Katten
Katten Muchin Rosenman LLP

Corporate and Financial Weekly Digest

NOVEMBER 6, 2009

SEC/CORPORATE

House Financial Services Committee Approves Exemption from SOX 404(b) Auditor Attestation Requirement for Smallest Public Companies

On November 4, the House Financial Services Committee approved an amendment to the Investor Protection Act of 2009 (H.R. 3817) introduced by Congressmen Scott Garrett (R-N.J.) and John Adler (D-N.J.) that would exempt companies with a public float under $75 million (non-accelerated filers) from the Sarbanes-Oxley Act (SOX) Section 404(b) requirement that management's assessment of the effectiveness of internal control over financial reporting be audited by an independent registered public accounting firm. The Investor Protection Act, including the Garrett-Adler Amendment, was also approved by the Financial Services Committee on November 4.

As described in the October 16 edition of *Corporate and Financial Weekly Digest*, the Securities and Exchange Commission recently extended the date for compliance by non-accelerated filers with the auditor attestation requirement to annual reports covering fiscal years ending on or after June 15, 2010, but indicated that it did not expect to further defer such obligation. If enacted, the Garrett-Adler Amendment would permanently exempt non-accelerated filers from the auditor attestation requirement.

If enacted, the Garrett-Adler Amendment would also require the SEC and the Comptroller General of the United States to conduct a joint study to determine how the SEC could reduce the burden of complying with SOX Section 404(b) for companies with a market capitalization between $75 million and $250 million, while maintaining investor protections for such companies. Such a study would also consider whether a complete exemption from SOX Section 404(b) would be appropriate to encourage companies to list their securities on exchanges in the United States in their initial public offerings.

Click here to view the complete text of the Garrett-Adler Amendment.

SEC Extends Postponement of Filing Fee Increases

On October 30, the Securities and Exchange Commission announced that it is extending its postponement of adjustments in fee rates relating to registration of securities, securities repurchases in going private transactions, proxy solicitations and transactions on exchanges and certain over-the-counter markets through December 18. The SEC will maintain its current fee rates during this period.

As previously reported in the May 8 and October 2 editions of *Corporate and Financial Weekly Digest*, for the government's fiscal year 2010, registration fees under the Securities Act will increase 28% from $55.80 per million dollars to $71.30 per million dollars. The increased rate also applies to the repurchase of securities in going private transactions, proxy solicitations and statements in corporate control transactions. The effective date for these increases is five days after the enactment of the SEC's regular appropriation.

The SEC plans to issue further notices via its website as to developments regarding the enactment of the SEC's regular appropriation and the effective dates for the fee rate changes.

Click here for the SEC's press release regarding the postponement of its fee changes.
Click here for the SEC's April 30 order announcing adjustments to its fee rates.

LITIGATION

Meaning of "Tradable Shares" in Purchase Agreement Is Deemed Ambiguous

A purchase agreement entered into by plaintiffs and defendant obligated the defendant to purchase 50,000 shares of common stock from plaintiffs by February 3, 2006, and outlined two possible methods of consideration for this purchase. Defendant could purchase the shares with a cash payment at the current market value of the shares, or, alternatively, if certain prerequisites were met, defendant had the option of purchasing the shares by delivering 50,000 "tradable shares" to the plaintiffs. Defendant failed to exercise either payment option by February 3, 2006. On April 12, 2006, defendant tendered a share certificate to plaintiffs bearing a legend stating that the sale of the securities was restricted until April 1, 2007. Plaintiffs rejected the certificate, arguing that the one-year trading restriction did not comport with the Purchase Agreement requirement that the defendant deliver "tradable shares."

Plaintiffs commenced an action for breach of contract in the U.S. District Court for the Eastern District of Michigan, seeking damages in excess of $250,000. After a series of motions, the district court held defendant liable and awarded damages to plaintiffs in the amount of $256,372. In assessing damages, the district court noted that even though the stock tender payment option, had it been properly exercised, would have yielded less consideration, and therefore a lower damages figure than the cash option, the Purchase Agreement contained an implicit "time is of the essence" requirement, which, by not tendering the shares by February 3, 2006, the defendant breached. After that date, the district court ruled, only the cash payment option was viable, and so only that option was considered in assessing damages.

