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Corporate and Financial Weekly Digest

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LITIGATION

Court Rejects Argument That Statements Were Not Misleading

The United States District Court for the Southern District of New York denied a motion to dismiss claims under Section 10(b) of the Securities Exchange Act brought by defendants, a manufacturer of pharmaceutical products and its officers. The plaintiff alleged that after conducting a clinical trial jointly with its marketing partner that concluded that the primary selling point for the company's product was not supported by the trial, the company issued a press release stating that the product was a "success" and that interest in two of the defendant's technologies had "never been higher." The plaintiff alleged, among other things, that this statement was a material misrepresentation that caused her, and similarly situated class members, to purchase the company's stock, and that she suffered damages when the company's stock price plummeted when the results of the clinical trial were later made public.

The defendants moved to dismiss the claim, arguing that they had no duty to disclose the results of the trial and that nothing in the company's press release was misleading. The court rejected defendants' argument, finding, among other things, that the company's statement that interest in the defendant's technologies had never been higher necessarily implied that the company and its partner were not in possession of information that the results of the clinical trial were negative. As a result, the court concluded that the statement was sufficiently misleading to constitute a material misstatement under Section 10(b) of the Exchange Act and denied the motion to dismiss. (*Billhoffer v. Flamel Technologies, SA*, 2009 WL 3241399 (S.D.N.Y. Oct. 5, 2009))

Court Holds Late Fee Provision Is Not Liquidated Damages Provision

The United States District Court for the District of Delaware denied defendant issuer's motion to dismiss plaintiff's claims for actual damages resulting from the defendant's failure to file a registration statement within the time period required by the parties' agreement. Pursuant to the parties' agreement, the defendant was obligated to file a resale registration statement with the Securities and Exchange Commission covering the securities issued to the plaintiff no later than 180 days after its initial public offering. The plaintiff brought an action against the defendant alleging, among other things, that the defendant breached this agreement by failing to timely register the securities and, as a result, owed the plaintiff actual damages, which it asserted was the difference between the warrant price of the shares and the highest price the shares reached after the date they should have been registered.

The defendant moved to dismiss the plaintiff's claim for actual damages, arguing, among other things, that a late fee provision in the agreement was a liquidated damages clause that precluded the plaintiff from collecting actual damages. In denying the motion to dismiss, the court noted that the late fee provision did not bear the label "liquidated damages," and therefore, in order for the provision to be considered a liquidated damages clause, there had to be some explicit evidence in the contract indicating that the late fee, which amounted to less than one-fifth the claimed actual damages, provided the plaintiff's sole damages in the event of a breach. The court held that because the defendant did not point to anything in the agreement that indicated that the late fee was to be the sole remedy for the breach of contract, the late fee provision was not a liquidated damages clause. (*Leeseberg v. Converted Organics*, *Inc.*, 2009 WL 3232778 (D. Del. Oct. 7, 2009))

BROKER DEALER

SEC Proposes Dark Pool Measures

The Securities and Exchange Commission voted at an open meeting on October 21 to approve proposals that would affect "dark pools," that is, alternative trading systems (ATS) that do not display quotations to the public. According to the SEC, trading volume on dark pools has steadily increased, and the Commission has been concerned about the lack of transparency, and the potential for the development of a two-tiered market that deprives the public of information about stock prices and liquidity, because of these developments. The proposals would ensure that actionable "indications of interest" are treated like quotations and are subjected to the same disclosure rules as those that apply to quotations. In addition, the proposals would lower the ATS trading volume threshold for displaying best-priced orders. Currently, an ATS that displays orders to more than one person is required to display its best-priced orders to the public when its trading volume for a stock is 5% or more; under the proposal this percentage would be lowered to 0.25%.

Read more.

CFTC

CFTC Proposes Amendments to FCM and IB Electronic Filing and Financial Reporting Requirements

The Commodity Futures Trading Commission has proposed amendments to its regulations regarding the financial reports and other notices that must be filed with the CFTC by futures commission merchants (FCMs) and introducing brokers (IBs). Among other things, the amendments would allow FCMs to electronically file any filing or other notice submitted pursuant to CFTC Regulation 1.10, including financial "early warning" notices. The rule changes also would amend the list of supporting documentation that must be filed by an FCM or IB that falls below its minimum adjusted net capital requirement, as well as the timeframe for filing such documentation. Specifically, the current list of required financial statements would be replaced by a general requirement to file documentation that "adequately reflects" the firm's financial condition, but the firm would be required to file such documentation at the time that it notifies the CFTC of the net capital deficiency, rather than within 24 hours as is currently the case. In addition, the amended rules would explicitly require that an income statement be included as part of the periodic unaudited financial reports that must be filed by FCMs and IBs.

The comment period for the CFTC proposal closes on November 12.

The Federal Register release detailing the proposal is available here.

BANKING

Federal Reserve Issues Guidance on Incentive Compensation Practices

On October 22, the Federal Reserve Board issued a proposal designed "to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of their organizations." The proposal includes two supervisory initiatives. One, applicable to 28 large, complex banking organizations, will review each firm's policies and practices to determine their consistency with the principles for risk-appropriate incentive compensation set forth in the proposal. These firm-specific policies will be assessed by supervisors in a special "horizontal review," a coordinated examination of practices at the 28 firms. The policies and implementing practices adopted by these firms in response to the final supervisory principles will become a part of the supervisory expectations for each firm and will be monitored for compliance. Second, supervisors will review compensation practices at regional, community and other banking organizations not classified as large and complex as part of the regular, risk-focused examination process. These reviews will be tailored to take account of the size, complexity and other characteristics of the banking organization.

