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SEC/CORPORATE

Delaware Amends Its Corporate Law to Prohibit Fee-Shifting, Approve Exclusive Forum Provisions and Facilitate At-The-Market Offerings

On June 24, Delaware's Governor signed legislation approving amendments to the Delaware General Corporation Law (DGCL). While annual amendments to the DGCL typically involve technical fixes, this year's legislation addresses a number of substantive issues described below:

- **Fee Shifting**. The Delaware Supreme Court's 2014 decision in *ATP Tour v. Deutscher Tennis Bund,* 91 A.3d 554 (Del. 2014), upholding the validity of an aggressive fee-shifting bylaw adopted by a non-stock corporation, generated significant controversy. Effectively overruling that decision, new Section 102(f) (Contents of Certificate of Incorporation) and new language in Section 109(b) (Bylaws) bar certificates of incorporation and bylaws of corporations (other than non-stock corporations) from imposing liability on stockholders for the attorneys' fees or expenses of the company or any other party. The prohibition applies to "internal corporate claims," meaning claims (including derivative claims) based upon (1) a violation of a duty by a current or former director or officer or controlling stockholder in such capacity or (2) claims for which the Delaware Court of Chancery has jurisdiction. One of the principal concerns prompting this prohibition was that fee-shifting could preclude not only meritless claims but also claims with merit.

  The prohibition does not affect the ability of parties to provide for fee-shifting in stockholders or other agreements signed by a stockholder.

- **Exclusive Forum.** Provisions in certificates of incorporation and bylaws requiring that intra-corporate claims be litigated exclusively in a designated forum, typically in the company's state of incorporation, have become increasingly popular and have generally been upheld when tested in a foreign court. These provisions are intended to address the phenomena of multi-forum litigation and forum shopping that are most commonly known in the context of merger litigation.

  New Section 115 (Forum Selection Provisions) specifically approves the inclusion of provisions in bylaws and certificates of incorporation that select Delaware courts (including federal courts) as the exclusive forum for "internal corporate claims." The provision does not bar a corporation from including an additional forum outside Delaware, but prohibits stripping the Delaware courts of jurisdiction. Bylaws mandating arbitration of internal corporate claims would not be permissible because they would deprive the Delaware courts of jurisdiction.

  Consistent with the fee-shifting amendments, Section 115 does not prohibit parties from including exclusive forum provisions in stockholders or other agreements signed by a stockholder.

- **Facilitating At-The-Market Offerings.** Delaware corporations have often delegated the pricing of public offerings to a board pricing committee, although the logistics for such committee can present practical challenges. In order to make it easier for public companies to issue stock as part of "at-the-market" programs, the 2015 legislation allows a board to delegate pricing authority to individuals who are not directors, and does not require that each individual stock issuance be separately authorized. The

amendments also will permit boards to delegate authority to officers to issue restricted stock. More specifically, amended Section 152 (Issuance of Stock; Lawful Consideration; Fully Paid Stock) allows the board to authorize stock to be issued in one or more transactions, in such amounts and at such times as are determined by or in the manner set forth in the relevant board resolution, as determined by a person or body that need not be the board or one of its committees, *provided* that the board resolution:

  - sets a ceiling on the number of shares that may be issued;
  - fixes a time period for the issuance of such shares; and
  - sets minimum consideration for which the shares may be issued. The minimum must not be less than the par value of shares that have a par value. The board may determine the amount of consideration by (1) setting minimum consideration or (2) approving a formula by which the amount or minimum amount of consideration is set. A formula for determining consideration may include reference to (or be made dependent upon) extrinsic facts, such as market prices or averages of market prices on one or more dates.

- **Consideration for Options or Rights**. Consistent with the approach to Section 152, the 2015 legislation amends Section 157(b) (Rights and Options Respecting Stock) to provide that a formula used to determine the consideration for stock issuable upon the exercise of rights and options may also be dependent upon extrinsic facts.

- **Ratification of Defective Corporate Acts.** In 2014, Delaware adopted new Sections 204 (Ratification of Defective Corporate Acts and Stock) and 205 (Procedures Regarding Validity of Defective Corporate Acts and Stock) that set out procedures to ratify stock or corporate acts that would otherwise be "void" or "voidable" due to a "failure of authorization." The 2015 legislation clarifies and confirms the operation of specified provisions, and makes certain other changes relating to the procedures for ratification.

The effective date for the amendments (other than those relating to the ratification of defective corporate acts) is August 1. The amendments to Sections 204 and 205 will be effective for board resolutions adopted on or after August 1 ratifying defective corporate acts.

