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Corporate and Financial Weekly Digest

JULY 2, 2009

SEC/CORPORATE

SEC Proposes Rules to Enhance Disclosure Regarding Corporate Governance and Clarify Proxy Rules

On July 1, the Securities and Exchange Commission proposed amendments intended to improve disclosure in the area of corporate governance and clarify the SEC's proxy rules.

The proposed amendments would require issuers to disclose in their proxy statements (i) the impact of overall compensation policies and practices (including those applicable to non-executive employees) on risk-taking; (ii) information concerning the qualifications, experience, skills and other attributes that qualify directors and nominees to serve on the board or a committee of the board; (iii) the role of the board of directors in risk management; (iv) the rationale for the issuer's corporate leadership structure; and (iv) potential conflicts of interests of compensation consultants.

More specifically, proposed amendments would revise disclosure of stock options and awards in the Summary Compensation Table and Director Compensation Table to require disclosure of the aggregate grant date fair value of awards in place of current disclosure of the dollar amount recognized for financial statement reporting purposes. In addition, companies would be required to disclose whether and why they have chosen to combine or separate the chief executive officer and board chair positions.

The proposal also seeks to accelerate disclosure of election results by requiring issuers to disclose voting results in a current report on Form 8-K filed with the SEC within four days after the applicable stockholder action. Currently, election results need not be reported until an issuer files its first quarterly report on Form 10-Q following the applicable meeting of stockholders.

The proposed amendments would also clarify the manner in which several proxy rules operate and facilitate stockholder communications and voting. Among other things, such amendments would permit stockholders soliciting proxies to round out a "short slate" of directors with directors named in another soliciting stockholder's proxy statement in the same manner currently permitted by the proxy rules for nominees named in the issuer's proxy statement.

Click here to read remarks from Sean Harrison of the Division of Corporate Finance.

SEC Proposes Rules on Shareholder Advisory Vote on Executive Compensation for TARP Recipients

On July 1, the Securities and Exchange Commission proposed to amend the federal proxy rules to require companies which have received financial assistance under the Troubled Asset Relief Program (TARP) to include in their proxy materials an advisory vote on executive compensation.

Under the proposed Rule 14a-20, the requirement to include a non-binding, shareholder advisory vote on executive compensation (also referred to as a "say-on-pay" vote) would apply to all solicitations at which proxies are solicited for the election of directors in connection with a company's annual meeting, or a special meeting in lieu of an annual meeting, during the period in which a company has outstanding obligations as a result of receiving TARP funds. The shareholder vote must cover the compensation of executives as disclosed pursuant to Item 402 of Regulation S-K, including the compensation discussion and analysis, the compensation tables and related material. Disclosure of such a vote, as well as a brief description of the effect of the vote, would be required under Item 20 of Schedule 14A. These proposed amendments represent the SEC's attempt to clarify and codify into the proxy rules the provisions of Section 111(e) of the Emergency Economic Stabilization Act of 2008, as amended, which requires TARP recipients to permit a separate shareholder advisory vote on executive compensation.

The proposed "say-on-pay" rules would not modify current disclosure requirements with respect to executive compensation. As a result, pursuant to scaled disclosure, smaller-reporting TARP recipients would not be required to provide a compensation discussion and analysis section in their proxy statements.

Public comments on the proposed rule amendments must be received by the Commission within 60 days after their publication in the Federal Register.

Click here to read the SEC's release regarding the proposed rules.
Click here to read remarks from John Harrington of the Division of Corporate Finance.

SEC Approves Change to NYSE Broker Discretionary Voting Rule

Please see BROKER DEALER below.

LITIGATION

D.C. Circuit Upholds Lifetime Bar from Supervisory Positions

The Court of Appeals for the District of Columbia has affirmed a Securities and Exchange Commission order permanently barring a former financial executive from associating with any broker or dealer in a supervisory capacity and suspending him for 12 months from associating with any broker or dealer in any capacity. The petitioner had founded the firm, which was a registered broker-dealer, served as its president and controlled all aspects of the company's business, including compliance. In March 2001, the petitioner, in his capacity as president of the firm, received a deficiency letter from the SEC, indicating that the company had committed various violations of federal securities laws, including a failure to "establish and employ adequate supervisory procedures." Although petitioner took some remedial measures after receiving the deficiency letter, he largely ignored the deficiencies and continued to operate the firm with a "laissez-faire approach to supervision."

