Katten Muchin Rosenman LLP

Corporate and Financial Weekly Digest

Business/Financial News in Brief
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SEC/Corporate

Majority Vote For Directors – Further Developments

In California, a State Senate bill was introduced on January 26 that would amend the California Corporations Code to require the affirmative vote of a majority of the shares of a corporation represented and voting at a meeting (provided such affirmative votes constitute at least a majority of a quorum) to elect a director of a California corporation in an uncontested election. A corporation would be entitled to amend its bylaws to elect to not be governed by the new standard, but such an amendment would require the approval of a majority of the corporation's outstanding shares.
http://www.leginfo.ca.gov/pub/bill/sen/sb_1201-1250/sb_1207_bill_20060126_introduced.html

On January 31, the board of directors of Dell Inc. amended the company's bylaws and corporate governance principles to provide for a new majority vote standard in uncontested director elections. Under the amended bylaws, a director nominee must receive favorable votes from holders of a majority of the shares entitled to vote. The revised corporate governance principles provide that an incumbent director who does not receive the required majority vote for re-election must tender a resignation for consideration by the board, and the board must accept or reject the resignation within 90 days. If Dell's press release is to be read literally, Dell has set a stricter standard than most—requiring a director to receive a majority of "shares entitled to vote" as opposed to a majority of shares present and voting at the shareholders meeting.
http://www1.us.dell.com/content/topics/global.aspx/corp/pressoffice/en/2006/2006_01_31_rr_000?c=us&l=en&s=corp

SEC Gives Notice of Meeting of SEC Advisory Committee on Smaller Public Companies

The Securities and Exchange Commission Advisory Committee on Smaller Public Companies, co-chaired by Katten Muchin Rosenman LLP partner Herb Wander, has provided notice that it will hold a public meeting on February 21. The Advisory Committee was established by the SEC to assess the impact of the Sarbanes-Oxley Act and other federal securities laws on smaller companies. The agenda for the meeting includes a discussion of a proposal to publish a draft of the Advisory Committee's Final Report for public comment. (http://www.knowledgemosaic.com/gateway/rules/Notice.33-8659.020106.pdf) See also the *Corporate and Financial Weekly Digest* issue of December 16, 2005.

SEC, Japan Financial Services Agency Announce Terms for Cooperation

On January 30, the Securities and Exchange Commission and the Japan Financial Services Agency (JFSA) announced terms for increased cooperation and collaboration. The increased cooperation and collaboration follows discussions that took place early in 2005 and has two main objectives: to identify and discuss regulatory issues of common concern and promote cooperation in the exchange of information in cross-border securities enforcement matters. The dialogue will be composed of regular meetings and ad hoc information exchange at the staff level and between high-level representatives of the SEC and JFSA.

Given recent developments in both the US and Japanese markets, the following topics have been identified for discussion in 2006:

- accounting and auditing standards;
- corporate governance and internal controls;
- approaches to facilitating technological advances in securities markets;
- cross-border cooperation and information sharing on enforcement matters;
- approaches to regulated entities and market intermediaries; and
- approaches to self-regulated entities and rating agencies.

http://www.sec.gov/news/press/2006-14.htm

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Banking

FDIC Releases On-Line Tool for Consumer Use in Effort to Guard Against Identity Theft

The Federal Deposit Insurance Corporation released on January 26, a new, on-line multimedia presentation for consumers to use in their efforts to protect against identity theft and secure their personal computers. In its release, the FDIC "encourages" financial institutions to provide consumers with a link to this new FDIC page from the institution's web site.

Specific recommendations to consumers from the FDIC include the following: (1) never provide personal information in response to an unsolicited telephone or internet request; (2) never provide a password over the phone or in response to an unsolicited internet request; (3) review account statements regularly to ensure all charges and transactions are correct; and (4) use a firewall and anti-virus and spyware protection software.

Should a consumer believe their personal information was compromised, the FDIC suggests that the consumer do the following: (1) contact the fraud department at one of the three major credit bureaus and ask that a fraud alert be placed on their file with all three companies; (2) review their credit reports periodically and carefully and look for inconsistencies or red flags such as accounts they did not open, debts they cannot explain or inquiries from companies they have not contacted; (3) contact the companies where the fraudulent activity occurred and follow-up all phone calls in writing; (4) file a police report with local police or the police department in the community where the crime took place and keep a copy of the report; and (5) file a complaint with the Federal Trade Commission.

To review the FDIC's presentation, visit http://www.fdic.gov/consumers/consumer/guard/index.html.

