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Katten Muchin Rosenman LLP

Corporate and Financial Weekly Digest

September 26, 2008

SEC/Corporate

SEC Issues Emergency Order to Temporarily Amend Rule 10b-18 of the Exchange Act

On September 18, the Securities and Exchange Commission issued an emergency order to temporarily amend Rule 10b-18 of the Securities Exchange Act of 1934 in response to the potential of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets. Generally, Rule 10b-18 of the Exchange Act provides issuers with a safe harbor to effect repurchases of securities within certain conditions.

The emergency order temporarily amends Rule 10b-18 of the Exchange Act as follows:

- Suspends the requirements of Rule 10b-18(b)(2)(i) which states that a Rule 10b-18 purchase must not be the opening (regular way) purchase reported in the consolidated system;

- Suspends the requirements of Rule 10b-18(b)(2)(ii) which states that a Rule 10b-18 purchase must not be effected during the 10 minutes before the scheduled close of the primary trading session in the principal market for the security, or the 10 minutes before the scheduled close of the primary trading session in the market where the purchase is effected, for a security that has value equal to the average daily trading volume for the security during the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected (ADTV) of $1 million or more, and a public float value of $150 million or more;

- Suspends the requirements of Rule 10b-18(b)(2)(iii) which states that a Rule 10b-18 purchase must not be effected during the 30 minutes before the scheduled close of the primary trading session in the principal market for the security, and the 30 minutes before the scheduled close of the primary trading session in the market where the purchase is effected, for all other securities; and

- Amends the requirements of Rule 10b-18(b)(4) so that the total volume of the Rule 10b-18 purchase of a security on any single day may not exceed 100% of the ADTV for the security.

The emergency order became effective at 12:01 a.m. EDT on September 19 and will terminate at 11:59 p.m. on October 2 unless it is further extended by the SEC.

http://www.sec.gov/rules/other/2008/34-58588.pdf

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SEC Publishes Final Rules Regarding Foreign Private Issuers and Cross-Border Tender Offers

On September 19, the Securities and Exchange Commission published Final Rules changing its cross-border exemptions for business combination transactions, tender and exchange offers and rights offerings by foreign private issuers to expand and enhance the utility of the exemptions. The changes are intended to encourage offerors and issuers in cross-border transactions to permit U.S. security holders to participate in these transactions on the same terms as other security holders and to reduce or eliminate the need for parties to such transactions to seek individual exemptive or no-action relief. The Commission also adopted amendments to the beneficial ownership reporting requirements for certain foreign institutional investors. These rule revisions will allow some foreign institutions to file beneficial ownership reports on a shorter form, under the same circumstances as their U.S. institutional counterparts. In addition, the Commission issued guidance on several cross-border issues. Several of these rule revisions will apply to all tender offers, including those for U.S. target companies.

Additionally, on September 23, the SEC published Final Rules amending the forms and disclosure requirements that apply to foreign companies offering securities in U.S. markets. The amendments would allow foreign private issuer status to be tested once a year, change the deadline for annual reports filed by foreign private issuers, revise the annual report and registration statement forms used by foreign private issuers to improve disclosure, and amend the rule regarding going private transactions to reflect recent regulatory changes. The SEC noted that the changes are appropriate in light of global market developments and advancements in technology with respect to the gathering and processing of information, and are consistent with the SEC's initiatives to move toward greater international agreement on the accounting and other non-financial statement disclosures that should be provided by issuers.

The effective date of the rule amendments in each case will be 60 days after their publication in the Federal Register. For more detailed information regarding each set of amendments, see the September 5, 2008 edition of *Corporate and Financial Weekly Digest*.

http://www.sec.gov/rules/final/2008/34-58597.pdf
http://www.sec.gov/rules/final/2008/33-8959.pdf

Litigation

NASD's Rejection of Advice of Counsel Defense Upheld

The Eleventh Circuit upheld a National Association of Securities Dealers (NASD) administrative decision holding that the defendant securities dealer violated NASD rules when he refused to answer questions and respond to written requests for tax records in the course of an on-the-record interview with NASD officials investigating a complaint. The defendant, proceeding *pro se* in the Eleventh Circuit, had previously refused to answer based on the advice of counsel. After NASD officials informed the defendant that disciplinary action would be recommended based on his failure to respond, the defendant produced the requested records under protest.

