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Corporate and Financial Weekly Digest

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From the Editor

Please note that *Corporate and Financial Weekly Digest* will not be published Friday, December 26, 2008, or Friday, January 2, 2009. The next issue will be distributed on January 9, 2009.

SEC/Corporate

SEC Adopts Rules Requiring Issuers to Provide Financial Information in Interactive Data Format

On December 17, the Securities and Exchange Commission adopted rules requiring issuers to provide financial statements in interactive data format using eXtensible Business Reporting Language (XBRL) in periodic reports and registration statements filed with the SEC. The interactive data will be filed as an exhibit to an issuer's financial statements and will supplement disclosure filed using the SEC's traditional EDGAR electronic filing format. The XBRL requirements apply to domestic and foreign companies using U.S. GAAP, and will eventually apply to foreign private issuers using International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

To create interactive data files, issuers will be required to tag their financial statements using labels from a standard list of tags. In the first year of an issuer's interactive data reporting, financial statement footnotes and schedules would only be tagged in block text (each financial statement note would require only one tag). Thereafter, issuers would also be required to tag detailed disclosures contained within their footnotes and schedules.

Interactive data reporting requirements will be phased in over a three-year period. Large Accelerated Filers that use U.S. GAAP and have a worldwide public float greater than $5 billion (approximately 500 companies) are required to begin including interactive data in their periodic reports and registration statements for fiscal periods ending on or after June 15, 2009 (the SEC's original proposal suggested December 15, 2008). All other domestic and foreign Large Accelerated Filers using U.S. GAAP are required to begin including interactive data in their periodic reports and registration statements for fiscal periods ending on or after June 15, 2010. All remaining filers using U.S. GAAP and foreign private issuers that prepare their filings in accordance with IFRS are required to begin including interactive data in their periodic reports and registration statements for fiscal periods ending on or after June 15, 2011.

Each issuer will be permitted a 30-day grace period for the filing of its first interactive data exhibit and for its first filing that is required to include footnotes and schedules tagged in detail. Issuers that fail to include required interactive data by the appropriate date would be deemed not current with their Exchange

SEC/CORPORATE

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Act reports, and as such would not be eligible to use short form registration statements and the resale exemptions of Rule 144 until the data are filed.

Interactive data files will be excluded from the Exchange Act's officer's certification requirements, and auditor assurance with respect to such data files will not be required. Under certain circumstances, interactive data files (i.e., the machine-readable XBRL data) will also be protected from liability during an issuer's first two years of filing such exhibits.

http://sec.gov/news/press/2008/2008-300.htm
http://sec.gov/news/speech/2008/spch121708mwg.htm

Litigation

Material Omission of Negative FDA Inspection Report Supports Securities Fraud Allegations

The defendant biotech company submitted an application to the Food and Drug Administration (FDA) to approve one of its drugs. As part of the approval process, an inspection of defendant's manufacturing facility was conducted, which resulted in the issuance of a "Form 483", which set forth significant objectionable conditions at the facility. During a conference call held with investors and security analysts after defendant received the Form 483, defendant's Chief Science Offer stated that "we hosted a good inspection" in response to a question of whether the facilities inspection "passed the muster." Defendant's receipt of the Form 483 was not disclosed during the call. Shortly thereafter, the FDA rejected defendant's approval application, citing defendant's facility inspection as one of the reasons for doing so. Immediately after the FDA's rejection, defendant's stock price fell by more than 60%.

Plaintiffs sued the defendant company and several of its officers for violating, among other things, section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 based on the "good inspection" comment made during the conference call. The defendant moved to dismiss, arguing that the statement was not actionable because it was a statement of opinion. The court rejected the argument, ruling that projections of optimism are actionable under federal securities laws if the statement is not genuinely believed, if there is not a reasonable basis for that belief, or if the speaker is aware of any undisclosed facts tending to seriously undermine the accuracy of the statement.

