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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Amends Executive and Director Compensation Disclosure Rules

On December 22, the Securities and Exchange Commission announced that it had adopted amendments to its executive and director compensation disclosure rules to conform the reporting of stock and option awards to Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (FAS 123R). FAS 123R requires recognition of the costs of equity awards over the period in which an employee is required to provide service in exchange for the award, usually the vesting period. The amendments are intended to align the reporting of equity awards in the Summary Compensation Table and the Director Compensation Table to the amounts disclosed in the financial statements under FAS 123R .

Under the amendments:

- The dollar values to be reported in the Stock Awards and Option Awards columns of the Summary Compensation Table and the Director Compensation Table are revised to disclose the compensation cost of those awards, before reflecting forfeitures, over the requisite service period (forfeitures are to be described in accompanying footnotes).
- The Grants of Plan-Based Awards Table is revised to require, in a new column, disclosure of the full grant date fair value of each individual equity award and the Director Compensation Table is revised to require footnote disclosure of the same information.
- The Grants of Plan-Based Awards Table is revised to require disclosure of any option or stock appreciation right that was repriced or otherwise materially modified during the last completed fiscal year, including the incremental fair value, computed as of the repricing or modification date, and the Director Compensation Table is revised to require footnote disclosure of the same incremental fair value information.

The amendments were effective immediately upon publication in the Federal Register. Compliance with the Item 402 amendments is required for proxy statements, information statements and registration statements filed on or after December 15, 2006 that are required to include Item 402 disclosure for fiscal years ending on or after December 15, 2006, and for Forms 10-K and 10-KSB for fiscal years ending on or after December 15, 2006. The SEC is soliciting comment on the amendments for a period of 30 days, and will consider those comments and make changes to the amendments if necessary.

The revised rules should reduce reporting anomalies arising from large one-time grants, particularly with respect to which executive officers are named in the compensation tables, and are more consistent with the other parts of the executive compensation disclosure rules.

The SEC's announcement is available at

http://www.sec.gov/news/digest/2006/dig122606.txt

SEC/CORPORATE

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Broker Dealer

Proposed Rule Change Regarding Proposed Combination Between NYSE Group, Inc. and Euronext N.V.

The New York Stock Exchange LLC submitted a rule filing to the Securities and Exchange Commission in connection with the proposed business combination of NYSE Group, Inc. (NYSE Group) with Euronext N.V. (Euronext). As a result of the combination, the businesses of NYSE Group and Euronext will be held under a single, publicly traded company NYSE Euronext (NYSE Euronext). The Euronext shareholders and the NYSE Group stockholders have approved the combination.

With the exception of certain modifications described in the rule filing, NYSE Group's current corporate structure and governance and NYSE's current corporate structure, governance and self-regulatory independence and separation will remain intact. Euronext and its subsidiaries will continue to operate their business and operations in substantially the same manner as they are currently conducted. Following the combination, NYSE Euronext will be a for-profit, publicly traded stock corporation and will act as a holding company for the businesses of the NYSE Group and Euronext.

The rule filing addresses the following corporate governance policies of NYSE Euronext: (i) the voting and ownership limitations of NYSE Euronext stock, namely various restrictions placed on the ability to vote and own shares of common stock of NYSE Euronext; (ii) provisions of the NYSE Euronext Bylaws designed to protect the independence of the self-regulatory function of the U.S.-regulated subsidiaries and European market subsidiaries of NYSE and Euronext, respectively; (iii) implementation of special arrangements consisting of two standby structures (involving a Dutch foundation and a Delaware trust) designed to take actions to mitigate the effects of any material adverse change in U.S. or European law, as the case may be; (iv) the NYSE Group ownership limitation; (v) the NYSE Group voting limitation; and (vi) other technical amendments to certain NYSE rules to reflect the combination.

http://www.sec.gov/rules/sro/nyse/2006/34-55026.pdf

Application of Trading Activity Fee to Certain NASD Members

The NASD issued Notice to Members 06-71 to supplement guidance provided in a previously-issued Notice to Members relating to the application of the Trading Activity Fee (TAF) to members acting in the capacity of an exchange specialist or market maker. The TAF is imposed by the NASD to fund the NASD's obligations to pay fees to the Securities and Exchange Commission under securities Exchange Act Section 31 based upon sales of over-the-counter securities. In such previously-issued Notice to Members, NASD maintained that the exemption for proprietary transactions effected on the NASDAQ Exchange in the capacity of a market maker was limited to the transactions effected through a registered market maker's attributable quote.

