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SEC/CORPORATE

Wall Street Reform Act Contains Significant Governance and Disclosure Provisions

Yesterday, the Senate approved the Dodd-Frank Wall Street Reform and Consumer Protection Act with no changes to the governance provisions of the Conference Committee version of the bill. President Obama is expected to sign it in the near future. The bill includes significant changes to corporate governance and executive compensation and disclosure applicable to publicly traded issuers. Provisions address say on pay, proxy access, compensation clawbacks, compensation committee independence and further restrictions on broker discretionary voting.

Click here to read the Katten *Client Advisory* providing a more detailed discussion of these Dodd-Frank provisions. Click here to read the bill.

Speech by SEC Chairman on Corporate Governance and Disclosure Initiatives

On July 9, Securities and Exchange Commission Chairman Mary Schapiro spoke at the National Conference of the Society of Corporate Secretaries and Governance Professionals in Chicago about upcoming SEC governance and disclosure rulemaking.

In particular, following enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC will be focusing on drafting implementing rules and initiating studies as directed by the Act. The staff will also be reevaluating all of the corporate issuer filing forms and disclosure requirements to confirm the current relevancy and comprehensiveness of the information. The SEC expects to act quickly as to recommendations for revision of the risk disclosure requirements and to consider more comprehensive changes such as changing filing formats so that basic information can be more easily updated by companies and used by investors.

Chairman Schapiro noted that the “SEC’s job is not to define for the market what constitutes ‘good’ or ‘bad’ governance, in a one-size-fits-all approach. Rather, the SEC’s job is to ensure that its rules support effective communication and accountability” among shareholders, directors and executives.

Read more.

SEC Publishes Concept Release on “Proxy Plumbing”

On July 14, the Securities and Exchange Commission unanimously approved the long-awaited concept release on mechanics of proxy distribution and collection. The release marks the Commission’s first public review of the proxy voting system in nearly 30 years. Highlighting that the proxy process is the principal means of communication between companies and investors, SEC Chairman Mary Schapiro stressed that the “transmission of this communication must be—and must be perceived to be—timely, accurate, unbiased, and fair.” The SEC hopes that the release will help guide the agency’s revisions of proxy mechanics and ensure that all market participants are afforded adequate proxy access.

The release solicits public comment on a number of key issues in three main areas: (1) accuracy, transparency and efficiency of the proxy voting process, (2) communication and shareholder participation, and (3) the relationship between voting power and economic interest. Within this framework, the release comprehensively analyzes a number of specific topics including:

- Over-voting and under-voting of shares: Securities intermediaries sometimes cast more or fewer votes than they actually hold as a result of the way securities transactions are cleared and settled and the way intermediaries then "allocate" votes to investors. The SEC questions whether it should regulate this practice and whether intermediaries should disclose the procedures they use to allocate votes to investors on whose behalf they hold securities.
- Vote confirmation: Under the current system, investors have limited ability to confirm whether their shares have been voted according to their instructions. The release suggests the possibility of requiring a process for vote confirmation.
- Proxy voting by institutional securities lenders: The release evaluates the impact of institutional securities lenders on the proxy voting process. Shares on loan cannot be voted unless the lender "recalls" the shares. The SEC considers the possibility of advance notice of matters to be voted on, which would give lenders adequate time to recall their shares and vote on relevant issues. The release also questions whether there is a need for more transparent disclosure of votes cast by institutional holders of securities.
- Proxy distribution fees: The proxy distribution fee structure has consistently been an area of major concern for the SEC. The release addresses various options for revamping the structure and size of fees charged, including the revision or elimination of stock exchange maximum fee schedules.
- Communication between issuers and beneficial owners of securities: The practice of holding securities in street name and rules enabling beneficial owners to conceal their identities from issuers have inhibited the ability of issuers to communicate with shareholders. The release seeks feedback on whether so-called "OBO" status should be revised or eliminated.
- Means to facilitate retail investor participation: Low retail investor participation rates have been an area of major concern for the SEC. The release suggests several initiatives to increase retail investor voting including better investor education, enhanced brokers' Internet platforms, advance voting instructions, enhancing investor-to-investor communications and improving the use of the Internet for distribution of proxy materials.
- Data-tagging proxy related materials: The release examines the costs and benefits of data-tagging proxy statement disclosure and asks whether such organization of information would enhance investor participation in the proxy voting process.
- Role and legal status of proxy advisory firms: Institutional investors' increased reliance on proxy advisory firms has raised various concerns. The release examines the necessity of enhancing disclosure of potential conflicts of interest and improving regulatory supervision over the formation of advisory firms' voting recommendations.
- Dual record dates: Some new state laws (Delaware, for example) permit dual record dates, changing the long established procedure of using a single record date to determine which shareholders are entitled to notice of a meeting and which shareholders are entitled to vote. Under the new laws, a shareholder who sells his shares after the record date no longer holds the right to vote. The release examines whether SEC rules should be revised to accommodate dual record dates.
- Empty voting: Investors have developed a variety of techniques to "decouple" voting rights from their economic interest in a company, resulting in the investor's having voting rights that exceed his/her economic interest in the company. The SEC examines whether such practice unduly influences voting results and asks whether disclosure of decoupling activities should be required.

