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Corporate and Financial Weekly Digest

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SEC/CORPORATE

SEC Proposes Amendments to Safe Harbor Rule for Equity Repurchases

On January 26, the Securities and Exchange Commission proposed amendments to Exchange Act Rule 10b-18, which provides a safe harbor for an issuer's repurchase of its equity securities on the open market. The proposed changes are intended to clarify and update the safe harbor provisions to reflect significant trading and market developments since the rule's initial adoption in 1982.

Rule 10b-18 provides a safe harbor for an issuer's purchases of its own shares on a given day, so long as the issuer satisfies certain manner, timing, price and volume conditions for all repurchases on that day. The SEC's proposed changes include the following:

- *Repurchases Using VWAP*. The repurchase safe harbor is currently limited to purchases for which the bid or purchase price is no higher than the highest independent bid or last independent transaction price, whichever is higher. The proposed amendment would also allow for repurchases using the volume weighted average price (VWAP) of the security, provided that, among other items, (1) the security is an "actively-traded security" as defined in Rule 101(c)(1) of Regulation M, (2) VWAP purchases are entered into or matched before the regular trading sessions, and the execution prices of VWAP-matched trades are determined based on a full trading day's volume, and (3) the issuer's VWAP purchases do not exceed 10% of the security's average daily trading volume and are not effected to manipulate the price or trading volume of the security.
- *"Flickering Quotes" Exception*. According to the current Rule 10b-18, if an issuer fails to meet all manner, timing, price and volume conditions with respect to any repurchase of its securities during a given day, then all of the issuer's repurchases for that day are disqualified from the safe harbor. The SEC's proposal excludes from this disqualification any instances where an issuer's repurchase satisfies the rule's price conditions upon entry of the order, but solely due to "flickering quotes" (rapid changes in the national best bid), fails to satisfy the rule's price condition upon execution. In such event, only the nonconforming trade (and not all of the day's repurchases) would be disqualified from the safe harbor.
- *Additional Timing Restrictions*. Rule 10b-18 presently states that an issuer's repurchase may not be the opening purchase reported in the consolidated system to qualify for the safe harbor. The SEC's proposal would add to such restriction opening purchases in the principal market for the security and in the market in which the purchase is effected. These changes are intended to diminish any effect that opening purchases in the relevant markets may have to signal the trading direction of a security.
- *Merger Exclusion*. With respect to special purpose acquisition company (SPAC) repurchases of its securities, the current safe harbor provision does not apply to purchases made from the public announcement of a merger or acquisition until the earlier of the closing of the transaction or the completion of the target's shareholders' vote on such transaction. The proposed amendment would set the end date for such excluded period as the completion of both the target's and the SPAC's shareholders' votes with respect to the transaction. Other provisions permitting SPACs to avail themselves of the Rule 10b-18 safe harbor provided in the current rule will remain unaffected.

The SEC is also seeking comment on whether expanding the price condition of Rule 10b-18 to include repurchases through electronic trading systems that use passive or independently derived pricing mechanisms would be appropriate. Public comments on the proposed rule amendments must be received by the SEC within 60 days after their publication in the *Federal Register*.

Click here to view the full SEC release proposing these amendments.

SEC Approves Interpretive Guidance on Disclosure Related to Climate Change

At a January 27 Open Meeting, the Securities and Exchange Commission, by a 3-2 vote, approved guidance on disclosure related to the effects on public companies of climate change and regulation concerning climate change.

In particular, the guidance seeks to clarify the responsibility of companies to disclose, where material:

- the direct and indirect effects on a registrant's business, financial condition and results of operations of, and the risks related to, existing and pending environmental regulation and legislation;
- the effects on a registrant's business of, and the risks related to, international accords and treaties related to climate change;
- the actual and potential, direct and indirect consequences (or opportunities) resulting from climate change and legal, business, political and scientific developments related to climate change, such as the effect on demand for a company's products of "green" technologies and products used or sold by the registrant or its competitors and the effect of such developments on a company's reputation; and
- the effect on a company's business and operations related to physical changes to the planet caused by climate change, such as rising seas, stronger storms and increased drought—the effects may be impaired production or distribution of products or damage to a company's property, plant or equipment.

The staff of the SEC noted that, in order to evaluate whether disclosure regarding the effects of pending climate change regulation (such as the federal cap and trade legislation) is required, registrants need to consider whether they have effective systems for collecting information about their emissions. Therefore, "management should ensure that it has sufficient information regarding the registrant's greenhouse gas emissions and other operational matters to evaluate the likelihood of a material effect arising from the subject legislation or regulation."

