Katten Muchin Rosenman LLP

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SEC/Corporate

SEC Flip Flops on Form S-3 Issue

In the March 10 edition of *Corporate and Financial Weekly Digest*, we reported that David Lynn, Chief Counsel of the Division of Corporation Finance of the Securities and Exchange Commission warned S-3 filers that if their Form 10-K incorporated proxy statement information by reference and they have not yet filed their proxy statement, and they incorporate their Form 10-K by reference into the S-3, the SEC will not declare the registration statement effective unless the proxy statement information is included in the S-3 prospectus or a Form 10-K/A. Mr. Lynn also stated that for Well Known Seasoned Issuers (WKSIs), while an automatic shelf registration statement would immediately become effective, proxy information would need to be filed before the filing of a prospectus to take down the shelf.

In a private telephone conversation among four prominent New York attorneys and senior SEC Staff members, the statement by Mr. Lynn with respect to WKSI shelf take-down was withdrawn. We understand the Staff's current position to be that they will not object to a take-down from an accelerated shelf registration statement even if the current proxy statement information is not included in the take-down prospectus or a previously filed Form 10-K or proxy statement. The Staff is reported to have stated that the parties must make their own decisions as to whether the registration statement and prospectus satisfy applicable disclosure requirements.

The previous Staff position that a non-automatic S-3 registration statement filed during this period will not be declared effective remains, but the Staff will not object to a take-down from an already effective non-automatic shelf registration statement during this period.

The Staff apparently does not intend to publish or otherwise make public either its March 4th SEC Speaks position or its changed position.

Sarbanes, Oxley and Others Disagree on SEC Authority to Grant Section 404 Exemption to Smaller Companies

In a letter dated March 2 sent to the Securities and Exchange Commission, Representative Michael Oxley, chairman of the House Financial Services Committee, and Representative Richard Baker, chairman of the Capital Markets Subcommittee, asserted that the SEC "currently possesses the authority to provide relief from provisions of the Sarbanes-Oxley Act" under both Section 36(a) of the Securities Exchange Act of 1934 and Section 3(a) of the Sarbanes-Oxley

Act of 2002 (the Act). The letter coincided with the SEC's solicitation of comments to the February 28 draft final report of the SEC Advisory Committee on Smaller Public Companies (the Committee), as previously reported in the March 3 and March 10 issues of *Corporate and Financial Weekly Digest*. The Committee recommended that certain small and microcap companies be exempted entirely from the requirements of Section 404 so long as they complied with certain other conditions, and that companies with less than $250 million in annual revenue be exempted from external auditor participation in the Section 404 process. The SEC's authority to implement these proposals was questioned by Senator Paul Sarbanes, who told reporters that he did not believe the SEC could exempt companies from Section 404 of the Act, although he believed the SEC and the Public Company Accounting Oversight Board have been given the authority to define the scope of the role of independent public accountants in attesting to management reports on internal controls under Section 404.

Other commentators, including AFL-CIO General Counsel Damon Silvers, have asserted that Section 404, unlike many other sections of the Act, does not constitute an amendment to the Exchange Act and that the SEC's exemptive authority does not extend to that portion of the Act. Additionally, in a February 22 meeting sponsored by the Council on Foreign Relations, former SEC Chairman Arthur Levitt stated that he was "very much opposed to indefinitely continuing two standards of compliance with Sarbanes-Oxley according to size" under Section 404.
(*Securities Regulation and Law Report*, 3/13/06, p. 416, 449)
http://www.cfr.org/publication/9932/securities_and_exchange_commission_in_a_globalizing_market.html

For more information, contact:
Robert L. Kohl at (212) 940-6380 or e-mail robert.kohl@kattenlaw.com,
Mark A. Conley at (310) 788-4690 or e-mail mark.conley@kattenlaw.com, or
David Pentlow at (212) 940- 6412 or e-mail david.pentlow@kattenlaw.com

Banking

Federal Reserve Approves Amendments to Regulation K Regarding Operations of Foreign Banks in U.S. and Foreign Operations of U.S. Banks

The Federal Reserve Board on March 15, announced its approval of a final rule to amend Regulation K to require Edge and Agreement corporations, and U.S. branches, agencies, and other offices of foreign banks supervised by the Board, to establish and maintain procedures reasonably designed to ensure and monitor compliance with the Bank Secrecy Act and related regulations.

