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BROKER DEALER

SEC Approves Amendments to FICC's Government Securities Division Rules Relating to Close Out Netting

On October 5, the Securities and Exchange Commission approved proposed amendments to the Fixed Income Clearing Corporation's (FICC) Government Securities Division (GSD) rules relating to close out netting. FICC's proposal adds a provision to the rules of the GSD to make it clear that close out netting would apply to obligations between FICC and its members in the event that FICC becomes insolvent or defaults in its obligations to its members.

The proposed rule change was prompted by requests from FICC dealer-members for more clarity with respect to the manner in which close out netting would apply to the obligations of FICC and its members in the event of an FICC insolvency or default. Under the rules that apply to certain FICC members, FICC's close out netting rules may permit members to calculate their capital requirements based on their net credit exposure to FICC.

Click here to read the language of FICC's proposed rule.
Click here to read the SEC's order approving FICC's proposed rule.

SEC Adopts Interim Final Security-Based Swap Reporting Rule

Section 766 of the Dodd-Frank Wall Street Reform and Consumer Protection Act generally requires security-based swaps that were entered into prior to July 21 and which were still outstanding as of that date ("pre-enactment unexpired security-based swaps") to be reported. Pursuant to that requirement, the Securities and Exchange Commission adopted an interim final rule (the Rule) in an effort to implement these reporting requirements pending the adoption of final rules relating to the reporting of security-based swaps and associated recordkeeping requirements. In addition, the Rule includes an interpretive note (the Note) which imposes current recordkeeping obligations on the parties to pre-enactment unexpired security-based swaps.

Reporting Obligations

New Rule 13Aa-2T under the Securities Exchange Act of 1934 requires that a counterparty to a pre-enactment unexpired security-based swap transaction submit certain information to a registered security-based swap data repository or to the SEC by the earlier of: (x) the compliance date that will be established by SEC rules, or (y) within 60 days after a security-based swap data repository is registered with the SEC and becomes operational. The information required to be reported includes: (1) a copy of the transaction confirmation in electronic form, if available, or in written form if there is no electronic copy; and (2) if available, the time the transaction was executed. The Rule also requires the parties to pre-enactment unexpired security-based swap transactions to provide the SEC with any information relating to these transactions that the SEC may request.

Reporting Party

New Rule 13Aa-2T also provides that if only one of the parties to the security-based swap is a security-based swap dealer or major security-based swap participant, that party must report the security-based swap. If one party

is a security-based swap dealer and the other party is a major security-based swap participant, the security-based swap dealer must report the swap. If neither party is a security-based swap dealer or major security-based swap participant, then the parties must select which one of them is responsible for reporting the security-based swap.

Record Retention

The Note to the Rule requires the parties to a pre-enactment unexpired security-based swap to retain all information and documents that currently exist relating to the terms of these transactions. This information includes, but is not limited to: (1) any information necessary to identify and value the transaction; (2) the date and time of execution of the transaction; (3) information relevant to the price of the transaction; (4) whether the transaction was accepted for clearing by a "clearing agency" or "derivatives clearing organization," and if so, the identity of such clearing organization; (5) any modification(s) to the terms of the transaction; and (6) the final confirmation of the transaction.

The Note does not require the parties to create new records or modify their existing records with respect to pre-enactment unexpired security-based swaps. The SEC also made it clear that such information may be reported in the format in which it is kept.

Click here to read the SEC release.

SEC Releases Responses to Frequently Asked Questions Concerning Short Sale Rule

The Securities and Exchange Commission recently released its responses to frequently asked questions relating to Rule 201 of Regulation SHO. Rule 201 restricts the price at which short sales may be effected when a stock has experienced significant downward price pressure. In particular, Rule 201 implements (1) a "short sale circuit breaker" for National Market System stocks that once triggered prohibits the execution or display of short sale orders at a price less than or equal to the current national best bid for the remainder of the day and the following day; and (2) a "short sale exempt" marking category, which allows broker-dealers to mark certain sell orders as "short exempt" once the short sale circuit breaker has been triggered. The short sale circuit breaker is triggered by a 10% or more decrease in the price of the security from such security's closing price at the end of the regular trading hours on the prior trading day. Compliance with Rule 201 is required as of November 10.

The SEC's responses to the FAQs are available here.

CFTC

CFTC to Hold Public Meeting on Proposed Rules Under the Dodd-Frank Act

The Commodity Futures Trading Commission has announced that it will hold a meeting next week to address proposed rulemakings under the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding: (i) the definition of "agricultural commodity"; (ii) position reports for physical commodity swaps and options on physical commodity swaps; (iii) increasing privacy protections for consumer financial information under the Gramm-Leach-Bliley Act; and (iv) rules concerning business affiliate marketing and discarding consumer information under the Fair Credit Reporting Act.

