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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions

By Victor M. Rosenzweig*

This issue's Survey focuses on Securities and Exchange Commission ("SEC") rulemaking activities and major federal appellate decisions under the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act") during the fourth quarter of 2004.

SEC RULEMAKING

SEC Adopts Rules Relating to Registration and Disclosure for Asset-Backed Securities

On December 22, 2004, the SEC adopted new rules addressing the registration, disclosure and reporting requirements for asset-backed securities under the 1933 Act and 1934 Act. (See SEC Release Nos. 33-8518, 34-50905, December 22, 2004). The new rules update and clarify the 1933 Act registration requirements for asset-backed securities offerings, including:

- expanding the types of asset-backed securities that may be offered in delayed primary offerings on Form S-3 (See Release, page 29);
- consolidating and codifying existing interpretive positions that allow modified 1934 Act reporting that is more tailored to asset-backed securities (e.g. the thresholds for required disclosure about unaffiliated servicers and significant obligors were raised from 10% to 20%; and for derivatives that may be used in asset-back security transactions, for purposes of determining whether the derivatives counterparties reach the disclosure threshold, the derivative will be valued based upon the "maximum probable exposure" of the counterparty, rather than the maximum amount that could be payable under the terms of the contract (See Release, page 174);

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- providing tailored disclosure guidance and requirements for 1933 Act and 1934 Act filings involving asset-backed securities (See Release, page 100); and
- streamlining and codifying existing interpretive positions that permit the use of written communications in a registered offering of asset-backed securities in addition to the statutory registration statement prospectus.

Any registered offering of asset-backed securities commencing with an initial bona fide offer after December 31, 2005, and the asset-backed securities that are the subject of that registered offering, must comply with the new rules. For any such offerings that rely on 1933 Act Rule 415(a)(1)(x), 1933 Act registration statements filed after August 31, 2005 related to such offerings must be pre-effectively or post-effectively amended, as applicable, to make the prospectus included in Part I of the registration statement compliant and to make any required undertakings or other changes for Part II of the registration statement. For 1933 Act registration statements that were filed on or before August 31, 2005, the prospectus and prospectus supplement, taken together, relating to such offerings that rely on Rule 415(a)(1)(x) must comply, provided, that, (1) the 1933 Act registration statement will need to be post-effectively amended if any new undertakings are required to be made with respect to such offerings in Part II of the registration statement; and (2) the 1933 Act registration statement will need to be post-effectively amended to make the prospectus included in Part I of the registration statement compliant, as well as to make changes, if any, to Part II of the registration statement with respect to any registered offering of asset-backed securities under such registration statement commencing with an initial bona fide offer after March 31, 2006.

SEC Adopts Rules Relating to the Final Phase-In Period for Acceleration of Periodic Report Filing Dates

On November 17, 2004, the SEC adopted new rules that amend the completion of the final phase-in of the accelerated filing deadlines for annual and quarterly reports for one year. These new rules also change the deadlines for transition reports to ensure that the deadlines are similar to the deadlines for periodic reports. The new rules provide that the deadline for an accelerated filer to file its annual report for its fiscal year ending on or after December 15, 2004 will remain at 75 days after fiscal year end. Similarly, the quarterly report deadlines for the three

subsequently filed quarterly reports will remain at 40 days after quarter end. The current year two deadlines therefore will remain in place for one additional year, which is year three of the phase-in period. The phase-in schedule will resume in year four, during which an accelerated filer will have to file its annual report within 60 days after its fiscal year ending on or after December 15, 2005. The company will then have to file its next three quarterly reports within 35 days after quarter end. At the end of year four, the accelerated filing phase-in period will be complete, with the 60-day and 35-day deadlines remaining in place for accelerated filers for all subsequent periods. (See SEC Release Nos. 33-8507, 34-50684, November 17, 2004).

The new rules also provide for conforming amendments to Regulation S-X to apply the postponed phase-in period to the financial information updating requirements in other SEC filings, such as 1934 Act registration statements and proxy statements and information statements under Section 14 of the 1934 Act, as these updating requirements also are tied to periodic report due dates under the 1934 Act. Updated interim financial information will continue to be required within 130 days after the end of the registrant's fiscal year for a fiscal year ending on or after December 15, 2004 and before December 15, 2005. The phase-in schedule will resume in year four, during which updated interim financial information will be required within 125 days after the end of the registrant's fiscal year for fiscal years ending on or after December 15, 2005.