The full text of the amendments is available here.

SEC Division of Corporation Finance Issues New C&DIs Relating to New "Regulation A+"

On June 23, the Securities and Exchange Commission's Division of Corporation Finance issued new Compliance and Disclosure Interpretations (C&DIs) relating to the recently expanded Regulation A, commonly referred to as "Regulation A+". Regulation A+, which was promulgated under the Jumpstart Our Business Startups Act (JOBS Act), permits eligible issuers to offer up to $50 million of their securities within any 12-month period in quasi-public offerings. As noted in the June 19 edition of the *Corporate & Financial Weekly Digest*, Regulation A+ became effective on June 19.

Among other things, the new C&DIs addressed the following issues:

- C&DI 182.03 clarifies that an issuer whose business primarily involves managing operations located outside of the United States will still be considered to have its principal place of business in the United States or Canada if its officers, partners or managers primarily direct, control and coordinate the issuer's activities from the United States or Canada. Regulation A is only available to issuers with a principal place of business in the United States or Canada, subject to certain limitations.

- C&DIs 182.04, 182.05 and 182.06 provide that Regulation A is available to an issuer that (1) was formerly required to file reports under the Securities Exchange Act of 1934, as amended (Exchange Act), (2) is currently a voluntary filer under the Exchange Act or (3) is a wholly owned subsidiary of an Exchange Act reporting company parent, provided the parent is not acting as a guarantor or co-issuer of the securities. Regulation A is not available to issuers that are required to be reporting companies under the Exchange Act.

- C&DI 182.07 provides that Regulation A may be utilized in merger and acquisition transactions other than business acquisition shelf transactions.

- C&DI 182.08 provides that a newly created entity may utilize its inception date as its balance sheet date so long as the inception date is within nine months before the date of filing or qualification, and the date of filing or qualification is not more than three months after such entity reaches its first annual balance sheet date. To the extent that an issuer uses its inception date as its balance sheet date, statements of comprehensive income, cash flows and changes in stockholders' equity will not be applicable.

- C&DI 182.09 provides that an issuer may solicit interest in a Regulation A offering on an electronic platform that limits the number of characters or amount of text that may be included without the information required by Rule 255 under the Securities Act of 1933, as amended, so long as (1) the communication is distributed through a platform that has technological limitations on the number of characters or amount of text that may be included in the communication, (2) including the required statements in their entirety, together with the other information, would cause the communication to exceed the limit on the number of characters or amount of text and (3) the communication contains an active hyperlink to the required statements that otherwise satisfy Rule 255 and, where possible, prominently conveys that important or required information is provided through the hyperlink.

- C&DI 182.10 clarifies that although state securities (blue sky) law registration and qualification requirements are pre-empted in the case of primary offerings by the issuer or secondary offerings of securities by selling security holders in a Tier 2 Regulation A offering, the pre-emption does not apply to resales of securities purchased in a Tier 2 Regulation A offering.

CFTC

CFTC's Division of Market Oversight Issues Updated Guidebook for Part 20 Reports

The Commodity Futures Trading Commission's Division of Market Oversight has issued an updated Guidebook and Appendices for reports to the CFTC under Part 20 of its regulations, which require large trader reports for certain physical commodity swaps.

The Guidebook and Appendices, which supersede prior versions of those documents, detail technical corrections corresponding to validation rules that the CFTC will use to review Part 20 submissions. The Guidebook includes reporting formats and record layouts for position reports and Form 102S filings, a data dictionary for mapping reportable data elements to a record layout and examples for converting swaps into futures equivalent units. The Appendices provide coding schema examples for FpML and FIXML formats.

The new validation rules are scheduled to be implemented in a test environment on July 6, and to go live on August 31.

More information is available here.

CFTC's Division of Market Oversight to Hold Public Roundtable Regarding Made Available To Trade Determinations

The Commodity Futures Trading Commission's Division of Market Oversight will hold a public roundtable on July 15 from 10:00 a.m. to 2:00 p.m. (ET) to discuss the provision of the Commodity Exchange Act that, with an exception for "end users," requires transactions in certain swaps to be executed only on a swap execution facility or designated contract market.

The roundtable will focus on approaches to the mandatory trading requirement, academic perspectives on made available to trade (MAT) determinations, data-based assessments of MAT and an industry analysis of the MAT process. Members of the public may submit comments regarding the roundtable topics electronically through the CFTC's online comments process, or via mail sent to:

Christopher Kirkpatrick
Secretary, Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

All comments must be submitted by August 17.

