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Corporate and Financial Weekly Digest

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A Note from the Editor

Please note that *Corporate and Financial Weekly Digest* will not be published next Friday, November 2. The next issue will be distributed on November 9.

Robert Kohl

SEC/Corporate

SEC Approves Stock Option-Value Auctions

On October 17, the Securities and Exchange Commission approved a market-based method for valuing employee stock options under Financial Accounting Standards (FASB) Statement No. 123R. The Office of the Chief Accountant of the SEC issued a letter to Zions Bancorporation permitting Zions to use an auction process to value employee stock options under FASB Statement No. 123R. The SEC gave preliminary clearance to Zions in January of 2007 for the use of the auction process, but attached some conditions to its approval.

FASB Statement No. 123R governs the accounting for employee stock options. It requires that all equity based awards to employees be recognized in the income statement based upon their fair value. The two most common pricing methodologies used for establishing the fair value are the Black Scholes model and the Lattice or Binomial model. The SEC's October 17 letter provides a potential alternative to these methodologies.

The Zions system creates "tracking securities" called Employee Stock Option Appreciation Rights Securities (ESOARS) that emulate options awarded to employees. The ESOARS are sold to institutions and sophisticated individuals in an auction process. ESOARS track the value of an employee stock option grant by making payments to holders of the securities at the same time as employees exercise their options. In this way ESOARS attempt to replicate the value of the employee options.

Zions first held an ESOARS auction in May of 2006, providing a market value based on bids received. The value was about half that derived under the Black Scholes model. The Company intends to use the valuation for FASB 123R purposes.

The SEC's October 17 letter states that the ESOARS instrument was sufficiently designed to be used as a market-based method for valuing employee stock options under FASB Statement No. 123R. Further, the SEC did not object to Zions' position that the market clearing price of ESOARS in the May 2007 auction was a reasonable estimate of the grant-date fair value of employee stock options granted by Zions in May 2007.

SEC/CORPORATE

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The SEC articulated the following minimum key factors to use in evaluating any future auction process used to determine grant-date fair value:

- Are there a sufficient number of sophisticated bidders to constitute an active market?
- Do the bidders have sufficient information to value the investment and make an investment decision?
- Does the pattern of bidding reflect what one would normally observe in an active market?
- Do the bidders' perceptions of material costs of holding, hedging or trading the instrument substantially affect their valuation of the instrument?

The SEC also noted with approval the use of a model-based price to cross-check the values derived from using a market-based approach.

The SEC stated its support for the development of a variety of competing market-based objective measurements of the fair value of employee stock options. As such, the SEC's October 17 letter may open the door for other companies to use the same approach or alternative approaches to establish stock option grant-date fair value under FASB Statement No. 123R.

http://www.sec.gov/info/accountants/staffletters/zions101707.pdf

Key Findings from the 2007 Business Roundtable Corporate Governance Survey

On September 28, Business Roundtable, an association of chief executive officers of 160 leading U.S. companies, released the results of its fifth annual survey on corporate governance practices amongst its members. The survey showed a strong trend toward increased independence and company oversight by company boards of directors. Specifically, the survey showed an increase in the number of independent directors serving on corporate boards (90% of the responding companies reported that their boards were at least 80% independent in 2007 and the same percentage have an independent chairman, lead director or presiding director) and a significant rise in the number of companies that have adopted majority voting for directors (82% of the responding companies).

This year's survey also included questions that focused on governance reform, including:

- Executive Sessions: 71% of boards of directors meet in executive session each year and 97% of Audit Committees (85% at each meeting), 92% of Compensation Committees and 68% of Nominating/Governance Committees meet in executive session each year.
- CEOs Serving on Other Boards: 75% of CEOs serve on no more than one other public company board. Nearly half (48%) of CEOs serve on only one other public company board, while 27% of CEOs do not serve on any other public company boards.
- Shareholder Communications: Only 38% of the companies responded that board members have met with shareholders in the last year.
- Sarbanes-Oxley: Sarbanes-Oxley compliance spending continues to decline. Approximately 50% of companies stated that they expect

costs to decrease moderately in light of the Securities and Exchange Commission's interpretive guidance and the Public Company Accounting Oversight Board's Auditing Standard No.5 regarding internal controls over financial reporting.

