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SEC/Corporate

SEC May Consider Corporate Use of Blogs

Christopher Cox, Chairman of the Securities and Exchange Commission, has invited the Chief Executive Officer and President of Sun Microsystems Inc., avid blogger Jonathan Schwartz, to speak to the SEC about the idea of allowing companies to disclose significant financial information through web blogs. Chairman Cox's posting on Mr. Schwartz's blog was in response to a September 25 letter from Mr. Schwartz in which Mr. Schwartz suggested that, in light of the evolution of the Internet, the SEC should allow certain types of corporate website postings, including electronic mail alerts, to satisfy the broad non-exclusionary dissemination conditions of Regulation FD.

Chairman Cox commented that the SEC has recognized the importance of corporate websites and the Internet in providing important corporate information and developments to the market, both in connection with capital raising and disclosing ongoing corporate developments and also acknowledged that corporate websites are a tremendous vehicle for the broad delivery of timely information. But he questions whether there exist effective means to guarantee that a corporation uses its website in ways that assure broad non-exclusionary access.

The full text of Chairman Cox's response is available at
http://blogs.sun.com/jonathan/entry/sunlight_on_a_cloudy_day...#comments

Big Four Call for Company Accounts Rethink

The world's biggest accounting firms have joined forces to call for a radical overhaul of how companies report performance. They will propose changes that would result in the most significant shake-up of the data flows that sustain markets since the U.S. introduced accounting standards and independent auditing in the 1930s.

Heads of the "big-four" accounting firms, Ernst & Young, PricewaterhouseCoopers, Deloitte & Touche and KPMG, together with Grant Thornton and BDO Seidman, are calling for quarterly financial statements to be replaced by real-time, Internet-based reporting, encompassing a wider range of performance measures. The "big-four" reason that many non-financial measures provide a more valuable indication of a company's future prospects, and that corporate reporting has been largely untouched by the Internet which has revolutionized the way companies operate. Mike Rake, Chairman of KPMG International, has stated that "[t]here are significant shortcomings to U.S. GAAP (generally accepted accounting principles) and issues of concern with international financial reporting standards. We're not in a very happy situation."

The accounting firms are seeking to provoke regulators and policy makers to take action that will address rising anger over the cost and perceived irrelevance of much financial reporting. The proposed changes are likely to meet resistance from companies and skepticism from some market watchdogs.
For a link to the Big Four Report, see
http://www.globalpublicpolicysymposium.com/CEO_Vision.pdf

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Banking

OTS Introduces Enhanced NPV Model for Monitoring Interest Rate Risk

WASHINGTON, D.C. – The Office of Thrift Supervision (OTS), which regulates the nation's savings banks, announced on November 6 that it is enhancing its Net Portfolio Value (NPV) Model. The Enhanced NPV Model will expand the OTS's off-site monitoring capability of the interest rate risk exposure of individual thrift institutions, and improve the efficiency and effectiveness of on-site examinations. It will also further improve the agency's unique ability, available only to OTS regulated institutions, to provide institutions with quarterly estimates of their interest rate risk exposures.

The new model will provide institutional users with greater transparency and accessibility, expanded interest rate risk reports, and greater accuracy in pricing routines for single-family mortgages and financial derivatives. Key upgrades to the existing model include the addition of customized interest rate risk stress scenarios, and new pricing routines for a variety of financial instruments with embedded options.

The OTS indicated that the Enhanced NPV Model will be used for the September 2006 financial reporting cycle. Additional information on the current and Enhanced NPV Models can be found in the *Quarterly Review of Interest Rate Risk*, 4th Quarter 2005 and 1st Quarter 2006 and the *NPV Model Handbook* on the OTS web site.
http://www.ots.treas.gov/

