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CORPORATE & FINANCIAL
WEEKLY DIGEST

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SEC/CORPORATE

Amendments to Dodd-Frank Act Introduced in House

On March 16, members of the Capital Markets Subcommittee of the House Financial Services Committee introduced several bills designed to amend or supplement the Dodd-Frank Wall Street Reform and Consumer Protection Act, including those described below:

The Burdensome Data Collection Relief Act, H.R. 1062, would repeal the requirements of Section 953(b) of the Dodd-Frank Act, which requires publicly traded companies to disclose their median annual total compensation of all employees.

The Small Company Capital Formation Act, H.R. 1070, would amend Section 3(b) of the Securities Act of 1933 to increase the offering threshold for companies exempted from Securities and Exchange Commission registration under Regulation A from $5 million to $50 million. The Small Company Capital Formation Act also requires the SEC to review the offering amount limitation every two years and, if the SEC decides not to increase such offering threshold, report to the Committee on Financial Services of the House of Representatives and the Committee on Banking of the Senate its reasons for not increasing the amount.

The Small Business Capital Access and Job Preservation Act, H.R. 1082, would amend Section 203 of the Investment Advisers Act to exempt advisers to private equity funds from the registration requirements imposed on such advisers under the Dodd-Frank Act. The Small Business Capital Access and Job Preservation Act does, however, require advisers to private equity funds to maintain records and provide the SEC with annual or other reports as necessary and appropriate in the public interest and in the protection of investors even if not formally registered with the SEC.

A discussion draft of the Asset-Backed Market Stabilization Act provides for the repeal of Section 939G of the Dodd-Frank Act and the restoration of Rule 436(g) of the Securities Act of 1933, which was repealed by such section. Rule 436(g) of the Securities Act provided that the security rating assigned to a class of securities by a credit rating agency is not considered part of the registration statement prepared or certified by an expert. The repeal of Rule 436(g) in effect required issuers to obtain and file a consent from the credit rating agency with any registration statement if ratings are to be disclosed. Since rating agencies refused to provide such a consent, the asset-backed securities market effectively ceased to function, forcing the SEC to issue a temporary no-action letter on July 22, 2010, and a permanent no-action letter on November 23, 2010.

Click here to read the press release from the Capital Markets Subcommittee.
Click here to read the Burdensome Data Collection Relief Act.
Click here to read the Small Company Capital Formation Act.
Click here to read the Small Business Capital Access and Job Preservation Act.
Click here to read the discussion draft of the Asset-Backed Market Stabilization Act.

BROKER DEALER

FINRA Proposes Registration, Qualification and Continuing Education Requirements for Certain Member Firm Operations Personnel

The Financial Industry Regulatory Authority is seeking comments on a proposal to require registration of certain individuals of a member firm who perform and oversee member operations functions. Accordingly, FINRA is proposing to adopt a new representative registration category and qualification examination for "Operations Professionals," which generally would include those persons who are engaged in, responsible for or supervising certain member operations functions specified in the proposed rule, such as activities relating to client account data, maintenance of funds, account management and stock loan and securities lending. Any person required to register as an Operations Professional (subject to certain exceptions) would be required to pass a new Operations Professional qualification examination, a principles-based exam with a regulatory focus to test, among other things, the person's understanding of his professional responsibilities, before such registration may become effective.

In addition to the licensing and exam requirements, FINRA also is proposing to expand its continuing education requirements to require that Operations Professionals be subject to FINRA's Regulatory Element and Firm Element training as set forth in proposed FINRA Rule 1250. Persons subject to the new Operations Professional registration category would be considered associated persons of a member firm irrespective of their employing entity, and would be subject to all FINRA rules applicable to associated persons and/or registered persons. Comments are due to FINRA 21 days after publication in the *Federal Register*.

Click here to read Securities and Exchange Commission Release No. 34-64080.

