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Corporate and Financial Weekly Digest

March 27, 2009

SEC/Corporate

NASDAQ Further Extends Suspension of Continued Listing Requirements

The NASDAQ Stock Market LLC has filed with the Securities and Exchange Commission a proposed rule change to extend until July 19, the temporary suspension of continued listing requirements related to bid price and market value of publicly-held shares for listing on the NASDAQ Stock Market. The current suspension was to expire on April 19. Stating that market conditions have not improved since the suspension began in October 2008, and that both the number of securities trading below $1.00 and the number of securities trading between $1.00 and $2.00 on NASDAQ has increased over that time, NASDAQ proposes to continue the temporary suspension of the bid price and market value of publicly-held share requirements for an additional three months.

Under the suspension, companies would not be cited for new bid price or market value of publicly-held shares deficiencies during the suspension period, and the time allowed to companies already in a compliance period or in the hearings process for bid price or market value of publicly-held shares deficiencies would remain suspended with respect to those requirements. Following the temporary suspension, any new deficiencies would be determined using data starting on July 20. When the suspension expires, companies that were in a compliance period as of October 16, 2008, when the suspension first began, would receive the balance of any pending compliance period in effect at the time of the initial suspension.

http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2009/SR-NASDAQ-2009-026.pdf

Comment Letter Submitted by the Society to the SEC Regarding NYSE Rule 452

The Society of Corporate Secretaries & Governance Professionals (the Society), which serves over 2,500 issuers, recently submitted a comment letter to the Securities and Exchange Commission regarding the New York Stock Exchange's proposed change to NYSE Rule 452 which would eliminate broker discretionary voting for the election of directors.

According to the Society, the broker discretionary vote "does reflect the overall views of ...the 'street name' retail holders". The elimination of broker votes would de-stabilize the proxy voting system, the Society argues, because a disproportionate amount of weight would then shift to institutional investors who are influenced by large proxy advisory services who often effectively decide the results of annual shareholders meetings without having an economic interest in the shares that are voted.

SEC/CORPORATE

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The Society also argues that the elimination of broker discretionary votes would result in significant costs and burdens for issuers: approval of proposals would require higher proxy solicitation fees while making it more difficult for issuers to achieve quorums, particularly smaller issuers.

Accordingly, the Society urged the Commission to refrain from changing any individual part of the proxy system before conducting a thorough examination of the entire proxy voting system. In that context the Society believes that the following measures should be considered:

- **Proportional Voting**, whereby brokers vote uninstructed shares in the same proportion as the actual retail vote.
- **Notice and Access**, which thus far has seen low participation by retail investors, should be revised by permitting shareholders to receive a voting instruction form, with return envelope, along with the initial notice card, which should lead to higher retail voting levels.
- **Regulating Proxy Advisors** to require disclosure of conflicts of interest and business practices.
- **Investor Education** should be facilitated by an effort to educate retail shareholders about the proxy voting system and the impact of voting decisions.

The Society recommended that the Commission extend the comment period by an additional 90 days to allow the Commission and interested parties additional time to collect data and to complete an evaluation of the measures addressed in the Society's Comment Letter.

http://www.governanceprofessionals.org/Document.asp?DocID=1557&SnID=1053165658

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Securities Fraud Involving Asset Purchase Agreement Adequately Pled

A New York federal district court denied motions to dismiss federal securities fraud claims brought against two former officers of a computer software company, World Logistics Services (World Logistics).

Plaintiffs, a publicly traded company and its wholly-owned subsidiary, entered into a Purchase Agreement with defendants to acquire certain assets of World Logistics in exchange for cash and plaintiffs' stock. In their complaint, plaintiffs alleged that they entered into the Purchase Agreement believing that they were acquiring exclusive rights to the assets at issue when, in fact, defendants had already granted "non-exclusive" rights to such assets to another company. Accordingly, plaintiffs brought claims for securities fraud under Sections 10(b) and 20(a) of the Securities Exchange Act. Defendants filed separate motions to dismiss the complaint.