The meeting will take place at 9:30 a.m. on October 19. Please click here to see the CFTC's press release for information on attending the meeting in person or online, or listening in via conference call.

CFTC Proposals Published for Comment in the Federal Register

Two of the proposals approved by the Commodity Futures Trading Commission at its meeting on October 1 and reported in the October 8, 2010 edition of *Corporate and Financial Weekly Digest* were published for comment in the Federal Register on October 14.

The release requesting comment on the CFTC's interim final rule requiring the reporting of certain information concerning unexpired swaps entered into prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act is available here. The comment period ends November 15.

The release requesting comment on the CFTC's proposed rules regarding financial resources requirements for derivatives clearing organizations is available here. The comment period ends December 13.

NFA Issues Notice to Members regarding Guidance on CFTC Forex Regulations

The National Futures Association (NFA), after consultation with the Commodity Futures Trading Commission, published additional guidance on the CFTC's final forex regulations, which are effective October 18. NFA clarified the following:

i. Futures commission merchants (FCMs), retail foreign exchange dealers (RFEDs) and introducing brokers (IBs) are not required under CFTC Regulation 5.5 to provide existing customers with the most recent quarterly customer account information (unless requested by the customer) or required disclosure documents (or to obtain a disclosure document acknowledgment from such customers). Such requests only apply to customers that open accounts on or after October 18.

ii. Only the following types of entities may be used to hold assets equal to the total amount owed to U.S. customers for Forex transactions: (a) in the U.S., a domestic regulated bank or trust company, an SEC registered broker-dealer (that is also a Financial Industry Regulatory Authority member) or a CFTC registered FCM (that is also an NFA member), and (b) in a "money center country" (as defined in CFTC Regulation 1.49), a bank or trust company with regulatory capital greater than $1 billion, a foreign equivalent of a broker-dealer or FCM with regulatory capital greater than $100 million or an FCM registered with CFTC and a member of NFA.

iii. Any registered FCM, RFED, IB, commodity pool operator or commodity trading advisor must be approved by NFA as a forex firm prior to engaging in retail forex transactions. Any such firm must have at least one principal registered as an associated person (AP) and approved as a forex AP. Two exams are required for any individual who solicits or supervises the solicitation of retail Forex business: the National Commodity Futures Examination (Series 3) and the Retail Off Exchange Forex Examination (Series 34) (though APs, sole proprietors or floor brokers who were registered as such on May 22, 2008 are exempt from taking the Series 34 exam, absent any 2 year or greater gap in their registration since that date).

iv. Entities defined in the Commodity Exchange Act §§ 2(c)(2)(B)(ii)(II)(aa), (bb), (ee) and (ff) may solicit retail Forex orders, manage retail Forex accounts or operate a retail Forex pool without registering with the CFTC in the relevant capacity.

The NFA Notice is available here.

LITIGATION

Chancery Court Approves Hostile Bidder's Bylaw Amendment Advancing Date of Target's Annual Meeting

In the midst of a takeover battle by defendant Air Products and Chemicals, Inc. for control of Airgas, Inc., the Court of Chancery of Delaware upheld a bylaw amendment sponsored by Air Products that moved up the date of Airgas's upcoming 2011 annual shareholder meeting by approximately nine months, thereby potentially shortening the term to be served by members of Airgas's staggered board.

Air Products launched a proxy contest to acquire control of Airgas's board of directors after Airgas rejected multiple merger proposals. Prior to the start of the proxy contest, Airgas had in place multiple takeover defenses, including a nine-member staggered board of three equal classes, with one class up for reelection each year at the annual shareholder meeting.

At Airgas's September 15 annual shareholder meeting, Air Products' three nominees were elected to the Airgas board of directors, and the Airgas shareholders approved an Air Products sponsored bylaw amendment that moved the date of Airgas's 2011 annual meeting up from August/September (when it traditionally had been held) to January. The effect of the bylaw amendment is that the Airgas directors up for election in 2011 will not necessarily serve full three-year terms.

Airgas argued that the Air Products' bylaw amendment was invalid because: (1) the amendment constituted a change to Airgas's bylaw provisions requiring a staggered board and therefore required a 67% vote to pass; (2) the amendment was inconsistent with the provisions of Airgas's certificate of incorporation providing for a staggered board; and (3) the amendment was contrary to the Delaware General Corporation Law's provisions authorizing corporations to adopt staggered boards.

In a case of first impression, the Delaware's Chancery Court rejected each of these arguments on the ground that, in the court's view, Airgas's bylaws and certificate of incorporation provided only that directors were to stand for reelection at annual meetings held at some point during the third year after their initial election; the bylaws and certificates did not clearly provide that Airgas directors were to serve full three-year terms. To resolve the ambiguity, the court relied on the "rule of construction in favor of franchise rights" and upheld the Air Products sponsored bylaw.