The Court of Appeals found that the district court erred in failing to consider the ambiguous nature of the phrase "tradable shares" in the Purchase Agreement, and as a result it vacated the district court's decision and remanded it for trial to resolve that ambiguity. The Court of Appeals reasoned that the resolution of this ambiguity was essential to the determination of both liability and damages because, if, as defendant had argued before the district court, "tradable shares" could be subject to a one-year restriction, time was clearly not of the essence in the Purchase Agreement, and no liability would result from defendant's late tender of the shares. On the other hand, if "tradable shares" means immediately tradable shares, time must have been of the essence, and defendant would be liable. Resolution of the meaning of "tradable shares" was therefore critical to the determination of whether a "time is of the essence" requirement should be read into the Purchase Agreement, and thus whether defendant was liable for his failure to tender any consideration by February 3, 2006. (*Hubbard v. Geostar Fin. Servs. Corp.*, No. 08-1617, 2009 WL 3486653 (6th Cir. Oct. 29, 2006))

Court of Appeals for the Eleventh Circuit Affirms SEC's Civil Enforcement Judgment Entered upon Default

In December 2007, the Securities and Exchange Commission commenced a civil enforcement action against Don Warner Reinhard in the U.S. District Court for the Southern District of Florida. Mr. Reinhard, who controlled an investment firm and a hedge fund, was charged with making false and misleading statements and omissions of material facts to his clients in the offer and sale of collateralized mortgage obligations. Mr. Reinhard failed to file an answer in the ensuing months after receiving the complaint, and, as a result, the SEC obtained a default judgment against him in the amount of $5,875,241.09 plus pre-judgment interest.

On appeal, Mr. Reinhard claimed (i) the district court erred in granting him only a seven-day extension of time, which he deemed insufficient to properly answer the SEC's complaint; (ii) the district court should not have ruled on the validity of the service of process without hearing testimony from the process server; and (ii) the service of process was improper.

In affirming the district court's decision, the Court of Appeals for the Eleventh Circuit reasoned that the district court's granting of a seven-day extension was sufficient, because with the new extended deadline, Mr. Reinhard had in fact over two months to answer the complaint.

Furthermore, the Court of Appeals found that the district court did not err by failing to hold an evidentiary hearing to assess whether service of process had been proper. Although such a hearing may sometimes assist the resolution of such an issue, it is by no means necessary. Mr. Reinhard's argument that service of process was improper was also deemed incorrect, because Fed. R. Civ. P. 4(e)(i) incorporates state procedures for service of a summons, and the manner in which process was served upon Mr. Reinhard was sufficient under Florida law. (*Securities & Exch. Comm'n v. Reinhard*, No. 09-10213, 2009 WL 3448849 (11th Cir. Oct. 28, 2009))

BROKER DEALER

Modifications Proposed for Optional Anti-Internalization Functionality

The NASDAQ Stock Market LLC and NASDAQ OMX BX, Inc. filed proposed rule changes with the Securities and Exchange Commission relating to their respective voluntary anti-internalization functionality rules. Anti-internalization functionality is designed to assist market participants in complying with certain Employee Retirement Income Security Act rules and regulations that preclude and/or limit managing broker-dealers of such accounts from trading as principal with orders generated for those accounts. It can also assist market participants in reducing execution fees potentially resulting from the interaction of executable buy and sell trading interest from the same firm.

Under the new rule, the market participants would be given an additional option when entering quotes and orders using the same market participant identifier (MPID) that they do not wish to have automatically interact with each other in the system. This option will direct the system not to execute any part of the interacting quotes/orders from the same MPID and, instead, cancel the oldest of the interacting quotes/orders back to the entering party.

Click here to read the press release on the NASDAQ Stock Market.
Click here to read the press release on the NASDAQ OMX BX.

CBOE Issues Regulatory Circular on Members' Obligations When Providing Access to Exchange Systems

The Chicago Board Options Exchange (CBOE) issued a regulatory circular to its members in order to highlight certain supervisory obligations for members when providing client access to CBOE systems. CBOE reminds its members that they are responsible for every order submitted to CBOE on their behalf, whether by their associated persons or their clients. The circular provides a number of recommendations to its members in order to assist them in maintaining adequate procedures and controls to monitor and supervise the entry of orders to minimize the potential for errors and misuse of CBOE systems.

Read more.