In denying defendants' motions, the court concluded that plaintiffs adequately pled all elements of their securities claims. The court held that plaintiffs adequately pled scienter by alleging that defendants were "personally liable" for more than $2 million in World Logistics' overdue payroll taxes and thus had an incentive to commit the alleged securities fraud. Because defendants' liability to Word Logistics at the time of the parties' transaction was "present, existing and personal," rather than a "mere speculative possibility," it created a "concrete and personal" motive for securities fraud. In addition, the court rejected defendants' argument that their alleged misrepresentations or omissions were not made "in connection with" a purchase or sale of securities. Noting that Rule 10b-5 prohibits fraud in connection with a contract to purchase stock, the court concluded that plaintiffs' allegations satisfy the "in connection with" element because the Purchase Agreement was a contract to purchase plaintiffs' stock in exchange for the World Logistics' assets at issue. (*Janel World Trade, Ltd. v. World Logistics Services, Inc.*, 2009 WL 735072 (S.D.N.Y. March 20, 2009))

Contractual Right to Arbitration Forfeited by Refusal to Respond to Discovery Requests

A federal district court denied defendants' motion to compel arbitration of a contractual dispute pursuant to the contract's mandatory arbitration clause where the same defendants had defaulted in an arbitration proceeding commenced by plaintiffs two years ago involving the same dispute.

Defendants' motion to compel arbitration was based on the fact that the contract at issue provided that any disputes thereunder "shall be solely and finally settled by arbitration" and that parties "renounce all recourse to litigation." Finding that the case is subject to arbitration based on the plain language of the contract, the court noted that there is a "strong policy" in favor of arbitration under the Federal Arbitration Act (FAA) unless a party has forfeited its right to arbitrate through a default or a waiver. Because the FAA does not define a "waiver" or "default," the determination of whether such waiver or default has occurred has to be made on the facts of each case.

In this case, the district court denied defendants' motion to compel arbitration, concluding that defendants defaulted on their contractually mandated right to arbitrate. Specifically, the court noted that, prior to commencing the present lawsuit, plaintiffs had filed a case with the American Arbitration Association (AAA) and served discovery requests on defendants as part of the arbitration proceedings. However, defendants never responded to such discovery requests and plaintiffs were told that the AAA could not compel defendants to participate in the arbitration proceedings. (*Youngs v. Haugh*, 2009 WL 701013 (N.D. Tex. March 18, 2009))

Broker Dealer

Expansion of Options Exchanges' $1 Strike Price Programs

Through several releases on March 17, the Securities and Exchange Commission approved or designated as immediately effective the substantially similar rule changes proposed by each of the following options exchanges (each, an Exchange) to expand its $1 strike price program (the Program) under which options may be listed at $1 strike price intervals: the International Securities Exchange, LLC; Chicago Board Options Exchange, Inc.; NYSE Arca, Inc.; NYSE Alternext US LLC; the NASDAQ Stock Market LLC (for its options market); NASDAQ OMX BX, Inc.; and NASDAQ OMX PHLX, Inc.

The rules of each Exchange have been modified to allow the Exchange to select 55 individual stocks (up from 10 individual stocks) to be part of the Program. The price range for options to be listed under the Program has been expanded from the previous range of $3 to $50 to the range of $1 to $50 (though other existing restrictions on listing $1 strikes remain in effect). Each Exchange has also added a delisting policy, under which the Exchange will review, on a monthly basis, series listed under the Program with a strike price more than $5 from the current value of the underlying security and will delist certain series with no open interest in both the put and the call series.

http://www.sec.gov/rules/sro/ise/2009/34-59587.pdf
http://www.sec.gov/rules/sro/nasdaq/2009/34-59588.pdf
http://www.sec.gov/rules/sro/bx/2009/34-59589.pdf
http://www.sec.gov/rules/sro/phlx/2009/34-59590.pdf

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Stock Exchanges Propose "Modified" Uptick Rule