- Pay-for-Performance: 40% of the companies responding indicated that they adjusted the pay-for-performance element of senior executive compensation in the past year. In 2006, 57% of the companies reported doing so.

http://www.businessroundtable.org/index.aspx

Broker Dealer

Enhanced Disclosure Requirements for TRACE-Eligible Debt Proposed

The Financial Industry Regulatory Authority (FINRA) has proposed NASD Rule 2231, which would mandate enhanced informational disclosures to investors in TRACE-Eligible debt securities. Proposed disclosures on the customer's confirmation would include specific debt security information such as CUSIP and TRACE symbol, broker-dealer transaction charges or that a mark-up or mark-down was charged in a principal transaction, lowest credit rating of the bond (including source), and cash flow information including the frequency of interest and/or principal payments. Other proposed confirmation disclosures include yield to maturity and call feature information, and variable coupon rate information. Members would be required to inform customers that transaction price information is publicly available at no charge on the FINRA web site at www.bondinfo.com.

The proposed rule would require members to disclose in account statements to customers buying or selling TRACE-Eligible debt securities that a FINRA-prepared document titled, "Important Information You Need to Know About Investing in Corporate Bonds" is available either on the web at www.finra.org, or from their broker-dealer upon written request. The document must be provided within three business days of a customer's written request, or ten business days if the request is received more than six months after the transaction.

The investor education piece provides investors with basic information on bond investing, including corporate bond basics (yield, price, call features), corporate bond risks (investment risk, call and reinvestment risk, refunding risk and sinking funds provisions, default and credit risk, liquidity risk) and special features (floating rate bonds, zero-coupon bonds, secured bonds, convertible bonds and junior or subordinated bonds). The FINRA-prepared document also includes a section on broker compensation for selling bonds, and information about what a similar bond might cost.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-20601.pdf

New Rules Proposed for Distributing Independent Third Party Research

The Financial Industry Regulatory Authority has proposed amendments to NASD Rule 2711 and NYSE Rule 472 that would define "third party research reports" as any report produced by a person or entity other than a member, and create a further sub-category of "independent third party research." The new-sub-category would be defined as research produced by an entity that has no affiliation or business or contractual relationship with a member or its affiliates reasonably likely to inform the content of its research reports, and that makes coverage and content determinations without any input from the

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distributing member or its affiliates. Members distributing independent third-party research to the public would be exempt from current rules requiring disclosure reviews and sign-offs affirming that the report contains no untrue statement of material fact or is otherwise not false or misleading.

Members distributing independent third party research would have to disclose the receipt of investment banking compensation from the issuer in the past 12 months or that will be sought in the next 3 months, ownership or 1% or more of any class of the subject company's securities, if the member makes a market in the subject company's securities and any other conflicts of interest. This disclosure would not be required when the third party independent research reports are made available by a member upon request, through a member-maintained website, or by a member to a customer in connection with a solicited order in which the registered representative informed the customer of the availability of such independent research.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-18958.pdf

SEC Approves FINRA Rule on Fairness Opinions

The Securities and Exchange Commission approved NASD Rule 2290 to enhance disclosures and procedures in connection with the issuance of fairness opinions by members in situations where the issuing member has reason to know the opinion will be provided or described to the company's public shareholders. Any member acting as a financial advisor to a party that is the subject of a fairness opinion would be required to disclose in the fairness opinion whether it will receive compensation contingent on the successful completion of the transaction, for rendering the fairness opinion and/or for serving as an advisor. Members would also be required to disclose any material relationships existing during the two-year period preceding the issuance of the fairness opinion in which any compensation was received as a result of the relationship between the member and any party to the pending transaction.

Under the rule, members would be required to disclose whether any information supplied by a party to the transaction that formed a substantial basis for the fairness opinion had been independently verified, and identify such information. Other disclosures would include whether the fairness opinion was approved by a fairness committee, and whether the fairness opinion expresses an opinion on the compensation to be received by the company's officers, directors or employees relative to compensation to public shareholders. Members would also need to institute written procedures setting out the types of underlying transactions for which the member would use a fairness committee, the process for selecting personnel to be on the committee, the necessary qualifications for persons serving on the committee, and the process to promote a "balanced review" by the fairness committee. Finally, the rule would require members to utilize a process to determine whether the valuation analyses used in the fairness opinion are appropriate.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-20585.pdf

Banking

Final Rules Released on Marketing by Affiliated Companies

Pursuant to the Fair and Accurate Transactions Act of 2003 (the FACT Act), on October 25, 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 and the Office of

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Thrift Supervision (the Banking Agencies) issued final rules with respect to the use by a financial institution of certain information received from an affiliate to market to consumers.

