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SEC / CORPORATE

NYSE Issues Proposed Amendment to Limit Issuance of Material News After Market Close

On August 18, the New York Stock Exchange (NYSE) issued a proposed amendment to Section 202.06 of the NYSE Listed Company Manual, which would prohibit the issuance of material news by a listed company between the official closing time of the NYSE's trading session until the earlier of the publication of such company's official closing price or five minutes after the NYSE's official closing time. In explaining the purpose of the proposed amendment, the NYSE noted that, because trading can occur after 4:00 p.m. ET (the NYSE's official closing time) on other markets "if a listed company released material news immediately after 4:00 p.m., but before the closing auction on the NYSE is completed, there can be a significant price difference in nearly contemporaneous trades on other markets and the closing price on the [NYSE]."

The full text of the proposed amendment is available here.

2017 Amendments to the Delaware General Corporation Law

In its most recently completed session, the Delaware state legislature adopted amendments to various provisions of the Delaware General Corporation Law (DGCL). These amendments became effective August 1. While many of the amendments were technical in nature (e.g., amendments to the merger provisions of DGCL §§ 252, 253, 258 and 267 to consistently use the term "foreign corporation" when referring to corporations organized under the laws of any jurisdiction other than the State of Delaware), others are of more significance to practitioners.

Blockchain Amendments. Sections 219 and 224 of the DGCL (relating to stockholder lists and forms of corporate records, respectively) were amended to permit the use of distributed ledger or "blockchain" technology (i.e., a growing list of shared, linked and continuously verified records to which new records are continuously added in a linear, chronological order) in maintaining stock ledgers and other corporate records. The amendments permit (but do not require) Delaware corporations to opt to use blockchain technology to maintain their stock records rather than using a centrally located stock registry. Specifically, DGCL § 219(c) was amended to define a ''stock ledger'' as ''one or more records administered by or on behalf of the corporation in which the names of all of the corporation's stockholders of record, the address and number of shares registered in the name of each such stockholder, and all issuances and transfers of stock of the corporation are recorded in accordance with § 224 of this title.'' Section 224 of the DGCL, in turn, has been amended to permit the maintenance of corporate records in one or more electronic databases, with the important caveat that the database chosen must permit the records to be reduced to paper form within a "reasonable" (presumably short) period of time. The amendments to DGCL § 224 also require that the technology used to maintain a stock ledger must permit the preparation of the lists of stockholders specified in DGCL §§ 219 and 220 (related to stockholder meetings and inspection of books and records, respectively) and be capable or recording the information required by DGCL §§ 156, 159, 217(a) and 218 (relating to partially paid shares, collateral transfers, voting rights of fiduciaries, and voting trusts and voting agreements, respectively) and recording transfers of stock as contemplated by the Delaware Uniform Commercial Code.

Similarly, notices required under DGCL §§ 151(f), 202(a) and 364 (relating to notices to holders of uncertificated stock and restrictions on transfers of securities) are now permitted to be given by electronic transmission. The term "electronic transmission" is defined in DGCL § 232, which section has been amended to permit the use of electronic networks or databases including ''any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved and reviewed by a recipient thereof . . . " Importantly, DGCL § 232, as amended, requires that such communication be capable of being directly reproduced in paper form by its recipient through an automated process.

These changes were driven in part by the "Delaware Blockchain Initiative," an effort championed by Delaware's former governor to promote the use of blockchain technology. While potentially very powerful and having broad long-term implications for everything from the maintenance of stockholder and other corporate records to the clearing of stock trades, in the short term, this technology will likely require the development of new systems and tools by vendors to exploit its potential before being broadly adopted.

Stockholder Written Consents. In a move to simplify the lives of practitioners, DGCL § 228 was amended to eliminate the requirement that stockholder written consents be individually dated at the time of signing by the signatory stockholder. As amended, DGCL § 228 also clarifies that written consents with future effective dates must be effective within 60 days of the delivery of the first consent to the corporation, marking a slight change from the previous rule measuring the 60-day period from the earliest dated consent delivered.

