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SEC/Corporate

SEC Issues New Fee Rates

The Securities and Exchange Commission announced September 29 that the fees that public companies and other issuers pay to register their securities with the SEC will be reduced. Five days after the enactment of the SEC's 2007 fiscal year budget appropriation, the Section 6(b) fee rate applicable to the registration of securities, the Section 13(e) fee rate applicable to the repurchase of securities, and the Section 14(g) fee rate applicable to proxy solicitations and statements in corporate control transactions will decrease to $30.70 per million from the current rate of $107.00 per million.

In addition, thirty days after the date of enactment of the Commission's budget appropriation, the Section 31 fee rate applicable to securities transactions on the exchanges and in the over-the-counter markets will decrease to $15.30 per million from the current rate of $30.70 per million. On that same date, the assessment on security futures transactions under Section 31(d) will decrease to $0.0042 for each round turn transaction from the current rate of $0.009 for each such transaction.
http://www.sec.gov/news/press/2006/2006-168.htm.

California Eliminates Tax Clearance Certificate Requirement

Effective September 29, California law was amended to eliminate the requirement that a dissolving or withdrawing corporation, limited liability company or limited liability partnership obtain a Tax Clearance Certificate from the California Franchise Tax Board prior to giving effect to a dissolution or withdrawal. The amended law also requires the termination document filed with the California Secretary of State to include an additional specified statement regarding the filing of a final franchise or annual tax return with the California Franchise Tax Board.

In addition to eliminating the requirement that a dissolving or withdrawing entity obtain a Tax Clearance Certificate prior to such dissolution or withdrawal, the amended California law provides that the minimum franchise tax and the annual tax, as applicable, would not be assessed against these entities in the year that a final return is filed if the entity did not thereafter do business in California and dissolution, surrender or cancellation of the entity is completed before the end of the 12-month period following the date the final tax return was filed.
http://www.ss.ca.gov/business/bpd_forms.htm.
http://www.leginfo.ca.gov/pub/bill/asm/ab_2301-2350/ab_2341_bill_20060912_enrolled.html

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Broker Dealer

NSCC Proposes Next Day Settlement Rules

The National Securities Clearing Corporation (NSCC) has proposed to modify its procedures for equity trade processing to enable cash, next day, and seller's option equity trades received on a locked-in basis from self-regulatory organizations (SROs) and Qualified Special Representatives to be processed in NSCC's Continuous Net Settlement (CNS) system. Currently, next day trades are settled on a trade-for-trade basis directly between counterparties, rather than through NSCC's facilities. NSSC recently developed real-time capabilities, which could allow members to have cash, next day, and seller's option equity trades in CNS-eligible CUSIPS made eligible for processing in CNS.

NSCC also proposed to modify its clearing fund formula by including an additional component that is intended to mitigate the risk associated with trades that are processed on a settlement cycle shorter than three days by calculating an average clearing fund requirement for this activity based upon historical activity.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-15985.pdf

NYSE Information Memorandum on the Implementation of the NMS Linkage Plan

The New York Stock Exchange, Inc. issued Information Memorandum No. 06-70 on the implementation of the NMS linkage plan. The Information Memorandum highlights the effect of the NMS Linkage Plan, which replaced the Intermarket Trading System as of October 1.

There are several changes to the pre-opening pricing, such as: (i) the specialist is no longer required to disseminate a price range according to the "applicable price range" parameters contained in NYSE Rule 15(c)(i)(A)(1); (ii) the specialist is no longer required to open the security within the disseminated pre-opening notification range; (iii) the specialist can now disseminate a pre-opening price range that straddled the previous day's consolidated closing price; and (iv) the specialist, after disseminating a pre-opening notification, is no longer required to set a delay to the opening of the subject security after the time of the pre-opening notification. Responses to a specialist pre-opening price range from regional centers must be sent over Super DOT.

