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Corporate and Financial Weekly Digest

November 9, 2007

SEC/Corporate

SEC to Act on Three of Six Small Business Initiatives; Other Corp. Fin. Proposals

The Securities and Exchange Commission has published its agenda for its open meeting of November 15. Included in the agenda is consideration of the adoption of the following proposals:

- Amendments to Rule 144 to, among other things, shorten from one year to six months the minimum holding period for resales of restricted securities of reporting companies, eliminate Form 144 filing requirements for non-affiliates, eliminate the "manner of sale" requirement for debt securities and codify several Staff interpretations. (*Securities Act Release No. 8813*, 6/22/07);

- Extend the benefit of optional disclosure and reporting requirements for smaller companies with a public float of less than $75 million, up from $25 million for most companies today, by creating a new category of "smaller reporting companies". In addition, the current Regulation S-B disclosure requirements would be integrated into Regulation S-K and the "S-B" forms would be eliminated. (*Securities Act Release No. 33-8819*, 7/6/07); and

- Amend Exchange Act Rule 12h-1 to provide two exemptions from the registration requirements of the Securities Exchange Act for compensatory employee stock options. The more significant of these exemptions would be applicable to non-public companies that have issued stock options to a significant number of employees and provides relief for such non-reporting companies that issue options to 500 or more eligible participants under option plans. A second exemption would be available to issuers that have registered under Section 12 a class of securities underlying the compensatory employee stock options, making clear that they do not need to separately register such options under the Exchange Act. (*Exchange Act Release No. 34-56010*, 7/5/07).

In addition, the SEC will be considering whether to accept financial statements prepared in accordance with International Financial Reporting Standards without reconciliation to U.S. GAAP in filings by foreign private issuers.

As to the three other recent SEC small business initiatives (Regulation D, electronic filing of Form D and Form S-3 liberalization), at the PLI Annual Institute on Securities Regulation, John White, Director of the Division of Corporation Finance of the Securities and Exchange Commission, stated that they may still be acted upon by the Commission during 2007, but that consideration may be deferred until early 2008.

SEC/CORPORATE

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Mr. White also shed some light on the Commission's consideration of its two alternative shareholder access proposals, indicating that the Commission was seeking "some level of certainty" for the 2008 proxy season, but hinting that there could be a short-term 2008 rule followed by a different, final rule covering shareholder access.

http://www.sec.gov/news/openmeetings/2007/ssamtg111507.htm

Broker Dealer

Amendments to CBOE Complex Order Rule

The Chicago Board Options Exchange, Incorporated (CBOE) is proposing to amend CBOE Rule 6.53C, "Complex Orders on the Hybrid System," which governs the electronic handling and execution of complex orders by CBOE's Hybrid System. The proposed amendments would allow for the electronic handling and execution of stock-option orders on CBOE. The stock-option orders consist of an option component and a stock component. With the establishment of the CBOE Stock Exchange (CBSX), CBOE can now handle and trade stock-option orders electronically, with the stock component execution taking place on CBSX.

The main differences between the handling of stock-option orders and other complex order types handled pursuant to CBOE Rule 6.53C are as follows: (i) the stock portion of the stock-option order will be executed on CBSX; (ii) the execution of a stock-option order submitted to the Complex Order Book is slightly different; (iii) the manner in which stock-option orders are executed through the Complex Order Auction; and (iv) the N-second group timer will not be in effect for stock-option orders.

http://www.sec.gov/rules/sro/cboe/2007/34-56701.pdf

NYSE Rescinds Rule 80A

A New York Stock Exchange filing to eliminate limitations on program trading order entry procedures contained in NYSE Rule 80A became effective on November 2. The rule was rescinded because, according to the Exchange, "it did not appear that the approach to market volatility envisioned by the use of these "collars" is as meaningful today as when the rule was formalized in the late 1980s" in response to the market break of 1987. Recent trading patterns led the Exchange to conclude that volatility was "neither restrained nor enhanced" by the imposition of the collars.

http://www.sec.gov/rules/sro/nyse/2007/34-56726.pdf

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852573860054C408/$FILE/Microsoft%20Word%20-%20Document%20in%2007-106.pdf

Banking

Federal Agencies to Require Identity Theft Prevention Programs

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, the Office of Thrift Supervision and the Federal Trade Commission (collectively, the "Agencies") issued October 31, 2007 final rules on identity theft red flags and notices of address discrepancies. Financial institutions and creditors are required to comply with the regulations if they offer or maintain "covered accounts," defined as "(i) an account primarily

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for personal, family or household purposes, that involves or is designed to permit multiple payments or transactions, or (ii) any other account for which there is a reasonably foreseeable risk to customers or the safety and soundness of the financial institution or creditor from identity theft."

