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SEC/CORPORATE

SEC Further Delays Planned Rulemaking Schedule to Implement Certain Provisions of the Dodd-Frank Act

On July 29, the Securities and Exchange Commission once again updated its planned schedule for adopting rules and taking other actions to implement the corporate governance and disclosure provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. As reported in the April 15, 2011, edition of *Corporate and Financial Weekly Digest*, the SEC had previously announced its revised planned rulemaking schedule to implement provisions of the Dodd-Frank Act. Below are updated time periods set forth in the SEC's further revised rulemaking schedule for governance and disclosure rules to be adopted during such time periods, as well as certain related actions. Section references are to the Dodd-Frank Act.

The following rules will be proposed in August – December 2011 and implemented in January – June 2012:

- Disclosure of pay-for-performance, pay ratios and hedging by employees and directors (Sections 953 and 955)
- Clawback of executive compensation (Section 954)

The following rules will be implemented in August – December 2011:

- Revision to the "accredited investor" standard (Section 413)
- Disclosure by institutional investment managers of votes on executive compensation (Section 951)
- Exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence; compensation consultant conflicts (Section 952)
- Disclosure related to "conflict minerals" and mine safety information; disclosure by resource extraction issuers (Sections 1502-1504)

The following rule will be implemented in January – June 2012:

- Disclosure of, and prohibitions of certain, executive compensation structures and arrangements (Section 956)

The following action will be taken in July – December 2012:

- Report to Congress on study and review of use of compensation consultants and effects of such use (Section 952)

The following rule will be issued at a date to be determined:

- Definition of “other significant matters” for purposes of exchange standards regarding broker voting of uninstructed shares (Section 957)

Given the SEC’s revised rulemaking schedule, it is highly unlikely that the requirements set forth above relating to disclosure of pay-for-performance, pay ratios and hedging by employees and directors, rules regarding executive compensation clawbacks, and disclosure of, and prohibition of certain, executive compensation arrangements will be effective for the 2012 proxy season. The revised schedule indicates that the SEC expects to implement by the end of 2011 final rules relating to, among other things, exchange listing standards for compensation committee and adviser independence and disclosure of compensation consultant conflicts; therefore, these new disclosure requirements may be effective for the 2012 proxy season, while the independence requirements will be subject to further rule implementation by the exchanges. As to disclosure related to “conflict minerals,” because the Dodd-Frank Act provides that these rules will be effective beginning with the first full fiscal year following the SEC’s adoption, this disclosure cannot be required for the 2012 proxy season.

Click here for the SEC’s complete updated rulemaking schedule for the Dodd-Frank Act.

LITIGATION

Revisions of Earnings Forecasts Fail to Support Securities Fraud Claims

A federal court in Texas dismissed a purported securities fraud class action against a clothing retailer because the claims (a) were based on deficient confidential witness statements and (b) failed to demonstrate that the company’s inaccurate earnings projections were made with knowledge of falsity.

An investor sued Men’s Wearhouse, Inc. under § 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 after the company revised its earnings projections during the third and fourth quarters of 2007. The company’s stock fell 63 percent after these announcements, and the plaintiff proffered statements from four anonymous employees who said company executives should have known the original forecasts were overly optimistic and failed to disclose unfavorable information about the company’s business prospects provided by middle managers. Men’s Wearhouse moved to dismiss.

The U.S. District Court for the Southern District of Texas was critical of the role played by the plaintiff’s confidential witnesses, stating that, “A secret witness is not far above a false witness.” Even if the anonymous employees were believed, the court added, their statements did not demonstrate that executives had committed fraud but established only that the witnesses disagreed with the strategies and policies of company executives. Moreover, the plaintiff’s allegations did not support a fraud claim because the company’s earnings forecasts were presented as future projections and were not made with actual knowledge of falsity.

Material Yard Workers Local 1175 Ben. Funds v. Men's Wearhouse Inc., Civ. No. H–09–3265, 2011 WL 3059229 (July 22, 2011).

Lender’s Good Faith Scuttles Breach of Contract Claim

The U.S. Court of Appeals for the Fourth Circuit affirmed the summary judgment dismissal of a breach of contract claim asserted by a medical services company because the totality of the circumstances demonstrated that the lender complied with the loan agreement by acting in good faith when it declared default.

