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Corporate and Financial Weekly Digest

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SEC/CORPORATE

SEC Adopts Final Rules on Shareholder Advisory Vote on Executive Compensation for TARP Recipients

On January 12, the Securities and Exchange Commission adopted final rules that require companies which have received financial assistance under the Troubled Asset Relief Program (TARP) to include in their proxy statement a separate shareholder vote on executive compensation as required to be disclosed under Item 402 of Regulation S-K. Under the TARP provisions, the vote is nonbinding. The proposals to these amendments were previously reported in the July 2, 2009, edition of *Corporate and Financial Weekly Digest*.

In response to comments received on the proposed rules, the SEC has also amended Rule 14a-6(a) under the Exchange Act to clarify that TARP recipients will not be required to file a preliminary proxy statement because of inclusion of the required separate shareholder vote on executive compensation. Also, new Rule 14a-20 under the Exchange Act has been modified from the proposal to clarify requirements for TARP recipients that are smaller reporting companies. The separate TARP shareholder vote does not require compensation discussion and analysis (CD&A) by a smaller reporting company eligible to omit CD&A under the scaled disclosure provisions of Item 402 of Regulation S-K.

The final rules are effective 30 days after publication in the *Federal Register*.

Click here for the Final Rule Release No. 34-61335.

SEC Issues New Interpretations on Use of Non-GAAP Financial Measures and Item 2.02 of Form 8-K

On January 11, the Securities and Exchange Commission's Division of Corporation Finance issued new Compliance and Disclosure Interpretations (C&DIs) on rules, regulations and forms related to non-generally accepted accounting principles (GAAP) financial measures Item 2.02 of Form 8-K. In particular, the C&DIs addressed the use of non-GAAP measures in the context of business combinations, and offered further guidance with respect to Item 10(e) of Regulation S-K (which governs the use of non-GAAP financial measures in SEC filings); the reporting of segments; earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA); foreign private issuers and voluntary filers and disclosures under Item 2.02 of Form 8-K, regardless of whether the disclosure includes non-GAAP measures.

The C&DIs supersede the SEC's Frequently Asked Questions regarding the use of non-GAAP financial measures published in June 2003 and incorporate some of the SEC's prior guidance on these matters.

In addition to the restatement of the SEC's previously published interpretations, the C&DIs included the following new guidance:

- The SEC clarified that if material non-public information is disclosed on a company's earnings conference call which was not previously addressed in the earnings release for such call, then the company's obligation to disclose such information pursuant to Item 2.02 of Form 8-K is limited only to such information which was not published in the earnings release and that the filing of the transcript of that portion would satisfy the requirement.
- The SEC confirmed that Item 10(e) of Regulation S-K applies to free-writing prospectuses included in or incorporated by reference into a registration statement or other filing under the Securities Exchange Act of 1934, but does not apply to other free-writing prospectuses.
- The SEC stated that, for purposes of reconciling non-GAAP measures, it is not appropriate to present a full non-GAAP income statement, as doing so may attach undue influence to the non-GAAP information.
- The SEC affirmed that, when reconciling a non-GAAP performance measure, a company may present an

adjustment "net of tax" so long as issuer discloses both the tax effect of each reconciling item and how the tax effect was calculated.

- The SEC stated that a table illustrating a breakdown of revenues by product, which revenues do not sum to the amounts set forth in the company's financial statements, is not considered a non-GAAP financial measure so long as the product revenue amounts are calculated in accordance with GAAP.
- The SEC clarified that "funds from operations" may be presented on a basis other than as defined and clarified by the National Association of Real Estate Investment Trusts as of January 1, 2000, provided that any adjustments made to "funds from operations" comply with the requirements of Item 10(e) of Regulation S-K for a performance measure or liquidity measure, as applicable.

Click here to view the new C&DIs with respect to the use of non-GAAP financial measures.

LITIGATION

Dismissal of Securities Fraud Claim Involving Hurricane Katrina Losses Affirmed

The U.S. Court of Appeals for the Second Circuit affirmed the district court's dismissal of a securities fraud class action suit brought against defendant PXRE Group, Ltd. (a reinsurance company) and its officers and directors because plaintiffs failed to adequately plead scienter.

