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CORPORATE & FINANCIAL
WEEKLY DIGEST

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SEC/CORPORATE

SEC Publishes Final Rule for Dodd-Frank Permanent Exemption of Non-Accelerated Filers from SOX 404(b) Auditor Attestation Reports

On September 15, the Securities and Exchange Commission adopted amendments to its rules and forms to conform them to new Section 404(c) of the Sarbanes-Oxley Act, as added by Section 989G of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 404(c) provides that the auditor attestation report on internal controls over financial reporting required in annual reports under Section 404(b) of the Sarbanes-Oxley Act shall not apply with respect to any audit report of an issuer that is neither an accelerated filer nor a large accelerated filer as defined in Rule 12b-2 under the Securities Exchange Act of 1934. Prior to enactment of the Dodd-Frank Act, a non-accelerated filer (a company with a public equity float under $75 million) would have been required under Item 308 of Regulation S-K to include an auditor attestation report in the filer's annual report filed with the SEC for fiscal years ending on or after June 15, 2010.

Click here for the complete text of the SEC's adopting release.

SEC Addresses Disclosure of Short-Term Borrowing

At a September 17 open meeting, the Securities and Exchange Commission, by a unanimous vote, approved the publication for comment of proposed rules that would require enhanced disclosure of short-term borrowings by registrants. The SEC also approved the publication of guidance regarding enhanced disclosure of short-term borrowing under existing rules requiring disclosure of an issuer's liquidity and capital resources.

The proposed rules would require the issuer's Management Discussion and Analysis (MD&A) to include quantitative and qualitative disclosure regarding short-term borrowing *during* the period reported. Current rules require issuers to disclose short-term borrowing *as of the end* of the period reported. The proposed rules would require issuers to disclose, among other things, the average and maximum amount of short-term borrowing during the period reported as well as the weighted average interest rates for all classes of short-term borrowing. So-called "Financial Companies" (as such term will be defined in the proposed rules) will be required to provide such averages and maximum borrowings on a daily basis, while other issuers will be required to provide such information on a monthly basis.

The SEC also approved interpretive guidance intended to remind issuers that current rules regarding disclosure of liquidity and capital resources as part of MD&A do not permit the use of financial structures to mask an issuer's financial condition. In that regard, the guidance will clarify that financial ratios presented in periodic reports may not be presented in a way that obscures an issuer's financial condition. Lastly, the guidance will address the presentation of information in an issuer's table of contractual obligations.

According to the SEC, the new rules are primarily intended to address concerns that a "snapshot" of an issuer's financial condition as of the end of a period may not shed light on an issuer's need for short-term borrowing or fully inform investors of the risks or capital requirements for the company.

The text of the proposed rules and interpretive guidance was not available at press time, but a press release is expected to be posted to the SEC's website.

BROKER DEALER

FINRA Sanctions Trillium Brokerage Services, Director of Trading, Chief Compliance Officer and Nine Traders $2.26 Million for Illicit "Layering" Trading Strategy

On September 13, the Financial Industry Regulatory Authority announced that it has censured and fined Trillium Brokerage Services, LLC, a New York-based proprietary trading firm, $1 million for using an illicit high-frequency trading strategy and related supervisory failures. Nine traders at Trillium entered numerous layered orders on the NASDAQ Stock Market and NYSE Arca designed to create the false appearance of buying or selling in an attempt to obtain better prices than they would have otherwise, FINRA said in a news release.

According to FINRA, the Trillium traders created a false appearance of buy- or sell-side pressure by entering the non-bona fide orders, often in substantial size relative to a stock's overall legitimate pending order volume. As a result, other market participants were induced to enter orders to execute against limit orders previously entered by the Trillium traders. Once such orders were filled, FINRA said, the Trillium traders would then immediately cancel orders that had only been designed to create the false appearance of market activity. The 46,000 instances generated approximately $575,000 in profit and took place over a three-month period, beginning on November 1, 2006.

