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SEC/CORPORATE

SEC Stays Implementation of Shareholder Proxy Access Rules

On September 29, the Business Roundtable and the U.S. Chamber of Commerce filed a petition for review with the U.S. Court of Appeals for the D.C. Circuit challenging the validity of new Rule 14a-11, the so-called proxy access rule. On the same date, the Business Roundtable and U.S. Chamber of Commerce filed a petition with the Securities and Exchange Commission seeking to stay the implementation of Rule 14a-11 pending resolution of the matter by the Court of Appeals. This rule was adopted in August by the SEC along with an Amendment to Rule 14a-8, and was to become effective on November 15. See the August 27 edition of *Corporate and Financial Weekly Digest* for a summary of Rules 14a-11 and 14a-8 (i)(8).

On October 4, the SEC granted the requested stay in the implementation of Rule 14a-11. It also stayed the effectiveness of Amended Rule 14a-8, even though not part of the petitioner's petition, on the basis that it was "intertwined" with Rule 14a-11, and cited a potential for confusion if the amendment to Rule 14a-8 were to become effective while Rule 14a-11 is stayed. While the parties have agreed to seek expedited review, the SEC's stay of the two rules will remain in effect pending resolution of the matter by the Court of Appeals.

Most legal analysts, as well as a spokesman for the SEC, believe that the matter will not be resolved until some time in the spring of 2011, with the practical result that these rules will not be in effect for most public companies (including those with fiscal years ending December 31) until the 2012 proxy season.

Click here for Business Roundtable's petition to the Court of Appeals.
Click here for Business Roundtable's petition to the SEC for a stay.
Click here for the SEC's order granting stay.

BROKER DEALER

Supplemental FOCUS Filing Requirement Applicable to Certain Joint Broker-Dealers/Futures Commission Merchants

Financial Industry Regulatory Authority member firms that are futures commission merchants and clear over-the-counter (OTC) derivatives for customers through Chicago Mercantile Exchange Inc. (CME) must soon begin filing a new statement pertaining to such OTC derivatives with FINRA as part of their monthly Financial and Operational Combined Uniform Single (FOCUS) Report. This requirement arises from recent amendments by CME to its financial reporting rules and forms and by National Futures Association to its financial requirement rules. The new statement—the Statement of Sequestration Requirements and Funds in Cleared OTC Derivatives Sequestered Accounts—is due to FINRA beginning with the monthly FOCUS Report that is due on November 23 (covering the October 2010 reporting period).

Click here to read FINRA Regulatory Notice 10-46.

SEC Approves Rule Change to Reinstitute Short Exempt Marking for Trade Reporting and OATS

The Securities and Exchange Commission has approved the Financial Industry Regulatory Authority's proposed rule change to amend FINRA's trade reporting and Order Audit Trail System rules. The implementation date for the new rules is November 10. Among other things, the rule change requires members to indicate on trade reports submitted to FINRA if a transaction is "short sale exempt" and, when an order is received or originated, to record the designation of an order as a short sale exempt order if the order may be marked "short exempt" pursuant to SEC Regulation SHO.

Click here to read SEC Release No. 34-63032.
Click here for information on FINRA's original proposal to reinstitute short exempt marking for trade reporting and OATS in the August 27 edition of *Corporate and Financial Weekly Digest*.

CFTC

CFTC Proposes Rules on DCO Financial Resource Requirements, Conflicts of Interest

In connection with its ongoing implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Commodity Futures Trading Commission last Friday voted to propose several rules for publication in the *Federal Register*. The CFTC proposals include rules relating to the financial resources requirements for derivatives clearing organizations (DCOs) and the mitigation of conflicts of interest by DCOs, designated contract markets (DCMs), and swap execution facilities (SEFs).

Under the proposed financial resources rules, DCOs would be required to maintain financial resources that, at a minimum, (i) exceed the total amount that would be required for a DCO to meet its financial obligations to its clearing members notwithstanding a default by the clearing member (or, in the case of DCOs designated as "systematically important" by the Financial Stability Oversight Council, the two clearing members) creating the largest financial exposure for the DCO in extreme but plausible market conditions, and (ii) enable the DCO to cover its operating costs for a period of one year, as calculated on a rolling basis. For purposes of meeting the first requirement above, DCOs would be permitted to include: (1) margin of a defaulting clearing member, (2) the DCO's own capital, (3) guaranty fund deposits, (4) default insurance, and (5) potential assessments (subject to certain haircuts and other restrictions) for additional guaranty fund contributions. For purposes of the second requirement, DCOs would be permitted to include the DCO's own capital and any other financial resource deemed acceptable by the CFTC, which would have to include unencumbered, liquid financial assets (which could include a committed line of credit or similar facility) equal to at least six months' operating costs.

The proposed rules regarding mitigation of conflicts of interest by DCOs, DCMs and SEFs impose specific structural governance requirements and limitations on the ownership of such entities. The governance requirements would, among other things, require that the boards of directors of such entities include a minimum number of "public directors" and certain specified committees and disciplinary panels (each subject to specific composition requirements). The ownership limitations set forth in the proposed rules would require the applicable DCO, DCM or SEF to cap the voting power of any of its members (taken together with the member's affiliates) at 20%. A DCO (but not a DCM or SEF) could choose one of two alternatives to come into compliance with this requirement (or petition the CFTC for a waiver of such requirements). One alternative would cap at 5% the amount of voting power held or exercised by any DCO member or other "enumerated entity" (which generally includes certain large banks, swap dealers, major swap participants and their affiliates). The other alternative would cap at 20% the amount of voting equity or voting power held or exercised by any single DCO member, and would further impose a 40% cap on the aggregate voting equity or power held or exercised by all enumerated entities.

