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SEC/CORPORATE

ISS Announces ISS Governance QuickScore to Replace GRId

Institutional Shareholder Services (ISS) recently announced that, effective in late February or early March, it is replacing its Governance Risk Indicators (GRId) database with the new ISS Governance QuickScore (QuickScore), which is designed to quantitatively identify risks within a company.

Although GRId and QuickScore both attempt to measure governance risk, QuickScore is a more quantitatively driven system that searches for relationships between governance factors and important financial metrics, with an overlay that aligns qualitative aspects of governance with ISS policy. The quantitative methodology is based on ISS's best practices as to numerous governance factors. Additionally, where GRId provided a color-coded scoring of qualitative risk factors, QuickScore assigns a numeric score based on four governance dimensions: board, compensation, shareholder rights and audit.

Initially, QuickScore will rate over 4,000 companies within 25 markets, including the 3,000 largest US companies by market cap, the 250 largest Canadian companies by market cap and United Kingdom, Europe, Japan and Asia Pacific companies in the MSCI-EAFE index. Companies rated by QuickScore have been granted access to ISS's free data verification site, where they can review data ISS has collected on the QuickScore factors. Companies will have the ability to submit requests to ISS for data changes or updates through this site until February 15, at which time it will close until QuickScore is launched. ISS intends to begin including a covered company's QuickScore in its proxy research reports beginning in late February or early March.

Additional information regarding QuickScore is available here.

Petitioners File Opening Brief Challenging SEC's Conflict Minerals Rule

The National Association of Manufacturers, the Chamber of Commerce of the United States of America and Business Roundtable recently filed their opening brief with the US Court of Appeals for the District of Columbia Circuit in their suit against the Securities and Exchange Commission challenging the final SEC rule implementing Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as the "conflict minerals rule." As reported in *Corporate and Financial Weekly Digest* of August 24, 2012, the conflict minerals rule mandates disclosure and reporting requirements regarding the use by issuers of certain minerals sourced from the Democratic Republic of the Congo (DRC) and adjoining countries.

In their brief, the petitioners argue that the court should strike down the conflict minerals rule for the following reasons: (1) the SEC failed to conduct a proper cost-benefit analysis and, in particular, did not determine whether the rule would achieve the intended benefit for the DRC and underestimated the rule's costs to issuers; (2) the SEC misconstrued the statute in concluding that it could not adopt a de minimis exception to the rule; (3) the rule wrongly requires due diligence and a Conflict Minerals Report from companies that merely have a "reason to believe" their minerals "may have originated" in the covered region (rather than limiting the rule's application to companies whose minerals "did originate" in the region); (4) the SEC failed to justify its decision to require companies to trace minerals back to the smelter or refiner, even though commenters suggested the far less

burdensome approach to use “flow-down” clauses in contracts to require suppliers not to source conflict minerals from the covered countries; (5) the SEC mistakenly interpreted the statute to apply to companies that do not manufacture any products and merely contract for the manufacture of products; (6) the rule is internally inconsistent because it gives smaller issuers four years to create the infrastructure necessary to trace conflict minerals in their supply chain, while giving larger issuers only two years, despite acknowledging that many large issuers cannot meet their obligations under the rule without obtaining information from smaller companies; and (7) the rule compels speech in violation of the First Amendment by requiring companies to describe their products as “not DRC conflict free,” even in circumstances in which a company is simply unable to trace their supply chains to determine their minerals’ origins, thereby forcing companies to associate themselves falsely with groups engaged in human rights violations. (Brief of Petitioners, *National Association of Manufacturers v. SEC*, No. 12-1422 (D.C. Cir. filed Jan. 16, 2013), ECF No. 1415549.)

The SEC’s brief is due on March 1.

SEC Roundtable Discusses Decimalization and Tick Sizes

On February 5, the Securities and Exchange Commission hosted a roundtable discussion regarding the impact that decimal-based pricing increments (i.e., decimalization), which replaced fraction-based tick sizes in 2001, has had on US securities markets, investors, issuers and market professionals. Some have argued that decimalization is one of the principal reasons for the dramatic decrease in smaller initial public offerings. Participants in the roundtable included academics, representatives of securities exchanges, institutional investors, venture capital firms, market makers, retail brokerage firms and other market professionals.