Generally, under the final rules, a financial institution may not obtain certain consumer eligibility information from an affiliate to solicit a consumer unless the (i) the consumer has been given notice that such activity may occur, (ii) the consumer has been given the ability to opt out of such solicitations, and (iii) the consumer has not exercised its opt out right. Pursuant to the regulation, the opt out period must be effective for a period of at least five years and, upon expiration of the opt out, the consumer must be given a renewal notice.

The regulation does not apply to a person using consumer eligibility information: (i) to make solicitations to a consumer with whom the person has a pre-existing business relationship; (ii) to perform services for another affiliate subject to certain conditions; (iii) in response to a communication initiated by the consumer; or (iv) to make a solicitation that has been authorized or requested by the consumer.

According to the Banking Agencies' press release, the Securities and Exchange Commission and the Federal Trade Commission will also issue similar releases.

The final rules are effective on January 1, 2008, and all covered entities must comply with the rules by October 1, 2008.

http://www.federalreserve.gov/newsevents/press/bcreg/20071025a.htm

United Kingdom Developments

FSA Publishes Feedback on Financial Promotion Rules

On October 15, the UK Financial Services Authority (FSA) published answers to commonly asked questions it has received relating to its new rules on client communications and financial promotions. The rules come into effect on November 1 and form Chapter 4 of FSA's new Conduct of Business Sourcebook (COBS).

www.fsa.gov.uk/pages/Doing/Regulated/newcob/comms2.shtml

LSE Censures and Fines AIM Nomad

On October 19, the London Stock Exchange (LSE) announced that Nabbarro Wells & Co Limited, a nominated adviser (nomad) of the UK's Alternative Investment Market (AIM), had been fined £250,000 and publicly censured for breaches of Rule 39 of the AIM Rules and Part 2 of the AIM Nominated Adviser Eligibility Criteria.

Observing that it delegates to nomads certain important regulatory responsibilities, such as that of assessing the appropriateness of companies for AIM and stating that nomads fulfil a vital role in maintaining the quality of companies, the LSE imposed sanctions on Nabbarro Wells for its: (i) insufficient systems and controls, (ii) failure to act with due skill and care, (iii) failure to undertake the necessary level of due diligence to assess the appropriateness of certain companies for admission to trading on AIM, and (iv) failure to make due and careful enquiry into whether certain companies' AIM admission documents complied with AIM rules.

www.londonstockexchange.com/NR/rdonlyres/B037D460-B3C5-42E6-8BCB-E08D34131B40/0/AD1v4clean.pdf

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FSA Publishes Financial Crime Newsletter

On October 23, the Financial Services Authority published its ninth Financial Crime Newsletter, which gave updates on the FSA's work on issues including: identity theft prevention, information security for appointed representatives, property fraud, illegal "boiler rooms" and changes to the UK's financial sanctions procedures.

www.fsa.gov.uk/pubs/newsletters/fc_newsletter9.pdf

EU Developments

CESR Launches Consultation on UCITS Investor Disclosures

On October 16, the European Committee of European Securities Regulators (CESR) published a consultation paper on the content and form of Key Investor Information (KII) disclosures for retail orientated Undertakings in Collective Investment Securities (UCITS) funds.

The consultation has been launched on the request of the EU's European Commission. The Commission has asked CESR to provide advice on the form and contents of KII, which it proposes to introduce as a replacement for the simplified prospectus currently used with UCITS funds.

It is CESR's view that KII should contain only the essential elements for assisting retail investors in making and carrying out informed investment decisions. In this context, CESR has considered factors likely to make product information disclosures useful to retail investors. The consultation sets out CESR's recommendations on the scope, format and content of KII, the use of past performance information and on charges.

