

**News in Brief**

October 5, 2007

**Securities and Exchange Commission/  
Corporate****Division of Corporation Finance Director John White Comments on Executive Compensation Disclosure**

While the Securities and Exchange Commission's (SEC) Division of Corporation Finance does not currently intend to issue additional executive compensation disclosure rules in 2007, Director John White has stated that the Securities and Exchange Commission staff will determine if revisions to the current rules are necessary and will adjust and clean up the rules as needed.

In August, the staff sent out comment letters to 300 companies in a broad range of industries. Registrants were given 30 days to indicate when they will respond to these comment letters. In late September, the Securities and Exchange Commission started faxing a second wave of comment letters. Based on its reviews, the Division of Corporation Finance plans to release a report on its findings, which will give companies further guidance with respect to complying with Securities and Exchange Commission executive compensation rules.

According to White, this report will focus on the registrant's manner of presentation and its compensation disclosure and analysis (CD&A). White commented that he would like to see companies to be more specific in their analysis, but to continue to use plain English and not necessarily lengthen disclosure. With respect to CD&A, White asks that the registrants disclose and analyze the material factors used to set compensation.

<http://business.cch.com>

**Due Diligence Did Not Prevent An Action For Breach Of Representations And Warranties In Acquisition Agreement**

In *Cobalt Operating, LLC v. James Crystal Enterprises, LLC* (Del. Ch. July 20, 2007), the Court of Chancery addressed the issue of whether the purchaser of a business could prevail on its breach of contract and fraud claims regardless of the fact that the purchaser performed due diligence that discovered discrepancies that later formed the basis of its claims. The Court entered judgment in favor of the purchaser – finding that it reasonably

relied upon the seller's representations in the asset purchase agreement.

In 2002, Cobalt Operating, LLC ("Cobalt") agreed to buy a radio station from James Crystal Enterprises, LLC and James Crystal Licenses, LLC (collectively, "Crystal"). Shortly after closing, Cobalt discovered that the radio station was not able to air all of the commercials sold. Cobalt filed an action claiming that Crystal breached numerous contractual representations in the asset purchase agreement and that Cobalt reasonably relied upon Crystal's fraudulent representations. Crystal denied the allegations and claimed that Cobalt could not have reasonably relied upon Crystal's representations because Cobalt's due diligence revealed the accounting discrepancies underlying Cobalt's claims.

The Court held that Crystal breached numerous contractual representations, including the representation that the financial statements that reflected annual cash flow of \$5 million were not materially misleading and that Crystal was in compliance with applicable law. The Court rejected Crystal's argument that Cobalt's discovery of accounting discrepancies prior to the acquisition precluded Cobalt from arguing it reasonably relied upon Crystal's representations because the Court found the asset purchase agreement contained (i) an "express and unqualified representation regarding the material accuracy" of the radio station's financial statements, and (ii) a representation that Crystal was in compliance with applicable law. Furthermore, the Court found that Cobalt's failure to discover the fraud during due diligence was not unreasonable because the fraud was intentionally concealed from Cobalt when it investigated the accounting discrepancies.

**A Hedge Haven Makes Its Rules Even Lighter**

The Wall Street Journal reported that the island of Jersey in the English Channel has decided to relax its existing light regulatory oversight of hedge funds even further. The Financial Services Commission, Jersey's regulator, will change the regulations effecting hedge funds where investors have put in a minimum of \$1 million. The new rules will begin in January. Funds may opt for the new lighter regulatory scheme. The change in this offshore center's regulation may lead others to follow the trend. Some of the other offshore

centers are Guernsey, the Cayman Islands and the British Virgin Islands.

Jersey is home to hedge funds with a total of more than £40 billion, or \$81 billion, under management. Those funds may opt for a regime that requires no regulatory authorization to register, no outside audit and no public filings of prospectus changes. Funds may still choose the more rigorous oversight according to Robert Kirkby, a technical director at Jersey Finance, a quasi-governmental body. The Wall Street Journal reported that "under Jersey's Expert Fund regime, which applies to most hedge funds on the island, a fund must have outside auditors and a board that includes at least one Jersey resident. It also must inform the local regulator of any significant changes to its business, such as updates to the fund's prospectus."

Although many funds are registered offshore, the managers are usually based in the United States or United Kingdom and subject to the antifraud laws of the United States or United Kingdom. Regulators in Europe and the United States are advocating for more regulation of hedge funds instead of lighter regulation. According to the article, the Securities and Exchange Commission attempted to regulate hedge funds by requiring most fund advisors to register with the Securities and Exchange Commission. The agency also wanted the hedge funds to be subject to routine inspections and examinations. The rule was thrown out last year by a federal appeals court. Since the ruling, the Securities and Exchange Commission has looked at proposals to raise the monetary threshold investors must meet in order to buy into a fund.

The article reported that according to Hedge Fund Research, Inc., "offshore-registered hedge funds held \$1.17 trillion in July 2007, up from \$431 billion five years earlier and representing about two thirds of all hedge-fund assets."

