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SEC/CORPORATE

SEC Staff Publishes New Guidance on Shareholder Proposals

On October 16 the Securities and Exchange Commission's Division of Corporation Finance issued Staff Legal Bulletin No. 14G (SLB 14G) providing guidance with respect to three issues in connection with shareholder proxy proposals that arose during the 2012 proxy season.

The first issue addresses the requirement in Rule 14a-8 under the Securities Exchange Act of 1934 that a shareholder must provide documentation evidencing that the shareholder has continuously held at least $2,000 in market value (or 1%) of the company's voting securities for at least one year as of the date the shareholder submits the proposal. If the shareholder is not a record owner, the shareholder must submit a written statement as to his beneficial ownership from the record holder of the securities. In an earlier Staff Legal Bulletin (SLB 14F), the Division of Corporation Finance stated that only securities intermediaries that are participants in the Depositary Trust Company (DTC) could be viewed as "record holders" and therefore a beneficial owner must obtain a proof of ownership letter from the DTC participant through which the securities are held. SLB 14G expands this interpretation to provide that proof of ownership letters from entities that are affiliates of DTC participants can also meet the requisite proof of ownership standard.

SLB 14G also addresses the manner in which a company must notify a shareholder proponent if it views that the proponent failed to follow one of the eligibility or procedural requirements under Rule 14a-8. It provides that the company seeking to exclude a proposal on duration of ownership grounds must specify the deficiencies it has identified, including the specific date on which the proposal was submitted, and must explain that what is required is a letter verifying continuous ownership of the requisite amount of securities for the one-year period preceding and including such date. SLB 14G specifies that the proponent's date of submission is the date the proposal is postmarked or transmitted electronically.

Finally, SLB 14G clarifies the circumstances under which a website address referencing the contents of a proponent's website may be properly excluded. While noting that a website address will be "counted" as one word for purposes of the Rule 14a-8(d) 500 word limitation, SLB 14G also sets forth circumstances under which a proposal that links to information on the proponent's website may be excluded under Rule 14a-8(i)(3) as vague and indefinite.

Read more.

ISS Proposes Updates to its Proxy Voting Policies for 2013

On October 16, Institutional Shareholder Services (ISS) published for comment proposed changes to its proxy voting policies for 2013. ISS' proposed policy updates for 2013 applicable to US issuers relate to board responsiveness to majority-supported shareholder proposals, management "say on pay" proposals, say on "golden parachute" proposals, and the use of environmental and social metrics in determining executive compensation:

Board Responses to Majority-Supported Shareholder Proposals. ISS proposed a policy to recommend that shareholders vote against the election of, or withhold votes from, an entire board of directors if the board failed to act on a shareholder proposal that received the support of a majority of *votes cast* in the previous year. Under its current policy, ISS recommends that shareholders vote against (or withhold votes from) directors if the board failed to act on a shareholder proposal that received support of (i) a majority of shares *outstanding* in the previous year or (ii) a majority of the *votes cast* in the last year and one of the two previous years. According to ISS, the proposed change is intended to reflect institutional investors' growing expectation that issuers will implement shareholder proposals that receive support from a majority of votes cast, as well as increased issuer responsiveness to shareholder proposals, based on the results of ISS' 2012-2013 Policy Survey (the ISS Policy Survey).

Management Say on Pay Proposals. With respect to management "say on pay" advisory votes, ISS proposed to modify its methodology for selecting peer groups as part of its quantitative analysis, incorporate comparisons of "realizable" compensation to grant date pay as part of its qualitative analysis of pay for performance alignment, and add pledging of shares as a factor that may lead to a negative recommendation under ISS' existing problematic pay practices evaluation.

- *Peer Group Selection*. Currently, ISS' pay for performance evaluation begins with a quantitative comparison of a company's performance to that of a peer group selected by ISS based on the company's Global Industry Classification Standard (GICS) classification. According to ISS, its current methodology may omit competitors of the target company and/or include firms that are not properly considered "peers" for a number of reasons, including the fact that many companies (or their competitors) may engage in multiple lines of business that are not reflected in the GICS classification. Under the proposed policy revisions, ISS would give increased deference to company-selected peers as an input in ISS' peer group methodology, while maintaining an approach that includes company size and market capitalization constraints.

