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SEC/Corporate

NYSE Adopts Recommendation to Eliminate Broker Voting in 2008

On October 24, the New York Stock Exchange submitted a proposed amendment to NYSE Rule 452 to the Securities and Exchange Commission to eliminate broker discretionary voting on the election of directors. Subject to the Commission's approval, the proposed amendment will be effective for all shareholder meetings held on or after January 1, 2008 (except to the extent that a meeting was originally scheduled to be held in 2007 but was adjourned to 2008). Under the current NYSE Rule 452, brokers are permitted to vote the shares they hold for investors on certain "routine" proposals if the owner of the stock does not provide voting instructions at least ten days before a schedule meeting. An uncontested election for a company's board of directors is currently considered "routine."
In the NYSE press release announcing the proposed rule change, Catherine R. Kinney, the NYSE's President and co-COO, stressed the importance of the election of directors and stated that "[s]hareholder voting on the election of directors is a critical component of good corporate governance." The proposed change would enhance the effectiveness of campaigns to withhold votes for directors, particularly if a company has adopted majority voting for director by-laws as many state corporation laws now permit.

The proposed amendment will increase the costs of uncontested elections, as issuers will have to spend more money and effort to reach shareholders who previously did not vote. These costs may increase substantially with the rise of majority voting for directors, as issuers may have to obtain votes from shareholders who may not realize that their failure to vote constitutes a "no" vote. In its submission to the SEC, the NYSE acknowledges such costs but reasons that such costs are required to be paid for better corporate governance and transparency of the election process.

The full text of the NYSE's press release is available at
http://www.nyse.com/Frameset.html?nyseref=&displayPage=/press/1161166307645.html

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Banking

FDIC Announces Final Rule Related to One-Time Assessment Credit

The Federal Deposit Insurance Corporation (FDIC) announced on October 10, its final rule related to the one-time credit of $4.7 billion to banks and thrifts as required by the Federal Deposit Insurance Reform Act of 2005. The rule will take effect on January 1, 2007 and sunset on December 31, 2008. During the rule's effective period, the FDIC intends to begin a more comprehensive notice-and-comment rulemaking to explore alternative credit distributions to take effect in 2009 and thereafter.

To be eligible for the credit, an institution must have been in existence prior to December 31, 1996 and paid insurance premiums before such date, or meet the agency's definition of a "successor" to such institution. According to the FDIC, more than 7,300 institutions are eligible for the credit.

Credits may be used to offset future assessments levied by the FDIC. The exact amount of the credit will be determined by the FDIC and the institution will be notified of such amount. The final rule provides a mechanism for institutions to challenge the agency's determination provided the challenging institution adheres to the prescribed administrative process.

For more information, see 71 Federal Register 61385 (Oct. 18, 2006).

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Broker Dealer

NASD Extends Date to Complete Firm-Element Continuing Education to Qualify to Engage in a Security Futures Business

The NASD proposes to amend NASD Rule 1022 (Categories of Principal Registration) and NASD Rule 1032 (Categories of Registered Representatives) to extend to December 31, 2009 the date by which eligible registrants must complete firm-element continuing education to qualify to engage in a security futures business.

In 2003, the NASD modified the following registration categories to include the activities of engaging in and supervising security futures activities: (i) Registered Options and Security Futures Principal (Series 4); (ii) Limited Principal--General Securities Sales Supervisor (Series 9/10); (iii) General Securities Representative (Series 7), and (iv) Limited Representative--Options and Security Futures Series (Series 42). Persons currently registered or becoming registered in these categories were required to complete firm-element continuing education addressing security futures before conducting any security futures business.

Although the NASD initially considered replacing this requirement with revised qualification examinations that addressed security futures, until such plans are enacted it will continue to require completion of firm-element continuing education before engaging in any security futures business.
http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_017662.pdf

NASD Proposes Change to Enhance Brut Directed Cross Order

The NASD, through its subsidiary, The Nasdaq Stock Market, Inc., proposes to enhance the flexibility of the Brut Directed Cross Order directed to the New York Stock Exchange by allowing it to check and, if appropriate, interact with available liquidity in any of the three Nasdaq-operated execution systems (ITS/CAES, Brut and INET) before further processing.

Currently, Brut Directed Cross Orders directed to the NYSE first are processed in the Brut System and, after exhausting available liquidity, are automatically routed to ITS/CAES and Nasdaq's INET Facility for potential execution. If instructed by the entering party, the orders are routed to other market centers that provide automated electronic executions before being sent to the NYSE.

Nasdaq proposes to modify this procedure by ensuring each Nasdaq-operated execution facility is checked for available liquidity before the order is routed away to another market. No Brut Directed Cross Order will execute in a Nasdaq-operated execution venue at an inferior price to one that is available at an accessible alternative venue.
http://www.nasdaq.com/about/SR-NASD-2006-117_NASDAQ_Rule_Filing.pdf

ISE, NYSE Arca Propose Penny Pilot Program in Options Trading

The International Stock Exchange (ISE) and New York Stock Exchange Arca, Inc. (NYSE Arca) have each submitted a proposed Penny Pilot Program (Pilot) in options trading, in which each exchange will reduce its quotes in the options markets to increments as low as $0.01 for certain options issues.

The Securities and Exchange Commission mandated the Pilot beginning January 26, 2007, in which the six U.S. options exchanges will have to reduce the minimum price variation for 13 classes of options from $0.05 to $0.01 for series trading at less than $3, and from $.10 to $0.05 for series trading at or above $3.