In addition to the nine traders, FINRA also took action against Trillium's Director of Trading and its Chief Compliance Officer. The 11 individuals were fined $802,500, required to return $292,000 in profits and suspended from the securities industry for periods ranging from six months to two years. As part of the settlement, Trillium and the individuals neither admitted nor denied the charges, but consented to the entry of FINRA's findings.

To read the Letter of Acceptance, Waiver and Consent to FINRA, click here.

LITIGATION

Craigslist Poison Pill and Right of First Refusal Rescinded by Delaware Chancery Court

On September 9, the Delaware Court of Chancery issued its decision in *eBay Domestic Holdings, Inc. v. Newmark, et al.*, which arose from a dispute between eBay and craigslist concerning eBay's decision to compete with craigslist in the online classifieds business while at the same time owning a substantial minority stake in craigslist.

In August 2004, eBay acquired a 28.4% interest in craigslist, becoming one of three shareholders in the privately held company. The terms of eBay's investment were memorialized in a Shareholders' Agreement, which set forth: (1) eBay's confidentiality obligations as a craigslist stockholder; (2) eBay's right to consent to certain transactions in which craigslist may engage; (3) numerous transfer restrictions on the shares owned by the three craigslist shareholders; (4) eBay's right to compete with craigslist, subject to certain consequences; and (5) the consequences if eBay chose to compete with craigslist. The Stock Purchase Agreement required eBay to approve a new charter for craigslist which provided for a three-person board of directors to be elected based on cumulative voting. The voting arrangement was such that each of the three shareholders—eBay, Craig Newmark and James Buckmaster—could elect one of three directors.

On June 29, 2007, eBay launched a direct competitor site to craigslist. Upon learning of the new site, craigslist sent eBay a "Notice of Competitive Activity" pursuant to the Shareholders' Agreement, which notice provided a 90-day cure period before eBay would lose (1) its consent rights, (2) its preemptive rights over the issuance of new shares, and (3) its right of first refusal over the remaining shareholders' shares. Upon eBay's failure to cure within the 90-day period, in January 2008, Mr. Newmark and Mr. Buckmaster, in their capacity as directors: (1) adopted a stockholder Rights Plan that restricted eBay from purchasing additional craigslist shares and limited eBay's ability to freely sell its craigslist shares to third parties; (2) implemented a staggered board through amendments to the craigslist charter that made it impossible for eBay to ever unilaterally elect another board member; and (3) sought to obtain a right of first refusal (ROFR) in favor of craigslist by offering to issue one new share of craigslist stock for every five shares held by a craigslist stockholder who granted an ROFR in craigslist's favor. Both Mr. Newmark and Mr. Buckmaster accepted the right of first refusal offer in their capacity as stockholders and received new shares. EBay declined the offer and did not receive any new shares, and its ownership became diluted as a result of the ROFR.

In April 2008, eBay filed suit in the Delaware Court of Chancery, claiming that the January 2008 board actions breached Mr. Newmark's and Mr. Buckmaster's fiduciary duties to eBay as a minority shareholder.

First, the court applied the enhanced scrutiny test set forth in *Unocal Corp. v. Mesa Petroleum Co.* to determine whether the Rights Plan was a proportional response to a perceived threat to craigslist's corporate policy and effectiveness. In the court's view, poison pills "fundamentally are defensive devices" subject to *Unocal* scrutiny. The court determined that craigslist did not adopt the Rights Plan as a reasonable response to a perceived threat to corporate policy, but rather, that Mr. Newmark and Mr. Buckmaster resented eBay's decision to compete, and therefore adopted the Rights Plan as a punitive measure. Accordingly, the court rescinded the Rights Plan.

