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Corporate and Financial Weekly Digest

A Note from the Editor

Please note that *Corporate and Financial Weekly Digest* will not be published next Friday, December 28. The next issue will be distributed on January 4, 2008.

Robert Kohl

December 20, 2007

SEC/Corporate

SEC Proposes Amendments to Form S-11

On December 14, the Securities and Exchange Commission published proposed amendments to Form S-11, a registration statement used by real estate entities to register securities offerings under the Securities Act of 1933. The proposed amendments would allow issuers using Form S-11 to incorporate by reference to their previously filed Securities Exchange Act of 1934 documents. These amendments mirror amendments the SEC adopted in 2005 allowing "backward" incorporation by reference on Forms S-1 and F-1. Under the proposal, issuers using Form S-11 will continue not to be permitted to incorporate reports and materials filed after the registration statement.

The proposed amendments would only allow incorporation by reference on Form S-11 if the issuer:

- Has filed its annual report for its most recent fiscal year;
- Is current in its reporting obligations under the Exchange Act; and
- Makes incorporated Exchange Act reports and documents available and accessible on a web site maintained by or for the issuer.

Blank check companies, shell companies and penny stock registrants would not be eligible to incorporate by reference into their filings on Form S-11.

The SEC will take comments from the public for 30 days after publication of the proposed amendment in the federal register.

http://www.sec.gov/rules/proposed/2007/33-8871.pdf

SEC/CORPORATE

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SEC Publishes Two Final Rules

On December 19, the Securities and Exchange Commission published its final rules adopting amendments to its disclosure and reporting requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934 to expand the number of "smaller reporting companies" that qualify for its "scaled disclosure" requirements and to move the scaled disclosure requirements from Regulation S-B to Regulation S-K.

http://www.sec.gov/rules/final/2007/33-8876.pdf

Also on December 19, the Securities and Exchange Commission published final rules adopting amendments to the eligibility requirements of Form S-3 and Form F-3 of the Securities Act of 1933 to allow companies with less than the current $75 million public float requirement to nevertheless register primary offerings of their securities on such forms. There are certain restrictions, including that the amount of securities those companies may sell pursuant to the expanded eligibility standard in any one-year period cannot exceed one-third of their public float.

http://www.sec.gov/rules/final/2007/33-8878.pdf

Broker Dealer

Proposed Rule Change Eliminating the Class Gate

The American Stock Exchange LLC, Boston Stock Exchange, Inc., Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, NYSE Arca, Inc., and Philadelphia Stock Exchange, Inc. (each, an Exchange and, collectively, the Exchanges), respectively, filed with the Securities and Exchange Commission proposed rule changes which would eliminate a restriction on Principal Order (P Order) access through the intermarket options market linkage (Linkage).

Currently, once an Exchange automatically executes a P Order in a series of an Eligible Option Class, it may reject any other P Orders sent in the same Eligible Option Class by the same Exchange for 15 seconds after the initial execution unless there is a price change in the receiving Exchange's disseminated offer (bid) in the series in which there was the initial execution and such price continues to be the national best bid or offer.

The Exchanges proposed to eliminate the Class Gate provision because the Exchanges have removed restrictions on non-customer access to the automatic execution systems thereby rendering the Class Gate restriction unnecessary. The SEC approved the proposed rule changes on an accelerated basis.

http://www.sec.gov/rules/sro/amex/2007/34-56808.pdf

Elimination of Options Specialists' Agency Responsibilities and Establishment of Amex Book Clerks

The Securities and Exchange Commission has approved the proposed rule change eliminating the agency obligations of Amex's options specialists and establishing Amex Book Clerks. This rule permits Amex to designate Amex's employees or independent contractors to serve as Amex Book Clerks, responsible for maintaining and operating the ANTE Central Book (i.e., the specialist's customer limit order book) and the ANTE Display Book.

http://sec.gov/rules/sro/amex/2007/34-56804.pdf

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Proposed Amex Rule Change Relating to Actions of Book Clerks

The Amex filed with the Securities and Exchange Commission the proposed rule change providing for the limited liability of Amex in connection with the actions of Amex Book Clerks. The purpose of the new proposed Rule 996 – ANTE is to permit members, member organizations and associated persons of member organizations to bring a claim or claims against Amex, in limited circumstances, for the actions of Book Clerks, relating to (i) maintaining and operating the customer limit order book and display book, and (ii) effecting proper executions of orders placed in the customer order limit book.

http://www.sec.gov/rules/sro/amex/2007/34-56805.pdf

NYSE Amends Rule 98 Guidelines

The NYSE has proposed to grant NYSE Regulation exemptive authority to allow prospective specialist firms and their approved persons a temporary exemption from having to operate as separate and distinct organizations. Currently, NYSE Rule 98 Guidelines require a specialist member organization and its approved persons to be in separate, registered broker-dealer organizations.