The roundtable, which will be held at the CFTC's headquarters in Washington, DC, will be open to the public and accessible through a listen-only, toll-free telephone line. A transcript of the roundtable will be available on www.cftc.gov.

More information is available here.

FIA Market Technology Division Releases Recommendations to Prepare for Leap Second Event

The Futures Industry Association's (FIA) Market Technology Division (MTD) published a report of recommendations to prepare the industry for the leap second event on June 30.

A leap second is the addition of an extra second at the end of the day to realign the Coordinated Universal Time standard with mean solar time. Periodically adding the leap second corrects for irregularities in the earth's rate of rotation.

The last leap second occurred on June 30, 2012. Several systems, including Internet servers, encountered issues processing the additional second. Leap second computer issues could disrupt trading operations across exchanges, clearinghouses, brokers, investors and financial industry service providers.

The FIA MTD's report provides recommendations on how to develop and implement a continuity and recovery plan, implement enterprise time management, update vulnerable systems, actively monitor critical systems and possibly adjust market activity. The report also provides a global exchange matrix delineating each exchange's plan for the leap second addition, an overview of Network Time Protocol and Precision Time Protocol, a comparison of leap second dilution before and after the event, and hardware and software resources for leap second information.

FIA MTD's Preparing For Leap Second Report is available here.

LITIGATION

Massachusetts Federal Jury Convicts Amateur Golfer for Insider Trading

A federal jury in the District of Massachusetts recently convicted Eric McPhail of securities fraud — one of the first criminal insider trading convictions since the US Court of Appeals for the Second Circuit's decision in *United States v. Newman*.

The allegations arose out of information Mr. McPhail received from a close friend— an executive at American Superconductor Corporation (AMSC) — who was a member of the same country club and went on golf and other trips together. This information allegedly included nonpublic information about AMSC's business activities. According to the government, Mr. McPhail then gave this information to other friends of his, who made trades based on the information and earned more than $500,000. Mr. McPhail is alleged to have tipped those friends in return for golf tournament fees and meals, and to have told one of them after a tip that he "like[s] Pinot Noir and love[s] steak…looking forward to getting paid back."

Mr. McPhail previously sought to dismiss the indictment, arguing that no benefit was conferred on the AMSC executive as required by *Newman*, and that the relationship between Mr. McPhail and the executive did not have the sort of expectation of privacy necessary for insider trading under the misappropriation theory. The Second Circuit denied that motion, holding that the indictment sufficiently alleged a relationship of trust and confidentiality between Mr. McPhail and the executive, and that, in contrast to holdings in other recent post-*Newman* cases,

neither *Newman* nor US Supreme Court precedent required that, in a misappropriation case such as this one, Mr. McPhail or his friends be aware of a benefit received by the executive in exchange for the information. Ultimately, the jury convicted Mr. McPhail, finding that he had a sufficient relationship of trust and confidence with the executive.

U.S. v. McPhail, No. 14-10201 (D. Mass. June 16, 2015)

UK DEVELOPMENTS

Final Rules Concerning the Restrictions Imposed On the Retail Distribution of CoCos and Other Regulatory Capital Instruments

In August 2014, the UK Financial Conduct Authority (FCA) used its consumer protection powers for the first time and introduced temporary product intervention rules (Temporary Rules) that restricted the distribution of contingent convertible instruments (CoCos) and similar products to retail investors for a period of 12 months commencing October 1, 2014. These distribution restrictions did not impact the distribution of CoCos and similar products to professional or institutional clients, or to exempt persons.

In accordance with its stated intention when implementing the Temporary Rules, on October 29, 2014, the FCA published a consultation paper (Consultation Paper) in which it outlined proposed permanent rules on the distribution of CoCos and certain other core regulatory share capital instruments issued by mutual societies (together, Reg. Cap. Instruments) to retail investors. A summary of the Consultation Paper can be found here.

On June 16, the FCA published Policy Statement PS15/14 (Policy Statement) with respect to the distribution of CoCos and other Reg. Cap. Instruments in which the FCA summarized the feedback it had received from its earlier consultation, and also set out the final rules (Final Rules) that it will implement on the matter. Consistent with its earlier stated position in the Consultation Paper, and after having considered all feedback, in the Policy Statement, the FCA continues to regard CoCos and certain other Reg. Cap. Instruments issued by mutual societies as posing particular risks of inappropriate distribution to ordinary retail customers. Additionally, the FCA also remains of the view that the restrictions on retail distribution of CoCos and similar products currently in place under the Temporary Rules represent a "reasonable and proportionate regulatory response to the significant risk of harm to [retail] consumers that we have identified." Nevertheless, based on feedback received, the FCA has made certain amendments to the Final Rules when compared with those proposed in the Consultation Paper.