In 2002 and 2003, two of the company's employees conspired to conceal approximately $6.5 million in losses by entering fictitious trades into the company's record system, omitting unprofitable trades from the records, and stealing $4.5 million from a customer account to cover the losses from unauthorized trading. Although petitioner was "entirely ignorant" of the scheme at the time, he was subsequently tried by the SEC and found to have violated Exchange Act Section 15(b) and Securities Investor Protection Act Section 14(b) for failing to exercise his supervisory duties.

On appeal to the D.C. Circuit, petitioner argued that the imposed sanctions he received were "arbitrary and capricious" because the SEC failed to address evidence of his character and experience, misconstrued the evidence, and imposed unnecessarily harsh sanctions. The Court rejected petitioner's arguments, holding that the SEC's interpretation of the evidence was reasonable and that evidence of petitioner's character and professional accomplishments was immaterial in light of the substantial evidence of petitioner's negligence and recklessness in the performance of his supervisory duties. In addition, the Court held that a lifetime bar from supervisory positions was an appropriate sanction given the "egregious" failure to implement even the most basic supervisory procedures. (*Horning v. SEC*, 2009 WL 1812765 (D.C. Cir. June 26, 2009))

Late Service Provides Basis for Denial of Motion to Vacate Arbitration Award

A federal court has denied a motion to vacate an arbitration award where notice of the motion was served four days after the statutory period for such service. The arbitration award at issue, awarding defendant brokerage commission fees, was dated June 4, 2008. Defendant filed a petition to confirm the arbitration award on July 9, 2008. On August 20, 2008, plaintiff filed a complaint to vacate the award, but did not serve the complaint on defendant until September 8, 2008.

Defendant subsequently moved for summary judgment on its petition to confirm the arbitration award and on plaintiff's complaint to vacate the award, arguing that plaintiff failed to timely serve its motion to vacate. The court granted both of defendant's summary judgment motions.

The court first noted that Section 12 of the Federal Arbitration Act (FAA), 9 U.S.C. Section 12, provides that "notice of a motion to vacate, modify or correct an award must be served upon the adverse party within three months after the award is filed or delivered." Here, the arbitration award was delivered on June 4, 2008, but plaintiff did not serve its notice of a motion to vacate the award until September 8, 2008, more than three months after the award was issued. The court emphasized that the statute is "clear" and "unambiguous" in that it "explicitly states" that the motion to vacate must be "served," not "filed," within three months of delivering the award and that none of the authorities relied upon by plaintiff provided any basis for departing from this clear language.

In addition, the court declined to exercise its discretion to extend the statutory time for service. In doing so, the court rejected plaintiff's contention that his interpretation of the statutory language is reasonable where plaintiff failed to provide any binding authority supporting such interpretation. Moreover, the court observed that the 11th Circuit has declined to carve out a due diligence exception to FAA Section 12 because, among other things, of the summary nature of proceedings to confirm arbitration awards. Following the logic of the 11th Circuit, the court held that extending statutory deadlines would be "contrary to the 'role of arbitration as a mechanism for speedy dispute resolution' that awards finality in a timely manner." (*Mitra v. Global Financial Corp.*, 2009 WL 1833932 (S.D. Fla. June 25, 2009))

BROKER DEALER

Establishment of "Flash And Cancel" Order Type for Nasdaq OMX BX

NASDAQ OMX BX, Inc. (Nasdaq OMX BX) proposed a rule change to establish a new voluntary Flash and Cancel Order type. A Flash and Cancel Order will provide an optional pre-cancellation display period for market and marketable limit orders so designated. An analogous order type and the corresponding functionality is already in use by The NASDAQ Stock Market LLC (as reported in the June 19 edition of *Corporate and Financial Weekly Digest*) and the CBOE Stock Exchange. The proposed rule change, filed by Nasdaq OMX BX with the Securities and Exchange Commission on June 23, was effective immediately upon filing.

The SEC release is available here.

SEC Approves Change to NYSE Broker Discretionary Voting Rule

At its open meeting on July 1, the Securities and Exchange Commission voted 3-2 to approve the New York Stock Exchange's proposed rule change to amend NYSE Rule 452 and corresponding Listed Company Manual Section 402.08 to eliminate broker discretionary voting for the election of directors of NYSE-listed companies with the exception of companies registered under the Investment Company Act of 1940. Supporters of the proposal see it as a way to empower shareholders by preventing uninstructed broker voting in elections of directors. The two commissioners who voted against the proposal had several concerns, including that although the change applies solely to the NYSE, it may have broader effects, particularly for retail investors, that have not been closely analyzed.

