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CORPORATE & FINANCIAL
WEEKLY DIGEST

June 4, 2010

SEC/CORPORATE

SEC Chairman Issues Statement on GAAP-IFRS Convergence Project

On June 2, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) announced modifications to their timetable for, and prioritization of, standards being developed by these boards in connection with improving U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) and achieving convergence of GAAP and IFRS. According to the joint statement issued by the FASB and IASB, these boards had previously set June 2011 as the target date for completing all major convergence projects. During the past few months, stakeholders voiced concerns about their ability to provide input on the large number of exposure drafts of standards planned for publication in the second quarter of this year. In response, the FASB and IASB are developing a modified strategy to take account of these concerns that would prioritize certain major projects and stagger publication of exposure drafts, resulting in the extension of the target completion dates for some convergence projects to the second half of 2011.

The Securities and Exchange Commission's Chairman, Mary Schapiro, issued a statement on June 2 in which she indicated that the modification by the FASB and IASB to the timing for completion of certain convergence projects should not impact the SEC staff's analyses under the Work Plan issued by the SEC in February 2010, the results of which will aid the SEC in its evaluation of the impact that the use of IFRS by U.S. issuers would have on the U.S. securities market. Chairman Schapiro also stated that the SEC remains on schedule for its determination in 2011 of whether and how to incorporate IFRS into the financial reporting system for U.S. issuers.

Click here for the full text of the joint statement issued by the FASB and IASB.
Click here for the full text of Chairman Schapiro's statement.

BROKER DEALER

SEC Approves Amendments to Trade Reporting Requirements for Restricted Equity Securities and Revisions to OTC Equity Security Definition

The Securities and Exchange Commission has approved several Financial Industry Regulatory Authority amendments to the reporting provisions regarding the OTC Reporting Facility (ORF). Effective June 28, firms are required to report restricted equity securities transactions traded pursuant to SEC Rule 144A to ORF by 8 p.m. Eastern Time. In addition, the amendments change the definition of "OTC Equity Security" (also effective June 28) to align the term more closely with SEC rule terminology and improve consistency across the FINRA rulebook. FINRA also has amended the ORF rules to add an exception to the reporting requirements for OTC Equity Securities transactions reported on or through an exchange.

Click here to read FINRA Regulatory Notice 10-26.

PRIVATE INVESTMENT FUNDS

Carried Interest Legislation Passes House

On May 28, the House of Representatives passed the American Jobs and Closing Tax Loopholes Act of 2010 by a vote of 215 to 204. Among other things, the bill would tax a specified percentage of the income allocated to an interest in an investment fund or an investment real estate partnership held by the fund's manager or other persons related to the manager disproportionately to capital invested—often referred to as the "carried interest"—as well as the gain from a sale of such interest as ordinary income. The bill would treat 50% of such income and gain as ordinary income prior to January 1, 2013, and 75% of such income and gain as ordinary income thereafter. Amounts treated as ordinary income under the provisions of the bill would also be deemed "self-employment income" for purposes of the self-employment tax, although the largest part of the self-employment tax is still capped. The bill is proposed to be effective January 1, 2011, for funds whose taxable year is the calendar year. The bill will now be sent to the Senate for its approval, and if approved, the bill is expected to be signed into law by President Obama.

To read the text of the bill, click here.

LITIGATION

District Court Denies Motion to Dismiss in Options Backdating Action

The U.S. District Court for the Northern District of Texas denied defendants' motion to dismiss plaintiffs' claims under Sections 14(a), 10(b) and 29(b) of the Securities Exchange Act, and state law violations for insider trading and misappropriation of information.

Plaintiffs, shareholders of Fossil, Inc., sued derivatively on behalf of the corporation, alleging that defendants, current or former directors or officers of the company, backdated stock option grants to themselves, to other top Fossil executives and to Fossil employees. Plaintiffs further alleged that defendants concealed the backdating scheme, and refused to exercise Fossil's legal rights to compel disgorgement of the wrongly obtained incentive proceeds.

