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CORPORATE & FINANCIAL
WEEKLY DIGEST

March 23, 2012

SEC/CORPORATE

Senate Passes Revised Version of JOBS Bill

H.R. 3606, the Jump-Start Our Business Start-ups Bill (the JOBS Bill), passed the House of Representatives with broad bipartisan support on March 8. The JOBS Bill includes significant reforms intended to facilitate capital raising by small businesses. It includes, among other things:

- A new category of issuer, the "emerging growth company", which includes companies with revenue of less than $1 billion in the most recently completed fiscal year, until the company becomes a large accelerated filer, reaches the fifth anniversary of its initial public offering of equity securities, or issues more than $1 billion in nonconvertible debt in any three year period. Emerging growth companies (a) would be exempt from the attestation requirements of Section 404(b) of the Sarbanes-Oxley Act of 2002, (b) would only have to present two years of audited financial data and selected financial information in a registration statement for an initial public offering, and (c) would be exempt from certain other disclosure requirements including selected disclosures relating to executive compensation;

- A repeal of the ban on general solicitation or general advertising in Regulation D offerings and Rule 144A offerings, so long as the issuer or seller took reasonable steps to ensure that all purchasers were accredited investors or qualified institutional buyers, as applicable;

- An increase in the maximum amount of proceeds that can be raised pursuant to Regulation A from $5 million to $50 million;

- An increase in the number of shareholders of record that would trigger registration under the Securities Exchange Act of 1934 from 500 to 2000, so long as not more than 499 holders were nonaccredited investors; and

- New Section 4(6) of the Securities Act of 1933 (the so-called "crowdfunding" provision), which would permit issuers to raise up to $2 million from nonaccredited investors without registering under the Securities Act of 1933, subject to financial statement and other disclosure requirements and limitations on how much can be raised from any individual investor.

On March 22, the Senate passed an amended version of the JOBS Bill and sent it back to the House of Representatives to be reconciled with the original version. The Senate amendments principally consist of amendments to Section 4(6) requiring the SEC to report to Congress every two years on its findings on whether use of Section 4(6) has resulted in excessive fraud (and, if not, to make an affirmative statement to Congress that "the amount of fraud related to issuances made pursuant to section 4(6) of the Securities Act of 1933, as amended by this title, was not excessive during the reporting period."). The remaining provisions of H.R. 3606 were adopted in their entirety. Katten will publish a full Client Advisory when the JOBS Bill is signed into law.

The text of the amendments can be found here.

BROKER DEALER

SEC Staff Issues Risk Alert on Municipal Securities Underwriting Practices

On March 19, 2012, the Securities and Exchange Commission's (SEC) Office of Compliance Inspections and Examinations released a National Exam Risk Alert regarding the enhancement of municipal securities underwriting practices. In the Risk Alert, the staff of the SEC's National Exam Program (NEP staff) observes that broker-dealers may not be engaging in sufficient due diligence practices and provides examples of effective practices.

The Risk Alert reminds broker-dealer underwriters of their due diligence and supervisory obligations under various laws and rules. SEC Rule 15c2-12 under the Securities Exchange Act of 1934 (Rule 15c2-12) sets forth broker-dealer obligations when participating in an underwriting, such as providing continuing disclosure information of annual financial information and material event notices. In addition to Rule 15c2-12, the SEC has provided interpretive guidance regarding broker-dealers' obligations under the anti-fraud provisions of the federal securities laws, which require broker-dealers to form a "reasonable basis" for offering new issues of municipal securities. By participating in an offering, a municipal underwriter is deemed to be making an implicit representation that it has a reasonable belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offering. Sole reliance on an issuer's representations will not suffice in meeting an underwriter's obligations.

NEP staff reminds broker-dealers that the SEC has provided a non-exclusive list of six factors that it believes generally would be relevant in determining the reasonableness of an underwriter's basis for assessing truthfulness of key representations in a final official statement. These factors are:

- the extent to which the underwriter relied on municipal officials and other persons whose duties have given them knowledge of particular facts;
- the role of the underwriter (e.g., manager, syndicate member, selling dealer);
- the type of bonds being offered (general obligation, revenue or private activity);
- the past familiarity of the underwriter with the issuer;
- the length of time until maturity of the securities; and
- whether the bonds are competitively bid or are distributed in a negotiated offering.

