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Corporate and Financial Weekly Digest

May 18, 2007

SEC/Corporate

SEC to Meet on Internal Controls and Disclosure Requirements

On May 16, the Securities and Exchange Commission gave notice that it will hold an open meeting on May 23, to consider (i) whether to adopt interpretative guidance for management regarding its evaluation and assessment of internal control over financial reporting, (ii) rule proposals addressing the registration and disclosure requirements for smaller companies and private offerings of securities and (iii) whether to adopt rules to implement provisions of the Credit Rating Agency Reform Act of 2006.

In connection with its consideration of interpretive guidance regarding the evaluation and assessment of internal control over financial reporting, the SEC will also consider whether to adopt amendments to Rules 13a-15(c) and 15d-15(c) of the Securities Exchange Act of 1934, as amended, that would make it clear that an evaluation that complies with the SEC's interpretive guidance would satisfy the annual management evaluation required by those rules. In addition, the SEC will consider whether to adopt amendments to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X to require the expression of a single opinion directly on the effectiveness of internal control over financial reporting by the auditor in its attestation report, and whether to adopt amendments to Exchange Act Rule 12b-2 and Rule 1-02 of Regulation S-X to define certain terms.

In its consideration of the registration and disclosure requirements for smaller companies, as well as private offerings of securities, the SEC will consider whether:

- to propose amendments to increase the number of companies eligible for the scaled disclosure and reporting requirements for smaller reporting companies;
- to propose amendments to expand the eligibility requirements of Form S-3 and Form F-3 to permit registration of primary offerings by companies with a public float of less than $75 million, subject to restrictions on the amount of securities sold in any one-year period;
- to propose exemptions from the registration requirements of the Exchange Act for grants of compensatory employee stock options by non-reporting companies;
- to propose a new Regulation D exemption for offers and sales of securities to a newly defined subset of "accredited investors" and revisions to the Regulation D definition of "accredited investor," disqualification provisions, and integration safe harbor, and to provide interpretive guidance regarding integration;

SEC/CORPORATE

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- to propose revisions to Form D and mandate electronic filing of Form D; and
- to propose amendments to Rule 144 to revise the holding period for the resale of restricted securities, simplify compliance for non-affiliates, revise the Form 144 filing thresholds, and codify certain staff interpretations, as well as to propose amendments to Rule 145.

http://www.sec.gov/news/openmeetings/2007/ssamtg052307.htm.

PCAOB to Vote on Final Standard on Auditing Internal Control

On May 16, the Public Company Accounting Oversight Board (PCAOB) announced that on May 24, it will vote on a final standard on auditing internal control over financial reporting, as well as a related independence rule and conforming amendments to the PCAOB's auditing standards. If adopted, the new standard would supersede the PCAOB's existing auditing standard, Auditing Standard No. 2, "An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements."

The PCAOB open meeting is scheduled for 9:30 a.m. and will be held in the PCAOB's open meeting room at 1666 K Street, N.W., Washington, D.C. The meeting will be open to the public and will be webcast via a link on the PCAOB's web site (www.pcaobus.org) that will be made available on the day of the meeting. The open meeting also will be available via podcast later in the day.

http://www.pcaobus.org/News_and_Events/News/2007/05-16.aspx.

Broker Dealer

No Rule 144 Tacking Limited Liability Company Interest with Successor Corporation Stock

The Securities and Exchange Commission staff denied the request of Smart Move, Inc. to allow shareholders to tack their holding period of the corporation stock with their holding period of membership interests in the predecessor limited liability company. The reorganization into the corporation occurred when the limited liability company merged into its wholly owned corporate subsidiary. The staff reply gave no explanation why this was contrary to its position in Hygeia Sciences, Inc., p.a. March 13, 1986. Hygeia set forth five elements to tack holding periods of a limited liability company membership interest with stock of a successor corporation. These are: (i) the governing document contemplates the reorganization; (ii) equity holders of the predecessor entity may not veto or have meaningful decision-making authority with respect to the reorganization; (iii) in the reorganization equity holders receive shares proportionate to their equity interests in the predecessor; (iv) the successor corporation carries on substantially the same business as the predecessor; and (v) no additional consideration was paid for the shares received in exchange for their membership interests. The only distinction between the two situations was the original limited liability company agreement in Smart Move did not provide for a succession without member consent, but it was amended to do so.

http://www.sec.gov/divisions/corpfin/cf-noaction/2007/smartmove051607-144.htm

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SROs Require Twice a Month Reporting of Short Interest

