

SEC/CORPORATE

SEC Publishes Guidance for Investment Advisers and Proxy Advisory Firms Regarding Proxy Voting and Solicitation

On June 30, the Securities and Exchange Commission's Division of Investment Management and Division of Corporation Finance published Staff Legal Bulletin No. 20 (SLB 20), which offers guidance regarding investment advisers' responsibilities in voting proxies and retaining proxy advisory firms, as well as the availability of two exemptions from federal proxy rules often relied upon by proxy advisory firms.

Investment Adviser Proxy Voting

As a fiduciary, an investment adviser owes each of its clients a duty of care and loyalty with respect to services provided on the client's behalf, including proxy voting. Moreover, Rule 206(4)-7 under the Investment Advisers Act of 1940 prohibits investment advisers from exercising voting authority with respect to client securities unless the adviser, among other things, adopts and implements written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interests of its clients (Proxy Voting Rule). SLB 20 provides examples of the steps an adviser can take to demonstrate its compliance with the Proxy Voting Rule, such as periodically sampling and reviewing proxy votes to ensure compliance with the adviser's proxy voting policy and procedures, and assessing the adequacy of such policy and procedures at least annually to ensure that they are being implemented correctly and that proxies are voted in the best interest of clients. SLB 20 also clarifies that, while an investment adviser that assumes proxy voting authority for a client must do so in compliance with the Proxy Voting Rule, an investment adviser and its client may agree to limit the scope of the investment adviser's obligation to exercise proxy voting authority in appropriate circumstances.

SLB 20 also addresses investment advisers' obligations in connection with the retention and oversight of proxy advisory firms. In considering whether to retain a proxy advisory firm, an investment adviser should ascertain whether the advisory firm has the capacity and competency to adequately analyze proxy issues. SLB 20 clarifies that, in evaluating a proxy advisory firm, an investment adviser could consider, for example, the adequacy and quality of the advisory firm's personnel, as well as its policies and procedures for ensuring recommendations are based on current and accurate information and for addressing conflicts of interest.

If a proxy advisory firm is retained, an investment adviser should adopt and implement policies and procedures that are reasonably designed to provide ongoing oversight of the proxy advisory firm to ensure that the investment adviser, through the investment advisory firm, continues to vote proxies in the best interests of its clients. The investment adviser also has a duty to monitor the effectiveness of the proxy advisory firm's policies for addressing conflicts of interest and to take reasonable steps to address any factual errors upon which a proxy advisory firm's recommendations may be based.

Proxy Advisory Firm Exemptions from Proxy Rules

SLB 20 also clarifies the Division of Corporation Finance's interpretation of two exemptions from federal proxy rules upon which proxy advisory firms often rely. A proxy advisory firm is subject to federal proxy rules if it engages in a "solicitation," which is defined under Rule 14a-1(l) under the Securities Exchange Act of 1934

(Exchange Act) to include “the furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.” Rule 14a-2(b)(1) under the Exchange Act exempts from the information and filing requirements of federal proxy rules “any solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another’s behalf, the power to act as a proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization.” Where, for example, a proxy advisory firm only distributes reports containing recommendations, but does not solicit proxies, the exemption under Rule 14a-2(b)(1) would be available. In contrast, SLB 20 clarifies that if a shareholder (such as an institutional investor) retains a proxy advisory firm to assist in the establishment of general proxy voting guidelines and policies, the exemption under Rule 14a-2(b)(1) would not be available to the proxy advisory firm where the proxy advisory firm is authorized to apply such guidelines to vote on the shareholder’s behalf because the proxy advisory firm would be viewed as having “solicited the power to act as a proxy” for its client.

Rule 14a-2(b)(3) under the Exchange Act provides an additional exemption for furnishing information to a person with whom a business relationship exists, provided that the person furnishing the advice gives financial advice in the ordinary course of business; discloses to the recipient of the advice any significant relationship with the company or any of its affiliates, or a security holder proponent of the matter on which the advice is given, as well as any material interest of the person in such matter; receives no special commission for furnishing the advice from any person other than the person to whom the advice is given (and others who receive similar advice); and does not furnish the advice on behalf of any person soliciting proxies or on behalf of a participant in a contested election. SLB 20 clarifies that a relationship generally would be considered “significant,” or a “material interest” would exist, if knowledge of the relationship or interest would reasonably be expected to affect the recipient’s assessment of the reliability and objectivity of the adviser and the advice. SLB 20 further indicates that any such relationship or interest must be disclosed to the recipient of the advice (either publicly or between the proxy advisory firm and its client) and clarifies the type of information that must be disclosed.

