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SEC/CORPORATE

SEC Division of Corporation Finance Issues 13 New and Revised C&DIs

On May 16, the Securities and Exchange Commission's Division of Corporation Finance issued 13 new and revised Compliance and Disclosure Interpretations (C&DIs) on a range of topics under the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), and the related rules, forms and disclosure provisions thereunder. The new and revised C&DIs included the following interpretive guidance:

C&DI 129.03 states that, if an affiliate of a company transfers, by bona fide gift, company stock acquired in the open market (i.e., the securities are not "restricted securities" in the affiliate's hands) to a donee in a non-public transaction, the donee need not comply with any Rule 144 holding period requirement under the Securities Act for subsequent sales (notwithstanding the fact that the securities are "restricted securities" in the hands of the donee immediately following such gift) and may resell such securities pursuant to Rule 144 subject only to Rule 144's current public information requirement.

C&DI 133.07 clarifies that an affiliate's sales of securities back to the issuer in a non-public transaction (i.e., a transaction that is exempt from registration under Section 4 of the Securities Act) may be excluded when calculating the amount of securities that may be sold by the affiliate under Rule 144 under the Securities Act.

C&DI 210.03 states that an automatic shelf registration statement on Form S-3 (available for "well known seasoned issuers") that registers the offer and sale of a specified number of securities of a specified class of securities may be post-effectively amended to add more securities of the same class already registered.

C&DI 228.04 clarifies that, while a registrant may omit "the identities of selling security holders and amounts of securities to be registered on their behalf" from the prospectus included in a non-automatic shelf registration statement until after effectiveness of the registration statement, the prospectus must disclose the aggregate number of shares being registered for resale before effectiveness.

C&DI 256.22 clarifies that, when an acquiror seeks consent from the target's stockholders with respect to a business combination involving the issuance of securities in reliance on Rule 505 or 506 of Regulation D under the Securities Act, and the target's stockholders include non-accredited investors, financial statements and other information required under Securities Act Rule 502(b)(2) must be provided to the target's non-accredited investor stockholders a "reasonable amount of time" prior to obtaining any written consents from them. This interpretation is based on the Staff's view that the delivery of the written consent in such context constitutes the "sale" for purposes of Rules 505 and 506 under the Securities Act.

C&DI 532.01 clarifies the Staff's position that, where a pledgor who is an affiliate of an issuer defaults on a loan that is secured by a bona fide pledge of the issuer's stock acquired by the affiliate in the open market, the pledgee may resell such securities under Rule 144 under the Securities Act without regard to any holding period requirement under the Securities Act, provided that the pledgee is not an affiliate of the issuer and that Rule 144's current public information requirement is satisfied.

C&DI 116.24 clarifies the Staff's position that, when calculating whether the size of an offering consisting of common stock and warrants sought to be registered on Form S-3 under General Instruction I.B.6 (limited primary offerings by certain registrants) exceeds the one-third cap in General Instruction I.B.6(a), the registrant must comply with Instruction 2 thereto (which provides a formula for calculating the aggregate market value of securities sold during any period of twelve calendar months) in calculating the market value of the warrants, even when the warrants are not exercisable for common stock within twelve months.

C&DI 125.12 states that, if a registrant "meets the requirements for use of Form S-3," it may incorporate by reference into a Form S-4 (typically used for business combination transactions) risk factor disclosure included in the registrant's most recent Form 10-K. Offering-specific risks, however, are required to be disclosed in the Form S-4 itself.

C&DI 119.03 clarifies how to disclose in an issuer's summary compensation table, pursuant to Item 402 of Regulation S-K, non-cash compensation granted to a named executive officer in lieu of salary or bonus that the named executive officer has elected to forego, based on the value of the stock, equity-based or other form of non-cash compensation as compared to the amount of salary or bonus foregone at the election of the named executive officer.