The BATS Exchange, the New York Stock Exchange and the NASDAQ Stock Market jointly issued a letter to the Securities and Exchange Commission urging it to adopt a "modified uptick" rule that includes a "circuit breaker" feature to combat abusive short selling. The SEC is currently considering a number of measures in the short sale area including a re-adoption of the uptick rule it removed in 2007. The exchanges argued that the old uptick rule "would likely prove difficult to implement and enforce" in today's current rapid trading and penny increment market environment. As such, the exchanges called for a simple uptick rule that would be triggered after the price of a stock has experienced a precipitous decline (e.g., a 10 percent drop) and would allow short sales only at a price *above* the highest prevailing national bid in combination.

http://www.batstrading.com/JointShortSaleLetter

ISE Publishes Proposal for Reforming Regulation of U.S. Financial Markets

The International Securities Exchange (ISE) published a proposal outlining recommendations for reforming the regulation of U.S. financial markets. The proposal includes a call for the creation of a new Financial Markets Commission (FMC) that oversees all U.S. financial markets and trading platforms to address the fragmented regulatory responsibilities and differing regulatory approaches in the current system. The proposal urged a move toward risk-based regulation rather than the rules-based approach currently used under the Securities Exchange Act of 1934. To accomplish this shift, ISE recommended the adoption of a transitional authority to oversee the transition of functions from the Securities and Exchange Commission and the Commodity Futures Trading Commission to the FMC.

http://www.ise.com/assets/files/about_ise/ISE_Proposal_for_US_Financial_Market_Regulatory_Reform.pdf

Financial Markets

Treasury Secretary Outlines Framework for Regulatory Reform

On March 26, Treasury Secretary Timothy Geithner provided an overview of the Obama administration's planned overhaul of the financial regulatory system to the Committee on Financial Services of the House of Representatives. The framework has four broad components:

- addressing systemic risk;
- protecting consumers and investors;
- streamlining the regulatory structure to eliminate gaps; and
- fostering international coordination.

Secretary Geithner's testimony focused mainly on Treasury's ideas for addressing systemic risk which has six main elements:

- creating a single independent regulator with responsibility over Systemically Important Financial Firms (SIFFs) and critical payment and settlement systems;
- higher standards on capital and risk management for SIFFs;
- requiring advisors to private pools of capital that exceed a certain size to register with the SEC and provide additional investor and counterparty disclosure;
- comprehensive oversight of the OTC derivatives markets, including requiring centralized clearing of many OTC derivatives, greater use of

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exchange traded instruments, increased reporting and recordkeeping and more rigorous eligibility and compliance requirements;

- increased regulation of money market funds; and
- federal jurisdiction over resolution of non-bank financial firms that may pose systemic risks.

Treasury has proposed draft legislation to address the last element, resolution of non-bank financial firms, and has promised to elaborate and provide more details on the other parts of the framework in the near future.

http://www.house.gov/apps/list/hearing/financialsvcs_dem/geithner032609.pdf
http://www.treas.gov/press/releases/tg72.htm

Private Investment Funds

Treasury Secretary Calls for Greater Regulation of Hedge Funds

One of the key elements of the Framework for Regulatory Reform outlined by Treasury Secretary Timothy Geithner in his testimony to Congress on March 26 was greater regulation of hedge funds and other private investment pools, including private equity and venture capital funds.

The Treasury Department recommends that all advisors of private investment funds with assets under management above a certain threshold be required to register with the SEC and the funds managed by such registered advisors should be subject to investor and counterparty disclosure requirements and heightened regulatory reporting requirements. The additional regulatory reporting would include a requirement to report on a confidential basis information necessary to assess whether the fund is so large or highly leveraged that it poses a threat to financial stability. The SEC would share such reports that it receives with the proposed systemic risk regulator. If a fund were deemed to pose a systemic threat, it would then become subject to capital and risk management requirements and other "prudential regulation" standards of the systemic risk regulator.

