Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

October 21, 2011

SEC/CORPORATE

ISS Publishes Proposed Changes to Proxy Voting Policies

On October 18, Institutional Shareholder Services (ISS) published for comment proposed changes to its proxy voting policies for 2012. ISS' proposed policy updates for 2012 include the following:

Board and Proxy Access

- ISS clarified that, in determining whether to recommend shareholders vote FOR the election of directors serving on a company's compensation committee, ISS will analyze, on a case-by-case basis, the company's response to advisory votes on executive compensation (i.e., "say-on-pay" votes) receiving significant opposition. Such analysis will take into account the level of opposition to executive compensation policies and practices, the company's ownership structure, disclosure regarding efforts to engage institutional investors regarding compensation issues, the company's response to investor input, specific actions taken to address issues that resulted in significant opposition to executive compensation and actions taken with respect to prior executive compensation issues of concern. ISS noted that when a significant number of shareholders oppose a company's executive compensation policies and practices, an appropriate response must include disclosure of the company's outreach efforts to major institutional investors as well as concrete actions to address investors' concerns. ISS requested comments regarding whether an explicit response is merited where less than 70% of shareholders vote in favor of say-on-pay proposals (and, if not 70%, what a suitable threshold would be), how quickly boards should be required to respond to significant opposition and whether ISS should consider additional factors in its analysis.

- ISS proposed to recommend shareholders withhold votes for, or vote against, incumbent directors if a board implements say-on-pay votes on a less frequent basis than the frequency which received the majority of votes cast at the most recent shareholder meeting where a say-on-pay frequency vote was held. ISS will determine its voting recommendations on a case-by-case basis if a board implements an advisory vote on executive compensation on a less frequent basis than the frequency which received a plurality, but not a majority, of votes cast, taking into account the board's rationale for choosing a frequency that is different than the frequency supported by a plurality of shareholders, the company's ownership structure, ISS' analysis of the company's executive compensation and other factors. ISS is soliciting comments regarding other factors that should be considered in its analysis of responses to say-on-pay frequency votes.

- ISS proposed to analyze shareholder proposals seeking proxy access on a case-by-case basis taking into account the proponent's rationale for the proposal at the targeted company, the ownership thresholds proposed in the resolutions (e.g., percentage and duration of ownership), the maximum number of directors that shareholders may nominate each year and the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations.

Executive Compensation

- In connection with ISS' recommendations concerning say-on-pay proposals, ISS proposed to use a new methodology to evaluate pay-for-performance alignment, which will identify companies that have demonstrated strong, satisfactory, or weak alignment between total shareholder returns and CEO compensation over an extended period of time. The new methodology will incorporate a quantitative analysis followed, if applicable, by further qualitative analysis. The quantitative analysis will examine the degree of alignment between a company's shareholder returns and its CEO's pay relative to peer companies over a one and three year period, the multiple of a CEO's total pay relative to the peer group median and the alignment between the trend in the CEO's pay and the company's returns over the past five fiscal years. Companies that demonstrate strong or satisfactory alignment will generally receive a positive recommendation while companies demonstrating weak alignment will receive further qualitative analysis. ISS has specifically requested comments regarding whether the factors to be considered by ISS' proposed analysis align with institutional investors' approach, whether the ISS analysis gives adequate consideration to long-term alignment, and whether additional factors ought to be considered.

- ISS is proposing to analyze, on a case-by-case basis, equity plan proposals of newly-public companies seeking favorable tax treatment under Section 162(m) of the Internal Revenue Code (which requires shareholder approval before a public company may award performance-based equity to named executive officers in order to qualify as performance-based compensation). Under the proposed policy, ISS would fully analyze the applicable equity plan, including the total shareholder value transfer under the plan, repricing provisions, change in control provisions and the burn rate of the plan. ISS is specifically seeking comment as to whether the potential tax deduction on performance-based compensation for named executive officers outweigh the adverse impact of problematic features in equity plans for newly-public companies and whether the compensation committee should be held responsible for equity plans that do not receive favorable tax treatment because shareholders do not support problematic aspects of the plan.