Both sets of rules are scheduled for publication in the *Federal Register* on October 8. The comment period for the conflicts of interest mitigation rules will expire 30 days from the date of publication; the comment period for the financial resources rules will expire 60 days from the date of their publication.

Additional information regarding the proposed rules, including the rule text and related Q&As, can be found here.

NFA Announces Effective Date of Amendments to Assessments on Foreign Exchange Trades

The National Futures Association (NFA) has announced that recent amendments to NFA Bylaw 1301(b), which sets forth the schedule of dues and assessments for futures commission merchants (FCMs), will take effect on November 1. The amendments, which were submitted to the Commodity Futures Trading Commission on August 30, create an exemption from the NFA assessments charged to FCMs with respect to trades entered on or subject to the rules of a foreign board of trade by their customers. Specifically, the new exemption exempts from the NFA assessment fee the proprietary trading activity of any person who has membership privileges on an NFA member contract market which had an annual transaction volume during the prior calendar year of more than 1 million. The parents, affiliates and subsidiaries of a such a person are counted separately for this purpose.

The NFA Notice to Members announcing the effective date of the amendments, which includes a link to the amendments, is available here.

NFA Proposes Amendments to Interpretive Notice on Enhanced Supervisory Requirements

The National Futures Association (NFA) has submitted proposed amendments to its Interpretive Notice entitled "NFA Compliance Rule 2-9: Enhanced Supervisory Requirements" to the Commodity Futures Trading Commission. The Interpretive Notice sets out enhanced supervisory requirements that apply to certain NFA member firms due to the prior association of their associated persons or principals with disciplined firms. Among other things, the amendments provide limited relief to certain firms that are currently subject to enhanced supervisory requirements due to a principal's prior affiliations; amend the enhanced capital requirements applicable to futures commission merchants, commodity pool operators and commodity trading advisors who are subject to enhanced supervisory requirements; require the inclusion of certain information in the written supervisory procedures of such firms; and require quarterly (rather than monthly, as is currently the case) reporting by such firms of their compliance with the enhanced supervisory requirements.

The NFA proposal was submitted to the CFTC on October 6 and, unless the CFTC notifies NFA that it has determined to review the proposal, will take effect 10 days after receipt by the CFTC.

The proposed amendments can be found here.

LITIGATION

Motion to Dismiss Claims for Infringing Use of Photographs Granted in Part and Denied in Part

The U.S. District Court for the Southern District of New York granted in part and denied in part copyright infringement claims brought by plaintiff, a professional photographer, against a publisher of textbooks and other related educational materials, alleging that defendant exceeded its licenses to use plaintiff's photographs in its publications.

Defendant entered into several licensing agreements with various photo bureaus. Although defendant contracted with the photo bureaus, plaintiff retained the registered copyright for the photographs. Plaintiff alleged that on numerous occasions defendant exceeded the allowed print run for the photographs under the licensing agreements without first seeking plaintiff's prior authorization or paying an additional licensing fee.

Defendant moved to dismiss. The district court granted the motion in connection with one of the photo bureaus, reasoning that the contractual provision in the relevant licensing agreement clearly stated that the photo bureau forgoes its right to sue for copyright infringement until defendant has been invoiced for an unauthorized usage, and failed to pay that amount within ten days of being billed. Plaintiff's complaint failed to allege that defendant was invoiced for the allegedly unauthorized usage of the photos, and plaintiff's related infringement claim was accordingly dismissed.

The district court nevertheless denied defendant's motion to dismiss the claims arising out of the agreements with the other photo bureaus, reasoning that the allegations of the complaint properly stated a cause of action, despite being largely pled upon information and belief. (*Wu v. Pearson Education, Inc.,* No. 09 Civ. 6557, 2010 WL 3791676 (S.D.N.Y. Sept. 29, 2010))

Scienter Inadequately Pled Under the Standard Set Forth in the PSLRA

The U.S. District Court for the Southern District of Indiana dismissed plaintiff's securities fraud action against a nationwide health care benefits provider, and its officers and directors, in which plaintiff alleged that defendants artificially inflated the price of the stock by making certain false and misleading statements.

Specifically, plaintiff alleged that the defendant health care provider was experiencing system integration and claims processing problems, a growing claims backlog, lack of visibility into claims data, an inability to establish adequate reserves, and problems in adequately pricing products, prior to and during the class period, and that, as a result, certain statements defendants made during this time were false and misleading.

Defendants moved to dismiss, arguing that the allegations of securities fraud in plaintiff's amended complaint did not adequately plead scienter under the enhanced pleading standard of the Private Securities Litigation Reform Act (PSLRA), and that the allegedly false and misleading statements at issue fell within the PSLRA's safe harbor for forward-looking statements.

The court granted defendants' motion, finding that the allegations in plaintiff's amended complaint did not create a strong inference that defendants recklessly disregarded the truth when making the allegedly false statements. The court also found that the statements at issue fell within the PSLRA's safe harbor, because they were accompanied by meaningful cautionary language and failed to create a strong inference of actual knowledge on the part of defendants. (*Wade v. Wellpoint, Inc.,* 2010 WL 3766324 (S.D. Ind. Sept. 22, 2010))

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