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Corporate and Financial Weekly Digest

SEPTEMBER 11, 2009

## SEC/CORPORATE

**NYSE Proposes Changes to Its Corporate Governance Listing Standards**

On August 26, the New York Stock Exchange proposed amendments modifying certain of the corporate governance disclosure requirements contained in Section 303A of the NYSE Listed Company Manual in order to clarify disclosure requirements, codify certain interpretations and replace certain disclosure requirements by incorporating applicable Securities and Exchange Commission standards.

First, the proposed amendments would require that any waiver of an issuer's code of business conduct and ethics granted to an executive officer or director be reported to shareholders within four business days of such waiver (rather than the current two to three days) via a press release or on Form 8-K. The proposed amendments will also permit issuers to hold regular executive sessions of independent directors in place of the currently required annual meetings of non-management directors. The amendments propose that companies that cease to qualify as foreign private issuers under SEC rules be granted a limited transition period with respect to shareholder approval of equity compensation plans that were in place prior to the issuer ceasing to qualify as a foreign private issuer and subsequently becoming subject to Section 303A.08 of the NYSE Listed Company Manual. That section requires shareholder approval of equity compensation plans. Such transition period would end upon the later of (i) six months following the date as of which the issuer fails to qualify for foreign private issuer status pursuant to SEC Exchange Act Rule 3b-4 (the test of which is conducted annually at the end of an issuer's second fiscal quarter) or (ii) the issuer's first annual meeting following such Rule 3b-4 determination; provided, however, that such transition period lasts no more than one year.

The proposed amendments would also require an issuer to determine whether a member of the issuer's audit committee who serves on the audit committee of two or more issuers would impair such director's ability to serve on the issuer's audit committee and to disclose to shareholders whether the issuer limits the number of audit committees upon which its directors may serve. Finally, the proposed amendments would revise the corporate governance disclosure requirements contained in the NYSE Listed Company Manual to conform with the corporate governance disclosure requirements of Item 407 of the SEC's Regulation S-K.

Read more.

## LITIGATION

**Eighth Circuit Affirms PSLRA Dismissal for Failure to Specify Misleading Statements**

The defendant company, a subprime lender and issuer of mortgage-backed securities, suffered significant declines in its stock price after it disclosed in February 2007 that its financial results and expectations for future earnings were far less than it had previously anticipated. Following the disclosure, the plaintiff shareholders brought a class action complaint against the company and its officers and directors alleging violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The defendants moved to dismiss, arguing that the complaint did not satisfy the Private Securities Litigation Reform Act's (PSLRA's) pleading requirements.

The District Court granted the motion with prejudice, and the Eighth Circuit affirmed. Although the plaintiffs cited thirty-six pages of press releases, Securities and Exchange Commission filings, and transcripts of conference calls during the class period, the Eighth Circuit held that plaintiffs' complaint did not specify "what specific statements within these communications are alleged to be false or misleading."

In addition, the court held that even if the complaint could be read to identify the statements that allegedly were false or misleading, "[t]he complaint does not provide any link between an alleged misleading statement and specific factual allegations demonstrating the reasons *why* the statements were false or misleading." The plaintiffs attempted to explain why the statements were false in a one-paragraph summary, but the court held that the "broad allegations" in that paragraph did not "necessarily show that the defendants' statements were misleading, or provide the level of particularity required by the PSLRA." (*In re 2007 Novastar Fin., Inc. Sec. Litig.*, No. 08-2452, 2009 WL 2747281 (8th Cir. Sept. 1, 2009))

**Court Denies Request to Dismiss Claims That Officer Improperly Accrued Reserve Funds**

The defendant, an executive officer of the U.S. subsidiary of a Swiss medical technology company, moved for summary judgment dismissing the Securities and Exchange Commission's claims that he violated the antifraud and books and records provisions of the Securities Exchange Act of 1934. The SEC's allegations stemmed from an improperly accrued "recall reserve" fund created in connection with the recall of a faulty medical device and the corrective surgeries that were necessary for patients who received the devices. After the recalls commenced, a number of patients initiated class action lawsuits, which were consolidated and settled in May 2002.