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Broker Dealer

SEC Approves Regulation NMS Exemption for Certain Sub-Penny Trade-Throughs

Regulation NMS, the implementation of which begins May 21, 2007 and will be completed by October 8, 2007, requires a trading center to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs of protected quotations in National Market System stocks. The SEC in Rule 611(d) is exempting trading centers from the foregoing requirement of Rule 611(a) when: (i) the price of the protected quotation that is traded through is $1.00 or less; and (ii) the price of the trade-through transaction is less than $0.01 away from the price of the protected quotation that was traded through. In the absence of an exemption, trading centers generally would be required to prevent the

execution of incoming orders against their own displayed quotations with prices that could be only $0.0001 away from a protected quotation displayed by another trading center.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-18635.pdf

SEC Approves Amendment to Research Report Rules

The Securities and Exchange Commission approved amendments to NASD Rule 2711 and NYSE Rule 472, which govern research analysts and research reports. The amendments simultaneously create new exemptions to the rules and broaden their scope by altering the definitions of several key terms.

One of many changes is exclusion of the following from the definition of "research report:" (i) reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index; (ii) reports commenting on economic, political or market conditions; (iii) technical analysis concerning the demand and supply for a sector, index, or industry based on trading volume and price; (iv) statistical summaries of multiple companies' financial data, including listings of current ratings; (v) reports that recommend increasing or decreasing holdings in particular industries or sectors; and (vi) notices of ratings or price target changes. This exclusion requires that the member organization simultaneously directs the readers of the notice to the most recent research report on the subject company that includes all applicable and any updated disclosures. The rule also exclude research reports distributed to fewer than 15 persons.

In addition, the rules now specifically include "conference calls" in the definition of "public appearance." However, password-protected webcasts, conference calls, and similar events with fifteen or more existing customers are excluded when: (i) the event participants have previously received the most current research report or other documentation pertaining to the equity security in question, which documentation includes the applicable disclosures; and (ii) during the public appearance, the research analyst corrects or updates any disclosures that are inaccurate, misleading or no longer applicable. Notwithstanding the foregoing, a public appearance would include attendance at a seminar or conference call with 15 or more persons unless such persons represent less than 15 investors, and seminars and conference calls with one or more media representatives in attendance, even if there are less than 15 persons in attendance.
http://www.sec.gov/rules/sro/nyse/2006/34-54616.pdf

FinCEN Proposes Lowering Levels for Recording Money Transfers

The Financial Crimes Enforcement Network Department of the Treasury (FinCEN) and the Board of Governors of the Federal Revenue System (Fed) currently require broker-dealers, futures commission merchants and introducing brokers to record and retain specified records in connection with the transmittal of funds of $3,000 or more. This requirement does not apply when the transmitter and the recipient are any of (i) a bank, (ii) a wholly owned domestic subsidiary of a bank, (iii) a broker-dealer, futures commission merchant or introducing broker, (iv) a wholly owned domestic subsidiary of a broker-dealer, futures commission merchant or introducing broker, or (v) the U.S. or a state or local government. FinCEN and the Fed have proposed to lower the recordkeeping requirements to transmittals of $1,000 or more, and requested comments on elimination of the minimums for recordkeeping.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/06-5567.pdf

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United Kingdom Developments

The Companies Act 2006 Completes its Passage through Parliament

The Companies Act 2006 completed its passage through Parliament on November 8, receiving Royal Assent.

The Act, which, with 1300 sections, is the longest ever UK statute, introduces sweeping changes intended to simplify and improve company law and also consolidates the current UK Companies Acts. The Department of Trade and Industry announced the Act's Royal Assent stating: "company law has been substantially rewritten to make it easier to understand and more flexible - especially for small businesses."

About a third of the Act is intended to be a restatement of the previous law in clearer and simpler language. The effective dates for the Act's various provisions will vary. The Government has stated that it expects all provisions to be implemented by October 2008.