The Information Memorandum further notes that the ITS Block Trade Policy has been eliminated and a block trade-through will be treated the same as a trade-through of any size in that the member representing the block-sized order(s) must route to each other participating market displaying a bid (offer) superior to the execution price interest to trade at the "top of the book" displayed price and size, rather than the NYSE block execution price.
http://www.sec.gov/rules/sro/nms/2006/34-54551.pdf
http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852571F80054CCA2/$FILE/Microsoft%20Word%20-%20Document%20in%2006-70.pdf

NYSE Proposes Changes to Rule 409 - Statements of Accounts to Customers and New Rule 409A - SIPC Disclosure

The New York Stock Exchange, Inc. proposes to amend NYSE Rule 409(e) to require that each statement of account sent to a customer include a legend advising the customer to promptly report any inaccuracy or discrepancy in that person's account to his or her brokerage firm. If the account is subject to a clearing agreement pursuant to NYSE Rule 382, amended NYSE Rule 409(e) would require the legend to advise that the customer's notification be sent to both the introducing firm and the clearing firm. The legend also would advise the customer that he or she should reconfirm any oral communications with either the clearing or introducing firm in writing to further protect the customer's rights, including rights under the Securities Investor Protection Act.

NYSE is also proposing to adopt a new rule, NYSE Rule 409A, which would require member organizations to advise each customer in writing, upon the opening of an account and at least annually thereafter, that he or she may obtain information from the Securities Investor Protection Corporation (SIPC). Proposed Rule 409A would require the written advisories to include SIPC's website address and telephone number.

These rule changes were proposed in response to studies conducted by the Government Accountability Office on the need for better disclosure of SIPC's policies.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-16112.pdf

NYSE Issues Information Memorandum on Short Position Reporting Rule 421

The New York Stock Exchange, Inc. issued Information Memorandum 06-69 reminding member organizations of their obligations to maintain adequate and effective written procedures designed to facilitate accurate compilation and reporting of open short positions as required by NYSE Rule 421.

The NYSE recommended that firm internal controls address the following areas of the short interest reporting process: (i) systems designed to ensure the integrity of the firm's books and records that are used to compile reportable short positions; (ii) procedures and controls to ensure that reportable short positions are properly identified, including those of affiliates and correspondents, if applicable; (iii) procedures and controls for appropriate testing of the firm's electronic and other systems that are responsible for "capturing" reportable short position; and (iv) an adequate overall system of supervision for the short interest reporting process.

Among other things, the NYSE suggests written supervisory procedures to monitor, review and verify the accuracy of short position dates. This would include attention to short positions of affiliates; avoiding an improper netting of short positions; avoid double counting, e.g., Prime Broker not executing broker reports; and a review of cancels and rebills. The NYSE also suggested a pre-filing verification and confirmation of selected short positions and evidencing such review by an appropriate supervisor.
http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E88525712D005BB1C8/$FILE/Microsoft%20Word%20-%20Document%20in%2006-69.pdf

NASD Amends Safe Harbor for Business Expansion

The NASD released Notice to Members (NTM) 06-56, explaining modifications to NASD Interpretative Material 1011-1 - Safe Harbor for Business Expansions (IM-1011-1).

NASD Rule 1017 requires member firms to apply for prior approval of material changes in business. IM-1011-1 creates a safe harbor for certain types of expansions that are presumed not to be a "material change in business operations." However, the safe harbor in IM-1011-1 is not available to any member that has a "disciplinary history," meaning a finding of a violation by a member or a principal of the member in the past five years by the SEC, a self-regulatory organization or a foreign financial regulatory authority of one or more specified provisions (or comparable foreign provisions) or rules or regulations thereunder.