Click [here](#) to view the complete text of SLB 20.

SEC Division of Corporation Finance Issues C&DIs Relating to Accredited Investor Verification Methods

On July 3, the Securities and Exchange Commission’s Division of Corporation Finance issued six new Compliance and Disclosure Interpretations (C&DIs) with respect to determination of accredited investor status and, in particular, verification of accredited investor status under Rule 506(c) of the Securities Act of 1933 (the rule adopted by the SEC in 2013 that allows general solicitation in connection with offerings under Rule 506 of Regulation D). The new C&DIs include the following interpretative guidance:

[C&DI 255.48](#) provides that when determining the annual income of a purchaser whose income is not reported in US dollars under the income test for qualifying as an accredited investor, an issuer may use either (a) the exchange rate that is in effect on the last day of the year for which income is being determined or (b) the average exchange rate for that year.

[C&DI 255.49](#) clarifies that when determining the net worth of a purchaser under the net worth test for qualifying as an accredited investor, a person may include assets or property in an account held jointly with a non-spouse to the extent of his or her percentage ownership in the account or property.

[C&DI 260.35](#) provides that, when verifying an accredited investor’s annual income under Rule 506(c), an issuer may not rely on the safe harbor provisions with respect to a purchaser’s Internal Revenue Service forms for the “two most recent years” where an IRS form for the most recently completed year is not yet available for that purchaser. However, the SEC suggests that an issuer could reasonably conclude that a purchaser is an accredited investor under the principles-based verification method (Principles-Based Method) by (a) reviewing the IRS forms from the two years prior to the most recently completed year and (b) obtaining other written representations from the purchaser that the purchaser has met, and will meet for the current year, the requisite income level.

[C&DI 260.36](#) provides that, when verifying an accredited investor’s annual income under Rule 506(c), an issuer may not rely on the safe harbor provisions with respect to IRS tax forms where a purchaser is not a US taxpayer and can only provide comparable tax forms from a foreign jurisdiction. However, the SEC suggests that an issuer could reasonably conclude that a purchaser is an accredited investor under the Principles-Based Method by

reviewing filed tax forms that report income from a foreign jurisdiction that impose comparable penalties for falsely reported information.

[C&DI 260.37](#) clarifies that, when verifying an accredited investor's net worth under Rule 506(c), an issuer may not rely on the safe harbor provisions with respect to tax assessments dated within the prior three months where the most recent such tax assessment is dated more than three months from the time of verification. However, the SEC suggests that an issuer could reasonably conclude that a purchaser is an accredited investor under the Principles-Based Method by relying on the most-recent tax assessment dated more than three months from the time of verification if it reflects a value that, after deducting the purchaser's liabilities, shows the purchaser's net worth is substantially higher than \$1,000,000.

[C&DI 260.38](#) clarifies that, when evaluating a purchaser's liabilities for purposes of verifying an accredited investor's net worth under Rule 506(c), an issuer may not rely on the safe harbor provisions with respect to reports generated by "nationwide consumer reporting agencies" where the issuer reviews a consumer report from a non-US consumer reporting agency. However, the SEC suggests that an issuer could reasonably conclude that a purchaser is an accredited investor under the Principles-Based Method by obtaining a representation from the purchaser that all liabilities are disclosed on the foreign consumer report.

If an issuer employing any of the Principles-Based Methods has a reason to question the applicable measure of determining a purchaser's accredited investor status, it must conduct additional verification measures to establish that it has taken reasonable steps to verify that purchaser's accredited investor status.

BROKER-DEALER

FINRA to Conduct Targeted Examinations Regarding Order Routing and Execution Quality of Customer Orders in Exchange-Listed Stocks

The Financial Industry Regulatory Authority, Inc.'s Market Regulation Department has issued a targeted examination letter dated July 2014 to certain FINRA member firms notifying each firm that FINRA's Trading Examinations Unit (TEU) is conducting a review of the firm's processes and procedures in connection with order routing and execution quality of customer orders in exchange-listed stocks. As part of the review, TEU is requesting certain information from January 1, 2014 to the present, including, among other things, the firm's (i) written supervisory procedures related to FINRA Rule 5310 (regarding best execution and interpositioning), (ii) customer order execution procedures and reviews, including an explanation of how the firm's exchange order-routing decisions are made for customer non-marketable limit orders and customer market and marketable limit orders, (iii) use of other broker-dealers for execution of customer orders and (iv) policies regarding passing exchange maker/taker fees on to its customers.