Mary Schapiro, Chairman of the SEC, indicated that the interpretive guidance was not intended to amend or expand existing disclosure requirements, or alter the threshold for materiality. Rather, the SEC expressed the view that the guidance is intended to ensure that existing disclosure requirements are consistently applied to matters related to climate change. Specifically, the SEC indicated that disclosure regarding the material effects of climate change and climate change regulation already exist in Regulation S-K under Items 101 (which, among other things, requires disclosure regarding the effects of regulation and information regarding planned expenditures), 103 (which requires disclosure of legal proceedings), 503 (risk factors) and 303 (management's discussion and analysis of, among other things, material trends effecting the registrant's business)

Finally, the SEC noted that the guidance represented a "first step" in addressing disclosure related to climate change and indicated that it would consider further action in the area of environmental disclosure in the future.

The SEC intends to publish the guidance described above as soon as possible.

Click here to view the SEC's press release regarding the guidance described above.
Click here to view the text of Chairman Schapiro's remarks regarding the guidance described above.
Click here to view the text of Commissioner Luis Aguilar's remarks regarding the guidance described above.
Click here to view the text of Commissioner Elisse Walter's remarks regarding the guidance described above.

LITIGATION

Third Circuit Holds That Non-Compete Clauses Survive a Change in Corporate Ownership

The U.S. Court of Appeals for the Third Circuit has held that a non-compete clause is enforceable by a corporation after it has undergone "a substantial change in stock ownership." Matthew Wood joined Zambelli Fireworks Manufacturing Company, Inc. (Zambelli) in 2001, when the company was a family business. When he joined Zambelli, Mr. Wood signed an employment agreement that contained a two-year non-compete clause and later agreed to a new agreement with similar, but more comprehensive, restrictive covenants.

In May 2007, a major sale of Zambelli's stock took place, pursuant to which the Zambelli family sold their interest to one remaining family member and a holding company comprised of private investors. Unhappy with the change, Mr. Wood sought new employment shortly after the transaction was consummated and, in early 2008, went to work for a competitor, Pyrotecnico F/X LLC (Pyrotecnico). Zambelli sued both Wood and Pyrotecnico to enforce the non-compete clause and the district court, sitting in diversity, granted an injunction against the defendants, who appealed.

Mr. Wood argued that the non-compete clause he signed in 2001 was no longer valid because the family-owned entity that executed the agreement was required to assign the non-compete agreement to the "purchasing business entity" after the majority of Zambelli's stock was sold. The Third Circuit rejected this argument, ruling that a stock sale—unlike a sale of assets—does not alter the corporate entity and that, as a result, no assignment was necessary. In so ruling, the court pointed out that a change in corporate culture is not equivalent to a change in the corporate entity and has no effect on a legally binding contract. Accordingly, the court ruled that Zambelli and its new ownership could enforce the non-compete agreement against Mr. Wood. (*Zambelli Fireworks Mfg. Co. v. Wood*, Civ. No. 09-1526, 2010 WL 143682 (3d Cir. Jan. 15, 2010))

Court Upholds Forum-Selection Clause in Independent Contractor's Contract

The U.S. District Court for the Northern District of Texas has ruled that the breach of contract claims asserted by several of the company's sales agents were covered by forum-selection clauses in their contracts, rejecting the sales agents' argument that the clauses were unenforceable. The agents were independent contractors that provided sales services for Smith & Nephew, Inc. (Smith), a medical supplies company. When Smith terminated its contracts with the sales agents, the agents asserted a number of claims against Smith, including claims for breach of contract.

In its January 19 ruling, the district court granted Smith's motion to transfer venue for the breach of contract claims to Tennessee, where Smith's headquarters are located, pursuant to forum-selection clauses in the parties' contracts. The agents had argued that the forum selection clauses were unenforceable on two primary grounds: (1) that Smith's alleged material breach of the parties' contracts prohibited it from enforcing the forum selection clauses and (2) the clauses were unreasonable and unjust because the majority of the witnesses were located in Texas, not Tennessee, and because the agents were coerced into accepting the clauses to secure employment with Smith. The court rejected each of these arguments.