NTM 06-56 explains that NASD Rule 2110 (requirement to observe high standards of commercial honor and just and equitable principles of trade) is regularly included in charges of violation by a member firm or its principals. The amended IM-1011-1 will only make a member firm ineligible for the safe harbor when the violation involved unauthorized trading, churning, conversion, material misrepresentations or omissions to a customer, front-running, trading ahead of research reports, or excessive markups. The amendment becomes effective on November 3.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_017595.pdf

CBOE STOC and Regulation NMS

The Securities and Exchange Commission recently approved the Chicago Board Options Exchange, Inc.'s (CBOE) proposal to establish a new electronic trading system for non-option securities known as ''Stock Trading on CBOEdirect'' or ''STOC.'' The SEC approved additional rules and additional system functionality to STOC designed to comply with Regulation NMS and to enable CBOE to qualify as an automated trading center whose quotations will be protected under Regulation NMS.

As approved, STOC orders and quotes will be automated – no manual order entry is permitted. If the system is down, no order will be accepted. CBOE members are required not to cause a locked or crossed market through the use of STOC. If another market center repeatedly fails to respond within one second to orders attempting to access its quotations, STOC may invoke self help in order to execute and must also notify that market center. Finally, CBOE will contract with its participants, a Routing Service Provider and a third party broker-dealer to act as a "give up" on away trading center to route STOC orders to a third party when STOC is not the NBBO. When STOC is not the NBBO, the STOC primary market maker in that security is to act as agent for the customer to obtain the NBBO for the customer.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-16364.pdf

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Banking

Federal Banking Agencies Issue Guidance on Non-Traditional Mortgage Products

On September 29, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration (collectively, the Agencies) issued final guidance to address the risks posed by residential mortgage products (typically known as "nontraditional," "alternative," or "exotic" mortgages) that allow borrowers to defer payment of principal and sometimes interest (the Guidance).

According to the Agencies, although such products have been available for quite some time, the number of institutions offering such products has rapidly expanded. In addition, according to the Agencies, these products are being offered to a wider range of applicants.

The Guidance sets forth the importance of "carefully managing the potential heightened risk levels created by these loans." In particular, management should: (i) ensure that loan terms and underwriting standards are consistent with prudent lending practices; (ii) recognize that many nontraditional mortgage loans are untested in a stressed environment; and (iii) ensure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice.
http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060929/default.htm

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Litigation

Plaintiffs Not Collaterally Estopped from Proceeding Against Owners of Closely Held Corporation on a Veil-Piercing Theory

Two former employees of defendants Ikahn Productions and Winter Films commenced an arbitration against the companies, which were closely-held, and their owners seeking compensation for alleged breaches of their employment contracts. The arbitration was stayed against the owners because they did not sign the contracts in their individual capacity, but the employees were successful in their claims against Ikahn and Winter. Plaintiffs then commenced an action against Ikahn and Winter, as well as the owners of the companies, asserting breach of contract claims and seeking to hold the owners liable on a veil-piercing theory for the companies' failure to pay the amounts due under the arbitration award. The Court found that plaintiffs' breach of contract claims against the individuals were precluded by the prior determination staying the arbitration against them, but ruled that the claim to enforce the arbitration award on a veil-piercing theory was not barred by collateral estoppel and could proceed. In doing so, the court pointed out that the decision staying the arbitration was based on the argument that the individual defendants were not signatories to the contract, but did not address, and therefore did not preclude, claims against the individuals based on a veil-piercing theory. (*Feitshans v. Kahn*, No. 06 Civ. 2125, 2006 WL 2714706 (S.D.N.Y. Sept. 21, 2006))

Court Refuses to Pierce Corporate Veil to Help Guarantors Avoid Contribution Claims