SEC Adopts Rules Relating to Issuer Transfer Restrictions or Prohibitions On Ownership by Securities Intermediaries

On December 7, 2004, the SEC adopted new rules under the 1934 Act that prohibit registered transfer agents from effecting any transfer of any equity security registered under Section 12 or any equity security that subjects an issuer to reporting under Section 15(d) of the 1934 Act if such security is subject to any restriction or prohibition on transfer to or from a securities intermediary, such as clearing agencies, banks, or broker-dealers. The effective date for these new rules is March 7, 2005. (See SEC Release No. 34-50758a, December 7, 2004).

SEC Adopts Rules Relating to Disposal of Consumer Report Information

On December 2, 2004, the SEC adopted new rules that amend Regulation S-P requiring financial institutions to adopt policies and procedures to safeguard customer information. The amended rule implements the

provision in section 216 of the Fair and Accurate Credit Transactions Act of 2003 requiring proper disposal of consumer report information and records. Section 216 directs the SEC and other federal agencies to adopt regulations requiring that any person who maintains or possesses consumer report information or any compilation of consumer report information derived from a consumer report for a business purpose to properly dispose of the information. The amendments also require the policies and procedures adopted under the safeguard rule to be in writing. Covered entities must comply with the new rules by July 1, 2005. (See SEC Release No. 34-50781, December 2, 2004).

SEC Adopts Rules Relating to Self-Regulatory Organizations

On August 23, 2004, the SEC adopted final rules relating to self-regulatory organizations ("SROs"). The various facets of the rule are discussed below. (SEC Release No. 34-50486, October 4, 2004).

Electronic Filing

The new rules require self-regulatory organizations ("SROs") to file proposed rule changes electronically with the SEC through a Web-based system. To implement electronic filing of SRO proposed rule changes, the new rules amend Rule 19b-4 and Form 19b-4 to require SROs to file all proposed rule changes on Form 19b-4, and any amendments to Form 19b-4, electronically with the SEC in accordance with the procedures and in the format specified in Rule 19b-4 and Form 19b-4. Each SRO will be given access to a secure Web site, the Electronic Form 19b-4 Filing System ("EFFS"), which will enable authorized individuals at the SRO to file with the SEC an electronic Form 19b-4 on behalf of the SRO. Accordingly, the current requirement in Form 19b-4 that SROs submit multiple paper copies of proposed rule changes to the SEC will be eliminated. Pursuant to the new rules, a proposed rule change would be deemed filed with the SEC on the business day that the SRO electronically submits the proposed rule change to the SEC, as long as (1) the SEC receives the proposed rule change on or before 5:30 p.m., Eastern Standard Time or Eastern Daylight Saving Time, whichever is currently in effect; and (2) the SRO files the proposed rule change in accordance with the requirements of Rule 19b-4 and Form 19b-4, as amended.

Regarding signature requirements, the new rules amend Form 19b-4 so that a "duly authorized officer" of an SRO is required to file proposed rule changes with an electronic signature. Additionally, the new rules require each duly authorized signatory to obtain a digital ID to provide both

the SEC and the SRO with further assurances about the authenticity and integrity of the electronically-submitted Form 19b-4. Each signatory also will be required to manually sign the Form 19b-4, authenticating, acknowledging, or otherwise adopting his or her electronic signature that is attached to or logically associated with the filing. In accordance with Rule 17a-1 under the 1934 Act, the SRO will be required to retain that manual signature page of the rule filing, authenticating the signatory's electronic signature, for not less than five years after the Form 19b-4 is filed with the SEC, and, upon request, furnish a copy of it to the SEC or its staff.

As of 5:30 p.m. Eastern Standard Time on November 5, 2004, the SEC ceased to accept SRO proposed rule changes in paper format. Beginning at 9:00 a.m. Eastern Standard Time on November 8, 2004, SROs will be required to file all Forms 19b-4 and any amendments to Forms 19b-4 electronically, according to the procedures and in the format described in Rule 19b-4 and Form 19b-4, as amended.