According to the Federal Reserve, "Flaws in incentive compensation practices were one of many factors contributing to the financial crisis. Inappropriate bonus or other compensation practices can incent senior executives or lower level employees, such as traders or mortgage officers, to take imprudent risks that significantly and adversely affect the firm. With that in mind, the Federal Reserve's guidance and supervisory reviews cover all employees who have the ability to materially affect the risk profile of an organization, either individually, or as part of a group." The findings from these reviews will be incorporated into the banking organization's supervisory ratings. In appropriate circumstances, the Federal Reserve may require an organization to develop a corrective action plan to rectify deficiencies in its incentive compensation programs and processes.

Comments will be accepted on the proposed guidance for 30 days after publication in the *Federal Register*, which is expected shortly.

Click here to read the proposed guidance.
Click here to read a Q&A on the proposed guidance.

STRUCTURED FINANCE AND SECURITIZATION

Fitch's Re-REMIC Moratorium Expanded to All U.S. Alt-A RMBS

On October 16, Fitch Ratings announced that as of October 14, its moratorium on rating certain U.S. residential mortgage-backed securities (RMBS) re-securitizations was expanded to include all Alternative A-Paper (Alt-A) loan transactions. The agency's existing moratorium previously covered U.S. re-securitizations of RMBS backed by subprime loans and Alt-A loans only if the RMBS utilized an overcollateralization structure.

Read more.

Fitch Comments on FDIC Legal Isolation Issue

On October 21, Fitch Ratings released a document titled "Fitch Comments on ABS from FDIC Insured Banks under New Rules." Fitch is concerned that, upon the effectiveness of the Statement of Financial Accounting Standards No. 166 later this year, banks may cease to qualify for the Federal Deposit Insurance Corporation's (FDIC's) 2000 "safe harbor" regulation when the FDIC acts as a conservator for insolvent institutions because they will no longer be able to treat transfers of assets to securitization vehicles as sales under generally accepted accounting principals. For some transactions, Fitch believes ratings higher than the originator may not be possible, but for static and discreet pool securitizations, Fitch "AAA" ratings may still be obtained.

Read more.

EXECUTIVE COMPENSATION AND ERISA

Please see "Federal Reserve Issues Guidance on Incentive Compensation Practices" in **Banking** above.

UK DEVELOPMENTS

UK Regime for Registration of Charges Created by Non-UK Companies Simplified

The Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 (RoC Regulations) now provide that (a) no "Slavenburg" registrations of charges created after September 30 will be accepted and (b) charges may only be registered against foreign companies which have a place of business in the UK registered with the Registrar of Companies.

The practice of filing Slavenburg registrations originated from the 1980 High Court *Slavenburg Bank* decision. This led to a concern that where a charge was created under English law by a company without an established and registered UK place of business and the charging company subsequently set up business in the UK, the unregistered charge would be void for not being registered within 21 days after its creation or within 21 days of the date when the non-UK company established and registered a UK place of business.

The pre-October 1 solution to this problem was to deliver the charge to the Registrar of Companies. Such deliveries were noted on the Slavenburg register and this prevented the charge from being considered void on a subsequent registration by the foreign company of a UK place of business.

This problem has now been solved by the RoC Regulations. There is now no obligation to deliver to the Registrar of Companies charges created by non-UK companies which have not registered a place of business in the UK. The Registrar will no longer accept Slavenburg registrations in respect of charges created on or after October 1.

Court of Appeal Rules FSA Can Prosecute Offenses Not Specified in Statute

In early October, the English Court of Appeal ruled that the power of the UK Financial Services Authority (FSA) to prosecute criminal offenses was not limited to the offenses specified in sections 401 and 402 of the Financial Services and Markets Act 2000. In particular, the Court of Appeal ruled that the FSA has the power to prosecute money laundering and other offenses within the ambit of the FSA's statutory objectives.

To read the full opinion click here.

FSA Issues Discussion Paper on Turner Review

On October 22, the UK Financial Services Authority (FSA) issued a discussion paper on issues raised by the Turner Review (as reported in the March 20 edition of *Corporate and Financial Weekly Digest*). The discussion paper focuses in particular on policy measures to address the problem of systemically important "too-big-to-fail" banks. It also examines the trade-offs involved in increasing capital and liquidity requirements, and stresses the need to assess the cumulative impact of multiple reforms.

The paper identifies the dangers posed by those firms that are seen as too big or too interconnected to fail, or too big to rescue. It describes the full range of policy options—including the creation of "narrow banks"—in order to provide the basis for an informed debate. It also outlines the position which the FSA is currently proposing in international fora.

To read the paper in full click here.

EU DEVELOPMENTS

European Commission Issues Communication on Derivatives Markets

On October 21, the European Commission released a communication entitled *Ensuring Efficient, Safe and Sound Derivatives Markets: Future Policy Actions*. The communication sets out the Commission's intended future policy designed to increase transparency of the derivatives market, to reduce counterparty and operational risk in trading, and to enhance market integrity and oversight. The communication follows from the consultation launched by the Commission in July (as reported in the July 10 edition of *Corporate and Financial Weekly Digest*). The Commission will make legislative proposals in 2010.

In the communication, the Commission states that it "believes that a paradigm shift must take place away from the traditional view that derivatives are financial instruments for professional use, for which light-handed regulation was thought sufficient, towards an approach where legislation allows markets to price risks properly. As a result, the proposed measures will shift derivative markets from predominantly OTC bilateral to more centralized clearing and trading."

To read the communication click here.

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LITIGATION

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