- *Realizable Pay*. ISS is also considering adding realizable pay to its qualitative analysis of say on pay proposals for large companies. The revised policy would take into account not only the grant date value of compensation paid to executives, but also the change in value of performance-based awards based on the actual performance of a company's stock.

- *Pledging Company Stock*. ISS proposed to add pledging of shares as a factor that may lead to a negative recommendation under ISS' existing pay practices evaluation. ISS noted that pledging company stock by a named executive officer could be detrimental to shareholders if the executive is required to sell a large amount of stock, and may be utilized as part of a hedging strategy that could immunize an executive from the negative performance of the stock.

Say on Golden Parachute Proposals. ISS proposed to update its current policy on proposals to approve compensation payable to named executive officers in connection with a change in control of an issuer (i.e., "golden parachute" proposals). Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, issuers are required to hold separate shareholder votes on potential golden parachute payments when they seek approval of mergers and similar transactions. ISS proposed to update its policy with respect to votes on golden parachute payments (i) to consider existing change-in-control arrangements maintained with named executive officers rather than focusing only on new or extended arrangements and (ii) to place additional scrutiny on multiple problematic features in change-in-control arrangements that will result in a negative recommendation (such as single trigger cash severance or option acceleration or excessive severance). Under the proposed policy, ISS would make voting recommendations on a case-by-case basis with respect to golden parachute proposals, taking into account existing change-in-control arrangements maintained with named executive officers (in addition to considering new or extended arrangements). ISS also noted that it would evaluate golden parachute compensation in assessing broader say on pay proposals in accordance with the above guidelines.

Environmental and Social Non-Performance Compensation Proposals. ISS proposed to modify its existing policy of recommending that shareholders vote against proposals to link executive compensation to environmental or social (non-financial) metrics (Sustainability Metrics). Under the proposed policy, ISS would consider proposals to link executive compensation to Sustainability Metrics on a case-by-case basis. According to ISS, the proposal is intended to provide ISS with greater flexibility, particularly in light of the increased use of Sustainability Metrics in determining executive compensation and the results of the ISS Policy Survey, wherein approximately two thirds of investor respondents indicated either that the use of Sustainability Metrics in executive compensation would be beneficial or that a case-by-case approach is appropriate.

The comment period for ISS' 2013 proxy voting policies ends on October 31.

To view the complete text of ISS' draft policy updates for 2013, including those applicable to non-US issuers and specific aspects of the policy updates for which ISS is seeking comments, click here.

SEC Establishes Risk Management and Operations Standards for Registered Clearing Agencies

The Securities and Exchange Commission adopted new rule 17Ad-22 under the Securities Exchange Act of 1934 (the Exchange Act) that establishes minimum requirements regarding how registered clearing agencies that provide central counterparty services (Clearing Agencies) must maintain effective risk management procedures and controls as well as meet the statutory requirements under the Exchange Act on an ongoing basis.

Generally, the rule requires a Clearing Agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) measure its credit exposures to its participants at least once a day; (ii) use margin requirements to limit its credit exposures to participants using risk-based models and parameters, to be reviewed at least monthly; (iii) maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions (and a default by the two participant families to which it has the largest exposures for security-based swap clearing agencies); and (iv) provide for an annual model validation by a qualified person who is free of influence from the persons responsible for the development or operation of the models being validated.

The rule also provides membership standards for central counterparties. Under the rule, a Clearing Agency is required to establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) provide the opportunity to obtain membership in the clearing agency for persons who are not dealers or security-based swap dealers on fair and reasonable terms; (ii) have membership standards that do not require participants to maintain minimum size portfolios or minimum transaction volumes; and (iii) provide a person that maintains net capital equal to or greater than $50 million with the ability to obtain membership provided that the person is able to comply with other reasonable membership standards, with net capital requirements being scalable in relation to the risks posed by such person's activities to the clearing agency.

In addition, the rule requires a Clearing Agency to (i) calculate quarterly or upon SEC request, and maintain a record of, the financial resources that would be needed in the event of a participant default; and (ii) post on its website its annual audited financial statements within 60 days after the end of its fiscal year. The rule also establishes several new operational standards for Clearing Agencies.

The rule will become effective 60 days after its publication in the *Federal Register*.

Click here to read the SEC's Adopting Release for Rule 17Ad-22.

