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Corporate and Financial Weekly Digest

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SEC/CORPORATE

SEC Revises "Ordinary Business" View of Risk and CEO Succession Shareholder Proposals

On October 27, the staff of the Securities and Exchange Commission's Division of Corporation Finance issued a legal bulletin revising the Division's earlier guidance on shareholder proposals relating to corporate risk and on succession planning for a chief executive officer.

Under the SEC's Rule 14a-8(i)(7), shareholder proposals may be excluded from a public company's proxy statement if the proposals "deal with a matter relating to the company's ordinary business operations." Previous guidance issued by the Division of Corporation Finance permitted companies to exclude shareholder proposals as ordinary business matters if such proposals focused on a company engaging in an internal assessment of the risks and liabilities that it faced as a result of its operations, unless the evaluation related to operations that may adversely affect the environment or the public's health. The Division's new guidance indicates an increased focus on the underlying subject matter to which the risk pertains or that gives rise to the risk. Where a shareholder proposal "transcends day-to-day business" matters of the company and raises significant policy issues, that proposal will not be excludable by a company merely because it requires an evaluation of risk. Further, and even more generally, the staff legal bulletin makes clear that a proposal relating to the board of directors' role in risk assessment and management "may transcend the day-to-day business matters of the company." These positions are likely to allow for inclusion in proxy statements of a wide range of carefully worded proposals on public policy issues.

The bulletin also sets forth new guidance regarding shareholder proposals focusing on chief executive officer succession planning. Previously, the Division's interpretation of SEC rules permitted the exclusion of shareholder proposals relating to the management of a company's workforce as an ordinary business matter. Following recent market turmoil, the Division now considers CEO succession policy to be a significant policy issue transcending a company's ordinary business and thus does not regard such proposals as excludable ordinary business.

Read more.

LITIGATION

Eighth Circuit Affirms Dismissal of Mortgage Lender Shareholders' 10b-5 Claims Against Auditors

Plaintiffs, shareholders in UCAP, Inc., a multi-state provider of mortgage lending and brokerage services, brought a 10b-5 action against several UCAP executives and UCAP's outside auditor, Moore Stephens Frost, PLC (MSF). Plaintiffs alleged that defendants defrauded them by inducing them to invest in UCAP through misrepresentations and false statements about UCAP's financial condition. The U.S. District Court for the Western District of Arkansas dismissed the action, holding that plaintiffs failed to meet the heightened pleading standards of the Private Securities Litigation Reform Act. After an earlier appeal was denied, plaintiffs appealed the dismissal of the claims against MSF for federal securities fraud.

The Eighth Circuit upheld the District Court's dismissal of the claims against MSF, finding that the complaint failed to allege loss causation adequately. In order to plead loss causation, a plaintiff must "state facts showing a causal connection between defendant's misstatements and the plaintiff's losses." The court found that the complaint's allegations that the investors suffered damages because they purchased stock at "artificially inflated prices" inadequately plead loss causation because it did not set forth either (i) the value of UCAP's stock when plaintiffs made their investments or (ii) the value of the stock at the time of the restatements of UCAP's financials. The failure to allege such facts was particularly damaging to plaintiffs' case because UCAP's financial troubles were publicly known prior to the time the restatements were announced. (*McAdams v. McCord*, No. 09-1303, 2009 WL 3350036 (8th Cir. October 20, 2009))

Second Circuit Holds Non-Signatory May Be Bound by Predecessor's Forum Selection Clause

In 1993, Aguas Argentinas, S.A. entered into a concession agreement with the Argentinean government to modernize and operate the Buenos Aires residential water and sewer system and collect fees for its use. Following a series of defaults on loans acquired to make capital investments, Aguas restructured the loans into two interim financial agreements (IFAs), by which several lenders purchased some of Aguas's debt in exchange for payment of past-due interest. The IFAs contained, *inter alia*, a New York forum selection clause, a New York choice of law provision, and a provision binding "successors and assigns." Aguas subsequently defaulted on the interest payments owed under the IFAs, and the Argentinean government terminated the concessions and assigned the concession agreements and certain other assets of Aguas to defendant Agua y Saneamientos Argentinos, S.A. (AySA).

Plaintiff, Aguas Lenders Recovery Group LLC (ALRG), an entity whose members were holders of Aguas's debt and which was assigned that debt, brought an action in the U.S. District Court for the Southern District of New York for the unpaid debt, arguing that AySA is "not entitled to step into Aguas's shoes yet disclaim Aguas's loans." The District Court dismissed the action on forum non conveniens grounds, holding that because neither party to the litigation was a signatory to the IFAs, the forum selection clauses could not be invoked by plaintiff. Plaintiff appealed.