First, the court held that a defendant's alleged breach of contract will not invalidate the contract's forum selection clause, particularly where the plaintiff was asserting claims under the same contract. Second, the court noted that the fact that the majority of witnesses were located in another forum did not, by itself, provide grounds for invalidating a forum selection clause. Finally, the court found that Smith's insistence that the forum selection clauses be included in the parties' contracts was a factor in favor of enforcement as it demonstrated that it was an important term that was the result of legitimate bargaining between the parties. As a result, the court enforced the forum-selection clauses and transferred the breach of contract claims to Tennessee, but retained jurisdiction over the agents' other claims, which it dismissed with leave to replead. (*Redden v. Smith & Nephew, Inc*., Civ. No. 3:09-1380-L, 2010 WL 184428 (N.D. Tex. Jan. 19, 2010))

BROKER DEALER

FINRA Issues Guidance Regarding Social Networking Websites

The Financial Industry Regulatory Authority, Inc. issued a Regulatory Notice providing guidance relating to social networking websites, blogs and other related communication methods. The question-and-answer format guidance touches on, among other things, member firm responsibilities in the areas of recordkeeping, the applicability of the suitability rule, and supervision of associated person participation on social web sites. The Notice was based on input FINRA received from a Social Networking Task Force (composed of FINRA staff and industry representatives) that examined the use of social media websites for legitimate business purposes. FINRA's stated goal was to flexibly interpret its rules in ways that allow firms to utilize new technologies without sacrificing investor protection concerns.

Read more.

NYSE and NYSE Amex Announce Sub-Penny Changes

The New York Stock Exchange, LLC (NYSE) and NYSE Amex LLC (NYSE Amex) announced that each market will begin quoting, trading and routing to other market centers bids and offers priced below $1.00 that contain a sub-penny component. The changes will become effective February 1. The changes were made in connection with approved changes to NYSE and NYSE Amex Equities Rules 62. Currently, a bid/offer received by either NYSE or NYSE Amex containing a sub-penny component is rounded down/up to the next round penny.

Read more.

PRIVATE INVESTMENT FUNDS

Please see "CFTC Chairman Remarks on OTC Derivatives Reform" in **OTC Derivatives** below.

OTC DERIVATIVES

CFTC Chairman Remarks on OTC Derivatives Reform

Commodity Futures Trading Commission Chairman Gary Gensler spoke on January 27 at Fordham University College of Business Administration regarding his belief that regulatory reform must be enacted to promote transparency and reduce risk in the over-the-counter (OTC) derivatives markets. Chairman Gensler stated that comprehensive OTC derivative reform should include the following regulation:

- explicitly require regulators to establish capital and margin requirements for all derivatives dealers;
- require derivatives dealers to meet business conduct standards that both protect the integrity of the market and lower risk from OTC derivatives transactions. Such standards should ensure the timely and accurate confirmation, processing, netting, documentation and valuation of all transactions;
- subject derivatives dealers to recordkeeping and reporting requirements for all of their OTC derivatives transactions—including a complete audit trail and mandatory reporting of trades; and
- require dealers to bring all of their standardized derivatives transactions onto transparent trading venues and to regulated clearinghouses.

Chairman Gensler also highlighted the following three recommendations to enhance their authorities in the futures and securities markets that were included in the October 2009 CFTC and Securities and Exchange Commission joint report on harmonization of regulation:

- establish requirements for commodity and futures dealers to avoid conflicts of interest similar to information firewalls between analyst and trading functions that currently exist for securities dealers;
- govern broker-dealers, investment advisers and commodity trading advisors by a uniform fiduciary standard that financial advice should be solely in the interest of the customer (these parties are currently subject to different fiduciary standards when providing investment advice); and
- ban misappropriated government information from use in commodity markets trading.

Chairman Gensler's speech can be found here.

CFTC

CFTC Releases Annual Report Guidance for Commodity Pool Operators

The Commodity Futures Trading Commission has issued its annual guidance letter to registered commodity pool operators (CPOs), intended to assist CPOs and their public accountants in the preparation and filing of annual financial reports. The letter covers a number of relevant topics, including recent amendments to relevant CFTC regulations, filing procedures and due dates, considerations applicable to master/feeder and fund of funds structures, exceptions to the use of generally accepted accounting principles, reporting requirements for pools in liquidation and series funds with limited liability among different series, and various accounting developments.

The CFTC press release can be found here.
The guidance letter can be found here.