Environmental and Social

- In light of the 2010 *Citizens United* decision by the U.S. Supreme Court, ISS proposed to shift its current policy on corporate political contribution disclosure proposals from analyzing such proposals on a case-by-case basis to generally recommending that shareholder vote FOR proposals requesting greater disclosure of a company's policies and oversight of political contributions and trade association spending policies and activities.

The comment period for ISS' 2012 proxy voting policies ends on October 31, and ISS expects to release its final policy updates during the week of November 14.

To view the complete text of ISS' draft policy updates for 2012, click here.

SEC's Division of Corporation Finance Issues Bulletin Regarding Legal and Tax Opinions

On October 14, the staff of the SEC's Division of Corporation Finance issued a legal bulletin (No. 19) regarding legality and tax opinions filed in connection with registered offerings of securities. The bulletin covers the requirements for these opinions, the staff's views regarding the required elements for these opinions and the staff's practices in reviewing them.

Legality Opinions

Item 601(b)(5)(i) of Regulation S-K requires that all filings for registered offerings of securities under the Securities Act of 1933 include an opinion of counsel regarding the legality of the securities being offered and sold pursuant to the registration statement. The bulletin notes that, as a general rule, counsel's signed legality opinion must be filed as an exhibit to the registration statement before it becomes effective, and the opinion may not be subject to any unacceptable qualifications, conditions or assumptions. Among other things, the bulletin:

- confirms that a legality opinion for debt securities or guarantees must refer to the law of the jurisdiction governing the agreement or instrument, must consider the law of the jurisdiction under which the registrant is organized in order to provide a "binding obligation" opinion, and may rely upon the opinion of local counsel to satisfy this requirement (in which case both legal opinions must be filed as exhibits);

- confirms that in a legality opinion covering the registration of options, warrants or rights, to the extent that the registrant also registers the offer and sale of securities underlying the options, warrants or rights, the opinion also must opine on the legality of the underlying securities;

- confirms that for shareholders' rights plans ("poison pills"), because there may be a significant level of uncertainty under state law that makes it difficult for counsel to render a "binding obligation" opinion, the opinion may acknowledge the uncertainties involved and discuss the possibility of a determination that would question the legality of the rights at a later date;

- confirms that when the registrant registers the offer and sale of units comprised of two or more underlying securities, the opinion must address the legality of each component of the unit, as well as the unit itself; and

- confirms that purchasers of securities in registered offerings are entitled to rely on filed opinions, and that the staff does not accept any limitation on reliance.

Tax Opinions

Item 601(b)(8) of Regulation S-K requires opinions on tax matters for (i) filings on Form S-11, (ii) filings to which Securities Act Industry Guide 5 applies, (iii) roll-up transactions and (iv) other registered offerings where "the tax consequences are material to an investor and a representation as to tax consequences is set forth in the filing." Either legal counsel or an independent public or certified accountant can give such an opinion supporting the tax matters and consequences to shareholders described in the filing. A revenue ruling from the IRS also will satisfy this requirement. Among other things, the bulletin:

- confirms that a tax opinion need address only material federal tax consequences, and if the author of the opinion is unable to opine on a material tax consequence, that fact must be disclosed along with the reason why the author cannot so opine and a discussion of possible alternatives and risks to investors of that tax consequence;

- confirms that a description of the law does not satisfy the requirement to provide an opinion on the material tax consequences as applied to the specific facts of the particular transaction; and

- confirms that if there is a lack of authority directly addressing the tax consequences of the transaction, conflicting authority or significant doubt about the tax consequences of the transaction, counsel or accountant may issue a "should" or "more likely than not" opinion to make clear that the opinion is subject to a degree of uncertainty.

Click here for Staff Legal Bulletin No. 19.

CFTC

Derivatives Clearing Organization General Provisions and Core Principles

The Commodity Futures Trading Commission (the CFTC) has adopted final rules implementing numerous general provisions and most core principles relating to derivatives clearing organizations (DCOs) at its October 18 open meeting. The final rules were approved by a 3-2 vote (Commissioners Sommers and O'Malia dissenting). The rules, which address15 of the 18 DCO Core Principles, were adopted largely as proposed. The CFTC did not adopt rules implementing the core principles relating to governance fitness standards, conflicts of interest and composition of governing boards. The effective dates for the final rules are staggered. Some rules will be effective 60 days after publication in the Federal Register, and others will be effective 180 days or a year after publication in the Federal Register.

