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Corporate and Financial Weekly Digest

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SEC/CORPORATE

SEC Adopts Proxy Rule Changes to Notice and Access Model

On February 22, the Securities and Exchange Commission adopted final rule changes to its notice and access proxy solicitation model (also known as the "notice-only option") which provides for Internet availability of proxy materials following the provision to shareholders of a notice of Internet availability. The amendments to Exchange Act Rule 14a-16, which governs use of the notice-only option, aim to facilitate shareholders' understanding of the proxy solicitation process and to improve shareholder response rates, which have been lower when companies have used the notice-only option than when companies mail a full set of proxy materials to shareholders. The final rules include several revisions to the proposed rule changes previously reported in the October 16, 2009, edition of *Corporate and Financial Weekly Digest*.

The final rule changes include amending Rule 14a-16(d) to eliminate the requirement to include a specific legend regarding the purpose of the notice, the online availability of proxy materials and the process for obtaining paper copies. The amended rule requires notices to address these topics without specifying the exact language to be used. In response to comment letters, new Rule 14a-16(d)(2) requires that the notice (1) indicate that it is not a form for voting and presents only an overview of the proxy materials, and (2) encourage shareholders to review the proxy materials before voting.

New Rule 14a-16(f)(2)(iv) allows companies and soliciting shareholders to include along with the notice an explanation of the process of receiving or reviewing proxy materials and voting, as proposed. The SEC also incorporated commenters' suggestions to permit companies and soliciting shareholders to explain to shareholders the reasons for using the notice-only option. Furthermore, in its adopting release, the SEC confirmed prior guidance that the notice need not directly mirror the proxy card in form.

Additionally, as proposed in its earlier release, the SEC amended Rule 14a-16(l)(2)(ii) to require a soliciting person other than the issuer electing to use the notice-only option to file a preliminary proxy statement within 10 days after the issuer files its definitive proxy statement, and to send its notice to shareholders no later than the date such soliciting person files its definitive proxy statement.

Click here for the SEC's release regarding the new proxy rules.

SEC Issues Technical Corrections to Recent Rule Amendments

On February 23, the Securities and Exchange Commission made technical corrections to rule amendments adopted on December 19, 2009, in the areas of corporate governance and proxy disclosure. The SEC corrected Forms 10-Q and 10-K to retain the current numbering of the items appearing in each form (rather than renumbering such items as provided in the December 19 amendments). Registrants should insert "Reserved" for Part II, Item 4 of the Form 10-Q and for Part I, Item 4 of the Form 10-K from and after March 1. In addition, the SEC corrected Form 8-K to add an instruction that allows certain wholly owned subsidiaries to omit disclosure of shareholder voting results

Click here to view the text of the SEC's corrections to its December 19 rule amendments.

LITIGATION

Employer Not Named in Employment Agreement Can Enforce Arbitration Clause

The U.S. District Court for the Southern District of Florida held that a scrivener's error identifying the wrong entity as employer did not preclude enforcement of an arbitration clause in an employment agreement.

Florida resident Eldiberto Garcia brought a Fair Labor Standards Act claim against his former employer Mason Contract Products, LLC, which then sought to compel arbitration in New York pursuant to a written employment agreement signed by Mr. Garcia. The agreement incorrectly identified MRC Industries—a company affiliated with Mason but neither its parent nor subsidiary—as employer. Although the company official who signed the document was a principal of both Mason and MRC, the document made no reference to Mason, and thus Mr. Garcia argued that Mason could not compel him to arbitrate in New York.

The district court stated that it was "personally sympathetic with Garcia," but held that precedent compelled enforcement on the grounds of estoppel, noting that "arbitration agreements are widely and broadly enforced in the Eleventh Circuit." (*Garcia v. Mason Contract Products, LLC*, No. 08 Civ. 23103, 2010 WL 520805 (Feb. 9, 2010))

Unwitting Beneficiaries of Ponzi Scheme Cannot Discharge Debt Under Chapter 7

Beneficiaries of a Ponzi scheme who were subsequently found liable to cheated investors under state securities laws could not discharge this liability under Chapter 7 of the Bankruptcy Code, the U.S. District Court for the Western District of Oklahoma ruled.