The Bank Secrecy Act generally requires a financial institution doing business in the United States to keep records and make reports that have a high degree of usefulness in criminal, tax, or regulatory proceedings. Domestic financial institutions, such as state member banks subject to the Board's Regulation H, already have been required to establish and maintain programs to ensure and monitor compliance with the Bank Secrecy Act. The Board's final rule amends Regulation K to require Edge and Agreement corporations and U.S. branches, agencies, and other offices of foreign banks to implement and maintain similar compliance programs.

The Board's final rule is consistent with regulations issued by the Department of the Treasury under section 352 of the USA PATRIOT Act, which requires all financial institutions to maintain effective anti-money-laundering programs.
http://www.federalreserve.gov/BoardDocs/Press/bcreg/2006/200603152/attachment.pdf

For more information, contact:
Jeff Werthan at (202) 625-3569 or e-mail jeff.werthan@kattenlaw.com, or
Christina J. Grigorian at (202) 625-3541 or e-mail christina.grigorian@kattenlaw.com

Broker Dealer

NYSE Requires Filing of CEO Certificate and Compliance Report

The New York Stock Exchange, Inc. issued Information Memo No. 06-08 on March 13. The NYSE stated that an electronic survey will be distributed to member firms with a reply due by April 3 through the NYSE's Electronic Filing Platform. The reply must identify the firm's Chief Executive Officer (CEO) and Chief Compliance Officer (CCO), and include the compliance report called for by Rule 342 addressing the member firm's supervision and compliance efforts during the preceding calendar year as well as ongoing compliance procedures and processes, preferably in PDF format. The annual CEO certificate required under Rule 342.30 must be submitted in hard copy to the firm's Finance Coordinator by April 3, because April 1, the original due date, is a Saturday. The Memo clarified that the compliance report must be submitted to the members of the board of directors or audit committee of the member firm before the CEO certification is filed. It need not be distributed in a formal meeting, and the compliance report need not be approved by the board or audit committee prior to filing the CEO certificate.
http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfroMemosNyseCom/85256FCB005E19E8852571300078EBDD/$FILE/Microsoft%20Word%20-%20Document%20in%2006-8.pdf

NYSE Notices Trading Permit Fee and Related Fees

In connection with the March 8 merger with Archipelago, the New York Stock Exchange, Inc. ceased having membership interests. Persons wishing to trade on the NYSE floor have to buy a trading permit. In advance of each year, the NYSE will conduct a Dutch auction for trading permits for the coming year. The Dutch auction for 2006 resulted in a price of $49,290, which was adjusted to $40,147.50 to reflect that trading began on March 8, instead of January 1. 1,274 permits were sold. An additional 92 permits are available for purchase at 110% of the auction price ($54,219). The permit price is payable in monthly installments in advance, as well as a deposit of the last month's payment. There is a $1,000 fee for approval of new members. A $1,000 fee is charged to transfer a permit to an affiliate or a firm that continues the business of the transferring firm. An annual badge charge of $250 is also imposed. The annual regulatory fee of $16 million is divided among specialist firms based upon the number of permits held by them. Non-specialist firms pay an annual $11,000 regulatory fee per trading permit. Member firms that do not conduct a public business will be charged a minimum $180 regulatory fee.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-3574.pdf