The court held that the defendant's failure to mention its receipt of the Form 483 was a material omission which, if it had been disclosed, could reasonably be inferred to have resulted in some reasonable investors disagreeing with defendant's description of the inspection as "good." The court further held that the plaintiff sufficiently pleaded scienter. The court noted that the totality of defendants' knowledge of the issuance of the Form 483 (which the parties agreed was a form that was only issued for "significant objectionable conditions"), defendant's failure to mention the Form 483 and defendant's "good inspection" comment were sufficient to satisfy the applicable scienter standard under *Tellabs*. (*McGuire v. Dendreon Corporation*, 2008 WL 5130042 (W.D. Wash. 2008))

Court Sustains Attorney-Client Privilege Claims for Internal Emails After *In Camera* Review

Applying Pennsylvania law, a court ruled that the defendant corporation had properly withheld certain documents sought in discovery under the attorney-client privilege. Before turning to the specific documents in issue, the court ruled that (i) if a communication is made to in-house counsel "primarily" for the purpose of gaining or providing legal assistance, then the privilege applies, and (ii) communications with a subordinate of an attorney are privileged if the

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subordinate is acting as the attorney's agent in connection with communications otherwise covered by the privilege.

After conducting an *in camera* review of the documents in issue—mainly redacted emails in chains of emails that were otherwise produced—the court ruled that all documents were entitled to protection. For example, among the ten or so documents in issue, the court sustained the privilege claim over an email that a paralegal sent at the direction of defendant's in-house counsel to executives intimately involved with negotiating the contract at issue in the litigation. The email set forth proposed contract language and sought feedback. The court ruled that disclosure of the email would reveal client communications and legal advice that was incorporated into the proposed contract language. Two other emails withheld as privileged consisted of (i) an email that a non-lawyer executive working on the contract at issue sent to other non-lawyer employees working on the deal on which in-house counsel was "cc'd," and (ii) a reply to the sender of the first email that was "cc'd" to in-house counsel. The court rejected the plaintiff's argument that these emails were instances in which a privilege was sought to be manufactured by merely copying an attorney on emails between executives. To the contrary, the court found that because the business people were communicating with each other and in-house counsel to relay legal advice and seek additional guidance on contract terms, the communications were privileged. (*Southeastern Pennsylvania Transportation Authority v. CaremarkPCS Health L.P*. 2008 WL 5170169 (E.D.Pa. 2008))

Broker Dealer

FINRA Provides Guidance Regarding Cash Alternatives

On December 16, the Financial Industry Regulatory Authority (FINRA) issued guidance regarding member firm sales of investment products marketed as alternatives to cash holdings. Although all member firm communications must comply with applicable FINRA sales practices rules, the notice specifically cautions firms selling "cash alternative" products to: (i) avoid overstating a product's similarities to a cash holding and provide balanced disclosure of the risks and returns associated with a particular product; (ii) conduct adequate due diligence to understand the features of a product; (iii) conduct appropriate customer suitability analyses; (iv) monitor market and economic conditions that may cause the description of an investment as a cash alternative to become inaccurate or misleading, and adopt procedures reasonably designed to ensure that the firm responds to those changing conditions; and (v) train registered persons regarding the features, risks and suitability of these products.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117559.pdf

FINRA Proposes New Best Execution Rule

The Financial Industry Regulatory Authority (FINRA) requested comment on December 16 on a proposed new best execution rule for the FINRA rulebook. The proposed rule would be based largely on the current NASD Rule 2320. The notice described four key amendments: (i) the new FINRA rule would provide that a member firm has met its best execution obligations regarding orders for foreign securities with no U.S. market if certain conditions are met; (ii) the existing provisions in NASD Rule 2320(g) would be replaced with new Supplementary Material addressing a member firm's best execution obligations when handling orders for securities with limited quotation information; (iii) the new FINRA rule would codify a member firm's obligation to regularly and rigorously review execution quality; and (iv) new Supplementary Material would be adopted within the proposed rule that would address a member firm's

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obligations when handling an order that the customer has instructed the member firm to route to a particular market for execution. Comments on the proposal are due by January 29, 2009.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117553.pdf