Two unwitting investors in a $9 million Ponzi scheme who benefited from the fraud were sued by those who lost money, and a state court found the investors liable for unjust enrichment pursuant to the Oklahoma Uniform Securities Act, Okla. Stat. tit. 71 Section 1-101 *et. seq*, requiring them to disgorge the profits received from the scheme.

The investors sought to discharge this debt by filing Chapter 7 bankruptcy actions. The Bankruptcy Court held that debts stemming from violations of state securities laws are not dischargeable. The investors appealed, arguing that they did not directly violate the Oklahoma statute, but the district court affirmed, holding that the Oklahoma statute provides for disgorgement of profits despite the absence of wrongful intent. (*Okla. Dept. of Secs. ex rel. Faught v. Matthews*, No. 09 Civ. 185-D, 2010 WL 567837 (W.D.Okla. Feb. 10, 2010)); (*Okla. Dept. of Secs. ex rel. Faught v. Wilcox*, No. 09 Civ. 186-D, 2010 WL 567988 (W.D.Okla. Feb. 10, 2010))

BROKER DEALER

SEC Adopts Uptick Rule Restricting Certain Short Sales

The Securities and Exchange Commission has adopted the alternative uptick rule (Rule 201) restricting short selling on any stock that has dropped more than 10% in one day. The "circuit breaker" under Rule 201 would be triggered for a security any day in which its price declines by 10% or more from the prior day's closing price. Once the circuit breaker has been triggered for a security, short selling would only be permitted when the price of that security is above the current national best bid for the remainder of the day as well as the following day.

Rule 201 generally applies to all equity securities that are listed on a national securities exchange, whether traded on an exchange or in the over-the-counter market, and requires trading centers to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the execution or display of a prohibited short sale. Rule 201 will become effective 60 days after the date of publication of the release in the *Federal Register*, and then market participants will have six months to comply with the requirements. Publication in the *Federal Register* is expected shortly.

The SEC press release announcing the rule can be obtained by clicking here.

Click here to read an August 2009 Katten *Client Advisory* for information on proposed short sale restrictions previously considered by the SEC.

SEC Approves Amendments to FINRA Rules Governing Expedited Proceedings

The Securities and Exchange Commission has approved amendments to the Financial Industry Regulatory Authority Rule 9550 Series, which provides a procedural mechanism for FINRA to address certain types of misconduct more quickly than would be possible using the ordinary FINRA disciplinary process. The amendments modify various time requirements regarding expedited proceedings, add an expedited proceeding for failure to pay restitution and harmonize a remedy in an expedited procedure with a remedy in the FINRA By-Laws. The amendments become effective March 25.

Click here to read FINRA Regulatory Notice 10-13.

FINRA Provides Guidance from SEC on FAS 167 for FOCUS Reporting

The Financial Industry Regulatory Authority has issued Regulatory Notice 10-12 providing members with guidance from the Securities and Exchange Commission's Division of Trading and Markets on the procedures for reporting adjustments on the FOCUS Report resulting from the Financial Accounting Standard Board's Statement of Financial Accounting Standards No. 167 (FAS 167) *Amendments to FASB Interpretation No. 46(R)*. FAS 167, among other things, established new standards for reporting transfers of assets to special-purpose entities, known as variable interest entities (VIEs) under Generally Accepted Accounting Principles, and for consolidating VIEs. Firms are required to consider the impact of the FAS 167 provisions on all future FOCUS Report filings, commencing with the January 2010 FOCUS Report.

Click here to read FINRA Regulatory Notice 10-12.