BSE to Enter into Regulatory Services Agreement

The Boston Stock Exchange, Inc. (BSE) has proposed to enter into a regulatory services agreement with the Chicago Board of Options Exchange (CBOE) and the other options exchanges participating in the proposed Options Regulatory Surveillance Authority. If approved, the CBOE would perform, for and in the name of the BSE, the regulatory obligations of the BSE as a registered national securities exchange. BSE will remain ultimately responsible for such supervision and regulation. However, the actions of CBOE under the contract will be deemed the actions of the BSE.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-3547.pdf

Nasdaq Files Minor Rule Violation Plan

The Nasdaq Stock Market LLC has filed a minor rule violation plan with the Securities and Exchange Commission for violations of certain rules which result in a fine of no more than $2500. The violations would not be reportable to the SEC under Securities Exchange Act Rule 19d-1 until the end of the calendar quarter and only in summary form. The SEC previously stated that as a condition of Nasdaq operating as a national securities exchange, Nasdaq had to file a minor rule violation plan. As filed, the plan deals with violations of Rules 2210, 2211, IM-2210-1 (communications with the public), 3360 (failure to timely file reports of short positions), 3310 (failure to keep and preserve books and records, correspondence and memoranda), 8211 (failure to submit trading data as requested), 1013 (failure to update Form BD), 1031 (failure to timely amend Forms U-4 for registered individuals), 1031 (failure to timely amend Forms U-5 for terminated registered persons), 1120 (failure to comply with the firm element of the continuing education rule), 3010(b) (failure to comply with the taping rule), 3070 (failure to file reports of complaints, violations, etc.), 4619 (failure to timely file reports pursuant to SEC Regulation M), 6954 and 6955 (failure to timely file OATS reports), 11870 (failure to effect a timely transfer of a customer's account) and SEC Regulation NMS Rule 602(b)(5) (failure to update customer quotes in an ECN), SEC Rule 17a-5 (failure to timely file a FOCUS Report) and SEC Rule 17a-10 (failure to timely file Schedule I).
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-3809.pdf

NASD Issues Revised Sanctions Guidelines

In Notice to Members 06-10 the National Association of Securities Dealers, Inc. issued revisions to its guidelines for sanctioning member firms and their associated persons effective March 31. It increased penalties and expanded the considerations used in determining the penalty for several rule violations. Order Audit Trail System (OATS) and Trade Reporting and Compliance Engine (TRACE) violations will take into consideration aggravating and mitigating factors. Among these are whether the firm checked its OATS or TRACE reporting screen maintained by the NASD, and the frequency and thoroughness of the firm's review of the performance of its third party reporter. In other areas where a firm uses a program or system supplied by a third party to meet its regulatory obligations, the sanctions will take into consideration the firm's testing of such systems, overview of the system's performance and the actions of the third party provider. In general, first time sanctions will be at least $5000, second time sanctions will be $10,000 and if there is a pattern or patterns of violations sanctions will be on a per violation basis.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_016119.pdf

For more information, contact:
James D. Van De Graaff at (312) 902-5227 or e-mail james.vandegraaff@kattenlaw.com,
Daren R. Domina at (212) 940-6517 or e-mail daren.domina@kattenlaw.com,
Michael T. Foley at (312) 902-5494 or e-mail michael.foley@kattenlaw.com,
Lance A. Zinman at (312) 902-5212 or e-mail lance.zinman@kattenlaw.com,
Patricia L. Levy at (312) 902 5322 or e-mail patricia.levy@kattenlaw.com, or
Morris N. Simkin at (212) 940-8654 or e-mail morris.simkin@kattenlaw.com

