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SEC/Corporate

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NYSE Proposes to Eliminate Broker Discretionary Voting for Directors

On May 23, the New York Stock Exchange filed an amendment with the Securities and Exchange Commission to its proposal to amend Rule 452 to eliminate broker discretionary voting for the election of directors. Currently, brokers may vote on "routine" proposals if the beneficial owner of the stock has not provided specific voting instructions to the broker at least ten days before a scheduled meeting. Under the NYSE proposal, not only director elections that are contested, but also director elections that are uncontested would be deemed "non-routine." The proposed amendment was originally filed in October 2006, but has been revised to exclude registered investment companies from its application. Registered investment companies have a higher percentage of retail investors who vote only 30% of the time, and the NYSE was concerned that investment companies would have difficulty obtaining a quorum at shareholder meetings.

The NYSE's Proxy Working Group, which recommended the changes to Rule 452, said in its report in June 2006, that the amendment would likely increase the costs of uncontested director elections, as issuers will have to spend more money and effort to reach shareholders who previously did not vote. The amendment may also increase the influence of special interest groups or others with a particular agenda to challenge an incumbent board, at the expense of smaller shareholders. The Proxy Working Group is expected to issue an addendum to its 2006 report and recommendations which will likely include a proposal from Steve Norman, corporate secretary of American Express, for "client directed voting," or so-called standing instructions. Pursuant to this proposal, if the shareholder chooses not to vote, his or her voting instruction is good until canceled, thereby allowing the broker to vote.

The elimination of broker discretionary voting may be one of several proxy reforms for the next proxy season, but there are other competing proposals such as proportional voting, where brokers would vote unvoted shares in the same proportion as voted shares.

http://apps.nyse.com/commdata/pub19b4.nsf/docs/55715EE120D3281C852572E40076FF7D/$FILE/NYSE-2006-92%20A-1.pdf.

Connecticut Opts Out of the Governmental Accounting Standards Board's Rules

On June 6, the Connecticut Senate passed a bill, previously approved by the Connecticut House of Representatives on May 24, that will allow its comptroller to wipe $1.1 billion of debt from the state's books contrary to recommendations by the Governmental Accounting Standard Board. This legislation is effective with the fiscal year commencing July 1, 2009. The state

of Texas also recently passed legislation allowing local governments to ignore a new GASB rule requiring disclosure of retiree costs. The Connecticut legislation allows Connecticut's comptroller to decide which accounting standards Connecticut uses for its finances

The GASB, based in Norwalk, Connecticut, is the national group that sets standards for local governments under the authority of the Securities and Exchange Commission, and wants Connecticut to abide by rules that require governments to report their finances as they are accrued and adopt a plan to pay the debt back over 14 years.

http://www.cga.ct.gov/2007/FC/2007HB-07338-R000781-FC.htm.

PCAOB Files Proposed Auditing Standard on Internal Controls with SEC

On June 7, the Securities and Exchange Commission announced that the Public Company Accounting Oversight Board had filed proposed Auditing Standard No. 5, an Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements, as well as a related independence rule and conforming amendments to other auditing standards. The proposed rule is subject to review and comment, as well as SEC approval; if approved, it will replace current Auditing Standard No. 2. The guidance provided by AS 5 is intended to permit auditors carrying out an audit of management's assessment of internal controls under Section 404 of the Sarbanes-Oxley Act of 2002 to focus on areas that present the greatest risk of material misstatements in financial statements, and thus to lower the burden of Section 404 compliance for smaller companies. In testimony given before the Committee on Small Business of the House of Representatives on June 5, SEC Chairman Cox expressed a belief that AS 5 and the SEC's new guidance on Section 404 would enable smaller companies to comply with the existing Section 404 compliance deadlines without undue difficulty or expense.

http://www.securitiesmosaic.com/gateway/rules/OB.34-55876.060707.pdf

http://www.securitiesmosaic.com/Gateway/Frames/FrameOpen.asp?ContentASP=/fpdb/commnewsa.asp

Broker Dealer

NASD Issues Mark-Up Policy for Debt Securities

The NASD has issued Notice to Members 07-28 regarding the mark-up policy for transactions in debt securities other than municipal and government bond and certain other debt (the Debt Mark-Up Interpretation). The Debt Mark-Up Interpretation supplements NASD Rule 2440, "Fair Prices and Commissions," which requires broker-dealers to charge customers fair mark-ups and commissions. Generally, a broker-dealer may not charge a commission or mark-up that is unfair, unreasonable or excessive.