FINRA to Amend Arbitration Rules Regarding Deficient Claims

The Financial Industry Regulatory Authority has amended its Codes of Arbitration Procedure for Customer and Industry Disputes to clarify that if a claim deficiency is corrected within 30 days from the time a party receives notice of a deficiency, the claim will be considered filed on the date the initial statement of claim was filed. The amendments become effective on March 22 and apply to claims filed on or after that date.

Click here to read FINRA Regulatory Notice 10-11.

PRIVATE INVESTMENT FUNDS

Please see "Deadline for Annual Form ADV Update Approaches" in **Investment Companies and Investment Advisers** below.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

Deadline for Annual Form ADV Update Approaches

For investment advisers registered with the Securities and Exchange Commission, the annual updating amendment of Form ADV Parts 1 and II must be completed, and Form ADV Part 1 must be filed electronically through the Investment Adviser Registration Depository (IARD), within 90 days after such investment advisers' fiscal year-end. March 31, 2010, is therefore the filing deadline for an investment adviser whose last fiscal year ended December 31, 2009. Form ADV Part II is not filed with the SEC but is deemed filed once finalized. If an adviser is registered in a state that requires an annual amendment, the state-registered adviser also should file the annual updating amendment within 90 days after its fiscal year-end.

In recent years the SEC has waived any IARD annual filing fees. However, this year, SEC-registered advisers must pay an annual filing fee, which will be based on assets under management. The filing fees for the annual amendment filing are $40 for assets under management which are less than $25 million, $150 for assets under management between $25 million and $100 million, and $200 for assets under management which are more than $100 million.

BANKING

Fed Explains New Overdraft Rules for Debit and ATM Cards

A new online Federal Reserve Board publication will help consumers better understand rules that provide additional protection when a debit card or automated teller machine (ATM) transaction causes an account to be overdrawn.

Federal Reserve Board rules that take effect on July 1 prohibit financial institutions from charging overdraft fees for ATM and one-time debit card transactions unless a consumer consents, or opts in, to the overdraft service for those types of transactions. “What You Need to Know: New Overdraft Rules for Debit and ATM Cards” provides an explanation of how the rules will affect existing and new account holders. It contains basic information about types and typical costs of overdraft services and defines common terms consumers may encounter in communications from their banks about overdrafts.

Under the Board’s rules, financial institutions must provide consumers a notice that explains the financial institution’s overdraft services, including the fees associated with the services, and the consumer’s choices. Institutions will soon begin providing these notices, and this publication will help consumers understand how to use the information to make the best choices regarding overdraft services.

The publication is available here.

EXECUTIVE COMPENSATION AND ERISA

Employers Should Note White House Attempt to Revive Health Care Reforms

The White House has released a health care reform plan similar to legislation passed by the Senate in December, and the plan might be headed to the budget reconciliation process for approval. Several provisions in the White House plan are of particular interest to employers.

Under the White House proposal, no mandate would be imposed on employers to provide health care coverage, but most employers would be required to defray the cost if employees enroll in the health exchange established by the proposal. Small businesses would receive $40 billion in tax credits to support coverage for their employees beginning in 2010, and employers with fewer than 50 employees would be exempt from any employer responsibility requirements. The individual mandate for coverage is retained, but the assessments are lowered for those who choose not to become insured.

The tax on so-called “Cadillac plans” is based on the proposal in the Senate bill, which was negotiated with key unions. However, the threshold premium for tax would be raised from $8,500 for singles to $10,200 and from $23,000 for families to $27,500, and would index these amounts for subsequent years at general inflation plus 1%. The provisions would become effective in 2018. Premiums for dental and vision benefits are excluded.

The proposal also provides for a federal authority called the Health Insurance Rate Authority to regulate health insurance premiums. The proposal retains the state-based health insurance exchange and does not contain a public health insurance option.

