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Corporate and Financial Weekly Digest

MAY 1, 2009

SEC/CORPORATE

SEC's Division of Corporation Finance Updates Its C&DIs

On April 24, the Division of Corporation Finance of the Securities and Exchange Commission released updated versions of its Compliance and Disclosure Interpretations (C&DIs) in a number of major areas, including 1933 Act Sections; 1933 Act Rules; 1933 Act Forms; 1934 Act Rules; Section 16 Rules and Forms; 1934 Act Forms; Form 8-K; and Regulation S-K. In each of these C&DIs, the interpretations that are followed by "[Apr. 24, 2009]" are the added or revised interpretations.

On April 30, the Division of Corporation Finance further updated its 1934 Act Forms C&DI to include instructions relating to compliance with the new XBRL box that appears on the cover of Forms 10-Q and 10-K.

Read more.

SEC to Propose Proxy Access Rules This Month

In an April 27 address to the Society of American Business Editors and Writers, Mary Schapiro, Chairman of the Securities and Exchange Commission, stated that the SEC will be considering a proposal this month to "remove the barriers that make it costly and difficult for a company's owners to nominate directors." While the SEC has on several occasions in the past addressed the issue of permitting access to an issuer's proxy statement for the purpose of including directors nominated by shareholders, the long-standing SEC rule permitting the exclusion of matters relating to director nominations has remained in effect. It is likely, though, that this time around some form of proxy access rule will be adopted. According to Chairman Schapiro, the SEC's proposal will "ensure that any procedural requirements for access are rational, and not a means to thwart effective investor participation....". The SEC has not yet publicly released the date in May at which such a proposal will be considered by the SEC's Commissioners.

Read more.

See also the Katten *Client Advisory* on this subject.

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LITIGATION

Federal Court Rules Against SEC In An Insider Tipping Case

A federal district court has ruled that the Securities and Exchange Commission failed to show by preponderance of the evidence that a corporate executive violated the securities laws' prohibition against disclosing material inside information.

The SEC alleged that defendant Frederick Anton, Chairman of the Board of Directors of publicly traded company PMA Capital Corporation (PMA), had a telephone conversation with David Johnson, a retired former executive of PMA, on October 31, 2003, during which Anton disclosed that PMA would be discontinuing its dividend and increasing its loss reserves. In the next three days, Johnson sold 40,000 shares of his PMA stock and advised his

children to sell their PMA shares. On November 4, 2003, PMA announced that it would be increasing its loss reserves by about $150 million and that it planned to suspend dividends. As a result of his stock sales, Johnson avoided a total loss of over $325,000. He was subsequently charged with insider trading and settled with the SEC by paying a total of over $786,000. The SEC then filed its tipper liability action against Anton.

In ruling for defendant after trial, the court found that the testimony against Anton was inconsistent and lacked credibility. Specifically, the fact that dividend elimination was discussed for the first time at a November 2, 2003, Board meeting indicated that Anton could not have discussed dividend elimination with Johnson on October 31. In addition, although Anton was aware of a "strong possibility" of a reserve increase, there was no evidence that he was involved in discussions or had "definite information" about such increase after September 30, 2003. Moreover, the court noted that information about a reserve increase, by itself, was not material where there was no alleged quantification of such increase and a strong likelihood of a future reserve increase was publicly known through PMA's public disclosures. Finally, the court emphasized that the SEC did not show that Anton benefited financially from the alleged disclosure or that he conferred the information on Johnson as a gift, when the two were not friends. (*SEC v. Anton*, 2009 WL 1109324 (E.D.Pa. Apr. 23, 2009))

Federal Court Denies Motion to Vacate Arbitration Award

A federal court has granted plaintiff's petition to confirm a $2.1 million arbitration award issued by American Arbitration Association arbitrators in a contract dispute. In opposing plaintiff's petition, defendant moved to vacate the award on two grounds: (i) the arbitrators' alleged improper refusal to grant a continuance to allow defendant to obtain new counsel; and (ii) the alleged partiality of one of the arbitrators due to a personal relationship with one of plaintiff's attorneys. The court denied defendant's motion to vacate in its entirety.

