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Corporate and Financial Weekly Digest

November 14, 2008

SEC/Corporate

SEC's Division of Corporation Finance Issues Further Guidance on Shareholder Proposals

On November 7, the Securities and Exchange Commission's Division of Corporation Finance issued Staff Legal Bulletin No. 14D (CF) providing information for companies and shareholders regarding Rule 14a-8 of the Securities Exchange Act of 1934. The bulletin discusses the following:

- A company may omit a shareholder proposal recommending, requesting or requiring the board of directors to amend the company's charter pursuant to Rule 14a-(8)(i)(1), Rule 14a-(8)(i)(2) or Rule 14a-8(i)(6) of the Exchange Act if the company can establish that applicable state law requires any such amendment to be initiated by the board of directors and then approved by shareholders in order for the charter to be amended as a matter of law. However, a company could not omit such proposal pursuant to Rule 14a-(8)(i)(1), Rule 14a-(8)(i)(2) or Rule 14a-8(i)(6) of the Exchange Act if such proposal instead recommended or requested that the board of directors "take the steps necessary" to amend the company's charter.

- Companies and shareholder proponents can email no-action requests and correspondence related to Rule 14a-8 of the Exchange Act to the SEC at shareholderproposals@sec.gov.

- A company can exclude a shareholder's proposal by sending a notice of defect to such shareholder proponent if the company's records indicate that the shareholder proponent has not owned the minimum amount of securities for the required period of time as set forth in Rule 14a-8(b) of the Exchange Act. However, because shareholders can also hold company securities through a broker or bank, in a situation where company records indicate that the shareholder proponent does not satisfy the ownership eligibility requirements in Rule 14a-8(b) of the Exchange Act, the company must first inform the shareholder proponent that the shareholder proponent must provide proof of ownership that satisfies the requirements of Rule 14a-8(b) of the Exchange Act.

- Shareholders who submit proposals pursuant to Rule 14a-8 of the Exchange Act must provide the company with a copy of any correspondence submitted in response to the company's no-action request in accordance with Rule 14a-8(k) of the Exchange Act. Additionally, pursuant to G.9 of Staff Legal Bulletin No. 14, both the company and the shareholder proponent should promptly forward to each other copies of all correspondence provided to the SEC in connection with Rule 14a-8 no action requests.

SEC/CORPORATE

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The Division of Corporation Finance notes that additional guidance may be obtained from Staff Legal Bulletin No. 14, Staff Legal Bulletin No. 14A, Staff Legal Bulletin No. 14B and Staff Legal Bulletin No. 14C .

http://www.sec.gov/interps/legal/cfslb14d.htm

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Sale of Stock in Restaurant Did Not Support Federal Securities Fraud Claims

Plaintiffs, the purchasers of all the shares of stock in Chef Vincent, Inc., a corporation created to own, operate and manage Chef Vincent, a restaurant located in Miami, Florida, asserted claims against the defendant-seller under Section 10(b) of the Securities Exchange Act of 1934 (the 1934 Act) and Rule 10(b)-5. Plaintiffs asserted that the defendant made material misrepresentations in connection with the transaction. Defendant moved to dismiss the claim for lack of federal question subject matter jurisdiction.

The court framed the issue regarding whether federal question jurisdiction existed as depending upon whether the transaction involved the sale of stocks in name only or constituted the type of sale to which the 1934 Act was intended to apply. As the court recognized, “the mere fact that the instrument that effectuated the transfer of Chef Vincent was called ‘stock’ does not mean that it falls within the purview of the 1934 Act.”

