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Corporate and Financial Weekly Digest

FEBRUARY 5, 2010

SEC/CORPORATE

SEC Publishes Interpretive Guidance on Disclosure Related to Climate Change

As described in the January 29 edition of *Corporate and Financial Weekly Digest*, the Securities and Exchange Commission recently approved guidance on disclosure related to the effects on public companies of climate change and regulation concerning climate change.

The text of the SEC's guidance regarding climate change was published on February 2 and can be viewed by clicking here.

SEC Approves NASDAQ's Proposed Rules to Modify Delisting Procedures

On January 29, the Securities and Exchange Commission approved NASDAQ's proposal to amend its listing procedures to modify the timeframes for certain compliance periods and for a company to submit a plan to regain compliance. Below is a summary of the final rules.

The final rules increase the number of consecutive trading days of below required market value of listed securities that would trigger non-compliance from 10 days to 30 days. The final rules also increase the period for regaining compliance for companies that are non-compliant with market value of listed securities test and market value of publicly traded shares test from 90 days to 180 days. Under the final rules, the maximum amount of time that a company has to regain compliance after failing to meet the market value of listed securities or market value of publicly held shares requirements is 18 months, assuming the 180-day compliance period is exhausted, an appeal to a Hearing Panel is taken, and after further review by the NASDAQ Listing Council the delisting is stayed and an extension granted.

NASDAQ also increased the number of calendar days for noncompliant companies to submit a plan for compliance to the NASDAQ staff from 15 to 45, with the staff permitted to grant up to a 5-day extension for good cause shown.

Click here for the Final Rules.

LITIGATION

Securities Fraud Claim Under PSLRA Not "Frivolous"; Sanctions Unwarranted

Michael Fishoff sued his former employer, Coty Inc., for alleged violations of the federal securities laws arising from Mr. Fishoff's attempt to exercise options awarded to him pursuant to the company's Long Term Incentive Plan. Mr. Fishoff alleged that Coty's executives exercised their options in advance of a predicted decline in the company's stock value, but improperly prevented him from exercising his options under the same conditions. The U.S. District Court for the Southern District of New York dismissed Mr. Fishoff's securities fraud claims in June 2009, finding that he failed to meet the heightened pleading standards for fraud under the Private Securities Litigation Reform Act (PSLRA) and Federal Rule of Civil Procedure 9(b). Coty subsequently sought sanctions against Mr. Fishoff pursuant to Federal Rule of Civil Procedure 11 and the PSLRA.

Under Rule 11, when an attorney presents a pleading, written motion or other paper to a court, that attorney certifies that the claims, defenses and other legal contentions contained therein are warranted by existing law or by a non-frivolous argument for extending, modifying or reversing existing law, or for establishing new law. An attorney who does not comply with Rule 11 is subject to sanctions. The PSLRA requires that, at the conclusion of a securities class action, the court must include specific findings in the record as to whether each party and each counsel complied with Rule 11. If Rule 11 was violated, sanctions under the PSLRA are mandatory.

In its sanctions motion, Coty argued that Mr. Fishoff's securities fraud claim and opposition to its motion to dismiss were "frivolous" because, under an objective standard of reasonableness, it was clear that there was "no chance of success and no reasonable argument to extend, modify or reverse the law as it stands." Although the court dismissed Mr. Fishoff's securities fraud argument, it did not find the claim "frivolous," concluding that while Mr. Fishoff failed to adequately plead scienter, scienter is the most difficult and controversial aspect of a securities fraud claim. Accordingly, the court concluded that sanctions against Mr. Fishoff under Rule 11 and the PSLRA were unwarranted. (*Fishoff v. Coty Inc.*, No. 09 Civ. 628 (SAS), 2010 WL 305358 (S.D.N.Y. Jan. 25, 2010))

SEC Enforces New Rule on Short Selling

The Securities and Exchange Commission recently charged two California investment advisery firms, AGB Partners LLC and Palmyra Capital Advisors LLC, with engaging in improper short selling of securities in advance of their participation in a company's secondary offering, in violation of Rule 105 of Regulation M. In October 2007, the SEC amended Rule 105, which is designed to prohibit manipulative short selling ahead of follow-on securities offerings. The revised rule generally prohibits the purchase of offering shares by any person who sold short the same securities within five business days before the pricing of the offering.