C&DI 118.09 clarifies that Instruction 5 to Item 402(b) of Regulation S-K, which provides that "[d]isclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G and Item 10(e) of Regulation S-K," is also applicable to disclosure regarding the issuer's actual results with respect to the non-GAAP measure that is used as a target, so long as such disclosure is made in the context of a discussion about the target levels and disclosure as to how the applicable target level is calculated from the registrant's audited financial statements is provided.

C&DI 134.04 clarifies how wide the range of estimated offering prices may be for purposes of disclosure in a preliminary prospectus for an initial public offering of securities (other than debt securities). For initial public offerings, a price range in excess of $2 will not be considered bona fide, if the offering price is less than or equal to $10 per share, and (ii) a price range in excess of 20% of the high end of the range will not be considered bona fide, if the offering price exceeds $10 per share. If an auction clearing price will be used as the primary factor in establishing the final offering price, (i) a price range in excess of $4 will not be considered bona fide for offerings up to $20 per share, and (ii) a price range in excess of 20% of the high end of the range will not be considered bona fide for offerings over $20 per share.

C&DI 146.17 clarifies that the interactive data filing requirements apply to registration statements of reporting issuers that omit pricing information from a registration statement in reliance on Securities Act Rule 430A, notwithstanding the provisions of Item 601(b)(101)(i) of Regulation S-K, which provide that an interactive data file is "required for a registration statement under the Securities Act only if the registration statement contains a price or price range." C&DI 146.17 explains that, in general, "disclosure that satisfies the requirements in Item 501(b)(3) of Regulation S-K to state the "offering price" will be considered a "price or price range" for purposes of the interactive data rules." Accordingly, registration statements for shelf offerings, at-the-market offerings, exchange offers and secondary offerings must comply with the interactive data filing requirement even though they generally do not include a specific offering price at the time of effectiveness, unless the financial statements are incorporated by reference into the registration statement.

C&DI 110.01 provides that, for purposes of Item 2.06 (Material Impairments) of Form 8-K, if the impairment conclusion coincides with (but is not necessarily made "in connection with") the preparation, review or audit of financial statements required to be included in the next periodic report due to be filed under the Exchange Act and the other conditions of the Instruction to Item 2.06 are satisfied, a filing would not be required under Item 2.06.

CFTC

CFTC Issues Final Trade Execution Rules

On May 16, the Commodity Futures Trading Commission approved a new regulatory framework applicable to swap execution facilities (SEFs). The regulatory framework governs the registration and operation of SEFs, and is largely based on the Core Principles and other requirements contained in Section 5h of the Commodity Exchange

Act (CEA). At its May 16 meeting, the CFTC also adopted final rules relating to minimum block sizes for certain swaps and the process by which designated contract markets (DCMs) and SEFs may make a swap "available to trade."

The CFTC's final rules applicable to SEFs make clear that any person operating a trading system in which multiple market participants have the ability to trade swaps by accepting bids and offers made by multiple participants (a "multiple-to-multiple" system) must register as a SEF. On the other hand, a person offering a trading system in which only one market participant has the ability to trade with other market participants (a "one-to-many" system) is not required to register as a SEF.

A SEF must, at a minimum, offer market participants an "order book," which is defined as (i) an electronic trading facility, (ii) a trading facility or (iii) a trading system in which all market participants have the ability to enter orders, observe or receive orders and transact on such orders. For swaps subject to the trade execution requirement in Section 2(h)(8) of the CEA (i.e., swaps that are subject to mandatory clearing which have been made "available to trade" on a SEF or a DCM), a SEF additionally may allow its participants to execute trades in such swaps as block trades or through requests for quotes (RFQs). In contrast, swaps that are not subject to the Section 2(h)(8) trade execution requirement may be executed on a SEF by any means of interstate commerce.

The CFTC has established a temporary registration process that is designed to allow an applicant to operate a SEF while the CFTC's determination on the applicant's application for full registration is pending. The temporary registration process is available to applicants who file a complete application within the 60 days following publication of the final rules in the Federal Register, but is effective only after notice from the CFTC granting temporary registration. Temporary registration is not required for exempt commercial markets, electronic boards of trade and other facilities that have operated in reliance on CFTC no-action relief, provided that they submit a complete application by the compliance date for the final rules (120 days after publication of the final rules in the Federal Register).