The publication of the concept release triggers a 90-day public comment period, during which market participants will have an opportunity voice their opinions about the SEC's concerns related to proxy mechanics.

Click here to read the Securities and Exchange Commission Concept Release No. 34-62495.

BROKER DEALER

SEC Approves Amendments to FINRA's BrokerCheck

The Securities and Exchange Commission has approved Financial Industry Regulatory Authority amendments to its BrokerCheck system to expand the information released through BrokerCheck and establish a formal process to dispute the accuracy of or update information disclosed through BrokerCheck. A significant change is that

FINRA has expanded the disclosure period for a FINRA member's formerly associated persons from two years to ten years. Additionally, the conditions that must be met before "Historic Complaints" are displayed in BrokerCheck will be eliminated, and consequently, all Historic Complaints that were archived after the implementation of the Central Registration Depository on August 16, 1999, will become publicly available through BrokerCheck.

FINRA also will make publicly available on a permanent basis information regarding formerly associated persons, regardless of the time elapsed since such persons were associated with a FINRA member, if, among other things, they pleaded guilty or were convicted of a crime, were the subject of an investment-related civil injunction or court finding or were named in legal proceedings that resulted in an arbitration award or civil judgment against such person. Anticipating increased demand to ensure the accuracy of information displayed through BrokerCheck, FINRA also has formalized the process for brokers to dispute the accuracy of such information and will allow brokers to submit a written dispute notice and supporting documents to FINRA using an online form.

Click here to read Securities and Exchange Commission Release No. 34-62476.

SEC Approves FINRA's Request to Increase the Number of Arbitrators on NLSS Lists

The Securities and Exchange Commission has approved a Financial Industry Regulatory Authority rule proposal to increase the number of arbitrators on lists generated by the "Neutral List Selection System," a computer system that generates random lists of arbitrators from FINRA's roster of arbitrators for arbitration cases. FINRA stated that increasing the number of arbitrators on such lists will increase the odds that parties will be appointed arbitrators they have chosen and ranked.

Click here to read Securities and Exchange Commission Release No. 34-62480.

CFTC

CFTC Proposes New Rules Regarding Account Ownership and Control Information

The Commodity Futures Trading Commission has proposed to issue new regulations under which the CFTC would collect account ownership and control information on a weekly basis from reporting entities from designated contract markets (DCMs), exempt commercial markets (ECMs) that list significant price discovery contracts, and foreign boards of trade that provide direct access to U.S. market participants. The CFTC Notice follows an Advanced Notice of Proposed Rulemaking on the same topic that was published for comment in July 2009, and incorporates certain changes made in response to comments received on the Advance Notice. Under the proposed rules, various account ownership and control information, including identifying and contact information with respect to both beneficial owners and account controllers, whether the account is traded pursuant to an automated system, the executing and clearing brokers, and an indication of whether the account is a firm omnibus account, will be collected by the CFTC via an account Ownership and Control Report.