The SEC found that AGB Partners LLC and its principals, Gregory Bied and Andrew Goldberger, netted thousands of dollars in improper profits by shorting in advance of their purchase of stock in a secondary offering. According to the SEC's order, AGB Partners used two accounts: one for short selling funded with Bied's and Goldberger's personal assets, and the other a private investment fund managed for outside clients for participating in follow-on offerings. Although the amended Rule 105 created an exception to allow otherwise prohibited trades if the trades occur in separate accounts, the SEC's order found that these accounts fell outside the separate accounts exception because of Goldberger's and Bied's especially close collaboration with the accounts.

The SEC charged Palmyra Capital Advisors LLC with violating short selling rules and improperly profiting in three of its managed hedge funds. The SEC found that the firm violated Rule 105 in connection with short sales made in advance of a public offering by Capital One Financial Corp., resulting in improper profits of $225,500. Palmyra sold short a total of 50,000 shares of Capital One stock on September 18, 2008, and then received 50,000 shares from Capital One's secondary offering on September 24, 2008.

Both firms have agreed to settle the SEC's charges, consenting to be censured, disgorge profits and pay monetary penalties.

Read more.

BROKER DEALER

SEC Approves FINRA Rule Changes Regarding Reporting of Trade Cancellations

The Securities and Exchange Commission recently approved proposed rule amendments by the Financial Industry Regulatory Authority, Inc. that will change certain current trade reporting requirements. The rule changes will, among other things, allow firms to submit certain over-the-counter (OTC) trade cancellations on trade date until the close of the FINRA/NASDAQ Trade Reporting Facility (FINRA/NASDAQ TRF) and the OTC Reporting Facility (ORF) at 8 p.m. Eastern Time (ET). Under current FINRA rules, trade cancellations to the FINRA/NASDAQ TRF and ORF are based on the traditional 5:15 p.m. ET "media" cut-off time for the submission of trades for public dissemination purposes.

Read more.

NASDAQ Expects to Launch Third Equities Market in May 2010

NASDAQ OMX announced in an Equity Trader Alert that it expects to launch a third U.S. equity trading platform in May 2010, pending regulatory review and approval by the Securities and Exchange Commission. The third market, to be named NASDAQ OMX PSX, or simply PSX, will be organized under the license acquired from NASDAQ OMX's 2007 purchase of the Philadelphia Stock Exchange. According to NASDAQ OMX, the new PSX will feature a "price-size priority pro-rata" structure in contrast to the price-time priority models offered by the NASDAQ Stock Market and NASDAQ OMX BX.

Read more.

PRIVATE INVESTMENT FUNDS

Volcker Testifies Before Senate Banking Committee

Paul Volcker, former Chairman of the Federal Reserve Board and current Chairman of the President's Economic Recovery Advisory Board, spoke before the Senate Committee on Banking, Housing, and Urban Affairs on February 2 regarding President Barack Obama's so-called "Volcker Rule" proposal. The Volcker Rule would prohibit a bank or bank holding company from owning, investing in, or sponsoring hedge funds or private equity funds, or engaging in proprietary trading operations for its own profit unrelated to serving its customers. Volker specifically addressed three questions that have arisen about the proposal. First, on the issue of international consensus on the proposed approach, he expressed his belief that there were substantial grounds to anticipate success as the approach was more fully understood. Second, he felt that the functional definition of hedge funds and private equity funds that commercial banks would be forbidden to own, sponsor or invest in, and proprietary trading in which they would be forbidden to engage, would not be overly difficult to delineate. Third, he highlighted the strong conflicts of interest inherent in the participation of commercial banking organizations in proprietary or private investment activity. Volcker remarked, "Hedge funds, private equity funds, and trading activities unrelated to customer needs and continuing banking relationships should stand on their own, without the subsidies implied by public support for depository institutions."

Volcker emphasized that the proposed restrictions were part of a broader effort for structural reform to help deal with the problem of "too big to fail" and the related moral hazard. To ensure that large institutions and their managers and creditors do not assume a public rescue will be forthcoming in times of pressure, Volcker expressed support for the proposed House bill that provides authority to a designated agency to intervene and take control of major financial institutions to avoid their collapse. However, according to Volcker, non-"systemically significant" non-bank institutions, such as hedge funds, private equity funds, and other private institutions, should be allowed to fail in a competitive free enterprise system.

Volcker's statement can be obtained by clicking here.
Click here to read the January 22 edition of *Corporate and Financial Weekly Digest* for more information on President Obama's proposal.

