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Corporate and Financial Weekly Digest

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SEC/CORPORATE

NYSE Temporarily Lowers Certain Compliance Standards for Continued Listing

On May 12, the New York Stock Exchange LLC filed an immediately effective rule amendment with the Securities and Exchange Commission that temporarily reduced from $75 million to $50 million the 30 trading day average market capitalization and stockholders' equity requirements for continued listing of certain companies. The decreased market capitalization and stockholders' equity requirements apply to companies that initially qualified for listing under the "Earnings Test", "Asset and Equity Test" or "Initial Listing Standard for Companies Transferring from NYSE Arca" provisions of the NYSE Listed Company Manual. The NYSE rule amendment was adopted on a "pilot program" basis and is scheduled to expire after October 31, 2009.

Listed companies that are above the $50 million market capitalization and stockholders' equity compliance thresholds under the amendment will be deemed to have returned to compliance as of May 12.

The NYSE believes the reduction of market capitalization and stockholders' equity thresholds is appropriate given the current market environment, which has resulted in significant declines in stock prices and market capitalizations, increases in volatility and significant write-downs in the value of their assets or significant impairment charges. Consequently, a far greater number of listed companies have fallen below the continued listing standards in the past 18 months than since June 2005, when the NYSE increased the standards to $75 million from $50 million. The NYSE also acknowledged that the stock prices and stockholders' equity for many of these companies may not return to pre-recession levels for a considerable period of time.

Read more.

LITIGATION

Court Orders All Profits of Ponzi Scheme Disgorged

The Securities and Exchange Commission sued individual and corporate defendants for violations of Sections 5 and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, arising from defendants' sale of securities to finance the production of various entertainment projects.

Following entry of consent injunctions against each defendant barring future securities law violations, the court ordered disgorgement in an amount to be determined after discovery, finding that disgorgement was appropriate to ensure that the defendants did not profit from their improper actions. Thereafter the SEC reached agreement with all defendants but one as to the amount of disgorgement.

As to the sole remaining defendant, following an evidentiary hearing, the court found that the defendant had perpetrated a "massive securities fraud lasting at least eight years" during which he raised at least $300 million through the operation of a Ponzi scheme. The court further found that the SEC's disgorgement request of $4,035,479 reasonably approximated the amount the defendant had caused his companies to improperly pay on his behalf for such things as alimony, artwork, exotic cars, personal income taxes, etc. The court then ruled that because the SEC had presented evidence reasonably approximating the amount of the defendant's ill-gotten gain, the burden shifted to the defendant to show the amount was not reasonable.

The defendant argued that the disgorgement amount was too high because he did not receive any salary during the eight years in issue. He offered evidence of salaries earned by executives in businesses in the same industry and sought to reduce the disgorgement amount demanded by the SEC by netting out a reasonable salary. While acknowledging that the defendant had not been paid a salary, the court rejected the argument, ruling that there was

no compensation to which defendant was entitled based upon his operation of an illegal Ponzi scheme. (*SEC v. Utsick*, 2007 WL 1404726 (S.D. Fla. May 19, 2009))

No Rescission of Investment Contract Absent Finding of Fraud

Plaintiffs sued an individual defendant in whose company they had invested, alleging violations of the Securities Exchange Act of 1934, breach of the investment contract, and common law fraud based upon defendant's failure to disclose ongoing litigation at the time plaintiffs purchased their stock from the defendant for $1,050,000. Following trial, the jury returned a verdict in plaintiffs' favor on the breach of contract claim but against plaintiffs on their securities fraud and common law fraud claims. Further, on the contract claim the jury awarded no damages to plaintiffs but did find that plaintiffs were entitled to rescind their stock purchase agreement with the defendant.

Both parties moved to overturn the verdict, with the defendant arguing that the jury's finding of no damages suggested that the jury did not find a breach of contract and the plaintiffs arguing that the court should "harmonize" the rescission component of the verdict by ordering the defendant to return the $1,050,000 stock purchase price to plaintiffs.