The comment period for the Notice of Proposed Rulemaking will end 60 days after the publication of the Notice in the *Federal Register*. A copy of the Notice is available here.

CFTC Proposes New DCM and DCO Business Continuity and Disaster Recovery Standards

The Commodity Futures Trading Commission has published proposed rules that would establish standards for the recovery and resumption of operations by certain designated contract markets (DCMs) and derivatives clearing organizations (DCOs). The proposed standards would apply to DCMs that are determined by the CFTC to be "critical financial markets," as well as to the DCOs for those markets, and would require any such DCM or DCO to establish and maintain business continuity and disaster recovery plans and resources (including appropriate geographic dispersal of personnel and infrastructure) sufficient to satisfy an objective of resuming trading and clearing operations on a same-day basis.

The comment period for the Notice of Proposed Rulemaking will end 30 days after the publication of the Notice in the *Federal Register*. A copy of the Notice is available here.

LITIGATION

Appropriation of Business Plan Supports Unfairness Claims

An energy firm may be liable for adopting the business plan of a prospective partner even though the appropriated plan was not unique enough to support a claim under New York's "submission of an idea" doctrine.

The principals of Sokol Holdings, Inc. sought the rights to develop oil fields in western Kazakhstan and devised a plan to obtain a controlling interest in Emir Oil, LLP, a Kazakh firm licensed to conduct such exploration. Sokol presented this plan, which contained a confidentiality provision, to BMB Munai, Inc., which would provide initial financing under the plan. When BMB later withheld the initial financing and acquired Emir Oil on its own, Sokol sued for breach of contract under New York's "submission of an idea" doctrine, as well as for unfair competition and unjust enrichment.

BMB sought dismissal, arguing that Sokol's business plan was not novel enough to support a claim for breach of the confidentiality clause, and that the other claims were predicated on this purported breach. The U.S. District Court for the Southern District of New York agreed that Sokol's plan lacked the uniqueness required for the breach of contract claim. But the court also ruled that BMB's appropriation of Sokol's work supported its claims for unfair competition and unjust enrichment and denied dismissal of those claims. (*Sokol Holdings, Inc. v. BMB Munai, Inc.*, 2010 WL 2605842 (S.D.N.Y. June 29, 2010))

Former LLC's Senior Trader Can Pursue Federal Securities Claim

A former senior employee and member of a limited liability company can pursue his securities fraud claim against the firm and its managing member because his passive investment in the company supported a claim under Section 10(b) of the Securities Exchange Act of 1934.

Christopher Shirley was a member and senior trader of investment company JED Capital, LLC, and developed several of JED's trading systems while receiving a share of the profits he generated. JED's managing member convinced Mr. Shirley to invest $250,000 in the company by promising him that the funds would be used to expand JED's trading operations. The manager actually funneled funds to his other ventures, according to Mr. Shirley, and Mr. Shirley sued JED and its manager for violating Section 10(b).

The defendants contended that Mr. Shirley was not a passive investor, and thus failed to state a Section 10(b) claim, because he received a portion of JED's profits as compensation and because he was involved in JED's daily operations. The U.S. District Court for the Northern District of Illinois rejected this argument, holding that Mr. Shirley's inability to control how JED deployed its capital showed that he was sufficiently dependent on the entrepreneurial actions of the manager to support his federal claim. (*Shirley v. JED Capital, LLC*, 2010 WL 2721855 (N.D.Ill. July 8, 2010))

BANKING

Federal Banking Regulators Agree to Revise and Strengthen FDIC "Backup" Authority

On July 12, the four bank regulatory agencies, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision (OTS), and the Federal Deposit Insurance Corporation (FDIC) entered into a Memorandum of Understanding (MOU) that enhances the FDIC's existing backup authority over insured depository institutions that the FDIC does not directly supervise. These institutions include national banks, federal savings associations and savings banks, and state-chartered banks that are members of the Federal Reserve System.