First, the court held that arbitrators acted within their discretion when they refused to grant a continuance and defendant failed to show there was sufficient cause for a postponement. Specifically, the court noted that the hearing at issue had already been postponed at the request of defendant's former counsel and that defendant advised the arbitration panel one day prior to the hearing about its counsel's withdrawal, without offering any reason for such withdrawal.

Second, the court held that defendant failed to show "evident partiality" by an arbitrator. Specifically, although defendant alleged to have overheard conversations between one of the arbitrators and one of plaintiff's attorneys about "numerous shared social experiences," including joint vacations and golf, the court ruled that a reasonable person would not have to conclude from such casual conversations overheard that the arbitrator was partial to plaintiff. Moreover, the court noted that the lawyer for plaintiff filed an affidavit stating that he had no personal, social or professional relationship, or any ex parte communications, with the arbitrator. The court also noted that the fact that the arbitration panel's decision was unanimous goes against the finding of partiality.

Accordingly, the court granted plaintiff's petition to confirm the arbitration award. (*Martik Brothers, Inc. v. Kiebler Slippery Rock*, LLC, 2009 WL 1065893 (W.D.Pa. Apr. 20, 2009))

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BROKER DEALER

FINRA Proposes Amendments to Expand BrokerCheck Disclosure

The Financial Industry Regulatory Authority has proposed changes to the rule (FINRA Rule 8312) that governs how it releases information to the public via its online BrokerCheck system. BrokerCheck has historically limited this public disclosure to certain information regarding current member firms, former member firms, persons currently associated with a member firm and persons who were associated with a member firm within the preceding two years. The proposal would expand BrokerCheck disclosure to include former associated persons with reportable histories even when such persons have not been registered with a firm for over two years.

Read more.

NYSE Arca Proposes Rule 6.62 Amendments

NYSE Arca, Inc. (NYSE Arca) filed with the Securities and Exchange Commission a proposed rule change to amend its Rule 6.62 to (i) offer the "WAIT" order modifier for use with orders entered into the NYSE Arca System; (ii) allow the use of attributable orders; and (iii) offer PNP Plus Orders.

The WAIT modifier will instruct the System to wait precisely one second from the time of order entry before processing the order in accordance with the other instructions attached to that order. Attributable orders allow users to voluntarily display their firm IDs on the orders. A PNP Order is an order entered into the NYSE Arca System for execution on NYSE Arca, but not for routing to away markets. Because of the condition to not route PNP Orders, they are cancelled if they would otherwise lock or cross the national best bid and offer. Generally, the new proposed PNP Plus Order would include functionality that would cause the order to be re-priced and re-ranked with each change in the national best bid and offer.

Read more.

CBOE Proposes Changes to Obvious Error Rules

In a rule filing submitted to the Securities and Exchange Commission on April 8, the Chicago Board Options Exchange, Inc. (CBOE) proposed to amend its rules to create a uniform obvious error approach for options on all equity, index, exchange-traded fund (ETF) and holding company depositary receipts (HOLDRS). As proposed, Rule 24.16 (which currently relates only to options on index, ETF and HOLDRS) would be merged into Rule 6.25 (which currently relates only to equity options). As part of the proposal, Rule 6.25 would be amended with respect to its "Obvious Price Error" provision and to include a provision for a "Catastrophic Error Procedure" (to address certain extreme circumstances). The CBOE also proposed various changes relating to erroneous prints and quotes in the underlying and related instruments, as well as adjustments to the definition of the term "Trading Officials" and the composition of "Obvious Error Panels." The SEC is accepting comments on this rule proposal through May 15.

Read more.

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PRIVATE INVESTMENT FUNDS

Please see "European Commission Announces Proposed Alternative Investment Fund Managers Directive" in **EU Developments** below.