Plaintiffs' claims for securities fraud, brought under Sections 10(b) and 20(a) of the Securities and Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5, stemmed from the individual defendants' representations regarding PXRE's potential loss exposure from Hurricane Katrina. The district court granted defendants' motion to dismiss because the complaint failed to raise a strong inference of scienter, which requires allegations that defendants had the motive and opportunity to commit fraud, or strong circumstantial evidence of conscious behavior or recklessness.

On appeal, plaintiffs asserted that the district court erred by, among other things, failing to find that the magnitude of PXRE's understatement of losses did not support scienter, and by discounting defendants' motive and opportunity in making their alleged misstatements. The Second Circuit rejected plaintiffs' arguments and affirmed, holding that the plaintiffs' allegations failed to give rise to a strong inference that defendants acted with the requisite state of mind to support a securities fraud claim. (*Condra v. PXRE Group Ltd.*, No. 09-1370, 2009 WL 4893719 (2nd Cir. Dec. 21, 2009))

Fraud Claim Fails for Lack of Material Misrepresentation and Damages

The U.S. Court of Appeals for the Seventh Circuit affirmed the district court's dismissal of a fraud claim brought by plaintiff, a provider of home health care services, which purchased from defendant infrared lamps designed to relieve joint pain and improve circulation.

Plaintiff alleged that prior to purchasing the lamps, defendant's sales representative informed it that the lamps had been approved by the Food and Drug Administration for the treatment of peripheral neuropathy, a condition involving numbness and tingling in the extremities. Defendant disputed this claim and asserted that its sales representative stated only that the lamps had been approved by the FDA and not that the lamps had been approved for any specific purpose. The district court dismissed plaintiff's fraud claim because, among other things, plaintiff failed to present any evidence of damages stemming from the alleged fraud.

On appeal, the Seventh Circuit affirmed the district court's decision on the ground that even if plaintiff's allegations regarding defendant's sales representative's remarks were correct, the misrepresentation was immaterial, and thus no fraud claim could lie. The court noted that plaintiff had the expected results from the lamps because they relieved plaintiff's patients' symptoms from peripheral neuropathy. In addition, plaintiff replaced the defendant's lamps with another company's lamps, which, like plaintiff's lamps, were not approved by the FDA for treatment of the condition itself but only its symptoms. Because plaintiff could show neither material misstatement nor damages, the dismissal was affirmed. (*Nightingale Home Healthcare, Inc. v. Anodyne Therapy, LLC*, No. 09-2523, 2009 WL 4894242 (7th Cir. Dec. 21, 2009))

BROKER DEALER

FINRA Proposes New Consolidated Rules Relating to Stock Loans

The Financial Industry Regulatory Authority issued Regulatory Notice 10-03 requesting comment on proposals relating to FINRA rules governing securities loans and borrowing and permissible use of customers' securities and

callable securities. Proposed FINRA Rule 4314 sets forth requirements that would be applicable to a member firm that is a party to an agreement for the loan or borrowing of securities. Proposed FINRA Rule 4330 sets forth requirements that would be applicable to a member firm's borrowing or lending of a customer's margin securities that are eligible to be pledged or loaned. Finally, proposed FINRA Rule 4340 sets forth obligations that would be applicable to any callable securities a member firm has in its possession or control. Comments are due to FINRA by March 5.

Read more.

SEC to Seek Public Comment in Equity Market Structure Concept Release

The Securities and Exchange Commission voted on January 13 to undertake a far-reaching review of the current equity market structure. The initiative was in response to widely recognized industry changes that have occurred in connection with recent trends away from floor-based trading to sub-millisecond electronic markets. The SEC approved the issuance of a concept release prepared by staff that would address, among other things, issues relating to high frequency trading strategies, co-location of trading servers and the proliferation of "dark pools" that do not publicly display price quotations. Chairman Mary Schapiro stated that "we must continually assess how changes in the market are affecting investors... and try to understand how these changes may impact the markets in the future, so we can steer clear of any unnecessary risks to investors." Public comments are due within 90 days after the concept release is published in the *Federal Register*.

