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CORPORATE & FINANCIAL
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SEC/CORPORATE

SEC to Consider Concept Release on Proxy Mechanics

The Securities and Exchange Commission has announced that it will hold an open meeting on July 14 to consider issuance of its long-anticipated concept release on proxy mechanics. The concept release is expected to cover a wide variety of topics relating to shareholder communication and proxy voting. The topics may include whether investors should continue to have the right to maintain the confidentiality of their investments (the "NOBO/OBO" mechanism), ways to increase retail shareholder voting (e.g., "client directed voting"), the structure of the overall system for distribution of proxy materials, including the fees paid by issuers, and whether the SEC should adopt additional regulations governing the activities of proxy advisors retained by institutional investors. We anticipate a 90-day comment period, and encourage all interested parties to weigh in on these important topics.

Read more.

BROKER DEALER

SEC Seeks Public Comment on Expansion of Stock-by-Stock Circuit Breaker Program

On June 30, the Securities and Exchange Commission announced that the exchanges and the Financial Industry Regulatory Authority filed proposed rules to expand the newly adopted stock-by-stock circuit breaker program. Trading in a security included in the program is paused for a five-minute period if the security experiences a 10% change in price over the preceding five minutes. Currently, only stocks in the S&P 500 Index are subject to stock-by-stock circuit breakers. Under the new proposal, all stocks in the Russell 1000 Index and certain exchange-traded funds would be added to the program.

The proposed rules, which are expected to be in effect on a pilot basis until December 10, will be published in the *Federal Register* for a 10-day public comment period.

To read the SEC's order implementing the stock-by-stock circuit breaker program, click here.

See also the June 11 edition of *Corporate and Financial Weekly Digest* discussing the SEC's approval of rules requiring the exchanges and FINRA to implement stock-by-stock circuit breakers.

SEC Reopens Comment Period on Elimination of Flash Order Exception for Listed Options

The Securities and Exchange Commission has reopened the period for public comment on its proposal to eliminate the flash order exception set out in Rule 602 of Regulation NMS, solely as it relates to listed options. Flash orders generally are orders that are exposed to market participants for a very brief period (typically less than a second) and are immediately executable at prices that "lock" the best displayed quote on the opposite side of the market (without such order being routed away to another market for execution). In September 2009, the SEC previously proposed to amend Rule 602 of Regulation NMS to eliminate the exception which allows exchanges to

permit the use of flash orders for trading both NMS stocks and listed options without including such orders in the exchange's consolidated quotation data.

In reopening the comment period on the proposed rule change with respect to listed options, the SEC has specifically requested comment on a number of issues, including the relationship between flash orders and access fees charged by options exchanges (including the advisability of a cap on such access fees), the relative quality of execution received by flash and non-flash orders in listed options, how brokers assess whether flashed orders receive "best execution" and whether the elimination of the flash order exception would lead to more aggressive quoting by options exchanges (and corresponding narrowing of "national best bid and offer" spreads for listed options).

The comment period closes on August 9.

A copy of the SEC release is available here.

SEC Approves FINRA Rule Change Implementing Certain Regulatory Protections in the OTC Equity Securities Market

On June 22, the Securities and Exchange Commission approved rule changes that the Financial Industry Regulatory Authority proposed in August 2009 that would extend certain of the rules that apply to National Market System securities to over-the-counter (OTC) equity securities. The new rules:

- prohibit FINRA members from displaying, ranking or accepting a bid or offer, order or indication of interest in an OTC equity security in an increment smaller than one cent where such bid or offer, order or indication of interest is one dollar or more per share;
- require that FINRA members implement policies and procedures to prevent displaying, locking or crossing quotations in an OTC equity security within the same inter-dealer quotation system;
- allow market-makers, alternative trading systems and electronic communications networks to charge undisplayed access fees and limit non-subscriber access and post-transaction fees in all OTC equity securities; and
- require a market-maker displaying price quotations in an inter-dealer quotation system to immediately display any customer limit order it receives that improves (1) the price of a bid or offer or (2) the size of its bid or offer by more than a de minimis amount, with certain exceptions.

The SEC Release No. 34-62359 is available here.

LITIGATION

Parent Corporate Defendants Exposed to Liability in ERISA Suit Under Veil-Piercing Theory

The U.S. District Court for the District of Delaware denied defendants' motion to dismiss an Employee Retirement Income Security Act (ERISA) complaint, ruling among other things that plaintiffs properly alleged facts to reach the corporate parent defendants on a theory of piercing the corporate veil.