The Court of Appeals for the Second Circuit vacated the judgment, holding that if successorship is established, a non-signatory to an agreement will be subject to the presumption of enforceability of a mandatory forum selection clause. Any other conclusion, the court held, would be inconsistent with the Supreme Court's decision in *M/S Bremen v. Zapata Off-Shore Co.* 407 U.S. 1 (1972), as well as the successorship doctrine, which "prevents parties to contracts from using evasive, formalistic means lacking economic substance to escape contractual obligations." The court noted that it saw "no reason to treat forum selection provisions differently from other contractual obligations." Having decided that a non-signatory successor may be bound by a forum selection clause, the court remanded the case for the District Court to decide whether AySA was a successor of Aguas. (*Aguas Lenders Recovery Group LLC v. Suez, S.A., et al.*, No. 08-1589-cv, 2009 WL 3403172 (2d Cir. Oct. 23, 2009))

BROKER DEALER

FINRA Chairman Discusses Regulatory Developments, Investment Advisor and Broker-Dealer Oversight

In his October 27 speech at the annual meeting of the Securities Industry and Financial Markets Association, Financial Industry Regulatory Authority Chairman and Chief Executive Officer Richard Ketchum continued to endorse a fiduciary standard of care for both investment advisors and broker-dealers who provide investment advice. Underscoring this message, Chairman Ketchum said that FINRA "whole-heartedly" embraces the recommendation in the Obama administration's proposed Investor Protection Act that all persons who provide investment advice should be held to a fiduciary standard. Chairman Ketchum also emphasized the need to harmonize and reinvigorate the oversight and enforcement of the fiduciary standard to better identify and prevent fraud.

Chairman Ketchum addressed various other topics, including recent developments in the financial markets and in financial regulation, the need for financial services firms to rethink their product lines and sales practices and institute product committees, FINRA's concerns about the annuities and life settlements industries and the emergence of social networking sites as a medium for financial professionals to contact customers. Chairman Ketchum closed his speech by discussing the recent "fragmentation" of the equity markets as a result of the increasing number of genuine liquidity centers and proposed that a unified single regulator oversee consolidated pool data from the various equity markets.

Click here to read Chairman Ketchum's speech.

See also the June 12 edition of *Corporate and Financial Weekly Digest* discussing Chairman Ketchum's past remarks regarding harmonization of the oversight regimes for investment advisors and broker-dealers and various other topics.

SEC Chairman Reviews SEC Progress, Investment Advisor and Broker-Dealer Oversight and "ABS Act"

Securities and Exchange Commission Chairman Mary Schapiro discussed recent financial regulatory developments and outlined the SEC's progress since she took office in her speech at the Securities Industry and Financial Markets Association's annual meeting on October 27. Chairman Schapiro voiced the SEC's support for the Obama administration and Congressman Paul Kanjorski's recent proposals for a fiduciary standard for all financial services professionals who provide investment advice about securities, regardless of whether the professional "carries the label 'broker-dealer' or 'investment advisor.'"

Chairman Schapiro also focused on the asset-backed securities (ABS) market. In addition to the SEC reviewing its regulation of ABS, Chairman Schapiro proposed creating new legislation directed solely at securitizations designed to enhance investor protection in this market sector by additional disclosure requirements of material information. Among the other topics Chairman Schapiro addressed were the risks of new products available to investors, the SEC's new Division of Risk, Strategy and Financial Innovation, market-structure transparency (dark pools), complex fee arrangements, target date funds, the life settlement industry, recent proposals regarding hedge fund investment advisor registration and recent bills regulating the over-the-counter derivatives market.

Click here to read Chairman Schapiro's speech.

FINRA Provides Additional Resources on Continuing Education

The Financial Industry Regulatory Authority issued Regulatory Notice 09-61 discussing the Firm Element Advisory (FEA), a publication by the Securities Industry/Regulatory Council on Continuing Education (Council) highlighting current regulatory and sales practice issues for firms to include in their Firm Element training plans. In response to the firms' requests for more resources to help with Firm Element planning, the Council has developed the "Guide to Firm Element Needs Analysis and Training Plan Development" and a web-based tool that can be used to search through a database of regulatory resources. The Council has also included a section in the FEA listing training resources provided by industry regulators.