The Act includes provisions that:

- give greater clarity on directors' duties, including making clear that they have to act in the interests of shareholders, but in doing so have to pay regard to the longer term, the interests of employees, suppliers, consumers and the environment;

- implement the EU Takeovers and Transparency Directives (these provisions are expected to be in force by January 2007);

- encourage narrative reporting by companies to be forward-looking, covering risks as well as opportunities, with explicit requirements for quoted companies;

- provide an option for all directors and shareholders to file a service address on the public record rather than a private address;

- promote shareholder engagement by enhancing the powers of proxies and making it easier for indirect investors to be informed and exercise governance rights in the company;

- create a new offence of recklessly or knowingly including misleading, false or deceptive matters in an audit report;

- provide a power to require institutional investors to disclose how they use their votes. The Government has stated that it hopes that such disclosure will be achieved without the need to exercise the power and that regulations will not be put in place without prior consultation and a detailed cost analysis;

- simplify the regime applicable to private companies including: the introduction of new model articles of association and providing that a private company is no longer obliged to have a company secretary or an annual general (shareholders) meeting.

The full text of the Act as passed is expected to be available towards the end of November. Among its simplifications of prior law, the Act extends to the whole of the UK, so that there will no longer be a separate company law regime for Northern Ireland.
http://www.publications.parliament.uk/pa/pabills/200506/companies.htm

FSA Reviews its Approach to the Private Equity Market

On November 6, the UK's Financial Services Authority (FSA) published discussion paper DP06/6 *Private equity: a discussion of risk and regulatory engagement* seeking industry views on the impact that the growth of the private equity market over recent years has had on the UK's capital markets.

Developments in private equity markets such as increased leverage on transactions, the use of complex risk transfer mechanisms (e.g. assignment and sub-participation) and an increased use of credit derivatives have led the FSA to conclude that their may be an increased risk to the stability of the UK's financial markets and may reduce the efficiency of the UK's capital markets. The FSA is also increasingly concerned about the risks of market abuse from the use of price-sensitive information between market participants and conflicts of interest that may arise between a private equity fund, its investors and any companies it owns. DP06/6 sets out in detail the risks that the FSA has identified in the private equity markets.

Currently, the FSA closely supervises 14 of the largest private equity and venture capital managers and risk mitigation programs that have been established for those firms. As a result of the FSA's recent concerns, they are now planning further action and are seeking the industry's views. Additional actions that the FSA proposes to take include establishing an "alternative investments centre" team within the FSA to increase the use of targeted market surveillance.
http://www.fsa.gov.uk/pubs/discussion/dp06_06.pdf

Fraud Act 2006 Passed

The Fraud Act 2006 also received Royal Assent on November 8. It creates a new general offence of fraud replacing various prior criminal offences involving deception offences under various criminal statutes.

The new fraud offence can be committed

- by false representation;
- by failing to disclose information; or
- by abuse of position

http://www.publications.parliament.uk/pa/pabills/200506/fraud.htm

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Litigation

Antitrust Claims Dismissed for Lack of Standing and Failure to Plead Concerted Action

Plaintiff, an internet merchant, sued MasterCard International, Inc., alleging, *inter alia*, that MasterCard's chargeback policies for internet transactions that customers disputed and canceled violated Section 1 of the Sherman Act. MasterCard is comprised of and owned by more than 20,000 member banks. Plaintiff alleged that MasterCard's chargeback policies forced internet merchants to assume the risk of fraud by not extending to them the same payment guarantee MasterCard provided to merchants who were able to produce customer-signed sales receipts for disputed charges. Affirming the District Court's decision, the

Second Circuit held that plaintiff lacked antitrust standing and could not demonstrate antitrust injury. MasterCard's chargebacks for cancelled transactions were assessed against the member banks, not internet merchants. While the Court acknowledge that "generally" these costs were passed on to the merchants, this was of no help to the plaintiff, who the Court characterized as an indirect payor "analogous to" the famously unsuccessful "indirect purchasers" in *Illinois Brick*. Simply put, such indirect impact prevented the plaintiff from establishing the requisite "antitrust injury." A separate fatal flaw was the plaintiff's failure to plead that MasterCard's member banks entered into a joint agreement to pass these costs on to the merchants. According to the Court, the fact that member banks engaged in largely parallel behavior in passing on the higher expenses associated with internet credit card transactions "hardly was evidence of concerted conduct." (*Paycom Billing Services, Inc. v. Mastercard International, Inc.*, 2006 WL 3041938 (2d Cir. Oct. 27, 2006))