After a hearing, the NASD Hearing Panel issued a decision barring the defendant from practice for failing to respond to the NASD's requests until being notified that disciplinary charges would be filed. The defendant administratively appealed, and the sanction was reduced to a one-year suspension. The defendant then appealed to the Securities and Exchange Commission, which affirmed the findings and sanction after an independent review. The defendant appealed the SEC's determination to the Eleventh

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Circuit Court of Appeals.

In denying the defendant's petition and upholding the SEC's ruling, the court held, among other things, that substantial evidence existed to support the SEC's rejection of the defendant's defense of reliance on contrary advice from counsel. Specifically, the court found the defendant cited no authority "to the SEC to show that advice of counsel [to withhold the requested documents] constituted a legal defense, and . . . the SEC relied on prior agency determinations to the contrary, and this reliance is entitled to deference." (*Erenstein v. SEC*, 2008 WL 4216552 (11th Cir. Sept. 16, 2008))

Damages Award Reversed for Failure to Reference Date of Breach

The Tenth Circuit reversed a jury verdict for more than $5 million in a breach of contract action for failure to deliver securities in connection with a stock sharing agreement between several tenured professors for work done for a third party economic consulting company. The alleged breach concerned a letter agreement between the parties whereby the plaintiffs would assist the defendant in reaching his billable hours targets for the company in exchange for a share of the stock awarded to the defendant by the company for his work. After disposing of the defendant's challenges to the jury's findings as to liability, the Tenth Circuit reversed the jury's damages verdict on grounds of improper jury instructions as to the appropriate measure of damages.

Over the period between when the agreement by its terms expired and the date of trial, the value of the disputed shares fluctuated substantially. The District Court, however, gave no instruction to the jury as to the date on which the stock was to be valued for purposes of calculating damages.

Reversing the jury's verdict, the Tenth Circuit found that the District Court's failure to instruct the jury as to the date of valuation constituted reversible error. Specifically, the court held that Utah law provides for multiple measures of damages, however each requires a finding as to the date of breach. In the same vein, the court held that the value of the shares on the date the defendant actually sold them was "legally irrelevant" under any cognizable measure of damages. As such, the court remanded the case to the District Court for a determination as to the appropriate measure of damages, this time "by reference to the date of breach." (*Kearl v. Rausser*, 2008 WL 4228381 (10th Cir. Sept. 17, 2008))

Broker Dealer

SEC Approves FINRA Amended Minimum Price-Improvement Standards

The Securities and Exchange Commission has approved a proposal by the Financial Industry Regulatory Authority (FINRA) to amend Minimum Price-Improvement standards. The FINRA proposal addresses the issue that the specified amount or upper limit on the minimum price improvement requirement of $0.01 was disproportionately high for securities trading below $0.01 and that it should vary proportionately with the amount of the limit order price. The proposal revises current price-improvement standards to:

- Amend the standards set forth in Interpretive Material 2110–2 to add a number of tiers to the minimum price-improvement standard for customer limit orders priced below $0.01;
- Include a measure for OTC equity securities priced over $1.00 that the price improvement be the lesser of $0.01 or one-half of the current inside spread limit;
- Change the price improvement standards for customer limit orders priced outside the inside market; and

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- Require firms to protect any more aggressively priced customer limit orders triggered under IM–2110–2, even if those limit orders were not directly triggered by the minimum price improvement standards of IM–2110–2.22.