FINRA Reminds Firms of Electronic Reporting Obligations for Specified Events and Quarterly Customer Complaints

The Financial Industry Regulatory Authority has issued a Regulatory Notice reminding member firms of their electronic reporting obligations regarding specified events and quarterly customer complaint information required under current NASD Rule 3070 and Incorporated New York Stock Exchange Rule 351, and new FINRA Rule 4530, which becomes effective July 1. In the Regulatory Notice, FINRA reminds member firms that for matters that become subject to reporting prior to July 1, NASD Rule 3070 and Incorporated NYSE Rule 351 will remain in effect. For matters that become subject to reporting on or after July 1, under new FINRA Rule 4530, member firms must continue to report specified events and quarterly statistical and summary information on written customer complaints electronically via the Regulatory Filings Application on the FINRA Firm Gateway.

Click here to read FINRA Regulatory Notice 11-10.

OTC DERIVATIVES

SEC Retains Existing Rules on Beneficial Ownership and Derivatives

Section 766 of the Dodd-Frank Wall Street Reform and Consumer Protection Act specifies that the Securities and Exchange Commission must set rules to determine the extent to which a security-based swap will be deemed to involve the acquisition of beneficial ownership of underlying equity securities for the purposes of Sections 13 and 16 of the Securities Exchange Act of 1934. The SEC has decided that existing Rules 13d-3 and 16a-1 already provide sufficient guidance on this topic so it is merely proposing to "re-adopt" those rules without change in order to meet the requirement of Section 766. The SEC accordingly issued on March 17 a notice of proposed rule that contains a lengthy discussion of the current rules and states that "the purpose of the proposed rulemaking is solely to preserve the regulatory status quo." Comments are due on April 15.

The notice of the proposed rule can be found here.

CFTC

CME Amends Rule to Require Books and Records to Be Produced in Electronic Format

The Chicago Mercantile Exchange, the Chicago Board of Trade, the New York Mercantile Exchange, and the Commodity Exchange have together released a special executive report (SER) announcing the amendment of Rule 432 (General Offenses), section L.3, for each of the exchanges. The amendment will require that books or records requested from a market participant by exchange staff be provided in the format and medium specified in the request.

Under the amendment, all books and records provided to the Market Regulation Department must by default be provided in electronic format, unless the request specifies another format. Generally, it is anticipated that documents will be requested in PDF format and audio recordings will be requested to be on a compact disc or via email in an MP3 or WAV file, though exchange staff may still request original source documents (e.g., handwritten order tickets). Each document request will specify the medium and format in which the produced information should be contained.

If a market participant is unable to comply with the exchange-requested format or medium, the participant may petition the exchange to accept an alternate format or medium. Such a petition should (1) be made at least two business days before the request due date, (2) be in writing (including via email), (3) provide the basis for the request, and (4) provide a proposed production date. All requests will be subject to approval by the Market Regulation Department.

The amendment to Rule 432 will become effective on March 28.

The SER regarding the amendments to Rule 432 can be found here.

CFTC Issues Advisory Notice Regarding Updates to Special Account Information on Form 102

The Commodity Futures Trading Commission's Division of Market Oversight has issued an advisory notice to remind futures commission merchants (FCMs), clearing members and foreign brokers of their obligation to maintain up-to-date information regarding special account information on Form 102 submitted to the CFTC. Failure to properly and timely update information contained in a Form 102 constitutes an actionable violation under the Commodity Exchange Act and CFTC Regulations.

CFTC Regulation 17.01 generally requires FCMs, clearing members and foreign brokers to report all special accounts carried on the books of the FCM, clearing member or foreign broker on Form 102 upon the establishment of the account. CFTC Regulation 17.01(g) requires that each Form 102 be updated any time there is a change in any information contained therein, including any changes to the name, address, business telephone number, registration status, legal organization or principal business of the account holder, or the account number or account name.

The advisory notice can be found here.

LITIGATION

Second Circuit Affirms Option Backdating Conviction

The U.S. Court of Appeals for the Second Circuit recently affirmed the conviction of James Treacy, the former Chief Operating Officer and President of Monster Worldwide, Inc., in connection with a conspiracy to backdate stock options. In September 2009, Mr. Treacy was sentenced to 24 months' imprisonment and ordered to pay restitution and forfeiture of over $6 million. Mr. Treacy appealed his sentence arguing, among other things, that (1) the district court abused its discretion in conducting *voir dire* when it declined to question prospective jurors about their views on corporate America generally, and (2) the district court committed clear error in calculating the forfeiture amount.