It is possible for the Senate to use the budget reconciliation process to enact health care reforms, which would allow changes in the Senate bill with a simple majority instead of the 60 votes needed to stop filibusters. However, provisions not directly related to the budget (e.g., creation of the Health Insurance Rate Authority) could not be included in a reconciliation package.

The saga continues with no clear vision of what the final result might be.

More information about the White House proposal can be found here.

UK DEVELOPMENTS

FSA Hedge Fund Surveys Conclusions Published

On February 23, the UK Financial Services Authority (FSA) published a report entitled "Assessing possible sources of systemic risk from hedge funds." The report sets out the FSA's key findings and conclusions from two surveys it conducted in October 2009—the Hedge Funds as Counterparties Survey (HFACS) and the Hedge Fund Survey (HFS). The FSA intends to continue conducting these surveys every six months to help monitor trends in hedge funds.

The HFACS has been conducted every six months since 2005. It asks some of the largest FSA-authorized banks with exposures to hedge funds about their credit counterparty risks.

The HFS was introduced in October 2009 to complement the HFACS. It surveyed the 50 largest FSA-authorized investment managers representing about 20% of the global industry. The survey asks questions about the assets the firms managed and the larger funds for which they undertake management activities.

The report's conclusions were that: "The HFACS data suggests that on 31 October 2009 major hedge funds did not pose a potentially destabilising credit counterparty risk across the surveyed banks. HFS data shows a relatively low level of 'leverage' under our various measures and suggests a contained level of risk from hedge funds at that time."

The FSA stated that it hoped that its "work in this area can contribute to the ongoing debate about" the proposed EU Alternative Investment Fund Managers Directive (AIFMD). The clear message sent by the FSA in making this statement is that the survey results, which indicate the low systemic risk posed by the hedge fund sector, should be preferred to the preconceptions of some of the politicians and others promoting aspects of the AIFMD proposals.

To read the report in full, click here.

FSA Fines Financial Advice Firm £700,000 for Failings Relating to Lehman-Backed Structured Product Sales

On February 25, the UK Financial Services Authority (FSA) published the Final Notice it has issued to RSM Tenon Financial Services (Tenon), fining it £700,000 (approximately $1,070,000) for significant failings in its advice and sales processes relating to Lehman-backed structured products and for having poor systems and controls to prevent unsuitable advice in its structured product and pension switching business. The fine was discounted by 30% because Tenon cooperated fully with the FSA and agreed to settle at an early stage in the investigation. Without the discount, the fine would have been £1,000,000 (approximately $1,500,000).

The FSA concluded that, in relation to its sales of Lehman-backed structured products, Tenon failed to treat some of its customers fairly. Tenon had breached two of the FSA's Principles for Businesses by failing to take reasonable care to organize and control its affairs responsibly and effectively and by failing to take reasonable care to ensure the suitability of its advice to its customers. In addition, in relation to Tenon's structured products and pension switching business more generally, the FSA found that the firm failed to have effective risk management systems in place to manage and control its affairs, and it ultimately failed to minimize or prevent the risk of unsuitable sales.

In addition to the fine, the FSA has required Tenon to:

- Conduct a past business review of all sales of Lehman-backed structured products. Customers who received unsuitable advice will be able to sell their investment back to Tenon and to receive reimbursement of their money invested plus interest.
- Review sales of other structured products between November 2007 and December 2009 and pay appropriate redress where unsuitable advice was given
- Conduct a review of pension switching business it transacted between April 2006 and December 2009 to assess the suitability of recommendations made to customers and, if appropriate, implement a customer redress program
- Commission a "skilled person review" of its current sales and compliance processes to assess their appropriateness and the suitability of recommendations made to customers.

The FSA will oversee the business reviews and the redress process that it has ordered, and an independent third party will also review the work undertaken by Tenon.

This is the first enforcement action resulting from the FSA's review of the marketing and distribution of structured products, particularly those backed by Lehman Brothers entities, which was concluded in October 2009.

To read the Final Notice in full, click here.

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