Plaintiffs, former employees of two subsidiary companies named as defendants, brought a series of claims alleging that their former employer failed to make payments due under the company's group severance plan following a period of layoffs. In addition to the subsidiary defendants, plaintiffs also named two corporate parent entities. Plaintiffs made a variety of factual submissions supporting their veil-piercing argument including, for example, that the parent defendants retained a 77% shareholder interest on one of the subsidiaries, that substantial financing, over €500 million (approximately $635 million), was provided to the subsidiary defendants by one of the parent defendants, and that the parents reported the subsidiaries' earnings on a consolidated basis in some of their own financial statements. Relying on these and other facts provided by the plaintiffs, the court noted that the standard for piercing the corporate veil was reduced in ERISA cases and denied defendants' motion to dismiss. In so doing, the court found that plaintiffs successfully alleged that the corporate parent and subsidiary defendants were a "single entity" under the alter ego doctrine, and that if the parent defendants did, as alleged, misdirect funds, exercise crippling control and purposefully siphon profits from one subsidiary to prop up another, then plaintiffs successfully alleged a requisite fraud or injustice to pierce the corporate veil. (*Blair v. Infineon Tech. A.G.*, Civ. No. 09-295 (SLR), 2010 WL 2608959 (D.Del. June 29, 2010))

Ninth Circuit Affirms Dismissal of Securities Class Action on Materiality and Safe Harbor Grounds

The U.S. Court of Appeals for the Ninth Circuit upheld a district court's dismissal of a securities fraud class action suit, ruling that defendants' alleged incomplete disclosures were not material omissions and that the issuer's earnings projections fell within the statutory safe harbor under the Private Securities Litigation Reform Act (PSLRA). In the process, the court clarified case law within that circuit on the application of the PSLRA safe harbor provisions.

Cutera, Inc. is a retailer of lasers and other light-based aesthetic systems sold to medical professionals for use in cosmetic procedures. A purported class of shareholder plaintiffs sued based on alleged misrepresentations and omissions concerning an expansion of Cutera's sales force in 2005 and 2006 to include junior sales executives and a lower-priced laser. The program did not proceed as hoped and was ultimately abandoned. During the program's rollout, Cutera executives stated in a conference call in January of 2007 that they "wanted to have a more junior sales force focus on a certain segment of the market. We didn't get the productivity we were looking for with that." Despite this statement, Cutera projected a significant increase in revenue and its share price spiked. In later statements in April and May, Cutera downgraded its revenue projections, attributed in part to lower productivity levels from its recent sales expansion and "aberrantly high turnover." The May press release, in particular, noted "the unsuccessful implementation of our junior sales program, unusually high sales employee turnover, and disappointing results from... national accounts." Cutera's share price closed after the May release more than 18% off the previous day's price. The court ruled that despite the fluctuations in share price, there was no material difference between Cutera's statements in January and its later statements in April and May. Plaintiffs failed to show that a reasonable investor would have received a materially different impression of Cutera's state of affairs had the company used the April or May language in January.

The court also dismissed plaintiffs' claims to the extent they relied on misleading revenue projections, finding that Cutera's projections fell within the statutory safe harbor for forward-looking statements accompanied by meaningful cautionary disclosures. In so doing, the court clarified that under Ninth Circuit law, the various prongs or separate safe harbors set forth in the PSLRA are independent and should not be read in the conjunctive. The court's decision is consistent with other circuits in holding that allegations showing a strong inference of actual knowledge cannot overcome safe harbor protection for such forward-looking statements. The court expressly rejected a footnote from one of its prior cases, seized on by plaintiffs and certain trial courts, which suggested that an actual knowledge showing could in fact defeat safe harbor protection for forward-looking statements accompanied by meaningful cautionary disclosures. (*In re Cutera Sec. Litig.*, No. 08-17627, 2010 WL 2595281 (9th. Cir. June 30, 2010))

BANKING

Federal Housing Finance Agency Warns About PACE Loans; Warning Communicated by FDIC

The Federal Housing Finance Agency (FHFA), the agency that regulates Freddie Mac, Fannie Mae and the Federal Home Loan Banks, has determined that certain energy retrofit lending programs present significant safety and soundness concerns that must be addressed by its regulatees. Specifically, programs denominated as Property Assessed Clean Energy (PACE) seek to foster lending for retrofits of residential or commercial properties through a county or city's tax assessment regime. Under most of these programs, such loans acquire a priority lien over existing mortgages. The FHFA has taken the position that such loans "present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation."

FHFA has urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities. Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption.

The Federal Deposit Insurance Corporation considered the FHFA announcement sufficiently important to warn insured institutions (banks and savings associations) that "these programs could affect their residential mortgage lending activities and the ability to sell loans to Fannie Mae and Freddie Mac."

Click here to read the FHFA press release.
Click here to read the financial institution letter from the FDIC.

EXECUTIVE COMPENSATION AND ERISA

DOL Expands Employees Who May Qualify for FMLA Leave

The Family Medical Leave Act (FMLA) allows qualified employees to take up to 12 weeks of unpaid, job-protected leave in order, among other things, to care for a child postpartum, to bond with a child after adoption, or to care for a child with a serious illness. In a recent Administrator's Interpretation, the U.S. Department of Labor (DOL) expanded the category of people who may qualify for leave in this context.

The FMLA entitles an employee to leave in certain childcare situations where the employee is standing *in loco parentis*, or in the place of the parent. In such a case, a legal or biological relationship between the child and the caregiver is not required. A previously promulgated FMLA regulation defined being *in loco parentis* as both providing day-to-day care of the child and financially supporting the child.