Treasury suggests a number of factors that should be considered in determining when an firm is "systemically important," including (i) the financial system's interdependence with the firm, (ii) size, (iii) leverage, and (iv) importance as a source of credit and a source of liquidity for the financial system. The determinations would be based on function rather than form. If implemented as laid out, the proposals could lead to significantly increased regulation of large private funds and their advisors.

http://www.house.gov/apps/list/hearing/financialsvcs_dem/geithner032609.pdf
http://www.treas.gov/press/releases/tg72.htm

SEC Commissioner Walter discusses Enforcement Priorities

In testimony to the House of Representatives Committee on Financial Services on March 20 outlining the Securities and Exchange Commission's overall enforcement program, goals and needs, Commissioner Elisse B. Walter discussed the current focus of the SEC enforcement division in respect of hedge funds. The SEC has formed a Hedge Funds Working Group within the Enforcement Division to address hedge fund related investigations. She said that in respect of hedge funds, the SEC's current enforcement focus includes potential manipulation, abusive short selling and collusion, valuations of illiquid assets, and whether advisors of fund-of-funds and "feeder funds" (i.e., conduits for investment into unaffiliated underlying funds) have exercised requisite due diligence on the underlying funds. She also testified that "[t]he huge number of liquidations and suspensions of redemptions by hedge funds in the past year have created particular concern as to whether hedge fund advisors may be

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favoring their own interests above others and whether principals, employees or favored investors of the hedge fund advisor may have received 'preferential redemptions' from the fund at issue."

Commissioner Walter also discussed other SEC enforcement activity that may also affect hedge funds, such as investigation of alleged circulation of false rumors and manipulation, and inadequate or fraudulent disclosure of issues relating to subprime mortgage securities. The Enforcement Division's recently created Rumors and Market Manipulation Working Group has been investigating, in parallel with NYSE and FINRA, market data obtained from numerous hedge funds, broker-dealers and institutional investors under oath to determine, among other things, if credit defualt swaps were used to manipulate equities prices of six large financial issuers in the recent market turbulence.

http://www.house.gov/apps/list/hearing/financialsvcs_dem/walter032009.pdf

OTC Derivatives

Treasury's Regulatory Reform Would Regulate OTC Derivatives

Treasury Secretary Timothy Geithner testified to the Committee on Financial Services of the House of Representatives on March 26 outlining proposals to regulate credit default swaps and OTC derivatives. The proposed oversight would include:

- treating all OTC derivatives dealers as "systemically important firms" subject to strong regulation and supervision;
- clearing all standardized OTC derivatives contracts through designated central counterparties which are themselves subject to comprehensive regulation and supervision;
- imposing robust standards on the trading of non-standardized OTC derivatives, including trade reporting, documentation, netting, collateral, margin and close-out practices;
- making aggregate trading volume and position data available to the market and individual trade and position data available to regulators on a confidential basis; and
- increasing eligibility and record keeping requirements and imposing a heightened standard of care on all OTC derivative market participants.

The proposal also calls for greater use of exchange traded instruments rather than OTC derivatives.

http://www.house.gov/apps/list/hearing/financialsvcs_dem/geithner032609.pdf
http://www.treas.gov/press/releases/tg72.htm

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CFTC

CFTC Adopts Final Rules for ECM Significant Price Discovery Contracts

The Commodity Futures Trading Commission has published final regulations implementing the provisions of the CFTC Reauthorization Act of 2008 (the 2008 Act) relating to "significant price discovery contracts" (SPDCs) traded on exempt commercial markets (ECMs). The new regulations extend the large trader reporting rules currently applicable to designated contract markets to apply to SPDCs traded on ECMs. The regulations also amend the provisions of CFTC Regulation 36.3 to further specify the information that ECMs must provide to the CFTC on an initial and ongoing basis regarding the ECM's operations and those agreements, contracts or transactions traded on the ECM that have not been deemed SPDCs.

The amendments also provide additional guidance regarding the criteria the

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CFTC will consider in determining whether a particular instrument is an SPDC and the self-regulatory responsibilities of ECMs with respect to SPDCs. Consistent with the 2008 Act, the new regulations require an ECM that lists an SPDC for trading to implement a trade monitoring program, develop an audit trail to monitor for market abuses, adopt position limits or position accountability levels, and publish certain daily trading information.