Effective September 1, broker-dealers must report open short interest positions in all securities they carry, listed or not, twice a month. Generally, this means open short positions on a settlement date on the 15th and last business day of each month, and if that is not a settlement day, on the preceding business day, reports are due, generally, two business days later.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_019161.pdf

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852572DD006F0D63/$FILE/Microsoft%20Word%20-%20Document%20in%2007-45.pdf

NASD Trade Reporting for Exemptions From NMS Rule 611

The National Association of Securities Dealers has identified five fields in its trade reporting requirements to identify exceptions to Regulation NMS Rule 611's requirements not to trade through existing national best bid and offer quotations. These require a firm to identify, a trade relying upon such an exemption including settlement type, specifying one of the exceptions in Rule 611(b), whether the trade was reported late or executed outside normal market orders, and information referenced under NASD rules – e.g., vwap trades, stopped stock, etc.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_019150.pdf

NYSE Reminds Members of Regulation NMS Compliance Dates

NYSE Regulation Inc. has issued Information Memorandum 07-44 reminding members of the following Reg NMS compliance dates:

- July 9 – the start of full industry compliance with Regulation NMS for 250 NMS stocks (100 NYSE stocks, 100 NASDAQ stocks, and 50 Amex stocks).
- July 9 until August 20 – the revised Pilot Stocks Phase, which marks the start of full industry compliance with Regulation NMS for all remaining NMS stocks.
- August 20 until October 8 – the revised All Stocks Phase, which marks the completion of phased-in compliance with Regulation NMS.

October 8 is the final date for compliance with Rules 610 (non-discriminatory access to quotation) and 611 (trade-throughs prohibited) and also reminded members of the need to use appropriate trade modifiers when reporting trades.

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852572DB004FD736/$FILE/Microsoft%20Word%20-%20Document%20in%2007-44.pdf

Investment Companies and Investment Advisers

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

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Failing Balance Sheet Test But Operating Substantial Business Does Not Make You an Investment Company

The Seventh Circuit ruled in *Securities and Exchange Commission v. National Presto Industries, Inc.* that while National Presto met the definition of an inadvertent investment company under the Investment Company Act of 1940 (Company Act) because more than 40% of its assets were securities other than government securities, cash and securities of subsidiaries, it was not an investment company under the Company Act. National Presto used to manufacture cookware, diapers, other household items and munitions. It sold off most of its manufacturing plants and contracted one manufacturing operation. The court noted that it held intellectual property of substantial value that was not carried on its books at its full economic value.

National Prestos' arguments that its investment in pre-funded municipal bonds backed by government securities were the equivalent of investment in governments and its investment in auction rate notes with weekly resets and rights of redemption was the equivalent of cash and could have brought it below the 40% test were rejected. The court applied the five part test set forth in *In re Tonopah Mining Co*., 26 Sec 426 (1947), and noted this was the first time the SEC argued that a firm with a substantial ongoing presence in product markets was an inadvertent investment company.

The tests as applied are: (i) company's history – here the court noted that National Presto continuously sold consumer products and munitions; (ii) how it presents itself to the investing public – the company's website, annual report and publicity depict it as an operating company; (iii) activities of its officers and directors – 95% of its managers time is devoted to running its consumer products and munitions businesses; (iv) source of its income-- in the period covered 50.22% of its net profits were derived from securities investments; and (v) nature of its assets -- although National Presto met the 40% test, the court noted that assets, such as patents and trademarks, that do not show up on a balance sheet make applying a balance sheet test misleading.

http://www.ca7.uscourts.gov/tmp/370PZ7CK.pdf

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Banking

Joint Interim Rules Expanding Examination Cycle for Certain Financial Institutions Issued

Effective April 10, the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision (collectively, the Agencies) jointly issued interim rules to implement the Financial Services Regulatory Relief Act of 2006. In particular, the Agencies are amending their respective rules to raise, from $250 million to $500 million, the total asset threshold below which an insured depository institution that meets certain other requirements may qualify for an 18-month (up from 12 months) onsite examination cycle.

In addition, institutions with between $250 million and $500 million in total assets that received a composite rating of 1 or 2 (under the CAMELS rating system), and that meet certain other criteria, may qualify for an 18-month examination cycle. The relevant Agencies are also making conforming changes to similarly expand the examination cycle (to 18 months) for the U.S. branches and agencies of foreign banks.

