Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

October 22, 2010

SEC/CORPORATE

SEC Proposes Rules for Say-on-Pay and Investment Manager Proxy Vote Reporting

On October 18, the Securities and Exchange Commission proposed new rules under Section 14A of the Securities Exchange Act of 1934, which was enacted by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 14A requires public companies to conduct separate non-binding shareholder advisory votes to approve the named executive officer (NEO) compensation (say-on-pay) and the frequency of the say-on-pay vote (say-on-when). Section 14A also requires expanded, tabular format disclosure of executive compensation in connection with mergers or similar transactions (golden parachutes) and a related separate advisory vote on golden parachutes in merger proxy statements. These requirements are effective for annual or special shareholder meetings occurring on or after January 21, 2011.

Inclusion of the say-on-pay or say-on-when proposal does not require the filing of a preliminary proxy statement. The proposed rules also require disclosure in Compensation Discussion and Analysis (CD&A) whether, and if so, how companies have considered the results of previous say-on-pay votes. The proposed rules require that shareholders shall be given a separate say-on-when vote to determine the frequency of the say-on-pay vote, i.e., whether it shall be as often as every year, every other year or once every three years. The separate say-on-when vote must occur at least once every six years. Because companies that have received Troubled Asset Relief Program (TARP) funds are required to have annual say-on-pay votes, these companies are exempt from the requirement to include a say-on-when proposal until the company is no longer subject to the TARP restrictions. While the proposed rules require smaller reporting companies to include a say-on-pay vote, smaller reporting companies can continue to follow the scaled compensation disclosure requirements and are not required to include CD&A.

The proposed rules also require institutional investment managers who are required to file Form 13F (generally those who manage publicly traded equity securities having an aggregate fair market value of at least $100 million) to file Form N-PX, Annual Report of Proxy Voting Record, by August 31 of each year to report the manager’s votes relating to the say-on-pay, say-on-when and golden parachute matters described above. Form N-PX, which is currently required to be filed by registered management investment companies, is being amended for use by institutional investment managers as well.

The comment period for the proposed rules closes on November 18.

Click here and here to read the text of the proposed rules.

BROKER DEALER

FINRA Reminds Firms of Sales Practice Obligations for Commodity Futures-Linked Securities

The Financial Industry Regulatory Authority has issued a Regulatory Notice reminding firms of their sales practice obligations regarding securities that offer exposure to the commodities markets. FINRA cautions that firms must

ensure that communications with the public about these securities are fair and balanced, that recommendations to customers are suitable and that firm registered representatives understand and can inform customers about these securities before recommending them. To meet these obligations, firms must train registered personnel about the characteristics, risks and rewards of these products before they allow their registered persons to sell the products to investors. Firms also must have adequate written supervisory procedures and controls in place reasonably designed to ensure that commodity-futures linked securities sales comply with applicable federal securities laws and FINRA rules.

Click here to read FINRA Regulatory Notice 10-51.

Content, Review and Filing Rules Now Apply to Certain Free Writing Prospectuses

The content standards, principal review requirements and applicable filing requirements contained in NASD Rules 2210 and 2211 now apply to free writing prospectuses distributed by broker-dealers in a manner reasonably designed to lead to their broad unrestricted dissemination. Through FINRA Regulatory Notice 10-52, the Financial Industry Regulatory Authority has withdrawn previous interpretive guidance excluding such free writing prospectuses from these NASD rules, which establish standards for the content of broker-dealer communications with the public. According to FINRA, a free writing prospectus distributed by a broker-dealer in a manner reasonably designed to lead to its broad unrestricted dissemination presents the same investor protection concerns as communications regulated by these rules, which are designed to ensure that communications with the public by broker-dealers are fair, balanced and not misleading.

Click here to read FINRA Regulatory Notice 10-52.

PRIVATE INVESTMENT FUNDS

SEC Charges Hedge Fund Managers with Fraud for Side Pocket Valuation and Theft of Investor Assets

The Securities and Exchange Commission filed a complaint on October 19 in the U.S. District Court for the Northern District of Georgia against hedge fund portfolio managers Paul Mannion, Jr. and Andrew Reckles and their investment advisory entities, PEF Advisors LLC and PEF Advisors Ltd., for defrauding investors in the Palisades Master Fund, L.P. According to the complaint, Mr. Mannion and Mr. Reckles knowingly or recklessly overvalued Fund investments that they placed in a “side pocket” and charged excessive management fees to the Fund while simultaneously selling millions of dollars worth of the same securities from their personal accounts. The complaint also alleges that the defendants stole and exercised warrants belonging to the Fund, misappropriated investor cash and securities on other occasions to make personal investments, and made material misrepresentations regarding their short trading positions in order to participate in a PIPE transaction. The SEC is charging defendants with violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940, and is seeking injunctive relief, disgorgement of profits, prejudgment interest and financial penalties.