SEC Approves NASD Rule Amendments Updating Standards for Options Communications

On December 5, the Securities and Exchange Commission approved amendments to NASD Rule 2220, Options Communications with the Public, that were proposed by the Financial Industry Regulatory Authority (FINRA) to provide greater consistency with FINRA's general rules on communications with the public. The amendments: (i) conform, to the extent appropriate, definitions and terminology across FINRA's communications rules; (ii) change the requirements for principal review of correspondence regarding options to match the requirements for correspondence generally; and (iii) update standards for the content of communications made prior to delivery of the options disclosure document. These amendments will take effect on March 4, 2009.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117493.pdf

FINRA Issues Guidance on Regulation M Rule Amendments

On December 15, the Financial Industry Regulatory Authority (FINRA) released a Regulatory Notice providing additional information on new FINRA rules regarding notification requirements and marketplace-specific rules related to Regulation M. The new rules, which were approved by the Securities and Exchange Commission in September and became effective on December 15, include new Regulation M notification requirements for firms participating in securities offerings, with such requirements applying uniformly to listed and unlisted securities. Firm notification forms are available on FINRA's website.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117501.pdf

SEC Approves CBOE Rule Change Establishing Voluntary Professional Designation

On December 10, the Securities and Exchange Commission approved a proposed rule change by the Chicago Board Options Exchange to establish a "Voluntary Professional" designation. This designation permits non-broker-dealer customers to voluntarily have their orders processed similarly to broker-dealer orders for order handling, order execution and cancel fee calculation purposes.

http://www.cboe.org/publish/InfoCir/IC08-199.pdf
http://www.cboe.org/publish/InfoCir/IC08-203.pdf

Structured Finance and Securitization

Fed, OTS and NCUA Issue New Consumer Protection Credit Card Rules

On December 18, the Federal Reserve Board, Office of Thrift Supervision and National Credit Union Administration approved final rules aimed at better protecting credit card users from unfair and deceptive practices and improving disclosures consumers receive in connection with credit card accounts and revolving credit plans. The new rules include changes to Regulation AA (Unfair

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Acts or Practices) that will:

- protect consumers from unexpected interest charges, including increases in the rate charged during the first year after account opening and increases in the rate charged on pre-existing credit card balances;
- forbid banks from calculating interest using the "two-cycle" billing method in which consumers who pay the full balance one month, but not the next month, are charged interest for the second month using the account balance for days in the previous billing cycle as well as the current cycle;
- prohibit a bank from treating a payment as late for any purpose unless the consumer receives a reasonable amount of time to make that payment;
- prohibit the use of payment allocation methods that unfairly maximize interest charges by requiring banks to allocate payments which exceed the minimum payment balance to the balance with the highest interest rate first or pro rata among all balances; and
- address concerns raised by subprime credit cards with high fees and low credit limits by limiting those fees in certain cases.

The rules also include changes to Regulation Z (Truth in Lending) that are intended to make credit card applications and solicitation disclosures easier for consumers to use, enhance cost disclosures at account opening to make information more conspicuous and easier to read and make disclosures on periodic statements, such as disclosure of interest and fee totals, more understandable to more effectively inform consumers of the total cost of credit.

http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm
http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a1.pdf

FHFA Streamlined Loan Modification Program Becomes Effective

On December 18, the Streamlined Modification Program (SMP) announced by the Federal Housing Finance Agency on November 11 went into effect. Borrowers with mortgages owned by Freddie Mac or Fannie Mae can be considered for the SMP if they (i) own and occupy the property as a primary residence, (ii) have not filed for bankruptcy, and (iii) have missed at least three payments. Under the SMP, mortgage and escrow payments can be reduced up to 38 percent of an eligible borrower's gross monthly income by one or more of the following: reducing mortgage rates, extending the mortgage term up to 40 years or forbearing part of the principal.

http://www.freddiemac.com/news/archives/servicing/2008/20081218_streamlined.html?eSRVcing