The court rejected the motions. After reviewing the evidence relating to the fraud claim, the court found that despite plaintiffs' testimony that had they known of the ongoing litigation they would not have made the decision to invest, other evidence suggested that plaintiffs did know of the litigation prior to investing. Based upon this evidence the court found that the jury could have both reasonably rejected plaintiffs' fraud claims and, while finding a technical breach of contract, declined to award any damages for the breach.

Turning to the jury's rescission award, after labeling rescission an "equitable remedy," the court stated that it would treat the verdict on rescission as advisory. The court ruled that rescission of the stock purchase agreement would only be warranted if the plaintiffs had been defrauded and had made a prompt demand for rescission upon discovering the fraud. However, because the jury rejected the fraud claim, the court held that there was no basis upon which it could order rescission, stating that "without proof of an underlying harm [i.e., fraud], the jury's advice on a [rescission] remedy is immaterial." (*Stafford Investments, LLC v. Vito*, 2009 WL 1362513 (E.D. Pa. May 14, 2009))

BROKER DEALER

Interim Pilot Program on Margin Requirements for Transactions in Credit Default Swaps

The Securities and Exchange Commission has approved new Financial Industry Regulatory Authority Rule 4240, which establishes an interim pilot program with respect to margin requirements for certain transactions in credit default swaps (CDS) and requires members to adopt related risk monitoring procedures and guidelines. The Interim Pilot Program's requirements generally apply to any CDS transactions which are executed by a member, regardless of the type of account in which the transaction is booked and regardless of whether the transactions are subject to individual negotiation.

The Interim Pilot Program requires that any member that desires to clear CDS through a clearing agency must notify FINRA in advance in writing. For Chicago Mercantile Exchange (CME) cleared CDS that offset CDS transactions between the member and its counterparties, Rule 4240 requires the member to collect margin which is not less than the margin required to be deposited by the member at CME with respect to such transactions. For other cleared CDS and over-the-counter CDS, sellers of protection would be required to post a percentage of notional amount of the CDS, which percentage would vary depending on the size of the coupon payments required to be made under, and the maturity date of, the CDS. For buyers of protection, the margin required would be equal to 50% of the amount of margin that would be required from a seller of protection on the same CDS. Under Rule 4240, the percentages of the notional amount required to be deposited as margin for CDS index transactions would be lower than the percentages required for single name CDS transactions.

Rule 4240 also requires members to take a concentration haircut as follows. First, the member would identify its most concentrated CDS position and calculate its current and potential exposure with respect to this position. If this amount exceeds the member's tentative net capital, the member would be required to take a capital charge equal to the margin required for this position under Rule 4240. The member could reduce the amount of this charge by the amount of any excess margin that it holds with respect to its counterparties. The new rule also requires members to monitor the risk of any accounts that engage in CDS transactions and to maintain a comprehensive written risk analysis methodology for assessing the potential risk to the member's capital over a specified range of possible market movements over a specified time period.

Read more.

FINRA Unveils Changes to Proposed Rule Regarding Rumors

The Financial Industry Regulatory Authority issued a Regulatory Notice requesting comments on its newly re-proposed FINRA Rule 2030 addressing the origination and circulation of rumors. FINRA received substantial public comment when it first proposed Rule 2030 in November 2008. The new formulation more closely resembles the existing New York Stock Exchange rule dealing with rumors. The Regulatory Notice summarizes the changes to the text of the proposed rule, including amendments to the language of the general prohibition, a more focused reporting requirement and new supplementary material that includes a definition of the term "rumor" and three limited exceptions to the prohibition for certain permissible communications.

Read more.

FINANCIAL MARKETS

CFTC Chairman Recommends Enhanced Oversight of OTC Derivatives

In testimony before the Senate Committee on Agriculture, Nutrition and Forestry on June 4, Gary Gensler, Chairman of the Commodity Futures Trading Commission, called for expanded regulatory authority and oversight with respect to over-the-counter (OTC) derivatives markets. Chairman Gensler proposed the implementation of a two-pronged regulatory regime, with enhanced regulatory oversight over both derivatives dealers and the derivatives markets themselves.