NASD is now expanding the exemption for such transactions to include any transactions effected through both attributable and unattributable orders and quotes. The expansion of this exemption is retroactively effective to August 1, 2006. In this Notice to Members, NASD has also provided additional guidance regarding the application of the TAF with respect to riskless principal transactions.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_018118.pdf

Change Relating to the Time a Marketable Order is Exposed on the Box Book

The Securities and Exchange Commission approved on an accelerated basis a proposed rule change amending Section 16 (Execution and Price/Time Priority) of Chapter V of the Rules of the Boston Options Exchange (BOX), which provides for the filtering of BOX in-bound order to prevent trade-

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throughs. Under the previous rule, when the BOX market is not at the national best bid or offer (NBBO), an order would sit on the BOX Book for three seconds before being routed to an exchange displaying the NBBO or returned to the market participant. This rule change reduces the time period to one second.

The SEC noted that the proposed rule change does not alter the order handling and routing procedures of the Filter in any other way than to reduce the exposure time for a marketable order on the BOX Book.

http://sec.gov/rules/sro/bse/2006/34-54884.pdf

http://www.bostonstock.com/legal/filings/BOX_RULES_12_27_06.pdf

Banking

FDIC Releases Guidance Related to Bank Security Breaches

In its Winter 2006 edition of *Supervisory Insights* released on January 3, 2007, the Federal Deposit Insurance Corporation has set forth information related to incident response programs to be utilized when a security breach or data compromise occurs.

As stated in the materials, "banks are increasingly becoming prime targets for attack because they hold valuable data that, when compromised, may lead to identity theft and financial loss." Moreover, the guidance notes that, "despite the industry's efforts at identifying and correcting security vulnerabilities, every bank is susceptible to weaknesses such as improperly configured systems, software vulnerabilities, and zero-day exploits."

The guidance notes that the federal regulators addressed incident response programs in April 2005 with interpretive guidance. That guidance involved two areas: reaction and notification. As described by the regulators, the reaction procedures are those that are the "initial actions taken once a compromise has been identified." The notification procedures are those processes involved in "communicating the details or events of the incident to interested parties and may sometimes involve reporting requirements."

Aside from developing policies and procedures with respect to those requirements, this guidance suggests the following best practices: (i) preparation, which includes establishing an incident response team and defining what constitutes an "incident"; (ii) detection, which includes identifying indicators of unauthorized system access and involving legal counsel; (iii) containment, which involves establishing notification escalation procedures and organizing a public relations program; (iv) recovery, which includes determining whether configurations or processes should be changed and testing affected systems or procedures prior to implementation; and (v) follow-up, which includes conducting a "lessons learned" meeting at the conclusion of the incident.

http://www.fdic.gov/regulations/examinations/supervisory/insights/siwin06/article01_incident.html

BANKING

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United Kingdom Developments

UK Implementation of the Markets in Financial Instruments Directive (MiFID)

Statutory Instruments prepared by the UK's HM Treasury for MiFID implementation have recently been published by Office of Public Sector Information (OPSI) including:

- amendments to the UK Regulated Activities Order replacing the existing Investment Services Directive override, introducing a new regulated activity of operating a multilateral trading facility (MTF) and extending the scope of specified investments to include new financial instruments

UK DEVELOPMENTS

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(including options and futures on all commodities and various other non-financial products and contracts for differences based on credit derivatives,

http://www.opsi.gov.uk/si/si2006/20063384.htm

- amendments to the UK Exemption Order referring to the activity of operating an MTF, exempting European Economic Area authorized operators of regulated markets or MTFs, and disapplying certain exemptions where the person who would benefit is an investment firm or credit institution carrying on an activity within the scope of MiFID;

http://www.opsi.gov.uk/si/si2006/draft/ukdsi_0110755537_en.pdf

- introduction of the MiFID passport and setting out prescribed information requirements, minimum conditions on firms and requirements firms must satisfy before any significant change to their operations;

http://www.opsi.gov.uk/si/si2006/20063385.htm

- recognition requirements for investment exchanges and clearing houses to partly implement MiFID provisions relating to the organization and operation of derivative and stock exchanges;

http://www.opsi.gov.uk/si/si2006/20063386.htm

- provisions for amending the UK appointed representatives regime to accommodate MiFID tied agents and to provide certain exemptions from the general prohibition in respect of the placing of financial instruments and advising in respect of such placings and requiring representatives to be entered on a register; and

http://www.opsi.gov.uk/si/si2006/uksi_20063414_en.pdf

- introduction of confidential information regulations that make minor changes to the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Order 2001.