Recent developments, including decisions by two specialist firms to close their NYSE specialist operations, prompted NYSE to add greater flexibility to permit new firms to qualify as specialist member organizations. Prospective specialist organizations would continue to be subject to information barrier requirements between specialist operations and approved person operations.

http://www.sec.gov/rules/sro/nyse/2007/34-56895.pdf

Changes to Options Linkage Plan "Turn-Around" Times

The various options exchanges submitted a proposal to amend their respective rules in connection with recent amendments to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (Linkage Plan). The Linkage Plan amendments involved changes to reduce the required "turn-around" time requirement from five to three seconds.

The proposed changes mean that options exchange members would be required to wait for only three seconds after submitting a "Linkage Order" for a response before trading through the non-responsive exchange and would also be entitled to reject any response purporting to be an execution received after the three-second threshold. The options exchanges believed that the reduction in "turn around" time would facilitate "speedy executions of orders while not adversely affecting the ability of members to make markets on their exchanges."

http://www.sec.gov/rules/sro/nms/2007/34-56893.pdf
http://www.sec.gov/rules/sro/amex/2007/34-56898.pdf

SEC Approves Delta Hedging Exemption Rule Change Pertaining to Permitted Class of Entities

The Securities and Exchange Commission has approved a proposed FINRA rule change that will expand the class of entities permitted to use the delta hedging exemption from equity options position limits. Under the rule, eligibility for the delta hedging exemption would be expanded beyond "OTC derivatives dealers" to include FINRA members and non-member affiliates, provided its position in standardized and/or conventional equity options is delta neutral under a "Permitted Pricing Model." The expanded class of members and non-member affiliates who rely on the exemption will be required to provide written certification to FINRA affirming the use of a "Permitted Pricing Model." Certain

other specifications are required to be in writing, such as aggregate positions of 200 or more contracts on the same side of the market.

http://www.sec.gov/rules/sro/nasd/2007/34-56916.pdf

NYSE Rule Pertaining to Events of Extreme Market Volatility

The NYSE has filed with the Securities and Exchange Commission for immediate effectiveness a new rule that will authorize the NYSE to suspend certain rule requirements relating to the opening of securities in the event of extreme market volatility or market-wide price dislocation. Extreme volatility impacts NYSE's pre-opening rule requirements, which ove

r the past few months has led to undue delays in NYSE openings. The new rule will permit a qualified NYSE officer to declare an extreme market volatility condition, which will suspend certain pre-opening rules. The new rule is intended to ensure timely, fair and orderly opening of securities.

A variety of factors need to be met in order for the rule to be invoked, including, but not limited to, the following:

- Volatility during the previous day's trading session;
- Substantial activity in the futures market before the opening of the NYSE;
- The volume of pre-opening indications of interest;
- Evidence of significant pre-opening order imbalances across the market; and
- News and corporate events.

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852573B0007D02C8/$FILE/Microsoft%20Word%20-%20Document%20in%2007-110.pdf

Banking

Federal Reserve Revises Home Mortgage Rules

On December 18, the Federal Reserve Board proposed changes to Regulation Z, which implements the Truth in Lending Act. The amendments are designed to help protect consumers in the mortgage market from unfair, abusive, or deceptive lending practices.

The proposed rules would establish four key protections for "higher priced mortgage loans" defined as those loans secured by a consumer's principal dwelling and having an annual percentage rate (APR) that exceeds the comparable Treasury security by three or more percentage points for first-lien loans, or five or more percentage points for subordinate-lien loans.

With respect to "higher priced mortgage loans," the proposed rules would:

- Prohibit lenders from extending credit without regard to a borrower's ability to repay from sources other than the home's value;
- Require lenders to verify income and assets they rely upon in making loans;
- Restrict prepayment penalties unless certain conditions are met; and
- Require the lender to establish escrow accounts for the payment of property taxes and homeowner's insurance, but allow borrowers to opt out of escrows after one year.

BANKING

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With respect to all loans secured by a consumer's principal residence, regardless of the loan's APR, the proposed rules would:

- Prohibit lenders from paying a mortgage broker more than the consumer had agreed in advance that the broker would receive;
- Prohibit any creditor or mortgage broker from encouraging an appraiser to misrepresent the value of a home; and
- Prohibit certain loan servicing practices.

The proposed rules would also ban seven deceptive or misleading advertising practices, including representing that a rate is "fixed" when the rate is only fixed for a limited time.

The comment period ends 90 days after publication of the proposal in the *Federal Register*.

http://www.federalreserve.gov/newsevents/press/bcreg/20071218a.htm

UK Developments

FSA Fines Norwich Union Life for Exposing Customers to Fraud

On December 17, the UK Financial Services Authority (FSA) announced that it had fined Norwich Union Life (NUL) £1.26 million ($2.5 million) for not implementing effective systems and controls to protect confidential information and manage its risk of being a victim of financial crime in breach of FSA Principle 3.

