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SEC/Corporate

New York Stock Exchange Submits Broker Voting Reforms for Comment

The New York Stock Exchange has endorsed reforms that would prevent brokers from voting in favor of the election of directors without explicit instructions from the beneficial holders of those shares. Current rules treat the election of directors as a "routine" matter, so that brokers may vote in favor of electing directors in the absence of specific instructions from their clients. The proposal was drafted by a working group headed by Larry Sonsini, chairman of the law firm Wilson, Sonsini, Goodrich and Rosati. An estimated 70-80 percent of all public company shares are held by brokers in "street name" for their beneficial owners, and recent dissident shareholder campaigns have hinged on broker votes. (*Securities Mosaic*, 6/7/06)

SEC Chairman Cox Says Backdating of Stock Option Grants is a "Serious Concern"

Securities and Exchange Commission Chairman Christopher Cox said Tuesday that the increasing number of companies under investigation for allegations of backdating or other manipulation of stock option grants is "of serious concern" to the Commission. Over 34 companies have disclosed criminal, regulatory or internal probes into falsifying or manipulating dates on options awards to benefit executives, including backdating option grants to coincide with low stock prices to create guaranteed profits regardless of performance. Cox also said he believed that the Commission's proposed reforms to executive compensation disclosure would improve the Commission's ability to address this issue, and that the final rule would include additional disclosure requirements intended to address backdating concerns.
(*Securities Mosaic*, 6/7/06)

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Broker Dealer

Application of Short Sale Delivery Requirements to Non-Reporting OTC Equity Securities

The Securities and Exchange Commission recently approved new Rule 3210 which applies short sale delivery requirements to those equity securities not otherwise covered by the delivery requirements of Regulation SHO, namely non-reporting OTC equity securities. The Rule requires participants of

registered clearing agencies to take action on failures to deliver that exist for 13 consecutive settlement days in certain non-reporting securities (i.e., any equity security that is not a reporting security under Regulation SHO and, for five consecutive settlement days, has aggregate fails to deliver at a registered clearing agency of 10,000 shares or more and a reported last sale during normal market hours for the security on that settlement day that would value the aggregate fail to deliver position at $50,000 or more). NASD will publish daily a list of the securities that fall within the foregoing parameters. Additionally, under the new Rule if the fail to deliver position is not closed out in the requisite time period, a participant of a registered clearing agency or any broker-dealer for which it clears transactions is prohibited from effecting further short sales in the particular specified security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the fail to deliver position is closed out. To the extent that the participant can identify the broker-dealer(s) that have contributed to the fail to deliver, the requirement to borrow or arrange to borrow prior to effecting further short sales may apply only to those particular broker-dealers to which the participant has allocated such fail to deliver position. The Rule becomes effective on July 3.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_016718.pdf

Amendments to Rule 6740 Relating to Submission of SEC Rule 15c2-11 Information to NASD

The Securities and Exchange Commission approved amendments to NASD Rule 6740 relating to submission of SEC Rule 15c2-11 information to NASD prior to quotation of non-NASDAQ securities. SEC Rule 15c2-11 requires a broker-dealer to review and maintain specified information about a security and issuer (e.g., prospectus, annual report) prior to publishing a quotation for a security in any quotation medium. NASD Rule 6740 prohibits an NASD member from initiating or resuming the quotation of a non-NASDAQ security in a quotation medium unless the member has demonstrated compliance with the requirements of SEC Rule 15c2-11 by filing with NASD a Form 211, along with the specified information required under SEC Rule 15c2-11, at least three business days before the quotation is published or displayed. The Rule amendments relieve members of their obligation to file with NASD copies of information required under SEC Rule 15c2-11 that is publicly available through the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system (although firms will no longer be required to file copies of EDGAR information with NASD, they nonetheless remain obligated to review and maintain information as required by SEC Rule 15c2-11). The amendments become effective on June 29.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_016697.pdf

ISE Proposes to Create New Category of Professional Customer

The International Securities Exchange, Inc. (ISE) recently filed proposed amendments to its priority rules and fee schedule for certain non-broker-dealer orders. Presently, ISE rules define a "Public Customer" as a person or entity that is not a broker or dealer in securities and a "Non-Customer" is any person or entity that is a broker or dealer in securities. Various ISE rules provide marketplace advantages to the orders of Public Customers over those of Non-Customers – i.e., orders of Public Customers are given priority over those of Non-Customers and market maker quotes at the same price, and ISE members generally are not charged a transaction fee for execution of orders for Public Customers. These rules are in place to attract retail investor order flow to the ISE by leveling the playing field for retail investors over market professionals and providing competitive pricing. The proposed amendments are meant to properly distinguish between non-professional retail investors and certain professionals (the current rules do not include any such differentiation). In particular, under the amendments, execution priority in specified situations would be given to the orders of "Priority Customers" (i.e., a person or entity that is not a broker or dealer in securities and does not regularly place more than 100 orders in listed options per day for its own beneficial account(s)) over those of "Professionals" (i.e., a person or entity that is not a Priority Customer). A person or entity would be considered to regularly place more than 100 orders per day for its own beneficial account(s) in listed options if it does so on more than two out of ten consecutive trading

days. All orders of Public Customers would continue to be treated equally for purposes of the linkage-related rules.
http://www.iseoptions.com/legal/pdf/proposed_rule_changes/SR-ISE-2006-26$Professional_Account_Holders$20060505.pdf