To read the SEC’s press release, click here.
To read the SEC’s complaint, click here.

CFTC

CFTC to Hold Open Meeting on Third Series of Proposed Rules under Dodd-Frank Act

The Commodity Futures Trading Commission has announced that it will be holding a public meeting on Tuesday, October 26 at 9:30 a.m. Eastern to consider the issuance of several proposed rulemakings. Proposed rulemakings under the Dodd-Frank Wall Street Reform and Consumer Protection Act that will be discussed at the meeting include:

- prohibition of market manipulation and disruptive trade practices;
- provisions common to registered entities;
- removing any reference to or reliance on credit ratings in CFTC regulations and proposing alternatives; and
- process of review of swaps for mandatory clearing.

In addition, the CFTC will consider one proposed rulemaking not arising out of the Dodd-Frank Act involving CFTC Rule 1.25, the investment of customer funds and funds held in an account for foreign futures and foreign options transactions.

The meeting will be webcast on the Internet, and the audio feed of the meeting will be available on a listen-only conference call.

The webcast of the meeting can be accessed at www.cftc.gov. The listen-only conference call can be dialed in to at 1-866-844-9416, with a pass code of 28228.

The *Federal Register* releases concerning the proposed rulemakings to be discussed can be accessed here.

CFTC Launches Online Form for Submitting Comments

The Commodity Futures Trading Commission has introduced an online form through which comments to *Federal Register* releases and industry filings may be submitted. The online form for submitting comments can be accessed here.

Comments submitted will become part of the public record and will be published on the CFTC's website without prior review and without the removal of any personally identifying or other sensitive information. Therefore, commenters should not submit information that they wish to remain confidential or not be disclosed to the public.

The CFTC press release regarding the new online comment form can be found here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Proposes Rule to Exclude Family Offices from Regulation as Investment Advisers

The Securities and Exchange Commission has proposed Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940, as amended (Advisers Act), to define "family offices" that would be excluded from the definition of "investment adviser." The proposed rule was mandated in Section 409 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act).

Family offices are established by wealthy families to manage their wealth, plan for their families' financial future and provide other services to family members. Absent an exclusion, family offices would typically fall under the definition of investment adviser under the Advisers Act.

Many family offices have previously relied on the exemption from registration under the Advisers Act in Section 203(b)(3) for an investment adviser who during the course of the preceding 12 months has had fewer than 15 clients and who neither holds itself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company or business development company. The Act eliminated the exemption contained in Section 203(b)(3), effective July 21, 2011.

The proposed rule is intended to codify the exemptive orders that the SEC has issued to family offices and generally would be limited to family offices (1) that provide advice about securities only to family clients, (2) that family members own and control, and (3) that do not hold themselves out to the public as an investment adviser. Family members would generally include the following:

- founders (i.e., a natural person and his or her spouse or spousal equivalent for whose benefit the family office was established and any subsequent spouse of such individuals), their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents;
- parents of the founders; and
- siblings of the founders and such siblings' spouses or spousal equivalents and their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses or spousal equivalents.

The definition of family member differs from or expands upon previous SEC exemptive orders by considering stepchildren as lineal descendants and spousal equivalents in addition to spouses and parents of the founders as family members.

Family clients would generally include any (1) family member, (2) certain key employees, (3) charities established and funded exclusively by one or more family members or former family members, (4) trust or estate existing for the sole benefit of one or more family clients, and (5) entities owned and controlled exclusively by, and operated for the sole benefit of, one or more family members. Former family members including former spouses, spousal equivalents and stepchildren and certain former key employees would be considered family clients to the extent of any investments held through the family office at the time they became a former family member or former key employee. In the event assets under the management of a family office are involuntarily transferred to a person who is not a family client, the family office could continue to advise such client for four months following the transfer of any such asset without effecting its exclusion from the definition of investment company.

The Advisers Act and the proposed rule both contain a “grandfathering clause” that precludes the SEC from excluding certain family offices from the definition that provide investment advice to certain clients and had provided investment advice to those clients before January 1, 2010.