CFTC

DCIO Confirms Certain TLGP Securities as Permitted Investments for Customer Funds

The Commodity Futures Trading Commission's Division of Clearing and Intermediary Oversight (DCIO) has issued an Interpretation confirming that certain corporate debt securities guaranteed by the Federal Deposit Insurance Corporation under its Temporary Liquidity Guarantee Program (TLGP) are permitted investments for customer segregated or secured amount funds. Under the Interpretation, in order for a TLGP security to qualify as a permitted investment for customer segregated funds held by a futures commission merchant (FCM), the security must satisfy all of the requirements of CFTC Regulation 1.25, and, in addition: (a) must be part of an issuance of greater than $1 billion, (b) must be denominated in U.S. dollars, and (c) must be guaranteed for its entire term. TLGP securities satisfying these requirements also would be permitted investments of customer secured amount funds under CFTC Regulation 30.7. For purposes of applying the rating, concentration and other requirements of Regulation 1.25, DCIO indicated that TLGP securities should be treated as corporate notes or bonds (and not as U.S. government securities), but that, for purposes of applying the FCM net capital "haircuts" pursuant to CFTC Regulation 1.17, TLGP securities would be subject to the haircuts specified in Securities and Exchange Commission Rule 15c3-1(c)(2)(vi)(A) for securities guaranteed by the United States or a federal agency.

The DCIO Interpretation is available here.

DCIO Proposes New Annual Questionnaire for Regulation 30.10 Relief Recipients

The Commodity Futures Trading Commission's Division of Clearing and Intermediary Oversight (DCIO) has proposed a new annual questionnaire to be completed by recipients of relief pursuant to CFTC Regulation 30.10. Regulation 30.10 relief permits persons located and operating outside of the United States that are subject to a comparable regulatory framework to solicit and accept orders directly from U.S. customers without being required to register as futures commission merchants with the CFTC. The proposed questionnaire is intended to obtain information regarding potentially material changes that could impact the basis for the original grant of relief, including changes in control of the recipient of such relief, changes in the legal or regulatory framework in the country where the recipient is located and any arbitration and/or disciplinary proceedings arising from the recipient's transactions with U.S. customers.

The comment period for the DCIO proposal closes on April 5.

The DCIO proposal is available here.

BANKING

FinCEN Releases SAR Activity Review

On January 22, the Financial Crimes Enforcement Network (FinCEN), a department of the U.S. Treasury, issued its 13th edition of *The SAR Activity Review – By the Numbers*. SARs are suspicious activity reports that must be filed by numerous entities in the financial sectors, including insured depository institutions.

For insured depository institutions, this report is a compilation of statistical data gathered from SARs filed between April 1, 1996, and June 30, 2009. For other institutions, such as casinos and money services businesses, this report compiles relevant statistical data from the date of initial required reporting until June 30, 2009.

Interestingly, the report notes the following: (1) in the first six months of 2009, the total volume of SARs increased 9% compared to the same six-month period in 2008; (2) non depository institution SARs comprised 43% of all SARs filed, a number that is unchanged from the same six-month period in 2008; and (3) SARs related to mortgage fraud continue to rise.

For more information and the full text of the report, click here.

STRUCTURED FINANCE AND SECURITIZATION

Bankruptcy Court Rules That "Flip Clauses" Violate Bankruptcy Code

On January 25, Judge Peck of the U.S. Bankruptcy Court for the Southern District of New York entered a declaratory judgment in favor of Lehman Brothers Special Financing Inc. (LBSF) in a case examining a collateralized debt obligation (CDO) transaction and concerning the effect of event of default provisions on the payment priorities of LBSF as swap counterparty under certain swap agreements and the holders of certain credit-linked synthetic portfolio notes. The payment waterfalls (Priority Provisions) of most CDO transactions give priority to swap counterparties over noteholders. In many cases, the priority is "flipped" and noteholders then receive priority when there is a swap counterparty default. Judge Peck's recent decision may preclude enforcement of such "flip" priorities in the bankruptcy of the swap counterparty.

The bankruptcy court held that (1) the "flip clauses" in the Priority Provisions at issue in the LBSF case, which sought to modify LBSF's payment priority following its insolvency, constitute unenforceable "ipso facto" clauses that violate sections of the Bankruptcy Code, and (2) any action to enforce such provisions would violate the automatic stay under the Bankruptcy Code. (*Lehman Brothers Special Financing, Inc. v. BNY Corporate Trustee Services, Ltd.*, Case No. 08-13555, Adv. No. 09-01242 (January 25, 2010))

Trustees of similar transactions may have difficulty navigating the legal landscape with respect to flip clauses as Judge Peck's ruling directly contradicts a ruling handed down by UK courts in July 2009.