House Financial Services Committee Passes Investor Protection Act

On November 4, the House Financial Services Committee passed H.R. 3817, the Investor Protection Act, by a vote of 41-28. The legislation is part of a broader effort to modernize America's financial regulatory system and was introduced by Rep. Paul Kanjorski (D-PA), Chairman of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises. Chairman Kanjorski noted that with the goals of maintaining a sound economy and improving investor protection and confidence, "The Investor Protection Act aims to achieve these goals while also improving enforcement powers at the [Securities and Exchange Commission] and implementing a fiduciary standard for broker-dealers and investment advisors to ensure that customers' interests are at the forefront of investment recommendations."

In sum, the Investor Protection Act attempts to address the following:

- **Protecting Investors and Righting Wrongs**—The Investor Protection Act will reform the SEC to strengthen its powers, better protect investors, and efficiently and effectively regulate securities markets.
- **Comprehensive Securities Review and Reorganization**—An expeditious, independent, comprehensive study of the entire securities industry by a high caliber body will identify reforms and force the SEC and other entities to put in place further improvements designed to ensure superior investor protection.
- **Enhanced SEC Enforcement Powers and Funding**—The Investor Protection Act will double the authorized funding for the SEC over five years and provide new enforcement powers and regulatory authorities to the SEC.
- **Fiduciary Duty**—Every financial intermediary who provides advice will have a fiduciary duty toward their customers.
- **Whistleblower Bounties**—A whistleblower bounty program will create incentives to identify wrongdoing in securities markets and reward individuals whose tips lead to successful enforcement actions.
- **Ending Mandatory Arbitration**—Because mandatory arbitration has limited the ability of defrauded investors to seek redress, the SEC will gain the power to bar these clauses in customer contracts.
- **Closing Loopholes and Fixing Faulty Laws**—An example of such loophole is the Public Company Accounting Oversight Board's lack of power to examine the auditors of broker-dealers.

Read more.

PRIVATE INVESTMENT FUNDS

Massachusetts Requires Data Protection Compliance

The Massachusetts Office of Consumer Affairs and Business Regulation has enacted Standards for the Protection of Personal Information of Residents of the Commonwealth (the Standards) to protect personal data of Massachusetts residents. Effective March 1, 2010, the Standards apply to all persons, including investment advisors, hedge funds, private equity funds, and commodity pools, that own, license, store or maintain personal information—the first and last name and middle initial together with such person's social security number, driver's license or other state issued i.d. number or credit or debit card, or other financial account number—about an individual resident in the Commonwealth of Massachusetts. Persons in possession of such personal information will be required to develop, implement, maintain and monitor a comprehensive, written information security program applicable to any records containing such personal information. The Standards require a security program that is appropriate to (i) the size, scope and type of business of the person obligated to safeguard the personal information under such comprehensive information security program, (ii) the amount of resources available to such person, (iii) the amount of stored data, and (iv) the need for security and confidentiality of both consumer and employee information. Objections to the scope and impact of the law on interstate commerce have been raised.

To read the Standards click here.

Norm Champ Named Associate Regional Director for Examinations in SEC New York Regional Office

The Securities and Exchange Commission announced the hiring of Norm Champ as Associate Regional Director for Examinations in the agency's New York Regional Office (NYRO). Mr. Champ is the former general counsel at hedge fund Chilton Investment Co. and was formerly on the board of industry group the Managed Funds Association. Mr. Champ will manage principal functions of NYRO, including: (i) conducting examinations of broker-dealers, transfer agents, investment companies, investment advisors and self-regulatory organizations; (ii) assessing the compliance, activities and risks of registered securities firms in the region; (iii) providing assistance and information to securities firms and to investors in the region; and (iv) providing information and/or assistance to enforcement staff and criminal authorities with respect to possible violations of federal securities laws and regulations.

To read the SEC press release click here.