With respect to derivatives dealers, the proposed regulatory structure would require uniform registration of all dealers and would subject them to capital requirements, initial margining requirements, business conduct rules and recordkeeping and reporting requirements (including public reporting of aggregate position and trade information). To enhance direct oversight over derivatives markets, Chairman Gensler's proposal would require standardized OTC derivatives contracts to be cleared through central clearinghouses and traded on exchanges and/or transparent electronic trading facilities. With respect to customized derivative instruments that cannot be cleared or traded on an exchange, regulators would nonetheless be granted antifraud and anti-manipulation authority over such instruments, as well as the power to impose margin, recordkeeping and reporting requirements. Chairman Gensler also recommended that the CFTC be given broad authority to implement position limits, including aggregate position limits, across markets.

A copy of Chairman Gensler's testimony is available here.

OTC DERIVATIVES

Proposed Energy Act Has Implications for OTC Derivatives

The Energy and Commerce Committee of the U.S. House of Representatives approved H.R. 2454, The American Clean Energy and Security Act (Energy Act), a bill containing provisions directly aimed at over-the-counter derivatives. The Energy Act establishes default regulatory authority of the Commodity Futures Trading Commission over allowance derivative markets, and amends the Commodity Exchange Act to provide greater oversight of energy derivatives and credit default swaps (CDS). More specifically, Sec. 355 of the Energy Act limits the eligibility of CDS purchasers by providing that each such purchaser must (i) own a credit instrument insured by the CDS; (ii) experience financial loss if an event subject of the CDS occurs with respect to the credit instrument; and (iii) meet certain minimum capital adequacy standards.

A copy of the current draft of the Energy Act is available here.

Lehman Requests Bar Date for Creditor Claims

On May 26, Lehman Brothers Holdings Inc. (LBHI) filed a motion requesting the U.S. Bankruptcy Court for the Southern District of New York to establish August 24 as the deadline for filing proofs of claim against LBHI and its affiliates, and to establish a procedure for such filing, including a required form to be completed online relating to derivatives claims, and a new proof of claim form specific to this case. The proposed documentation imposes on creditors a burden to fully document their claims, without the cooperation of the debtor and to a far greater extent than would ordinarily be required in filing a proof of claim, as developed in case law over the years. The proposed proof of claim would require claimants to provide detailed documentation of each underlying agreement and trade, all correspondence relating to trade termination and valuation as per the proposed "Derivative Questionnaire," and proof of delivery for all termination and valuation notices. Derivative claims against a guarantor would also require

additional information, including completion of a proposed "Guarantee Questionnaire." Interested parties should file objections with the Court prior to noon on June 12. A hearing is tentatively scheduled for June 17 at 2:00 p.m.

A copy of the motion is available here.

BANKING

FDIC Tightens and Clarifies Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized

The Board of Directors of the Federal Deposit Insurance Corporation (FDIC) on May 29 issued a final rule changing the way the FDIC administers its statutory restrictions on the deposit interest rates paid by banks that are less than well capitalized. The Federal Deposit Insurance Act requires the FDIC to prevent banks that are less than well capitalized from soliciting deposits at interest rates that significantly exceed prevailing rates. The FDIC's current regulation ties permissible interest rates paid by these banks on some deposits solicited nationally to the comparable maturity Treasury yield, and ties permissible interest rates on deposits solicited locally to undefined prevailing local interest rates.

The final rule defines nationally prevailing deposit rates as a direct calculation of those national averages, as computed and published by the FDIC based on available data. Reliance on the Treasury yields in the existing regulation would be discontinued. In recognition of the blurring of local deposit market boundaries brought about by the Internet and other innovations, the final rule also establishes a presumption that locally prevailing deposit rates equal the national rates published by the FDIC. This presumption could be overturned by evidence presented by banks to the FDIC.

As of first quarter 2009, there were 248 banks that reported being less than well capitalized, out of more than 8,200 banks nationwide. The rule is effective January 1, 2010. Effective immediately, the FDIC will regularly publish national rates and caps, and permit institutions that are less than well capitalized to avail themselves of these rates as a safe harbor for complying with the statutory interest rate restrictions.

Read more.

Federal Reserve Outlines TARP Repayment Criteria

The Federal Reserve Board on June 1 outlined the criteria it will use to evaluate applications to redeem U.S. Treasury capital from the 19 bank holding companies (BHC) that participated in the Supervisory Capital Assessment Program.

