SEWARD & KISSEL LLP

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SEC PROPOSED AMENDMENTS TO "SAFE HARBOR" RULES OF REGULATION D

In May 2007, the Securities and Exchange Commission ("SEC") proposed four principal revisions to Regulation D. Under the Securities Act of 1933 ("Securities Act"), offers to sell securities must be registered with the SEC unless exempt. The Securities Act generally exempts private placements, and Regulation D is the SEC's set of "safe harbor" rules that places several conditions on an issuer in order to qualify for the private placement exemption.

First, the SEC has proposed to permit most issuers to engage in limited advertising for offers and sales of securities so long as the target audience is limited to a new category of investors called "large accredited investors." The existing rule disqualifies advertised offerings from the coverage of Regulation D. "Large accredited investors," would have to meet higher monetary thresholds than "accredited investors" to prove a higher level of sophistication. A legal entity (i.e., corporation or partnership) must possess over $5 million in assets to qualify as an "accredited investor," whereas it must possess $10 million in investments to qualify as a "large accredited investor." Similarly, an individual must have either a net worth of $1 million or make an annual income of $200,000 (or $300,000 with a spouse) in each of the two most recent years to qualify as an "accredited investor," whereas he or she must have $2.5 million in investments or have an annual income of $400,000 (or $600,000 with a spouse) to qualify as a "large accredited investor." Legal entities who qualify as "accredited investors not subject to a monetary threshold" would still not be subject to a monetary threshold to qualify as "large accredited investors." The same applies to individuals who qualify as accredited investors not subject to a monetary threshold, such as directors, officers, and general partners of the issuer.

Second, the SEC has proposed four changes to the "accredited investor" definition. The first proposed change is that an entity may alternatively qualify as an "accredited investor" by being an entity owning $5 million or an individual owning $750,000 in "investments," which exclude the value of a business or personal residence. Under the second proposed change, married investors lacking the signed commitment of their spouse would only be allowed to apply 50% of the value of their joint investments toward the qualifying dollar threshold. The third proposed change would index the qualifying dollar thresholds to inflation beginning in 2012. Lastly, the fourth change would widen the scope of entities eligible for "accredited investor" status to include previously ineligible entities such as labor unions.

Third, the SEC has proposed shortening the window for the integration rule in Regulation D from six months to 90 days. This would widen the permissible time for issuers to raise capital before or after a Regulation D offering without being forced to integrate multiple offerings together. The integration doctrine prohibits an issuer from improperly avoiding registration by attempting to divide a single offering

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into multiple smaller offerings exempt from registration. The doctrine requires "integrating" such improper multiple offers into one offer which may require SEC registration and thereby deem earlier offerings to have violated the Securities Act. The SEC provided a "safe harbor" from integration for offers and sales occurring more than six months before or after a Regulation D offer. Concerned that six months may be too long a wait for smaller companies to raise capital, the SEC now proposes reducing that window to 90 days.

Fourth, the SEC proposes a uniform disqualification provision that would preclude issuers who have violated the law or engaged in wrongdoing from relying on Regulation D.

SEC Rescinds "Uptick" Rule

The SEC has rescinded the short sale price test, or "uptick" rule, under the Securities Exchange Act of 1934 ("Exchange Act"). The amendments are intended to provide a more consistent regulatory environment for short selling by removing restrictions on the execution prices of short sales, as well as prohibiting any self-regulatory organization ("SRO") from having a price test. Rule 10a-1 was originally implemented in order to restrict short selling in a declining market. The SEC temporarily suspended Rule 10a-1 for one year in 2004 in order to determine the extent that a price test was necessary in the current market. The SEC determined through this test program that a price test rule was no longer needed.

In addition, the SEC is amending Rule 200(g) of Regulation SHO, removing the requirement that a broker-dealer mark a sell order of an equity security as "short exempt" if the seller is relying on an exception from a price test.

SEC Proposes changes to Rule 144 Holding Period For Restricted Securities and Rule 145 Resale Restrictions

On May 23, 2007 the SEC proposed revisions to Rule 144 and Rule 145 of the Securities Act to shorten the holding period for restricted securities and liberalize the re-selling rule.