Dismissal Granted Where Plaintiffs Failed to Adequately Plead Misrepresentation Claims

Plaintiffs, minority shareholders of a privately held bank, Napa Community Bank (NCB), filed a class action against NCB's publicly-traded majority shareholder and its CEO alleging violations of both the Securities Act of 1933 and the Securities Exchange Act of 1934 for misrepresentation and omissions in connection with the majority shareholder's exchange tender offer for the stock of NCB. Plaintiffs alleged, *inter alia*, that there were material misrepresentations and omissions in the registration statement filed in connection with the exchange tender offer and that defendants made the same and additional misrepresentations in connection with the tender offer. According to the complaint, as a result of these misstatements and omissions, plaintiffs sold their stock for substantially less than fair market value. The Court granted defendants' Rule 12(b)(6) motion and dismissed the complaint. After recognizing that the heightened pleading requirements of the Private Securities Litigation Reform Act do not apply to 1933 Act claims, the Court acknowledged that plaintiffs typically need only satisfy the ordinary notice pleading standard for §§ 11 and 12 claims under the 1933 Act. However, because the plaintiffs' 1933 Act claims were based on the plaintiffs' "wholesale adoption" of their 1934 Act claims, the Court ruled that the 1933 Act clauses "sounded in fraud" and, thus, were subject to Fed. R. Civ. P. 9(b)'s requirement to plead fraud with particularity. Under this standard, the Court held that the plaintiffs' allegations of misrepresentations and omissions could not withstand defendants' motion to dismiss. The Court found the 1934 Act claims similarly defective. In addition, the Court ruled that the 1934 Act claims did not satisfy the PSLRA pleading requirements because they did not plead with the requisite particularity the who, what, where or when with respect to the scienter element of the §§ 10 and 14 claims. (*Rubke v. Capitol Bancorp. Ltd.*, 2006 WL 3065590 (N.D. Cal. Oct. 27, 2006))

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CFTC

CFTC Requests NFA to Refrain from Granting FCM Registration to Firms Domiciled in Certain Jurisdictions

In a November 8 e-mail to the National Futures Association's General Counsel, the Commodity Futures Trading Commission's Division of Clearing and Intermediary Oversight (DCIO) asked NFA to refrain from acting on applications for FCM registration from firms domiciled in jurisdictions where the CFTC does not have a cooperative relationship or where the CFTC has not been asked to review the nature and effectiveness of the existing regulatory framework. According to DCIO, applications from firms located in such jurisdictions raise concerns about NFA's ability to perform its regulatory responsibilities with respect to those firms. The moratorium is to remain in effect until NFA receives further guidance from CFTC staff.

CFTC Confirms that IB Registration Not Required for Order-Routing Software

The Commodity Futures Trading Commission staff issued an interpretative letter confirming that a registered broker-dealer (BD) that provides its customers with a software program for routing orders directly to a designated contract market (DCM) is not acting as an introducing broker (IB). The Program assists the BD's customers in making trading decisions – but does not provide express "buy" or "sell" signals – and is intended to be available to any FCM that wants to give its customers the ability to bypass the FCM's order routing portal and submit orders directly to a DCM for execution. The BD explained that customers using the Program would use FCMs with whom the customers shared an existing relationship, and affirmed that it would not recommend, propose, or encourage its customers to use any particular FCM or solicit customers for an FCM in any other manner. Lastly, although the BD would collect a fee for each transaction executed through the Program, all such fees would be separate from, and in addition to, any fee or commission agreed upon between the customer and its FCM. Based on these representations, the CFTC concluded that the BD is not an IB and is not required to register as such.
http://cftc.gov/files/tm/letters/06letters/tm06-29.pdf

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