NYSE Arca and ISE have each submitted a proposal with the SEC to begin the six-month Pilot quoting options issues listed for trading on its respective options platform in $0.01 increments as opposed to the current industry standard of $0.05 for option issues quoted under $3. Pricing increments for options quoted at $3 per contract or greater would be reduced from $0.10 to $0.05 for issues in the Pilot. Quoting for all options issues other than those in the Pilot will continue at $0.05 for options issues trading at less that $3, and $0.10 for quoting in options issues trading at $3 or more.

The proposed Pilot will begin January 26, 2007 with the following 13 underlying issues:

QQQQ	Nasdaq-100 Index Tracking Stock
IWM	iShares Russell 2000 Index Fund
SMH	Semiconductor Holdrs Trust
GE	General Electric Company
AMD	Advanced Micro Devices, Inc.
MSFT	Microsoft Corporation
INTC	Intel Corporation
CAT	Caterpillar Inc.
WFMI	Whole Foods Market, Inc.
TXN	Texas Instruments Incorporated
GLG	Glamis Gold Ltd.
FLEX	Flextronics International Ltd.
SUNW	Sun Microsystems, Inc

http://www.nysearca.com/content/regulation/prf/2006/SR-NYSEArca-2006-73.pdf
http://www.iseoptions.com/legal/pdf/proposed_rule_changes/SR-ISE-2006-62$Pilot_Program_to_Quote_and_Trade_Certain_Options_in_Pennies$20061011.pdf

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United Kingdom Developments

HMRC Consults on Investment Manager Exemption

On October 20, HM Revenue & Customs (HMRC) released for consultation a draft of its revised Statement of Practice concerning the application of the Investment Manager Exemption (IME). The significance of the IME is that unless it applies to the London-based managers of hedge funds and other offshore funds, the funds can be liable to UK tax on their profits (subject only to relief available under any applicable double tax treaty.) The IME is particularly important for more actively managed vehicles, such as hedge funds.

The HMRC consultation draft addresses a number of issues with respect to the IME's qualifying conditions, including:

- Basis on which a manger and a fund are considered to be independent
- Customary payment rate for managers
- What transactions are "trading" as opposed to "investment"

Responses to the Consultation are due by January 12, 2007 and HMRC aims to a issue final revised Statement of Practice by March 31, 2007.
http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_026217

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Litigation

Seventh Circuit Denies Petition to Review SEC Cease-and-Desist Order Against CFO

The Seventh Circuit denied a petition for review of a cease-and-desist order issued by the Securities and Exchange Commission because substantial evidence showed that the petitioner, the former CFO of a public company, caused the company to make misleading financial statements to investors in violation of Sections 10(b), 13(b)(2) and 13(b)(5) of the Securities Exchange Act of 1934 by (i) drafting financial statements that overestimated the company's profits, (ii) approving a draft Form 10-K that contained the inaccurate financial statements, and (iii) representing that no adjustment to the financial statements was required. The Court rejected the CFO's argument that because she did not sign the Form 10-K she could not be liable under Rule 10b-5, ruling that direct communication with investors was not required where the CFO knowingly caused materially misleading information to be incorporated in the Form 10-K. The Court also rejected the CFO's lack of scienter argument. Substantial evidence supported the SEC's finding of scienter based upon the CFO's "extreme departure from the requisite standard of ordinary care" including, among other things, the CFO's knowledge that the company's financial accounting systems were in critical disarray and that a material $5 million billing discrepancy between the company and its largest customer had not been disclosed. (*McConville v. S.E.C., No. 05-3510, 2006 WL 2873031 (7th Cir. Oct. 11, 2006))*

Equitable Estoppel and Waiver Survive as Defenses in SEC Suit

Defendants asserted statute of limitations, laches, equitable estoppel and waiver affirmative defenses to the Securities and Exchange Commission's claim that they illegally pocketed more than $9 million when they obtained majority control of an insolvent company, changed its name, used false publicity to market the company, sold shares to the public as part of an alleged "pump and dump" scheme, and concealed their actions by filing falsified reports. The SEC filed its lawsuit six years after commencing its investigation of the allegedly unlawful activities. The Court dismissed the statute of limitations defense because the relief sought in the case – a complete accounting, an injunction and disgorgement – were all "equitable" in nature and, thus, not subject to the 5 year statute of limitations cited by the defendants. The Court also dismissed the laches defense, ruling that it had no application where, as here, the SEC was acting in the public interest in enforcing the securities laws. However, the Court rejected the SEC's motion to dismiss the equitable estoppel and wavier defenses. While recognizing that "generally, equitable estoppel cannot be asserted against the government absent severe circumstances," the Court ruled that given the length and manner of the SEC's delay here, it would be premature to dismiss the defense at the pleading stage. With respect to the waiver defense, after finding that the SEC had identified no legal authority barring defendants from asserting such an affirmative defense against the government, the Court declined to resolve in the SEC's favor at the pleading stage the factual dispute as to whether the lengthy passage of time from the start of the investigation could be found to constitute a waiver or whether, as the SEC contended, the defendants' actions prevented the SEC from prosecuting the action sooner. *(Securities and Exchange Commission v. PacketPort.com, Inc., No. 3:05-cv-1747 (JCH), 2006 WL 2798804 (D. Conn. Sept. 27, 2006))*

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