In a debt security transaction with a customer, the broker-dealer's mark-up (mark-down) must be calculated based upon the prevailing market price of that security. The Debt Mark-Up Interpretation states that, presumptively, the prevailing market price of a debt security is the broker-dealer's contemporaneous cost (or, in a sale, the broker-dealer's contemporaneous proceeds). The Debt Mark-Up Interpretation also addresses the procedures for a broker-dealer not to use its contemporaneous cost as the measure.

A broker-dealer may overcome the presumption that its contemporaneous cost (proceeds) is the prevailing market price if any of three events has occurred: (i) interest rates changed after the broker-dealer's contemporaneous transaction

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to a degree that such change would reasonably cause a change in debt securities pricing; (ii) the credit quality of the debt security changed significantly after the broker-dealer's contemporaneous transaction; or (iii) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the broker-dealer's contemporaneous transaction.

When the broker-dealer has no contemporaneous transaction, or one or more of the three events specified above has occurred, the Debt Mark-Up Interpretation identifies the following three factors that must be considered in hierarchical order: a) contemporaneous inter-dealer transactions in the same security; b) qualifying contemporaneous institutional account-dealer trades in the same security; and c) qualifying contemporaneous quotations.

If none of these three hierarchy pricing factors are determinative of the relevant pricing information, the broker-dealer may then consider the pricing information from "similar" securities. A broker-dealer should consider, among other things, credit quality of both securities, ratings, collateralization, spreads (over U.S. Treasury securities of similar duration) at which the securities are usually traded, general structural similarities (such as calls, maturity, embedded options), the size of the issue, float, recent turnover, and transferability or restrictions thereto.

When neither the hierarchy pricing factors nor similar securities can be used to establish the prevailing market price, the Debt Mark-Up Interpretation allows the broker-dealer to use pricing information derived from an economic model to determine the prevailing market price of a debt security for purposes of a mark-up.

In addition, the Debt Mark-Up Interpretation includes an exemption for transactions in non-investment grade debt securities between broker-dealers and qualified institutional buyers as defined in Rule 144A (each a QIB). To rely upon the QIB exemption, a broker-dealer must determine that: (i) the customer is a QIB; (ii) the security that the QIB wishes to buy or sell is a non-investment grade debt security; and (iii) after considering the factors set forth in IM-2310-3, which addresses institutional customer suitability factors, the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction to which the broker- dealer seeks to apply the exemption. If the broker-dealer establishes all three elements, then the QIB exemption from the Debt Mark-Up Interpretation may be applied by the broker-dealer.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_019229.pdf

Municipal Securities Rulemaking Board Amends Advertising Rule

The Securities and Exchange Commission recently approved a rule proposal to modify Municipal Securities Rulemaking Board (MSRB) Rule G–21. The proposed rule change consists of (i) amendments to Rule G–21, on advertising, and Rule G–27, on supervision, and (ii) an interpretation on general advertising disclosures, blind advertisements and annual reports relating to municipal fund securities.

In 2005, the MSRB adopted new section (e) of Rule G–21 that established specific standards for advertisements by brokers, dealers and municipal securities dealers of municipal fund securities. This section of the rule was modeled in part on Rule 482 promulgated under the Securities Act of 1933 and also codified previous MSRB interpretive guidance on advertisements of municipal fund securities, e.g.., college savings plans. The rule change further harmonizes the MSRB's advertising rule with the rules of the SEC and NASD

relating to investment company advertising. The rule change also provides certain clarifications of and exceptions to existing standards relating to characteristics of the municipal fund securities market.