Mr. Treacy proposed that the district court ask potential jurors 77 questions, a number of which pertained specifically to the jurors' experiences with, and views of, corporate America. The district court refused to give the jury a written questionnaire or to inquire directly about bias toward corporate executives, instead orally asking each juror about his or her knowledge of stock options generally and experience therewith. On appeal, Mr. Treacy argued that the district court's failure to inquire broadly about juror biases against corporate America, in light of the general animosity in the spring of 2009 towards corporate executives, constituted reversible error. The court was unpersuaded by this argument, noting that a district court may find that warning a jury against an improper bias, which was given by the district court here, may be more effective in some cases than inquiring specifically about that bias.

Mr. Treacy also argued that the district court's forfeiture award was improperly inflated because it was based on the wrong measurement dates for the issuance of the stock options. The Second Circuit rejected Mr. Treacy's argument that the option grant should have been calculated from the date Monster's chief executive made a commitment to grant him the options. The court pointed out that the chief executive, who was a participant in the backdating scheme, did not have the authority to grant the options without the approval of the board's compensation committee. As a result, the date of the chief executive's decision to grant the options was irrelevant, and the court affirmed the district court's decision to use the dates when the options were granted in accordance with Monster's procedures. The court did, however, accept Mr. Treacy's argument that the district court incorrectly decided to assign the same measurement date to all options granted as of a certain date even though the evidence established that the options were granted in rounds. (*U.S. v. Treacy*, 2011 WL 799781 (2d Cir. March 9, 2011))

Improper Accounting Adjustments Held Insufficient Basis for Securities Fraud Claims

A federal district court in California recently dismissed class action securities fraud claims arising out of several improper accounting adjustments made by VeriFone Holdings, Inc. On September 15, 2010, purchasers of VeriFone common stock filed their Third Amended Complaint in a consolidated securities fraud class action against the corporation and certain of its officers and directors. Plaintiffs alleged that defendants violated Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5 by engaging in a scheme to defraud, making false statements, omitting material facts and performing deceptive acts which led to the gross overstatement of operating income and, ultimately, the restatement of VeriFone's financials. Defendants moved to dismiss, arguing, among other things, that that plaintiffs did not adequately allege scienter as to each individual or the corporation.

The restatement was necessitated by a series of accounting errors made by Paul Periolat, VeriFone's supply chain controller. In particular, after receiving internal preliminary financial results that were below the company's forecasts, VeriFone's chief executives demanded that management figure out what had happened. In response, Mr. Periolat determined, incorrectly, that the company was not accounting for its inventory properly and made several manual adjustments to the financial results that inflated VeriFone's earnings. Mr. Periolat acted without having the adjustments scrutinized or approved by more senior VeriFone management. Thus, Mr. Periolat manually adjusted the amount of inventory held by a foreign subsidiary, without speaking with the foreign subsidiary's controller and despite knowing that the subsidiary had proper procedures in place for accounting for inventory.

The district court held that Mr. Periolat's faulty accounting adjustments may have been grossly negligent, but did not support a strong inference that Mr. Periolat or VeriFone acted with scienter. Although the court determined that the allegations of scienter were "cogent," it held that other, non-fraudulent inferences were more compelling. In particular, because the adjustments Mr. Periolat made were not concealed in any way and Mr. Periolat's previous projections were accurate, the court determined that the most likely explanation for Mr. Periolat's actions was that he believed his adjustments were correct. (*In re VeriFone Holdings, Inc. Securities Litigation*, 2011 WL 843959 (N.D.Cal. March 8, 2011))

BANKING

FDIC Board Approves Proposed Rule to Set Claims Process; Puts Burden of Proof on Officers and Directors to Exonerate Themselves

The Board of Directors of the Federal Deposit Insurance Corporation (FDIC) on March 15 approved a Notice of Proposed Rulemaking (NPR) to further clarify application of the Orderly Liquidation Authority (OLA) contained in

Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act. (The NPR issued an interim rule on the same subject on January 18, which "clarified certain discrete issues under the OLA." The earlier interim rule addressed discrete topics including the payment of similarly situated creditors, the honoring of personal services contracts, the recognition of contingent claims, the treatment of any remaining shareholder value in the case of a covered financial company that is a subsidiary of an insurance company, and limitations on liens that the FDIC may take on the assets of a covered financial company that is an insurance company or covered subsidiary.)