Panelists discussed whether the current decimalization regime could be enhanced to promote capital formation and, in particular, revitalize the market for initial public offerings in the United States. The roundtable focused on the impact of decimalization on small- and mid-cap companies (generally, companies with market capitalizations below $1 billion), and the potential advantages and disadvantages of larger tick sizes in terms of liquidity, the availability of analyst research for small- and mid-cap companies, price discovery and transaction costs. Panelists also discussed the potential merits and design of a potential SEC pilot program intended to establish an empirical basis for action, if any, that the SEC may take with respect to tick sizes. While SEC staff members indicated that no final decision had been made to move forward with a pilot program, participants in the roundtable generally favored the concept of such a program.

The roundtable represents part of the SEC’s response to Section 106(b) of the Jumpstart Our Business Startups Act, which required the SEC to study and report on the impact that decimalization has had on the number of initial public offerings since its implementation, as well as the impact decimalization has had on liquidity for small- and mid-cap company securities. In the SEC’s July 2012 Report to Congress on Decimalization delivered pursuant to the JOBS Act, the SEC staff recommended that the SEC “solicit the views of investors, companies, market professionals, academics and other interested parties on the broad topic of decimalization,” including how to best study its effects. The staff also recommended that the SEC not then proceed with any specific rulemaking to increase tick sizes.

To view a webcast of the roundtable, click here.

BROKER DEALER

SEC Issues Frequently Asked Questions on Exemption from Broker-Dealer Registration Under the JOBS Act

The Securities and Exchange Commission’s Division of Trading and Markets has issued Frequently Asked Questions (FAQs) that provide guidance on the exemption from broker-dealer registration in Section 201(c) of the Jumpstart Our Business Startups Act. Section 201(c) of the JOBS Act adds Section 4(b) to the Securities Act of 1933 (Securities Act) to provide that persons participating in an offering under Rule 506 of the Securities Act are not subject to broker-dealer registration solely because (i) that person maintains a platform or mechanism that permits the offer, sale, purchase, negotiation, general solicitation or advertisements or similar or related activities by issuers of such securities; (ii) that person or any person associated with that person co-invests in such securities; or (iii) that person or any person associated with that person provides ancillary services with respect to

such securities. In addition, that person and each person associated with that person may not (i) receive compensation in connection with the purchase or sale of such security, (ii) have possession of customer funds or securities in connection with the purchase or sale of such security, and (iii) be subject to a statutory disqualification as defined under Section 3(a)(39) of the Securities Act.

In the FAQs, the SEC clarified that the exemption from broker-dealer registration in Section 4(b) of the Securities Act (Section 4(b) Exemption) is fully operational and does not require the SEC to issue or adopt any rules. The Section 4(b) Exemption is only available to those persons who do not receive any compensation in connection with the purchase or sale of securities. This restriction is not limited to transaction-based compensation. The SEC advised that it interprets the term "compensation" broadly to include any direct or indirect economic benefit to such persons. However, the SEC provided that profits with respect to co-investment in the securities offered on the platform or mechanism would not be considered impermissible compensation for purposes of the Section 4(b) Exemption. The SEC also advised that, assuming all conditions are met, the Section 4(b) Exemption does not limit the types of persons who are permitted to maintain a platform or mechanism for an issuer's securities. Accordingly, associated persons of issuers that otherwise qualify for the Section 4(b) Exemption may rely on it to be exempt from broker-dealer registration; however, the employees of an internal marketing department or the investor relations department of an affiliated adviser of a complex of privately offered funds may not rely on the Section 4(b) Exemption if such employees are paid salaries to promote, offer and sell shares of the privately offered funds.

Click here to read the SEC's Division of Trading and Markets Frequently Asked Questions.

CFTC

trueEX Requests that CFTC Amend Order of Designation as a Contract Market

The Commodity Futures Trading Commission is seeking public comment regarding a request by trueEX LLC (trueEX) to amend its order of designation as a contract market. Pursuant to the request, trueEX intends to allow for intermediation in connection with trading activities on the trueEX platform. trueEX currently only allows principal-to-principal trading on its platform.

Comments must be submitted to the CFTC by March 1, 2013. The CFTC notice requesting comment is available here. The request submitted to the CFTC is available here.

LITIGATION

Seventh Circuit Affirms Dismissal of Former Bank Executive's APA and FIRREA Claims

The US Court of Appeals for the Seventh Circuit recently affirmed an Illinois district court's dismissal of claims brought by the former chairman and controlling stockholder of an Illinois-state chartered bank against the Federal Deposit Insurance Corporation (FDIC), both in its regulatory capacity (FDIC-Corporate) and its receiver capacity (FDIC-Receiver).