Second, the court applied the business judgment rule to the adoption of the staggered board because, in the court's view, the staggered board was not "a defensive measure at all" in light of the parties' circumstances. The court deemed the staggered board amendments to be a sound business judgment, noting that, "[p]reventing a competitor that is also a minority stockholder from unilaterally placing a director on the board so that confidential corporate information will not be freely shared with that competitor is a legitimate and rational business purpose." Thus, the court held that there was no breach of fiduciary duty by approving the staggered board amendment.

Finally, the court applied the entire fairness test to the passage of the ROFR, rather than the business judgment rule, because both Mr. Newmark and Mr. Buckmaster stood on both sides of the transaction. To prove that the ROFR was entirely fair, they had to prove that the transaction was effectuated at a fair price, and the product of fair dealing. In finding that the price was unfair, the court explained: "Although each craigslist stockholder had to grant a right of first refusal over the same number of shares to obtain a newly issued share, eBay had to surrender full transferability of its shares to craigslist, but [Buckmaster] and [Newmark] only had to substitute craigslist for themselves as the party holding a right of first refusal on their shares." The court ultimately held that Mr. Newmark and Mr. Buckmaster breached their fiduciary duty of loyalty by using their power as directors and majority shareholders to implement an interested transaction that was not entirely fair to eBay, and therefore the court rescinded the ROFR. (*eBay Domestic Holdings, Inc. v. Newmark,* 2010 WL 3516473 (Del. Ch. Sept. 9, 2010))

Chancery Court Denies Dollar Thrifty Stockholder Motion for Preliminary Injunction

On September 8, the Delaware Court of Chancery denied a motion for a preliminary injunction to prevent the consummation of a merger plan, pursuant to which Hertz Global Holdings, Inc. will buy all the shares of rental car competitor Dollar Thrifty Automotive Group, Inc. Under the Hertz merger plan, Hertz will pay $32.80 per share in cash (including a $200 million special dividend that will only be paid in the event of the merger) and 0.6366 shares of Hertz stock for each share of Dollar Thrifty stock. At signing, the merger consideration was valued at $41 per share. Avis Budget Group, Inc. has emerged with a bid a that tops the Hertz bid, offering a combination of cash and stock valued at $46.50 per share. The primary differences between the Hertz bid and the Avis bid are that Avis has refused to promise to pay *any* reverse termination fee in the event that antitrust approval for an Avis-Dollar Thrifty merger is not obtained, and Avis has not matched the level of divestitures Hertz is willing to make in order to achieve antitrust approval.

Under the principles set forth in *Revlon v. MacAndrews & Forbes Holdings, Inc.*, when a company is sold in a change of control transaction, a board is charged with the obligation to secure the best value reasonably attainable for its shareholders. Here, the shareholders that brought the injunctive action argued that by failing to take affirmative steps to draw Avis into a bidding contest with Hertz before signing a definitive merger agreement with Hertz, the Dollar Thrifty Board breached its duty to take a reasonable approach to immediate value maximization, as required by *Revlon*.

In denying the motion, the court found that the Board's behavior was entirely reasonable and properly motivated. The court noted that the record reflects that "the entire Dollar Thrifty Board had no conflict of interest that gave them a motive to do other than the right thing. The record reveals no preference on the part of the Board for Hertz over Avis or any other acquirer... When directors who are well motivated, have displayed no entrenchment motivation over several years, and who diligently involve themselves in the deal process choose a course of action, this court should be reluctant to second-guess their actions as unreasonable." (*In re Dollar Thrifty Shareholder Litigation*, 2010 WL 3503471 (Del. Ch. Sept. 8, 2010))

BANKING

U.S. Banking Agencies Support Basel Agreement

On September 12, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (the Banking Agencies) released a statement in support of the agreement reached at the meeting of the G-10 Governors and Heads of Supervision regarding the recommendations made by the Basel Committee on Banking Supervision.

The agreement requires the ten signatory countries to increase the quality, quantity and international consistency of capital; to strengthen liquidity standards; to discourage excessive leverage and risk taking; and to reduce procyclicality in regulatory requirements.