Rule 144 creates a safe harbor from SEC registration for resales of restricted securities and for securities owned by "non-affiliates" of the issuer who satisfy certain conditions. An "affiliate" is one who controls, is controlled by, or is under common control with, the issuer. Both affiliates and non-affiliates are subject to mandatory holding periods before they may resell restricted securities. The proposed revisions shorten holding periods and simplify compliance. For example, under current regulations, non-affiliates may engage in limited resales after holding restricted securities for one year. And if they have not been affiliates during the prior three months, they may engage in unlimited resales so long as they have held on to the restricted securities for two years. Under the proposed amendments, a non-affiliate who has not been an affiliate during the prior three months could engage in unlimited resales of securities of Exchange Act reporting companies after a holding period of only six months. However, the public information requirement would apply to resales after the six month holding period but before the one year anniversary of the date the securities were acquired.

With respect to non-reporting companies, under the proposal, non-affiliates could engage in unlimited resales after a holding period of one year, if they have not been affiliates during the prior three months.

However, the proposed amendments toll the holding period for both affiliates and non-affiliates engaged in certain hedging transactions, up to a maximum of one year. There is no tolling of the holding period under the current regulations.

In addition, manner of sale restrictions (i.e., sales limited to so-called "brokers' transactions") are reduced under the proposed amendments. These restrictions currently apply to resales of any security under Rule 144. Under the proposed amendments they would not apply to resales of debt securities by affiliates nor to any permitted resale by a non-affiliate.

The proposed amendments would also simplify Form 144 compliance. Currently a seller must file a Form 144 for sales of over 500 shares or over $10,000 within any rolling three-month period. The proposed amendments would completely remove the filing requirement for non-affiliates, and elevate the threshold for affiliates to sales of over 1,000 shares or $50,000, respectively.

Finally, the proposed amendments would greatly limit the scope of the presumptive underwriter provision of Rule 145 which applies to resales of securities of companies involved in business combinations. Under Rule 145(c), parties to a transaction other than the issuer or its affiliates are deemed to be underwriters, and Rule 145(d) sets forth restrictions on the resale of securities by underwriters.

The proposed amendment would eliminate this presumptive underwriter provision except for Rule 145(a) transactions involving a shell company (other than a business related shell company). The proposal would then mirror this change in Rule 145(d) so that persons deemed underwriters would be allowed to resell securities to the same extent as affiliates of a shell company under the proposed amendments to Rule 144. Thus securities, of a party to the transaction that was a shell company could only be sold if the party has since ceased to be a shell company and 90 days have elapsed since the securities were acquired in the transaction. Consistent with the proposed amendments to Rule 144, after six months from being acquired in the transaction such securities may be resold subject to the public information condition of Rule 144, and may be freely resold after one year.

This elimination of the presumptive underwriter provision, with the limited exceptions illustrated above, should increase the ability to raise capital and reduce costs in the reselling of securities received in business combination transactions.

SEC Soliciting Public Comments on Proposed Elimination of Reconciliation Requirement for IFRS Financial Statements

The SEC is submitting for comment revisions on a proposal to amend Form 20-F and make conforming changes to Regulation S-X to accept financial statements prepared by foreign private issuers prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB") without reconciliation to generally accepted accounting principles ("GAAP") as used in the United States. The financial statements would need to be prepared on the basis of the English language version of IFRS as published by the IASB in order to be acceptable without a reconciliation to U.S. GAAP.

The proposed amendments would be to Form 20-F under the Exchange Act, Rules 3-10 and 4-01 of Regulation S-X, Forms F-4 and S-4 under the Securities Act and Rule 701 under the Securities Act.

The proposed amendments would change the reconciliation requirement, whereby financial statements filed by a foreign private issuer that are prepared in accordance with a basis of accounting other than U.S. GAAP must identify and quantify the material differences, disclosing the differences and, to the extent practicable, the effect of each such variation given from the requirements of U.S. GAAP and Regulation S-X.