The Chancery Court suggested that this decision will not diminish the effectiveness of staggered boards because drafters remain free to write bylaws and certificates of incorporation that unambiguously set forth the duration of the term to be served by directors on staggered boards. According to the Chancery Court, "This is not the end of the world for staggered boards; it is an easy fix if it needs fixing." (*Airgas, Inc. v. Air Products and Chemicals, Inc.*, C.A. No. 5817-CC (Del. Ch. Oct. 8, 2010))

Second Circuit Affirms Rule 11 Sanctions Award Pursuant to PSLRA

The U.S. District Court for the Second Circuit held that where a plaintiff and his counsel knowingly commenced a securities action in which the only purchase of an actual security occurred 18 years earlier, and failed to disclose that fact in the complaint, Rule 11 sanctions were warranted because the claim was clearly time-barred by the applicable statute of limitations.

Plaintiff John Libaire, Jr. and his attorney alleged in their complaint that, in addition to plaintiff's purchase of a single share of common stock 18 years earlier, Mr. Libaire's 2005 payment of annual dues to defendant North Fork Preserve, Inc. also constituted the purchase of a security. According to plaintiff, this later "purchase" established that his securities fraud claims were not time-barred.

Under Second Circuit law, a transaction may be deemed a security where there has been an investment in a common venture that is premised on a reasonable expectation of profits to be derived from the entrepreneurial or management efforts of others. The Second Circuit affirmed the district court's ruling that the payment of annual membership dues could not satisfy the "reasonable expectation of profits" element.

The Private Securities Litigation Reform Act requires district courts, at the conclusion of private actions arising under the federal securities laws, to make Rule 11 findings as to each party and each attorney. The Second Circuit determined that because plaintiff's arguments lacked support in the case law, and were "objectively unreasonable," it was patently clear that the claim had no chance of success under existing precedents.

These facts, along with plaintiff's failure to allege any viable misrepresentation on defendant's part, led the Second Circuit to affirm the award of sanctions for violating Rule 11 of the Federal Rules of Civil Procedure. In affirming the sanctions award, the court also took into account that plaintiff had previously commenced and lost state court actions asserting virtually identical allegations against the same defendants. Under these circumstances, the court found that the federal action was brought to harass defendants, and that sanctions against plaintiff and his counsel therefore were warranted. (*Libaire v. Kaplan*, No. 09-2659-cv, 2010 WL 3894711 (2d Cir. Oct. 6, 2010))

BANKING

FDIC Issues Guidance on Golden Parachute Applications

On October 14, the Federal Deposit Insurance Corporation (FDIC) issued revised guidance on golden parachute payments made to "institution-affiliated parties" (IAPs), such as bank employees, officers and directors, when such institutions are in a "troubled condition" (i.e., such institution is rated a composite "4" or "5" or meets other criteria). Certain golden parachute payments may be made in such circumstances, although application to the FDIC must be made and certain materials must be provided.

In the guidance, the FDIC notes that, in order for an institution to make or agree to make a golden parachute payment when it is in a troubled condition, the applicant institution must demonstrate that: (1) the IAP has not committed any fraudulent act or omission, or breach of trust or fiduciary duty or insider abuse, that has had a material adverse effect on the institution or covered company; (2) that the IAP is not "substantially responsible" for the insolvency or troubled condition of the institution or covered company; and (3) that the IAP has not violated any applicable federal or state banking law that has had or is likely to have a material effect on the institution or covered company.

Importantly, the FDIC has clarified in the guidance the following with respect to such payments or agreements to make such payments: (1) combined applications are permitted in situations where an institution seeks to pay relatively small amounts to lower-level employees with similar responsibilities *or* to implement a reduction-in-force or reorganization and must terminate numerous employees to cut costs; (2) there is now a *de minimis* payment amount of $5,000 per individual that will automatically be approved without requiring an official review (although a list of recipients must be retained by the institution); and (3) the FDIC is unlikely to approve golden parachute payments for institutions that are in a precarious financial position unless the institution can demonstrate near-term benefits that outweigh the cost of the payments and the payment is not contrary to the golden parachute restrictions.

For more information, click here.

For more information, contact:

FINANCIAL SERVICES		
Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@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
Joseph Iskowitz	212.940.6351	joseph.iskowitz@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
LITIGATION		
William M. Regan	212.940.6541	william.regan@kattenlaw.com
BANKING		
Jeffrey M. Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Christina Grigorian	202.625.3541	christina.grigorian@kattenlaw.com

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Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

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London affiliate: Katten Muchin Rosenman Cornish LLP.