CFTC Approves Registration of ICE Clear Europe Limited as a Derivatives Clearing Organization

The Commodity Futures Trading Commission has granted ICE Clear Europe Limited (ICE Clear Europe) registration as a derivatives clearing organization (DCO). ICE Clear Europe had been operating as a multilateral clearing organization pursuant to Section 409 of the Federal Deposit Insurance Corporation Improvements Act and, in that capacity, provided clearing services to qualified U.S. participants trading energy-based over-the-counter (OTC) derivatives contracts and credit default swaps on European reference entities. As a registered DCO, ICE Clear Europe will be permitted to clear futures contracts, options on futures contracts and options on commodities, in addition to OTC derivatives contracts. ICE Clear Europe is also a Recognized Clearing House in the UK and, among other products, clears futures contracts listed for trading on ICE Futures Europe.

The CFTC press release can be found here.
The order granting registration as a DCO can be found here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Adopts Money Market Fund Reforms

On January 27, the Securities and Exchange Commission adopted new rules designed to address weaknesses in the money market fund regulatory regime exposed by the recent financial crisis. The new rules seek to (1) reduce the level of risk taken by money market fund portfolio managers, (2) enhance disclosure of portfolio securities, and (3) improve money market fund operations.

With respect to reducing risk, the new rules establish minimum portfolio liquidity requirements (as a percentage of assets), increase limitations on a money market fund's ability to purchase "second tier" securities and shorten portfolio average maturity limits. In addition, portfolio managers will be required to develop procedures to anticipate the likelihood of large redemptions and to hold sufficiently liquid securities to meet foreseeable redemptions, conduct periodic stress tests and designate annually at least four Nationally Recognized Statistical Rating Organizations whose ratings the fund's board deems to be reliable.

The new rules require money market funds to post, on a monthly basis, their portfolio holdings on their websites and disclose them to the SEC through an interactive database. Disclosure to the SEC would include a money market fund's "shadow" net asset value (NAV) based on market prices, rather than the stable $1.00 NAV at which shareholder transactions are processed. In order to promote orderly liquidation, the new rules permit a money market fund's board of directors to suspend redemptions if the fund is about to "break the buck" and it elects to liquidate the fund. The rules also expand the ability of affiliates to purchase distressed assets in order to protect a fund against losses.

The new rules will become effective 60 days after publication in the *Federal Register*.

The SEC press release, which includes details on credit quality standards, maturity limits of portfolio securities and liquidity requirements, is available here.

BANKING

OCC Approves First Use of "Shelf Charter" to Acquire a Failed Bank

On January 22, the Office of the Comptroller of the Currency (OCC) announced its first use of a "shelf charter" for the acquisition of a failed bank, allowing Bond Street Bank, National Association (Bond Street), to acquire a failed Florida state-chartered bank. Specifically, Bond Street was allowed to acquire Premier American Bank, a state-chartered bank closed on the same day by the Florida Department of Financial Services, Division of Banking, which in turn appointed the Federal Deposit Insurance Corporation as receiver.

The "shelf charter" is a new mechanism that involves the granting of preliminary approval to investors for a national bank charter. The charter is inactive (i.e., on the "shelf") until such time as the investor group is in a position to acquire a troubled institution. By granting entities shelf charters, the OCC has expanded the pool of potential buyers available to troubled institutions.

Bond Street was granted its shelf charter on October 23, 2009.

For more information, click here.

ANTITRUST

DOJ Settles Gun-Jumping Case Arising from 2007 Merger

The Federal Trade Commission and the Department of Justice (DOJ) are ever vigilant to ensure that parties involved in a merger or acquisition do not "jump the gun," or combine their businesses until after the expiration of the Waiting Period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the Act). In the latest case, the DOJ found that parties had jumped the gun when, prior to the expiration of the Waiting Period, the target sought the consent of the acquirer with respect to contracts made in the ordinary course of business. This is a classic problem that parties to an acquisition face between the time of signing and closing. The case underscores the importance of the parties remaining independent prior to the expiration of the Waiting Period.

This particular action stems from the 2007 merger between Smithfield Foods, Inc. and Premium Standard Farms, LLC. The parties announced the proposed merger in September 2006 and made their respective filings under the Act in October 2006. In November 2006, the DOJ issued a Second Request for Information to the parties. This extended the Waiting Period until the parties complied with the Second Request. The Waiting Period finally expired on March 7, 2007, and the parties closed the transaction thereafter.