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United Kingdom Developments

Anti-Money Laundering Rules – Fundamental Changes to the UK Regulatory Scheme

In two linked developments the Financial Services Authority has announced the replacement of its detailed Money Laundering Sourcebook with high level provisions to be included in the Systems and Controls Sourcebook, and the Joint Money Laundering Steering Group (JMLSG) has published revised guidance on the prevention of money laundering and the financing of terrorism for the financial services industry.

The new FSA rules require FSA regulated firms to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime and to ensure that these systems and controls (1) enable it to identify, assess, monitor and manage money laundering risk; and (2) are comprehensive and proportionate to the nature, scale and complexity of its activities.
See http://www.fsa.gov.uk/pubs/policy/ps06_01.pdf for details

At the same time the JMLSG guidance (first issued in 1994 and the subject of two major overhauls since then) has been fundamentally modified in a manner which will change the way that firms approach the management of money laundering/terrorist financing risk and in particular the way in which they deal with new customers. The new guidance is designed to enable the UK financial services industry to take a more risk-based approach to anti money laundering.

Like the FSA, the JMLSG seeks to move firms' obligations to senior management. The key change in emphasis reduces the routine documentation verification aspects of anti money laundering and endeavors to direct firms' focus towards the minority of customers who represent a higher risk.

The JMLSG guidance will take effect after approval by The Treasury, regarded as a mere formality, and a transitional period to allow firms to implement changes in procedures
See http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=362&a=6759 for details

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Broker Dealer

NASD Issues Interpretation of Rule 2111

The National Association of Securities Dealers, Inc. has issued Notice to Members 06-03 interpreting Rule 2111. Rule 2111 prohibits a member firm holding a customer market order from trading for its own account at prices that would satisfy the customer's order unless the firm immediately thereafter executes the customer market order at the price at which the firm traded. Rule 2111 applies to orders in Nasdaq listed securities as well as exchange listed securities. It will apply to customer market orders received from other firms, e.g., a clearing firm receiving an order from an introducing firm. If a firm routes a customer market order to a market center, such as an ECN, the order will no longer be deemed a customer market order. However, the firm will have to monitor the market center for compliance with the best

execution rule (Rule 2320). An order placed on behalf of an institutional investor for more than 10,000 shares with a value in excess of $100,000 may be negotiated so that the firm can trade alongside or ahead of the customer. While Rule 2111 does not mandate a particular methodology for market order handling, firms are expected to choose a methodology to deal with instances where they receive multiple orders and assure that the methodology chosen is applied consistently and complies with applicable rules and regulations, including those for order handling and execution priority of all firm customer orders. The selected methodology must be documented and written supervisory procedures and systems must be in place for compliance with it. In no event may a firm have a preferred customer list for order execution. If a proprietary trading desk is adequately walled off from the trading desk to which the customer's order is routed and does not know of customer orders, Rule 2111 will not apply to trades of that proprietary trading desk.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_015833.pdf

NYSE Amends its Anti-Money Laundering Rule

The New York Stock Exchange, Inc. received approval from the Securities and Exchange Commission to amend its anti-money laundering (AML) rule, Rule 445. The amendments call for independent testing of a member firm's AML system on an annual, calendar year basis. The testing party may be an employee of the member firm or of an affiliate if the person consents to NYSE jurisdiction and is approved in advance by the NYSE. Third parties will not likely be approved by the NYSE. If there is a change in individuals because of a change in personnel, and not because of a change in the structure of their relationships (e.g., the AML officer for a bank holding company serves as a broker-dealer's AML person and a new officer is appointed), only notice to the NYSE is required. The person conducting the AML testing must have knowledge of the Bank Secrecy Act's requirements.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-1227.pdf

NASD Grants Exception from 2 Year Rule for Military Service

The National Association of Securities Dealers, Inc. has received approval from the Securities and Exchange Commission to adopt IM-1000-2. This interpretation grants an exception from the requirement that a person not associated with a member firm for over two years must retake the qualifying examinations. Specifically, it permits persons who commenced active military duty within the two year period to exclude the period commencing with the start of service if they rejoin a member firm within ninety days after termination of service, otherwise the two year period will be extended only by the time between termination and commencement of military duty. The NASD must be notified of the person's completion of active duty within the earlier of two years following completion of service or upon re-registration with a member firm.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-1307.pdf