CFTC

CFTC Permits Clearing of Agricultural Swaps

The Commodity Futures Trading Commission has issued an exemptive order, pursuant to Section 4(c) of the Commodity Exchange Act (CEA), to ICE Clear U.S., Inc. (ICE Clear), authorizing ICE Clear to clear certain over-the-counter (OTC) swap transactions involving coffee, sugar or cocoa entered into between persons who qualify as eligible swap participants (ESPs) under Part 35 of the CFTC's Regulations. The order further provides that all floor members of ICE Futures U.S., Inc. (ICE Futures) registered with the CFTC will be deemed ESPs and permitted to enter into such swaps for their own accounts, subject to compliance with certain conditions specified in the order. The CFTC also provided relief, pursuant to Section 4d of the CEA, to allow ICE Clear and registered futures commission merchants (FCMs) to hold the

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cleared OTC swap contracts and funds or securities supporting such swaps in customer segregated funds accounts.

http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e8-30057a.pdf

Banking

Banking Agencies Modify Definitions in Community Reinvestment Act

On December 17, the Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision announced their annual adjustment to the asset-size thresholds used to define "small bank," "small savings association," "intermediate small bank," and "intermediate small savings association" under the regulations promulgated pursuant to the Community Reinvestment Act.

Under the new rules, (i) the definition of "small bank" or "small savings association" means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than $1.109 billion; and (ii) the definition of "intermediate small bank" or "intermediate small savings association" means a small institution with assets of at least $277 million as of December 31 of both of the prior two calendar years, and less than $1.109 billion as of December 31 of either of the two prior calendar years. These changes are the result of a 4.49 percent increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers for the period ending November 2008. The adjustments are effective as of January 1, 2009.

http://www.federalreserve.gov/newsevents/press/bcreg/20081217a.htm

Banking Agencies Approve Final Rule on Deduction of Goodwill from Tier I Capital

On December 16, the Federal Reserve Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision announced the approval of a final rule that changes how banks, bank holding companies and savings associations (Banking Organizations) calculate regulatory capital. Under the new rule, Banking Organizations may reduce the amount of goodwill required to be deducted from tier I capital by the amount of any deferred tax liability associated with such goodwill. The regulatory capital deduction for goodwill will be equal to the maximum capital reduction resulting from a complete write-off of the goodwill under U.S. GAAP.

The final rule will be effective 30 days following publication in the Federal Register, but Banking Organizations may elect to adopt its provisions for purposes of regulatory capital reporting for the period ending December 31, 2008.

http://www.ots.treas.gov/?p=PressReleases&ContentRecord_id=41a6f155-1e0b-8562-ebd0-42831291faa9

EU Developments

European Commission Consults on Hedge Fund Regulation

On December 17, the European Commission published a consultation paper seeking views on whether regulation and supervision of hedge funds should be reassessed. The consultation follows from an initiative of the European Parliament demanding regulation of hedge funds and private equity funds and instructing the Commission to propose legislation (see the September 26, 2008, edition of *Corporate and Financial Weekly Digest*).

BANKING

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The European Commission consultation seeks views on whether it is necessary to: (i) increase the capacity of the current regulatory framework to monitor and react to risks originating in the hedge fund sector; (ii) reassess the systemic relevance of hedge funds; (iii) address market integrity and efficiency issues including short selling and limits on leverage; (iv) improve management of market risks in areas including asset valuations and conflicts of interest; and (v) provide greater transparency to investors and increase investor protection.

Also, in relation to a number of the consultation points, the Commission asks how an appropriate regulatory initiative should be designed to complement and reinforce existing industry codes. The Commission considers that any adjustment to the current "policy stance as regards hedge funds" should be part of the overall EU review of the regulatory and supervisory framework in financial markets and its comprehensive policy response to the current financial crisis.

The responses to the consultation will also serve as the basis for the EU's contribution to the consideration of similar issues by the G-20 and International Organization of Securities Commissions. The consultation closes on January 31, 2009. Feedback from the consultation will be discussed at a high-level conference to be held in Brussels in late February 2009.

ec.europa.eu/internal_market/consultations/docs/hedgefunds/consultation_paper_en.pdf

* Click here to access the *Corporate and Financial Weekly Digest* archive.

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