Applying established precedent, the court determined that the capital-raising and profit-making regulatory purposes of the 1934 Act were not meant to apply to the stock sale underlying the plaintiffs’ claims. In holding that the “stock” in Chef Vincent, Inc. was not a “security” as defined under the 1934 Act, and, thus, that its sale did not support the court’s exercise of federal question jurisdiction, the court noted that the “touchstone” in determining if a stock is a 1934 Act “security” is whether it represents an ownership interest in a common venture based on an expectation of profits derived from the entrepreneurial efforts of others. The court found that the stock in question did not meet that test because it was merely the “vehicle of transfer” for the purchase and sale of an entire business with respect to which the plaintiffs’ expectation of profits would only come from their own efforts. (*Vejasi v. Chef Vincent Inc.*, No. 08-22048-CIV, 2008 WL 4792049 (S.D. Fla. Oct. 31, 2008))

Directors of Insolvent Company Did Not Breach Fiduciary Duties

Plaintiff, the trustee of the Chapter 7 estate of Security Asset Capital Corporation (SACC), a corporate debtor, brought an action against the debtor’s officers and directors, alleging that they breached their fiduciary duties by failing to commence Chapter 7 liquidation once SACC became insolvent. Plaintiffs asserted that defendants continued to operated SACC even after it was hopelessly insolvent and without business prospects in order to continue to receive compensation and consulting fees from SACC’s remaining assets and to oppose a potential SEC enforcement action against certain individual defendants.

The court held that the defendants did not breach their fiduciary duties. While recognizing that such a duty applies to creditors once a company is in the “zone of insolvency,” the court nevertheless ruled that the officers and directors of an insolvent corporation are not obligated, as a matter of law, to liquidate the corporation for the benefit of unsecured creditors and may, in accordance with the normal application of the “business judgment rule,” pursue risky restructuring plans in good faith attempts to regain solvency.

The court ruled that the defendants' pursuit of a more risky and, ultimately, unsuccessful strategy than an immediate Chapter 7 liquidation was reasonable. In support of its ruling, the court found that the "defendants operated SACC professionally and responsibly, that they properly sought and relied on the advice of counsel, and that they acted with due regard for the interest of all SACC's constituencies." The court further found that there was no evidence that defendants' compensation was inappropriate or that they were otherwise motivated by self-interest to the detriment of SACC. (*Security Asset Capital Corporation v. Tenney*, No. 04-32889, 2008 WL 4811394 (Bankr. D.Minn. Nov. 5, 2008))

Broker Dealer

FINRA Amends Incorporated NYSE Rules to Reduce Regulatory Duplication

The Financial Industry Regulatory Authority, Inc. (FINRA) has issued Regulatory Notice 08-64 to advise members of Securities and Exchange Commission approval of amendments to certain Incorporated New York Stock Exchange Rules. The amendments reduce regulatory disparities between National Association of Securities Dealers and Incorporated NYSE Rules in the Transitional Rulebook and relieve dual members of conflicting or unnecessary regulatory burdens in the interim period before the Consolidated FINRA Rulebook is completed. In addition to deleting certain rules that are outdated and no longer necessary, material amendments include:

- changing the track record requirement for supervisory personnel;
- eliminating certain prescribed training periods;
- eliminating specific registration and qualification requirements as they pertain to registered representatives, securities traders and their direct supervisors;
- deleting the requirement that member firms give prompt written notice of control relationships to the NYSE;
- repositioning requirements pertaining to "private securities transactions";
- eliminating the requirement that supervisors devote their entire time during business hours to their member organization;
- limiting the definition of the term "customer complaint"; and
- revising the proportional contribution requirement for joint accounts with immediate family members.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117350.pdf

NYSE Issues Rule 123(e) and 123(f) Report Cards

The New York Stock Exchange announced on October 31, that it will implement the second release of Front End System Capture (FESC) Report Cards for monitoring compliance with NYSE Rules 123(e) and 123(f). These rules require Floor Members to submit order information to the FESC database before the orders are represented on the floor, and also requires all reports of executions related to such orders be reported through FESC. Additionally, the Rule requires Floor Members to submit specific data elements to be recorded when an order is entered and the related execution is reported.

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FESC Report Cards will contain the following five categories of information: (i) reports of execution submitted without corresponding order details; (ii) reports of execution submitted prior to the entry of the order details; (iii) reports of execution for an order with aggregate size greater than the order's size; (iv) reports of execution with missing or invalid account types; and (v) FESC submissions with missing or invalid order details. NYSE Regulation, Inc.'s Division of Market Surveillance (MKS) will make the Report Cards available from the Electronic Filing Platform (EFP) Portal Authorized Applications Panel, under the name FESC Report Cards. Members can access the EFP via the following link: https://efp.nyse.com/efp/efp_login.html.