Among other things, advertisements including fund results must also include the cost information for that fund – total fees and expenses an investor would actually incur for each fund for which performance data is shown. Also, advertisements including performance data must include the annual operating expense ratio as of the most recent practicable date.

The proposal became effective upon publication on June 5, except that dealers will not be required to implement the new provisions of Rule G–21(e)(i)(A)(3) and (4)(a)(iii) relating to disclosure of maximum sales load and total annual operating expense ratio (as well as the related provisions of Rule G–21(e)(ii)(A), G–21(e)(vii) and G–27(d)(ii)) for any advertisement submitted or caused to be submitted for publication, or any advertisement or correspondence otherwise distributed to the public, prior to July 15, 2007.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-10767.pdf

Amex Proposes Trading Binary Options

The Securities and Exchange Commission has published for comment the most recent amendment to the American Stock Exchange's proposal to list and trade binary options on securities and exchange traded funds (ETFs). A binary option is a European styled option that pays a pre-agreed amount to the buyer if a certain even occurs before expiration, and pays nothing to the buyer otherwise, while the seller/writer retains the premium.

The Amex proposes two Fixed Return Options (FRO). An FRO High would pay the buyer $100 if the on expiration date that day's volume weighted average price of the underlying security or ETF exceeded the specified price. An FRO Low would pay the buyer $100 if on expiration date that day's volume weighted average price of the underlying security or ETF was below the specified price. FROs would have the same expiration cycle as regular options, and would be cleared through the Options Clearing Corporation. Because they are European style options they could only be exercised at expiration, and the Amex would require that all "in the money" FROs be exercised. There would be a 25,000 contract position limit. Margin would be 100% of the purchase price and in the case of a sale the difference between $100 and the premium received from the sale of the FRO.

To be eligible for initial listing of an FRO the underlying security must have: (i) market capitalization of at least $40 billion; (ii) minimum trading volume of at least one billion shares over the last 12 months; (iii) minimum average daily trading volume of at least $200 million during the prior six months; and (iv) market price of the underlying security must be at least $10 during the preceding five consecutive business days For listing of additional series of an FRO on a security the underlying security must have: (i) market capitalization of at least $30 billion; (ii) average daily trading volume over the last 12 months of at least one billion shares; (iii) minimum average daily trading volume of four million shares; and (iv) minimum average daily trading value of $125 million during the prior six months; and (v) a market price per share of at least $5.

To be eligible for initial listing of an FRO on an ETF, the underlying must have: (i) minimum trading volume over the last 12 months of at least one billion shares; (ii) minimum average daily trading volume of at least four million shares; (iii) minimum average daily value traded of at least $200 million over the prior six months; and (iv) the market price of the underlying security was at least $10 for the five consecutive preceding trading days. For listing of

additional series of an FRO on an ETF, the ETF must have: (i) minimum trading volume of at least one billion shares over the preceding 12 months; (ii) minimum average daily volume of at least four million shares; (iii) minimum average daily value traded of at least $125 million; and (iv) a market price of at least $5.

http://www.sec.gov/rules/sro/amex/2007/34-55843.pdf

NYSE Will Allow Co-CCO and Co-COO

In Information Memo No. 07-51 the New York Stock Exchange announced that it would allow designating more than one chief compliance officer (CCO) and more than one chief operating officer (COO) if the member firm supplies the Exchange with a written plan allocating specific responsibilities between the co-officers providing for adequate supervision in their respective areas and in the areas where the separate parts overlap, e.g. retail sale of new issues where a CCO covers retail and another covers investment banking. If such a plan is accepted by the NYSE the co-officers would only be liable for supervisory violations in their specific areas. The NYSE stated that there could not be co-chief executive officers or co-chief financial officers

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852572F1006376B9/$FILE/Microsoft%20Word%20-%20Document%20in%2007-51.pdf