The adopting release relating to the Core Principles and other requirements for SEFs is available here.

The CFTC also adopted final rules establishing minimum block sizes for swaps. Swap transactions that fall into one of the five following asset classes are subject to minimum block size standards set by the CFTC: (i) interest rate; (ii) credit; (iii) equity; (iv) foreign exchange and (v) other commodity. The appropriate block sizes will be established by the CFTC in accordance with a two-phase approach based on asset class. Minimum block sizes in interest rate and credit swaps will be determined using a 50% notional amount calculation in the first phase and a 67% notional amount calculation in the second phase, with the notional amount in each case representing a trimmed average of publicly reportable transactions over the preceding three years. Block trades in foreign exchange swaps that are economically related to a futures contract will initially have minimum thresholds based upon the block sizes set by the relevant DCMs, with a 67% notional amount calculation for most foreign exchange swaps in the second phase. The principles that apply to foreign exchange swaps will generally also apply to other commodity swaps. Equity swaps will not qualify as block trades, regardless of size.

The adopting release relating to minimum block sizes is available here.

Lastly, the CFTC issued final rules that prescribe the process by which DCMs and SEFs make a swap available to trade. CEA Section 2(h)(8) requires all swaps subject to mandatory clearing under CEA Section 2(h)(7) to be traded on a DCM or SEF, unless no DCM or SEF has made such swap available to trade. If a swap subject to mandatory clearing is listed on a DCM or SEF, the DCM or SEF may submit an available-to-trade determination to the CFTC pursuant to either the CFTC Regulation 40.5 rule approval process or CFTC Regulation 40.6 certification process. The determination must consider one or more of the following factors: (i) whether there are ready and willing buyers and sellers; (ii) the frequency or size of transactions; (iii) the trading volume; (iv) the number and types of market participants; (v) the bid/ask spread; and (vi) the usual number of resting firm or indicative bids and offers. The CFTC noted that it is not necessary for a SEF or DCM to consider more than one factor in making an available to trade determination, and that satisfying any one of the factors set forth above would sufficiently indicate that a swap is available to trade.

The adopting release relating to the trade execution requirement is available here.

CFTC Issues Interpretive Guidance on Disruptive Trade Practices

The Commodity Futures Trading Commission has issued interpretive guidance and a policy statement (interpretive statement) with respect to Section 4c(a)(5) of the Commodity Exchange Act (CEA), which prohibits certain disruptive trading practices. Specifically, Section 4c(a)(5) prohibits any person from engaging in any trading, practice or conduct on or subject to the rules of a registered entity that: (i) violates bids or offers; (ii) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (iii) is in the nature of "spoofing," *i.e.,* bidding or offering with the intent to cancel the bid or offer before execution.

The interpretive statement will become effective upon publication in the Federal Register.

Click here for the interpretive statement.

LITIGATION

New York District Court Dismisses Complaint Alleging Foreign Antitrust Activity

The US District Court for the Southern District of New York recently held that alleged anticompetitive conduct by Chinese technology manufacturers taking place entirely within China did not create sufficient direct effects on US commerce in order for a federal court to exercise jurisdiction under the US antitrust laws.

Plaintiff, a Chinese manufacturer of Universal Serial Bus (USB) connectors, sued rival Chinese USB manufacturers under the Sherman Act. Plaintiff alleged that Defendants (i) made misrepresentations to a USB standards board; (ii) wrongfully refused to agree to licensing terms with Plaintiff; and (iii) brought patent infringement claims against Plaintiff in bad faith. Plaintiff further alleged that Defendants had engaged in this conduct in order to force Plaintiff out of business, so that Defendants could monopolize the USB market.