In connection with the Commission's vote on the concept release, it also (1) voted to approve the proposal of a new SEC rule that would effectively ban broker-dealers from providing customers with "naked" access to markets and (2) approved a new Nasdaq rule that requires broker-dealers offering sponsored access to Nasdaq to establish certain controls over the financial and regulatory risks of that activity.

Click here to read more about the concept release.
Click here to read more about the new market access rule.

CFTC

CFTC Proposes Position Limits and Exemptions for Certain Energy Contracts

At an open meeting on January 14, the Commodity Futures Trading Commission voted 4 to 1 (Commissioner Sommers dissenting) to propose rule amendments that would establish federal speculative position limits for futures and options contracts on Henry Hub natural gas, light sweet crude oil (West Texas Intermediate), New York Harbor No. 2 heating oil, and New York Harbor gasoline blendstock. The CFTC's notice of proposed rulemaking would establish (1) exchange-specific all-months-combined and single-month limits for economically similar contracts in the same commodity that settle in the same manner (e.g., New York Mercantile Exchange (NYMEX) physically settled futures, options and calendar spreads on Henry Hub Natural Gas), (2) aggregate all-months-combined and single-month limits that apply across all reporting markets and all settlement methods (e.g., NYMEX physically and cash-settled Henry Hub Natural Gas contracts and IntercontinentalExchange (ICE) cash-settled Henry Hub Natural Gas Swap contracts), and (3) aggregate spot-month limits, consistent with exchange-set spot month position limits set by NYMEX and ICE for the affected commodities beginning with the February 2010 contract month. The federal limits would supplement existing exchange-set position limits and position accountability levels.

The CFTC's proposed non-spot month position limits would be calculated based on open interest, while the proposed spot-month limits would be based on estimated deliverable supply, and would in each case be reset on an annual basis. The limits would not apply to basis contracts and diversified commodity index futures contracts.

The proposal includes a bona fide hedging exemption from the proposed position limits for traders hedging commercial risks, a limited risk management exemption for swap dealers, and an exemption for certain delta-adjusted positions. In addition, the proposal would require aggregation at the owner level, rather than permitting disaggregation for positions controlled by "independent account controllers."

The CFTC has requested comment on its proposed rules, as well as numerous related issues, including (1) the potential application of the newly proposed position limit regime to various other commodities, including agricultural commodities, soft commodities and precious metals, (2) how pending legislation, which would permit the CFTC to set position limits for over-the-counter and certain foreign-listed instruments, should be taken into account in proposing federal speculative position limits, (3) whether large, passive, unleveraged and long-only positions in futures contracts should be subjected to different regulatory standards, and (4) the feasibility of a "look-through" exemption from speculative position limits for swap dealers (i.e., granting an exemption to swap

dealers who are offsetting risks from swaps with counterparties that would have been entitled to a hedge exemption had they hedged their own exposure directly).

The comment period for the CFTC notice will end 90 days after the date of its publication in the *Federal Register*.

Information regarding the CFTC proposal, including links to the notice of proposed rulemaking and related documentation is available here.

CFTC Seeks Public Comment on Proposed Retail Forex Regulations

The Commodity Futures Trading Commission has published for comment proposed regulations concerning the offer and sale of over-the-counter foreign currency transactions to retail customers. The proposed regulations require the registration of counterparties offering retail foreign currency contracts as either retail foreign exchange dealers (RFEDs) or, if otherwise primarily or substantially engaged in exchange-traded futures transactions, futures commission merchants (FCMs). The proposed regulations, which Congress required the CFTC to adopt in the CFTC Reauthorization Act of 2008, would establish, among other things, registration, disclosure, recordkeeping, financial reporting, minimum capital and other operational standards.

Persons who solicit orders, exercise discretionary trading authority and operate pools with respect to retail forex would also be required to register, as introducing brokers, commodity trading advisors, commodity pool operators or as associated persons of such entities, as appropriate. Current exemptions from registration as a commodity pool operator or commodity trading advisor would generally continue to apply, however. Permitted counterparties that are otherwise regulated, such as financial institutions and SEC-registered brokers or dealers, would not be subject to regulation under the proposal.

The proposed regulations also require FCMs and RFEDs to maintain net capital of $20 million plus 5% of the amount, if any, by which liabilities to retail forex customers exceed $10 million. Leverage in retail customer accounts would be subject to a 10-to-1 limitation.

