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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Announces Over One Million Corporate and Mutual Fund Reports now Fully Searchable on SEC Website

On June 12, the Securities and Exchange Commission announced that all information filed on EDGAR by companies and mutual funds for the past two years is now fully searchable online through the SEC website. The new full text search function, which is still in the beta testing stage, is accessible via the SEC website at http://searchwww.sec.gov/EDGARFSClient/jsp/EDGAR_MainAccess.jsp. Users can now search by keywords (using Boolean operators such as "AND" or "OR") and date, and may also specify form type, company name and CIK number, and may now retrieve filings by multiple companies or mutual funds simultaneously. Mutual fund investors may now also search by individual fund or share class due to a numerical identifier for each fund or class within mutual fund prospectuses (which often include information on many funds or classes). The new search function is not limited to voluntary participants in the SEC's eXtensible Business Reporting Language (XBRL) program, which allows additional interactive data to be included in financial statement filings.

This type of full text search has been available for some time via third party services, which charge a fee; these third party services often offer additional functions, such as the ability to highlight keywords when found in a document or to navigate directly from one instance of a found keyword to the next, which the SEC website does not currently offer. The SEC has encouraged users to provide feedback on the new search function by e-mailing comments and suggestions to textsearch@sec.gov.
http://www.sec.gov/news/digest/2006/dig061306.txt

SEC Appoints Mark W. Olson as Chair of PCAOB and Reappoints Founding Member Kayla Gillian

The Securities and Exchange Commission announced on June 19 that Mark W. Olson, currently a Federal Reserve Board Governor, has been appointed Chairman of the five-member Public Company Accounting Oversight Board until 2010, and that founding PCAOB member Kayla Gillian had been reappointed.

Mr. Olson joined the Federal Reserve on Dec. 7, 2001 and has served as Administrative Governor since August 2002, responsible for management of the Federal Reserve Board. Ms. Gillan was first appointed to the PCAOB in 2002. From 1996 to 2002, she was General Counsel to the California Public Employees' Retirement System (CalPERS).
http://www.sec.gov/news/press/2006/2006-98.htm
http://www.sec.gov/news/press/2006/2006-97.htm

SEC and United Kingdom Regulators Release Statements Regarding Mergers of U.S. and European Exchanges

In a highly unusual step, the Securities and Exchange Commission's Office of International Affairs and Divisions of Market Regulation and Corporation Finance released a fact sheet on June 16 concerning potential cross-border exchange mergers. The fact sheet is an apparent response to concerns that have been reported in the European business and investment community that mergers and acquisitions of European Exchanges by U.S. owners (in particular, Nasdaq's acquisition of a 25 percent stake in the London Stock Exchange and the New York Stock Exchange's attempts to acquire Euronext) would subject companies listed on such European exchanges to U.S. regulations, including the Sarbanes-Oxley Act of 2002. The SEC fact sheet stated that "whether a non-U.S. exchange, and thereby its listed companies, would be subject to U.S. registration depends upon a careful analysis of the activities of the non-U.S. exchange in the United States," and that "the non-U.S. exchange would only become subject to U.S. securities laws if that exchange is operating within the U.S., not merely because it is affiliated with a U.S. exchange."

In a similarly unusual step apparently calculated to address the same concerns, Callum McCarthy, chairman of the U.K. Financial Services Authority, publicly stated on June 12 that "neither the FSA nor the Securities and Exchange Commission consider that U.S. ownership of the LSE, in and of itself, would result in U.S. regulations, including Sarbanes-Oxley, applying to companies listed or quoted on its markets or member firms of the LSE".
Compliance Week, 6/20/06; http://www.sec.gov/news/press/2006/2006-96.htm

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Broker Dealer

The Chicago Board Options Exchange Proposes Rule Amendments Concerning DPM and e-DPM Membership Ownership Requirements