http://www.opsi.gov.uk/si/si2006/uksi_20063413_en.pdf

Two further Instruments will follow and additional changes implementing MiFID will be included in the UK's Financial Services Authority rules.

Litigation

"Culpable Participation" Is Not Required to State "Controlling Person" Claim

Plaintiffs filed a class action lawsuit alleging that HydroFlo, a company that invests in a portfolio of private companies, and certain of its officers and directors, violated sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by issuing a series of press releases which inaccurately reported information concerning one of HydroFlo's largest portfolio companies.

Defendant Traveller, a Director of HydroFlo, moved to dismiss the section 20(a) claim asserted against him. Traveller argued that in addition to pleading (i) a predicate violation of Section 10(b), and (ii) that the defendant had control over the primary violator, plaintiffs were also required to allege facts demonstrating his "culpable participation" in the predicate act in order to state a claim for control person liability. Traveller further argued that the heightened pleading requirements under the PSLRA (including its state of mind pleading requirements) apply to section 20(a) claims.

While recognizing that a split of authority exists regarding whether the alleged control person's "culpable participation" must be pled and the applicable pleading burden, the court sided with the majority view, ruling (i) that the plain language of Section 20(a) assigns secondary liability upon a demonstration of a primary violation, without prescribing culpability as a *prima facie* element of

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the claim, and (ii) because Section 20(a) does not require that the control person act with scienter, the plaintiff need not comply with PSLRA's heightened pleading standards. The Court held that, under the applicable standards, the Plaintiffs had sufficiently pled their section 20(a) claim and, accordingly, denied defendant's motion to dismiss. (*Huttenstine et al. v. Mast et al.*, 2006 WL 3771096 (E.D.N.C. December 21, 2006))

Scienter Pleading Requirement Under PSLRA Satisfied As to Two Defendants

Plaintiff investors filed a class action lawsuit against company in which they invested and its senior corporate officers, alleging violations of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Plaintiffs alleged that defendants caused the company's stock price to be artificially inflated by, among other things, materially overstating income by failing to recognize known liabilities, concealing a decline in demand for its products, and deceiving investors about its excessive inventory and accounts receivable. Defendants moved to dismiss the Second Consolidated Amended Complaint solely on the basis that it did not allege sufficient facts that each defendant knew or recklessly disregarded that statements were false or misleading when made.

After noting PSLRA's requirement that both falsity and scienter be pled with particularity and that the facts alleged must give rise to a strong inference of scienter, the Court examined whether such allegations had been made against any of the individual defendants. The Court found the allegations lacking as to all but two, noting that many of the allegations were made against the defendants as a group and that such allegations were "too nebulous" to support the requisite strong inference of scienter against any particular defendant.

As to the two individual defendants that were not dismissed, the Court ruled that allegations that they deliberately decided not to report a substantial deferred compensation award payable to one of the two defendants in order to artificially and materially inflate the Company's income and stock price despite their knowledge at the time that the omission was false and misleading satisfied PSLRA's heightened pleading standard. (*Navarre Corporation Securities Litigation*, 2006 WL 3759750 (D.Minn. December 21, 2006))

CFTC

CFTC Lacks Jurisdiction to Review Firm's "Disciplined" Status

The Commodity Futures Trading Commission concluded on December 21 that it lacked jurisdiction to review a claim that the National Futures Association (NFA) improperly placed American Financial Trading Corp. (AFTC) on NFA's list of disciplined firms. AFTC sought review of the NFA's decision on the basis that it settled an NFA disciplinary action in 2002 on terms that precluded NFA from including it on the list. The Commission concluded that it did not have jurisdiction to review NFA's decision because NFA's act of listing AFTC as a disciplined firm was neither a disciplinary action nor other event that the Commission has jurisdiction to review.

CFTC

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