In addition, broker-dealers have the responsibility to supervise municipal securities activities to confirm compliance with SEC requirements and the rules of the Municipal Securities Rulemaking Board (MSRB). Generally, broker-dealers must establish and maintain a system of supervision including written policies and procedures, annual examinations or testing of the system of supervision and submission of annual reports to senior management. Broker-dealers also must implement measures to monitor compliance with those policies and procedures and an appropriate system of follow-up and review if red flags are detected.

NEP staff has been concerned about the level of due diligence and supervision carried out by underwriters in connection with offerings of municipal securities. As a result, NEP staff has been looking for evidence that broker-dealers have:

- created and maintained an adequate supervisory system and written policies and procedures setting forth the due diligence obligations of personnel carrying out responsibilities under Rule 15c2-12, applicable SEC guidance, MSRB rules and the anti-fraud provisions of the federal securities laws; and
- created and maintained adequate written evidence of their performance of such obligations for purposes of internal compliance reviews by internal audit and/or the compliance departments, as well as for SEC staff examinations.

While conducting examinations, NEP staff observed instances where municipal underwriters did not maintain (nor did they require the creation and maintenance of) adequate written evidence that they complied with their due diligence obligations. The SEC notes that such an approach makes it difficult for firms to demonstrate that they have fulfilled their due diligence obligations and their duty to reasonably supervise with a view to preventing and detecting violations of the federal securities laws.

Due to a concern over potentially lax due diligence and supervisory practices, NEP staff also provided the following examples of effective practices:

- Maintain written policies and procedures that address regulatory due diligence requirements and the firm's expectations as to how personnel can develop a reasonable basis for offering any municipal new issue securities;

- Create a senior-level commitment committee that reviews and approves deal-specific sets of materials in municipal securities underwritings;

- Create due diligence checklists to evidence due diligence and supervisory reviews;

- Ask underwriters' counsel or issuer's counsel to prepare outlines of disclosure issues to be discussed in due diligence calls;

- Prepare a memorandum describing due diligence calls, issues noted and how they were resolved, as well as their review of the final or "deemed final" official statement;

- Have personnel engage in various on-site examination activities, including meetings with municipal officials, visits to facilities and an examination of an issuer's records and current economic trends and forecasts that bear on the ability of the issuer to pay its debt; and

- Develop recordkeeping checklists to assist personnel in maintaining records that evidence the due diligence that was performed, as well as specifying where such records should be maintained.

NEP staff noted that these examples could assist a firm in evidencing how the firm is meeting its obligation to perform sufficient due diligence and documenting its municipal underwriting efforts.

While the alert does not have the same impact as an official SEC pronouncement, broker-dealers should be aware that regulators will look to it in analyzing broker-dealer compliance with applicable rules and their obligations in municipal securities underwritings. Click here to read the Alert.

CFTC

ISDA Dodd-Frank Documentation Project

The International Swaps and Derivatives Association has launched a project to bring its master agreement and credit support document forms into compliance with the requirements of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) governing swaps and security-based swaps. The detailed rules promulgated by the CFTC and the SEC under the mandate of Title VII set many specific requirements for trading relationship documentation and also impose other obligations on market participants (such as notice and general disclosure obligations) that can be most efficiently discharged by way of standardized document provisions. The scope of the project includes:

- a standard set of amendments to facilitate updating of existing swap relationship documentation for Dodd-Frank compliance purposes;

- industry documentation, such as general and product specific risk disclosures, to assist members in satisfying their on-going regulatory requirements; and

- a range of implementation vehicles, including centralized mechanisms such as an ISDA protocol to facilitate the incorporation of relevant provisions into existing bilateral master agreements.