Court Revives Vicarious Liability Claims Against Amaranth Master and Feeder Funds for Market Manipulation

On April 27, Judge Shira Scheindlin of the U.S. District Court for the Southern District of New York revived certain previously dismissed claims alleging that defendants manipulated the prices of natural gas futures contracts in violation of the Commodity Exchange Act. The claims were made against Amaranth Advisors LLC, funds it advised and certain other parties in a class action suit on behalf of parties who traded in natural gas futures and options on futures during a certain period in 2006. Plaintiffs had repled various claims after the court's decision of October 4, 2008, granting defendants' motions to dismiss the claims. The court denied defendants' new motion to dismiss the repled claims alleging vicarious liability on the part of Amaranth LLC (a master fund advised by Amaranth Advisors LLC) and affiliated feeder funds (Funds). Judge Scheindlin ruled that vicarious liability claims against the Funds may proceed based on an alleged agency relationship between each Fund and the investment advisory entities and employees who allegedly engaged in market manipulation. She found that the plaintiffs demonstrated sufficiently for the claim to continue the plausibility of an agency relationship with the feeder funds through written advisory agreements, and of an agency relationship with the master fund based on statements

made by the master fund in another litigation, which agency relationships could be the basis for vicarious liability of the Funds for acts of the agents.

The ruling can be obtained through PACER.

New York, Illinois Ban Payments for Investment of State Retirement Funds

On April 22, New York State Comptroller Thomas DiNapoli published updated policies and procedures banning the use of placement agents, paid intermediaries and registered lobbyists with respect to the State's Common Retirement Fund (CRF) in response to recent events. The revised policies and procedures require any outside investment manager managing assets of the CRF directly (in a managed account or a fund) or, if the CRF has discretion to decline any investment recommended, indirectly through another manager or pooled investment vehicle, to provide a Disclosure Letter to the CRF certifying that no placement agent was employed in connection with the investment and none of the CRF's representatives, advisors or consultants received any benefit in connection with the investment. The Comptroller would like the procedures to be officially adopted into state regulation. The definition of Placement Agent in the policy and procedures appears to encompass any party engaged by covered investment managers to help market and sell fund interests or management services, even if use of a registered broker-dealer in connection with the distribution of fund interests would be required by applicable federal securities laws.

Earlier, on April 3, the Illinois General Assembly passed a number of ethics reforms including prohibitions on employees, board members and spouses of employees or board members of the state's five pension systems from accepting fees or gifts in connection with investment of assets of the plans and a ban on retaining any person or entity to attempt to influence the outcome of an investment decision or decision to obtain investment advice or services by the state pension plans if the compensation is contingent, partially or wholly, on obtaining the investment or mandate. Other legislation is pending that would further clarify the standards applicable to investment managers' and funds' use of paid solicitors and placement agents in connection with a complete reorganization of the Illinois pension system.

To read the New York press release, policies and procedures, click here.
To read the Illinois press release, click here.
For information about pending bill SB1734, click here.

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CFTC

CFTC Adopts Final Definitions of "Public Director"

On April 27, the Commodity Futures Trading Commission announced its adoption of a final definition of "public director" for the acceptable practices to Section 5(d)(15) (Core Principle 15) of the Commodity Exchange Act. Core Principle 15 requires designated contract markets (DCMs) to establish and enforce rules to minimize conflicts of interest in the decision making process; the acceptable practices provide guidance on the composition of a DCM's board of directors and certain committees. The acceptable practices provide, among other things, that at least 35% of a DCM's board and any executive committees consist of public directors, that a DCM's regulatory programs fall under the authority of a board-level regulatory oversight committee consisting exclusively of public directors, and that a DCM's disciplinary panels include at least one public director. The definition of "public director" includes a materiality test, requiring a public director to "have no material relationships with the contract market," and describes certain relationships that are deemed to be material. DCMs must demonstrate full compliance with Core Principle 15 by April 27, 2010.

Read more.

CFTC's Energy and Environmental Markets Advisory Committee to Hold Public Meeting

On April 29, the Commodity Futures Trading Commission gave notice that its Energy and Environmental Markets Advisory Committee will conduct a public meeting on May 13 to discuss energy and environmental market issues. Members of the public wishing to make written or oral statements must inform the Committee in accordance with the procedure outlined in the notice.

Read more.

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BANKING

Treasury Announces Receipt of Applications to Become Fund Managers Under Public Private Investment Program

The U.S. Treasury Department announced on April 29 the receipt of more than 100 "unique" applications from potential fund managers interested in participating in the Legacy Securities portion of the Public Private Investment Program (PPIP). A variety of institutions applied, including "traditional fixed income, real estate, and alternative asset managers." Under Treasury rules applicable to the PPIP, successful applicants must demonstrate a capacity to raise private capital and manage funds in a manner consistent with the Treasury's goal of protecting taxpayers. The Treasury will also evaluate the applicant's depth of experience investing in eligible assets. Finally, the applicant must be headquartered in the United States.