Among other issues, the court analyzed the accrual of a loss contingency in the fourth quarter of 2002 relating to the success fee paid to the company's attorney for settling the litigation. Although the company originally agreed to pay the attorney a $5 million fee, plus a $20 million success fee, after the company's stock price soared, the attorney sought, and was ultimately paid, an additional $25 million. The SEC alleged that the loss contingency should have accrued in the third quarter of 2002, when the defendant allegedly learned that the additional payment would be made, and that the defendant was liable, both as a primary violator and as an aider and abettor, for antifraud and books and records violations because he "took part or participated in the decision not to accrue" the payment at that time and also "failed to retain adequate documentation to support recognizing the payment in the proper reporting period."

The court held that although the propriety of the accrual could not be resolved on summary judgment, the defendant could not be liable as a primary violator of the antifraud provisions because it was necessary to show that he caused the misstatements to be made and "'[c]ausation' cannot be satisfied by mere 'participation.'" However, the court held that he could be liable for aiding and abetting the antifraud provisions because participation could be found to satisfy the "substantial assistance" requirement necessary for liability under those provisions. Further, the court held that even if the defendant was not responsible for the company's financial statements as a whole, "a genuine issue of material fact exists as to whether [defendant] was responsible for accounting for the [transaction] and retaining adequate documentation" and thus denied the motion to dismiss the books and records violations. (*SEC v. May*, No. 07-1867 (JDB), 2009 WL 2634876 (D.D.C. Aug. 28, 2009))

## BROKER DEALER

**NYSE Arca Establishes Risk Management Gateway Service**

NYSE Arca, Inc. (Arca or Exchange) submitted a rule filing with the Securities and Exchange Commission to establish the Risk Management Gateway (RMG) service as a facility of Arca. The RMG facility is intended to assist Exchange Equity Trading Permit Holders (ETP Holders) in monitoring and overseeing the activity of "sponsored access" customers. The facility will enable sponsoring ETP Holders to route sponsored customer orders through an Exchange-provided risk filter before such orders are routed to the Exchange's trading systems for execution. The facility's software will review orders passing through the filter to determine whether the orders comply with certain preset parameters established by the sponsoring ETP Holder.

Read more.

**NYSE Arca Files Changes to Equities Rules**

NYSE Arca has filed a rule change with the Securities and Exchange Commission proposing to (i) eliminate the requirement of NYSE Arca Equities Rule 7.26 that market makers establish and maintain certain specifically prescribed information barriers, (ii) adopt new NYSE Arca Equities Rule 6.7 prohibiting Equity Trading Permit Holders from establishing, increasing, decreasing or liquidating an inventory position in a security or a derivative of such security based on non-public advance knowledge of the content or timing of a research report relating to that security, and (iii) revise NYSE Arca Equities Rule 6.18 to clarify that the requirements of this rule are consistent with the similar requirements of NASD Rule 3010. The SEC has approved the proposed rule change on an accelerated basis.

Read more.

# CFTC

### NFA Proposes Quarterly Reporting Requirement for CPOs

The National Futures Association (NFA) has proposed new Compliance Rule 2-46, which would require registered commodity pool operators (CPOs), including those that have claimed an exemption pursuant to Commodity Futures Trading Commission Rule 4.7, to file a quarterly report with NFA containing certain specified information. The report would be due within 45 days after the end of each calendar quarter and would be required to include (i) the identity of the pool's administrator, carrying broker(s), trading manager(s) and custodians; (ii) a statement of changes in the pool's net asset value over the quarter; (iii) monthly performance information for the quarter; and (iv) a schedule identifying any investments exceeding 10% of the pool's net asset value as of the end of the quarter.

NFA filed the proposed rule with the CFTC on August 25 pursuant to Section 17(j) of the Commodity Exchange Act, which authorizes NFA to make a rule effective 10 days after receipt by the CFTC, unless the CFTC notifies NFA that it intends to review the rule, and NFA intends to make the new rule effective once necessary programming changes to NFA's reporting systems are completed. The new rule would not apply to persons operating pursuant to an exemption from registration under CFTC Regulation 4.13.

Information regarding the new rule is available here.