The Chicago Board Options Exchange has filed proposed amendments to CBOE Rules 8.85 and 8.92. CBOE Rules 8.85 and 8.92, respectively, require Designated Primary Market Makers (DPM) and electronic-DPMs (e-DPM) to own (and/or lease) a certain number of exchange memberships, based upon the number of trading locations served by a DPM and the number of products allocated to an e-DPM. Under Rules 8.85 and 8.92, as amended, the number of exchange memberships necessary will be based upon the aggregate "appointment cost" for the classes allocated to that organization. The appointment costs will be rebalanced once each calendar quarter, and at such time each organization will be required to own or lease the appropriate number of exchange memberships reflecting the revised appointment costs of the classes that have been allocated to it. Additionally, because members may be approved to function in a number of capacities, including as a DPM, e-DPM and Remote Market Maker (RMM), the proposed amendments would allow a firm to use any excess membership capacity as a DPM in its capacity as an RMM or e-DPM, and, likewise would allow a firm to use any excess membership capacity as an e-DPM as an RMM or DPM.
http://www.cboe.org/publish/RuleFilingsSEC/SR-CBOE-2006-058.pdf

Court of Appeals Affirms the International Securities Exchange's Ability to Trade Options on Exchange Traded Funds Without a License

The International Securities Exchange (ISE) announced that the United States Court of Appeals, Second Circuit unanimously affirmed the ruling of the lower court, which dismissed the complaints of Dow Jones & Company, Inc. and Standard & Poor's against ISE and The Options Clearing Corporation (OCC).

S&P and Dow Jones brought suit against ISE and OCC alleging that ISE's unlicensed trading of options on SPDRs® and DIAMONDS® created by S&P and Dow Jones, respectively, infringed their intellectual property rights. The trial court ruled that ISE's unlicensed trading did not infringe the plaintiffs' intellectual property rights and dismissed complaints against ISE and OCC. On appeal the Second Circuit affirmed, holding that the trading and clearing of options on the shares of exchange traded funds that track the performance of stock market indexes does not constitute misappropriation of the stock market index owners' intellectual property or unfair competition.
http://phx.corporate-ir.net/phoenix.zhtml?c=176358&p=irol-newsArticle&ID=873614&highlight

NASD Deadline to File Form BR and to Amend Forms U4

The definition of "Uniform Branch Office Definition" under NASD Rule 3010(g)(2) becomes effective July 3. Accordingly, NASD members must submit a Form BR through CRD for all branch office locations by such date. A "branch office" is defined as any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security, or that is held out as such. A main office of a firm must be registered as a branch office if the activities at the location satisfy the definition of "branch office" under the Rule. For example, a location that is being held out to the public or a location that is responsible for supervising the activities of associated persons at other offices would fall within the scope of the definition and would need to be registered. In addition to this filing requirement, all members must amend Forms U4 to link all their registered individuals to a minimum of one registered location. For complete filing requirements see the Branch Office Registration Program page on the NASD Web site.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_016204.pdf

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Investment Advisor and Investment Company

Circuit Court Vacates SEC Hedge Fund Adviser Registration Rule

In a June 23 opinion, the Circuit Court of Appeals for the District of Columbia (*Goldstein v. Securities and Exchange Commission*, No. 04-1434) vacated and remanded to the Securities and Exchange Commission the amendments to Rule 203(b)(3)-1 and the adoption of Rule 203(b)(3)-2 under the Investment Advisers Act of 1940 requiring most advisers/managers of a hedge fund to register as investment advisers with the SEC under the Advisers Act. The court rejected the SEC's arguments and, based upon discussed prior cases and statutory amendments that it deemed

relevant, determined that the SEC did not have the authority to take the actions it took. Until the court issues its order, the hedge fund adviser registration rules are still technically effective.

In a June 23 statement, SEC Chairman Cox indicated that in response to the court's finding he has directed the SEC Staff to provide the Commission a set of alternatives for its consideration.