Defendants argued that plaintiffs' Sections10(b) and 14(a) claims should be dismissed because the complaint failed to meet the heightened pleading requirements set forth in the Private Securities Litigation Reform Act (PSLRA). Defendants argued that plaintiffs' complaint failed to give rise to strong inferences that defendants acted with at least severe recklessness by approving the backdated options, and thus plaintiff failed to sufficiently plead scienter under Section 10(b). The court rejected defendants' arguments and found that the complaint contained specific and particularized allegations that each individual defendant knew of the backdating of options as well as false and inflated reports of earnings, and sold company stock without disclosing the materially adverse information.

Defendants also contended that the complaint failed to plead facts that created a strong inference that any defendant acted with negligence by failing to disclose the backdating scheme in the company's proxy solicitations, and that the Section 14(a) claim must be dismissed. The court concluded that the PSLRA standard was satisfied because the complaint alleged that (1) each defendant signed and approved proxy statements falsely representing that options were granted in accordance with shareholder approved plans, and (2) each defendant was negligent in not knowing the correct and omitted material facts that the options were in fact backdated, because each defendant had previously approved granting millions of backdated options. (*In re Fossil, Inc., Derivative Litigation*, No. 06-cv-1672, 2010 WL 2102327 (N.D. Tex. May 19, 2010))

Claims Concerning Food Packaging Allowed to Proceed

The U.S. District Court for the Eastern District of New York allowed plaintiff's deceptive business practice, false advertising and unjust enrichment claims based on the misleading packaging of a food product to proceed. Plaintiff's claims stemmed from plaintiff's purchase of a box of a food product, Berry Green. Plaintiff alleged that Berry Green lists only its metric weight, and not its weight according to the U.S. Customary or "imperial unit" system. Plaintiff further alleged that Berry Green comes in a non-transparent box that is 6 5/8 inches tall, and that, inside the box, there is a 5 5/8 inches tall jar that is only half-full with the product.

In finding that plaintiff could pursue her deceptive business practices claim, the court concluded that the allegations in the complaint that the Berry Green packaging gives the false impression that consumers bought more than they actually received was sufficient to plead the "materially misleading" element of a deceptive business practices claim. The court found that plaintiff's allegation that had she understood the true amount of the product she would not have purchased it sufficiently pled that plaintiff was injured as a result of the materially misleading packaging. The district court also denied defendant's motion to dismiss plaintiff's false advertising claim, because allegations of excessive slack-fill in packaging stated a claim for false advertising. (*Waldman v. New Chapter, Inc.,* No. 09-CV-3514, 2010 WL 2076024 (E.D.N.Y. May 19, 2010))

BANKING

Unlawful Internet Gambling Enforcement Act of 2006 Examination Procedures

On May 20, the Office of the Comptroller of the Currency issued interagency guidance for reviewing compliance with the joint rule promulgated by the U.S. Treasury Department and the Federal Reserve Board pursuant to the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA or Act).

The Act prohibits gambling businesses from knowingly accepting payments in connection with the participation of another person in a bet or wager that involves the use of the Internet and that is unlawful under any federal or state law (termed "restricted transactions" in the Act). Pursuant to the Act, Treasury and the Federal Reserve Board (in consultation with the U.S. Attorney General) promulgated regulations requiring financial institutions and certain other participants in designated payment systems to establish and implement policies and procedures reasonably designed to prevent or prohibit the processing of restricted transactions. Compliance with the rule was required as of June 1.

The rule requires certain participants in the designated payment systems to establish policies and procedures that are reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. A "participant" is defined as "an operator of a designated payment system, a financial transaction provider that is a member of, or has contracted for financial transaction services with, or is otherwise participating in, a designated payment system, or a third-party processor." The term "participant" does not include a participant's customer unless the customer is also a financial transaction provider participating on its own behalf in the designated payment system.

The interagency examination guidance includes an overview of the UIGEA and the joint rule (*Federal Register*, 73 FR 69382, November 18, 2008), a summary chart of the obligations of non-exempt participants (Appendix A), and the examination procedures (Appendix B).