The final rules can be found here.

Position Limits for Futures and Swaps

At its October 18 open meeting, the Commodity Futures Trading Commission (the CFTC) also approved final rules on speculative position limits for futures and swaps. The final rules were approved by a 3-2 vote (Commissioners Sommers and O'Malia dissenting) and reflect certain material changes to the rules proposed in January, including the retention of certain aggregation exemptions that would have been eliminated by the proposed rules. The details of the final position limit rules are the subject of a forthcoming Katten *Client Advisory*.

The CFTC "Fact Sheets" and "Q&As" on the final position limit rules may be found here.

Amendments to Effective Date for Swap Regulation

The Commodity Futures Trading Commission (the CFTC) has proposed to extend its earlier exemptive order that provides temporary relief from certain swap-related provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) that would otherwise have taken effect on July 16 (the Order). Specifically, the Order provided relief with respect to (1) self-effectuating provisions of the Dodd-Frank Act that referenced terms requiring further definition, and (2) self-effectuating provisions of the Dodd-Frank Act that repealed existing statutory safe harbors for over-the-counter derivatives transactions.

The Order originally included an outside "sunset" date of December 31, after which the relief granted by the Order would expire. Under the proposed amendment, the latest "sunset" date for the Order would be extended until July 16, 2012.

The proposed amendment may be found here.

BROKER DEALER

FINRA Proposed Rule Regarding Best Execution and Interpositioning

On October 17, Financial Industry Regulatory Authority filed with the Securities and Exchange Commission a proposed rule change to adopt NASD Rule 2320 (Best Execution and Interpositioning) and Interpretive Material (IM) 2320 (Interpretive Guidance with Respect to Best Execution Requirements) as FINRA Rule 5310 in the consolidated FINRA rulebook. Like NASD Rule 2320 (commonly known as the "Best Execution Rule"), FINRA Rule 5310 would require a member, in any transaction for or with a customer or a customer of another broker-dealer, to "use *reasonable diligence* to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." FINRA Rule 5310 is based largely on NASD Rule 2320. In addition, IM-2320 will be adopted as Supplementary Material to Rule 5310; however, it is important to note that the Supplementary Material contains the following significant changes:

- <u>Replacement of the Three Quote Rule.</u> NASD Rule 2320(f) (commonly referred to as the "Three Quote Rule") generally requires members that execute transactions in non-exchange-listed securities on behalf of customers to contact a minimum of three dealers (or all dealers if three or fewer) and obtain quotations from those dealers if there are fewer than two quotations displayed on an inter-dealer quotation system that permits quotation updates on a real-time basis.

  The Supplementary Material eliminates the Three Quote Rule and emphasizes a member's best execution obligations when handling customer orders involving securities (equity or debt) for which there is limited pricing information or quotations available. The Supplementary Material requires members to have written policies and procedures in place to (1) address the steps the member will take to determine the best market for securities in the absence of multiple quotations or pricing information and (2) document how they have complied with those policies and procedures. The Supplementary Material specifically notes that—when handling orders for such securities—members should generally seek out other sources of pricing information or potential liquidity, which may include obtaining quotations from other sources (*e.g.*, other firms that the member previously has traded within the security).

- <u>Regular and Rigorous Review of Execution Quality.</u> The Supplementary Material codifies a member's obligations when it undertakes a regular and rigorous review of execution quality likely to be obtained from different market centers. The Supplementary Material simply codifies guidelines set forth and explained in various SEC releases and NASD Notices to Members. *See*, *e.g.*, Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996); and NASD Notice to Members 01-22 (April 2001). The Supplementary Material does not alter a member's obligation to conduct a regular and rigorous review of execution quality.