A Client Advisory discussing the opinion and its implications will be distributed shortly.
http://pacer.cadc.uscourts.gov/docs/common/opinions/200606/04-1434a.pdf
http://www.sec.gov/news/press/2006/2006-101.htm

SEC Permits Limited Fund Pyramiding

On June 20, the Securities and Exchange Commission adopted Rules 12d1-1, 12d1-2 and 12d1-3 under the Investment Company Act of 1940 ('40 Act) and amended certain disclosure forms for investment companies. The new rules are effective July 30, and are a codification of exemption orders that the SEC had regularly given in the past.

Rule 12d1-1 will permit cash sweep arrangements into a registered or unregistered money market fund (acquired fund) by a registered or unregistered investment company (acquiring fund) in excess of the 3% of fund shares limits imposed upon investment in an acquired fund under Sections 12(d)(1)(A) and 12(d)(1)(B) of the '40 Act. To the extent that these acquisitions may result in the two funds being "affiliates" under the '40 Act, relief is also granted from the prohibitions of Section 17 (transactions between or among a fund and affiliates of the fund).

Rule 12d1-2 will provide that a fund of funds that invests exclusively in affiliated open-end funds and unit investment trusts may now invest in unaffiliated funds, securities not issued by a fund and in money market funds, subject to various conditions.

Rule 12d1-3 will allow a fund investing in unaffiliated funds greater flexibility in structuring the sales load it charges. The rule now allows an unaffiliated fund of funds to charge a sales load that, together with the sales load charged by the underlying fund, does not exceed the limits on sales loads established by the NASD for fund of funds.

The SEC is requiring disclosure of the adviser fees paid to the adviser of the acquired fund shares purchased by the acquiring fund, and urges the board of the acquiring fund to consider reducing the adviser's fees by the amount of the fees charged by the adviser to the acquired fund that are attributable to the shares purchased by the acquiring fund.
http://www.sec.gov/rules/final/2006/33-8713.pdf

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Banking

Banking Agencies Release Publication to Assist Banking Institutions in Preparing for a Catastrophic Event

On June 15, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration and the Conference of State Bank Supervisors (collectively, the Banking Agencies) jointly released a booklet entitled Lessons Learned from Hurricane Katrina: Preparing Your Institution for a Catastrophic Event.

The booklet is intended to assist other institutions assess and prepare for a catastrophic event. According to the press release announcing the publication of the booklet, although institutions' existing disaster recovery and business continuity plans generally worked well in enabling institutions to restore operations swiftly, the "unprecedented destruction and aftermath of the hurricane caused major disruptions that exceeded the scope of some institutions' disaster recovery and business continuity plans." Hardships enumerated by the Banking Agencies include:

1) Communications outages made it difficult to locate missing personnel.
2) Access to and reliable transportation into restricted areas were not always available.
3) Lack of electrical power or fuel for generators rendered computer systems inoperable.
4) Multiple facilities were destroyed or sustained significant damage.
5) Some branches and ATMs were under water for weeks.
6) Mail service was interrupted for months in some areas.

http://www.ffiec.gov/press/pr061506a.htm

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Litigation

Demand Futile Where Directors not Disinterested

Plaintiff shareholders brought a derivative action against ten of the company's current and former directors, alleging that they breached their duty of loyalty by failing to oversee and monitor the company's internal accounting controls and compliance with federal export control laws. Defendants moved to dismiss the complaint on the grounds that the plaintiffs did not make a pre-suit demand on the board of directors, and plaintiffs opposed on the grounds that any demand would have been futile because a majority of the directors faced "a substantial likelihood of personal liability" and so were unable to make an "independent and disinterested" decision regarding the prosecution of the litigation. The Court found that the chief executive officer of the company could not impartially consider a demand on the board because his financial dependence on the Company made it improbable that he could perform his fiduciary duties without being influenced by the risk of personal liability. In addition, the Court held that the five members of the audit committee also faced a "substantial likelihood" of personal liability because of their alleged failure to act after being alerted of potential export control violations. Thus, as a reasonable doubt existed that six of the ten directors on the board at the time of the demand were disinterested, demand was

futile and the motion to dismiss was denied. (*In re Vecco Instruments, Inc. Sec. Litig.*, Nos. 05 MD 1695 (CM), 05 CV 10224 – 26 (CM), slip op., 2006 WL 1650656 (S.D.N.Y. June 14, 2006))

