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# Corporate and Financial Weekly Digest

**January 25, 2008**

## SEC/Corporate

### SEC Releases Final Rules Facilitating Electronic Shareholder Forums

On January 18, the Securities and Exchange Commission released amendments to the proxy rules under the Securities Exchange Act of 1934 intended to facilitate greater online interaction among shareholders in shareholder forums. The amendments clarify that participation in electronic shareholder forums that could constitute a solicitation under the proxy rules is exempt from most of the proxy rules if certain conditions are met.

The conditions for exemption (contained in amendments to Rule 14a-2) require solicitations via an electronic shareholder forum to occur either (i) 60 or more days prior to the date announced by the company for its annual or special meeting of shareholders or (ii) if the company announces the date for either an annual or special meeting less than 60 days prior to such meeting, no more than 2 days after company's announcement of the meeting's date. A person who makes a solicitation outside of this window or is directly or indirectly seeking the power to act as a proxy for another security holder would be required to comply with Regulation 14A.

In addition, new Rule 14a-17 clarifies that a shareholder or company (or third party acting on their behalf) who establishes, maintains or operates an electronic shareholder forum will not be liable for statements made by another person participating in such forum. A person making statements on such a forum will, however, remain liable for the content of their statements under traditional liability theories under federal securities laws, including liability for participation in fraud, deception or manipulation.

http://www.sec.gov/rules/final/2008/34-57172.pdf

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## Broker Dealer

### Proposed Rule Amendments to Establish a Delta Hedge Exemption

The Philadelphia Stock Exchange, Inc. (Phlx) has filed with the Securities and Exchange Commission a proposed rule change to Phlx Rules 1000 and 1001 that will establish a delta hedge exemption from equity options position limits. The proposed rule change will provide the delta hedge exemption (the Exemption) to OTC Derivative Dealers, broker-dealers and certain other financial institutions. The proposed rule change will permit any member or non-member affiliate to apply the delta model developed by the Office of the Comptroller of the Currency. Moreover, certain other broker-dealers and affiliated entities will be permitted to use proprietary models to calculate options position net deltas, provided that the use of such models is in accordance with the entity's internal risk management control systems.

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Members and non-member affiliates who wish to utilize the Exemption will have the responsibility of informing Phlx through a written certification that the member and/or its affiliate will utilize an acceptable pricing model. Affiliates that cease to hedge stock options positions in accordance with such pricing models will need to immediately so inform the member. Options positions of a non-member are required to be carried by an affiliated member.

The proposal is aimed at permitting expanded hedge positions under the delta hedge exemption from equity options position limits in Phlx Rule 1001. The Chicago Board Options Exchange and the Financial Industry Regulatory Authority have each filed similar proposals, both of which have been approved by the SEC.

http://www.phlx.com/exchange/rulefilings/2008/SR-2008-05.pdf

**Allocation of Regulatory Responsibilities Among Exchanges**

The Securities and Exchange Commission issued an order approving and declaring effective a proposed plan (Plan) which was published for comment on November 9, 2007 by the American Stock Exchange LLC, the Boston Stock Exchange, Inc., CBOE, the International Securities Exchange, LLC, Financial Industry Regulatory Authority, Inc., NYSE Arca, Inc. and the Philadelphia Stock Exchange, Inc. (Exchanges). The Plan was intended to reduce regulatory duplication for broker-dealers that maintain memberships in more than one self-regulatory organization (each, a common member) by allocating regulatory responsibility for certain options-related market surveillance matters among the Exchanges.

Under the Plan, an Exchange will serve as the Designated Options Surveillance Regulator (DOSR) for each common member assigned to it and will assume regulatory responsibility with respect to that common member's compliance with applicable common rules for certain accounts. When an Exchange has been named as a common member's DOSR, all other self-regulatory organizations to which the common member belongs will be relieved of regulatory responsibility for that common member. The Plan will be administered by a committee known as the Options Surveillance Group.

http://www.sec.gov/rules/other/2007/34-56941.pdf

**SEC Approves CBOE Interpretation Terminating CBOT Members' Exercise Rights**

The Securities and Exchange Commission unanimously approved an interpretation of the Certificate of Incorporation of the Chicago Board Options Exchange, which terminates Chicago Board of Trade (CBOT) members' exercise rights on the CBOE. The CBOE had awarded every full member of the CBOT the opportunity to trade as a full CBOE member, known as an exercise right, in exchange for the CBOT's assistance when the CBOE's was formed. The CBOE determined, however, that the CBOT members' exercise rights were terminated when the CBOT was purchased by the Chicago Mercantile Exchange (CME) and ceased to exist as an independent entity.