United Kingdom Developments

AIC Publishes Corporate Governance Guide

The UK Association of Investment Companies (AIC) published its Corporate Governance Guide for Investment Companies on June 4. The guide incorporates the UK Combined Code on Corporate Governance, the AIC Code of Corporate Governance and certain requirements of the UK Listing Rules. The UK Financial Reporting Council has confirmed that AIC member companies which use the AIC Code and guide will be meeting their obligations in relation to the Combined Code and the associated disclosure requirements of the Listing Rules.

http://www.theaic.co.uk/files/technical/AICGuide.pdf

Litigation

Dismissal of Shareholder Fiduciary Duty Suit Affirmed

The Massachusetts Supreme Court affirmed the dismissal of a shareholder's claims against the directors of a biotechnology company for breach of fiduciary duty and breach of the covenant of good faith and fair dealing implied in the Company's articles of organization. The plaintiff claimed, on behalf of himself and all other holders of the company's publicly traded biosurgery division's "tracking" stock, that the directors committed these breaches by timing an exchange of the biosurgery division stock for company common stock to occur when the biosurgery stock was substantially undervalued.

Plaintiff argued that the implied covenant of good faith and fair dealing required the directors to exercise the exchange provision at a time that would create a valuation period in which the market price reflected the "true" fair market value of the stock. The directors allegedly breached the covenant by announcing the exchange shortly after reporting substantial revenue growth for the biosurgery division, which, as provided for in the articles of organization, established a valuation period of the twenty business days preceding the

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announcement. (In fact, under the formula established in the articles of organization, the exchange price ($1.77/share) was approximately 30% below the "tracking" stock's market price ($2.51/share) on the day the exchange was announced.) The court rejected the plaintiff's argument as contrary to the director's authority under the articles to declare an exchange at any time and the formula for determining the exchange value, ruling that the implied covenant of good faith and fair dealing could not be used to supply terms that the parties could have negotiated on their own.

The court also rejected the fiduciary duty claim after finding that the procedure for exchanging stock fell squarely within the shareholders' contract with the directors – i.e., the articles of organization. While recognizing that directors have fiduciary duties to shareholders, the court ruled that when shareholder rights arise under a contract, the obligations of the parties are determined by reference to contract law, and not by fiduciary principles. (*Chokel v. Genzyme Corp.*, No. SJC-09761, 2007 WL 1575336 (Mass. June 4, 2007))

Dismissal of Securities Fraud Claim Reversed by Eleventh Circuit

The Eleventh Circuit Court of Appeals reversed a district court's Rule 12(b)(6) dismissal of a securities fraud action for failure to state a claim. The district court dismissed after ruling that the plaintiff's interest in companies to be created in the future did not constitute a "security" within the meaning of federal securities laws. The Eleventh Circuit, after noting the broad definition of "security" in the federal securities laws, disagreed.

The Eleventh Circuit ruled that the Fourth Circuit decision the district court had relied upon -- in which the future interest that the plaintiff was to receive was "neither denominated stock by the parties, nor did it possess all the usual characteristics of stock" – was distinguishable. Unlike in the Fourth Circuit case, the agreement between the parties specifically referred to a "Shareholders Agreement," discussed "securities," and called the holders of these securities "stockholders." Under the circumstances, after making all inferences in favor of the plaintiff, the Eleventh Circuit held that it could not be said that plaintiff did not state a claim that implicated federal securities laws. (*Haddad v. RAV Bahamas, Ltd.*, No. 06-12869, 2007 WL 1558674 (11th Cir. (Fla.) May 31, 2007)).

CFTC

Ninth Circuit Rejects Challenge to CFTC Sanctions

The Ninth Circuit recently rejected a petition challenging the ability of the Commodity Futures Trading Commission to bring an action based on a violation of a position limit rule of a futures exchange. In August 2000, a customer of a Chicago Mercantile Exchange (CME) member firm intentionally violated the speculative position limit for frozen pork belly contracts. The CFTC, pursuant to Section 4a(e) of the Commodity Exchange Act, imposed a cease-and-desist order, a $110,000 fine and a 30-day ban trading ban based on the trader's violation of the CME rule.