The project is intended to produce results well in advance of the possible October 14 effective date of the external business conduct rules, but the exact timeline will be adjusted to reflect the actual completion of relevant rulemakings by the CFTC and SEC. Employees of ISDA member firms can join the project working group by registering on the ISDA website.

CFTC Issues No-Action Letter to Provide Temporary and Conditional Relief for Large Trader Reporting

On March 20, the Commodity Futures Trading Commission's Division of Market Oversight issued a no-action letter providing temporary and conditional relief for clearing organizations and clearing members that fail to submit fully compliant reports under the CFTC's large trader reporting system for swaps and swaptions. In order to qualify for relief, reporting parties must make a good-faith effort to comply with the large trader reporting requirements and clearing organizations and reporting entities must provide open interest data for positions during the entire relief period (March 1 through June 30) no later than the fifteenth day of the following month. The Division explained that good faith is demonstrated by filing otherwise fully compliant reports in an interim pipe-delimited text format.

Reporting parties that are able to file fully compliant reports cannot rely or continue to rely on the no-action relief. In addition, any reporting party that intends to rely on this relief must submit an e-mail to the CFTC at submissions@cftc.gov and SwapsLTR@cftc.gov no later than March 30, 2012 that describes (1) the ways in which the submissions are not compliant; (2) the arrangements that are being made to become fully compliant; and (3) the anticipated date of full compliance. The no-action relief will automatically expire on July 2.

Click here to view the no-action letter.

LITIGATION

Court Finds Exigent Circumstances Warrant Appointment of Receiver for an Insolvent, Closely Held Corporation

The Delaware Chancery Court recently found that exigent circumstances necessitated the appointment of a receiver for an insolvent company under section 291 of the Delaware General Corporation Law (DGCL). The insolvent company at issue had $1.9 million in tax debt and was at risk of losing a favorable settlement opportunity with the IRS due to an impasse between voting and non-voting shareholders. The Chancery Court reasoned that, under the circumstances of indisputable insolvency, a time-sensitive opportunity to settle a "value-destroying" tax debt, and the Board's insistence on a dubious transaction, there was sufficient exigency to justify the appointment of a receiver charged with ensuring that the company fairly attempted to take advantage of the possibly short-lived IRS offer. In addition to appointing a receiver, the Court granted the receiver the power to exercise independent business judgment to implement, in relation to the IRS offer, or to otherwise recommend whatever steps the receiver determined, in good faith, would maximize the value of the company for its various stakeholders.

Badii v. Metropolitan Hospice, Inc., C.A. No. 6192 – VCP (Del. Ch. Mar. 12, 2012).

Court Considers Whether Doctrine of Laches Bars Claims Arising Under Cancellable Contracts

The Delaware Chancery Court found that where the directors of a closely-held corporation retained the power to terminate or modify employment agreements, the decision to leave such agreements in place could be challenged as a breach of fiduciary duty even though a challenge to the initial decision to enter into these agreements was time-barred. The plaintiffs, minority shareholders in the closely-held corporation at issue, brought a derivative action challenging a series of related-party transactions. The defendants, the directors and majority shareholders, moved for judgment on the pleadings, contending that the equitable doctrine of laches barred the bulk of the plaintiffs' claims. Based on the parties' previous agreement as to a presumptive three-year limitations period for laches, the Court found that laches barred the plaintiffs' challenges to certain stock options granted in 2004 and 2005, and also barred a portion of the plaintiffs' challenges to compensation received under certain employment agreements entered into in August 2003. However, despite the original contract date of August 2003, the Court did not bar all of the plaintiffs' challenges related to these agreements. The Court reasoned that because the corporation could terminate the employment agreements on thirty days written notice, and because the Board retained the power to amend the agreements at their convenience, the plaintiffs had a right to challenge the company's on-going decision to leave the agreements in place as a breach of fiduciary duty. On this basis, the

Court held that the plaintiffs could challenge the fairness of the defendants' failure to terminate or modify their employment agreements from the laches cut-off date (March 18, 2008) though the present.

Buerger v. Apfel, C.A. No. 6539 – VCL (Del. Ch. Mar. 15, 2012).