The rule change, described in the March 6 edition of *Corporate and Financial Weekly Digest*, will be applicable to proxy voting for shareholder meetings held on or after January 1, 2010.

The archived webcast of the meeting will be available here.

FINRA Developing New Qualification Examination for Investment Banking Professionals

Earlier this year, the Securities and Exchange Commission approved a Financial Industry Regulatory Authority rule proposal to adopt a new limited registration category for investment banking professionals. The new requirement will become effective 90 days after FINRA announces the development of the new Series 79 qualification examination (the new test and associated fees will be subject to another round of SEC review and approval). After the new examination is implemented, qualified investment banking professionals exclusively focusing on investment banking transactions will no longer be required to take and pass the more comprehensive Series 7 examination.

Read more.

CFTC

CFTC Seeks Comment on Account Ownership and Control Report

On July 2, the Commodity Futures Trading Commission issued an advance notice of proposed rulemaking, seeking public comment on its stated intention to collect certain ownership, control and related information for all trading accounts active on U.S. futures exchanges. This information will be collected on a new "Ownership and Control Report" that would be submitted periodically by designated contract markets and other reporting entities. The CFTC envisions that the new report would include, among other things, the trading account number, the trading account's controller(s), an indication of whether the trading account is an omnibus account, the executing and clearing firms and their respective Trade Capture Report (TCR) identifiers. (TCR is an electronic file that is

submitted daily to the CFTC by designated contract markets and that contains trade and related order data for every matched trade facilitated by an exchange, whether executed via open-outcry, electronically, or non-competitively.) The deadline for comments is August 17.

Read more.

BANKING

U.S. Supreme Court Nullifies Long-Standing OCC Position on Preemption

On June 29, the U.S. Supreme Court issued its long-awaited opinion in *Cuomo v Clearing House Association*, a case that presented the question of whether the Attorney General of the State of New York validly could seek to enforce New York's lending laws in the face of a Comptroller of the Currency regulation that forbade the exercise of visitorial powers to any entity but itself. Distinguishing between visitorial powers, which are granted to the Office of the Comptroller of the Currency (OCC) by the National Bank Act, and a sovereign state's power to enforce the law, the high court concluded that the National Bank Act does preempt state action with respect to visitorial powers, but not with respect to the enforcement of state law. However, in so concluding, the Court dramatically cut back on the OCC's own definition of its visitorial powers.

Section 484(a) of the National Bank Act states that “[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice...” Pursuant to that statute, the OCC passed, after proper notice and comment, a regulation further describing and interpreting its visitorial powers. In addition to examination and inspection of the books and records of a national bank, the OCC claimed the sole ability to regulate and supervise and to enforce compliance with federal and state laws. Rejecting the familiar defense that where ambiguity exists as to the meaning of a term (in this case, the meaning of “visitorial powers”) a court must defer to a reasonable interpretation of the statute even if it is not the best interpretation, the Court held that the OCC went too far in claiming for itself the sole right to enforce compliance with law. In the words of the Court, “[w]e can discern the outer limits of the term ‘visitorial powers’ even through the clouded lens of history. They do not include, as the Comptroller's expansive regulation would provide, ordinary enforcement of the law.”

In so deciding, the Court distinguished its recent holding in *Watters v. Wachovia Bank, N.A.*, which held that a state may not exercise general supervision and control over the wholly owned subsidiary of a national bank, stating that “'[g]eneral supervision and control... are worlds apart from law enforcement.” The Court concluded its discussion of the issue by stating that “the unmistakable and utterly consistent teaching of our jurisprudence... is that a sovereign's ‘visitorial powers’ and its power to enforce the law are two different things... And contrary to what the Comptroller's regulation says, the National Bank Act pre-empts only the former.” As the Court explained:

> On a pragmatic level the difference between visitation and law enforcement is clear. If a state chooses to pursue enforcement of its laws in court, then it is not exercising its power of visitation and will be treated like a litigant. An attorney general... must file a lawsuit, survive a motion to dismiss, endure the rules of procedure and discovery, and risk sanctions if his claim is frivolous or his discovery tactics abusive... A visitor, by contrast, may inspect books and records at any time for any or no reason.