According to the DOJ's Complaint, during the Waiting Period, Premium Standard stopped exercising independent business judgment in the purchase of hogs, which it routinely made in the ordinary course of business. Instead, Premium Standard sought Smithfield's approval on three different multi-year hog purchase contracts. The DOJ's Complaint asserts that these contracts "were necessary to Premium Standard's on-going business and were entered into in the ordinary course." Because Smithfield granted consent to these "ordinary course" contracts, it exercised operational control over Premium Standard and thus acquired beneficial ownership of Smithfield prior to the expiration of the Waiting Period in violation of the Act. The DOJ and the parties settled the case, and the parties agreed to pay $900,000 in civil fines for this gun-jumping conduct.

Read more.

EXECUTIVE COMPENSATION AND ERISA

Understanding and Monitoring Retirement Plan Investments Is Focus of Recent Case

A Tennessee district court recently ruled that a directed trustee may seek indemnification from a retirement plan's internal fiduciaries if that trustee is liable for alleged losses in investment funds it recommended. (See *FedEx Corp. v. The Northern Trust Co.*, W.D. Tenn., No. 08-2827-STA-dkv, 1/25/10.)

In *FedEx*, internal fiduciaries (the Committee) of a FedEx-sponsored pension plan (the Plan) alleged that The Northern Trust Company (the Trustee) recommended two investment funds (the Funds) to the Committee that were against the Plan's investment policy. The Trustee was also the manager of the Funds. The Committee decided to invest Plan assets in the Funds. FedEx filed a lawsuit against the Trustee to recover alleged Plan losses resulting from investing in the Funds.

The Trustee countered that FedEx would be required to indemnify the Trustee for any amounts the Trustee might be required to restore to the Plan. The Trustee alleged that the Committee (1) is responsible for selecting the Plan's investments, (2) failed to understand the Funds before investing Plan assets in them, and (3) did not monitor the appropriateness of continued investment by the Plan. If the Trustee were to prevail, FedEx might be required to restore any Plan losses resulting from any fiduciary breach.

The Trustee alleged that it had no discretionary authority to invest in the Funds. Although FedEx alleged that the Trustee's fiduciary role expanded because the Trustee recommended the Funds, the court rejected this characterization and found that the Trustee acted as a discretionary trustee and not an investment fiduciary. As a result, the court denied FedEx's motion to dismiss the counterclaim.

While it did not decide the substantive issue, the court's decision means that FedEx and the Committee could be found to be liable for the Plan losses if such losses were found to have resulted from the failure to understand the nature of the Funds.

This case is a good reminder to plan fiduciaries to (1) fully understand the nature and risks of investments that they approve for the Plan and (2) oversee and monitor the Plan's investment managers. Elements of these duties can include receiving training and updates on Employee Retirement Income Security Act obligations, developing and applying a meaningful investment policy, using third-party investment consultants and scrutinizing the plan's investment managers and the investments they choose.

The district court's opinion can be found here.

For more information, contact:

SEC/CORPORATE

Robert L. Kohl	212.940.6380	robert.kohl@kattenlaw.com
David A. Pentlow	212.940.6412	david.pentlow@kattenlaw.com
Robert J. Wild	312.902.5567	robert.wild@kattenlaw.com
Eric I. Moskowitz	212.940.6690	eric.moskowitz@kattenlaw.com
Jonathan D. Weiner	212.940.6349	jonathan.weiner@kattenlaw.com

LITIGATION

William M. Regan	212.940.6541	william.regan@kattenlaw.com
Brian Schmidt	212.940.8579	brian.schmidt@kattenlaw.com

FINANCIAL SERVICES

Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Gary N. Distell	212.940.6490	gary.distell@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Robert M. McLaughlin	212.940.8510	robert.mclaughlin@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com

BANKING

Jeff Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Terra K. Atkinson	704.344.3194	terra.atkinson@kattenlaw.com
Christina J. Grigorian	202.625.3541	christina.grigorian@kattenlaw.com
Adam Bolter	202.625.3665	adam.bolter@kattenlaw.com

ANTITRUST

James J. Calder	212.940.6460	james.calder@kattenlaw.com
Laura Keidan Martin	312.902.5487	laura.martin@kattenlaw.com
David S. Stoner	212.940.6493	david.stoner@kattenlaw.com

EXECUTIVE COMPENSATION AND ERISA

Ann M. Kim	312.902.5589	ann.kim@kattenlaw.com
Gary W. Howell	312.902.5610	gary.howell@kattenlaw.com

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Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

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