Click here to read FINRA Regulatory Notice 09-61.

PRIVATE INVESTMENT FUNDS

House Committee Approves Hedge Fund Adviser Registration Act

The U.S. House of Representatives' Financial Services Committee voted 67-1 on October 27 to approve the draft Private Fund Investment Advisers Registration Act of 2009 for a full House vote. A vote by the full House on the bill is expected next month. The bill would amend the Investment Advisers Act of 1940 to eliminate the exemption from registration for advisors with fewer than 15 clients. The discussion draft of the bill as originally proposed would have required all investment advisors providing investment advice from the U.S. or to any U.S. clients to register with the Securities and Exchange Commission if, in the case of managers based in U.S. states with state advisor regulation regimes, they have more than $30 million in assets under management. The original discussion draft also would have required all non-U.S.-based investment advisors with any U.S. clients (unless such foreign advisors qualify for a narrow exemption for "foreign private fund advisors") and advisors based in Wyoming, which has no advisor regulation statute, to register with the SEC regardless of the assets they manage. This would have affected managers of hedge funds, private equity funds and commodity pools, and many foreign fund managers currently exempt from SEC registration, but would have continued to exempt managers of "venture capital funds," a term left to the SEC to define by rulemaking, although such investment advisors would have still been required to maintain such records and provide the SEC with such annual or other reports as determined by the SEC.

The bill as reported out of Committee includes a number of significant amendments, including the following:

- Investment advisors to private funds, if each private fund managed has less than $150 million in assets under management in the United States, would be exempt from registration, although such investment advisors would still be required to maintain such records and provide the SEC with such annual or other reports as determined by the SEC.
- The SEC would be required to take into account, in the application of the rules, the level of system risk presented by "mid-sized private funds."
- Advisors to small business investment companies licensed under the Small Business Investment Act of 1958 would be exempt from registration.
- Although the SEC would be authorized to define all terms, including the term "client," the SEC would be prohibited from defining "client" to include an investor in a private fund where the fund has entered into the advisory agreement.
- The bill would become effective one year following its enactment.
- The dollar thresholds established by the SEC for determining who is a "qualified client" eligible to pay performance-based compensation would be indexed to inflation.

To read the amendments approved by the Committee and the initial discussion draft click here.

Click here for more information on the proposed legislation in the October 2 edition of *Corporate and Financial Weekly Digest*.

BANKING

Senior Supervisors Group Issues Report on Risk Management Practices

Senior financial supervisors from seven countries (SSG) on October 21 issued a report that evaluates how weaknesses in risk management and internal controls contributed to banking industry distress during the financial crisis. The report—*Risk Management Lessons from the Global Banking Crisis of 2008*—reviews in detail the funding and liquidity issues central to the recent crisis and explores critical areas of risk management practices that the report finds in need of improvement across the financial services industry. The report concludes that despite firms' recent progress in improving risk management practices, underlying weaknesses in governance, incentive structures, information technology infrastructure and internal controls require substantial work to address.

The observations and conclusions in the report reflect the results of two initiatives undertaken by the SSG. These initiatives involved a series of interviews with firms about funding and liquidity challenges and a self-assessment exercise in which firms were asked to benchmark their risk management practices against a series of recommendations and observations taken from industry and supervisory studies published in 2008. This report represents a joint effort on the part of nine supervisory agencies in Canada, France, Germany, Japan, Switzerland, the United Kingdom and the United States. These initiatives were conducted to support the priorities of the Financial Stability Board, whose mission is to address vulnerabilities affecting the financial system and to promote global financial stability.

Read more.

STRUCTURED FINANCE AND SECURITIZATION

At ABS East 2009, Wilbur Ross Sees CMBS Trouble Ahead

On October 28, at the well-attended ABS East 2009 conference in Miami, co-sponsored by Katten Muchin Rosenman LLP, keynote speaker and Invesco Private Capital Chairman Wilbur Ross predicted trouble in 2010 for the commercial real estate and commercial mortgage-backed securities (CMBS) markets. As reported in *Total Securitization and Credit Markets*, Mr. Ross stated, "We think fundamentals probably are still in a deteriorating mode… We think there will be lots of problems." Mr. Ross pointed to various challenges, including the complexity of CMBS transactions, problems with commercial real estate workout methods, untested deal documentation and resistance to marking troubled loans to market. "First, they amend the loans, then they extend, then when that doesn't work, they just pretend about them. I believe we're moving into the pretend mode as we speak," he said. Mr. Ross also noted that additional government stimulus may be more likely as elections approach, and said, "I'm less worried about interest rates going up next year than I am about the strength of the economy if there isn't another stimulus of some sort."

