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SEC/CORPORATE

SEC Proposes Rule Regarding Disclosure of CEO-to-Worker Pay Ratio

On September 18, the Securities and Exchange Commission proposed a rule that would amend Item 402 of Regulation S-K to require an issuer to disclose, in addition to the annual total compensation of the issuer's chief executive officer, the median of the annual total compensation of all employees of such issuer and its subsidiaries (excluding the chief executive officer), and the ratio of such median annual total employee compensation to the annual total compensation of the chief executive officer. The proposed rule was approved by the SEC by a three to two vote over the objection of two SEC commissioners, who argued for postponing the proposal of the rule. Those objecting commissioners argued that the economic benefits of the proposed rule could not be clearly articulated, and that investors could be harmed because the pay ratio disclosure would not be precisely comparable across industries and issuers due to differing business practices and other company-specific factors. Prior to the SEC publishing the proposed rule, it received almost 23,000 comment letters and a petition with approximately 84,700 signatories. The SEC is required to implement this rule pursuant to Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The proposed rule would generally apply to issuers other than issuers that are emerging growth companies, smaller reporting companies or foreign private issuers (including issuers eligible for the US-Canadian Multi-Jurisdictional Disclosure System). Issuers subject to the rule would only be required to provide the pay ratio disclosure in annual reports on Form 10-K, registration statements and proxy and information statements, to the extent that such filings require the disclosure of a summary compensation table pursuant to Item 402(c) of Regulation S-K. In addition, the proposed rule would cover all employees of an issuer and its subsidiaries that are employed as of the end of the issuer's fiscal year, including part-time, temporary, seasonal and foreign employees, despite comments from numerous large international corporations that including international employees would lessen the comparative value of the pay ratio disclosure due to differences in costs of labor and costs of living.

The proposed rule would mandate that specific compensation figures and ratios be disclosed and would require that total compensation for employees be calculated in the manner prescribed by Item 402(c)(2)(x) of Regulation S-K. The proposed rule would, however, provide for some flexibility in making the required calculations. For example, issuers would be permitted to use a representative sample of employees instead of making the calculation based on all employees. The proposed rule would allow an issuer to calculate total compensation for each of the employees included in its calculation (whether all employees or a sample) pursuant to Item 402(c)(2)(x), and determine the median employee based on these calculations.

Alternatively, an issuer would be permitted to identify the median employee included in its calculation based on any consistently applied measure of compensation (e.g., compensation amounts reported in the issuer's tax or payroll records), and then calculate the total compensation for such employee in accordance with Item 402(c)(2)(x). An issuer would also be permitted to use reasonable estimates and assumptions when calculating annual total compensation, but would be required to disclose any material assumptions, adjustments or estimates used in its calculations, as well as the methodology used to identify the median employee.

Under the proposed rule, an issuer would be required to make the pay ratio disclosure with respect to compensation for its first fiscal year commencing on or after the effective date of the final rule. In other words, if the final rule becomes effective at some point in 2013, a calendar year filer would be required to include pay ratio disclosure regarding compensation for the 2014 fiscal year in its annual report for the 2014 fiscal year (filed in the first quarter of 2015) or its proxy or information statement for its 2015 annual meeting of stockholders. The proposed rule would also include a transition period for any newly public issuer, which would be required to make the pay ratio disclosure with respect to compensation for its first fiscal year commencing on or after the date on which such issuer became subject to the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934.

Significant concerns have been raised by large corporations and interest groups regarding the cost of obtaining the data needed to calculate the required median annual total compensation. The SEC believes that the proposed rule fulfills the requirements imposed by the Dodd-Frank Act while also minimizing the cost and time burden on issuers subject to the rule. The SEC has requested comments on the proposed rule by no later than 60 days following the date on which the proposed rule is published in the *Federal Register*.

A fact sheet regarding the proposed rule is available here, and the full proposing release is available here.

BROKER DEALER

SEC Issues Risk Alert on Short Selling in Connection with a Public Offering

The Securities and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) has issued a Risk Alert regarding Rule 105 of Regulation M's (Rule 105) restrictions on short selling in connection with a public offering. The Risk Alert provides that, since January 2010, the SEC has collected disgorgement, penalties and interest in excess of $42 million based on violations of Rule 105 and has settled over 40 actions in which it found that firms and/or individuals have violated Rule 105. The Risk Alert reminds firms of the need to consider certain control procedures that may improve firms' compliance with Rule 105 and the consequences of trading activities that fail to comply with Rule 105.

Rule 105 makes it unlawful for a person to purchase securities in a firm commitment equity offering from an underwriter or broker dealer participating in the offering if that person sold short the security that is the subject of the offering during the Rule 105 restricted period, absent an available exception discussed below. The Rule 105 restricted period is typically the period beginning five days before the pricing of the offered securities and ending with such pricing.

There are three exceptions to the Rule 105 restriction: (i) the bona fide purchase exception, (ii) the separate account exception and (iii) the investment company exception. The bona fide purchase exception generally provides that persons can purchase securities in the offering even if they sell short during the Rule 105 restricted period as long as they make bona fide purchases equivalent in quantity to the amount of the restricted period short sales prior to pricing. The exception for separate accounts generally allows a purchase of the offered securities in an account of a person where such person sold short in another account during the restricted period, if decisions regarding securities transactions for each account are made separately and without any coordination of trading or cooperation among or between the accounts. The investment company exception allows a registered fund (or series of such fund) to participate in an offering, even if another series of the registered fund or an affiliated registered fund (or series of such fund) sold short during the Rule 105 restricted period.