BANKING

FDIC Threatens Bank Directors Who Copy Bank Records For Defense Purposes and "Reminds" Bank Counsel of Their Fiduciary Duty

On March 19, the Federal Deposit Insurance Corporation (FDIC) issued Financial Institution Letter - 14 -2012, which among other things threatens directors and officers with enforcement action if they copy and remove financial institution and supervisory records "in anticipation of an institution's failure." The FDIC also stated that "copying and removing financial institution and supervisory records in anticipation of an institution's failure violates applicable federal statutes and FDIC regulations" and that "counsel representing an insured depository institution are reminded that their fiduciary duty, both legally and ethically, compels them to advance only the interests of the institution."

"This is a reminder to directors and officers that this activity is a breach of their fiduciary duty to the institution and an unsafe and unsound banking practice, which may also violate applicable laws and regulations and contravene the financial institution's information security program. Attorneys who represent an insured depository institution are also reminded that their fiduciary duty, both legally and ethically, obligates them to act in the best interests of the institution."

"Financial institution counsel who advise copying and removal of records contrary to the interests of the financial institution may be engaging in violations of law, codes of professional conduct, as well as breaches of fiduciary duty. The FDIC will investigate any matter that appears to violate confidentiality and pursue enforcement actions, as appropriate."

The action has been criticized by the American Association of Bank Directors, which believes that access to such records is a "fundamental right" and that the FDIC should have sought to pass a rule - not guidance - subject to notice and comment from the public pursuant to the Administrative Procedures Act.

For more information, click here.

FDIC Issues Proposal Regarding Enforceability of Contracts For Systemically Important Financial Institutions

On March 20, the Federal Deposit Insurance Corporation (FDIC) proposed a rule (Proposed Rule), with request for comments, that implements section 210(c)(16) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or the Act) , which permits the FDIC, as receiver for a financial company whose failure would pose a significant risk to the financial stability of the United States (a covered financial company), to enforce contracts of subsidiaries or affiliates of the covered financial company despite contract clauses that purport to terminate, accelerate, or provide for other remedies based on the insolvency, financial condition or receivership of the covered financial company.

The Proposed Rule makes clear that the effect of this enforcement authority is that no party may exercise any remedy under a contract simply as a result of the appointment of the receiver and the exercise of its orderly liquidation authorities as long as the receiver complies with the statutory requirements. "As a condition to maintaining these subsidiary contracts in full force and effect, the Corporation as receiver must either: (1) transfer any supporting obligations of the covered financial company that back the obligations of the subsidiary or affiliate under the contract (along with all assets and liabilities that relate to those supporting obligations) to a bridge financial company or qualified third-party transferee by the statutory one-business-day deadline; or (ii) provide adequate protection to such contract counterparties. The conditions contained in (i) and (ii) of the quoted statute were included to assure counterparties that any contractual right to guarantees or other support, including claims on collateral or other related assets, would be protected." The FDIC stated that "[a]lthough the statute speaks in terms of the power to enforce a contract to which the receiver is not a party, the Proposed Rule would recognize the practical effect of the intent of this authority, which is that the counterparty to such a contract may not exercise remedies in connection with a specified financial condition clause if the statutory conditions are met. No action is required of the receiver to enforce a linked contract; the Proposed Rule would make clear that the contract would remain in full force and effect unless the receiver failed to meet the requirements with respect to any supporting obligations of the covered financial company."