According to a press release issued by the FDIC, "[t]he revised agreement will improve the FDIC's ability to access information necessary to understand, evaluate, and mitigate its exposure to insured depository institutions, especially the largest and most complex firms. FDIC Chairman Sheila Bair said: "The FDIC needs to have a more active on-site presence and greater direct access to information and bank personnel in order to fully evaluate the risks to the deposit insurance fund on an ongoing basis and to be prepared for all contingencies."

Specifically, the revised MOU gives the FDIC backup supervision authority under an expanded list of circumstances, including when the insurance pricing system suggests an insured depository institution might be at higher risk, when institutions are defined as "large" under international regulatory guidelines, or when large, interconnected bank holding companies are defined as "systemic" by the financial reform legislation passed by Congress. At large, complex insured depositary institutions, the FDIC will establish an expanded continuous, full-time staff presence on-site.

In a public statement supporting the MOU, Comptroller of the Currency John Dugan, who serves on the FDIC's Board of Governors, noted "a critical need that, in carrying out this important FDIC function, nothing be done to undermine the primary supervisory responsibility and accountability of the primary federal regulator." According to Chairman Bair, "[t]he FDIC supports the role of the primary federal regulator and has no interest in infringing upon their authorities. However, the FDIC has needs that are separate and distinct from the primary federal regulator that must be met in order to satisfy our statutory responsibilities." Neither the Federal Reserve nor the OTS issued a formal press release with respect to the MOU.

According to a memorandum prepared by three FDIC division directors and approved by FDIC General Counsel Michael Bradfield, "[t]his proposal addresses the recommendations made by the FDIC and Treasury Inspectors General.... In particular, the MOU explicitly provides that it does not limit the authority of the FDIC to make Special Examinations of [insured depository institutions] both covered and uncovered by this MOU...."

Read more.

STRUCTURED FINANCE AND SECURITIZATION

Financial Reform Legislation Imposes New Requirements Relating to Asset-Backed Securities

On July 15, the U.S. Senate voted to pass the Dodd-Frank Wall Street Reform and Consumer Protection Act (H.R. 4173), which contains, among other things, provisions addressing risk retention, conflict of interest issues, and the treatment of Nationally Recognized Statistical Rating Organizations (NRSROs) under existing securities laws. The bill will now go to President Obama for his signature. The bill contains a 5% risk retention requirement for issuers of "asset-backed securities", including collateralized debt obligations, but exempts "qualified residential mortgages." For commercial mortgaged-backed securities, specified alternative forms of retention for commercial mortgages "may" be accepted as alternatives to retention, at the discretion of federal regulators. Additionally, portions of the bill will remove exemptions for NRSROs under Rule 436(g) of the Securities Act of 1933, which currently excludes NRSROs from being treated as "experts" when their ratings are used for a registered offering, and under Regulation FD. The legislation also amends the Securities Act of 1933 to prohibit any sponsor, underwriter, or placement agent of an asset-backed security, or any affiliate of any such entity, from engaging "in any transaction that would involve or result in any material conflict of interest…"

Please click here for the unofficial conference report of H.R. 4173.

EXECUTIVE COMPENSATION AND ERISA

New Regulations Released Regarding Health Care Reform

On June 22, interim final regulations were issued regarding the "Patient's Bill of Rights" requirements of the Patient Protection and Affordable Care Act of 2010 (PPACA), Pub. L. No. 111-148. These regulations were released jointly by the Departments of Health and Human Services, Labor (DOL) and Treasury. The regulations provide examples, safe harbors and other provisions helpful to the implementation of PPACA.

These rules are generally applicable to all group health plans for plan years starting on or after September 23, 2010, including "grandfathered" plans. This includes the annual dollar limits, the lifetime dollar limits, prohibition on preexisting condition exclusions and prohibition on coverage rescissions. However, the "patient protection" provisions do NOT apply to grandfathered plans.