With respect to CoCos, the scope of the Final Rules has been amended to only apply with respect to firms selling or promoting (or approving promotions of) CoCos (including CoCo funds) to retail investors (and which, therefore, do not apply to firms higher up the chain of distribution, such as those structuring products for distribution). The FCA does, however, reserve the right to further intervene if it finds that firms that are not subject to the Final Rules are acting in a manner that undermines the effect of the restrictions on the distribution of CoCos in the retail market. Unlike CoCos, for the reasons set out the Consultation Paper, the Final Rules continue not to restrict the distribution of Reg. Cap. Instruments to retail investors in their entirety, but instead impose certain requirements with respect to their retail distribution, including highlighting prescribed risk warnings and limiting the size of investment permitted to be made in this type of security by ordinary retail investors. Based on feedback received (and in contrast to the limit previously proposed in the Consultation Paper of 5 percent of net investable assets), the limit that the FCA is now applying in the Final Rules is 10 percent of a retail investor's net investable assets (which more closely aligns with the approach taken by the FCA in other rules with respect to non-readily realizable securities where the limit also is 10 percent). These requirements continue to apply only to the primary market; however, the FCA intends to continue to monitor the situation and reserves the right at a later stage to extend the relevant provisions of the Final Rules to apply to the secondary market to the extent it considers necessary.

The Final Rules applicable to other Reg. Cap. Instruments issued by mutual societies take effect from July 1, whereas the Final Rules relating to CoCos take effect on October 1 upon the expiration of the Temporary Rules. A copy of the Policy Statement containing the Final Rules can be found here.

UK FCA Publishes Latest "Market Watch" Newsletter

The UK Financial Conduct Authority (FCA) published the 48th edition of its "Market Watch" newsletter on June 22. Market Watch is the FCA's periodic newsletter for publishing its guidance on market conduct and transaction reporting issues. This latest edition includes guidance and commentary from the FCA on:

Trade Volume Advertising. Some firms choose to advertise their trading volumes solely through automatic feeds, which derive directly from the firm's trading software. These feeds are usually delayed and, therefore, during this time gap, the market remains unaware of recent trading activity. However, the FCA notes that some other firms choose to advertise trading volumes using both automatic feeds and an element of discretion, which allows traders to override the automatic feed. This discretionary element enables traders to immediately advertise any significant trading volume.

The FCA notes that some market participants have raised concerns to the FCA of firms publishing incorrect trading volume data in the equity market. The FCA highlights the possible market abuse risks related to such practices: (1) incorrectly advertised volumes could create false or misleading impressions as to the supply/ demand of stock traded by a firm, which could, in turn, encourage market participants to trade the stock through the firm, and (2) advertised volumes creating false or misleading impressions could amount to offenses under the EU Market Abuse Directive.

FCA Observations From Suspicious Transaction Reporting Supervisory Visits. Since 2013 the FCA has been undertaking a series of supervisory visits to a variety of FCA-authorized firms in the UK in order to better understand and assess the way in which potential incidents of market abuse are being identified, including looking at how staff escalate their concerns to their compliance officer, and how those compliance officers identify potential incidents of market abuse through surveillance.

The FCA believes that suspicious transaction reporting (STR) submission is inconsistent across all areas of the UK financial services industry, and that submission levels are sometimes too low. The FCA comments that the quality of the STRs that it receives is generally very good, although there are some firms that submit significantly fewer than their peers, and some asset classes for which the FCA believes surveillance is less-developed, which suggests that incidents are being missed. The FCA also believes that there may be cultural obstacles to the detection of market abuse in some asset classes, and has identified that some firms have failed to adapt their processes to close these gaps.

The FCA sees the detection of market abuse as a partnership between the regulator and industry, and is aware that it is important that the FCA helps firms — as the first line of defense against market abuse — to understand its expectations. To that end, the FCA provides detailed commentary in Market Watch 48 regarding some areas where it thinks firms could do better with STRs.

Direct Electronic Access Pre-Trade Controls. The FCA comments that in Market Watch 46 (July 2014), it detailed the events that led to a spike in the intraday price of a British bank. The FCA subsequently reviewed pre-trade controls for cash equity direct electronic access (DEA) trading more generally — covering Direct Market Access (DMA) and Sponsored Access (SA) trading. The FCA's findings, based on analysis of the documentation requested and onsite visits were focused in three areas: (1) pre-trade controls, (2) control setting and amendment procedures, and (3) ongoing monitoring and incident surveillance.

Market Watch 48 is available here.

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