By confirming the preemptive effect of visitorial powers but limiting their breadth, the Court's decision opens a wide world of potential litigation against national banks to state attorneys general should they believe that a national bank located in their jurisdiction is not complying with substantive state law. While undoubtedly those concerned with the advantages that national banks have long enjoyed in the preemption area will attempt to limit the effect of the Court’s ruling, arguably the balance of power, at least for the moment, has shifted to the state legislatures that draft substantive laws and to the state attorneys general that seek to enforce them.

It remains to be seen what effect the case will have on federal savings banks regulated by the Office of Thrift Supervision (OTS), which draws its power not from the National Bank Act, but from a different statute, the Home Owners Loan Act. It should also be noted that the Obama Administration has proposed a merger of the OCC and the OTS, and presumably the issue of if and to what extent preemption will exist for banks with a federal charter (post merger) will need to be addressed.

Read more.

Agencies Issue Interim Final Rule for Modified Mortgage Loans

The federal bank and thrift regulatory agencies on June 26 invited public comment on an interim final rule that provides that mortgage loans modified under the U.S. Department of the Treasury's Making Home Affordable

Program (MHAP) will retain the risk weight applicable before modification. On March 4, the Treasury announced guidelines under the MHAP to promote sustainable loan modifications for homeowners at risk of losing their homes to foreclosure. The interim final rule would provide a common interagency capital treatment for mortgage loans modified under MHAP. For example, mortgage loans risk weighted at 50% prior to modification would continue to be risk weighted at 50% after modification provided they continue to meet other applicable criteria.

Read more.

INSURANCE CAPITAL MARKETS

New York Court of Appeals Finds Life Settlement Brokers Have a Fiduciary Duty to Their Clients

In October 2006, the Attorney General of New York State commenced an enforcement action against Coventry First LLC and its parent corporation, executive vice-president and an affiliate (collectively, Coventry First). The complaint alleged that the defendants, life settlement providers, engaged in bid-rigging by paying substantial concealed commissions to life settlement brokers who, in return, persuaded their clients to accept Coventry First's offers rather than higher bids from rival life settlement providers. Included among the Attorney General's six causes of action was a claim for inducement of breach of fiduciary duty. Coventry First responded by filing a motion to dismiss for failure to state a cause of action and a motion to compel arbitration, both of which were denied by the New York Supreme Court. Upon Coventry First's appeal, the appellate division affirmed the lower court's ruling but granted leave to appeal to the court of appeals. On June 30, the New York Court of Appeals, affirming the appellate division's decision, issued a ruling stating that: (i) the arbitration agreements between the defendants and their alleged victims does not bar the Attorney General from pursuing victim-specific judicial relief in his enforcement action; and (ii) the Attorney General sufficiently pleaded Coventry First's knowledge of the life insurance brokers' fiduciary duties to withstand the motion to dismiss.

In its motion to compel arbitration, Coventry First had argued that because the Attorney General was suing on behalf of policy sellers who contracted with Coventry First, he was bound by their contractual obligation to arbitrate. The Court stated, "the Attorney General should not be limited, in his duty to protect the public interest, by an arbitration agreement he did not join. Such an arrangement between private parties cannot alter the Attorney General's statutory role or the remedies that he is empowered to seek." The Court also denied Coventry First's motion to dismiss the inducement of breach of fiduciary duty claim. In doing so, the Court, for the purposes of deciding the motion, accepted as true the Attorney General's statement that life settlement brokers hold themselves out as working to obtain the highest purchase price for their clients' policies and found that "[t]hese allegations comport with the legal theory of fiduciary duty." It then found that the Attorney General's allegations also sufficiently stated a claim that defendants knew that the brokers' conduct constituted a breach of fiduciary duty. The Court refuted Coventry First's argument that it could not have had the requisite knowledge because the fiduciary duty on the part of life settlement brokers had not previously been announced by the New York courts, citing email messages between Coventry First executives which referred to the fiduciary duties of life settlement brokers. (*People ex rel. Cuomo v. Coventry First, LLC*, 2009 WL 1851007 (N.Y., June 30, 2009))

STRUCTURED FINANCE AND SECURITIZATION

Agencies Issue Interim Final Rule for Modified Mortgage Loans

Please see BANKING above.