### CFTC Implements New Transparency Initiatives

The Commodity Futures Trading Commission has announced the implementation of several new transparency initiatives announced by CFTC Chairman Gary Gensler in early July. These new initiatives, which took effect on September 4, include changes to the CFTC's weekly "Commitments of Traders" reports to separately identify positions held by swaps dealers and professionally managed positions (such as those of hedge funds). Also on September 4, the CFTC began quarterly publication of a new report on index investment activity, based on data gathered through the CFTC's ongoing special call for information on swap dealers and index traders.

The CFTC's announcement is available here.

### Steven Schoenfeld Appointed Director of Division of Market Oversight

The Commodity Futures Trading Commission has announced the appointment of Steven Schoenfeld as Director of the Division of Market Oversight. Prior to accepting this appointment, Schoenfeld held various positions in the financial industry, most recently serving as President of Global Index Strategies.

The CFTC press release announcing Schoenfeld's appointment is available here.

# BANKING

### FDIC Board Approves Phase-Out of Temporary Liquidity Guarantee Program

On September 9, the Federal Deposit Insurance Corporation (FDIC) Board adopted a Notice of Proposed Rulemaking (NPR) that reaffirms the expiration of the debt guarantee component of the Temporary Liquidity Guarantee Program (TLGP) on October 31. Under the NPR, the FDIC will seek comment on whether a temporary emergency facility should be left in place for six months after the expiration of the current program.

FDIC Chairman Sheila Bair stated, "As domestic credit and liquidity markets appear to be normalizing and the number of entities utilizing the Debt Guarantee Program (DGP) has decreased, now is an important time to make clear our intent to end the program."

Highlights:

- Under Alternative A, the DGP would conclude as provided under current regulation. All insured depository institutions (IDIs) and other qualifying entities currently participating in the DGP would be permitted to issue FDIC-guaranteed senior unsecured debt until October 31, 2009, with the FDIC's guarantee expiring no later than December 31, 2012.

- Under Alternative B, the DGP generally would expire as above. However, the FDIC would establish a limited emergency guarantee facility that would permit IDIs (and other entities that had issued FDIC-guaranteed senior unsecured debt by September 9, 2009) to apply to the FDIC to issue FDIC-guaranteed debt for an additional six months. The FDIC's guarantee would continue to expire no later than December 31, 2012.

- To use the emergency guarantee facility described in Alternative B, applicants would be required to demonstrate their inability to issue non-guaranteed debt or to replace maturing debt as a result of market disruptions or other circumstances beyond their control. Applicants approved by the FDIC would pay an annualized participation fee of at least 300 basis points on FDIC-guaranteed debt issued and would be subject to other conditions imposed by the FDIC in accordance with Alternative B.

The NPR will be published in the Federal Register shortly and will be subject to a 15-day comment period.

Read more.

**Geithner Testifies Before Congress**

On September 10, Secretary of the Treasury Timothy Geithner testified before the Congressional Oversight Panel. Secretary Geithner, among other things, reaffirmed his belief in the need for stronger consumer protections and stronger regulatory oversight of, including capital standards applicable to, financial institutions.

Click here to read his written testimony.

## ANTITRUST

**Google Electronic Book Settlement Draws Objections**

Competitors and potential entrants in the e-book market have raised antitrust objections to a proposed settlement of a massive copyright dispute between Google, Inc.; the Authors Guild; and the American Association of Publishers. The objectors assert that the settlement would create high barriers to entry and would allow the parties to dominate the developing market for electronic books. More than a dozen parties filed objections to the proposed settlement, including competitors, academics, authors and foreign governments. The proposed settlement would end two different actions brought by publishers against Google in 2005. In those actions, the plaintiffs alleged that Google's plan to digitize book titles and make them searchable and readable online violated U.S. copyright law. Under the proposed settlement, Google would pay the two publishing organizations $125 million to resolve the claims and establish a registry that would allow authors and other rights-holders in the books to register their works in order to receive payment for online use of their titles. Google would automatically receive a license to any work published after 1923 for which no rights-holder claimed a copyright. The deadline for third party objections was September 10.