PRIVATE INVESTMENT FUNDS

IRS Delays Implementation of FATCA Tax Reporting Rules

The Internal Revenue Service this week released Announcement 2012-42 (the Announcement), which postpones until 2014 the need for foreign hedge funds and private equity funds to request Foreign Account Tax Compliance Act (FATCA) information and documentation from their investors. In effect, the IRS has delayed implementation of the FATCA tax reporting rules until 2014. The Announcement also postpones to 2017 the earliest date on which non-compliant investors will be subject to 30% withholding on the gross proceeds from the sale of US stock and securities.

Read more.

CFTC

CFTC Proposes Rules to Enhance Protections for Customer Funds

The Commodity Futures Trading Commission published proposed rules that are designed to increase protections for customers and customer funds held by futures commission merchants (FCMs) and derivatives clearing organizations (DCOs). The proposed rules clarify that an FCM must comply with the CFTC's segregation requirements at all times, including on an intra-day basis, and that FCMs bear sole responsibility for all losses that arise from investing customer segregated funds.

The proposed rules require an FCM to adopt a risk management program that, among other things, includes written procedures for establishing a target level for the amount of the FCM's own funds deposited in customer segregated funds accounts (commonly referred to as a residual interest), which exceeds the sum of all of such customers' margin deficits. The proposal also prohibits FCMs from loaning funds on an unsecured basis to finance customer trading activity. In the event that an FCM cannot immediately certify to the CFTC that it has sufficient access to liquidity to continue operations as a going concern, the proposed rules would authorize the CFTC to require the FCM to transfer its customer accounts and cease operations.

Under proposed Regulation 1.23, if an FCM deposits unencumbered proprietary funds into its customer segregated funds accounts, the FCM cannot withdraw any such funds unless it has completed its daily segregation calculation and such calculation shows that there are excess segregated funds in these accounts. If a withdrawal exceeds 25% of the FCM's residual interest, then the FCM must immediately file a written notice with the CFTC and its designated self-regulatory organization (DSRO). The proposed rules also require an FCM to disclose its residual interest targets on the Segregation and Secured Amount Schedules to the Form 1-FR. FCMs would be required to electronically file their segregation, secured amount and cleared swaps collateral calculations with the CFTC and their DSROs every business day.

The proposed rules require all customer funds that are deposited with a bank or trust company to be available for immediate withdrawal upon demand by the FCM or a DCO. In addition, any depository that holds customer segregated funds would be required to provide the CFTC and the DSRO read-only electronic access to the accounts in which such funds are held.

The CFTC has additionally proposed to require FCMs to hold customer funds in secured amount accounts in the United States, except when necessary to margin, guarantee or secure customers' foreign futures or foreign options positions.

The proposed rules are available here.

CFTC Issues Interpretive Statement Regarding Foreign Regulators and Swap Data Repositories

The Commodity Futures Trading Commission issued a final interpretive statement to provide guidance to foreign regulators and swap data repositories (SDRs) regarding the confidentiality and indemnification provisions of Section 21(d) of the Commodity Exchange Act (CEA).

Under the interpretive statement, the confidentiality and indemnification provisions do not apply to data reported to a registered SDR that is also registered with or authorized by a foreign regulator with respect to data that has been reported to the SDR under foreign law. The CFTC further indicated that a foreign regulatory authority may obtain confidential data, without execution of a indemnification agreement, pursuant to the provisions of Section 8(e) of the CEA.

The interpretive statement is available here.

LITIGATION

Claims for Corporate Indemnification and Piercing the Corporate Veil Not Mutually Exclusive

The US Court of Appeals for the Second Circuit reversed a district court decision holding that a plaintiff could not simultaneously seek indemnification from his corporate employer and also seek to pierce that corporation's veil. Plaintiff Emery Kertesz successfully defended a Delaware Court of Chancery suit brought by General Video Corporation (GVC), a corporation of which Kertesz previously was a minority shareholder and officer. Kertesz then sought indemnification in the US District Court for the Southern District of New York from GVC for costs incurred in the prior Delaware action, as well as piercing claims against Korn, the majority shareholder of GVC, should GVC not be able to satisfy the indemnification claim. The District Court held that Kertesz could not maintain that he was entitled to corporate indemnification while at the same time challenging the existence of the corporate structure.