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Litigation

Misleading Statement Does Not Give Rise to Securities Fraud Action

Although a GeoPharma press release disclosed that it was developing a "drug" for the treatment of mucositis, in fact, in its application to the FDA, GeoPharma only sought approval for a less lucrative "medical device." Following FDA approval, GeoPharma's press release described that approval as relating to a "prescription product," after which its stock price reached a new high. As soon as the FDA made clear that its approval related to a "medical device" rather than a "drug," the price of GeoPharma shares declined to its earlier levels. In dismissing a securities fraud class action complaint alleging that GeoPharma's disclosures were misleading because they failed to state that the FDA approval was not for a "drug," the court stated, among other things, that the purpose of Section 10(b) of the Securities Exchange Act of 1934 is to "punish knowing fraud or reckless behavior, not mistakes that arise from negligent or even grossly negligent behavior." Here, where the alleged wrongdoing involved a misleading (as opposed to a false) statement – that is, one that is accurate and truthful as far as it goes but, because it omits material information, could mislead a reasonable investor – the court, "rigorously appl[ying] the standard for pleading intent" dismissed the complaint with prejudice. *In re GeoPharma, Inc. Sec. Litig.,* No. 04 Civ. 9463 (SAS), 2006 WL 213274 (S.D.N.Y. Jan. 27, 2006).

Lead Plaintiff Appointed Despite Failure to Establish Largest Financial Interest

An individual investor sought appointment as lead plaintiff in a securities fraud class action. Under applicable law, a lead plaintiff must be a "member [] of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members." In his supporting affidavit, the movant stated that he had a MBA, that he suffered a financial loss as a result of the events at issue, and that he had familiarity with defendant company's business developments and financial disclosures. In granting his motion and appointing him lead plaintiff, the court noted that even though it "still question[s] if he has the largest financial interest in the pending lawsuit", "no member of the class has come forward to challenge the presumption that he is otherwise the most adequate plaintiff." *Clair v. DeLuca*, No. Civ.A. 03-288, 2006 WL 197119 (W.D. Pa. Jan. 26, 2006).

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CFTC

CFTC Adopts Rules on Alternative Capital Charges for Certain FCMs

The Commodity Futures Trading Commission has amended its regulations that impose minimum financial and related reporting requirements upon each person registered as a futures commission merchant (FCM). The amended regulations address the capital computations of FCMs that are registered with the Securities and Exchange Commission as securities brokers or dealers and that, pursuant to SEC regulations governing consolidated supervised entities, have received SEC approval to use internal mathematical models to determine the deductions from their capital for market risk and credit risk associated with their proprietary trading assets. The rules are effective immediately.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/06-982.pdf

NFA Proposes Amendments to Impose Additional Capital Requirements on FCMs that are Forex Dealer Members and FCMs with Retail Forex Affiliates

The National Futures Association has proposed amendments to its minimum financial requirements for NFA members that engage in over-the-counter forex transactions with retail customers. Under one proposal, NFA Member futures commission merchants (FCMs) that are forex dealer members and that act as counterparties to retail customers in over-the-counter forex options transactions would be required to maintain a minimum "adjusted net capital" (as defined in the CFTC Regulation 1.17) of $5 million. Under a second proposal, NFA Member FCMs would be required to maintain a minimum of $7.5 million adjusted net capital, if the Member FCM has an affiliate that engages in over-the-counter forex transactions with retail customers and that affiliate is authorized to engage in those transactions solely by virtue of its affiliation with a registered FCM.
http://www.nfa.futures.org/news/newsRuleSubLetter.asp?ArticleID=1526 and
http://www.nfa.futures.org/news/newsRuleSubLetter.asp?ArticleID=1529

CFTC Action on ICE Futures WTI Crude Futures Contract

On January 31, the Commodity Futures Trading Commission Division of Market Oversight notified the London-based futures exchange ICE Futures, formerly Intercontinental Petroleum Exchange Ltd. (IPE), that the exchange could offer its West Texas Intermediate (WTI) crude futures contract for trading in the United States in accordance with the terms and conditions of the no-action position the CFTC first granted the exchange in 1999. Earlier this week, U.S. Senator Charles Schumer asked the CFTC to rescind the CFTC's 1999 no-action relief granted allowing the exchange to make its electronic trading system available to participants in the U.S. Senator Schumer appeared to argue that a non-U.S. exchange should be required to be registered as a designated contract market in the U.S., if it lists for trading a contract considered to be a "U.S. contract" and not a "foreign contract." Although the CFTC determined not to take any action to prohibit trading in the WTI contract, the CFTC indicted that it "will be evaluating the use of the no-action process" in light of the issues raised by Senator Schumer.
http://www.cftc.gov/files/dea/icefutureslettertothecftc.pdf,
http://www.cftc.gov/files/dea/senatorschumerlettertocftc012606.pdf,
http://www.cftc.gov/files/dea/icelettertocftc013006.pdf,
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http://www.cftc.gov/files/dea/cftclettertosenatorschumer013106.pdf

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