The original reconciliation approach was introduced to design an integrated disclosure regime for foreign private issuers where the system parallels the system for domestic issuers but also takes into account the different circumstances of foreign registrants. It has since been determined, however, that the burden on foreign issuers of meeting the identical disclosure standards as domestic issuers, including reconciliation, might discourage them from offering their securities on the U.S. market.

The SEC encourages the movement towards a single set of high quality, globally accepted accounting standards and believes that allowing foreign private issuers to prepare in accordance with IFRS as published by the IASB without reconciliation to U.S. GAAP promotes this movement. The SEC states that their proposed changes also indicate the level of convergence already achieved between U.S. GAAP and IFRS as published by the IASB. It is also an indication of the desire to work towards a joint standard of accounting principles and practices.

The changes are expected to help issuers by decreasing the accounting work required in preparing U.S. filings. The changes are also expected to benefit issuers and investors by facilitating capital formation by foreign companies in the U.S. capital markets.

SEC Approves New Guidance for Compliance with Section 404 of Sarbanes-Oxley

The SEC approved interpretative guidance, effective June 27, 2007, to help public companies strengthen their internal controls over financial reporting while reducing unnecessary costs, particularly at smaller companies, and enhancing compliance under Section 404 of the Sarbanes Oxley Act of 2002.

The interpretative guidance is organized around two broad principles. First, it advocates that management should determine whether it has implemented controls that sufficiently address the risk that the company fails to prevent or detect in a timely way a material misstatement of its financial statements.

Second, the guidance advocates that management, in conducting its evaluation of its controls, efficiently allocate its resources based on

the severity of the risk. Thus management may use more efficient techniques, such as self-assessments, in areas at low risk of allowing a material misstatement in the financial statements, and logically devote more intense evaluation techniques to areas at higher risk of producing such material misstatements.

The SEC also approved Rule amendments providing that a company that performs an evaluation of internal control in accordance with the interpretative guidance satisfies the annual evaluation required by Exchange Act Rules 13a-15 and 15d-15. The full text of the interpretative guidance is now available at http://www.sec.gov/rules/interp/2007/33-8810.pdf.

SEC AMENDS RULE 105 OF REGULATION M DEALING WITH SHORT SELLING IN CONNECTION TO A PUBLIC OFFERING

The SEC adopted amendments, to be effective on October 9, 2007, to strengthen Rule 105 of Regulation M. Rule 105 is intended to prevent abusive short selling and market manipulation to ensure that offering prices are set by market forces rather than by manipulation.

When a trader expects to purchase shares in an offering, there is an incentive to sell short prior to the pricing of an offer, covering the short position with shares purchased at the reduced offering price. This allows the purchaser generally to lock in a guaranteed profit, but at the expense of the issuer and other shareholders.

The former Rule 105 focused its prohibition on the “covering” of short sales effected within five business days prior to the pricing of a registered public offering (including a secondary offering) with shares purchased in that offering. In recent years the SEC has observed widespread non-compliance with Rule 105 through sophisticated trading strategies designed to hide activity in violation of the rule.

In order to eliminate this problem, the SEC has revised the rule to eliminate the “covering” requirement and outright prohibit any purchasing of shares in the offering if a short sale in the securities was effected during the five business day period.

There are three exceptions: (1) transactions by mutual funds (not private funds); (2) cases where the trader, after the shorts were put on but before the offering is priced, buys the full number of shares that were shorted during the restricted period in "bona fide" purchases, and (3) where separate accounts execute the short and buy orders and effective information barriers separate those accounts. The “bona fide” purchase exception requires that, among other things, no other offsetting arrangements are entered into.

In connection with these changes to Regulation M, the SEC staff has noted that covering any short position with shares from a registered public offering, whether a secondary or follow-on (*i.e.*, primary) offering, may nonetheless violate the registration requirements of the Securities Act if the short sale was effected prior to the effectiveness of the registration statement for that offering. As such, care must be taken when buying in a secondary or follow-on public offering, to not engage in so-called "sham" transactions when covering short sales in or around the same time, that is, buying and selling in the open market without taking actual market risk. We expect the SEC to offer further guidance on this issue in the near future.