The amended regulations will become effective on April 22.

http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e9-6044a.pdf

CFTC Permits CME to Clear Certain OTC Agricultural Swaps

The Commodity Futures Trading Commission has issued an order authorizing the Chicago Mercantile Exchange (CME) to clear certain over-the-counter swaps in corn, wheat and soybeans in response to a petition filed in April 2008 by the CME and the Chicago Board of Trade (CBOT). The CFTC order also permits the CME and futures commission merchants (FCMs) clearing such swaps through the CME Clearing House to hold customers' positions in these swaps and related funds in a customer segregated funds account. Under the CFTC order, the swaps may only be entered into by "eligible swap participants" pursuant to Part 35 of the CFTC's regulations and will be listed by the CBOT for clearing (but not trading).

http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e9-6369a.pdf

CFTC Publishes Swap Dealer Hedge Exemption Concept Release

The Commodity Futures Trading Commission has published a concept release relating to its review of hedge exemptions for swap dealers. The concept release arises from a September 2008 CFTC staff report summarizing a review of the market activities of swap dealers and index traders. In that report, the staff recommended that the CFTC examine whether swap dealers' "bona fide hedge" exemptions from speculative position limits should be eliminated and replaced by more limited "risk management" exemptions, the availability of which would be further conditioned upon certain reporting and certification requirements. The concept release outlines the regulatory history of the hedge exemption and marketplace events leading up to the 2008 staff report. The concept release concludes with a request for comments on a series of questions relating to the advisability of eliminating the hedge exemption and the appropriate parameters for any new risk management exemptions.

The comment period for the concept release closes on May 26.

http://edocket.access.gpo.gov/2009/pdf/E9-6187.pdf

Banking

FinCEN Releases Report Regarding Mortgage Fraud

On March 16, the Financial Crimes Enforcement Network, an agency of the U.S. Treasury (FinCEN), released a report entitled *Mortgage Loan Fraud Connections with Other Financial Crime* that outlines how subjects reported by depository institutions to the agency for suspected mortgage loan fraud may also be involved in other financial crimes such as check fraud, money laundering, stock manipulation, currency structuring to avoid transaction reporting requirements and other crimes. In the course of its review of a five year period, FinCEN identified approximately 156,000 mortgage fraud subjects and found that approximately 2,360 were reported for suspicious activity in

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3,680 of the other reporting categories.

The report analyzed Suspicious Activity Reports (SARs) filed by depository institutions for mortgage fraud between July 2003 and June 2008. After pulling such SARs, the agency then looked at SARs filed by money services businesses, securities brokers and dealers or insurance companies, and by casinos and card clubs. In reviewing the SARs collectively, the reports provided information about ways in which the mortgage loan fraud subjects identified in SARs filed by depository institutions reportedly hid, moved or disposed of large sums of cash.

According to the Executive Summary, the purpose of the study was to "better understand the relationship between mortgage loan fraud and other financial crime and to identify ways in which financial crime extends through multiple financial industries."

http://www.fincen.gov/news_room/nr/pdf/20090316.pdf

OTS Issues Guidance Regarding Regulation R

On March 24, the Office of Thrift Supervision (OTS) released a memorandum to chief executive officers regarding Regulation R and bank brokerage activities. Importantly, Regulation R is effective on the first day of an institution's fiscal year beginning after September 30, 2008. For savings associations that utilize a calendar year, it is effective as of January 1.

Regulation R implements certain broker exceptions for banks and savings associations from the definition of "broker" in the Securities Exchange Act, as amended by the Gramm-Leach-Bliley Act. Such exceptions include those related to third-party networking arrangements, trust and fiduciary activities, deposit "sweep" activities, and custody and safekeeping activities. In addition, Regulation R includes exemptions related to foreign securities transactions, non-custodial securities lending transactions conducted in an agency capacity, and the execution of transactions other than through a broker-dealer.