Prohibition Against Lifetime and Annual Limits—PPACA prohibits plans from imposing annual limits or lifetime limits on the dollar amount of "essential health benefits." The regulations do not provide guidance regarding what is or is not considered an "essential health benefit," but permit good-faith efforts to comply with a reasonable interpretation of that term. The prohibition against annual limits will be phased in until 2014. The dollar value of "essential health benefits" must be no less than $750,000 for plan years beginning on or after September 23, 2010; no less than $1.25 million for plan years beginning on or after September 23, 2011; and no less than $2 million for plan years beginning on or after September 23, 2012 (and before January 1, 2014).

Additional notice and enrollment rules apply with respect to people whose coverage or benefits ended by reason of having reached a lifetime limit. For example, individuals who have reached the plan's lifetime limit prior to the effective date of the new regulations must be notified that the lifetime limit no longer applies, and those people who are not enrolled in the plan must be given an opportunity to do so.

Prohibition Against Preexisting Condition Exclusions—PPACA prohibits plans from imposing any preexisting condition exclusion on enrollees under age 19. Preexisting condition exclusions currently in effect are permitted to continue with regard to enrollees age 19 and older until the 2014 plan year. The regulations clarify that these prohibitions apply for purposes of denying enrollment in the plan and also specific benefit coverage.

Prohibition Against Coverage Rescission—PPACA prohibits plans from retroactively rescinding coverage unless due to fraud or intentional misrepresentation. The regulations provide guidance as to when rescission is permitted and what constitutes rescission. According to the regulations, it is permitted to retroactively terminate coverage for failure to pay premiums in a timely manner. Also, a termination with only a prospective effect is not considered a rescission and thus is permitted, such as if ineligible dependents are to be dropped pursuant to an audit of dependent coverage.

New Patient Protection Rules (Not Applicable to Grandfathered Plans)—If a plan utilizes a network of providers, there are three new choice-of-provider requirements imposed by PPACA: (1) the plan must allow participants to designate any participating Primary Care Provider (PCP) who is available; (2) the plan must allow a participating pediatrician to be designated as the PCP for a child; and (3) the plan cannot require any preauthorization or referral to access an OB/GYN. The regulations require plans to notify participants of these rights and provide model language.

Action—Though not all questions raised by PPACA have been answered, there has been enough guidance issued via regulations such that plan sponsors should be in the process of identifying required changes to existing plans for the upcoming open enrollment. Decisions will need to be made as to what changes will be made and as of what date, whether grandfather status will be lost if additional changes are made, documents need to be revised, and notification given to participants. An upcoming Katten *Client Advisory* will describe these regulations in more detail.

For a link to the interim final regulations, click here.

UK DEVELOPMENTS

UK Takeover Panel Bans Three

On July 14, the UK Takeover Panel announced the decision of the Takeover Appeal Board to uphold the decision of the Hearing Committee of the Takeover Panel to ban Daniel Posen, Brian Myerson and Brian Padgett for three years from all dealings with any person registered with the Financial Services Authority.

The Appeal Board upheld the finding that in March 2009, 6.7 million shares of Principle Capital Investment Trust Plc (PCIT) were acquired by Messrs. Posen, Myerson and Padgett acting jointly as a "concert party." In a deliberate attempt to circumvent the requirement under Rule 9 of the City Code on Takeovers and Mergers to make an offer to shareholders of PCIT generally, they purported to be acting separately rather than as a concert party. When the Takeover Panel investigated the transaction, in breach of their obligations to assist the Panel, Messrs. Posen, Myerson and Padgett attempted to conceal the circumstances relating to their acquisition of PCIT shares and to present a false picture.

This type of ban, known as "cold shouldering," is the first imposed by the Takeover Panel since 1992. It is effectively a three-year ban on any UK financial services or mergers and acquisition activity for the three men concerned.

Read more.

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