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SEC/CORPORATE

Section 16(b) Decision Provides Important Guidance

A recent opinion by the US District Court for the Southern District of New York denying a motion to dismiss "short-swing" profit claims under Section 16(b) of the Securities Exchange Act of 1934 against members of an alleged greater than 10 percent group under Section 13(d) provided some important guidance for securities practitioners. The plaintiff in *Greenberg v. Hudson Bay Master Fund Ltd.*, 2015 BL 140759, S.D.N.Y., 14 cv 5226 (DLC), (May, 12 2015), alleged that the defendants, shareholders of WPCS International Inc., had formed a Section 13(d) "group" that collectively owned more than 10 percent of WPCS common stock and then realized short-swing profits within a six –month period in violation of Section 16(b). The plaintiff inferred the formation of the group through (1) the defendants' participation in a private financing transaction involving WPCS and (2) their subsequent sale of a jointly owned business to WPCS. In denying the defendants' motion to dismiss, the District Court said that a group could be found to have been formed by the shareholders in connection with their sale of a jointly owned business to WPCS. However, the District Court also ruled that the defendants' participation in the same private financing was not, in and of itself, an adequate basis to find the existence of a group. The District Court noted that the use of a single agreement to cover all purchasers in a private placement is not unusual and that courts have routinely rejected the argument that transaction documents granting investors parallel rights and obligations create an inference that a group was formed. The District Court emphasized specific provisions included in the transaction documents asserting that the rights of the parties were separate and that the use of a single document was for the convenience of the issuer and should not create a presumption that the buyers were acting in concert.

The defendants had argued that, even if they were deemed members of a group with one another, the existence in warrants and convertible notes of "9.99 percent blocker provisions" (i.e., a provision that prohibits conversion/exercise to the extent that the holder would beneficially own more than 9.99 percent of the issuer's common stock upon such conversion/exercise) should prevent any presumptive group from collectively owning greater than 9.99 percent of the WPCS common stock. The District Court rejected that argument, noting that while the blocker provision explicitly restricted conversion/exercise to the extent the ownership of the holder and its "affiliates" exceeded 9.99 percent, it did not include language requiring the holder to count shares held by its Section 13(d) group members in the 9.99 percent calculation. Finally, defendant Iroquois Master Fund Ltd. argued that it could not be liable under Section 16(b) because its investment advisor, and not the Iroquois fund itself, is the sole beneficial owner of the shares held by the fund. Since registered investment advisors are generally exempt from Section 16(b) liability, Iroquois argued that there should be no liability in respect of trades made by the Iroquois fund. The District Court rejected this position, citing the US Court of Appeals for the Second Circuit decisions in *Huppe v. WPCS Intern. Inc.* and *Analytical Surveys Inc. v. Tonga Partners L.P.* both of which cases rejected the argument that a limited partnership could avoid Section 16(b) liability by delegating all voting and investment power to registered investment advisors.

The *Greenberg v. Hudson Bay* opinion provides several important insights:

- while participation in private placements with other investors does not in and of itself create a Section 13(d) group, it is advisable to include language in the transaction documents expressly providing that the obligations of the parties are several and not joint and that no action taken by a buyer pursuant to such

agreements shall be deemed to create a group or create a presumption that the buyers are in any way acting in concert;
- it is essential for blocker provisions to expressly apply the conversion cap with other parties that may be deemed to be a member of a Section 13(d) group with the applicable holder; and
- hedge funds cannot evade Section 16 obligations and liabilities by claiming that they have divested themselves of voting and dispositive power over shares in favor of their registered general partners or investment advisors; the funds themselves will generally be deemed beneficial owners of the shares that they hold.

Greenberg v. Hudson Bay Master Fund Ltd., 2015 BL 140759, S.D.N.Y., 14 cv 5226 (DLC), (May, 12 2015)

See "Form BE-10 Filing Deadline Looms" in the Private Investment Funds section.

BROKER-DEALER

FINRA Requests Comment on Proposed Amendments to Rules Governing Communications With the Public

The Financial Industry Regulatory Authority issued Regulatory Notice 15-16 to solicit comments on proposed amendments to FINRA Rules governing communications with the public. FINRA is proposing to amend FINRA Rule 2210 so that a firm that is in its first year of FINRA membership would only have to file the contents of its website and any material changes thereto 10 business days prior to first use, rather than filing all of its retail communications with the public. Additionally, FINRA is proposing to eliminate the requirement that firms file their investment analysis tool templates. FINRA also is proposing to amend Rule 2213 so that retail communications relating to bond mutual funds that include ratings provided by independent third parties and other communications would no longer need to be accompanied or preceded by the fund's prospectus or contain specific disclosures. Finally, FINRA is proposing to permit firms to file these communications within 10 business days of first use, rather than prior to first use.

The comment period expires on July 2.

Click here for Regulatory Notice 15-16.

PRIVATE INVESTMENT FUNDS

Form BE-10 Filing Deadline Looms

Every five years, the Bureau of Economic Analysis of the US Department of Commerce (BEA) conducts a survey concerning the extent of investment abroad by US individuals and entities (US persons). In the past, only US persons specifically requested to do so by the BEA were required to respond to the survey by filing a BE-10 report. This year, however, each US person who had a foreign affiliate (as described below) at any time during its 2014 fiscal year is required to file the report.