According to the final rules, financial institutions and creditors that offer or maintain covered accounts must develop and implement a written Identity Theft Prevention Program designed to combat theft with respect to both new and existing accounts. Such a program must provide that the financial institution or creditor is able to: (i) identify activity patterns that are "red flags" to possible identity theft (based upon, among other things, supervisory guidance and their own experience) and incorporate such red flags into the program; (ii) detect red flags incorporated into the program; (iii) respond to the red flags and attempt to mitigate any identity theft that has occurred; and (iv) ensure the program is periodically reviewed and updated to determine if components should be added or deleted.

As an aid to financial institutions subject to these rules, the Agencies included a supplement in the proposal that includes "patterns, practices, and specific forms of activity that indicate a possible risk of identity theft."
Finally, the rules require credit and debit card issuers to develop policies and procedures with respect to accountholders' request of a change in address followed shortly by a request for an additional or replacement card.

The final rules implement sections of the Fair and Accurate Credit Transactions Act of 2003. Mandatory compliance with the final rules is required by November 1, 2008.

http://www.occ.treas.gov/ftp/release/2007-122a.pdf.

United Kingdom Developments

Policy Statement Issued on Conduct of Business and Postponement of Telephone Recording

On October 26, the UK Financial Services Authority (FSA) published a further policy statement (PS07/18) on its conduct of business regime. The statement includes measures applicable to incoming firms from late-implementing EEA states and feedback on two previous consultations, *CP 07/9 - Conduct of Business Regime: Non-MiFID Deferred Matters* issued in May 2007 and *CP 07/16 - Consequential Handbook Amendments* issued in July 2007. The FSA stated that this Policy Statement "substantially completes" its consultation program arising from the implementation of the EU Markets in Financial Instruments Directive and its conduct of business reform.

PS07/18 also addressed FSA's proposals for mandatory telephone recording which had attracted widespread concern. The FSA stated that, in light of concerns expressed particularly about the cost-benefit analysis of its proposals, it would defer a final policy decision and rule-making until 2008, in order for further consideration, in discussion with industry, to be given to the issues raised by respondents to the earlier consultation.

http://www.fsa.gov.uk/pubs/policy/ps07_18.pdf

FSA Focuses on Hedge Fund Managers and Market Abuse

On October 29, the Financial Services Authority published issue 24 of its Market Watch Newsletter. The lead article focused on market abuse systems and controls of hedge fund managers (HFMs).

As part of the FSA's ongoing market abuse prevention work, a number of

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hedge fund managers were visited in order for the FSA to review their market abuse controls. The FSA's conclusion was stark. "We are disappointed by some of what we saw. We will be following up with the firms visited and are also launching a program of visits to a wider cross section of HFMs over the coming months to formally assess their market abuse systems and controls."

In the newsletter, the FSA set out their views on the sorts of measures which HFMs should be taking, along with examples of good practice which they found during their first set of visits.

http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter24.pdf

FSA Arrests Two in Boiler Room Criminal Investigation

On November 2, the Financial Services Authority announced the arrest of two men on October 31 in connection with an ongoing FSA investigation into overseas boiler room activities.

This is the FSA's first criminal investigation into such activities and followed several complaints the FSA had received of cold calling and high pressure selling.

The FSA obtained search and arrest warrants using its criminal powers under the Financial Services and Markets Act 2000 and also obtained freezing orders against assets of up to £5.45 million ($11 million).

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/112.shtml

EU Developments

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CEBS Gives in to Market Pressure on Large Exposures Regime

On November 6, the EU Committee of European Banking Supervisors (CEBS) published the first part of its technical advice reviewing its treatment of large exposures, produced in response to the European Commission's call for CEBS's advice on the EU's large exposures regime.

CEBS recognized shortcomings of the existing regime and proposed an amended limits-based "back-stop" regime. The advice also included an analysis of non-EU countries' approaches to large exposures.

http://www.c-ebs.org/press/06112007LEPart1.htm

UK Opposes Single European Regulator Proposal

On November 7, the Financial Services Authority and the UK Treasury published a joint paper rejecting calls for a single European financial services rulebook or regulator.