Competitors and potential competitors in the e-book market, such as Amazon.com and Yahoo!, Inc., filed objections with the court and argued that Google essentially will receive a "quasi-exclusive" license to so-called "orphan" works—titles for which no one has ever claimed a copyright. These companies argue that this license to Google would create a high barrier to entry to any potential competitor. In addition, opponents assert that the settlement would create a powerful "consortium" between Google and the publishing organizations that would enable the parties to set the price of digital books. Both the European Commission and the U.S. government have raised concerns with the settlement as well. The Department of Justice Antitrust Division has been investigating the competitive effects of the settlement since April, and Marybeth Peters, the U.S. Register of Copyrights, has objected to the settlement. This is the latest example of the application of antitrust and competition law to large aggregations of content by single players on the Internet. Judge Denny Chin of the Southern District of New York is expected to hold a hearing to discuss the fairness of the settlement on October 7.

Click here for the *New York Times* story.
Click here to read more on the Google Book Settlement.

## EXECUTIVE COMPENSATION AND ERISA

**Fiduciary Insurance Does Not Cover Alleged COBRA Violation**

An employer sponsor and administrator of a group health benefits plan was sued for alleged violations of its fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA) and the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). The employer in turn sought coverage from the insurance carrier from which it had purchased a fiduciary insurance policy. The carrier refused to defend the employer, basing its denial of coverage on the ground (among other grounds) that the claims against the employer did not constitute “wrongful acts” under the terms of the fiduciary policy. The employer brought suit against the carrier claiming that it was entitled to be defended.

The Fifth Circuit Court of Appeals affirmed the decision of the District Court in denying coverage under the fiduciary insurance policy. The reason is that the liability which was claimed was based upon the employer’s duty as a plan sponsor, not as a fiduciary of the benefit plan.

In asserting its entitlement to coverage, the employer pointed to the language from the suit which had been brought against it, alleging that it had “failed to provide continuation coverage to the terminated… employees and to otherwise satisfy any of the other obligations imposed upon [it] by COBRA.” The relevant COBRA obligations, at least as alleged, concerned the provision of access to the benefits under the medical plans.

The relevant provisions of the fiduciary insurance policy, which was expressly described as providing “fiduciary liability coverage,” insured only against claims of “wrongful acts.” The policy defined “wrongful acts” as “any breach of the responsibilities, obligations or duties imposed upon fiduciaries of the Sponsored Plan by [ERISA]… or any negligent act, error or omission in the Administration of any Sponsored Plan.”

One is a “fiduciary” under ERISA only “to the extent… he exercises any discretionary authority or discretionary control respecting management… or disposition of [plan] assets….” (29 U.S.C. Section 1002(21)(A)).

The Court of Appeals found, as did the lower court, that any alleged failure to offer continuing benefits under its benefit plans rests upon the employer as a plan sponsor, and sponsorship acts or omissions are not fiduciary in nature. The Court of Appeals noted that some circuits (such as the Third Circuit Court of Appeals) have allowed fiduciary-based relief for failure to advise participants of COBRA rights. However, the Fifth Circuit has taken care to distinguish between fiduciary and statutory ERISA duties. The court reasoned that the offer of health benefits—the core of the relevant claim in the suit—would require inclusion of new participants in the employer’s benefit plan. This, it concluded, would be a settlor, not a fiduciary, function. (*Mary Kay Holding Corp. v. Federal Insurance Co.*, 2009 U.S. App. LEXIS 2381 (5th Cir. 2009))

## UK DEVELOPMENTS

### FSA Issues *Market Watch* 33

The UK Financial Services Authority (FSA) published issue 33 of its *Market Watch* newsletter on August 28. It includes articles warning about order book manipulation and emphasizing the importance of Suspicious Transaction Reports (STRs) in preventing and detecting insider dealing.

The FSA highlighted conduct termed “layering” and “spoofing” in particular as manipulation of the order book for firms who offer direct market access (DMA) to their clients. This refers to the use of multiple orders which may give a false or misleading impression about the supply and demand for securities.

The FSA considers that such behavior can constitute market abuse and stated that it expects DMA providers to have appropriate systems and controls in place to identify and prevent it just as exchanges and multilateral trading facilities are required to do.

The FSA stated that in general it considers that the market abuse STR regime is working well, pointing out that suspicious transactions sometimes come to its attention where the firms involved have not submitted an STR, although the FSA would have expected to receive one. As a result, the FSA is “increasingly initiating telephone contact with firms as a matter of course in these cases.” The regulator wants to understand why firms do not submit STRs. It also explained that these phone calls will help it to identify where a firm’s practices may have fallen below the standards expected under the rules and that in appropriate cases this will lead to disciplinary action. The next item highlights the consequences of a failure to file an STR.