Parent not Alter Ego of Subsidiary Where no Bad Faith Conduct

Plaintiff won an action against defendant subsidiary corporation in 1999, after which the subsidiary filed for bankruptcy. Plaintiff then filed an amended complaint against the subsidiary and its parent company, asking the district court to pierce the corporate veil, alleging that the parent was the alter ego of the subsidiary. The district court refused to pierce the veil, and the plaintiff appealed. The Circuit Court affirmed, holding that in order to succeed on an alter ego theory, the plaintiff must prove, among other things, that an "inequitable result will follow" if the subsidiary's acts are not attributed to the parent. The Court pointed out that a plaintiff's inability to collect a judgment does not, by itself, qualify as an inequitable result. Rather, the Court held that to demonstrate an inequitable result, the plaintiff must be able to point to some evidence of bad faith conduct on the part of the defendants. Since plaintiff could not demonstrate any facts indicating that the parent company was involved in the subsidiary's wrongdoing, "the alter ego doctrine [could] not be invoked." (*Tamko Roofing Products, Inc. v. Smith Engineering Co.*, No. 04-3913, 2006 WL 1652723 (8th Cir. June 16, 2006))

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CFTC

Party's Use of Electronic Trading Systems is Sufficient to Support Finding of Personal Jurisdiction in New York State Courts

The New York Court of Appeals unanimously ruled that New York state courts may exercise personal jurisdiction pursuant to the state's long-arm statute over a "sophisticated institutional trader" that "knowingly enters [New York] – whether electronically or otherwise – to negotiate and conclude a substantial transaction." *Deutsche Bank Securities, Inc*. v. *Montana Board of Investments*.

A Montana Board of Investments (MBOI) investment officer located in Montana sent a Bloomberg instant message offering to sell certain Pennzoil bonds to a Deutsche Bank Securities, Inc. (DBSI) salesperson whom he knew was located in New York City. Hours after the DBSI salesperson confirmed the trade with the MBOI investment officer, Shell Oil publicly announced that it had agreed to acquire Pennzoil, an announcement that would potentially increase the value of the bonds. The following day, MBOI advised DBSI that it was breaking the trade because it believed that the ultimate buyer had inside information and the trade was therefore "unethical & probably illegal."

DBSI then sued MBOI in New York state court for breach of contract. MBOI argued, among other things, that the case must be dismissed for lack of personal jurisdiction. The Court of Appeals stated that the manner in which MBOI "entered" the state – electronically – had no impact on the scope of the state's long-arm statute and noted that it had previously ruled that the long-arm statute extends to "commercial actors and investors using electronic and telephonic means to project themselves into New York to conduct business transactions." The Court of Appeals then held that MBOI had availed itself of the benefits of conducting business in New York and had sufficient contacts with state to authorize the trial court to exercise jurisdiction, noting that MBOI had "entered New York to transact business here by knowingly initiating and pursuing a negotiation with a DBSI employee in New York" and had engaged in

approximately eight other bond transactions with DBSI's employee in New York in the thirteen months prior to the transaction at issue.
http://www.courts.state.ny.us/ctapps/decisions/jun06/71opn06.pdf

CFTC Requests Comments on Commitments of Traders Reports

The Commodity Futures Trading Commission is requesting comments on the Commitments of Traders reports, which are published weekly by the CFTC and reflect large (reportable) traders' positions in certain futures and options markets. Comments must be filed by August 21.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-9722.pdf

CFTC Allows Bombay Stock Exchange's Futures Contract to be Offered and Sold in the United States

The Commodity Futures Trading Commission's Office of General Counsel issued a no-action letter on June 14, permitting the offer and sale in the United States of the Bombay Stock Exchange's futures contract based on the Bombay Stock Exchange Sensitive Index, a broad-based, free-float market capitalization-weighted index designed to reflect the overall performance of the Indian equity market.
http://www.cftc.gov/opa/press06/opa5189-06.htm

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