Read more.

UK DEVELOPMENTS

FSA Fines and Bans Commodity Broker

On June 2, the UK Financial Services Authority (FSA) announced the imposition of a prohibition order on Andrew Charles Kerr together with a fine of £100,000 (approximately $145,000) for market abuse. At the time of his offense, Mr. Kerr was a broker with Sucden Limited. The FSA said that the company had cooperated fully with the FSA and there was no criticism of its supervision of Mr. Kerr nor of its internal procedures.

In August 2007, Client X, one of Mr. Kerr's clients, held a 2000 contract put options position on an exchange-traded coffee futures contract. Implementing a strategy planned with Client X, Mr. Kerr executed a series of trades designed to artificially increase the price of the coffee future during the trading period when the options reference price was determined. The intent was that the resulting price change would lead to the reference price moving above the strike price so that Client X would avoid incurring a loss on its put options position. By so doing Mr. Kerr committed market abuse by creating a false or misleading impression as to the price of the coffee futures contract and the options reference price.

The FSA determined that while the strategy was instigated by Client X, Mr. Kerr actively encouraged and participated in the market manipulation. It was a serious case of market abuse. In addition, Mr. Kerr provided false and misleading information during the FSA's investigation. This further demonstrated to the FSA that he lacked the integrity required of a fit and proper person and that he posed a risk to the FSA's statutory objective of maintaining confidence in the financial system. Accordingly, a prohibition order and substantial fine was the appropriate penalty.

Alexander Justham, the FSA's Director of Markets, said: "Market manipulation is a serious offence. Kerr breached the standards expected of approved persons and has paid the price. Participants in the futures and options markets should be in no doubt about how seriously the FSA views manipulation which disrupts proper pricing mechanisms and risks a false market in the underlying commodity."

Read more.

FSA Insider Dealing Prosecution Fails

On June 2, the UK Financial Services Authority (FSA) announced that, after a jury trial at Southwark Crown Court, not guilty verdicts had been entered against a finance director and two lawyers (present or past partners in City of London firms). The charges arose from profits alleged to have been made by the lawyers as a result of their trading in the shares of the finance director's technology company based on inside information provided by him when the company was taken over in 2006.

This case follows several successful recent criminal prosecutions by the FSA in insider trading cases. Margaret Cole, FSA Director of Enforcement and Financial Crime, stated that the FSA will continue with insider dealing prosecutions. She said that the FSA remains "100 per cent committed to the strategy of achieving credible deterrence. Bringing criminal prosecutions sends a message, loud and clear, that insider dealing is a serious crime and we are not afraid to pursue cases through the criminal courts."

Read more.

EU DEVELOPMENTS

CESR Publishes European Short Selling Technical Details

On May 26, the Committee of European Securities Regulators (CESR) published its report CESR/10-453 *Technical Details of the Pan-European Short Selling Disclosure Regime*.

CESR/10-453 follows on from CESR's *A Model for a Pan-European Short Selling Disclosure Regime* (CESR/10-088) (see the March 5, edition of *Corporate and Financial Weekly Digest*).

The technical details set out in CESR/10-453 relate to the key areas identified in CESR/10-088 as needing in-depth explanation and elaboration. Accordingly, further detail is provided on the following issues:

1) Determination of economic exposure for the purposes of calculating a net short position
2) Calculating changes of net short positions
3) Netting and aggregation within an organizational structure
4) The mechanics of disclosure
5) Exemptions from disclosure obligations

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
James B. Anderson	312.902.5620	james.anderson1@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
Robert M. McLaughlin	212.940.8510	robert.mclaughlin@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		
Bruce M. Sabados	212.940.6369	bruce.sabados@kattenlaw.com
Jonathan Rotenberg	212.940.6405	jonathan.rotenberg@kattenlaw.com
BANKING		
Jeffrey M. Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Terra K. Atkinson	704.344.3194	terra.atkinson@kattenlaw.com
Christina Grigorian	202.625.3541	christina.grigorian@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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Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

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