However, the Interpretation requires only one or the other in order to qualify for leave under the FMLA. Converting what was formally a two-part test to a one-part test will lead to more people qualifying for leave in an *in loco parentis* backdrop.

Such an Interpretation by the DOL is not binding on courts, but it is entitled to deference. While it remains to be seen how the courts will deal with this Interpretation, which, on its face, seems inconsistent with the regulation, employers should be mindful of it for a few reasons.

For instance, an employer should consider more carefully whether an employee who requests leave, but who is not a part of a traditional parent-child circumstance, is entitled to the leave. Along these lines, the Interpretation permits an employer to "require the employee to provide reasonable documentation or statement of the family relationship." Note that only a "simple statement" is required and employers should be cautious not to be too rigorous in their requirements lest they find themselves accused of putting a chilling effect on requests for leave, or worse, harassment.

Employers should also be mindful that the recent Interpretation may lead to a considerable increase in requests for FMLA leave.

The full text of the Interpretation, which provides a few helpful examples, is available here.

UK DEVELOPMENTS

FSA Fines Former CEO for Market Abuse

On July 6, the UK Financial Services Authority (FSA) announced that it had fined Henry Cameron, CEO of Sibir, a former Alternative Investment Market (AIM)-quoted energy company, £350,000 (approximately $530,000) for making misleading announcements to the market regarding payments from Sibir to its major shareholder Chalva Tchigirinski. The penalty reflected a Stage 1 (30%) discount under the FSA's settlement discount scheme.

Mr. Cameron was responsible for Sibir making two separate market announcements in December 2008 and February 2009, stating that Sibir had paid a total of $115.4 million to Mr. Tchigirinski. The correct amount was more than $300 million. This created a false market in Sibir's shares by giving a misleading impression as to the nature and value of Sibir's assets and the risks the company faced. When the true position became clear, Sibir's shares were suspended from trading on AIM and its quotation was subsequently cancelled. Cameron was suspended from Sibir in February 2009 and dismissed in April 2009.

Margaret Cole, Director of Enforcement and Financial Crime at the FSA, said, “As the most senior executive director at Sibir, Cameron should have known these announcements were misleading and the serious impact they were likely to have on the market. The consequences of his market abuse were so serious that it led to the suspension of trading in Sibir’s shares on AIM. Our fine reflects the gravity of his irresponsible actions and shows that we are serious about taking action against directors of publicly traded companies who commit market abuse. It is not acceptable for directors to take action which is in the interests of some shareholders while keeping others in the dark.”

Read more.

EU DEVELOPMENTS

European Banking Bonus Restrictions to Be Introduced

On July 7, the European Parliament approved, by a large majority, measures which will significantly restrict bonus payments by banks. They were passed in the context of amendments to the EU Capital Requirements Directive for banks and investment firms (proposal for a directive of the European Parliament and of the European Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitizations, and the supervisory review of remuneration policies).

The proportion of bonuses payable in cash may not exceed 30% of the total bonus amount (20% for large bonuses). Between 40% to 60% of all bonus must be deferred and can be clawed back if performance in subsequent years is not adequate. 50% of the total bonus would be paid as “contingent capital”—funds which can be called upon by the bank for use as capital if required. Bonuses must also be “capped to salary.” Each bank will have to establish limits on bonuses related to salaries, based on EU guidelines. There will be more stringent rules applicable to part-nationalized banks.

The detailed provisions implementing the above guidelines have not yet been published.

Separate draft remuneration rules for fund managers falling within the ambit of the draft Alternative Investment Funds Directive are being considered in the ongoing trialogue process between the European Commission, Council and the Parliament, under which the competing drafts produced by the European Council and the Parliament are being harmonized. An agreed text is expected to be passed to the Parliament for a plenary vote in September.

Read more.

For more information, contact:

SEC/CORPORATE		
Robert L. Kohl	212.940.6380	robert.kohl@kattenlaw.com
David A. Pentlow	212.940.6412	david.pentlow@kattenlaw.com
Robert J. Wild	312.902.5567	robert.wild@kattenlaw.com
Frank Zarb	202.625.3613	frank.zarb@kattenlaw.com
FINANCIAL SERVICES		
Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Joseph Iskowitz	212.940.6351	joseph.iskowitz@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com
LITIGATION		
William M. Regan	212.940.6541	william.regan@kattenlaw.com
Brian Schmidt	212.940.8579	brian.schmidt@kattenlaw.com
BANKING		
Jeffrey M. Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Christina Grigorian	202.625.3541	christina.grigorian@kattenlaw.com
EXECUTIVE COMPENSATION AND ERISA		
Steven G. Eckhaus	212.940.8860	steven.eckhaus@kattenlaw.com
Aimee S. Lin	212.940.6516	aimee.lin@kattenlaw.com
UK/EU DEVELOPMENTS		
Martin Cornish	44.20.7776.7622	martin.cornish@kattenlaw.co.uk
Edward Black	44.20.7776.7624	edward.black@kattenlaw.co.uk

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