The consultation closes on December 17 and CESR plans to provide its initial advice to the Commission in February 2008.

www.cesr-eu.org/popup2.php?id=4814

Litigation

Securities Fraud Class Action Complaint Dismissed for Violating Pleading Rules

A district court granted a corporation's motion to dismiss a securities fraud class action on the grounds that the consolidated complaint failed to satisfy the pleading requirements of Rule 8 of the Federal Rules of Civil Procedure. Rule 8 requires claims to be set out in short and plain terms. Defendants argued, and the Court agreed, that the complaint, containing 735 paragraphs in 228 pages and 67 pages of exhibits, was a "morass of allegations regarding an alleged 'scheme of option backdating and spring-loading,' a 'submarine patent scheme,' various infringement suits and regulatory actions, a bond offering, and alleged insider trading."

The Court also found that the complaint was "[l]oaded with multiple theories of conspiracies and wrongdoing" spanning a 13 year period, did not specify which allegations were asserted against which defendants, and required both the Court and defendants to guess as to which parties were involved in which allegedly fraudulent activity. The Court rejected the plaintiffs' argument that the complaint's length and complexity was required to meet the heightened pleading standard of the Private Securities Litigation Reform Act, ruling that the heightened standard was not an invitation to adopt a "kitchen-sink" approach to a pleading, nor an invitation to disregard Rule 8's requirement of "simplicity, directness and clarity." (*Kelley v. Rambus, Inc.,* 2007 WL 3022544 (N.D. Cal.

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Arbitrator Must Determine Applicable Law and Venue

In a dispute between the parties to an agreement containing a broad arbitration clause, the district court determined that disputes regarding the applicable law and venue for the arbitration were matters for the arbitrator to decide, and, accordingly, dismissed the plaintiff's lawsuit seeking a declaration that the arbitration must proceed in Virginia under Virginia law.

The Court first ruled that under the Federal Arbitration Act, a district court's role in litigation involving issues to compel arbitration potentially covered by an arbitration clause is limited to determining whether (i) the agreement to arbitrate is valid, and (ii) the dispute is within the scope of the arbitration agreement. The Court then examined the arbitration provision at issue, which required that "any dispute shall be finally resolved by binding arbitration," that "unless contrary to applicable law . . . the arbitration shall apply . . . the substantive law of the state of Illinois," and that "arbitration shall be held at such location as is required by applicable law, or if no location is required by applicable law, at Chicago."

The Court determined that these provisions demonstrated both the parties' agreement to arbitrate and their clear intention that the arbitrator, and not a court, determine the choice of law and venue issues. The provision's requirement that "any disputes" be determined by arbitration contained no language that supported the plaintiff's claim that the parties intended to submit to the courts disputes over venue and choice of law. (*J.W. Burress, Inc. v. John Deere Constr. & Forestry Co.,* 2007 WL 3023975 (W.D. Va. Oct. 15, 2007)).

CFTC

CFTC Seeks Expanded Authority

In a report delivered to Congress on October 24, the Commodity Futures Trading Commission recommended expansion of its oversight over trading of oil and natural gas contracts on exempt commercial markets (ECMs). The CFTC's legislative recommendations include: (i) large trader position reporting comparable to reporting requirements that currently apply to contracts traded on regulated exchanges; (ii) position limits and/or accountability levels comparable to those that currently apply to similar contracts traded on regulated exchanges; (iii) self-regulatory oversight to detect and prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process; and (iv) emergency authority for the CFTC and the ECM to prevent price manipulation and disruptions of the delivery or cash-settlement process. The CFTC recommended that these requirements apply to ECM contracts that serve a "significant price discovery function," a determination that would require that (x) trading volume in the ECM contract be sufficiently significant to affect regulated markets or become a pricing benchmark, and (y) the ECM contract either influence other markets or be materially referenced by others in interstate commerce on a frequent and recurring basis.

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/pr5403-07_ecmreport.pdf

GAO Issues Report on CFTC Energy Market Oversight

The Government Accountability Office has recommended that Congress consider expanding the authority of the Commodity Futures Trading Commission over energy derivatives trading, particularly in exempt commercial markets (ECMs). The GAO's October 19 report noted that, while the CFTC has

CFTC

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coordinated its enforcement actions with the Department of Justice, the Federal Energy Regulatory Commission and the New York Mercantile Exchange (among others), it was "difficult to determine" whether the CFTC enforcement action has "helped deter market manipulation or other abusive practices." Among other things, the GAO recommended that the CFTC consider revisions to the classifications in its Commitments of Traders report to improve the relevance, transparency and accuracy of public information on trading activity.

http://www.gao.gov/new.items/d08174t.pdf

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