<http://online.wsj.com/public/article/SB119102308704743294.html>

### **New Rules for Bank Broker Exceptions Under Exchange Act**

The Securities and Exchange Commission and the Federal Reserve Bank have adopted final rules implementing a "broker" exception for banks under § 3(a)(4) of the Exchange Act. The rules detail the type of securities activities banks can engage in without having to register with the Securities and Exchange Commission as a securities broker. According to the September 24, 2007 SEC and Fed joint release, "the rules implement the statutory exceptions that allow a bank, subject to certain conditions, to continue to conduct securities transactions for its customers as part of the bank's trust and fiduciary, custodial and deposit 'sweep' functions, and to refer customers to a

securities broker-dealer pursuant to a networking arrangement with the broker-dealer."

The relevant statutory exemptions were adopted pursuant to the Gramm-Leach-Bliley Act of 1999. Banks do not have to comply with the new rules until the first day of their fiscal year after September 30, 2008. The rules are detailed in Final Rule Release Nos. 34-56501 and 34-56502.

### **Litigation/White Collar**

#### **Freddie Mac & 4 Former Execs Settle Securities and Exchange Commission Accounting Fraud Action**

The Securities and Exchange Commission (SEC) has filed a settled enforcement action against "Freddie Mac" and four of its former executives in a securities fraud case concerning improper earning management over a five-year period.

The Securities and Exchange Commission's lawsuit alleges that the Federal Home Loan Mortgage Corporation, also known as 'Freddie Mac,' engaged in a fraudulent scheme which deceived investors about its true performance and profitability and misreported its net income by as much as 43% in one year and almost 31% in another year. The Securities and Exchange Commission contends that the misreporting created a multi-billion dollar accounting fraud.

A shareholder-owned, government-sponsored enterprise, Freddie Mac agreed to pay a \$50 million civil penalty without admitting or denying the allegations. The penalty is expected to be distributed to injured investors through a fair fund. In addition, the four executives agreed to pay civil penalties and disgorgement. The individuals used to be the top Freddie Mac executives: its president (and chief operating officer), its CFO and two senior vice presidents.

#### **Leading Securities Class Action Lawyer Indicted For Conspiracy**

A federal grand jury has indicted the co-founder of one of the country's most profitable securities class action law firms on charges that he conspired to pay kickbacks to persons who agreed to be plaintiffs.

Melvyn Weiss, whose law firm reportedly earned \$250 million over 25 years by filing class action lawsuits against some of the country's largest public corporations, is facing two counts of conspiracy and addition charges of obstruction of justice and making false statements about documents involved in a grand jury subpoena.

In a related development, a former senior partner at the firm, Steven Schulman, who had been indicted last year, agreed to plead guilty to a racketeering charge. The law firm itself was also

indicted last year.

According to the indictment and prosecutors' statements about it, the law firm secretly paid millions of dollars in kickbacks in order to induce potential plaintiffs to participate as named plaintiffs in the often-lucrative class action and securities fraud lawsuits. The securities lawsuits typically claimed that shareholders suffered losses because public companies and their executives misled them about financial conditions and performance.

The prosecutors contend that the kickbacks were usually paid in cash and that the law firm and its chosen plaintiffs lied in court documents to conceal the scheme.

Published for clients as a source of information. The material contained herein is not intended to be construed as legal advice or opinion.

CIRCULAR 230 DISCLOSURE: Pursuant to Regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

**FT. LAUDERDALE**

Las Olas Centre II  
350 East Las Olas Boulevard  
Suite 1600  
Ft. Lauderdale, FL 33301-2229  
Main: 954.463.2700  
Fax: 954.463.2224

**JACKSONVILLE**

50 North Laura Street  
Suite 2500  
Jacksonville, FL 32202-3640  
Main: 904.798.3700  
Fax: 904.798.3730

**LOS ANGELES**

725 South Figueroa Street  
38th Floor  
Los Angeles, CA 90017-5438  
Main: 213.688.9500  
Fax: 213.627.6342

**MIAMI**

One Southeast Third Avenue  
28th Floor  
Miami, FL 33131-1714  
Main: 305.374.5600  
Fax: 305.374.5095

**NEW YORK**

335 Madison Avenue  
Suite 2600  
New York, NY 10017-4636  
Main: 212.880.3800  
Fax: 212.880.8965

**ORLANDO**

CNL Tower II  
420 South Orange Avenue  
Suite 1200  
Orlando, FL 32801-4904  
Main: 407.423.4000  
Fax: 407.843.6610

**TALLAHASSEE**

106 East College Avenue  
Suite 1200  
Tallahassee, FL 32301  
Main: 850.224.9634  
Fax: 850.222.0103

**TAMPA**

Suntrust Financial Centre  
401 East Jackson street  
Suite 1700  
Tampa, FL 33602-5803  
Main: 813.223.7333  
Fax: 813.223.2837

**TYSONS CORNER**

8100 Boone Boulevard  
Suite 700  
Vienna, VA 22182-2683  
Main: 703.790.8750  
Fax: 703.448.1801 / 1767

**WASHINGTON, D.C.**

801 Pennsylvania Avenue, NW  
Suite 600  
Washington, D.C. 20004  
Main: 202.393.6222  
Fax: 202.393.5959

**WEST PALM BEACH**

Esperante Building  
222 Lakeview Avenue  
Fourth Floor  
West Palm Beach, FL 33401-6183  
Main: 561.653.5000  
Fax: 561.659.6313

[www.akerman.com](http://www.akerman.com)

©2007 Akerman Senterfitt. All rights reserved.