The memorandum also suggests certain compliance actions that should be undertaken by OTS-regulated entities, including: (i) making a determination if the savings association is engaging in any securities activities; (ii) developing written policies and procedures and establishing an effective training program to ensure compliance with certain statutory provisions in the Securities Exchange Act and Regulation R; and (iii) adjusting risk management, audit and compliance systems to include securities activities.

http://files.ots.treas.gov/25296.pdf

Structured Finance and Securitization

Treasury Unveils Public-Private Investment Program for Legacy Assets

On March 23, the U.S. Treasury (UST), in conjunction with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve, unveiled the Obama administration's plan to purchase troubled or "legacy" assets that are currently clogging the balance sheets of U.S. financial institutions. The Public Private Investment Program (PPIP), is expected to generate $500 billion of purchasing power (with the potential to expand to up to $1 trillion over time) to buy legacy assets by combining capital from private investors with $75 to $100 billion in UST provided TARP equity, which will then be substantially leveraged with debt guaranteed by the FDIC and/or issued by UST and the New York Federal Reserve Bank (NYFRB).

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The PPIP consists of three main elements: (i) a Legacy Loan Program to Public Private Investment Funds (PPIFs) to purchase residential and commercial real estate loans (Legacy Loans); (ii) a Legacy Securities Program, to form PPIFs to purchase asset-backed securities backed by legacy loan portfolios (Legacy Securities); and (iii) an expansion of the NYFRB's Term Asset-Backed Securities Loan Facility (TALF) to allow highly leveraged purchases of Legacy Securities with Federal Reserve TALF loans.

Please see Katten's *Client Advisory* published March 26 for a description of those three elements of the PPIP along with issues and questions for potential participants that have been identified by Katten's TARP Task Force.

UK Developments

UK DEVELOPMENTS

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FSA Publishes Consultation Paper on Remuneration

The UK Financial Services Authority (FSA) has published a consultation paper (CP 09/10 Reforming remuneration practices in financial services) which puts forward a Code of Practice (Code) on remuneration and formally consults on applying it to a group of 45 large banks and broker dealers and incorporating it into the FSA rules. The CP invites discussion on the possibility that the Code should be applied to all FSA-authorised firms.

The draft Code's basic requirement which would become an FSA rule is that "a firm must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote effective risk management." The FSA proposes that the Code's remaining ten principles should be put into the FSA rule book as guidance as to the evidence the FSA will focus on when assessing compliance with the Code.

The CP notes that in order to be effective, remuneration policies need to be implemented in a consistent global manner. In deciding whether and when to implement its proposals, the FSA will take into account whether it considers that there has been satisfactory alignment of implementation plans with respect to remuneration policies by regulatory authorities in other major financial centers.

The consultation period on implementation of the Code for larger banks and broker dealers lasts until May 18. The period for discussion and feedback on whether to extend the Code to other regulated firms ends on June 18.

http://www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_10.shtml

Guilty Verdict Obtained in First FSA Criminal Insider Dealing Case

On March 27, a lawyer and his father-in-law were found guilty of insider dealing in the first insider dealing criminal prosecution brought by the Financial Services Authority (FSA). The FSA has begun to bring criminal insider dealing cases as part of its tougher approach to tackling market abuse. Three further cases are currently pending.

The jury found that Christopher McQuoid, the general counsel at TTP Communications (TTP) had passed inside information to his father-in-law who traded and made a profit using the information. The FSA has obtained a court order freezing the profits made from the trade.

Margaret Cole, the FSA's director of enforcement stated: "By pursuing a criminal prosecution in this case, the FSA has shown that we will take tough action to achieve our aim of credible deterrence in the financial markets. Mr. McQuoid took advantage of the trust placed in him as TTP's legal counsel, and with his father-in-law, has been found guilty of cheating the market. Anyone engaging in similar acts should see this as a clear warning that the FSA intends to bring all its powers to bear to protect the integrity of our markets."

http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/042.shtml

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

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