Any BHC seeking to redeem U.S. Treasury capital must demonstrate an ability to access the long-term debt markets without reliance on the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program (TLGP), and must successfully demonstrate access to public equity markets.

In addition, the Federal Reserve's review of a BHC's application to redeem U.S. Treasury capital will include consideration of the following:

- whether a BHC can redeem its Treasury capital and remain in a position to continue to fulfill its role as an intermediary that facilitates lending to creditworthy households and businesses;
- whether, after redeeming its Treasury capital, a BHC will be able to maintain capital levels that are consistent with supervisory expectations;
- whether a BHC will be able to continue to serve as a source of financial and managerial strength and support to its subsidiary bank(s) after the redemption; and
- whether a BHC and its bank subsidiaries will be able to meet their ongoing funding requirements and obligations to counterparties while reducing reliance on government capital and the TLGP.

Finally, all BHCs must have a robust longer-term capital assessment and management process geared toward achieving and maintaining a prudent level and composition of capital commensurate with the BHC's business activities and firm-wide risk profile.

The Fed indicated that redemption approvals for an initial set of these applications are expected to be announced during the week of June 8. Applications will be evaluated periodically thereafter. Any banking organization wishing to redeem U.S. Treasury capital must first obtain approval from its primary federal regulator, which then forwards approved applications to the Treasury Department.

According to recent reports in the financial press, it is unclear to what extent the FDIC's views, which may in some cases differ from those of an organization's primary federal regulator, will be taken into account.

Read more.

FDIC Statement on Status of Legacy Loans Program

The Federal Deposit Insurance Corporation (FDIC) on June 3 "formally" announced that development of the Legacy Loans Program (LLP) will continue, but that a previously planned pilot sale of assets by open banks will be postponed. In making the announcement, Chairman Bair stated, "Banks have been able to raise capital without having to sell bad assets through the LLP, which reflects renewed investor confidence in our banking system. As a consequence, banks and their supervisors will take additional time to assess the magnitude and timing of troubled assets sales as part of our larger efforts to strengthen the banking sector." As a next step, the FDIC indicated that it will test the funding mechanism contemplated by the LLP in a sale of closed bank receivership assets this summer. According to the FDIC, the "funding mechanism draws upon concepts successfully employed by the Resolution Trust Corporation in the 1990s, which routinely assisted in the financing of asset sales through responsible use of leverage." The FDIC expects to solicit bids for this sale of receivership assets in July. It is unclear why the FDIC chose to categorized its announcement as formal, as opposed to informal, and whether and when, if ever, the LLP will be launched for open banks.

Read more.

STRUCTURED FINANCE AND SECURITIZATION

June Investors Request $11.4 Billion of TALF Loans for Assets Including Servicing Advance and Premium Finance ABS

On June 2, the Federal Reserve Bank of New York announced that on the June 2 subscription date investors requested $11.4 billion in loans under the Term Asset-Backed Securities Loan Facility (TALF), slightly more than the $10.6 billion of loan requests made in May. The total amount of TALF loan requests is now approximately $28.5 billion.

For the first time, investors requested TALF loans in the amount of $528 million for asset-backed securities (ABS) backed by premiums on property and casualty insurance and $494 million for ABS backed by residential mortgage servicing advances. Investors also requested TALF loans in the amount of $6.2 billion for credit card ABS, $3.3 billion for auto ABS, $590 million for equipment ABS, $227 million for student loan ABS, and $81 million for Small Business Administration loan ABS.

Read more.

President of New York Federal Reserve Bank Delivers Remarks on TALF

On June 4, William Dudley, President of the Federal Reserve Bank of New York, spoke at a Securities Industry and Financial Markets Association conference regarding his preliminary assessment of the Term Asset-Backed Securities Loan Facility (TALF). Mr. Dudley noted that prior to August 2007, as much as 60% of consumer credit was provided through the markets for asset-backed securities (ABS). However, beginning in August 2007, the yield spreads on ABS soared and the market for consumer ABS and commercial mortgage-backed securities (CMBS) effectively shut down. According to Mr. Dudley, the TALF program offers three attributes that the private sector has had difficulty in providing since that time: (i) leverage to purchase highly rated, low-risk assets, (ii) term financing, and (iii) protection against very adverse economic outcomes.