In approving the proposal, the SEC stated that the proposed rule change strikes a reasonable balance between protecting customer limit orders and enhancing the opportunity for investors to receive superior-priced limit order executions in OTC equity securities.

http://edocket.access.gpo.gov/2008/pdf/E8-22011.pdf

Structured Finance and Securitization

Treasury Proposes Troubled Asset Relief Program (TARP) and Congress Responds with Alternate Proposals

On September 20, the Treasury Department submitted a short three-page draft of a bill to Congress, which proposed a Troubled Asset Relief Program (TARP) giving the Treasury Secretary broad authority to purchase, manage and dispose of up to $700 billion of mortgage-related (and in some cases, non-mortgage related) troubled assets.

The Congressional Democrats immediately responded to Treasury's proposal with two alternate versions of the bill, drafted by Senate Banking Committee Chairman Chris Dodd and House Financial Services Committee Chairman Barney Frank, respectively. These versions of the legislation included strict oversight of the Treasury Secretary's actions under the program, greater reporting requirements and the opportunity for review of the Secretary's decisions. The proposals also added provisions regarding executive compensation caps, bankruptcy reform, foreclosure mitigation, and increased requirements for contracts entered into under the program.

Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke testified before Congress throughout the week and, after President Bush's primetime address on Wednesday evening, appeared to move toward a consensus. On Thursday afternoon, House Democrats, and House and Senate Republicans, announced an agreement on basic principles of the program. The joint agreement included items previously addressed in the draft proposals by Dodd and Frank, including equity sharing, application of profits to the national debt, strong oversight by a board and independent Inspector General, regular detailed reports by the Secretary to Congress, Government Accountability Office audits, and homeownership preservation (including foreclosure mitigation and the application of profits to the Affordable Housing Fund and Capital Magnet Fund). Finally, the joint agreement included a "fence" on available funds for the program, whereby $700 billion would be authorized, with only $250 billion available immediately and an additional $100 billion released upon the Treasury Secretary's certification that funds were needed. The agreement provides Congress with the authority to deny the final $350 billion through a joint resolution.

The White House meeting, however, showed that the program was far from completion as House Republicans announced a vastly different proposal of their own. The House Republican proposal focuses on using mortgage insurance and private capital to solve the problem and includes the following provisions:

- Requires holders of mortgage-backed securities to pay premiums for mortgage insurance;

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- Removes regulatory and tax barriers to allow for private capital to be brought into the market;
- Provides temporary tax relief for companies and temporary suspension of dividend payments by financial institutions;
- Requires participating firms to disclose to Treasury the value of their mortgage assets on their books and the value of any private bids within the last year for such assets;
- Requires that Securities and Exchange Commission (i) audit reports of failed companies to ensure that the financial standing of these troubled companies was accurately portrayed; and (ii) review performance of the Credit Rating Agencies and their ability to accurately reflect risks;
- Prohibits government-sponsored enterprises securitizing any "unsound" mortgages; and
- Creates a "blue ribbon panel" with representatives of Treasury, Securities and Exchange Commission, and the Federal Reserve to make recommendations for reforms of the financial sector by January 1, 2009.

Given the fundamental differences between the proposals, talks concerning this issue will likely extend into this weekend and a consensus may not be reached until early next week. Katten's TARP Task Force will continue to provide updates on the status of the program.

Treasury fact sheet:
http://www.treas.gov/press/releases/hp1150.htm
Treasury proposal:
http://www.mortgagebankers.org/NewsandMedia/IndustryNews/65211.htm
Dodd Bill:
http://banking.senate.gov/public/_files/Doddproposal92208.pdf
Frank Bill:
http://www.house.gov/apps/list/press/financialsvcs_dem/proposal.pdf
House Democrat, and Senate Democrat and Republican, Agreement of Principles:
http://blogs.wsj.com/economics/2008/09/25/text-of-lawmakers-agreement-on-principles/
House Republican Plan:
http://www.reuters.com/article/mergersNews/idUSN2553493020080926