DGCL § 203 Opt-Out. Section 203 of the DGCL, the Delaware control share acquisition statute, was amended to clarify when opt-outs permitted by the statute become effective. Delaware corporations may opt out of DGCL § 203 by expressly doing so in their original charter or by a subsequent amendment to their certificate of incorporation or bylaws approved by their stockholders in accordance with DGCL § 203. Pursuant to the amendments to DGCL § 203(b)(3), opt-outs effected by an amendment to a corporation's charter now become effective upon filing with the Delaware Secretary of State in accordance with DGCL § 103 (in the case of a corporation that has never had a class of voting stock listed on a national securities exchange or held of record by more than 2,000 stockholders, and has not elected in its original charter to be treated otherwise) or 12 months from such filing (in the case of all other corporations). Previously, such opt-outs became effective upon adoption or 12 months after adoption, depending upon which of the two categories the corporation fit into. In contrast, the effectiveness of opt-outs effected by bylaw amendments remains tied to the date of the adoption of the amendment.

Merger Amendments. A number of highly technical amendments were made to the merger provisions of the DGCL. Among the most significant are the changes to DGCL §§ 252, 253, 254, 256, 258, 263, 264 and 267 to bring consistency to the types of foreign entities with which Delaware corporations are permitted to merge or consolidate. As amended, mergers with foreign entities will be permitted if the foreign jurisdiction does not "prohibit" such merger. This uniform standard replaces various previous standards with minor variations in language requiring the merger to be "permitted " or that the foreign statute "not forbid" the merger. The revised language is intended to be both be permissive and impose consistency across types of legal entities. In addition, the amendments to DCGL §§ 254, 263 and 264 make clear that mergers with foreign entities of the types covered by such sections (joint stock or other association, partnership and limited liability companies) are now expressly permitted.

Second Circuit Issues Key Ruling Regarding Personal Benefit Requirement for Insider Trading Liability

In *United States vs. Martoma*, issued on August 23, the Second Circuit reexamined its standard for evaluating liability for insider trading under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. In particular, the Second Circuit clarified the personal benefit requirement for a finding of tippee liability. A tippee violates Section 10(b) and Rule 10b-5 when he or she makes a purchase or sale based on material, nonpublic information received from a tipper, such as a corporate insider, where the tippee knew or should have known that the tipper breached a fiduciary duty, and where the tipper received a personal benefit from the disclosure.

In *Martoma*, defendant-appellant Mathew Martoma challenged his convictions for conspiracy to commit securities fraud and securities fraud on the basis of insufficient evidence, showing a personal benefit to the tipper as required under the "pecuniary *quid pro quo*" theory of insider trading liability, and by challenging the jury instruction on what it means to receive a personal benefit. Martoma was a portfolio manager for the hedge fund S.A.C. Capital Advisors, LLC (SAC) who managed an investment portfolio focused on pharmaceutical and health care companies. During the relevant time period, two pharmaceutical companies were developing an experimental drug for the treatment of Alzheimer's disease. According to evidence presented at trial, Martoma met with two doctors involved in the clinical trial several times to discuss information about the clinical trial, despite the doctors' obligations to keep that information confidential. Both doctors were paid consultants. Ultimately, SAC reduced its position in the securities of both pharmaceutical companies, based on information gained by Martoma. When the final results of the trial were announced, the share price of both companies began to decline. As a result of the trades made in advance of the announcement, SAC gained $80.3 million and averted losses of $194.6 million.

Following Martoma's four-week jury trial, and during the pendency of his appeal, the Second Circuit decided *United States vs. Newman*. In *Newman*, the Second Circuit clarified the "personal benefit" requirement. 773 F.3d 438, 452 (2d Cir. 2014) *abrogated by Salman vs. United States*, 137 S. Ct. 420 (2016). The Second Circuit held that an inference of a "personal benefit" to the tipper was only permissible where there was "proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." *Id.* The Ninth Circuit subsequently declined to adopt the Second Circuit's reasoning regarding a personal benefit, creating a circuit split on the issue.

The Supreme Court resolved that circuit split in *Salman vs. United States*. The Court held that a "personal benefit" includes "the benefit one would obtain from simply making a gift of confidential information to a trading relative." *Salman*, 137 S. Ct. at 429. Additionally, the Supreme Court expressly rejected the Second Circuit's requirement that the tipper "also receive something of a 'pecuniary or similarly valuable nature' in exchange for gift to family or friends." *Id.* at 428. The Court stated that "the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds." *Id.*