The agreement calls for national jurisdictions to implement the new requirements beginning January 1, 2013, with a phased-in compliance regimen so that institutions have the opportunity to implement the new standards gradually over time.

In their statement of support, the Banking Agencies noted that the strengthening of capital is consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act and also noted that the Basel Committee continues to develop measures to improve the loss absorbing capacity for systemically important institutions.

For more information, click here.

ANTITRUST

FTC Announces Important Changes to Hart-Scott-Rodino Program

The Federal Trade Commission has recently issued a series of proposed amendments to the rules governing the Hart-Scott-Rodino (HSR) Premerger Notification Program. It has also proposed significant amendments to the HSR Report form itself. The link to the Commissions Notice of Proposed Rulemaking and request for public comment can be found here.

Three of the proposed changes will have substantial impact on financial buyers and other acquirers who operate multiple funds or other investment vehicles. First, HSR filers who share common managers with other entities will need to provide information on the other commonly managed entities—defined as “associates” in the amended rules—even though they are separately owned. Thus, funds that now share a common manager, or partnerships that share a common general partner, with the HSR filer will now be treated as “associates” of the filer and the filer will need to disclose information about them.

Second, acquiring firms will need to disclose whether their “associates” (or businesses that are owned by the associates) receive revenues from the same line of business as the acquired firm. This will require that the filer inquire into the business holdings and revenue sources of its associated entities.

Third, acquiring firms will also need to disclose minority holdings of their associates (holdings of 5-50%) in entities that also drive revenues from the same industry as the acquired firm.

For financial investors, private equity, and families of funds, these proposed amendments to the HSR rules are potentially quite significant. These changes will be addressed in greater detail in a Katten CLE seminar in New York on September 23.

EXECUTIVE COMPENSATION AND ERISA

New Rules Published for External Claims Appeals Procedures

The Internal Revenue Service, Department of Labor and Department of Health and Human Services published new rules in the *Federal Register* on August 26 regarding the new requirements for external claims appeals procedures for group health plans. These rules, under section 2719 of the Public Health Service Act, were enacted as part of Health Care Reform. The rules apply to group health plans which are NOT considered "grandfathered" under Health Care Reform.

The rules are contained in Employee Retirement Income Security Act (ERISA) Technical Release No. 2010-01. They are in the form of an "interim enforcement safe harbor," meaning that compliance with the safe harbor will protect the plan (and insurer) from violation of the statute. The safe harbor rules apply for plan years starting after September 23 until superseded by future guidance (which is to be published by July 1, 2011).

New Requirements

The highlights of the new federal procedure are:

1) Plan must allow filing of request for external review within four months of receipt of adverse determination.
2) Plan must complete review within five business days to determine whether request is complete/eligible.
3) Within one day of completion of review, Plan must issue notification to claimant. If claimant's request is incomplete, Plan must permit claimant to perfect the claim within the four-month filing period or 48 hours (whichever is later).
4) If external review is requested, Plan must assign review to accredited independent review organization (IRO).
5) Plan must have contracts with three IROs and must rotate claims assignment or use random process. Numerous provisions must be included in Plan's contract with IRO.
6) Plan must *immediately* provide coverage/payment if denial decision is overturned by external review.

Three model notices are provided for: adverse benefit determinations, final internal adverse benefit determinations, and final external review decisions.

Insured plans are to comply with state external claims requirements rather than the new federal procedure. However, if there is no applicable state procedure, insured plans must comply with the new federal procedure. (Six of the 50 states have no required state procedure.) Self-insured plans that are not otherwise subject to state insurance requirements (such as ERISA plans and governmental plans) may comply with *either* the new federal procedure *or* a state procedure

A copy of ERISA Technical Release No. 2010-01 can be found here.