The Proposed Rule addresses the following issues: (1) the definition of a "financial company" subject to resolution under Title II by establishing criteria for determining whether a company is "predominantly engaged in activities that are financial in nature or incidental thereto;" (2) recoupment of compensation from senior executives and directors, including the placement of the burden of proof on such individuals to exonerate themselves; (3) application of the power to avoid fraudulent or preferential transfers; (4) the priorities of expenses and unsecured claims; and (5) the administrative process for initial determination of claims and the process for judicial determination of claims disallowed by the receiver.

The FDIC stated that the NPR approved today "will provide a 'roadmap' for creditors to better understand their substantive and procedural rights under Title II by defining key elements determining how their claims will be determined and in what priority they will be paid." The FDIC further explained that "these regulations implement newly enacted provisions of the Dodd-Frank Act and do not necessarily inform or interpret the provisions of the Federal Deposit Insurance Act, 12 U.S.C. Section 1811 et seq. (FDI Act), and the law governing the resolution of failed insured depository institutions. Thus, some provisions implementing the Dodd-Frank Act may expand the rights and duties of parties with an interest in the resolution, or otherwise provide rights and duties that differ from those under the FDI Act."

According to the FDIC, the NPR also "clarifies additional issues important to the implementation of the OLA, including how compensation will be recouped (i.e., clawed back) from senior executives and directors who are substantially responsible for the failure of the firm." According to the FDIC, before seeking to recoup compensation, the receiver will consider whether the senior executive performed his or her responsibilities with the requisite degree of skill and care, and whether the individual caused a loss that materially contributed to the failure of the financial company. The FDIC is considering the use of additional qualitative and quantitative benchmarks to establish that the loss materially contributed to the failure of the covered financial company. Financial indicators under consideration as possible benchmarks are assets, net worth and capital, and the percentage or magnitude of loss associated with these benchmarks that would establish a material loss and trigger substantial responsibility.

Also noteworthy is the presumption that such officers are substantially responsible and thus subject to recoupment of up to two years of compensation. The FDIC explained:

> Substantial responsibility shall be presumed when the senior executive or director is the chairman of the board of directors, chief executive officer, president, chief financial officer, or acts in any other similar role regardless of his or her title if in this role he or she had responsibility for the strategic, policymaking, or company-wide operational decisions of the covered financial company. The FDIC as receiver also will presume the substantial responsibility of a senior executive or director who has been adjudged by a court or tribunal to have breached his or her duty of loyalty to the covered financial company. Finally, in order to ensure consistency this presumption also extends to a senior executive or director who has been removed from his or her position with a covered financial company under section 206(4) or section 206(5) of the Act.

An exception is created for executives recently hired by the financial company specifically for improving its condition. The proposal may generate controversy, since the downfall of a company may not necessarily be the fault of such officers or directors, yet the presumption causes the burden of proof to fall on such officers and directors to exonerate themselves; further, even assuming that certain officers or directors are responsible for a failure, and that other executives and directors of covered companies may have little or nothing to do with the actions of those individuals who may bring about such a company's demise, such other officers and directors will also bear the burden of proof under the FDIC proposal.

The NPR also details the FDIC's treatment of preferential and fraudulent transfers, the expected priorities of expenses and unsecured claims in the receivership of a covered financial company, how creditors can file claims against the receivership estate, how the FDIC as receiver will determine those claims, and how creditors can pursue their claims in federal court.

The NPR also clarifies the meaning of "financial company" under OLA. Under the proposal, a financial company will be defined as "predominantly engaged" in financial activates if the organization derived at least 85% of its total consolidated revenue from financial activities over the two most recent fiscal years. However, the definition also allows FDIC broad flexibility to revisit such determinations on a case-by-case basis.

Finally, additional rulemaking will follow, according to the FDIC, including certain rules required by the Act, such as rules governing receivership termination, receivership purchaser eligibility requirements, records retention requirements, as well as the orderly resolution of broker-dealers, including the priority scheme and claims process applicable to broker-dealers.

The proposed rule will be out for comment 60 days after publication in the *Federal Register*.

Read more.

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