The SEC decision does not affect the lawsuit previously filed by the CME against the CBOE in Delaware, asserting that CBOT members are entitled to equity in CBOE. Therefore, this issue will not be resolved until the Delaware courts rule.

http://www.sec.gov/rules/sro/cboe/2008/34-57159.pdf

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## Banking

### Banking Agencies Announce New Personnel Appointments

On January 24, the Office of Thrift Supervision (OTS) announced that it has appointed Frederick R. Casteel as OTS Ombudsman. Mr. Casteel has been with the OTS since 1989 and has served as Regional Director of the OTS Midwest Region for the past 15 years.

According to the press release announcing this appointment, Mr. Casteel will "act as a liaison to the OTS-regulated thrift industry, address thrift institutions' concerns about OTS regulatory actions and coordinate the resolution of thrift institutions' appeals of supervisory determinations." In addition to these duties, Mr. Casteel will be involved in "industry outreach, communication and education, and will make recommendations for improving OTS supervisory policies and procedures."

In addition, on January 24, the Financial Crimes Enforcement Network (FinCEN) announced the appointment of Peter Goodyear as Associate Director for Analysis and Liaison. Mr. Goodyear most recently served as a senior vice president of Citigroup. In his new position with FinCEN, he will oversee the agency's analysis of Bank Secrecy Act data in support of its law enforcement, regulatory and financial intelligence unit customers.

http://www.ots.treas.gov/docs/7/778001.html

http://www.fincen.gov/20080124.html


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## United Kingdom Developments

### UK Hedge Fund Working Group Publishes Best Practice Standards

On January 22, the Hedge Fund Working Group (HFWG) published its final report containing best practice standards for hedge fund managers following consultation with the hedge fund industry and interested parties. The HFWG published its initial consultation paper in October 2007 and received more than 75 written responses, as described in the October 12, 2007 edition of *Corporate and Financial Weekly Digest*.

The final report included voluntary standards that seek to address five key areas: disclosure, valuation, risk, the governance of funds, and hedge funds' conduct as shareholders.

The report also included recommendations for hedge fund managers to adopt in order to manage potential and actual conflicts of interest with the interests of investors which include adopting an independent process for valuing portfolios and implementing robust governance of funds. The report recommended enhanced disclosure for investors and the implementation of comprehensive risk management procedures. A proposed standard relating to the disclosure of positions held via contracts for differences (CFDs) is awaiting the outcome of a consultation by the UK Financial Services Authority into CFDs.

Compliance with the voluntary hedge fund standards will be on a "comply or explain" basis.

A new Hedge Fund Standards Board (HFSB) will be set up to oversee the new standards. Existing members of the HFWG will initially act as interim trustees of the HFSB and Sir Andrew Large will act as HFSB's interim chairman until permanent trustees are appointed.

Hedge fund managers are now being invited to become signatories to the new standards. Further details are provided on HSFB's website, www.hfsb.org.


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The HFWG, comprising 14 leading hedge fund managers based mainly in London, was set up in July 2007 in response to concerns both about the growing impact of hedge funds and financial stability. The standards aim to address these and other issues through increased disclosure to investors and other counterparties.

www.pellin.co.uk/HFWG/HFWG-FINAL-REPORT.pdf

**FSA Commences Criminal Prosecution for Insider Dealing**

On January 22, the Financial Services Authority (FSA) announced that former general counsel of TTP Communications PLC (TTP) Christopher McQuoid and McQuoid's father-in-law James Melbourne had appeared before the City of London Magistrates Court charged with insider dealing under section 52 of the UK's Criminal Justice Act 1993.