Katten Forms TARP Task Force

On September 23, Katten Muchin Rosenman LLP announced the formation of a new multidisciplinary task force to advise clients on the U.S. Department of the Treasury's proposed Troubled Asset Relief Program (TARP). Katten's TARP Task Force will provide a broad range of advisory services to financial institutions and other entities involved in Treasury's program, including program administrators, sellers and purchasers of assets to and from the program, and providers of services to the program, including refinancing and remediation or workouts of assets. The TARP Task Force draws upon its prior experience representing the Resolution Trust Corporation in its disposition of defaulted illiquid assets, and will include attorneys in the areas of structured finance and securitization, real estate, banking, financial services, derivatives, bankruptcy and litigation. The TARP Task Force will be led by New York-based partners Eric Adams, who also co-chairs Katten's Structured Finance and Securitization Practice, and Hays Ellisen, co-chair of the firm's Credit Crisis Solutions Group.

For more information, see the Client Advisories available here and here.

New York Governor Paterson Announces Plan to Regulate CDS Market

On September 22, New York Governor David Paterson announced that beginning in January New York State will begin to regulate part of the credit default swap market. The swaps falling within the new regulations will be considered insurance contracts, and therefore subject to state regulation. A swap will be deemed an insurance contract when the buyer of the swap owns the underlying security for which he is buying protection. Consequently, only entities licensed to conduct an insurance business can issue these swaps.

On the same date, the New York Insurance Department issued Circular Letter No. 19 (2008), which lays out best practices for financial guarantee insurers. The best practices limit financial guarantee insurers from guaranteeing collateralized debt obligations, require written risk control of underwriting policies, increase the minimum amount of capital and reserves a financial guarantee insurer must maintain, and institute measures aimed at limiting risks for financial guarantee insurers.

http://www.state.ny.us/governor/press/press_0922081.html
http://www.ins.state.ny.us/circltr/2008/cl08_19.htm

CFTC

CFTC Issues Guidance on Investments in Reserve Primary Fund

On September 24, the Division of Clearing and Intermediary Oversight (DCIO) of the Commodity Futures Trading Commission issued Guidance to the Joint Audit Committee regarding regulatory requirements applicable to futures commission merchants (FCMs) with investments in the Reserve Primary Fund (Fund). Pursuant to the Guidance, an FCM may include the investments in the Fund when calculating its capital, segregation and secured amount requirements provided that net asset value (NAV) is reduced to reflect currently available information. The Guidance set forth a declining scale of maximum NAVs: $0.94, effective September 29 and 30; $0.93, effective October 1 and 2; and $0.92, effective October 3 and thereafter. In addition, FCMs must continue to apply the 2% regulatory capital deduction required by CFTC Regulation 1.17 and, if the Fund or the Securities and Exchange Commission reports a lower NAV for the Fund, use that lower value.

http://www.cftc.gov/stellent/groups/public/@lrlettergeneral/documents/letter/08-17.pdf

CFTC Monitors Crude Oil Trading

On September 22, the Commodity Futures Trading Commission announced that its surveillance and enforcement staff are working with the compliance staff of the New York Mercantile Exchange to monitor that day's large price movement in the expiring September crude oil futures contract to ensure that market participants are not taking advantage of current financial market conditions for manipulative gain. As part of the investigation, CFTC staff can compel sworn testimony as well as production of crude oil market information, including recent trading activity.

http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5553-08.html

CFTC Amends Exemption for Foreign Firms Executing U.S. Customer Orders

On September 18, the Commodity Futures Trading Commission amended its Rule 3.10(c) to exempt from registration as a futures commission merchant or

CFTC

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introducing broker foreign firms that solicit or accept orders from U.S. persons for execution on U.S. markets. The exemption, which is limited to those foreign firms that have obtained relief from registration pursuant to CFTC Rule 30.10, codifies a series of no-action letters issued by CFTC staff over the last few years.

http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e8-21857a.pdf

Banking

OTS Seizes WAMU and Appoints FDIC as Receiver; Deposits and Loans Sold to JPMorgan Chase

In the biggest bank receivership in the history of the United States, the Office of Thrift Supervision seized Washington Mutual Bank on September 25 and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. While details are still emerging, it is at least clear that all deposits were transferred to JPMorgan, as were all loans and Qualified Financial Contracts, which include swaps, options, futures, forwards, repurchase agreements and any other Qualified Financial Contract as defined in 12 U.S.C. Section 1821(e)(8)(D).