UK DEVELOPMENTS

Treasury Issues Final Consultation on Investment Firms Insolvency Arrangements

On September 16, HM Treasury published its third consultation on new insolvency arrangements for investment firms. The consultation sets out the government's final proposals for a special administration regime (SAR) for investment firms. These proposals are derived from the December 2009 consultation entitled "Establishing resolution arrangement for investment banks" (see the December 18, 2009, edition of *Corporate and Financial Weekly Digest*).

The SAR is designed to enhance the method by which any investment firm failures occurring in the future will be dealt with. It will take the form of an administration procedure with special administration objectives (SAOs).

The new regime will include new SAOs designed to ensure that administrators focus on:

- the return of client assets;
- engagement with market infrastructure bodies and the authorities; and
- maximizing returns to creditors.

The government considers that the SAR will give administrators a clear framework within which to conduct investment firm administrations without needing to make frequent applications to the court for directions. In addition, it is hoped that the adjustments made by the SAR will make the UK insolvency regime less expensive and less disruptive.

Read more.

EU DEVELOPMENTS

European Commission Publishes Proposed OTC Derivatives Regulation

On September 15, the European Commission published its proposed regulation on over-the-counter (OTC) derivatives, central counterparties and trade repositories. The proposed regulation encompasses all OTC derivatives and is applicable to financial and non-financial firms who either use OTC derivatives or have large positions in OTC derivatives. It has two key aims: (1) increased transparency, and (2) reduced counterparty and operational risk.

The proposed regulation seeks to implement the objectives of the September 26, 2009, G20 Summit, which outlined compulsory clearing of standardized OTC derivative contracts and reporting of OTC derivatives contracts to trade repositories. (An earlier version of this proposal was described in the June 18 edition of *Corporate and Financial Weekly Digest.*)

The main elements of the proposed regulation are:

- mandatory central counterparty (CCP) clearing of OTC derivatives, subject to pre-defined eligibility criteria;
- risk mitigation—where OTC contracts are not eligible for CCP clearing, the proposed regulation requires the counterparties to the contract to put in place certain risk mitigation techniques;
- CCPs—the proposed regulation sets out the authorization and supervision requirements for CCPs established in EU member states including conduct of business, organizational and prudential requirements;
- interoperability—where there is an interoperability arrangement between two or more CCPs that involves a cross-system execution of transactions, the relevant CCPs will need prior approval from their national regulator contingent on satisfactory risk management procedures; and
- reporting obligation to trade repositories—detailed transactional information on OTC derivatives contracts will be required to be reported to trade repositories. The data held by trade repositories will be made available to national regulatory authorities. Trade repositories will be required to publish aggregate positions by class of derivatives on the contracts reported to them. The European Securities Markets Authority will be responsible for the registration and surveillance of trade repositories.

There will be certain exemptions from the clearing requirement, for example, where OTC derivatives are used for hedging business risk. However, in such cases firms will be required to hold more capital against the contracts.

Read more.

European Commission Publishes Proposed Short Selling and Credit Default Swap Regulation

On September 15, the European Commission published its proposal for the regulation of short selling and credit default swaps (CDS). The proposal largely follows the Committee of European Securities Regulators' recommendations, as described in the March 5 and June 18 editions of *Corporate and Financial Weekly Digest*.

The three main objectives of the regulation are: (1) the creation of a harmonized pan-European short selling regulatory regime; (2) increased transparency; and (3) the reduction of risk.

The Commission has proposed a two-tier disclosure regime: investors will be required to disclose net short positions to their national regulators once a threshold of 0.2% of the issued share capital of the relevant company is crossed and to make public disclosure to the market at a higher threshold of 0.5%. Naked short selling is severely restricted. There will also be a regime whereby market participants must inform regulators about credit default swap positions related to EU sovereign debt issuers.

The regulation contemplates the possibility of competent national authorities being given the power to temporarily ban or restrict short selling and CDS in emergency circumstances.

The proposal is now with the European Parliament and the European Council for their approval. Once adopted, the regulation would apply from July 1, 2012.

Read more.

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