The Risk Alert provides that it is important for firms to provide training to their employees regarding the application of Rule 105, develop and implement policies and procedures reasonably designed to achieve compliance with Rule 105 and enforce those policies and procedures. In determining the penalties associated with the violations in settled Rule 105 enforcement actions, the SEC has considered, among other factors, whether the firms implemented remedial efforts such as developing and implementing policies, procedures and controls to prevent or detect Rule 105 violations. In addition, the SEC's National Examination Program staff have raised inadequate policies and procedures that fail to identify, mitigate and manage risks involving short sales in connection with follow-on or secondary offerings. The Risk Alert reminds firms that prompt remedial steps to address violations of Rule 105 would not absolve a firm or individual from the violation of Rule 105, and these same remedial steps, had they been proactively implemented, may have prevented the violations.

Click here to read the Risk Alert.

CFTC

CFTC Seeks Comments on Amended EFRP Rule

On September 19, the Commodity Futures Trading Commission requested public comments on proposed amendments to the exchange for related position (EFRP) rules and Market Regulation Advisory Notice of the Chicago Mercantile Exchange, the Board of Trade of the City of Chicago, the New York Mercantile Exchange, the Commodity Exchange and the Board of Trade of Kansas City. The proposed revisions would prohibit transitory EFRPs and EFRP transactions between commonly controlled accounts. The revised rules and guidance also would prohibit the use of EFRPs to transfer funds between parties, permit the use of certain EFRP transactions in connection with inventory financing and clarify the recordkeeping and trade data submission requirements for EFRPs.

The CFTC's request for comment is available here.

The proposed rules and guidance are available here.

NFA Commences New Filing Requirement for Commodity Trading Advisors

On September 16, the National Futures Association (NFA) issued a notice to inform its members that NFA's new quarterly reporting requirement for commodity trading advisor (CTA) member firms pursuant to NFA Compliance Rule 2-46 is effective for the quarter ending September 30, 2013. The initial reports will be due on November 14, 2013. These quarterly reports, known as NFA Form PR, consist of the Commodity Futures Trading Commission's Form CTA-PR together with additional information relating to trading programs offered by the CTA, related monthly rates of return and assets under management for those trading programs. All NFA member CTAs must submit Form PR each quarter, regardless of whether they are currently active.

The NFA Notice to Members is available here.

LITIGATION

Second Circuit Affirms Judgment that SLUSA Precludes Madoff-Related Claims

The US Court of Appeals for the Second Circuit affirmed the district court's dismissal of two class action suits by European investors on behalf of all investors in certain funds (Funds), against JPMorgan Chase & Co. (JPMorgan) and Bank of New York Mellon (BNY) arising from Bernard L. Madoff's Ponzi scheme. In their complaints, the plaintiffs alleged that JPMorgan and BNY, among a number of other defendants, ignored "red flags" of Madoff's fraud and continued to funnel investor money through the Funds into Madoff's Ponzi scheme in order to collect fees. The plaintiffs further alleged that JPMorgan and BNY aided and abetted Madoff's fraud, engaged in a civil conspiracy with other defendants, aided and abetted conversion and breaches of fiduciary duties by the Funds, and were unjustly enriched at the expense of the investors in the Funds. The lower court found that the plaintiffs' claims were subject to the Securities Litigation Uniform Standards Act (SLUSA), which precludes certain class actions based on state law and arising from alleged misrepresentations or omissions made in connection with the purchase or sale of certain securities. In affirming the district court's decision, the Second Circuit held that even though the plaintiffs' interests in the Funds were not "covered securities," SLUSA nonetheless applied because Madoff's purported trading strategy involved "covered securities." Additionally, the Second Circuit held that SLUSA preempted the actions, even though the plaintiffs did not style their claims as securities fraud claims. Because the complaints essentially alleged that JPMorgan and BNY were part of Madoff's fraud, the Second Circuit held that the requirements of SLUSA were met.

Trezziova et al. v. Repex Ventures SA et al., Nos. 12-0156, 12-0162 (2d Cir. September 16, 2013).

Sixth Circuit Rejects Claim Preclusion Where Fraudulent Conduct Concealed in a Prior Action

The US Court of Appeals for the Sixth Circuit recently reversed a district court's decision to dismiss a complaint based on claim preclusion. In its complaint, Venture Global Engineering (VGE) alleged that Satyam Computer Services, Ltd. (Satyam) fraudulently induced VGE to enter into a joint venture by misrepresenting its finances. Satyam moved to dismiss on the grounds that VGE was precluded from bringing its claims because it failed to do so previously at an arbitration between the parties. The Sixth Circuit disagreed, finding that VGE based its claims on information Satyam had concealed and that, if a party wrongfully conceals facts that made it impossible for an opposing party to assert its claims in a prior proceeding, claim preclusion would not bar the opposing party from asserting those claims in a subsequent proceeding. Based on the evidence before it, the Sixth Circuit concluded that Satyam had concealed its true financial state by manipulating and falsifying its financial statements and, by doing so, made it impossible for VGE to bring its Racketeer Influenced and Corrupt Organizations Act, fraud in the inducement, common law fraud and fraudulent concealment claims. The court was not persuaded by Satyam's argument that actions that constitute the fraud itself could not be a basis for concealment of the fraud and determined that, in any event, VGE had pled actions by Satyam distinct from the fraud, in furtherance of the concealment of the fraud.

Venture Global Eng'g, LLC v. Satyam Computer Servs., Ltd., No. 12-2200 (6th Cir. Sept. 13, 2013).

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