The trader appealed, claiming that CME rules limited the CFTC's ability to impose sanctions for a violation of Section 4a(e) and that the CFTC's action constituted a deprivation of due process. The Ninth Circuit held that the plain language of Section 4a(e) unambiguously imposes liability for violations of contract market position limits and similarly rejected the trader's due process arguments. Importantly, the court also upheld the $110,000 fine, finding that the amount, which was roughly twice the trader's profits, was not excessive or an abuse of discretion,

http://www.ca9.uscourts.gov/ca9/newopinions.nsf/7362B49A9179A079882572

CFTC

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CFTC Approves CME Credit Derivative Product

The Commodity Futures Trading Commission has approved rules of the Chicago Mercantile Exchange relating to the trading of the North American Investment Grade High Volatility Credit Index Event contract. The contract is based on an index of reference entities (representing a bundle of corporate credits) and involves a payout in the event of certain credit events experienced by the reference entities, such as bankruptcy of failure to pay.

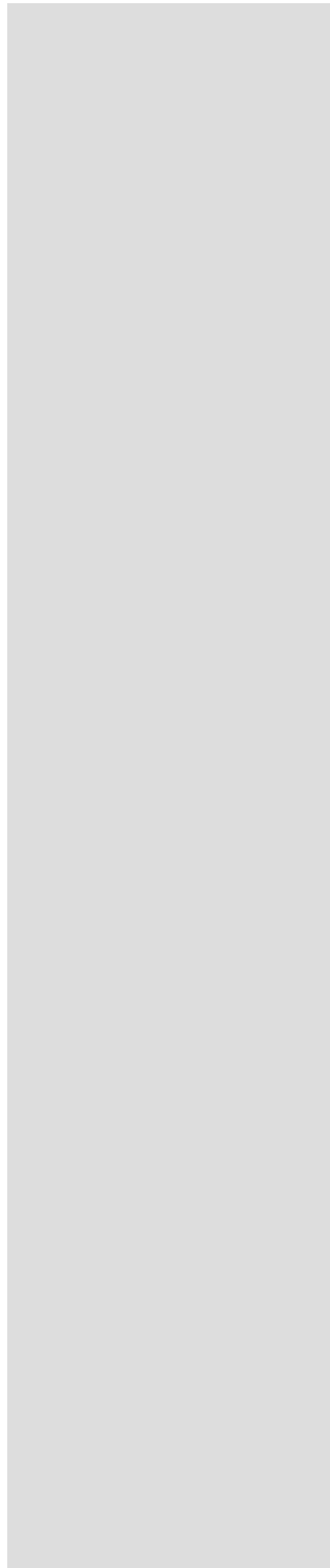
http://www.cftc.gov/opa/press07/opa5345-07.htm

CFTC Approves OCC Clearing of CBOE Credit Default Products

The Commodity Futures Trading Commission has issued an order under Section 4(c) of the Commodity Exchange Act exempting from the Commodity Exchange Act the trading and clearance of Credit Default Options (CDOs) and Credit Default Basket Options (CDBOs) to be listed and traded on the Chicago Board Options Exchange and cleared through The Options Clearing Corporation (the OCC) in its capacity as a securities clearing agency. (In addition to its securities clearing agency registration with the Securities and Exchange Commission, OCC is registered with the CFTC as a derivatives clearing organization.)

The CFTC noted that the proposed products were "close to the jurisdictional line between commodities and securities" but nevertheless issued the exemptive order "to promote responsible innovation and fair competition among futures markets and securities markets." The order is contingent upon the SEC's approval of the corresponding CBOE and OCC rule changes.

http://www.cftc.gov/files/opa/press07/opaexemptivefinalorder-6-5-07.pdf



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