The systems weaknesses meant that fraudsters were able to impersonate customers and obtain customer details from NUL's call centers. They were then able to use this information to obtain the surrender of 74 customers' life policies totaling £3.3 million ($6.6 million).

The FSA found that NUL had failed to properly assess the risks posed to its business by financial crime and, as a result, its customers were more likely to fall victim to financial crimes such as identity theft.

NUL had also failed to address issues that were highlighted by NUL's compliance department after the frauds were attempted or committed. The FSA stated that NUL had implemented a number of remedial actions and had co-operated fully with the FSA's investigation. Further, all of the fraudulently surrendered insurance policies have been reinstated in full. Because NUL agreed to settle the FSA investigation at an early stage, they qualified for a 30% discount on the penalty assessed under the FSA's executive settlement procedure.

www.fsa.gov.uk/pubs/final/Norwich_Union_Life.pdf

UK and Italian Regulators Sign Cooperation Agreement

On December 14, the Financial Services Authority announced that it has signed a Memorandum of Understanding (MoU) with the Italian regulator, Commissione Nazionale per le Società e la Borsa (CONSOB) following the merger of the London Stock Exchange Group plc and Borsa Italiana SpA (Borsa Italiana) on October 1, 2007. The MoU establishes the framework within which the FSA and CONSOB will cooperate in the oversight and supervision of the London Stock Exchange and Borsa Italiana.

www.fsa.gov.uk/pubs/mou/fsa_cnsb.pdf

UK DEVELOPMENTS

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Litigation

Arbitrability of False Endorsement Claims to be Determined by Arbitrator

After an insurance company entered into a software license and maintenance agreement with a software company, the software company posted on its website and in other marketing materials "endorsements" attributed to the insurance company's chief executive officer and another employee, both of whom contended that the endorsements were false and unauthorized.

When the software company refused to remove its references to the insurance company and the "endorsements" from these materials, the insurance company and the two executives brought suit for use of the company's trademark without permission in violation of the Lanham Act and the Uniform Deceptive Trade Practices Act and for common law misappropriation of identity claims.

The software company moved to dismiss the lawsuit, arguing that the agreements required arbitration of all claims arising out of or relating to the agreements. Because "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit," the Court determined that the CEO, who signed the agreement only on behalf of the company, and the employee, a non-signatory, could not be compelled to arbitrate.

However, the Court rejected the insurance company's argument that its "false endorsement" claims fell outside the intended scope of the applicable arbitration clauses and, thus, were not subject to arbitration. After noting that the clause in question expressly provided that whether a dispute is subject to arbitration is to be resolved by the arbitrator, the Court stayed the lawsuit pending the result of arbitration of the claims asserted against the insurance company. (*Midwest Fin. Holdings, LLC v. P & C Ins. Sys., Inc.*, 2007 WL 4302436 (C.D. Ill. Dec. 7, 2007))

Shareholder Could Not Maintain Lawsuit Against Other Shareholders

The plaintiff, an officer of a privately held corporation, filed suit against other shareholders who supported a recapitalization of the company. Pursuant to an agreement among the shareholders, the plaintiff was granted 1.4 million Class B shares to be held in trust until one of three events occurred (there was no dispute that none of the triggers had occurred).

The plaintiff alleged that the shareholders who voted in favor of the plan breached obligations owed to him under the shareholder agreement. He based his claim on a provision which provided that a recapitalization in which the Company was valued at less than $2.73 per share could not be approved by either the Board or the shareholders without the approval of the holders of at least 85% of the outstanding Class B shares, alleging that the defendant shareholders violated this provision by approving a recapitalization in which the company was valued at less than the stipulated amount.

Although the minutes reported that the owners of 87.71% of the Class B shares voted for the recapitalization, the plaintiff alleged that the vote failed to take his shares into account and, thus, violated the supermajority provision.

The District Court rejected the plaintiff's argument that the shareholder agreement permitted direct claims for breach of contract against shareholders who voted for recapitalizations in which the requisite supermajority was not achieved. The Court reasoned that such a construction would lead to "irrational results" and "impute superhuman prescience to the shareholders"

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who could not be charged with knowing the outcome of the vote before it was taken.

To avoid such results, the Court construed the agreement to mean that a vote for a recapitalization that failed to achieve the stipulated supermajority was a nullity but not one that subjected the shareholders who voted in favor of the recapitalization to liability for casting their votes in favor of the plan. Accordingly, the court granted defendants motion to dismiss the complaint. (*DeSouza v. PlusFunds Group, Inc.*, 2007 WL 4287745 (S.D.N.Y. Dec. 7, 2007))

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