There has recently been a debate about whether the existing pan-EU regulatory committees, CEBS, the Committee of European Securities Regulators (CESR), and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), is sufficient for enforcing supervisory convergence within the EU.

The FSA and Treasury believe that convergence of national regulatory frameworks and supervisory practices is desirable, but differences in national markets meant domestic supervisors would often need to adopt different approaches and apply different tools in their daily work.

The joint paper recommends that the committees operate in a principles-based

way, to achieve equivalent regulatory outcomes and the FSA and Treasury support moves towards more group-based approaches to supervision, where tasks are delegated amongst supervisors and where one supervisor has overall responsibility for the group as a whole.

The joint paper also commented that on occasion insufficient time had been allowed for implementing of EU legislation and that substantial directives and legislative changes should provide sufficient time between their adoption and their implementation date.

http://www.fsa.gov.uk/pubs/international/eu_framework.pdf

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Deletion of Computer Files Results in Entry of $80,000,000 Judgment

Hawaiian Airlines, Inc. (HA) filed a Chapter 11 bankruptcy. As part of its potential reorganization, HA provided confidential information to third-parties interested in investing in HA following their execution of a non-disclosure agreement (NDA). The NDA prohibited use of confidential information for any reason other than the potential investment and required the recipient to return or destroy all confidential information once it determined not to pursue an investment. Mesa Air Group (Mesa) expressed interest in the opportunity, had its CFO sign the NDA and received confidential information. However, rather than proceed with the investment Mesa entered into direct competition with HA.

HA sued Mesa for breach of the NDA and Mesa's attorneys promptly issued a "litigation hold" to Mesa's three top officers, including the CFO, in order to preserve all relevant documents. Mesa, however, did not make backups of its electronic records or of the hard drives of the computers issued to the three officers. Shortly after learning of the "litigation hold," the CFO acquired and applied special software to "scrub" the H drive on Mesa's computer network and on his laptop computers. The CFO engaged in this conduct both before and after submitting a sworn declaration that he had not copied or misused any confidential information and testifying at a hearing during which the court remarked on his lack of credibility.

After learning of the CFO's conduct, HA moved for the entry of a default judgment as a sanction against Mesa. The court found that the CFO's destruction of evidence was intentional and, even though there was no evidence that Mesa knew of the CFO's actions, ruled that his misconduct was attributable to Mesa. The court found that Mesa could (and should) have taken "reasonable, inexpensive and non-burdensome steps" to preserve evidence upon notice of the suit, such as making backups of the hard drives of executives with access to the confidential information. While the court refused to enter a default judgment, it ruled that an adverse inference should be drawn and, accordingly, found that Mesa had misused confidential information and that the misuse was a substantial factor in its decision to compete against HA. Based on these findings, the Court found that damages arising from Mesa's breach of the NDA totaled $80,000,000 and entered judgment in such amount. (*In re Hawaiin Airlines*, Case No. 03-0817 (Adv. Pro. No. 06-90026) (D. Haw. Oct. 30, 2007))

Securities Claims of Shareholder in Privately Held Company Dismissed

Plaintiff, the minority shareholder of a privately owned corporation, sued the majority shareholder and the corporation alleging violations of federal and state law claims in connection with a Buy-Sell Agreement (the Agreement) through which he obtained the right to sell his stock to the corporation at a fair market value price and his sale of such stock.

Defendants moved to dismiss plaintiff's cause of action under section 12(2) of the Securities Act of 1933, alleging that the majority shareholder concealed material information about the value of the corporation in the Agreement. After ruling that Section 12(2) imposes liability based upon misstatements contained in a prospectus, the Court dismissed the claim, ruling that the Agreement was not a "prospectus" under Section 12(2) because it did not "solicit the public to acquire securities."

The Court also dismissed the plaintiff's claim under section 10(b) of the Securities Exchange Act of 1934, which was based upon, among other things, plaintiff's allegation that the majority shareholder had no intention of honoring certain terms of the Agreement when he entered into it and that the defendants "dissuaded" him from reviewing corporate records and from engaging an independent appraiser. The Court ruled that plaintiff failed to allege with particularity facts satisfying the scienter element of his claim and which met the requirements of the Private Securities Litigation Reform Act . Further, the Court found that the complaint failed to sufficiently allege the specific information that defendants had allegedly concealed and why such information was material. (*Willer v. Civil Contractors & Engineers Inc.*, 2007 WL 3232493 (N.D.Ill. Oct. 30, 2007))

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