EXECUTIVE COMPENSATION AND ERISA

Federal Agencies Release Guidance for Implementation of Mental Health Parity and Addiction Equity Act

On January 29, the Internal Revenue Service, the Employee Benefits Security Administration and the Centers for Medicare & Medicaid Services together released interim final regulations and proposed regulations under the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008.

The Act, which became law on October 3, 2008, applies to insured health plans and group health plans sponsored by businesses with 50 or more employees that offer mental health and/or substance use disorder benefits. The Act requires covered plans to handle mental health and/or substance use disorder benefits in the same way that they handle medical and surgical benefits with respect to costs and access to care. The interim final regulations list six classifications of benefits that are subject to the parity and equity requirements, including: (1) inpatient, in-network; (2) inpatient, out-of-network; (3) outpatient, in-network; (4) outpatient, out-of-network; (5) emergency care; and (6) prescription drugs.

The interim final regulations provide that medical and surgical care and mental health and substance use disorder care must be treated equally for purposes of out-of-pocket costs, benefit limits and practices such as prior authorization and utilization review. For example, an insurance policy or a group health plan may not impose separate deductibles for medical/surgical services and mental health care, and it may not apply one out-of-pocket maximum to medical/surgical services and a different out-of-pocket maximum to mental health care. Any such deductible or maximum must encompass both types of care.

Under the regulations, new disclosure rules require covered group health plans to (1) make available to interested parties the criteria for medically necessary determinations for mental health or substance abuse disorder benefits and (2) provide, upon request, the reasons for any benefit denials.

The regulations apply for plan years beginning on or after July 1.

The text of the interim final regulations is available here.
The text of the proposed regulations is available here.

UK DEVELOPMENTS

SEC and FSA Announce Results of Strategic Dialogue Meeting

On February 1, the UK Financial Services Authority (FSA) and the Securities and Exchange Commission announced the results of a meeting held between Lord Turner and Hector Sants, Chairman and Chief Executive of the FSA, respectively, and Mary Schapiro, SEC Chairman.

The announcement disclosed that the UK and U.S. regulators discussed, among other matters: corporate governance and executive compensation; regulation of hedge funds and investment advisers and the protection of customer assets; disclosure regimes around client asset risks; market infrastructure, particularly relating to central counterparties for over-the-counter derivatives; market supervision; and cooperation on cross-border supervision.

The regulators agreed that enhanced supervisory cooperation was crucial to market integrity. In order to facilitate expanding cooperation in areas such as oversight of credit rating agencies, hedge fund advisors and the clearing of OTC derivatives, they agreed to undertake a review of the current 2006 Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Supervision of Financial Services Firms and Market Oversight.

According to FSA Chief Executive Hector Sants, “Global cooperation between regulators is central to tackling the reform agenda, and the relationship between the FSA and the SEC is key for international markets.” SEC Chairman Schapiro said, “This dialogue has proved its utility again in allowing the SEC and FSA to share expertise and experiences regarding the rapid changes occurring in our capital markets.”

Read more.

London Hedge Fund Manager Banned for Mismarking

On February 3, the UK Financial Services Authority (FSA) announced that it had banned Simon Treacher, a London-based hedge fund manager and fined him £140,000 (approximately $218,000) for deceiving investors by mismarking funds he managed and misleading the FSA during its investigation.

Simon Treacher was an FSA approved person employed by BlueBay Asset Management plc as a senior fund manager in Blue Bay’s emerging markets team. For a period of several months in 2008, he physically cut out and pasted different figures on to hard copies of documents used in the valuation process of assets of the funds he managed. Mr. Treacher then provided misleading information about his conduct to the FSA during its investigation.

The fraudulent alterations led to an apparent increase of approximately $27 million in the value of the funds in question. This resulted in investors being financially disadvantaged by approximately $650,000. The FSA stated that BlueBay had fully compensated the investors and that it made no criticism of BlueBay in connection with this investigation.

Mr. Treacher agreed to settle at an early stage of the FSA’s investigation, thereby qualifying for a 30% reduction in the fine which would otherwise have been £200,000 (approximately $312,000).

Read more.

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