The Treasury expects to inform applicants of their preliminary qualification around May 15. Once a fund receives preliminary qualification, it can begin raising the expected minimum of $500 million in private capital that will serve as the investment that, pending further approval, will be matched with taxpayer funds. Treasury anticipates opening the program to smaller fund managers in the future, which may result in a lower minimum private capital raising requirement.

Since announcing the program details on March 23, the Treasury has encouraged small, veteran, minority and women-owned private asset managers to partner with other private asset managers. On April 6, the Treasury extended the deadline for fund manager applications to provide more time to facilitate these types of partnerships.

Read more.

FinCEN Releases Guidance Regarding Currency Transaction Reporting

On April 27, the Financial Crimes Enforcement Network (FinCEN) released guidance to assist depository institutions in determining the appropriateness of exempting from currency transaction reporting requirements certain non-listed business customers that derive some portion of their annual gross revenues from ineligible business activities.

Under currency transaction reporting regulations, a bank may exempt certain customers from currency transaction reporting requirements if those customers meet specified criteria. An exemption is permitted to a customer deemed to be a "non-listed business", which is defined as a customer that (i) maintained a transaction account at the bank for at least two months or upon which the bank has conducted an appropriate risk-based analysis of the legitimacy of the customer's transactions prior to the customer having maintained such a transaction account for two months; (ii) frequently engages in transactions in currency in excess of $10,000 with the bank; and (iii) is incorporated or organized under the laws of the United States or a state or is registered as and eligible to do business within the United States or a state.

Certain businesses are ineligible for treatment as a "non-listed business", including those operating as a financial institution or as an agent of a financial institution of any type. The guidance makes clear, however, that a customer that engages in multiple business activities, including those that are generally ineligible for the exemption as a

non-listed business, may qualify for an exemption as a non-listed business so long as no more than 50% of its annual gross revenues are derived from one or more ineligible business activities. In order to determine whether a business customer engaged in multiple business activities meets this test, a bank must consider and maintain materials and other information to allow it to substantiate that the decision to exempt such business customer from currency transaction reporting was based upon its reasonable determination of the sources of such customer's gross revenues. According to FinCEN, this assessment should be based upon the institution's "understanding of the nature of the customer's business, the purpose of the customer's accounts, and the actual or anticipated activity in those accounts." Importantly, the regulation requires that the information supporting each designation of an exempt non-listed business customer must be reviewed and verified by the institution at least once per year.

FinCEN's guidance also states that it was developed after consultations with the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

For more information, click here.

Please see "Senate Defeats Mortgage Bankruptcy Cramdown Amendment" in **Structured Finance and Securitization** below.

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STRUCTURED FINANCE AND SECURITIZATION

Senate Defeats Mortgage Bankruptcy Cramdown Amendment

On April 30, Sen. Dick Durbin's amendment to S. 896, the Helping Families Save Their Homes Act of 2009 (the Act), which would have allowed bankruptcy judges to modify mortgages on primary residences, was defeated with twelve Democratic senators voting against the amendment. The House version of the Act, which provides a servicer safe harbor, Hope for Homeowners improvements, Federal Housing Administration changes and reforms to the Federal Deposit Insurance Corporation insurance fund, was previously reported on in the February 27, 2009, and March 13, 2009, editions of *Corporate and Financial Weekly Digest.* A substitute version of S. 896 was introduced by Senate Banking Committee Chairman Christopher Dodd and Sen. Richard Shelby that does not contain bankruptcy cramdown provisions and that contains different servicer safe harbor provisions from the original legislation.

For information on the Senate vote, click here.
For the new text of S. 896, click here.

FRBNY Issues Guide to Investors on Obtaining TALF Loans

On April 28, the Federal Reserve Bank of New York posted two additional documents to its website that provide an overview of the process that potential investors should follow in order to obtain a loan under the Term Asset-Backed Securities Loan Facility.

For more information, click here.