In connection with these changes, the Agencies have also made clear that a small institution meets the statutory "well managed" criteria for an 18-month examination cycle (pursuant to Section 10(d) of the Federal Deposit Insurance Act) if the institution has not only a CAMELS composite rating of 1 or 2, but also received a rating of 1 or 2 for the management component of the

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CAMELS rating at its most recent examination.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/07-1716.pdf

United Kingdom Developments

FSA Fines Private Bank for Weak Anti-Fraud Controls

The Financial Services Authority (FSA) announced on May 10 that it had fined BNP Paribas Private Bank £350,000 (approximately $690,000) for weaknesses in its anti-fraud systems and controls. This is the first time a private bank has been fined for weaknesses in its anti-fraud systems.

Between February 2002 and March 2005 a senior employee was able to fraudulently transfer £1.4 million out of clients' accounts using forged signatures and instructions and by falsifying change of address documents. The fraud was detected in 2005 and brought to the attention of the FSA.

After the bank brought the fraud to the FSA's attention, it co-operated fully with the investigation and qualified for a 30% discount on the penalty imposed by agreeing to settle at an early stage.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/060.shtml

FSA Fines Firm $240,000 for Unauthorized Investment Management

On May 11, the Financial Services Authority (FSA) has fined Charterhouse Consulting Wealth Management Limited (Charterhouse) £122,500 (approximately $240,000) for carrying out discretionary portfolio management without permission and for various conduct of business failings.

Charterhouse did not have the appropriate regulatory permission to act as a discretionary investment manager. The FSA found that Charterhouse would often send clients an email before 6.30 am in the morning proposing the switching of funds and requiring a response by 8.00 am. Switches would then take place without any instruction from the client. Charterhouse also failed to record sufficient “know your client” information to demonstrate the suitability of its advice, it failed to ensure transactions were appropriate for customers in light of their attitude to risk and it failed to communicate with its clients in a clear, fair and not misleading manner.

The FSA stated that the fine imposed took into account the mitigating steps taken by Charterhouse to prevent a recurrence of these rules breaches Charterhouse also agreed to settle at the earliest opportunity. The fine would otherwise have been £175,000 but the actual penalty reflected a 30% discount.

http://www.fsa.gov.uk/pubs/final/charterhouse_11may07.pdf

FSA Recognizes First Industry Guidance

In November 2006, the Financial Services Authority announced that as part of its move to “more principles-based regulation” it would recognize certain industry developed guidance and issued a Discussion Paper on the methodology for doing this.

The FSA has now confirmed that its supervision of outsourcing by firms will in the future take account of industry guidance which has been issued by MiFID Connect, a joint project established by eleven financial services industry

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associations. This is the first guidance developed by the industry which the FSA has recognized. It is also the first formal industry guidance related to the EU Markets in Financial Instruments Directive. The FSA has approved this Guidance before formally responding to the November 2006 Discussion Paper.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/062.shtml

UK Treasury Encourages EU Enforcement

UK Treasury Minister Ed Balls released the text of a letter he wrote on May 15 to Charlie McCreevy, European Commissioner for the Internal Market and Services, setting out his concerns over the potential failure of some EU Member States to implement the Markets in Financial Instruments Directive (MiFID) by the November 2007 deadline.

The letter welcomes the European Commission's efforts to force Member States to implement MiFID on time and urges it to maintain the pressure on member states to ensure the implementation deadline is successfully reached.

So far only the UK, Romania and Ireland have enacted the necessary domestic legislation and regulations needed to implement into national law the measures set out in MiFID. The failure of other Member States to do this will make it difficult or impossible to achieve the envisaged single market in financial services.

http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2007/press_56_07.cfm

Litigation

Plaintiff Class Adequately Pleaded Securities Fraud Claims

The shareholders of Nash Finch Company filed a securities fraud class action, alleging that the company and its officers made materially false and misleading statements concerning its acquisition of two major food distribution centers, including misrepresenting the increase in revenues and earnings that would result from the acquisitions. The complaint also alleged that the misrepresentations enabled the individual defendants to sell shares of Nash Finch stock at a higher price than they would otherwise have received. Defendants moved to dismiss, contending, among other things, that the alleged misrepresentations were not actionable because they were accompanied by cautionary language and that plaintiffs failed to adequately plead scienter as required by the Private Securities Litigation Reform Act (PSLRA). The court rejected these arguments.

The court found that the safe harbor that protects forward-looking statements accompanied by meaningful cautionary language did not support dismissal. After ruling that cautionary language cannot be "meaningful" if a defendant had actual knowledge of the falsity of the allegedly false forward looking statement, the court found that plaintiffs' allegations raised fact questions as to whether defendants knew their statements of anticipated revenues and earnings growth were false when made. In reaching this conclusion, the court determined that plaintiffs' allegations that defendants had "actual knowledge" of the falsity of their statements, which allegations were based on information from confidential witnesses formerly employed by Nash Finch and other reliable sources, satisfied PSLRA's heightened pleading standards.