McQuoid was formerly the head of legal at Thomas Cook and he was general counsel at TTP between 2000 and 2007.

The FSA have alleged that the two men were in possession of inside information about a proposed cash offer from Motorola Incorporated for the entire issued share capital of TTP when they acquired 153,824 shares in TTP on May 30, 2006.

The FSA has previously communicated its intention to take a harder line on insider trading and this is the first time it has brought a criminal case for insider trading. Previous cases had been brought under the FSA's civil enforcement powers.

The defendants have indicated a plea of not guilty. The Magistrates Court, as is usual with serious charges, committed the defendants for trial in the Crown Court. The proceedings were adjourned until February 19 and the defendants were granted bail.

www.fsa.gov.uk/pages/Library/Communication/PR/2008/006.shtml

## Litigation

**Seventh Circuit Finds "Strong Inference" of Scienter After *Tellabs* Remand**

The United States Supreme Court remanded plaintiffs' securities fraud action to the Seventh Circuit following the issuance of its landmark ruling in *Tellabs* regarding the allegations needed to satisfy the "strong inference" of scienter requirement of the Private Securities Litigation Reform Act in order to withstand a motion to dismiss claims under Securities Exchange Act Section 10(b) and Rule 10b-5.

In the Seventh Circuit's first opinion in *Tellabs* – prior to the remand – the Seventh Circuit ruled that plaintiffs (i) had adequately pleaded that defendants had made materially false statements, and (ii) had acted with the required scienter. The Supreme Court did not disturb the first ruling, but it disagreed with the Seventh Circuit's interpretation of "strong inference," ruling that the complaint must be dismissed unless "a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."

On remand, the Seventh Circuit identified the critical question as: How likely is it that the allegedly false statements "were the result of merely careless mistakes at the management level based on false information fed it from below, rather than of an intent to deceive or a reckless indifference to whether

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the statements were misleading?" In blunt language, the Court determined that it was "exceedingly unlikely" that the misstatements were the product of merely "careless" mistakes inasmuch as they all concerned Tellabs' flagship product and its heralded successor. The Court found it "very hard to credit" the notion that no senior member of management involved in making or authorizing the statements of inflated demand for these products knew of their falsity. After concluding that the alternative to "scienter at the corporate level" – i.e., a cascade of innocent mistakes or acts of subordinate employees was a far less likely explanation for the false statements, the Seventh Circuit held that plaintiffs had satisfied their burden of pleading scienter under the PSLRA. (*Makor Issues & Rights, Ltd. v. Tellabs Inc.*, No. 04-1687, 2008 WL 151180 (7th Cir. Jan. 17, 2008))

**"Tipped" Financial Information From Earnings Reports Deemed Material**

The United States District Court for the Southern District of New York refused to dismiss an insider trading action that the Securities and Exchange Commission filed against a member of the Board of Directors of a publicly traded company who allegedly disclosed material non-public information to his co-defendant friend. The defendant board member, who received the company's quarterly financial results showing a 12 percent decline in net income two days prior to their release, allegedly conveyed this non-public information to his friend who then sold his entire position, short-sold an additional 40,000 shares, and engaged in other transactions in the company's securities prior to the public earnings announcement. When the company disclosed its financial results, its share price dropped 20 percent.

The defendant board member moved to dismiss the complaint on the grounds that (i) it failed to allege with particularity the material information allegedly disclosed and, (ii) in any event, any information that may have been disclosed was immaterial as a matter of law. The Court denied the motion. First, the Court ruled that the complaint was "crystal clear" as to the information conveyed and that such information was not known to the public. The Court then rejected the defendant's materiality argument, stating that not only is materiality ordinarily a question of fact that is not susceptible to resolution on the pleadings, but also the Second Circuit has repeatedly found earnings reports to be material. The Court further determined that it was at least plausible that a factfinder would infer that the actual reported numbers were material in light of the 20% decline in the stock price following their disclosure. (*Securities and Exchange Commission v. Gad*, No. 07 Civ. 8385 (GEL), 2007 WL 4437230 (S.D.N.Y. Dec. 17, 2007))

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