These monopolization efforts would allegedly reduce competition and result in increased prices for products that used USB connectors and were sold in the United States. Under this theory, Plaintiff sued Defendants under US antitrust laws that forbid monopolization efforts affecting US commerce.

The District Court held that it lacked subject matter jurisdiction because the Sherman Act, as amended by the Foreign Trade Antitrust Improvements Act of 1982, prohibits attempted monopolization efforts taking place in foreign jurisdictions only where the foreign activity has a "direct, substantial, and reasonably foreseeable effect" on US commerce.

The Court found that Plaintiff's USB connectors, as components of more complex technological products, would have to go through several manufacturing steps before they reached American markets. Accordingly, the Court held that Defendants' alleged conduct, even if it would reduce the competition to create USB connectors in China, did not have the required direct effect on US commerce to create a violation of US antitrust laws.

Lotes Co, Ltd. V. Hon Hai Precision Industry Co, Ltd., et. al, No. 12 Civ. 7465(SAS), 2013 WL 2099227 (S.D.N.Y. May 14, 2013

Massachusetts District Court Affirms Scienter Requirement of False Statement Crime

The District Court for the District of Massachusetts recently held that in order to obtain a conviction for making a false statement to a government agent, the government must prove that the defendant knew, or reasonably should have known, that he was speaking to a government agent when he made the allegedly false statement.

Defendant, who was accused of securities fraud in connection with insider trading, received a phone call "out of the blue" at his workplace from SEC attorneys. The SEC attorneys, during an unrecorded phone call, asked Defendant a series of questions about potential insider trading. Based on that call, Defendant was charged with making a false statement to federal officials pursuant to 18 U.S.C. § 1001.

During his trial, Defendant testified that he was unsure of the identity of the callers, and, partly because of this, dodged their questions and sometimes responded untruthfully. Following his conviction, Defendant moved to vacate on the ground that the jury should have received an instruction that the government must prove that the defendant knew or reasonably should have known that he was speaking to a government agent when he made the allegedly false statement.

The District Court granted Defendant's motion to vacate and found that the government must prove that the defendant knew he or she was speaking with a federal official at the time of the false statement. The Court observed that "[t]he implications of the government's arguments here chill the blood."

United States v. Bindette, No. 10-cr-30036-MAP,(N.D. Tex. March 5, 2013)

EXECUTIVE COMPENSATION AND ERISA

Amendment of Public Company ESOPs may be Required

Many public companies allow their employees to invest a portion of their retirement plan balances in company stock. By making a company stock fund an available investment in a 401(k) plan, employees may share the potential gains otherwise reserved for stockholders. If the stock fund is structured to meet the legal requirements of an employee stock ownership plan (ESOP), the company can get an extra benefit—dividends paid on public company shares held by an ESOP can be deducted by the company.

ESOPs are subject to various compliance requirements that do not apply to other types of retirement plans. One such requirement is that a participant's ESOP account must be subject to diversification (*i.e.*, the participant must be given the opportunity to cash-in his or her shares and invest in something other than company stock). Prior to 2007, diversification was only required on a portion of a participant's ESOP account, and then only after the participant satisfied certain age and service requirements. However, beginning in 2007, for public company ESOPs that held employee contributions or were part of a larger 401(k) plan (often called a KSOP), diversification from company stock was required to be available much sooner. Since 2007, diversification from those ESOPs must be permitted immediately for employee contributions, while diversification of company contributions must be available once the employee has accrued at least three years of service.

In April 2013, the IRS issued Notice 2013-17 (Notice), which makes clear that retaining the pre-2007 diversification provisions in an ESOP subject to the new diversification requirements can cause a violation of applicable rules and may result in disqualification of the ESOP. To avoid negative consequences, public company ESOPs that are subject to the new diversification requirements should be reviewed and, if necessary, amended to remove the pre-2007 diversification provisions and the related distribution provisions. According to the Notice, such an amendment may need to be completed prior to December 31, 2013 (although a later date may be permissible in certain circumstances).

The Notice can be found here.

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