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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Announces Agenda for Open Meetings

On October 11, the Securities and Exchange Commission announced that it will consider, at an open meeting of the Commission to be held on December 13, recommendations regarding Section 404 of the Sarbanes-Oxley Act of 2002 and foreign private issuer deregistration. At the same meeting, the Commission will consider a final rule for internet proxy delivery, as well as proposals for revisions to the current rules concerning shareholder proxy initiatives. According to Commissioner Cox, this will permit discussion of how the internet can advance the dissemination and exchange of information among shareholders and companies, and thereby improve the entire proxy process.

The SEC also announced that the subject matter of its open meeting scheduled for October 18 will be whether to adopt amendments to the best-price rule for issuer and third party tender offers under the Securities Exchange Act of 1934. The amendments would clarify that the best-price rule applies only with respect to the consideration offered and paid for securities tendered in a tender offer and should not apply to consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the issuer or subject company.
http://www.sec.gov/news/press/2006/2006-172.htm

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Broker Dealer

SEC Approves Amendments to NASD Best Execution Rule and NASD Issues Related Interpretive Material

The NASD issued Notice to Members 06-58 announcing that the Securities and Exchange Commission approved amendments to NASD Rule 2320(a), the Best Execution Rule. The amendments clarify that a member firm's best execution obligation applies not only to transactions executed for its own customers, but also to orders routed to it by other broker-dealers for the originating broker-dealer's customers.

Further, NASD has adopted new Interpretive Material 2320 concerning the applicability of the Best Execution Rule. IM-2320 clarifies that a member's duty to provide best execution in any transaction "for or with a customer of another broker-dealer" does not apply in instances when another broker-dealer is

simply executing a customer order against the member's quote. The duty to provide best execution to customer orders received from other broker-dealers arises only when an order is routed from the originating broker-dealer to the recipient member for the purpose of order handling and execution. IM-2320 also provides that, for purposes of Rule 2320, the term "market" or "markets" should be interpreted broadly to include a variety of different venues, including, but not limited to, market centers that are trading a particular security. The amendments become effective on November 8.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_017607.pdf

ISE Adopts Exchange Fees for the ISE Stock Exchange

The International Securities Exchange (ISE) proposes to adopt fees, which include execution, access and regulatory fees, related to the trading of equity securities on the ISE Stock Exchange (the recently launched equity securities exchange subsidiary of ISE), as well as changes to existing language to clarify the application of certain fees that are specific to options trading only. ISE will charge execution fees based on a member's average daily shares executed, with the average daily volume calculated on a monthly basis. However, all execution fees will be waived until December 1. The monthly access fees for Electronic Access Members (EAMs) that trade options will remain unchanged even for EAMs that also trade equities on the ISE Stock Exchange. An EAM that trades equities only will be subject to a lower monthly access fee. With regard to annual regulatory fees, ISE will charge an EAM that trades either options or equities $5,000 per year, while an annual regulatory fee of $6,000 will be assessed for EAMs that trade both options and equities. The proposed rule changes are immediately effective.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/E6-16729.htm

NYSE Proposes Change to Rule 19 Related to Locking or Crossing Protected Quotations in NMS Securities

The New York Stock Exchange has adopted (effective immediately) NYSE Rule 19, which requires exchange members to reasonably avoid displaying quotations that lock or cross any protected quotations in a Regulation NMS security or any quotation, protected or not, in an NMS security that is disseminated pursuant to an effective national market system plan. Generally, the proposed rule provides that a locking or crossing quotation does not violate the prohibition when: (i) the trading center displaying the locked or crossed quotation is experiencing system malfunction; (ii) the protected bid was higher than the protected offer; (iii) the locking or crossing quotation was an automated quotation and the member simultaneously routed an intermarket sweep order to execute against the full displayed size of any locked or crossed quotation; or (iv) a manual quotation locks and crosses another manual quotation and the member that caused the lock or cross simultaneously routed an intermarket sweep order to execute against the full displayed size of the locked or crossed manual quotation.