Plaintiff brought an action seeking contribution from the co-guarantors on a line of credit that was extended to the Executive Hotel Group, a limited liability company. The Executive Hotel Group was formed by three limited partnerships, one of which was controlled by the plaintiff, and the other two were controlled by the defendants. When the Executive Hotel Group failed to make timely payments on the line of credit, the plaintiff paid a total of $4 million to the lender, while the defendants paid nothing. The defendants asserted that they were not liable for contribution because the operating agreement of the Executive Hotel Group precluded any of its members from seeking contribution from the other members, and instead required any advance by a member to be treated as a loan. The defendants further argued that the court should "pierce the corporate veil" and find that each individual defendant, although they did not sign the operating agreement of the Executive Hotel Group in their individual capacity, should be treated as having signed it individually so they could benefit from the clause prohibiting claims for contribution. The court refused to pierce the veil, holding that the equities sided with plaintiff, who was merely seeking to hold the defendants to the guarantees that they signed as individuals, and not the defendants, who clearly "owe[d] the money." *(Rogel v. Dubrinsky*, No. 06-10183, 2006 WL 2726941 (E.D. Mich. Sept. 22, 2006))

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CFTC

CFTC Issues No-Action Letter Permitting Direct Access to MexDer's Electronic Trading and Order Matching System

The Commodity Futures Trading Commission's Division of Market Oversight has issued a no-action letter to MexDer, the Mexican derivatives exchange, authorizing MexDer members located in the U.S. to install and use MexDer's electronic trading and order matching system (the System). The no-action letter, issued on September 28, confirms that MexDer may provide such direct access without first applying to the CFTC for designation as a contract market or registration as a derivatives transaction execution facility. The no-action letter specifically permits MexDer to make the System available to MexDer members that are: (i) located in the U.S. and trade on the System for their proprietary accounts; (ii) futures commission merchants (FCMs) or firms exempt from registration pursuant to CFTC Rule 30.10 (Rule 30.10 Firms) that submit orders from or on behalf of U.S. customers directly to the System for execution; and (iii) FCMs or Rule 30.10 Firms that transmit orders from or on behalf of U.S. customers via an automated routing system for execution on the System.
http://www.cftc.gov/files/tm/letters/06letters/tm06-23.pdf

CFTC Issues No-Action Letters to Euronext LIFFE and Euronext Paris Allowing CPOs and CTAs to Enter Orders through Terminals Located in the U.S.

The Commodity Futures Trading Commission's Division of Market Oversight has amended the no-action letters previously issued to LIFFE and Euronext Paris (the Exchanges) to authorize the Exchanges to provide direct access to member firms that are registered with the CFTC as commodity pool operators and commodity trading advisors or are exempt from such registration pursuant to Commission Regulation 4.13 or 4.14. The letters, issued on September 29, authorize such members to enter orders directly into the relevant Exchange's proprietary electronic trading and order matching system through terminals located in the U.S. on behalf of the pools they operate or the customer accounts over which they exercise trading discretion.
http://www.cftc.gov/files/tm/letters/06letters/tm06-24.pdf
http://www.cftc.gov/files/tm/letters/06letters/tm06-25.pdf

CFTC Proposes Amendment to Rule Governing Withdrawals of Equity Capital

The Commodity Futures Trading Commission has proposed to amend CFTC Rule 1.17 to provide that it may, by written order, temporarily prohibit the withdrawal of equity capital if such withdrawal would reduce the futures commission merchant's (FCM) excess adjusted net capital by 30 percent or more. The proposed amendment would authorize the CFTC to restrict, for up to 20 business days, any withdrawal of equity capital from the FCM and any unsecured advance or loan to a stockholder, partner, limited liability company member, sole proprietor, employee or affiliate if (i) such withdrawal, advance or loan, when aggregated with other withdrawals, advances or loans during a 30 calendar day period, would cause a net reduction in the FCM's excess adjusted net capital of 30 percent or more; and (ii) the CFTC has concluded that such withdrawal, advance or loan may be detrimental to the financial integrity of the FCM or may unduly jeopardize its ability to meet customer obligations. CFTC Rule 1.12(g) currently requires an FCM to provide the Commission with prior written notice but does not authorize the Commission to prohibit or otherwise restrict such a withdrawal.
The comment period relating to this proposed amendment closes on November 28.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-16035.pdf

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