Additional speakers at ABS East 2009 included Susan Stiehm, Markets Officer and Term Asset-Backed Securities Loan Facility Manager at the Federal Reserve Bank of New York, and Bruce Richards, President and Chief Executive Officer of Marathon Asset Management LLC.

For more information on the ABS East 2009 conference, click here.

Please also see "SEC Chairman Reviews SEC Progress, Investment Advisor and Broker-Dealer Oversight and 'ABS Act'" in **Broker Dealer** above.

ANTITRUST

Maryland Ban on Setting Minimum Resale Prices Takes Effect

A new Maryland law took effect this month that mitigates the impact of the U.S. Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS Inc.*, 551 U.S. 877 (2007). In *Leegin* the Court overturned a century-old precedent under which minimum resale price agreements between sellers of products and their resellers had been considered *per se* (automatic) violations of federal antitrust law. The Court determined that going forward such agreements should instead be evaluated on a case-by-case basis by weighing the potential efficiency and procompetitive benefits of the agreement against the potential anticompetitive harm.

The new Maryland law preserves a blanket prohibition against resale price maintenance under Maryland state antitrust law. (Md. Code Ann., Comm. Law Section 11-204(b) (effective October 1)) Thus, although resale price maintenance is now subject to a balancing test under federal law, the practice violates Maryland state law. State enforcers in some other states (including New York and California) have indicated that their states' existing laws also prohibit the practice. In addition, bills have been introduced in both houses of Congress to legislatively overturn *Leegin* at the federal level. Businesses that implemented or entered into minimum resale price programs after *Leegin*, or are considering doing so, should carefully review whether the agreements create antitrust risk under state laws and should monitor the status of federal legislation in this area.

Click here to read the Maryland statute.

EXECUTIVE COMPENSATION AND ERISA

December 31 is Same-Year Correction Deadline for 409A Failures in 2009

Pursuant to Notice 2008-113, the Internal Revenue Service is permitting corrections without penalty for certain unintentional operational failures under Section 409A of the Internal Revenue Code (Section 409A) that are corrected in the same year in which the failure occurs. Thus, the deadline for correcting such failures that occur during 2009 is December 31, 2009.

The following operational failures may be corrected without penalty if correction is completed in the same year that they occur:

- payments made in 2009 that should have been deferred to a later year;
- payments that violate the 6-month delay rule for "specified employees";
- payments deferred to a later year that should have been made in 2009 (i.e., excess deferrals); and
- correction of a less than fair market value exercise price for stock options that would otherwise be exempt from Section 409A.

To obtain relief for a same-year correction, the Notice sets forth certain steps that must be followed, including a requirement that the employer report certain information to the IRS and take steps to avoid recurrence of the failure.

Please note, while the Notice also permits correction of certain failures during later years, the Notice does not provide relief for the following Section 409A failures: (i) plan documentation failures, (ii) intentional operational failures, (iii) erroneous payments made during a year in which the employer experiences a substantial financial downturn if circumstances indicate that the employer will not be able to make the payment when it becomes due, and (iv) failures that are related to a "listed transaction" under Section 1.6011-4(b)(2) Treasury Regulation (generally relating to abusive tax avoidance transactions).

Although relief is not currently available for Section 409A documentation failures (i.e., documented plan terms that violate Section 409A), IRS employees have recently stated that a correction program for such failures may become available in the near future.

The Notice can be found here.

EU DEVELOPMENTS

European Commission Publishes Further Proposals on EU Financial Supervision

On October 26, the European Commission published draft legislative proposals on measures designed to strengthen the supervision of the EU financial sector. These follow the proposals announced on September 23 (as reported in the September 25 edition of *Corporate and Financial Weekly Digest*).

The legislative proposals amend existing European financial services legislation and aim to ensure that the new European Supervisory Authorities (ESAs) are able to work effectively. In particular, the proposals cover the following:

- defining the scope in which the ESAs will be able to propose technical standards for supervisory convergence, with a view to developing single European Economic Area-wide rule books;
- integrating the ESAs' ability to settle disagreements between national supervisors into areas where common decision-making processes already exist; and
- general amendments to enable existing European legislation to operate in the context of the new ESAs and to establish appropriate mechanisms for the exchange of information among national regulators.

To view the proposals in full, click here.

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