The new rules recognize that in rare circumstances SROs may be unable to file certain documents electronically. Therefore, under limited circumstances, the new rules allow SROs to file documents in paper format such as materials for which confidential treatment is requested. In addition, the SEC will allow SROs to file, in paper format, comment letters that the SRO received from its members before the SRO filed the proposed rule change with the SEC, so long as the SRO has demonstrated it is unable to convert the comment letters into electronic format.

Posting of Proposed Rule Changes on SRO Web Sites

The new rules also amend Rule 19b-4 to require each SRO to post all proposed rule changes, and any amendments thereto, on its public Web site within two business days after filing with the SEC. Under the new rules, a copy of the complete proposed rule change would continue to be made available in the SEC's Public Reference Room. The SEC is also adopting amendments requiring SROs to remove proposed rule filings that are deemed not properly filed and returned to SROs or withdrawn by SROs from their Web sites within two business days from SEC notification of improper filing or SRO withdrawal of the proposed rule. Companies must comply with these new rules by May 9, 2005.

Posting of Current and Complete Rule Text on SRO Web Sites

The new rules amend Rule 19b-4 to require SROs to post and maintain a current and complete version of their rules on their public Web sites within two business days after electronic notification by the SEC that it

has approved a proposed rule change, or in the case of proposed rule changes filed pursuant to Section 19(b)(3)(A) of the 1934 Act, that the SEC has issued a release providing notice of filing and immediate effectiveness of a proposed rule change. The SEC is developing an affirmative electronic notification to SROs via EFFS that a proposed rule change has been approved or an effective-upon-filing rule change has been noticed by the SEC. SROs will have immediate notice of the event that triggers its duty to update its rules within two business days. The requirement to update Web site rule text will run from the business day that the SRO receives an electronic notification via EFFS from the SEC, not the date of the SEC order or notice of proposed rule change filed pursuant to Section 19(b)(3)(A) of the 1934 Act. Companies must comply with these new rules by May 9, 2005.

Electronic Posting of National Market System Plans

The new rules require each participant in an effective National Market System Plan ("NMSP") to ensure that a current and complete version of the NMSP is posted on the NMSP's Web site or on a Web site designated by the NMSP participants within two business days after notification by the SEC of effectiveness of the NMSP. Each participant in any effective NMSP also will be required to ensure that the Web site is updated to reflect amendments to such NMSP no later than two business days after the NMSP participants have been notified by the SEC of its approval of a proposed amendment pursuant to Rule 11Aa3-2(c) of the 1934 Act. If the amendment is not effective for a certain period, the NMSP participants will be required to clearly indicate the effective date in the relevant text of the NMSP. The NMSP participants will also be required to post any proposed amendments filed pursuant to Rule 11Aa3-2(b) of the 1934 Act on a NMSP Web site or a designated Web site within two business days after the filing of the proposed amendments with the SEC. The NMSP participants will be required to remove from the Web site within two business days any proposed amendment that they determine to withdraw. Each NMSP participant will be required to provide a link to the Web site with the current version of the NMSP. Companies must comply with these new rules by May 9, 2005.

APPELLATE DECISIONS OF NOTE

Summary Judgment Affirmed where No Evidence that Underwriter Passed Title to Investor or Solicited Investor's Purchase of Bonds

An investor and class representative, who purchased a bond issue, sued the underwriter of the bond issue, alleging that the underwriter violated Sections 12(2) and 15 of the '33 Act. In an unpublished Order dated October 14, 2004, the Court of Appeals for the Seventh Circuit affirmed the district court's grant of summary judgment in favor of the underwriter, reasoning that the investor had failed to present evidence that would allow a reasonable fact finder to conclude that the underwriter passed title to him or solicited his purchase of the bonds; at most, the investor established his presence in the same chain of title as the underwriter, which is insufficient to establish liability under the relevant statutes. ***Daniels v. Blount Parrish & Co.*, 113 Fed. Appx. 174, 2004 WL 2348260 (7th Cir. 2004).**

No Reasonable Reliance on Oral Statements that Conflict with Signed Written Agreement