The CFTC press release can be found here.
The *Federal Register* entry for the proposed regulations can be found here.

BANKING

FDIC Releases Proposed Rule Incorporating Employee Compensation Structures into Risk Assessment System

On January 12, the Federal Deposit Insurance Corporation (FDIC) released an advance notice of proposed rulemaking (ANPR) seeking comment regarding whether certain employee compensation structures pose risks that should be part of the calculation determining an insured depository institution's deposit insurance premiums.

According to the releasing materials, the FDIC does "not seek to limit the amount which employees are compensated, but rather is concerned with adjusting risk-based deposit insurance assessment rates (risk-based assessment rates) to adequately compensate the Deposit Insurance Fund for the risks inherent in the design of certain compensation programs."

The ANPR includes 15 questions for which the agency seeks specific public comment. Comments are due 30 days after publication in the *Federal Register*.

For more information, click here.

EXECUTIVE COMPENSATION AND ERISA

DOL Issues Updated COBRA Subsidy Notices

Under the Consolidated Omnibus Budget Reconciliation Act (COBRA), certain group health plan participants who lose their coverage are permitted to continue coverage for a period of time by paying the premium themselves. The American Recovery and Reinvestment Act of 2009 (ARRA) provided a subsidy to certain eligible individuals for 65% of their COBRA premiums. ARRA was recently amended by the Department of Defense Appropriations Act of 2010 (DDAA), which made several significant changes to ARRA's original COBRA subsidy—including extending the subsidy from 9 to 15 months, and allowing an additional two months for individuals to qualify for the subsidy. Katten recently published a *Client Advisory* discussing such changes in detail.

The DDAA amendments require plan administrators to issue notices to certain individuals about the COBRA subsidy, and DDAA's changes thereto. To help plan administrators comply with DDAA's updated notice requirements, the Department of Labor (DOL) has created three updated model notices, each of which is designed for a particular group of individuals and contains information to help satisfy the notice provisions added by DDAA.

The updated model notices include the General Notice, the Premium Assistance Extension Notice and the Alternative Notice. The General Notice should generally be used going forward, as it contains information regarding the COBRA subsidy, as well as information required in a COBRA election notice. The Premium Assistance Extension Notice should be provided to individuals who have already received a COBRA election notice that did not include information regarding the extended subsidy. The Updated Alternative Notice should be provided by insurance issuers that provide group health insurance coverage to persons who became eligible for continuation coverage under a state law. In each case, the notices may require edits to ensure their accuracy.

The DOL's updated model COBRA subsidy notices can be found here.

UK DEVELOPMENTS

FSMT Decides That Research Analyst and Spread Better Friend Committed Market Abuse

On January 11, the UK Financial Services Authority (FSA) announced that a former research analyst and his friend have been found to have committed market abuse by using inside information to carry out a series of profitable spread bets.

During the summer of 2004, Mr. Chhabra was a research analyst at Evolution Securities Limited, a stockbroker. His friend, Mr. Patel, was an experienced spread better who regularly placed bets on FTSE indices. Following a thorough investigation into the activities of the two friends, both of whom were FSA Approved Persons, the FSA found that on three separate occasions Mr. Chhabra had become aware of important confidential information relating to listed companies. Mr. Chhabra had then contacted Mr. Patel, often within minutes of receiving the information, and shortly afterwards Mr. Patel had placed bets on the stocks of the listed companies concerned. The total benefit to Mr. Patel was found to be £85,541 (approximately $139,160).

The FSA found that they had committed market abuse and proposed to ban and fine them both. The pair referred the FSA's findings to the Financial Services and Markets Tribunal (FSMT). The FSMT is the independent judicial body which hears references from the FSA's decision notices regarding regulatory or disciplinary matters. Any firm or individual to whom an FSA decision notice is directed has the right to refer the matter to the FSMT, and the FSMT then determines what is the appropriate action for the FSA to take.

The FSMT confirmed the FSA's findings of market abuse. A separate hearing will take place to confirm the appropriate action to take against Mr. Chhabra and Mr. Patel.

To read the decision in full, click here.

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