Comments on the proposed rule are due November 18. The SEC release announcing the proposed rule may be found here.

LITIGATION

Fact Inquiry Necessary to Determinate Which Sales of Securities Were “By Means Of” Misstatements

The U.S. Bankruptcy Court for the District of Massachusetts recently denied a motion for summary judgment on the issue of damages by investors in Access Cardiosystems, Inc. against one of the defendants, Randall Fincke. The investors had asserted claims against Mr. Fincke under the Massachusetts version of the Uniform Securities Act, Section 410(a)(2) of the Massachusetts General Laws, which creates “civil liability for sales [of securities] by means of fraud or misrepresentation.” Section 410(a)(2) is almost identical to Section 12(2) of the Securities Act of 1933 and, in reaching its decision, the court relied upon both federal case law as well as case law from other states interpreting the Uniform Securities Act.

In 2009, the court ruled that Mr. Fincke made a material misstatement in a business plan when he stated that Access had been advised by its patent counsel that its product did not infringe on any patents known to counsel without having sought or received any such advice. Following this decision on liability, four of Access’s individual investors moved for summary judgment on the issue of damages, seeking to rescind all of their investment transactions and recover their total investment in the company.

The court found that rescission was not an available remedy because the investors no longer owned the securities and therefore could not tender those securities. However, as the court pointed out, the practical effect of its ruling that the investors could not rescind the transaction was minimal, since the calculation of damages would be based on the amount that would have been “recoverable upon a tender” of the securities. The court held that summary judgment on the issue of damages was inappropriate because there were genuine issues of disputed fact as to which transactions, if any, involved the sale of securities “by means of” the misstatements contained in the business plan. In reaching this conclusion, the court explained that although Section 410(a)(2) does not require a plaintiff to prove reliance or loss causation, the investor must nevertheless prove that each sale of securities for which it seeks damages was made in connection with the misrepresentation. (*In re Access Cardiosystems, Inc.*, 2010 WL 4053614 (Bkrtcy. D. Mass. Oct. 14, 2010))

Attendance at Executive Committee Meetings Insufficient to Satisfy Group Pleading Doctrine

The U.S. District Court for the Southern District of New York recently granted defendants’ motions to dismiss a consolidated class action asserting claims for securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 brought by shareholders of Celestica, Inc., a Canadian electronics corporation, against the company and its former officers, as well as against Onex Corporation, the largest controlling shareholder of Celestica, and Onex’s CEO (together, the Onex defendants) based on, among other things, the plaintiffs’ failure to plead fraud with the specificity required by Rule 9(b) of the Federal Rules of Civil Procedure.

Plaintiffs alleged that defendants disseminated materially false and misleading statements concerning Celestica’s earnings, profitability and financial future during conference calls and in publicly filed financial documents, thereby

artificially inflating Celestica's stock price to the ultimate detriment of its shareholders. In asserting the allegations of fraud against the Onex defendants, plaintiffs attempted to rely upon the "group pleading doctrine" to avoid application of Rule 9(b)'s requirement that a plaintiff identify the speaker of a purportedly fraudulent statement. The group pleading doctrine allows plaintiffs to attribute misleading statements to the group of defendants who were responsible for creating, reviewing or approving the purportedly false statements prior to their dissemination.

In support of their argument for applying the group pleading doctrine, plaintiffs asserted that the Onex CEO's regular attendance at executive committee meetings and the Onex defendants' significant holdings of Celestica securities enabled the Onex defendants to effectively control the company. As a result, the plaintiffs argued that the Onex defendants were sufficiently involved in the everyday business of the company to assume liability for any corporate misstatements. However, the court found these allegations did not establish that the Onex defendants had a "direct day-to-day involvement in Celestica's business affairs and operations necessary for attribution" of the statements to them. Thus, the court dismissed the complaint because the plaintiffs failed to allege the direct connection between the Onex defendants and the alleged misstatements necessary for application of the group pleading doctrine. (*In re Celestica Inc. Securities Litigation*, 1:07-cv-00312 (S.D.N.Y. October 14, 2010))

UK DEVELOPMENTS

Market Abuse Fine Increased by Appeal Tribunal

On October 20, the Financial Services and Markets Tribunal issued its decision in the matter of Andre Jean Scerri and the UK Financial Services Authority (FSA). Mr. Scerri's fine was increased from £46,062.50 to £66,062.50 (roughly $104,276).