The Proposed Rule also would clarify the meaning of the statutory provision regarding a contractual obligation that is "guaranteed or otherwise supported by" the covered financial company. Support includes guarantees that may or may not be collateralized, netting arrangements and other examples of financial support of the obligations of the subsidiary or affiliate under the contract. "In circumstances where a contract of a subsidiary or affiliate is linked to the financial condition of the parent company via a 'specified financial condition clause,' but where the obligations of the subsidiary or affiliate are not 'supported by' the covered financial company through guarantees or similar supporting obligations, the requirement to transfer support and related assets or provide adequate protection does not apply. The mere existence of a 'specified financial condition clause' does not constitute a 'support' obligation by the covered financial company, and the Proposed Rule would make it clear that the subsidiary contract remains enforceable without any requirement to effectively create new support where none originally existed." The Proposed Rule similarly apples broadly to all contracts, and not solely to qualified financial contracts. "For example, a real estate lease or a credit agreement, neither of which would typically be classified as a qualified financial contract, would be subject to enforcement under section 210(c)(16) and the Proposed Rule notwithstanding a specified financial condition clause that might, for instance, give a lessor the right to terminate a lease based upon a change in financial condition of the parent of the lessee. A swap agreement of a subsidiary or affiliate would be subject to the section 21O(c)(16) and the Proposed Rule in the same manner if the agreement contains specified financial condition clause."

The Proposed Rule would not affect other provisions of the Dodd-Frank Act governing qualified financial contracts, such as sections 21O(c)(8) ("Certain Qualified Financial Contracts") and 210(c)(9) ("Transfer of Qualified Financial Contracts"). "For example, where a covered financial company's support of a subsidiary or affiliate obligation would itself be considered a qualified financial contract, such as a securities contract, the provisions of section 210(c)(9) that prohibit the selective transfer of qualified financial contracts with a common counterparty (or a group of affiliated counterparties) would continue to apply." Comments are due 60 days after publication in the Federal Register.

For more information, click here.

FDIC Extends Comment Period On Stress Tests

On March 21, the Federal Deposit Insurance Corporation (FDIC) extended until April 30, 2012, the comment period on a proposal to implement the requirements in Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to require state, non-member banks and savings associations with more than $10 billion in consolidated assets to conduct annual stress tests.

Due to "the scope and complexity of the proposal," the FDIC extended the comment period to allow interested persons more time to analyze the issues and prepare their comments. Originally, comments were due by March 23.

FDIC Proposes Changes to Large Bank Assessment Rule To Quell Discomfort Among Large Banks

On March 19, the Federal Deposit Insurance Corporation (FDIC) proposed changes in key definitions that control how much money large banks will pay in order to maintain their insurance coverage from FDIC. The Federal Deposit Insurance Act (the FDI Act) requires that the deposit insurance assessment system be risk-based . It defines a risk-based system as one based on an institution's probability of causing a loss to the Deposit Insurance Fund (the DIF), taking into account the composition and concentration of the institution's assets and liabilities and any other factors that the FDIC determines are relevant, the likely amount of any such loss, and the revenue needs of the DIF. The FDI Act allows the FDIC to "establish separate risk-based assessment systems for large and small members of the Deposit Insurance Fund." Generally, "large" banks have more than $10 billion in assets.

On February 7, 2011, the FDIC Board adopted a final rule that amended its assessment regulations, by, among other things, establishing a new methodology for determining assessment rates for large and highly complex institutions (the February rule).

The proposed FDIC amendments to the February rule assessment system for large and highly complex institutions would: "(1) revise the definitions of certain higher risk assets, specifically leveraged loans, which would be renamed "higher-risk C&I loans and securities," and subprime consumer loans, which would be renamed "higher-risk consumer loans and securities"; (2) clarify the timing of classifying an asset as higher risk; (3) clarify the way securitizations (including those that meet the definition of nontraditional mortgage loans) are to be identified; and (4) further define terms that are used in the large bank pricing rule." The proposed changes would appear to go a long way to resolving concerns that banks did not and do not collect the type of information that they would have been required to report based on the February rule. It is interesting to observe the footnotes in the proposal, which explain, from FDIC's point of view, why staff did not appreciate the difficulty banks would have in reporting such information, and essentially take the position that banks did not explain the difficulties in a timely manner. Thus, FDIC stated that "…no comments were received on the November 2010 NPR indicating that large institutions would be unable to identify and report subprime or leveraged loans in accordance with the final rule's definitions in their Call Reports and TFRS beginning as of June 30, 2011. The data availability concerns were first expressed in comments on the PRA notice."

The proposed amendments would be effective on October 1, 2012, predicated on changes to the Call Report template.

For more information, click here.

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