The rule addresses intentional locks or crosses but does not specify how market centers should reconcile locks or crosses between two automated quotations. However, in the case of manual quotation locks or crosses of a previously disseminated automated quotation to a national market system plan, the member that disseminated the manual quotation is required to promptly withdraw the quotation or route an intermarket sweep order to execute against the full displayed size of the locked or crossed quotation. Further, the rule provides that NYSE technology will automatically route an intermarket sweep order to execute against the full displayed size of any participating market center that would be locked or crossed by an NYSE quotation prior to quoting.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/E6-16846.htm

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Litigation

Court Denies Injunction Requiring Defendant to Resume Supplying Products to Plaintiffs

Plaintiffs, cosmetics retailers, moved for a temporary restraining order and preliminary injunction requiring defendants, distributors of Amorepacific brand cosmetics (Amore), to resume supplying plaintiffs with Amore products during the pendency of the lawsuit. Plaintiffs alleged, among other things, that defendants violated several provisions of the Sherman Act and state antitrust laws by discontinuing sales of Amore products to retailers who refused to enter into exclusive distributorship agreements with defendants and stop carrying cosmetics from other manufacturers. Plaintiffs asserted that they would suffer irreparable harm, requiring them to close their stores due to the significant decline in sales, if defendants were not ordered to resume supplying their products to plaintiffs. The Court, denying plaintiffs' demand for injunctive relief, found that plaintiffs' delay of seven months since knowing of defendants' plans to restrict sales to exclusive distributors and of five months since their termination "negated" their ability to show the irreparable harm required for a preliminary injunction. The Court also held that plaintiffs could not demonstrate a substantial likelihood of success on the merits due to their lack of standing. Plaintiffs were unable to establish Article III standing because they caused their own alleged injury by rejecting the defendants' offer to enter into exclusive dealing agreements. Plaintiffs also were unable to establish standing under the antitrust laws since the challenged exclusive dealing arrangements were presumptively legal and did not prevent defendants' competitors from distributing competing products in the relevant market. (*Union Cosmetic Castle, Inc. v. Amorepacific Cosmetics USA, Inc.*, 2006 WL 2848016 (E.D.N.Y. Oct. 2, 2006))

Plaintiff Sufficiently Alleged Fraudulent Misrepresentation under PSLRA and Fed. R. Civ. P. 9(b).

The plaintiff sold his company to International Fiber Com, Inc. (IFC), which thereafter declared bankruptcy. In his complaint asserting federal and state securities law claims, the plaintiff alleged that defendants, executive officers of IFC at the time plaintiff sold his company, falsely overstated the company's revenues in its 1999 and 2000 financial statements. The complaint alleged that defendants participated in multiple GAAP violations, including manipulating work in progress figures, fraudulently booking revenue for a substantial order that had been canceled, and overstating inventory. In denying defendants' motion to dismiss the federal and state securities claims, the Court held that plaintiff had adequately pled specific facts establishing that the alleged GAAP violations constituted a "systematic, widespread and significant" inflation of revenue sufficient to support the misrepresentation element of the claims. It further held that plaintiff's allegations satisfied the scienter element. The Court rejected the defendants' argument that allegations showing that each defendant had the requisite state of mind as to every alleged fraudulent act was required. Instead, the Court ruled that plaintiff's allegations in their totality – which detailed defendants' direct participation in the various GAAP violations – were sufficient because they created a strong inference that defendants knew the financial statements were false when made. (*Wojtunik v. Kealy*, 2006 WL 2821564 (D. Ariz. Sept. 30, 2006))

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FIA Moves for Leave to File *Amicus* Brief in Support of Petition for Rehearing En Banc in *Klein & Co. v. NYBOT*

On October 10, the Futures Industry Association (FIA) filed a motion in the United States Court of Appeals for the Second Circuit for leave to file an *amicus* brief in support of a full-panel rehearing of *Klein & Co. Futures, Inc. v. Board of Trade of the City of New York*, No. 05-1374-cv(L) (2d Cir. Sept. 18, 2006). In its brief, the FIA challenges the Court's interpretation of the private right of action provisions contained in Section 22 of the Commodity Exchange Act (CEA). The *Klein* panel held that a plaintiff proceeding under either CEA § 22(a) or (b) must fit within one of the four categories enumerated in § 22(a)—in other words, the plaintiff must suffer damages as a result of transactions it has made in the market. The court concluded that clearing members do not effect transactions when clearing transactions on behalf of customers and, therefore, lacked standing to bring a private cause of action against an exchange and its clearinghouse for their alleged bad faith failure to enforce their own rules. The FIA contends that the standards applicable to private actions against brokers and other futures market intermediaries under CEA § 22(a) do not apply to a clearing broker's claim against an exchange or its clearinghouse under § 22(b). In the alternative, the FIA argues that clearing members, as principal participants in all exchange transactions, fall within the category of persons specifically categorized in CEA § 22(a)(1)(B), who "deposited with or paid to such person [the clearinghouse] money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make [a futures contract]."

CFTC Issues No-Action Letter to Taiwan Futures Exchange

The Commodity Futures Trading Commission's Office of General Counsel issued on October 11 a no-action letter to the Taiwan Futures Exchange permitting the offer and sale in the United States of futures contracts based on the MSCI Taiwan Index.
http://www.cftc.gov/opa/press06/opa5247-06.htm

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