Mr. Scerri was a private investor in Amerisur Resources plc. On May 23, 2007, he was given inside information by another private investor that an order had been placed for the following day at discounted prices (the Placing). Mr. Scerri immediately cancelled his order to increase his position in Amerisur. After Amerisur's broker formally made him an insider in the Placing, Mr. Scerri sold his remaining positions before the public announcements. He then rebuilt the majority of his position by buying back at discounted prices. The disgorgement represents the difference between the two prices.

The FSA initially decided not to impose the penalty of £20,000 (roughly $31,500) due to Mr. Scerri's financial hardship. However, the Tribunal found that his evidence had been incomplete and misleading and that his hardship had been self-induced (due to making hundreds of unsuccessful trades after being notified by the FSA of their proposed penalty).

To read more, click here.

FSA Publishes Policy Statement on the Client Assets Sourcebook

On October 20, the UK Financial Services Authority (FSA) published its Policy Statement (10/16) on the Client Assets Sourcebook (Enhancements) Instrument 2010.

The policy statement is relevant to regulated investment firms who hold the relevant client assets and money permissions, as well as their senior management and staff with client money and/or asset responsibility, their trade associations and firms who intend to hold or control client money.

Despite mixed feedback, the FSA broadly intends to proceed with proposals which were contained in CP10/9 *Enhancing the Client Assets Sourcebook (CASS)* (issued in March 2010). The FSA proposed:

- disclosure annexes for prime brokerage agreements;
- daily reports to prime brokerage clients;
- reduced maximum placements of client money with banks in the same corporate group as the relevant broker;
- prohibiting general liens in custodial agreements;
- establishing a CASS operational oversight controlled function; and
- bringing back the requirement to produce client money and asset returns.

The rules detailed in the policy statement will come into force in 2011.

The full policy statement can be found here.

HM Treasury Announces Bank Levy Legislation

On October 21, the UK Government published draft legislation on the bank levy. The draft details how the levy will work prior to implementation of final legislation (due to be published by the end of 2010).

The Government's proposals are based on the International Monetary Fund's Report to the G20, "A Fair and Substantial Contribution by the Financial Sector," which suggested a broad balance sheet charge. It is hoped that the bank levy will encourage less risky funding and will aid the wider agenda to improve regulatory standards and enhance financial stability.

For more information on the draft legislation, click here.

EU DEVELOPMENTS

European Council Announces Agreement on AIFMD

On October 19, the Economic and Financial Affairs Council of the European Union (ECOFIN) published a press release announcing that agreement had been reached on the Alternative Investment Fund Managers Directive (AIFMD). The Council hopes for a final text of the AIFMD to be before the European Parliament by November 10 (which would give an implementation deadline of early 2013 for member states).

The ECOFIN proposal appears to be based on the compromise proposal released on October 15 by the Belgian presidency of the EU Council (the Proposal). The Proposal sets out a dual system allowing non-EU managers to apply for a passport from 2015, while EU managers would be able to obtain a passport from implementation. The existing private placement regime would be replaced by this system in 2018 if the passport for non-EU managers was successful.

Under the Proposal, funds managed by EU managers must have depositaries, which must be liable to the fund, or to investors, for the loss of any financial instruments which they hold for the fund. This liability remains even where responsibility for custody has been delegated to a third party.

For more information, click here.
Click here to read an October 20 Katten *Client Advisory* on the AIFMD.

For more information, contact:

SEC/CORPORATE

Robert L. Kohl	212.940.6380	robert.kohl@kattenlaw.com
David A. Pentlow	212.940.6412	david.pentlow@kattenlaw.com
Robert J. Wild	312.902.5567	robert.wild@kattenlaw.com
Blase J. Kornacki	312.902.5626	blase.kornacki@kattenlaw.com

FINANCIAL SERVICES

Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@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
Joseph Iskowitz	212.940.6351	joseph.iskowitz@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

LITIGATION

Steven Shiffman	212.940.6785	steven.shiffman@kattenlaw.com
Jessica M. Garrett	212.940.6523	jessica.garrett@kattenlaw.com

UK/EU DEVELOPMENTS

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.

Published for clients as a source of information. The material contained herein is not to be construed as legal advice or opinion.

CIRCULAR 230 DISCLOSURE: Pursuant to regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

©2010 Katten Muchin Rosenman LLP. All rights reserved.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK 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.