Please see "Treasury Announces Receipt of Applications to Become Fund Managers Under Public Private Investment Program" in **Banking** above.

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ANTITRUST

Maryland Passes Law Making Resale Price Maintenance Per Se Illegal

On April 14, Governor Martin O'Malley signed Maryland Senate Bill 239, which amended Maryland's antitrust laws and made it illegal for manufacturers to require retailers to charge minimum prices for goods. The law specifically prohibits any "contract, combination, or conspiracy that establishes a minimum price below which a retailer, wholesaler, or distributor may not sell a commodity or service." This practice, also known as minimum resale price maintenance (RPM), was the subject of the Supreme Court's 2007 ruling in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007). In that case, the Court overturned a 100-year-old antitrust doctrine and found that RPM was not per se illegal, but rather that such claims would be subject to the "rule of reason," whereby a plaintiff must demonstrate actual harm to competition arising from the challenged practice. Maryland's new law, which takes effect on October 1, is a direct response to the Supreme Court's ruling in *Leegin* and restores the rule of per se illegality for RPM, at least for sales in Maryland.

Maryland's antitrust law already bans price-fixing; however, its state antitrust law follows the federal courts' interpretations of the Sherman Act. Since the Supreme Court determined that claims of RPM, a type of price-fixing, would be subject to the rule of reason analysis, Maryland courts would follow that federal interpretation when interpreting its own state antitrust law. Now, with this amendment to Maryland law, Maryland courts can once again explicitly forbid RPM under state antitrust law.

Other states may follow Maryland's lead, as more than thirty states' attorneys general had filed amicus curae briefs with the Court in connection with *Leegin*, arguing in favor of per se analysis for RPM claims. In addition, Sen. Herb Kohl has introduced a bill in the U.S. Senate titled the Discount Pricing Consumer Protection Act. This legislation, if passed, would once again make RPM per se illegal under federal antitrust law. Hearings on the bill are scheduled to take place next month.

Read more.

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UK DEVELOPMENTS

FSA Fines and Bans Manager for Mismarking Trading Positions to Hide Losses

On April 29, the UK Financial Services Authority (FSA) published the Final Notice issued to Mr. Loic Montserret, a former manager with BlueCrest Capital Management Limited (BlueCrest). The FSA fined Mr. Montserret £35,000 (approximately $52,000) and issued a prohibition order banning him from performing any controlled function at an FSA-regulated firm. This is the first time that the FSA has both banned and fined an individual for mismarking trading positions.

Mr. Montserret was a portfolio manager for one of BlueCrest's funds and had sole responsibility for managing the investments of one of that fund's trading books. The FSA makes no criticism of BlueCrest in the final notice.

After a significant fall in the value of the trading book for which Mr. Montserret was responsible, he mismarked four equity index options, valuing them at a multiple of between two and three times their true market price. The mismarking continued for 10 days until Mr. Montserret admitted his conduct to the head of his trading desk. At its worst, his conduct resulted in the Fund being overvalued by $8.6 million.

The FSA found that Mr. Montserret breached Statement of Principle 1 of the FSA's Principles for Approved Persons, acting without honesty and integrity. His actions prevented BlueCrest from effectively monitoring his trading book and resulted in customers receiving incorrect information on the Fund's valuation. This created a risk that customers would make investment decisions based on that incorrect information. As it happened, the Fund's independent month-end valuation was not affected, so the risk did not crystallise.

Margaret Cole, FSA Director of Enforcement, said, “It is important that investors can trust market professionals to always do their job appropriately and fairly. Our tough action in this case should serve as a deterrent to others who might damage market confidence by acting in a similar manner.”

Read more.

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EU DEVELOPMENTS

European Commission Announces Proposed Alternative Investment Fund Managers Directive

On April 29, the European Commission announced a proposed Alternative Investment Fund Managers Directive (Proposed Directive). The Proposed Directive has not yet been published by the Commission. The Proposed Directive requires approval by the European Parliament and the European Council. It will not come into force until two years after that approval, at the earliest in late 2011.