The court also found that plaintiffs adequately pleaded scienter, noting that allegations of "motive and opportunity" can establish scienter and that insider

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sales may be probative of motive. After finding that the timing and amount of the defendants' sales were suspicious and "dramatically inconsistent" with their prior trading practices, the Court ruled that the sales, coupled with plaintiffs' allegations of defendants' knowing misrepresentations and the unexpected resignations of senior officers after the Securities and Exchange Commission began an insider trading investigation, established a strong inference of scienter as required under the PSLRA. (*In re Nash Finch Co. Securities Litigation*, 2007 WL 1266658 (D. Minn. May 1, 2007))

Plaintiff Sufficiently Stated and Had Standing to Pursue Antitrust Claims

A corporation engaged in the business of shipping and transporting bulk liquid chemicals brought an action to recover damages incurred as a result of defendants' alleged conspiracy to, among other things, fix the price of international shipments of liquid chemicals, allocate customers, rig bids, and eliminate competitors, including plaintiff, by targeting their customers and employing predatory pricing tactics in violation of Section 1 of the Sherman Antitrust Act. Plaintiff commenced the lawsuit after filing for bankruptcy.

Defendants moved to dismiss the complaint on multiple grounds, including that plaintiff lacked standing to pursue the claims and that plaintiff failed to sufficiently state a claim for predatory pricing. Defendants argued that because plaintiff was not a customer of defendants and did not compete in the same market as defendants it lacked standing under the antitrust laws. While recognizing that the plaintiff operated in an entirely different geographical region than the defendants, the court rejected the argument because the complaint alleged that the conspiracy covered "the entire parcel tanker industry." The court reasoned that facts obtained in discovery could enable the plaintiff to show "interconnectedness" between the routes plaintiff operated and the routes defendants operated. Accordingly, dismissal at the pleading stage was not warranted.

Defendants' challenge to plaintiff's predatory pricing claim was also found to be deficient. Defendants based their argument on plaintiff's failure to plead that (i) defendants' set their prices below their "average variable costs", and (ii) there was a likelihood that defendants would be able to recoup such costs later on. While the court found support for defendants' position in the recent United States Supreme Court decision in *Weyerhauser Co. v. Ross-Simmons Hard-Wood Lumber, Co.*, No. 05-381 549 U.S. ___ (2007), it ruled that the burden defendants sought to impose on plaintiff, even after *Weyerhauser*, did not apply at the pleading stage. Accordingly, after noting that a heavier burden would arise at the summary judgment stage, the court ruled that plaintiff was not required to allege the specific terms of the defendants' alleged predatory pricing in the complaint and denied the motion to dismiss the claim. (*In re Parcel Tanker Shipping Services Antitrust Litigation*, 2007 WL 1346921 (D. Conn. May 4, 2007))

CFTC

CFTC Proposes Exempting Credit Default Products From CEA

The Commodity Futures Trading Commission has proposed to exempt the trading and clearing of certain credit default products that are proposed to be traded on the Chicago Board Options Exchange and cleared through The Options Clearing Corporation (OCC) from any applicable provisions of the Commodity Exchange Act (CEA). The CEA empowers the CFTC to exempt any transaction or class of transactions from most provisions of the CEA if, among other things, the CFTC determines that the exemption would be consistent with the public interest. The CFTC is requesting comment on whether it should exempt the credit default options and credit default basket

CFTC

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options to be listed and traded on the CBOE and cleared through the OCC, from provisions of the CEA that might otherwise be applicable to the trading and clearing such transactions. The comment period expires May 29.

http://www.cftc.gov/opa/press07/opa5334-07.htm

http://www.cftc.gov/files/foia/fedreg07/foi070514a.pdf

New Financial Requirements of Section 14 of the NFA Rules

In a Notice to Members dated May 15, the National Futures Association (NFA) announced that the Commodity Futures Trading Commission has approved new Section 14 of NFA's Financial Requirements (Assets Covering Liabilities to Retail Forex Customers). The new rule requires Forex Dealer Members (FDMs) to maintain sufficient assets at qualifying institutions located in the U.S. or a money center country (as defined in CFTC Regulation 1.49) to cover their liabilities to U.S. retail customers. The CFTC also approved a related amendment to an NFA Interpretive Notice. As amended, the Notice prohibits FDMs and their associates and agents from representing that forex funds are more secure because of the new requirements under Section 14. The amendments become effective July 1.

http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=1832

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