Click [here](#) to read the July 2014 Targeted Examination Letter.

LITIGATION

SEC Settles Civil FCPA Action Against Two Former Oil Services Executives

On the eve of a trial which was scheduled to begin this week, the Securities and Exchange Commission settled a civil Foreign Corrupt Practices Act (FCPA) case it brought against two former oil services executives. The case was an outgrowth of an industry-wide investigation the SEC had initially commenced beginning in 2010.

In February 2012, the SEC filed a complaint against Mark A. Jackson, who was the former CEO and CFO of Noble Corporation, and James J. Ruehlen, former Director and Division Manager of Noble's Nigerian subsidiary, alleging that they authorized the payment of bribes to customs officials to process false paperwork that purported to show the export and re-import of oil rigs, which was necessary under the requirements of Nigerian law. In fact, the rigs had never been moved. The SEC alleged that the scheme was part of a design to save Noble from losing business and incurring costs associated with exporting rigs from Nigeria and re-importing them under new permits. The complaint asserted violations of the anti-bribery and books and records provisions of the FCPA. The complaint also detailed the fact that Jackson had refused to cooperate during Noble's internal investigation of the matter and had asserted his Fifth Amendment rights and refused to testify during the SEC investigation.

The settlement with Jackson and Ruehlen was the last in a lengthy saga of FCPA actions against Noble and its former employees. Noble was initially charged with FCPA violations in a civil action in 2010. The company settled, agreeing to pay more than \$8 million in fees. The SEC filed charges against Jackson and Ruehlen in 2012 following the corporate settlement and also filed charges against Thomas F. O'Rourke, the former controller and head of internal audit at Noble. O'Rourke quickly settled and agreed to pay a penalty.

Despite pursuing the action for more than two years and alleging serious wrongdoing by the defendants, including responsibility for an extensive bribery scheme, the SEC agreed to settle with Jackson and Ruehlen just two days before their trial was to commence with an injunction against violating the books and records provision of the FCPA. Although Noble had settled its own case for a hefty penalty, neither Jackson nor Ruehlen were required to pay a fine, concede a violation of the bribery provisions of the FCPA nor agree to restrictions on employment.

SEC v. Jackson et al., No. 4:12-c-00563 (S.D. Tex. Jul. 7, 2014).

New York Jury Acquits Former Hedge Fund Manager of Insider Trading Conspiracy

In the first case of approximately 81 insider cases that the S.D.N.Y. has successfully brought alleging insider trading, a New York federal jury acquitted Rengan Rajaratnam (Rengan), a former hedge fund manager, of conspiracy to commit insider trading and the use of manipulative and deceptive devices to commit securities fraud.

Rengan was a former analyst and portfolio manager for Galleon Group. Galleon, which operated a family of hedge funds, was founded and headed by Raj Rajaratnam (Raj), Rengan's older brother. Raj, who was convicted of insider trading conspiracy and securities fraud in 2011 and is currently serving an 11-year prison sentence, was a superstar in the hedge fund industry prior to his 2009 arrest.

Rengan's indictment alleged that Rengan and Raj, along with others, participated in a 2008 conspiracy to defraud by obtaining, sharing and disclosing inside information belonging to publicly traded companies and trading on this information. The indictment further alleged that Rengan used this information to purchase shares in Clearwater Corporation after learning that Intel was planning to invest \$1 billion in the company, and that Raj purchased shares of Advance Micro Devices Inc. on behalf of Rengan based on a tip about a multibillion-dollar transaction. While the original indictment alleged seven charges, prosecutors dropped four of those seven in May 2014. Then, in the middle of the trial, US District Judge Naomi Reice Buchwald dismissed two more charges after ruling that the government failed to present sufficient evidence to prove them beyond a reasonable doubt. After this, the jury was left with only one charge to consider.

As part of its case, the government was required to prove that Rengan knew about the benefits the two tippers received from Raj in exchange for their inside information. During the trial, however, the two insider tippers testified that they admittedly should not have tipped Raj, but emphasized that they never told Rengan that Raj had given them money and other personal benefits in exchange for inside information. Consequently, a federal jury acquitted Rengan on the only charge remaining. The acquittal ended Manhattan US Attorney Preet Bharara's perfect record in stock-tipping cases.

USA v. Rajaratnam, No. 1:13-cr-00211 (S.D.N.Y. Jul. 8, 2014).

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