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852574F2005B7363/$FILE/Microsoft%20Word%20-%20Document%20in%2008-55.pdf

SEC Extends Current FINRA Section 31 Fee Rate

Section 31 of the Securities Exchange Act of 1934 requires the Securities and Exchange Commission to make annual adjustments to transactions fees paid by national exchanges to the SEC on each sale of securities. The SEC has been operating under a continuing resolution for fiscal year 2009 since October 1, 2008, so the rate applicable to the sales of specified securities transactions on the exchanges and in the over-the-counter markets pursuant to Section 31 will remain at the current rate of $5.60 per million until further notice. The Section 31 fee rate will increase from $5.60 per million to $9.30 per million 30 days after the date of enactment of the SEC's regular FY 2009 appropriation. The Financial Industry Regulatory Authority, Inc. (FINRA) will notify member firms through an Information Notice when the SEC's regular appropriation is enacted and the final date has been announced for implementing the rate change to $9.30 per million.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117352.pdf

Structured Finance and Securitization

FDIC Proposes Loss Sharing Plan to Promote Affordable Loan Modifications

On November 13, the Federal Deposit Insurance Corporation announced a proposal to promote affordable loan modifications on non-GSE distressed mortgage loans. Under its proposal, the FDIC, acting as a contractor for the Treasury Department, would pay servicers $1,000 to cover loan modification expenses and would share up to 50% of losses incurred if modified loans re-default. The program would (i) only cover owner-occupied properties, (ii) reduce the loss sharing percentage for underwater loans, (iii) involve an affordability test based on a 31% borrower mortgage debt-to-income ratio, and (iv) provide for a termination of the loss sharing guarantee after eight years. If adopted by the Treasury Department, the FDIC estimates (assuming a re-default rate of 33%) that the program would reduce nearly 1.5 million foreclosures of non-GSE distressed mortgage loans and cost approximately $24.4 billion.

Treasury Developing Consumer ABS Liquidity Facility

On November 12, Treasury Secretary Henry Paulson acknowledged that Treasury may support the asset-backed securities markets by using the Troubled Asset Relief Program "to encourage private investors to come back" to the ABS markets "by providing them access to federal financing." To support consumer access to credit outside the banking system, Paulson stated that the

STRUCTURED FINANCE AND SECURITIZATION

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Treasury and the Federal Reserve are exploring the development of a potential liquidity facility for AAA asset-backed securities, especially those backed by payments on auto loans, credit cards and student loans. "The asset-backed securitization market has played a critical role for many years in lowering the cost and increasing the availability of consumer finance ... Addressing the needs of the securitization sector will help get lending going again, helping consumers and supporting the US economy. While this securitization effort is targeted at consumer financing, the program we are evaluating may also be used to support new commercial and residential mortgage-backed securities lending."

http://www.treas.gov/press/releases/hp1265.htm

FHFA Announces Streamlined Modification Program for Agency Mortgage Loans

On November 11, the Federal Housing Finance Agency (FHFA) announced a "Streamlined Modification Program" that applies to Freddie Mac and Fannie Mae mortgage loans, and portfolio loans with participating investors, but will not apply to private-label securitized loans. The Streamlined Modification Program was developed by the FHFA in a joint effort with the Treasury Department, the Department of Housing and Urban Development, Fannie Mae, Freddie Mac, and the HOPE Now Alliance of mortgage servicers.

According to the FHFA, the program targets highest risk borrowers who (i) have missed three payments or more (90 days delinquent) on loans closed on or before January 1, 2008; (ii) own and occupy the property as a primary residence; (iii) owe 90% or more than the home is worth; and (iv) have not filed for bankruptcy.