As evidence of the TALF program's effectiveness, Mr. Dudley pointed to the gradual increase in ABS issuance, the fact that the market for those ABS deals is not wholly reliant on TALF (with more than half of the ABS subscriptions coming from non-TALF investors), and the fact that ABS spreads have decreased substantially. He deflected criticism that the TALF program may result in very high returns to investors by stating that high returns were necessary to stimulate investor interest. Finally, he stated that the continuing challenges facing the TALF program include (i) assuring investors that participation in TALF will not restrict their ability to conduct business in unforeseen ways, (ii) increasing participation by investors who are not permitted to use leverage, such as mutual funds, pension funds and insurance companies, and (iii) expanding TALF to include newly issued CMBS, legacy CMBS and possibly legacy residential mortgage-backed securities.

Read more.

Please see "FDIC Statement on Status of Legacy Loans Program" in **Banking**.

ANTITRUST

Federal Trade Commission Grants Final Approval for Whole Foods Deal

On May 29, the Federal Trade Commission (FTC) unanimously granted final approval to the acquisition of Wild Oats Markets, Inc. by Whole Foods Market, Inc. Under the agreed upon settlement between Whole Foods and the FTC, Whole Foods will sell 13 stores in Arizona, Colorado, Connecticut, Missouri, New Mexico, Nevada, Oregon and Utah. The grocer will also sell leases and assets for 19 stores that it had already closed. A divestiture trustee has the responsibility for selling these 32 stores within the next six months to a buyer approved by the FTC. If the trustee is unable to sell the stores within the next six months, the FTC may grant a six-month extension under the settlement.

This final settlement ends a battle between the FTC and Whole Foods that has lasted over two years. When Whole Foods and Wild Oats announced their transaction in February 2007, the FTC began its investigation. In June 2007, the FTC filed suit against the parties and requested a preliminary injunction blocking the acquisition. The FTC argued that the transaction would harm competition in the "natural grocer" market. In August 2007, however, the District Court for the District of Columbia refused to grant the preliminary injunction and the parties consummated the merger shortly thereafter.

The FTC then appealed the decision to the United States Circuit Court of Appeals for the District of Columbia. In July 2008, the D.C. Circuit Court reversed the District Court's decision, creating an unusual situation in which the FTC could force the parties to "unwind" parts of the already completed merger. The FTC resumed its administrative proceedings over the merger at that point, and the parties finally agreed upon the settlement in March 2009. The FTC allowed time for public comment on the settlement and now has approved it in the form agreed upon in March.

Complete details of the settlement can be found on the FTC website.

UK DEVELOPMENTS

FSA Proposes Extension of Disclosure Requirements for UK Financial Sector Net Short Positions

On June 1, the UK Financial Services Authority (FSA) issued Consultation Paper 09/15 in which it proposed to extend the current UK disclosure regime for net short positions in the stocks of UK financial sector companies which is due to expire on June 30.

The FSA does not propose at this time to place a time limit on the extension of the disclosure regime. In paragraph 3.4 of CP09/15 the FSA stated:

> We have considered a further time limited extension of the Disclosure Obligation. However, given our stated objectives, it is not possible to forecast how long the need for the obligation will continue and we believe that setting another specified period would be artificial. We are therefore now proposing extending the Disclosure Obligation without a fixed time limit. However, we emphasise that we do not intend this to be a permanent regime. Our expectation is that it would either be superseded in due course by broader permanent disclosure measures—preferably agreed on the widest possible international basis—and/or be revoked.

Short position disclosures under this regime are required to be made if a net short position in a relevant issuer exceeds 0.25% of the issued shared capital or the issuer. Further filings are required as the position increases by bands of 0.1% (i.e., a net short position reaches 0.35%, 0.45%, etc.).

The consultation period on the FSA proposals will close on June 12 to enable any new measures to be put in place before the June 30 expiration of the current regime.

Read more.

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