All depositors, apparently including uninsured depositors, were protected in the deal. Stockholders, as well as senior and subordinated debt holders, were not. The FDIC reportedly expended no cash from the insurance fund, and JPMorgan paid about $2 billion to acquire the assets and deposit liabilities, which involved approximately $135 billion in deposits.

http://www.fdic.gov/bank/individual/failed/wamu.html

Federal Reserve Issues Policy Statement on Equity Investments in Banks and Bank Holding Companies

On September 22, the Board of Governors of the Federal Reserve System (FRB) released a policy statement on equity investments in banks and bank holding companies (Policy Statement) that addresses when such investments may amount to a “controlling influence” over a bank or bank holding company (BHC). The Policy Statement expands the indicia of control an investing company may have without being considered to have a controlling influence and therefore subjecting itself to treatment as a BHC. Traditionally, companies have sought to avoid bank holding company status and the attendant regulation, examination, and capital requirements imposed by the FRB under the Bank Holding Company Act of 1956, as amended (BHCA).

The BHCA sets forth the tests by which control determinations are made with respect to banks and bank holding companies (banking organizations). Specifically, the BHCA provides that a company has control over a banking organization if (i) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25% or more of any class of voting securities of the banking organization; (ii) the company controls in any manner the election of a majority of the directors or trustees of the banking organization; or (iii) the FRB determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the banking organization.

The FRB had not previously provided significant guidance with respect to the third prong of the control test: namely, the facts and circumstances that amount to a determination that an investor has a “controlling influence” over a banking organization. The Policy Statement, however, discusses certain “controlling influence” factors, including board representation, total equity

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investments, consultations with management and permissible covenants that a banking organization may provide to an investor, and provides new guidance as to actions that are permissible without amounting to a "controlling influence" for purposes of the BHCA.

http://www.federalreserve.gov/newsevents/press/bcreg/20080922c.htm

UK Developments

Court Rules that FSA may Proceed with Insider Trading Cases

On September 19, the UK Financial Services Authority (FSA) was given permission to proceed with legal action in two insider trading cases. Judge Quentin Purdy of the City of Westminster Magistrates Court dismissed an application made on behalf of the defendants which argued that the FSA needed to seek the permission of either the UK Director of Public Prosecutions (DPP) or the UK Secretary of State before commencing insider trading prosecutions.

The Judge ruled that the FSA did not need the prior approval of the DPP or the Secretary of State. He said that it was plain that "the aim of Parliament in creating the FSA was to place it to the forefront in general regulation of fiscal markets, including, where necessary, criminal proceedings dealing with fiscal markets and their regulation."

www.business.timesonline.co.uk/tol/business/law/article4809805.ece

EU Developments

European Parliament Calls for Regulation of Hedge Funds and Private Equity

On September 23, the European Parliament adopted a report demanding regulation of private equity funds and hedge funds. The Parliament formally requested that the European Commission propose legislation before December 2008.

Parliament's detailed recommendations of matters to be covered by the Commission regulations included:

- Capital requirements,
- Greater disclosure of investment policy and risks,
- Increased transparency requirements with respect to prime brokers,
- A harmonized EU framework for venture capital and private equity,
- Prevention of asset stripping by private equity vehicles, and
- Enhanced requirements for management of conflicts of interest.

Generally, the Commission was instructed to examine all existing EU financial market legislation and identify any lacunae regarding the regulation of hedge funds and private equity and to submit proposals for plugging such gaps.

The Commission was also instructed to submit a proposal for the establishment of a European Union private placement regime allowing for cross-border distribution of investment products, including alternative investment vehicles, to eligible groups of sophisticated investors.

www.europarl.europa.eu/oeil/file.jsp?id=5558452

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