THE SUPREME COURT MAKES LIFE HARDER FOR SECURITIES PLAINTIFFS

Story contribution by Bruce Paulsen and Paula Odysseos*

Heralded as a victory for corporations facing private securities fraud actions, on June 21, 2007, the Supreme Court handed down its decision in Tellabs, Inc., et al. v. Makor Issues & Rights, Ltd., et al., 2007 U.S. LEXIS 8270, on June 21, 2007. Justice Ginsburg delivered the 8-1 decision by the Court. In Tellabs, the Supreme Court set forth a new test that an examining court should apply when analyzing whether a plaintiff has properly pled “scienter” (the level of intent a plaintiff must show, see below) in a securities fraud complaint.

The Private Securities Litigation Reform Act of 1995 (PSLRA) was enacted by Congress as a check against abusive litigation by private parties. The PSLRA, among other things, requires plaintiffs to state with particularity both the facts constituting alleged violations of the securities laws as well as the facts evidencing “scienter.” “Scienter,” latin for “knowingly,” is a measure of intent defined as “the defendant’s intention ‘to deceive, manipulate, or defraud.’” Section 21D(b)(2) of the PSLRA requires plaintiffs to “state with particularity facts giving rise to a strong inference that the defendant acted with the

required state of mind." The phrase "strong inference" was left undefined by Congress, and a split among the Courts of Appeals has ensued.

In Tellabs, the Seventh Circuit held that the "strong inference" standard would be satisfied if the complaint "alleged facts from which, if true, a reasonable person could infer that the defendant acted with the required intent." Notably, the Seventh Circuit rejected a more stringent standard adopted by the Sixth Circuit as set forth in Fidel v. Farley, 392 F.3d 220, 277 (6th Cir. 2004).

On appeal, the Supreme Court noted that the Seventh Circuit's standard failed to "capture the stricter demand Congress sought to convey in § 21D(b)(2) of the PSLRA" and held that the more stringent Sixth Circuit standard applied

In an attempt to create a "workable construction of the 'strong inference' standard", the Supreme Court, in Tellabs, held that a trial court "must engage in a comparative evaluation" and "must consider, not only inferences urged by the plaintiff . . . but also competing inferences rationally drawn from the facts alleged." Stated otherwise, "an inference of scienter must be more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent."

Post- Tellabs, a court faced with a motion to dismiss a securities fraud complaint must follow these steps: (1) accept all factual allegations in the complaint as true; (2) consider the complaint in its entirety, and (3) take into account plausible opposing inferences. Or, as summarized by the Supreme Court, the pertinent inquiry should be: "When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?"

Without deciding the case, the Supreme Court vacated the Seventh Circuit's decision, and remanded the case to permit the district court to reexamine the complaint.

In a concurring opinion, Justice Scalia criticized the Court's test, noting: "If a jade falcon were stolen from a room to which only A and B had access, could it possibly be said there was a 'strong inference' that B was the thief?" Justice Scalia maintains that the proper test "should be whether the inference of scienter (if any) is more plausible than the inference of innocence."

In short, the decision is one of a series regarded as "business-friendly" during this most recent term of the court, and raises a new hurdle for securities plaintiffs to get past a motion to dismiss a securities fraud complaint.

**Bruce Paulsen is a partner at Seward & Kissel in the Litigation Practice and specializes in Maritime as well as Securities matters. Questions concerning this Article can be directed to him at paulsen@sewkis.com.*

Paula Odysseos is an Associate in the Litigation Group at Seward & Kissel.

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If you have any questions or comments about this newsletter, please feel free to contact Gary J. Wolfe (212-574-1223) or Robert E. Lustrin (212-574-1420), or email by typing in the attorney's last name followed by ***@sewkis.com***

Seward & Kissel LLP

One Battery Park Plaza, New York, New York 10004
Telephone: (212) 574-1200 **Fax:** (212) 480 8421
Email: sknyc@sewkis.com
www.sewkis.com

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