Plaintiff Pethinaidu Veluchamy, together with other members of his family and the Veluchamy Family Foundation, owned 93.2% of First Mutual Bancorp of Illinois, Inc., a holding company that was the sole owner of Mutual Bank at Harvey, Illinois (Mutual Bank).

In June 2008, the Veluchamy family invested approximately $30 million in Mutual Bank, primarily through note purchases, in order to maintain Mutual Bank's "well-capitalized" rating. In early 2009, the Veluchamy family arranged for an additional capital infusion of $6 million in response to an order from the Illinois Department of Financial and Professional Regulation (IDFPR). On May 12, 2009, the IDFPR notified Mutual Bank that the bank needed another $70 million in capital to remain solvent, and that IDFPR would seize control of the bank if certain capital ratio benchmarks were not achieved within 60 days. On July 31, 2009, the IDFPR declared Mutual Bank insolvent and appointed the FDIC as receiver.

Shortly before the insolvency order, Mutual Bank's board voted to seek approval from the FDIC to redeem the $30 million note investment made by the Veluchamy family in June 2008, noting that the Veluchamy family had agreed to keep the returned capital in a deposit account at Mutual Bank (depositors have higher priority in a post-insolvency distribution than capital investors). FDIC-Corporate did not respond to the board's request, and FDIC-Receiver rejected proofs of claims submitted by the Veluchamy family that apparently sought to treat their $30 investment as a deposit account.

Plaintiffs brought an action under the Administrative Procedure Act (APA) and the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA).

The Seventh Circuit found that the appellants' APA claim against FDIC-Corporate was barred because the United States has not waived sovereign immunity for APA claims seeking money damages. The court affirmed dismissal of plaintiffs' FIRREA claims against FDIC-Receiver because plaintiffs' FIRREA claims were based on the FDIC's regulatory decision not to act on the bank's request for the redemption of the notes, as opposed to any actions taken by the bank itself.

Veluchamy v. FDIC, No. 10-3879 (7th Cir. Feb. 4, 2013).

Delaware Court of Chancery Analyzes Damages Claims in Failed Asset Sale

The Delaware Court of Chancery recently denied, with one exception, cross-motions for summary judgment in an action to determine damages arising from a failed asset purchase agreement.

Plaintiff Henkel Corporation (Henkel) entered into a December 2007 Asset Sale and Purchase Agreement (Agreement) to sell its consumer adhesive business (Business) to defendant Innovative Brands Holdings, LLC (IBH) for $127.5 million. After signing, IBH subsequently refused to complete the purchase.

Henkel commenced an action for specific performance. IBH filed counterclaims seeking a declaration that a material adverse event (MAE) had occurred and that it was not obligated to close, but that Henkel nonetheless remained bound by the no-shop clause. Later, during the litigation, IBH changed its position and waived all rights to purchase the Business or to enforce the no-shop. Henkel then sold the Business to Shurtape for $112 million, or $15.5 million less than the price agreed to by IBH.

The parties then proceeded to litigation regarding the amount of damages owed to Henkel by IBH for breach of the Agreement. Henkel sought three types of damages: (1) the $15.5 million difference between the purchase price in the Agreement and the amount it later agreed to with Shurtape (Sales Price Damages); (2) the costs Henkel incurred in conducting a second sale process (Transaction Damages); and (3) the attorneys' fees and expenses Henkel incurred due to IBH's breach (Legal Enforcement Damages).

IBH argued that the income generated by the Business during the period between the date IBH breached the Agreement and the eventual sale to the alternative buyer (Interim Period) should be offset against Henkel's damages. The court determined that Henkel's reasonable expectations were limited to revenues generated by the Business until the date it would have sold the Business to IBH under the Agreement. Allowing Henkel to receive both damages and the Interim Period income would result in a "windfall" to Henkel.

The court denied summary judgment, however, in large part because there were disputed issues of fact as to the date of IBH's breach, which the court needed to determine in order to calculate the Interim Period income to be offset against Henkel's damages.

Separately, the Agreement authorized Henkel to recover legal expenses and did not subject them to any offset by the Business' profits, as it did with regard to actual damages. Henkel was therefore entitled to partial summary judgment awarding its reasonable attorneys' fees and costs.

Henkel Corp. v. Innovative Brands Holdings LLC, No. 3663-VCN (Del. Ch. Jan. 31, 2013).

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