Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

July 25, 2014 Volume IX, Issue 29

BROKER-DEALER

SEC Approves FINRA Rule Limiting Expungement

On July 22, the Securities and Exchange Commission authorized the Financial Industry Regulatory Authority, Inc. to implement FINRA Rule 2081 prohibiting brokers from conditioning settlement of customer complaints on (or otherwise compensating customers for not opposing) expungement of the complaint from the Central Registration Depository system. The prohibition will apply to both written and oral agreements entered into during the course of settlement negotiations as well as to any agreements entered into separately. FINRA has stated that the purpose of Rule 2081 is to ensure that arbitrators grant expungement only as an extraordinary remedy in appropriate and narrow circumstances. FINRA will announce the effective date of Rule 2081 in a Regulatory Notice to be published shortly.

The SEC approval release of FINRA Rule 2081 is available here.

CFTC

CFTC Issues No-Action Relief from Certain Ownership and Control Reporting Requirements

On November 18, the Commodity Futures Trading Commission adopted rules modifying its ownership and control reporting requirements. Specifically, the CFTC adopted (i) a new Form 71 to collect information regarding omnibus accounts that exceed a specified volume threshold; (ii) a revised Form 40/40S (Reporting Traders); and (iii) a revised Form 102 (Special Accounts), which has three parts: Form 102A (special accounts), Form 102B (volume threshold accounts) and Form 102S (swaps). The new reporting requirements were to be effective August 15, 2014.

On July 23, the CFTC's Division of Market Oversight issued temporary no-action relief from the electronic reporting requirements of: (i) Form 102A and Form 102S until February 11, 2015; (ii) Form 102B until March 11, 2015; and (iii) Form 40/40S and Form 71 until February 11, 2016. The no-action relief requires market participants to continue to submit legacy Form 102, Form 102S, Form 40 and Form 40S, as appropriate. Futures commission merchants, clearing members and foreign brokers are also required to file an updated Form 102 within three days of any changes to the "special account" identification information previously reported to the CFTC on Form 102.

The no-action relief does not apply to the additional recordkeeping obligations imposed by revised CFTC Regulation 18.05, which will become effective on August 15.

CFTC Letter No. 14-95 is available here.

CFTC Releases Rule Enforcement Review of ICE Futures U.S.

On July 22, the Commodity Futures Trading Commission released the Division of Market Oversight's rule enforcement review of ICE Futures U.S. The rule enforcement review included the following recommendations:

- The exchange should ensure that its market surveillance department maintains staffing sufficient to perform all of its surveillance responsibilities, including timely completion of surveillance investigations.
- The role of exchange staff in enforcing clearinghouse requirements regarding open interest reporting should be formalized in the procedures manual of the exchange. If the exchange intends to continue to sanction misreporting of open interest, the exchange's rulebook should set forth specific rules stating that open interest misreporting represents a violation of exchange rules. The exchange should also maintain records of any sanctions issued by the clearinghouse so that it may properly account for recidivist behavior and impose sanctions that are sufficient to deter recidivism.
- The exchange should require market participants to resubmit detailed information on at least an annual basis to support single-month and all-month hedge exemptions.
- Prior to granting a hedge exemption, the exchange must ensure that an applicant complete each question in its exemption application. The exchange must also ensure that an applicant provides sufficiently detailed information to allow the exchange to analyze the underlying reasons for the request, and whether those reasons are consistent with the requirements for the exemption sought.

More information is available here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Issues Guidance on Proxy Voting

The Security and Exchange Commission's Divisions of Investment Management and Corporation Finance issued Staff Legal Bulletin No. 20 (IM/CF) on June 30 (SLB 20). SLB 20 provides guidance regarding proxy voting responsibilities of investment advisers and proxy advisory firms' exemptions from proxy rules. Rule 206(4)-6 under the Advisers Act requires advisers to have written proxy voting policies and procedures. SLB 20 states that advisers can ensure that proxies are being voted in their clients' best interests if, for example, they periodically sample proxy votes to review compliance with the advisers' policies and procedures or sample the voting on certain proposals. In any event, an adviser needs to be analyzing, at least annually, whether its proxy voting policies and procedures continue to be reasonably designed to ensure that proxies are voted in clients' best interests.

SLB 20 also clarifies that Rule 206(4)-6 does not require advisers to undertake all proxy voting responsibilities. The staff noted that most clients delegate the authority to vote proxies in relation to equity securities to investment advisers completely, without retaining any authority to vote such proxies. Nevertheless, advisers and clients may agree to limit the scope of advisers' proxy voting responsibilities. Such agreements may contain arrangements that:

- the time and costs associated with the mechanics of voting proxies with respect to certain types of proposals or issuers may not be in the clients' best interests;
- all proposals are voted in accordance with company management recommendations or with a particular shareholder proponent, absent a contrary instruction from the client or a determination by the adviser that a particular proposal should be voted in a different way because, for example, it furthers the adviser's strategy;
- the adviser will abstain from voting any proxies at all, regardless of whether the client undertakes to vote the proxies itself; and
- the adviser will focus on only particular types of proposals based on client preferences.

SLB 20 supports the proposition that advisers are not required to engage proxy advisory firms when they assume a delegation of proxy voting authority from their clients to avoid conflicts of interest issues. Instead, advisers may limit by contract the scope of their proxy voting authority.