The Proposed Directive will apply to alternative investment fund managers (AIFMs) managing a portfolio of more than €100 million (approximately $130 million). A higher threshold of €500 million (approximately $665 million) applies to AIFMs that do not use leverage and have a lock-in period of five years or more. AIFMs are defined to include not just managers of hedge funds, private equity funds and other alternative investment funds, but all managers of funds which are not UCITS funds meeting the requirements of the UCITS Directive 85/611/EEC. (UCITS funds are open-ended funds investing in transferable securities and certain other financial instruments which can be marketed to the general public in EU Member States). This will include, for example, managers of real estate funds, commodity funds and infrastructure funds.

The press release and frequently asked questions (FAQs) which the Commission has published indicate that the Proposed Directive:

- will require AIFMs to be authorized by the financial services regulator in their home state;
- will subject AIFMs to meet ongoing minimum financial resources requirements and other regulatory requirements including information disclosure to regulators with respect to its principle exposures, performance data and risk concentrations;
- will apply regulatory standards to key service providers to alternative investment funds, including requiring regulated depositaries and regulated valuation agents (valuators);
- will require AIFMs to meet defined standards with respect to management of risk, liquidity and conflicts of interest; and
- will permit AIFMs to market alternative investment funds to professional investors throughout the EU under a private placement regime. This will apply to funds established in non-EU jurisdictions only after a transitional period of three years from the date the Proposed Directive comes into effect and will be conditional on the jurisdiction of the fund’s domicile being recognized by the EU as having equivalent regulatory and supervisory standards and information-sharing and co-operation arrangements on tax and other matters.

The Commission stated that it anticipates “intense political discussion and negotiation” in view of the subject matter. It is clear that when the Directive is finally enacted it is likely to differ in significant respects from the Proposed Directive. On one side, the UK government and industry bodies such as the Hedge Fund Standards Board and the Alternative Investment Management Association have condemned the proposed Directive as too heavy handed. On the other side, the Socialist Group of the European Parliament has expressed its dismay that the proposal does not go far enough. The Socialist Group has spoken of a “proposal filled with loopholes which make the real regulatory effects highly ineffective” and is complaining that the Commission is proposing to regulate “only fund managers” and not the funds themselves.

Read more.

Commission Announces Two Recommendations on Remuneration

On April 29, the European Commission announced two Recommendations on remuneration: a Recommendation on remuneration in the financial services sector (FS Remuneration Recommendation) and a Recommendation on the regime for the remuneration of directors of listed companies (Directors' Pay Recommendation). Neither Recommendation has yet been published. So far the Commission has only published press releases and frequently asked questions (FAQs) in relation to the two Recommendations.

The FS Recommendation invites Member States to ensure that financial institutions have remuneration policies for risk-taking staff that are consistent with and promote sound and effective risk-management.

The FS Recommendation covers four areas:

- *Structure of pay*: Remuneration policies for risk-taking staff should be consistent with and promote sound and effective risk management. Financial institutions should strike an appropriate balance between basic pay and bonuses. The payment of the major part of any bonus should be deferred in order to take into account risks linked to the underlying performance through the business cycle. Performance measurement criteria should emphasize longer-term performance adjusted for risk, cost of capital and liquidity. There should be provisions for clawback of bonuses based on misstated data.
- *Governance*: The remuneration policy should be transparent internally, should be clear and properly documented and should contain measures to avoid conflicts of interest.
- *Disclosure*: There should be clear and easily understandable disclosure of the core elements of the remuneration policy; its design and operation should be disclosed to stakeholders.
- *Supervision*: Supervisors of financial institutions should ensure that sound remuneration policies are applied and are consistent with effective risk management.

In June, the FS Recommendation will be followed up by proposals to revise the Capital Requirements Directive to ensure that regulatory capital adequately covers the risks inherent in remuneration policies as well as banks' trading books and securitization positions.

The Directors' Pay Recommendation applies to directors of listed companies. It supplements previous Recommendations 2004/913/EC and 2005/162/EC. The new Directors' Pay Recommendation introduces limits on severance pay and bans severance pay in case of failure.

Further specific recommendations include the extension of existing disclosure requirements to improve shareholder oversight of remuneration policies; prohibiting non-executive directors from receiving share options as part of their remuneration to avoid conflict of interests; and strengthening the role of remuneration committees.

For more information on the FS Remuneration Recommendation, click here.
For more information on the Directors' Pay Recommendation, click here.

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