The Second Circuit reversed. The court noted that a successful piercing claim does not affect the corporation's legal structure or existence, but merely establishes that a majority shareholder is liable for *some specific act* of the corporation. The Second Circuit further noted that the District Court's rule would have the effect of allowing an abuse of the corporate form to exempt that corporation from its obligations to its officers. *Kertesz v. Korn*, No. 11-3685-cv (2d Cir. Oct. 17, 2012).

Battle of Experts on Damages Saves Securities Fraud Claims

The US District Court for the Southern District of California last week denied summary judgment to securities fraud defendants based on the plaintiffs' expert testimony regarding damages. Plaintiffs, former interest holders in the limited partnership Sav-On (a self storage facility company), sued Tony Luciani, the majority holder of Sav-On. Plaintiffs alleged that Luciani had induced them to sell him their interests by falsely undervaluing Sav-On and failing to disclose the upcoming sale of Sav-On property.

Luciani moved for summary judgment on the grounds that plaintiffs had not come forward with sufficiently reliable evidence of damages. Luciani's expert witness testified that that the fair market value of a 1% interest in Sav-On was $34,000, and thus plaintiffs—who received $45,000 per 1%—had suffered no out-of-pocket loss. Plaintiffs' expert witness countered that plaintiffs had sold a combined 28.69% interest in Sav-On. He then summed the values of (1) 28.69% of Sav-On's historic revenues, excluding revenues generated from the property sold and (2) 28.69% of the $8.3 million sale price to arrive at a value of $3 million—which was $1.7 million less than defendants had paid to plaintiffs and thus was their recoverable damages.

Luciani attacked plaintiffs' expert witness for, among other things, relying on an economic valuation of the partnership, rather than the market value. The court noted that because the partnership interests were relatively illiquid, an economic valuation would suffice as a measurement of damages, "[o]therwise, no cause of action for securities fraud could ever be brought for transactions involving illiquid securities." The court found that plaintiffs' expert analysis was sufficiently reliable on the issue of damages and therefore that there was a fact issue that could only be resolved at trial. *Luciani v. Luciani*, No. 3:10-cv-2583-JM (S.D. Cal. Oct. 17, 2012).

UK DEVELOPMENTS

FSA Disciplines Firms for Breaching Principle 3

On October 24, the UK Financial Services Authority (FSA) announced that it had fined two firms for failing to provide accurate and timely transaction reports. Plus500UK Limited (Plus500), an online contacts for difference (CFD) trading facility provider, was fined £205,128 (approximately $330,000) and James Sharp and Company (James Sharp), an independent stockbroker, was fined £49,000 (approximately $78,500).

The FSA found that between June 29, 2010, and November 5, 2011, Plus500 conducted 1,332,000 reportable transactions. It failed to report any of these transactions accurately and failed to report 189,000 of them at all. In relation to James Sharp, the FSA found that the firm had failed to report any of the approximately 71,000 reportable transactions that it undertook between November 5, 2007, and February 8, 2011.

The FSA concluded that each firm had breached Principle 3 of the FSA's Principles for Business as well as rule SUP 17.1.4R of the FSA Handbook which imposes specific transaction reporting obligations. The systems and controls of both firms were inadequate. Each firm failed to establish appropriate reporting systems, did not have any documented procedures in place in relation to transaction reporting, and failed to provide training to relevant staff.

The FSA stated that Plus500 is the first firm to be fined in respect of transaction reporting failures under the FSA penalties policy which applies to breaches occurring on or after March 6, 2010. Under the new policy, the penalty imposed is based on the number of affected transactions; in Plus500's case the penalty was higher than it would have been under the prior penalty regime.

David Lawton, FSA Director of Markets, said: "Accurate transaction reports are a key tool in our efforts to tackle market abuse. We will take action where necessary to ensure firms – regardless of size – comply with their reporting obligations. As well as a financial penalty, firms can also expect to incur the cost of resubmitting historically inaccurate reports."

Both firms had taken steps to improve their processes and resolve the errors, resubmitting reports to the FSA where necessary. The firms cooperated with the FSA and entered into settlements at an early stage of proceedings. Accordingly, both qualified for a 30% reduction of the fine.

This is the latest in a series of FSA disciplinary actions with respect to transaction reporting failures dating back to 2010. For examples of earlier disciplinary actions see the April 9, 2010, April 30, 2010, and January 28, 2011, editions of *Corporate and Financial Weekly Digest*.

Read more on Plus500.

Read more on James Sharp.

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