- Orders for Foreign Securities with No U.S. Market. NASD Rule 2320 does not specifically distinguish between orders for domestic securities and orders for foreign securities, even in cases where there is no U.S. market for the security. The Supplementary Material notes that the obligation to use "reasonable diligence" applies to customer orders in both domestic and foreign securities. However, the Supplementary Material recognizes that the handling of customer orders in foreign securities that do not trade in the U.S. can differ substantially from the handling of orders in U.S.-traded securities. Accordingly, the determination as to whether a member has satisfied its best execution obligation for transactions in these securities will be based on factors such as "the character of the particular foreign market" and "the accessibility of quotations in certain foreign markets."

  The Supplementary Material requires members who handle customer orders for foreign securities that do not trade in the U.S. to have specific written policies and procedures in place regarding its handling of customer orders for these securities that are reasonably designed to obtain the most favorable terms available for the customer, taking into account differences that may exist between U.S. markets and foreign markets. The Supplementary Material further notes that a member's best execution obligations also must evolve as changes occur in the market that may give rise to improved executions. As a result, members must regularly review their policies and procedures to assess the quality of executions received and update or revise these policies and procedures as necessary.

- Customer Instructions Regarding the Routing of Orders. The Supplementary Material addresses situations where the customer has—on an unsolicited basis—specifically instructed the member to route its order to a particular market. Under those circumstances, the member would not be required to make a best execution determination beyond that specific instruction; however, the Supplementary Material mandates that members process the customer's order promptly and in accordance with the terms of the order. The Supplementary Material also makes clear that where a customer has directed the member to route an order to another broker-dealer that is also a FINRA member, the receiving broker-dealer would be required to meet the requirements of Rule 5310 with respect to its handling of the order.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following SEC approval. The implementation date will be no later than 90 days following such publication.

Click here to read the Notice of Filing of Proposed Rule Change.

LITIGATION

Pennsylvania District Court Holds Swiss Corporation is Not Alter Ego of US Corporation

The plaintiff, a corporation seeking to recover outstanding debts incurred by TCI Trans Commodities A.G. (TCI Switzerland), a bankrupt Swiss entity, sued Trans Commodities, Inc. (TCINY), a New York corporation, to collect the debt. The plaintiff alleged that TCINY and TCI Switzerland were so intertwined or interrelated as to be "alter egos" or a "single entity," and thus TCINY was liable for TCI Switzerland's debt to the plaintiff.

The U.S. District Court for the Eastern District of Pennsylvania ruled that the plaintiff had not demonstrated that TCINY was the "alter ego" of TCI Switzerland, and granted TCINY's summary judgment motion. In attempting to show that TCINY sufficiently controlled TCI Switzerland to create alter-ego status, the plaintiff presented evidence that TCINY entered into a Consulting Agreement with TCI Switzerland and TCINY's employees spoke daily with TCI Switzerland's employees. One of TCINY's officers sent letters using TCI Switzerland's letterhead, and there were allegations that TCINY had direct control over TCI Switzerland's personnel decisions and claims processes.

Nevertheless, the court ruled that the plaintiff had not demonstrated sufficient evidence to warrant piercing the corporate veil. Although the parties differed on which state's law – either New York or Pennsylvania – should apply, the court found that under either state's law, the plaintiff had not presented sufficient evidence to overcome the strong presumption against piercing the corporate veil.

Macready et. al. v. TCI Trans Commodities, A.G., et al., Civil Action No. 00–4434, 2011 WL 4835829 (E.D. Penn Oct. 12, 2011).

California District Court Dismisses Securities Fraud Class Action Suit

Plaintiff-investors commenced a class action suit alleging a violation of the Securities and Exchange Act of 1934 on behalf of all persons who purchased shares of defendant NVIDIA's stock during a 9-month period. The plaintiff alleged that NVIDIA and its employees had misrepresented or omitted material facts related to manufacturing defects in its computer processors, and that they were damaged when the NVIDIA stock price dropped once the extent of the defects became known. The U.S District Court for the Northern District of California dismissed the plaintiffs' action because the complaint failed sufficiently to plead scienter as required for securities fraud.

The court found that plaintiffs in securities fraud claims brought in the Ninth Circuit and governed by the Private Securities Litigation Reform Act (PLSRA) must allege that defendants "made false or misleading statements either intentionally or with deliberate recklessness" in order to satisfy the element of scienter. The court found that the plaintiff must plead "a highly unreasonable omission...[which is] an extreme departure from ordinary care."