Qualifying homeowners will have their monthly mortgage payments reduced to an affordable payment, defined as no more than 38% of their household's monthly gross income, by options including interest rate reduction, loan term extension from 30 to 40 years, and principal deferral. Fannie Mae and Freddie Mac soon will issue specific guidance to their servicers, and implementation will be required by December 15. To encourage participation, servicers will receive a fixed payment of $800 for each loan modified through this program.

www.fhfa.gov/GetFile.aspx?FileID=169

CFTC

CFTC Requests Comments on OCC Clearing of Gold and Silver Trust Derivatives

The Commodity Futures Trading Commission has requested comments on its initial decision, in response to a petition by the Options Clearing Corporation (OCC), to exempt, pursuant to section 4(c) of the Commodity Exchange Act (CEA), the trading and clearing of options and security futures products based on iShares COMEX Gold Trust Shares and iShares Silver Trust Shares (collectively, the Shares) from certain provisions of the CEA. The new derivative products are proposed to be traded on national securities exchanges (in the case of options) and designated contract markets that are registered with the Securities and Exchange Commission as limited purpose national securities associations (in the case of security futures) and cleared in each case by OCC. Because the primary assets underlying the Shares are gold and silver, respectively, the proposed options and futures on the Shares are "novel instruments" that could implicate overlapping areas of regulatory authority between the CFTC and SEC.

CFTC

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The comment period for the proposed exemption closes November 19.

http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e8-26815a.pdf

Banking

Agencies Seek Comments on Proposed Interagency Appraisal and Evaluation Guidelines

In a move that could have significant implications for the entire banking industry, the federal bank, thrift and credit union regulatory agencies yesterday jointly issued for comment proposed Interagency Appraisal and Evaluation Guidelines. According to the release, the proposed guidance "builds on the existing federal regulatory framework to clarify risk management principles and internal controls for ensuring that financial institutions' real estate collateral valuations (both appraisals and evaluations) are reliable and support their real estate-related transactions." The initiative is intended to respond to heightened concerns over appraisals and credit quality.

The proposed guidance would replace the 1994 Interagency Appraisal and Evaluation Guidelines to incorporate recent supervisory issuances and reflect changes in industry practice, uniform appraisal standards and available technologies. As with prior issuances, the proposed guidance would apply to all real estate lending functions within a federal financial institution, including commercial and residential lending departments, capital market groups, and asset securitization and sales units.

The proposed revisions address:

- Additional detail on the agencies' expectations for an independent appraisal and evaluation function.
- Greater explanation of the agencies' minimum appraisal standards, including clarification of requirements for appraisals of residential tract developments.
- Revisions to the Uniform Standards of Professional Appraisal Practice, which are incorporated by reference in the agencies' appraisal regulations.
- Risk-focused appraisal and evaluation reviews separate and apart from an institution's compliance function.
- New appendices – Appendix A provides further clarification on real estate transactions that are exempt from the agencies' appraisal regulations; Appendix B addresses acceptable evaluation alternatives and use of automated valuation models; and Appendix C contains a new glossary of terms.

The agencies have requested comments on all aspects of the proposed guidance. Comments are due to the agencies sixty days after publication in the Federal Register, which is expected shortly.

http://files.ots.treas.gov/730042.pdf

Banking Agencies Announces Interagency Statement on Meeting the Needs of Creditworthy Borrowers

The federal banking agencies on Wednesday issued an Interagency Statement on Meeting the Needs of Creditworthy Borrowers to all Federal Deposit

BANKING

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Insurance Corporation (FDIC)-supervised institutions. The statement encourages financial institutions to support the lending needs of creditworthy borrowers, strengthen capital, engage in loss-mitigation strategies and foreclosure-prevention strategies with mortgage borrowers, and assess the incentive implications of compensation policies. Although the statement is designed to motivate lenders to, among other things, start lending in an effort to mitigate the effects of a recessionary environment, the statement also makes it clear that such lending must be done in a "prudent" manner, lending only to "creditworthy borrowers." The statement also encourages lenders to "work with borrowers to preserve homeownership and avoid preventable foreclosures, adjust dividend policies to preserve capital and lending capacity and employ compensation structures that encourage prudent lending."