Litigation

Sarbanes-Oxley Act does not Limit Corporate Obligation to Advance Defense Costs

In an action by a company against its former Chief Executive Officer (CEO) for breach of fiduciary duty, defendant sought summary judgment on his counterclaim requiring plaintiff, pursuant to its by-laws, to advance his defense costs. In rejecting plaintiff's argument as to the applicability of Section 402(a) of Sarbanes-Oxley, which makes it unlawful for a public company to extend a personal loan to any officer or

director, the Court determined that "an advance of defense costs pursuant to state law and corporate by-laws" does not constitute a "personal loan" within the meaning of Section 402(a). Among other things, it stated that, had Congress "intended such a radical step as prohibiting such advances, [it] surely would have made its purpose evident in explicit terms." Accordingly, it directed plaintiff to advance the reasonable expenses of its former CEO in defending the claim against him. (*Envirokare Tech, Inc. v. Pappas*, 2006 WL 623597 (S.D.N.Y. Mar. 10, 2006))

Business Expenses Incurred in Scheme to Defraud not Offset from Disgorgement

After defendants consented to the entry of a permanent injunction requiring, among other things, the disgorgement of proceeds from a pyramid and Ponzi scheme related to the fraudulent sale of unregistered promissory notes, the District Court rejected their attempt to set off business and operating expenses from the amount to be disgorged. Affirming, the Ninth Circuit held that it would be unjust for defendants to offset expenses incurred in a ruse created to defraud investors particularly where, as here, "the entire business enterprise and related expenses were not legitimate at all." (*SEC v. JT Wallenbrock & Assoc.*, 2006 WL 5729016 (9th Cir. Mar. 10, 2006))

For more information, contact:
Joel W. Sternman at (212) 940-7060 or e-mail j.sternman@kattenlaw.com, or
Daniel Edelson at (212) 940-6576 or e-mail daniel.edelson@kattenlaw.com

CFTC

CFTC Permits Chicago Mercantile Exchange Floor Brokers and Floor Traders to be Eligible Contract Participants

The Commodity Futures Trading Commission has issued an Order permitting Chicago Mercantile Exchange (CME) floor brokers and floor traders who are registered with the Commission to be eligible contract participants, as defined in Section 1a(12)(C) of the Commodity Exchange Act, when trading for their own accounts. The Order specifically allows CME floor brokers and floor traders to enter into certain over-the-counter transactions in excluded commodities if the CME floor brokers or floor traders have had such trades guaranteed by, and cleared at, the CME by a CME clearing member that is registered with the Commission as a futures commission merchant.
http://cftc.gov/files/opa/opacmeorder031506.pdf

For more information, contact:
Kenneth Rosenzweig at (312) 902-5381 or e-mail kenneth.rosenzweig@kattenlaw.com,
William Natbony at (212) 940-8930 or e-mail william.natbony@kattenlaw.com,
Fred M. Santo at (212) 940-8720 or e-mail fred.santo@kattenlaw.com,
David Benson at (312) 902-5642 or e-mail david.benson@kattenlaw.com,
Megan A. Flaherty at (312) 902-5589 or e-mail megan.flaherty@kattenlaw.com, or
Joshua Yang at (312) 902-5554 or e-mail joshua.yang@kattenlaw.com

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KattenMuchinRosenman LLP Locations www.kattenlaw.com

401 S. Tryon Street
Suite 2600
Charlotte, NC 28202-1935
704.444.2000 tel
704.444.2050 fax

525 W. Monroe Street
Chicago, IL 60661-3693
312.902.5200 tel
312.902.1061 fax

5215 N. O'Connor Boulevard
Suite 200
Irving, TX 75039-3732
972.868.9058 tel
972.868.9068 fax

1-3 Frederick's Place
Old Jewry
London EC2R 8AE
+44.20.7776.7620 tel
+44.20.7776.7621 fax

2029 Century Park East
Suite 2600
Los Angeles, CA 90067-3012
310.788.4400 tel
310.788.4471 fax

575 Madison Avenue
New York, NY 10022-2585
212.940.8800 tel
212.940.8776 fax

260 Sheridan Avenue
Suite 450
Palo Alto, CA 94306-2047
650.330.3652 tel
650.321.4746 fax

1025 Thomas Jefferson Street, NW
East Lobby, Suite 700
Washington, DC 20007-5201
202.625.3500 tel
202.298.7570 fax

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