to disclose the ongoing gambling commission investigation caused plaintiffs to (i) pay the $5 million non-refundable deposit, and (ii) undervalue the risk that governmental approval would not be forthcoming. (*CP St. Louis Casino, LLC v. Casino Queen, Inc.,* 2008 WL 450463 (S.D. Ill. Feb. 15, 2008))

CFTC

CFTC Seeks Rehearing on Foreign Currency Jurisdiction

On February 21, the Commodity Futures Trading Commission filed a petition for rehearing and suggestion for rehearing en banc with the U.S. Court of Appeals for the Sixth Circuit of the opinion in *CFTC v. Erskine*¸ which held that the foreign currency transactions at issue were "forward contracts" as opposed to "futures contracts" and, therefore, were not subject to CFTC jurisdiction. The CFTC argued that the panel had violated a rule of the Sixth Circuit, which provides that a reported decision of the court, in this case *The Andersons v. Horton Farms, Inc.* (relating to "hedge-to-arrive" contracts), may only be overruled by the court en banc. The CFTC also objected to the Court's finding that an instrument is a futures contract only if it is exchange-traded and contains standardized terms. The CFTC argued that the "totality of the circumstances" should be examined and, in the absence of a legitimate expectation of delivery by the parties, the instruments should be deemed to be futures contracts.

http://www.cftc.gov/stellent/groups/public/documents/legalpleading/ogcerskinepetition022208.pdf

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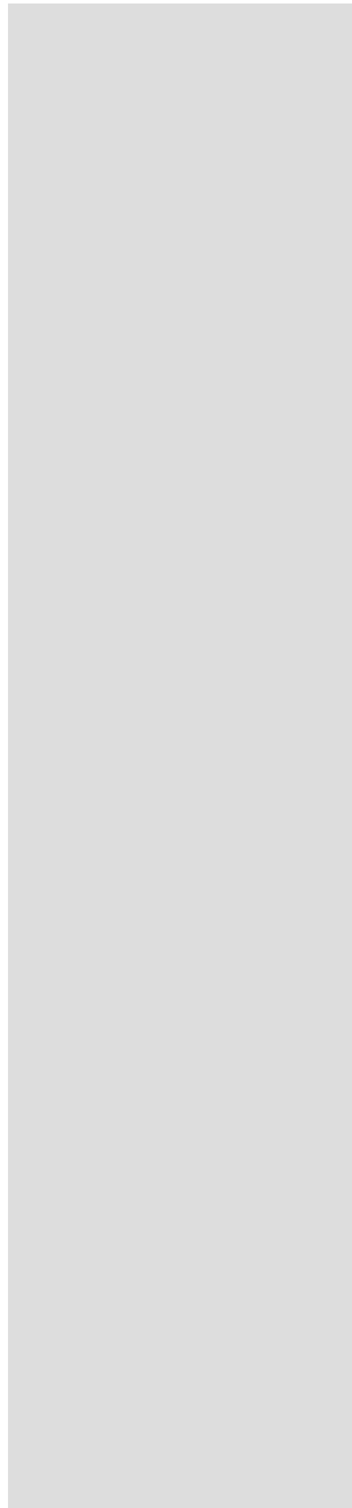

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