Foreign Account Tax Compliance Act of 2009 Would Require Additional Disclosure by Offshore Private Funds and their Advisors

Representative Charles Rangel and Senators Max Baucus, Richard Neal and John Kerry introduced the Foreign Account Tax Compliance Act of 2009 (Bill) in Congress, which would require U.S. withholding agents to withhold tax on payments of income from U.S. financial assets to "foreign financial institutions" unless such foreign financial institutions comply with certain disclosure obligations; require additional disclosure by U.S. persons with interests in foreign entities, accounts, and passive foreign investment companies; and require disclosure by any advisor who receives more than $100,000 in compensation for aiding a U.S. person in establishing a foreign entity or investing in foreign financial assets, or face penalties. The Bill would also treat payments under swaps that reference or are contingent on dividend payments the same as dividends, thereby requiring withholding of U.S. tax, absent a treaty. The Bill includes in the definition of "foreign financial institution" any foreign entity engaged primarily in the business of investing, reinvesting or trading securities, interests in partnerships, commodities or any interest (including a futures or forward contract or option) in such securities, partnership interests or commodities, which would make the disclosure and withholding requirements applicable to many private investment funds, including hedge funds and private equity funds and their advisors. The Bill also has the support of the Obama administration.

To read the text of the bill click here.
To read the press release click here.
To read Treasury Secretary Geithner's statement on the bill click here.

BANKING

FDIC Issues Guidance Regarding Commercial Real Estate Loan Workouts

On October 30, the Federal Deposit Insurance Corporation (FDIC), in coordination with the other member agencies of the Federal Financial Institutions Examination Council, adopted a policy statement recommending prudent commercial real estate (CRE) loan workouts.

According to the policy statement, performing loans, including those that have been renewed or restructured on reasonable modified terms, made to creditworthy borrowers will not be subject to adverse classification solely because the value of the underlying collateral declined.

In the related press release, the FDIC stated: “Financial institutions that implement prudent loan workout arrangements after performing comprehensive reviews of borrowers’ financial conditions will not be subject to criticism for engaging in these efforts, even if the restructured loans have weaknesses that result in adverse credit classifications.”

Notably, the policy statement includes examples of CRE loan workouts.

For more information, click here.

OECD MATTERS

FATF Reviewing Its Recommendations to Increase Transparency

On November 3, the Financial Action Task Force (FATF) of the Organization for Economic Cooperation and Development published a speech given by Paul Vlaanderen, FATF President, on October 30, entitled “The Need for Enhanced Transparency.” The speech focused on the need, emphasized by the current global financial crisis, to ensure that the vital parts of the FATF standards which are linked to transparency issues are fully effective. President Vlaanderen stated that FATF is reviewing three transparency related issues:

- **Customer due diligence obligations and beneficial ownership**—One of the main principles of the FATF standards is the obligation for financial institutions to identify their customers and any underlying beneficial owners. FATF is now considering whether its current standards are still the best tool for providing maximum customer transparency.
- **Transparency of legal persons and legal arrangements**—FATF will seek to improve the transparency of such persons and arrangements. This should provide regulatory and supervisory agencies with better and more timely access to beneficial ownership information.
- **Financial institution secrecy laws and cross-border exchange of information**—FATF will examine whether certain categories of laws potentially inhibit the implementation of the FATF recommendations.

To read the speech in full, click here.

For more information, contact:

SEC/CORPORATE

Robert L. Kohl	212.940.6380	robert.kohl@kattenlaw.com
Robert J. Wild	312.902.5567	robert.wild@kattenlaw.com
Meaghan B. Hanifin	312.902.5354	meaghan.hanifin@kattenlaw.com
Jonathan D. Weiner	212.940.6349	jonathan.weiner@kattenlaw.com

LITIGATION

Anthony L. Paccione	212.940.8502	anthony.paccione@kattenlaw.com
Jonathan Rotenberg	212.940.6405	jonathan.rotenberg@kattenlaw.com

FINANCIAL SERVICES		
Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Gary N. Distell	212.940.6490	gary.distell@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Patricia L. Levy	312.902.5322	patricia.levy@kattenlaw.com
Robert M. McLaughlin	212.940.8510	robert.mclaughlin@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com
BANKING		
Jeff Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Terra K. Atkinson	704.344.3194	terra.atkinson@kattenlaw.com
Christina J. Grigorian	202.625.3541	christina.grigorian@kattenlaw.com
Adam Bolter	202.625.3665	adam.bolter@kattenlaw.com
OECD MATTERS		
Martin Cornish	44.20.7776.7622	martin.cornish@kattenlaw.co.uk
Edward Black	44.20.7776.7624	edward.black@kattenlaw.co.uk

* Click here to access the *Corporate and Financial Weekly Digest* archive.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK PALO ALTO WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).

London affiliate: Katten Muchin Rosenman Cornish LLP.