On appeal, Martoma argued that it was not proven that he and the tipper had a "meaningfully close personal relationship" as required by the Second Circuit for a finding of insider trading liability. However, applying *Salman* and *Dirks vs. SEC*, 463 U.S. 646 (1983), which *Salman* reaffirmed, the Second Circuit held that "an insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed 'with the expectation that [the recipient] would trade on it,' . . . and the disclosure 'resemble[s] trading by the insider followed by a gift of the profits to the recipient,' . . . whether or not there was a 'meaningfully close personal relationship' between the tipper and tippee." *United States vs. Martoma*, No. 14-3599, 2017 WL 3611518, at *8 (2d Cir. Aug. 23, 2017) (internal citations omitted). The Second Circuit was careful to note that its holding "does not eliminate or vitiate the personal benefit rule; it merely acknowledges that it is *possible* to personally benefit from a disclosure of inside information as a gift to someone with whom one does not share a 'meaningfully close personal relationship.'" *Id.* at *9. In light of *Salman*, the court explicitly rejected "the categorical rule that an insider can *never* personally benefit from disclosing inside information as a gift without a 'meaningfully close personal relationship.'" *Id.* Accordingly, the Second Circuit affirmed Martoma's conviction.

DERIVATIVES

See "Federal Reserve Restricts Termination of Qualified Financial Contracts" in the Banking section.

BANKING

Federal Reserve Restricts Termination of Qualified Financial Contracts

On September 1, the Board of Governors of the Federal Reserve System adopted a final rule that will affect the rights of counterparties that enter into Qualified Financial Contracts (QFC) (e.g., derivatives, stock loans and repurchase agreements) with banks that have been designated as global systemically important banking organizations (GSIBs). This rule, which was proposed in 2016, would prohibit US GSIBs and their subsidiaries, and the US subsidiaries, branches, and agencies of foreign GSIBs, from entering into a QFC unless the counterparty to the contract has agreed contractually:

- to abide by the 48-hour stay of QFC termination found in Title II of the Dodd-Frank Act and in the Federal Deposit Insurance Act;
- to allow transfer of the QFC in the event of a resolution of its counterparty; and
- to refrain from exercising cross-default termination rights arising from the resolution of an affiliate of its GSIB counterparty.

The first two requirements do not apply to a QFC between a US person and a covered entity that is governed by US law because the applicable bank insolvency regime already covers those points. The rule in its entirety does not apply to QFCs between a covered entity and a central clearing party.

The rule includes an unusual safe harbor that deems a covered entity to be compliant if both it and a counterparty have adhered to an applicable resolution regime protocol sponsored by the International Swaps and Derivatives Association, Inc.

The Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation are expected to adopt identical rules in the near future, so that all relevant GSIBs are covered.

There are eight American banks currently subject to the new rule: Bank of America, The Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street and Wells Fargo. It is estimated that 20 foreign GSIBs with US operations are also covered. The definition of "subsidiary" for the purposes of determining whether an entity is covered by the rule comes from the Bank Holding Company Act and, therefore, picks up more entities than the more common standard of greater than 50 percent ownership. The definition of QFC covers "any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement and any similar agreement that the [FDIC] determines by regulation, resolution or order to be a qualified financial contract."

The rule is effective between the covered entities starting January 2019 and between covered entities and financial counterparties starting June 2019. The rule becomes generally effective for all other counterparties on January 1, 2020.

The relevant Federal Reserve press release and the text of the rule is available here.

FDIC Issues Revised Guidelines for Appeals of Material Supervisory Determinations

On September 6, the Federal Deposit Insurance Corporation (FDIC) issued revised guidelines entitled "Guidelines for Appeals of Material Supervisory Determinations", which govern appeals by all FDIC-supervised institutions to Division Directors and the Supervision Appeals Review Committee. These revised guidelines expand the circumstances under which banks may appeal a material supervisory determination, enhance consistency with the appeals processes of other federal banking agencies, and include other limited technical and conforming changes.

For example, the revised guidelines permit the appeal of the level of compliance with an existing formal enforcement action, the decision to initiate an informal enforcement action and matters requiring board attention. Moreover, the revised guidelines state that a formal enforcement-related action or decision does not affect an appeal that is pending under the guidelines. The revised guidelines also provide additional opportunities for appeal in certain circumstances, such as in the case of a referral to the US Attorney General or providing notice to the US Department of Housing and Urban Development for violations of the Equal Credit Opportunity Act. Finally, under the revised guidelines, the FDIC will publish annual reports on Division Directors' decisions regarding material supervisory determinations.

In connection with the revised guidelines, the FDIC is rescinding FIL-52-2016, entitled "FDIC Seeks Comment on Bank Appeals Guidelines." The FDIC is also rescinding FIL-113-2004, entitled "FDIC Appeals Processes."

The revised guidelines are available here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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