Sandy Springs Bank extended a loan and credit line to Capitol Radiology, LLC, under a loan agreement that provided Sandy Springs with a security interest in substantially all of Capitol’s assets and permitted Sandy Springs to declare default if it determined “in good faith” that it was under-collateralized. Capitol was dilatory in providing Sandy Springs with follow-up financial information, however, and Sandy Springs subsequently learned that Capitol was subject to an adverse court judgment and that a federal tax lien had been imposed against the home of its founder (which had also been pledged as security for the loans). Sandy Springs declared default and accelerated the loans. Capitol sued for breach of contract, but its claim was dismissed by the district court on summary judgment and Capitol appealed.

Capitol argued that there were questions of fact about whether the judgment and the federal tax lien represented material adverse events such that Sandy Springs could reasonably consider itself under-collateralized. The Fourth

Circuit disagreed, holding that Sandy Springs only had to have a "good faith" belief that it was insecure, and that the totality of the circumstances – including Capitol's failure to provide financial information in a timely fashion as well as the adverse judgment and tax lien – demonstrated as a matter of law that Sandy Springs acted in good faith.

Capitol Radiology, LLC v. Sandy Spring Bank, No. 10–1318, 2011 WL 2877966 (4th Cir. July 20, 2011).

BANKING

New Federal Reserve SR Letter Requires Notice Before Savings Associations May Declare Dividends

Effective July 21, 2011, any savings association that is a subsidiary of a savings and loan holding company (SLHC) must provide notice to its applicable Federal Reserve Bank at least 30 days before declaring a dividend. The duty to review and process these notices is one of the new responsibilities the Board assumed on July 21 as part of the supervisory and rulemaking authority previously held by the Office of Thrift Supervision (OTS) with respect to SLHCs.

The 30-day prior notice is required by statute. The statute also provides that the 30-day period runs from the date the notice is submitted to the agency, and that a dividend declared during the review period or without filing the notice is null and void.

Procedural Operations

A prior notice with respect to a proposed dividend declaration must be filed with the appropriate Reserve Bank on the designated form. Notices should be submitted to the Applications Units at each applicable Reserve Bank. In evaluating a savings association's notice, the Reserve Bank should work closely with the savings association's supervisor(s). Therefore, upon receiving a notice, the Reserve Bank should immediately transmit a copy of the notice to the savings association's supervisor(s) at the district or field office level, accompanied by a transmittal letter requesting comment within 15 calendar days. In addition, Reserve Bank supervision staff with direct inspection responsibility for the SLHC should be consulted to solicit their view of the request. Savings associations should be provided with contact information and relevant procedural expectations pertaining to the notification process.

To read the Supervision and Regulation Letters, click here.
To read the OTS Notice for Application for Capital Distribution, click here.

EXECUTIVE COMPENSATION AND ERISA

Pending Legislation Could Affect Employee Benefit Plans

Since the 112th Congress commenced at the beginning of this year, multiple bills have been introduced that, if enacted, would affect employee benefit plans and executive compensation. Some of this proposed legislation, which is currently in committee, is highlighted below.

401(k) Plans: Two pieces of legislation affecting 401(k) plan are pending. The first bill (found here) is intended to curb "leakage" of retirement savings from 401(k) plans prior to retirement. It would (1) extend the repayment term of a 401(k) loan if an employee loses his/her job; (2) prohibit the ability of employees to take loans from their 401(k) account via credit cards or similar arrangements; (3) limit an employee to having only three outstanding 401(k) loans at a time; and (4) permit an employee to make 401(k) contributions within the six-month period following a hardship distribution from his or her 401(k) account. The second bill (found here) would require employers sponsoring 401(k) plans to, at least annually, include an item on the employee's quarterly benefit statement that provides what the monthly annuity payment would be if the employee's current 401(k) balance was used to buy an annuity.

Executive and Equity Compensation: There are also two bills pending that would affect executive and equity compensation. One bill would repeal a provision of the Dodd-Frank legislation and another would alter employers' tax deduction for stock options. The first bill (found here) would eliminate the requirement that securities issuers disclose (1) the median annual total compensation of all employees other than the CEO; (2) the CEO's annual total compensation; and (3) the ratio between the two. This requirement is not yet in effect, so, if enacted, the repeal would maintain the status quo. The second bill (found here) would change the federal tax deduction rules so that an employer could only deduct stock option expenses to the extent such expenses are reflected on the employer's financial statements.

Flexible Spending Accounts (FSAs): Health FSAs allow employees to use pretax compensation to reimburse certain medical expenses. As one of the "revenue raisers" in the health care reform legislation, Health FSAs no longer can be used to reimburse costs for over-the-counter medications unless the employee has a prescription for the medication. This change was effective January 1, 2011. Legislation introduced in both chambers of Congress would repeal this provision. Thus, Health FSA funds would once again be permitted to reimburse an employee for the purchase of over-the-counter medications. The bills can be found here and here.

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