

Corporate and Financial Weekly Digest



February 9, 2007

Broker Dealer

Proposed Rule Changes Submitted to Permit Quotes in Pennies

The NYSE Arca, Inc. (NYSE Arca), the International Securities Exchange, LLC (ISE), the Chicago Board Options Exchange, Incorporated (CBOE), the Philadelphia Stock Exchange, Inc. (PHLX), the American Stock Exchange LLC (AMEX) and the Boston Stock Exchange, Inc. (BOX, and, collectively, the Exchanges) have all submitted to the Securities and Exchange Commission proposed rule changes to amend the Exchanges' respective rules to permit certain option classes to be quoted in pennies on a pilot basis (the Penny Pilot Program) and to adopt related quote mitigation strategies. The SEC issued orders granting approval for the proposed rule changes to create the Penny Pilot Program, which commenced on January 26.

Currently, all of the Exchanges quote options in nickel and dime increments. The minimum price variation for quotations in options series that are quoted at less than \$3 per contract is \$0.05 and the minimum price variation for quotations in options series that are quoted at \$3 per contract or greater is \$0.10. Under the Penny Pilot Program, market participants would be able to begin quoting in penny increments in the following series of option classes:

- Ishares Russell 2000 (IWM);
- NASDAQ-100 Index Tracking Stock (QQQQ);
- SemiConductor Holders Trust (SMH);
- General Electric Company (GE);
- Advanced Micro Devices, Inc. (AMD);
- Microsoft Corporation (MSFT);
- Intel Corporation (INTC);
- Caterpillar, Inc. (CAT);
- Whole Foods Market, Inc. (WFMI);
- Texas Instruments, Inc. (TXN);
- Flextronics International Ltd. (FLEX);
- Sun Microsystems, Inc. (SUNW); and

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- Agilent Technologies, Inc. (A).

Each of the Exchanges has committed to deliver a report to the SEC during the fourth month of the Penny Pilot Program providing data from the first three months of trading. The report would analyze the impact of penny pricing on market quality and options system capacity.

Additionally, each of the Exchanges has implemented, or intends to implement, its own quote mitigation strategy. As a result of the approval of, and to be consistent with, the Penny Pilot Program and implementation of the quote mitigation strategies, some of the Exchanges have proposed amendments to certain other rules of such Exchange.

<http://www.sec.gov/rules/sro/nysearca/2007/34-55156.pdf>

<http://www.sec.gov/rules/sro/ise/2007/34-55161.pdf>

<http://www.sec.gov/rules/sro/cboe/2007/34-55154.pdf>

<http://www.sec.gov/rules/sro/phlx/2007/34-55153.pdf>

<http://www.sec.gov/rules/sro/amex/2007/34-55162.pdf>

<http://www.sec.gov/rules/sro/bse/2007/34-55155.pdf>

Changes Proposed to Frequency of Short Interest Reporting

The National Association of Securities Dealers, Inc. (NASD), the New York Stock Exchange LLC (NYSE) and the American Stock Exchange LLC (AMEX) filed with the Securities and Exchange Commission proposed rule changes to increase the frequency of the short interest reporting requirements from monthly to twice per month.

NASD Rule 3360 requires members to report short positions as of the close of the settlement date designated by the NASD and that the data be received by the NASD no later than the second business day following such date. The NASD makes the aggregate short interest data publicly available. The effective date of the proposed rule change will be six months following the SEC's approval of the proposed rule change.

NYSE Rule 421 requires the member organizations to submit to the NYSE reports with respect to short positions in securities, covering such time period as may be designated by the NYSE. The NYSE makes the total short interest in each individual stock and warrant traded on the NYSE publicly available. The effective date of the proposed rule change will be six months following the SEC's approval of the proposed rule change.

AMEX currently requires members to maintain a record of total short positions in all customer and proprietary firm accounts in equity securities and to regularly report such information in the manner authorized by AMEX Rule 30 and described in the AMEX Minor Rule Violation Fine Systems (AMEX Rule 590, Par 3), AMEX Information Circulars and an Intermarket Surveillance Group Regulatory Memorandum. The proposed amendment would incorporate the short interest reporting requirements into new AMEX Rule 30A. AMEX makes the total short interest in each equity and equity-type security traded on AMEX publicly available. The effective date of the proposed

rule change will be six months following the SEC's approval of the proposed rule change.

NASD, NYSE and AMEX believe that increasing the frequency of short interest reporting will provide additional and more timely information to public investors and other interested parties related to short selling.

<http://sec.gov/rules/sro/nasd/2007/34-55170.pdf>

ISE Identification of Firms Entering Directed Orders

The International Securities Exchange, LLC (ISE) filed with the Securities and Exchange Commission a proposed rule change which would extend the pilot period for the system change that identifies to a Directed Market Maker (DMM) the identity of the firm entering a "directed order."

On January 5, 2006, the ISE initiated a system change to identify to a DMM the identity of the firm entering a directed order. The pilot expired on January 31, 2007. The ISE filed a separate system change on a pilot basis so that it is effective while the SEC is considering a separate proposed rule change to reflect the system change on a permanent basis (the Permanent Rule Change). The SEC has not taken any action with respect to the Permanent Rule Change. While the SEC continues to evaluate the Permanent Rule Change, the ISE proposes to extend the pilot until July 31, 2007.

<http://sec.gov/rules/sro/ise/2007/34-55144.pdf>

Banking

Banking Agencies Update Management Interlocks Act

As part of the Financial Services Regulatory Relief Act of 2006, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the Banking Agencies) have amended the small depository institution exemption in the Depository Institutions Management Interlocks Act (the DIMIA).