If an adviser retains or considers the continued retention of a third-party proxy advisory firm, SLB 20 emphasizes that the adviser should ascertain, among other things, whether the proxy advisory firm has the capacity and competency to analyze proxy issues adequately. Moreover, SLB 20 admonishes the adviser to have adequate policies and procedures for "sufficient ongoing oversight" of the proxy advisory firm to ensure that proxies are voted in the best interests of its clients. This oversight also requires (i) ensuring that voting recommendations are based on current and accurate information and (ii) identifying and addressing on an ongoing basis the proxy advisory firm's conflicts that can arise.

Click here to read all issues covered in the guidance on proxy voting.

LITIGATION

District Court Reaffirms Rule 10b5-1 Standard and Denies Motion to Dismiss Insider Trading Charges

The US District Court for the Northern District of Illinois denied a motion to dismiss a 16-count indictment for insider trading, finding the government adequately alleged each element of the offense.

Steven Dombrowski was the Director of Audit at Allscripts Healthcare Solutions, Inc., a publicly traded company. The government alleged that Dombrowski's position gave him access to material, nonpublic information, including advance knowledge of an April 2012 report that Allscripts' earnings were lower than expected. Before the report was released, Dombrowski purportedly used his wife's trading account to trade Allscripts stock and netted a profit of about $286,000.

Dombrowski filed a motion to dismiss the insider trading charges. Citing cases that included *United States v. Smith*, 155 F.3d 1051, 1066 (9th Cir. 1998) and *SEC v. Adler*, 137 F.3d 1325, 1337 (11th Cir. 1998), Dombrowski argued that, to prove he had traded "on the basis of" inside information, the government had to show he "used [such] information or that the information caused him to trade as he did," and not he merely traded "while possessing inside information."

The District Court denied the motion, finding that *Smith*, *Adler* and the like had been decided prior to the promulgation in 2000 of Rule 10b5-1, and it is now clear under that Rule that "awareness" of inside information is sufficient. As such, the government need not allege that a defendant "used" inside information. The District Court also noted that the indictment provided sufficient detail such that Dombrowski was aware of the charges and able to mount a defense against them.

United States v. Dombrowksi, Case No. 14-CR-41 (N.D. Ill. July 15, 2014).

SEC Settles Third-Party Insider Trading Claim Against Investor Relations Executive

The Securities and Exchange Commission recently announced a settlement with a partner at an investor relations firm who allegedly traded on inside information obtained through his representation of two companies.

According to the complaint filed on July 22, 2014 in the US District Court for the Southern District of New York, Kevin McGrath, a partner at Cameron Associates, obtained confidential information about Misonix Inc. and Clean Diesel Technologies, Inc. while he was helping prepare press releases for those companies. He then allegedly used that information to make trades that yielded a total of $11,776 profit.

More specifically, in early May 2009, McGrath discovered that Misonix expected to announce disappointing quarterly results. Shortly before the press release went public, McGrath sold all of his shares of Misonix. Because the price of Misonix dropped nearly 22 percent by market close the day after the announcement, McGrath was able to avoid losses of $5,400.

Conversely, McGrath purchased several shares of Clean Diesel after learning in May 2011 that the company planned to issue a press release about its receipt of nearly $2 million in product orders. Once the press release went public, Clean Diesel's share price jumped 95 percent, and McGrath subsequently sold his shares for a profit of $6,376.

Without admitting or denying the allegations, McGrath agreed to pay disgorgement of $11,776 with prejudgment interest of $1,492, and a civil penalty of $11,776. McGrath also agreed to a permanent injunction against further violations of the securities laws, and a conduct-based injunction that permanently requires him not to trade in the stock of any issuer for which he or his firm performed any services within a one-year period. Should he or his firm want to sell any shares received as compensation for services performed, they must provide written notice to, and receive written authorization from, the issuer.

SEC v. McGrath, Case No. 14-CV-5483 (S.D.N.Y. July 22, 2014).

For more information, contact:

FINANCIAL SERVICES		
Janet M. Angstadt	+1.312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	+1.212.940.6615	henry.bregstein@kattenlaw.com
Kimberly L. Broder	+1.212.940.6342	kimberly.broder@kattenlaw.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey Jr.	+1.212.940.8593	guy.dempsey@kattenlaw.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	+1.212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	+1.312.902.5241	arthur.hahn@kattenlaw.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Kathleen H. Moriarty	+1.212.940.6304	kathleen.moriarty@kattenlaw.com
Ross Pazzol	+1.312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	+1.312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
Peter J. Shea	+1.212.940.6447	peter.shea@kattenlaw.com
James Van De Graaff	+1.312.902.5227	james.vandegraaff@kattenlaw.com
Robert Weiss	+1.212.940.8584	robert.weiss@kattenlaw.com
Gregory E. Xethalis	+1.212.940.8587	gregory.xethalis@kattenlaw.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@kattenlaw.com
LITIGATION		
Michael M. Rosensaft	+1.212.940.6631	michael.rosensaft@kattenlaw.com
Tenley Mochizuki	+1.212.940.8568	tenley.mochizuki@kattenlaw.com

* Click here to access the *Corporate and Financial Weekly Digest* archive.

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.
©2014 Katten Muchin Rosenman LLP. All rights reserved.

Katten
Katten Muchin Rosenman LLP www.kattenlaw.com

AUSTIN | CENTURY CITY | CHARLOTTE | CHICAGO | HOUSTON | IRVING | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SAN FRANCISCO BAY AREA | SHANGHAI | WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).

London: Katten Muchin Rosenman UK LLP.