ANTITRUST

Supreme Court Will Hear Antitrust Case Involving NFL Licensing

In a case that may have great significance for sports leagues and other collaborations by businesses, the U.S. Supreme Court has granted certiorari in *American Needle, Inc. v. National Football League*. This case will likely provide important insight into whether antitrust laws will apply to a collection of individually owned businesses which seek to operate as a single entity. The case involves an allegation that the individual franchises of the National Football League violated Section 1 of the Sherman Act, the basic U.S. antitrust statute, by "conspiring" to grant an exclusive license to Reebok to sell hats and other headgear bearing the logos of NFL teams. The NFL argued Section 1 did not apply at all because its teams were operating as a "single entity" through NFL Properties, the NFL's licensing arm. Since a single entity cannot conspire with itself, Section 1 would not apply because it only comes into play when multiple actors are involved. The United States Court of Appeals for the Seventh Circuit ruled in favor of the NFL and dismissed the plaintiff's claims under the "single entity" defense. The plaintiff

petitioned the Supreme Court for review. In an unusual move, the NFL also petitioned the Supreme Court for review, even though it had won in the Court of Appeals. The NFL asked the Supreme Court to make an even broader ruling in the hope that the Court would expand the scope of the single-entity defense.

The issue the Court must now decide is whether the unique characteristics of a sports league grant the individual franchises the protection of the single-entity defense. If the Supreme Court rules in favor of the NFL, it could represent an expansion of the single-entity defense and could have significant implications with respect to collections of individually owned businesses that wish to work together to compete in a general marketplace. The Court will likely hear the case in early 2010. (*American Needle, Inc. v. National Football League*, 538 F.3d 736 (7th Cir. 2008))

EXECUTIVE COMPENSATION

IRS Can Levy Against Non-Transferable Stock Options

The Internal Revenue Service recently concluded in Chief Counsel Advice 200926001 (CCA) that it could enforce a tax levy served on an individual taxpayer by seizing and selling incentive and non-qualified stock options he had received during his employment as an executive for the company issuing the options. The IRS reached this conclusion despite option award provisions that permitted the options to be transferred only by will, the laws of descent or distribution or under a qualified domestic relations order.

Under federal tax law, when a taxpayer fails to pay a tax liability after notice and demand, a lien attaches to all of the taxpayer's property and property rights held by the taxpayer or a third party on behalf of the taxpayer. For this purpose, "property and property rights" includes, among other items, securities, salaries, wages, commissions or compensation. Such a lien generally applies only to property and property rights held by or on behalf of the taxpayer at the time of the levy, but a lien on wages and salary remains in effect until the tax liability is satisfied or becomes unenforceable. The tax law permits the IRS to seize and sell the taxpayer's property and property rights covered by the lien to pay the unpaid taxes.

The CCA describes the facts of the taxpayer's situation, including details regarding the evolution and vesting of his rights under the stock options and a settlement agreement entered into by the executive and the company. Among other things, the settlement agreement provided that the company would comply with any liens applicable to the executive or his property rights. The CCA found that, based on the facts, the taxpayer had a vested right to the options at the time the tax lien attached. Although the options were subject to specific restrictions on transferability, both statutory (in the case of the incentive stock options) and contractual, the CCA concluded that the options were not exempt from levy, seizure or sale by the IRS.

This issue is relevant for companies that award stock options as well as individual taxpayers who hold stock options and may have outstanding federal tax liability. Even if a stock option limits or restricts transfer of the option, if the option is vested the IRS may be able to seize the option and sell it to satisfy the individual taxpayer's unpaid federal taxes.

UK DEVELOPMENTS

UK Short Selling Disclosure Regime Extended

In the June 5 edition of *Corporate and Financial Weekly Digest*, we reported the proposal by the UK Financial Services Authority (FSA) to extend its existing short selling disclosure regime which was due to expire on June 30. The FSA said its expectation was "that it would either be superseded in due course by broader permanent disclosure measures—preferably agreed on the widest possible international basis—and/or be revoked."

On June 26, the FSA announced that it has extended, without an expiration date, the current disclosure regime. While no expiration date has been set, the FSA has emphasized that it does not intend to keep the regime permanently.

Short position disclosures remain required for net short positions in relevant issuers which exceed 0.25% of the issued share capital or the issuer. Further filings are required as the position increases by bands of 0.1% (i.e. the net short position reaches 0.35%, 0.45% etc).

Read more.

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