Recipients of stock options, who had taken the options as compensation for services provided to a corporation and were required by the corporation to sign lock-up agreements on the options, lost money when the value of the options plummeted. The stock option recipients sued the corporation and the underwriter of its initial public offering under Rule 10b-5 of the '34 Act for negligent misrepresentation, fraud, and breach of contract. On October 21, 2004, the Court of Appeals for the Eighth Circuit denied rehearing and rehearing en banc, finding that the district court properly granted the corporation's motion for judgment on the pleadings because 1) the stock option recipients could not establish reasonable reliance on the statements of the corporation and the underwriter, where those statements conflicted with the written lock-up agreement that the stock option recipients had signed; and 2) because there could be no breach of a prior oral contract allowing the stock option recipient to acquire unrestricted stock options where it was superceded by the later written lock-up agreement. There is a dissenting opinion. ***Syverson v. Firepond, Inc.*, 383 F.3d 745 (8th Cir. 2004).**

Failure of Acquiring Company to Discuss Threatened Litigation in Post-Merger 8-K Filing Does Not Necessarily Indicate that Threatened Litigation was Not Material at Time of Merger

A publicly-owned communications company ("appellant") that acquired another company through a merger sued the acquired company's sole shareholders, president, and shareholders' counsel (collectively, "appellees"), alleging securities fraud under Rule 10b-5 under the '34 Act, common law fraud, and civil conspiracy based on the appellees' failure to disclose, during merger negotiations, the threat of a multimillion dollar lawsuit by a former vice president of the acquired company. Reversing the district court's decision to grant summary judgment to the appellees, on October 26, 2004, the Court of Appeals for the District of Columbia Circuit found that there existed a material issue of fact as to whether the appellees' failure to disclose the potential litigation at the time of merger negotiations constituted securities fraud/common law fraud, and that the appellant's failure to disclose the threatened litigation in its 8-K filing subsequent to the merger did not preclude the possibility that the potential litigation had been material at the time of the merger negotiations. ***Media General, Inc. v. Tomlin*, 387 F.3d 865 (D.C. Cir. 2004).**

28 U.S.C. § 1447(d) Prohibits Review of District Court's Remand Order Based Upon Lack of Removal Jurisdiction

An investor brought a state court putative class action, to which the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") applied, alleging that the defendants violated the '33 Act by issuing a materially false and misleading Registration Statement and Prospectus. After the defendants removed the action to federal court, the investor sought remand, maintaining that SLUSA precluded the removal of a securities action that asserted only federal claims. Based on its lack of removal jurisdiction, the district court granted the investor's timely motion to remand. On November 5, 2004, the Court of Appeals for the Eleventh Circuit held that 28 U.S.C.A. § 1447(d) prohibited its review of the district court's order. ***Williams v. AFC Enterprises, Inc.*, 389 F.3d 1185 (11th Cir. 2004).**

Section 804 of Sarbanes-Oxley Does Not Revive Previously Expired Securities Claims

Investors in several cases filed prior to the enactment of Sarbanes-Oxley, who had withdrawn their securities fraud claims as time-barred, refiled their claims against a finance company, its officers, and its accounting firm, alleging that Section 804 of Sarbanes-Oxley expanded

the applicable statute of limitations and thereby revived their claims. On December 6, 2004, the Court of Appeals for the Second Circuit declined to apply Section 804 retroactively to revive the plaintiffs' claims, based on its determination that neither the language nor the legislative history of Section 804 mandated such revival, especially in light of the longstanding presumption against retroactivity. ***In re Enterprise Mortgage Acceptance Co., LLC, Securities Litigation*, 2004 WL 2785776 (2d Cir. 2004).**

Misstatement About CEO's Having Finished College Not Material

Stock owners sued a company as a purported class, alleging that publicly-filed documents stating that the CEO and Chairman of the Board had completed college when, in fact, he had not, constituted a violation of Section 11(a) of the '33 Act, Section 10(b) of the '34 Act, and Rule 10b-5. On December 21, 2004, the Court of Appeals for the Fourth Circuit affirmed the district court's dismissal of the complaint, finding that under the circumstances present, the misstatement about the CEO's education was not material because it did not alter the "total mix" of information available to investors. It should be noted that the Court limited its holding to the circumstances of this case. ***Greenhouse v. MCG Capital Corp.*, 2004 WL 2940871 (4th Cir. 2004)**