Read more.

### FSA Fines Manager for Suspicious Transaction Reporting Failure

The UK Financial Services Authority (FSA) announced on September 2 that it had fined Mark Lockwood, a former trading desk manager at a retail stockbroker, £20,000 (approx. $33,500) for failing to observe proper standards of market conduct. He failed to identify and report insider trading by clients in shares of Amerisur Resources plc, an oil and gas exploration company.

The transaction in question was a sale of shares on May 23, 2007, ahead of an announcement by the company of a placing of shares the next day. (Lockwood's clients were fined a total of £19,050 (approx. $32,000) in December 2008 after a separate FSA enforcement action). The FSA concluded that Lockwood knew of the impending transaction and ignored clear warning signals from the clients as to the basis of the trade. Lockwood's conduct resulted in the failure to prevent the trade and meant that his firm did not submit a Suspicious Transaction Report (STR) to the FSA. The trade came to the FSA's attention only because of an STR submitted by another broker.

Margaret Cole, the FSA's Director of Enforcement, said the fine emphasized the importance of the STR regime. The submission by broking firms of STRs is a key element in detecting market abuse. The failure to file an STR can mean that transactions based on inside information remain undetected and unpunished. Brokers and their employees should be in no doubt as to their responsibilities in this area, and the FSA will not hesitate to take action where they fail to meet them. See also the final paragraph of the previous item on *Market Watch* 33.

Read more.


**For more information, contact:**

| | | |
|---|---|---|
| SEC/CORPORATE | | |
| **Robert L. Kohl** | 212.940.6380 | robert.kohl@kattenlaw.com |
| **Robert J. Wild** | 312.902.5567 | robert.wild@kattenlaw.com |
| **David S. Kravitz** | 212.940.6354 | david.kravitz@kattenlaw.com |
| LITIGATION | | |
| **Steven Shiffman** | 212.940.6785 | steven.shiffman@kattenlaw.com |
| **Cameron Balahan** | 212.940.6437 | cameron.balahan@kattenlaw.com |
| FINANCIAL SERVICES | | |
| **Janet M. Angstadt** | 312.902.5494 | janet.angstadt@kattenlaw.com |
| **Henry Bregstein** | 212.940.6615 | henry.bregstein@kattenlaw.com |
| **Gary N. Distell** | 212.940.6490 | gary.distell@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 |
| **Patricia L. Levy** | 312.902.5322 | patricia.levy@kattenlaw.com |
| **Robert M. McLaughlin** | 212.940.8510 | robert.mclaughlin@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 |
| BANKING | | |
| **Jeff Werthan** | 202.625.3569 | jeff.werthan@kattenlaw.com |
| **Terra K. Atkinson** | 704.344.3194 | terra.atkinson@kattenlaw.com |
| **Christina J. Grigorian** | 202.625.3541 | christina.grigorian@kattenlaw.com |
| **Adam Bolter** | 202.625.3665 | adam.bolter@kattenlaw.com |

| | | |
|---|---|---|
| ANTITRUST | | |
| **James J. Calder** | 212.940.6460 | james.calder@kattenlaw.com |
| **Laura Keidan Martin** | 312.902.5487 | laura.martin@kattenlaw.com |
| **David S. Stoner** | 212.940.6493 | david.stoner@kattenlaw.com |
| EXECUTIVE COMPENSATION AND ERISA | | |
| **Russell E. Greenblatt** | 312.902.5222 | russell.greenblatt@kattenlaw.com |
| UK DEVELOPMENTS | | |
| **Martin Cornish** | 44.20.7776.7622 | martin.cornish@kattenlaw.co.uk |
| **Sam Tyfield** | 44.20.7776.7640 | sam.tyfield@kattenlaw.co.uk |
| **Edward Black** | 44.20.7776.7624 | edward.black@kattenlaw.co.uk |

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Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK PALO ALTO WASHINGTON, DC

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*London affiliate: Katten Muchin Rosenman Cornish LLP.*