NYSE Issues Information Memo Concerning Directed Brokerage Arrangements

NYSE Regulation, Inc. issued Information Memo 06-38 as a follow-up to New York Stock Exchange, Inc. Information Memo No. 05-54, "Disclosures and Sales Practices Concerning Mutual Funds and Variable Annuities" to clarify the obligations of NYSE members to abstain from any participation in formal or informal directed brokerage arrangements prohibited by Investment Company Act of 1940 Rule 12b-1(h). Rule 12b-1(h) prohibits a mutual fund from considering the sale and promotion of fund shares as a factor in the selection of broker-dealers to execute the fund's portfolio transactions (Executing Brokers) and from using commissions from securities transactions to provide additional compensation to broker-dealers that promote or sell fund shares (Selling Brokers). Similarly, NYSE Rules 401 and 476(a)(6) prohibit NYSE members from accepting such "directed brokerage." Information Memo 06-38 sets forth suggested best practices for firms that serve both as a Selling Broker and as an Executing Broker for a given mutual fund, to avoid violation of Rules 401 and 476(a)(6). Such best practices include due diligence with respect to the mutual fund's compliance with Rule 12b-1(h); establishment of policies and procedures that strictly prohibit receipt of directed brokerage; training of marketing, sales and trading desk staff; and full and prompt review of allegations or information tending to suggest the existence of a directed brokerage arrangement with a mutual fund.
http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E88525718000539A1F/$FILE/Microsoft%20Word%20-%20Document%20in%2006-38.pdf

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Litigation

Second Circuit Finds SEC Rule Exempting Foreign Issuers from Section 14(a) Requirements to be Valid

Plaintiffs brought a federal securities class action against a foreign corporation, its directors, and certain investors, alleging that the corporation's proxy statement was materially misleading, in violation of §§ 14(a) and 20(a) of the Securities Exchange Act. The district court dismissed the action on the ground that the corporation was a foreign issuer exempt from the Act's proxy solicitation rules under Rule 3a12-3. One plaintiff individually appealed the district court's decision, challenging the substantive and procedural validity of Rule 3a12-3. Appellant argued that the Securities and Exchange Commission exceeded its authority in adopting the Rule because it decreased investor protection. Appellant further argued that the SEC failed to make a formal determination that the exemption was not inconsistent with the public interest or the protection of investors, as is required for an exemption under § 12(h). The Second Circuit rejected appellant's arguments holding that § 12(h)'s requirement that exemptions be consistent with the public interest and the protection of investors did not bar all exemptions that decreased investor protections. Further, the Second Circuit found that the SEC was not required to issue detailed factual findings as long as its reasoning could be discerned from the record. (*Schiller v. Tower Semiconductor Ltd.*, No. 04-5295-cv, 2006 WL 1515832 (2d Cir. Jun. 1, 2006))

Antitrust Complaint Failed to Alleged any Specific Violation of the Sherman Act

Plaintiffs, purchasers of elevators and elevator maintenance services, brought an antitrust class action against defendants, the largest sellers of such products and services in the United States. Plaintiffs alleged that defendants (a) engaged in a horizontal price fixing conspiracy, (b) engaged in a conspiracy to monopolize the sale and maintenance of elevators, and (c) monopolized and attempted to monopolize the elevator maintenance market. In dismissing the second amended complaint without leave to re-plead, the district court held that plaintiffs failed to allege, among other things, specific transactions between any plaintiff and defendant that resulted in injury to a plaintiff, whether the defendants competed with each other in the relevant markets, or any specific monopolistic activity by specific defendants from which a conspiracy could be inferred. In addition, the court pointed out that the allegations of "conspiratorial wrongdoing" in the complaint were "nothing more than a list of theoretical possibilities, which one could postulate without knowing any facts." (*In re Elevator Antitrust Litigation*, 04 CV 1178 (TPG), 2006 WL 1470994 (S.D.N.Y. May 30, 2006))

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CFTC

FinCEN Clarifies FCM Due Diligence Obligations in Give-Up Arrangements

The U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) has provided guidance on the obligations of futures commission merchants (FCMs) subject to the final due diligence rules implementing Section 312 of the USA PATRIOT Act. In a recent letter to the Futures Industry Association, FinCEN stated that only the FCM operating as the carrying broker in a give-up arrangement is subject to compliance with the due diligence rule for correspondent accounts for foreign financial institutions.
http://www.futuresindustry.org/downloads/Regulatory/2006/Section312-6-5-06.pdf

NFA Changes Exempt Pool Filing Requirements

Based upon guidance from the Commodity Futures Trading Commission, the National Futures Association has announced that a Commodity Pool Operator (CPO) claiming an exemption under CFTC Regulation 4.13(a)(3) or (4) does not need to file a final annual report for the pool's activities prior to the filing of its exemption notice if the CPO has filed the pool's annual report for the fiscal year preceding the filing of the exemption notice. CFTC Regulations 4.13(a)(3) and (4) provide exemptions from CPO registration for persons offering pools with sophisticated participants and limited commodity interest trading, and pools with highly sophisticated participants, respectively.
http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=1602

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