Previously, under the DIMIA, a management official of one depository institution could not serve as a management official of another non-affiliated depository institution or depository institution holding company if the institutions or an affiliate of such institutions had offices in the same metropolitan statistical area unless both institutions had less than \$20 million in assets. Under the Banking Agencies' amendment, this asset limitation has been increased to \$50 million.

The new rule became effective on January 11.

<http://www.federalreserve.gov/boarddocs/press/bcreg/2006/200612062/default.htm>

United Kingdom Developments

FSA Publishes 2007-2008 Business Plan

The UK Financial Services Authority (FSA) published its 2007-2008 Business Plan on February 6. The plan sets out FSA's priorities for the coming year and emphasizes that FSA's main strategic priority will be

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its “drive towards more principles-based regulation.” Achieving this objective will require significant changes to the FSA’s rules and the way it explains its regulatory requirements, as well as to its staff’s skills and FSA’s information systems.

The Business Plan includes FSA’s full program of work and how it will be funded, including substantial additional spending on IT infrastructure. FSA’s budget will rise by 10.1% (£27.6 million) from 2006-2007. This will be funded by increased fees for FSA regulated firms.

FSA’s three strategic aims continue to be: (i) promoting efficient, orderly and fair markets; (ii) helping retail consumers achieve a fair deal; and (iii) improving business capability and effectiveness. The majority of FSA’s work in the coming year will be dealing with the implementation of the EU Markets in Financial Instruments Directive and the EU Capital Requirements Directive. FSA will also continue to focus on themes such as Treating Customers Fairly, retail distribution, payment protection insurance and commission transparency in the insurance sector.

FSA remains committed to increasing efforts to prevent, detect and prosecute market abuse and other forms of financial crime. Enforcement action will continue to be an important strategic tool in supporting FSA’s supervisory, thematic and market-monitoring activities. Internationally, FSA is planning to develop its relationship further with US regulatory authorities, including tests on handling financial crises which might affect both UK and US financial institutions and markets.

<http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/019.shtml>

Litigation

Securities Claims Dismissed for Failure to Satisfactorily Plead Scienter

Plaintiffs’ federal securities law class action complaint alleged that defendant, a mining company, made false and misleading statements in press releases and quarterly statements concerning the viability of the restructuring of its North West Operations (NWO) in South Africa, which accounted for a significant part of its business. In granting defendants’ motion to dismiss the Consolidated Amended Complaint, with leave to replead, the District Court held that defendants’ optimistic statements were statements of “opinion and puffery” and therefore not actionable unless plaintiffs could prove knowledge of falsity when made.

Further, the Court rejected plaintiffs’ arguments that defendants knew, or should have known, that the restructuring could not possibly succeed based on “specific metrics and formulas” that they used to analyze the profitability of its mines because plaintiffs failed to establish in its pleading that defendants had any “actual reports” or “actual data” that indicated that the efforts to restructure the NWO could not succeed. Finally, the Court held that accounting errors which led to defendants’ restatement of the first three quarters of 2004 appeared to be a result of the negligence of inexperienced accounting personnel and did not rise to a level of recklessness that would create a strong inference of scienter. (*In re DRDGOLD Ltd. Securities Litigation*, 2007 WL 313306

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(S.D.N.Y. Jan. 31, 2007))

Class Action Securities Claims Not Removable to Federal Court

The District Court granted plaintiffs' motion to remand two class actions which were removed to federal court by defendants, two mutual funds and their manager, pursuant to the Securities Litigation Uniform Standards Act of 1998 (SLUSA). Plaintiffs, long-term mutual fund investors, alleged that the value of their shares in defendants' funds were diluted as a result of certain objectionable practices in which defendants allegedly engaged. The Court noted that SLUSA was passed by Congress in order to prevent plaintiffs from evading the protections that federal law provides against abusive litigation by filing suit in State courts. While finding that, under SLUSA, federal courts are the "exclusive fora for most class actions involving the purchase and sale of securities," the Court ruled that plaintiffs' claims did not fall within SLUSA's preemptive scope.

The plaintiffs' claims were not brought "in connection with the purchase or sale of a covered security," but rather were brought on behalf of "holders of fund shares" (emphasis in original) whose interests were allegedly wrongfully diluted by defendants' conduct. Accordingly, the claims were not actionable under 10(b)(5) of the 1934 Securities and Exchange Act and, thus, were not removable. (*Dudley v. Putnam International Equity Fund*, 2007 WL 203988 (S.D. Ill. Jan. 27, 2007))

CFTC

Guidance for Preparing CPO Annual Financial Reports Published

The Commodity Futures Trading Commission's Division of Clearing and Intermediary Oversight has published its annual guidance letter to assist registered commodity pool operators (CPOs) and their accountants in preparing and filing required CPO annual financial reports. The letter is available on the CFTC's website or copies may be obtained by contacting the CFTC's Office of the Secretariat.

<http://www.cftc.gov/files/tm/tmcpoannualguidanceletter2006.pdf>

Study of Energy Futures Traders and Price Discovery Released

The Commodity Futures Trading Commission's Office of the Chief Economist has released a study analyzing the composition of traders across different energy futures contract maturities and their effect on price discovery in those markets. The study, "Market Growth, Trader Participation and Pricing In Energy Futures Markets," analyzes major changes in the size and term structure of the U.S. crude oil (WTI) futures market, finding substantial growth in and diversity of objectives among trader activity at the back end of the term structure since 2000. The CFTC staff found that the increase in market activity—and particularly the increased participation of non-traditional commercial traders and speculators—has contributed significantly to price discovery in WTI futures.

<http://www.cftc.gov/opa/press07/opa5287-07.htm>

CFTC

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