Presumably in an effort to further motivate institutions under its jurisdiction, the FDIC also stated that "State nonmember institutions' adherence to these expectations will be reflected in examination ratings the FDIC assigns for purposes of assessing safety and soundness, their compliance with laws and regulations, and their performance in meeting the requirements of the Community Reinvestment Act (CRA)." While the Statement itself stated that all institutions "are expected to adhere to the principles in this statement," the other banking agencies did not echo the FDIC statement about examination ratings in their respective press releases. The FDIC is the primary federal regulator of state-chartered banks that are not members of the Federal Reserve System.

It should also be noted that on November 13, the FDIC proposed a new loss sharing plan to promote affordable loan modifications. For more information, see the article in the Structured Finance and Securitization section of today's *Corporate and Financial Weekly Digest* which is located here.

http://www.fdic.gov/news/news/press/2008/pr08115.html

UK Developments

FSA Calls for International Co-ordination to Stop Boiler Rooms

On November 10 and 11 the UK Financial Services Authority held its first "anti-boiler room" conference of international regulators and law enforcement agencies. Attended by representatives from 20 countries, the aim of the conference was to encourage a global response to this global problem. Since boiler room fraud operations are typically located in a different jurisdiction than their target investors they can only be dealt with by coordinated information sharing and enforcement among national regulators.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/128.shtml

FSA Announces Two Individuals Fined for Market Abuse

On November 13, the UK Financial Services Authority announced that it had fined Richard Ralph, former British ambassador to Peru and former executive chairman of AIM-listed mining company, Monterrico Metals Plc (Monterrico), £117,691.41 (approximately $174,000) and Filip Boyen £81,982.95 (approximately $121,500) for market abuse. They had dealt in Monterrico's shares ahead of the takeover of Monterrico on the basis of inside information. The fines were made up of two elements: the disgorgement of the profit made by each of them and additional penalties of £105,000 and £52,500 respectively.

Although it was publicly known that Monterrico was in takeover discussions, the details of the negotiations concerning the precise terms of the transaction,

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in which Ralph was closely involved, were confidential. Knowing he was not allowed to buy shares, Ralph asked Boyen to do so on his behalf. Boyen did so and also bought further shares for himself.

Each was fined for dealing based on inside information and for improperly disclosing inside information. The additional penalty for each was reduced by 30% based on their cooperation and early admission of liability. The FSA also stated that, but for that co-operation, it would "have seriously considered taking criminal proceedings."

http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/133.shtml

EU Developments

From Financial Crisis to Recovery: A European Framework for Action

On November 12, the European Commission published a communication document in which it set out a three part approach which it intends to develop into an overall EU recovery action plan/framework designed to take Europe's financial sector from crisis to recovery.

The Commission considers that the EU and Member States must tackle the next stages of the financial crisis in a united, coordinated manner, turning the challenges presented by the crisis into opportunities. The Commission's proposed three part approach, which is set out in the communication document, involves:

- the creation of a new financial market architecture at EU level,
- dealing with the impact of the financial crisis on the real economy, and
- a global response to the financial crisis.

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0706:FIN:EN:PDF

EU Commission Adopts Proposal for Regulation of Credit Rating Agencies

On November 13, the European Commission proposed a series of measures for the regulation of credit rating agencies targeting conflicts of interest and the transparency of the activities of credit rating agencies, and mandating specific standards for certain aspects of the rating agencies' methodologies.

Under specific proposals, credit rating agencies:

- may not provide advisory services;
- will not be allowed to rate financial instruments if they do not have sufficient quality information on which to base their ratings;
- must disclose the models, methodologies and key assumptions on which they base their ratings;
- will be obliged to publish an annual transparency report;
- will be required to create an internal function to review the quality of their ratings; and
- will be required to have at least three independent directors on their boards of directors (i) whose remuneration must not depend on the business performance of the rating agency, (ii) who are appointed for a single term of office of five years or less, (iii) who may only be dismissed for professional misconduct, and (iv) at least one of whom is an expert in securitization and structured finance.

http://ec.europa.eu/internal_market/securities/agencies/index_en.htm

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