The court held that none of the plaintiffs' allegations met this high burden. None of the statements from confidential witnesses on which the plaintiffs relied in their complaint demonstrated that the defendant acted with the requisite intent. Statements from outside sources which suggested that NVIDIA should have acted differently in hindsight also did not establish the necessary scienter. A change in manufacturing procedure that suggested that NVIDIA knew that its materials may have contributed to the defects was also not sufficient to create the necessary inference that NVIDIA knew the scope of its liability for potential defects and chose to hide that fact. Given the plaintiffs' inability to meet the high pleading standard requirement for PLSRA securities violations, the court dismissed the complaint.

In re NVIDIA Corporation Securities Litigation, No. C 08–04260 RS, 2011 WL 4831192 (N.D.Cal. Oct. 12, 2011).

BANKING

Federal Reserve Approves Final Rule for "Living Wills"

The Board of Governors of the Federal Reserve System (the Board) on October 17 announced the approval of a final rule to implement the resolution plan requirement in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The final rule requires bank holding companies with assets of $50 billion or more and nonbank financial firms designated by the Financial Stability Oversight Council (the Council) for supervision by the Board to annually submit resolution plans to the Board and the Federal Deposit Insurance Corporation (the FDIC).

Specifically, section 165(d) of the Dodd-Frank Act requires each nonbank financial company supervised by the Board and each bank holding company with total consolidated assets of $50 billion or more (each a "covered company") to periodically submit to the Board, the FDIC and the Council a plan for such company's rapid and orderly resolution in the event of material financial distress or failure. That section also requires each covered company to report on the nature and extent of credit exposures of such covered company to significant bank holding companies and significant nonbank financial companies and the nature and extent of credit exposures of significant bank holding companies and significant nonbank financial companies to such covered company.

Each plan must describe the company's strategy for rapid and orderly resolution in bankruptcy during times of financial distress. A resolution plan must include a strategic analysis of the plan's components, a description of the range of specific actions the company proposes to take in resolution, and a description of the company's "organizational structure, material entities, interconnections and interdependencies, and management information systems." More specifically, the final rule requires each covered company to produce a resolution plan that includes information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of nonbank subsidiaries of the company; detailed descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company;

identification of the cross-guarantees tied to different securities; identification of major counterparties; a process for determining to whom the collateral of the company is pledged; and other information that the Board and the FDIC jointly require by rule or order.

The final rule also requires a strategic analysis by the covered company of how it can be resolved under Title 11 of the U.S. Code (the Bankruptcy Code) in a way that would not pose systemic risk to the financial system. In doing so, the company must map its core business lines and critical operations to material legal entities and provide integrated analyses of its corporate structure; credit and other exposures; funding, capital and cash flows; the domestic and foreign jurisdictions in which it operates; and its supporting information systems for core business lines and critical operations.

Companies subject to the rule will submit their initial resolution plans on a staggered basis. The first group of companies, generally those with $250 billion or more in non-bank assets, must submit their initial plans on or before July 1, 2012; the second group, generally those with $100 billion or more, must submit their initial plans on or before July 1, 2013; and the remaining companies, generally those with less than $100 billion in total non-bank assets, must submit their initial plans on or before December 31, 2013.

The rule becomes effective on November 30. To view the rule, click 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
Daniel J. Silverthorn	312.902.5502	daniel.silverthorn@kattenlaw.com
Jonathan D. Weiner	212.940.6349	jonathan.weiner@kattenlaw.com
FINANCIAL SERVICES		
Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Guy C. Dempsey, Jr.	212.940.8593	guy.dempsey@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
Maureen C. Guilfoile	312.902.5425	maureen.guilfoile@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Joseph Iskowitz	212.940.6351	joseph.iskowitz@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
LITIGATION		
Steven Shiffman	212.940.6785	steven.shiffman@kattenlaw.com
Joseph E. Gallo	212.940.6549	joseph.gallo@kattenlaw.com
BANKING		
Jeff Werthan	202.625.3569	jeff.werthan@kattenlaw.com