For purposes of the report, a "foreign affiliate" is any foreign entity in which the US person owned or controlled, directly or indirectly, at least 10 percent of the voting stock or an equivalent interest if the foreign entity is unincorporated. A US feeder fund that owns 10 percent or more of the voting shares or interests of an offshore master fund would therefore need to file the report with respect to the master fund.

If the US person owning the foreign affiliate is a company, the report must cover the entire "consolidated US domestic business enterprise" of which that US person is a part and is filed by the ultimate parent of that group. Similarly, when a foreign affiliate of a US person owns one or more other foreign entities, those lower tier entities would become foreign affiliates of the US person if the US person's indirect interest in those foreign entities meets the 10 percent voting threshold.

The separate instructions to Form BE-10 state that "if a US Person had no foreign affiliates during its 2014 fiscal year, it must file a BE-10 Claim for Not Filing." That instruction, standing alone, would require every US person to file either a BE-10 or a BE-10 Claim for Not Filing. However, the instructions printed on the BE-10 Claim for Not

Filing, as well as instructional material on the BEA website, clarify that the BE-10 Claim for Not Filing only applies to US persons without foreign affiliates who have received requests from the BEA to file the report.

The report is due by May 29, for filers required to file fewer than 50 forms and June 30, for filers required to file 50 or more forms (as described below). The BEA is open to granting month-long extensions if the request is reasonable and is made by the original filing date.

The report includes a Form BE-10A and one or more of Forms BE-10B, BE-10C and BE-10D. The determination of whether to file Form BE-10B, BE-10C and/or BE-10D depends on the amount of assets, sales, gross operating revenues and/or the net income of the filer's foreign affiliates for the 2014 fiscal year. A US person must file a full Form BE-10A if at any point during its 2014 fiscal year its total assets, sales, gross operating revenue, or net income exceeded $300 million. If none of the aforementioned thresholds are met, the US person only needs to file a partial Form BE-10A.

More information about the BE-10A is available here.

See "Section 16(b) Decision Provides Important Guidance" in the SEC/Corporate section.

CFTC

CFTC Announces Agenda For Upcoming Market Risk Advisory Committee Meeting

The Commodity Futures Trading Commission's Market Risk Advisory Committee (MRAC) announced its agenda for its upcoming meeting on June 2. MRAC will discuss: (1) the Bank of England's CBEST Program and its impact on addressing cybersecurity threats; and (2) the concentration of futures commission merchants and its effect on, and other factors currently affecting, derivatives markets liquidity. Members of the public may attend the meeting on a first-come, first-served basis or listen to the meeting via a live, toll-free conference call.

More information on MRAC's agenda is available here.

CFTC Proposes to Exempt Certain Southwest Power Pool Transactions

On May 18, the Commodity Futures Trading Commission issued a proposed order in response to an application submitted by Southwest Power Pool, Inc. (SPP) to exempt certain contracts, agreements and transactions for the purchase or sale of energy-related products from provisions of the Commodity Exchange Act (CEA) and CFTC Regulations. The proposed exemption would specifically exempt "transmission congestion rights," "energy transactions" and "operating reserve transactions," as those terms are defined in the proposed order, and any person or class of persons offering, entering into, rendering advice or rendering other services with respect to such qualifying transactions from all provisions of the CEA other than the CFTC's general anti-fraud and anti-manipulation authority and scienter-based prohibitions under Sections 2(a)(1)(B), 4(d), 4b, 4c(b), 4o, 4s(h)(1)(A), 4s(h)(4)(A), 6(c), 6(d), 6(e), 6c, 6d, 8, 9 and 13 of the CEA, and any implementing regulations promulgated thereunder.

In order to qualify for the exemption, each party to a qualifying transaction must be: (1) an "appropriate person," as defined in Sections 4(c)(3)(A) through (J) of the CEA; (2) an "eligible contract participant," as defined in Section 1a(18)(A) of the CEA and in CFTC Regulation 1.3(m); or (3) a person who actively participates in the generation, transmission or distribution of electric energy. The proposed order also would require that the qualifying transaction be offered or sold pursuant to SPP's Federal Energy Regulatory Committee-approved tariff.

Interested persons may comment on the proposed order until June 22. The CFTC's proposed order is available here.

CFTC Staff Issues No-Action Letters Relating to Swaps Trading Platforms in Australia

On May 19, the Commodity Futures Trading Commission issued two no-action letters granting relief to certain swaps trading platforms in Australia and participants executing swaps transactions on such platforms.

In CFTC Letter No. 15-29, the CFTC's Division of Market Oversight (DMO) and Division of Swap Dealer and Intermediary Oversight (DSIO) issued updated enabling no-action relief for qualifying swaps trading platforms that are licensed in Australia and regulated by the Australian Securities and Investments Commission (ASIC) (collectively referred to as "Qualifying Australian Licensed Markets"). The letter provides relief for: (1) Qualifying Australian Licensed Markets from the swap execution facility (SEF) registration requirement in Section 5h(a)(1) of the Commodity Exchange Act (CEA) and CFTC Regulation 37.3(a)(1); (2) parties executing swap transactions on Qualifying Australian Licensed Markets from the trade execution mandate in Section 2(h)(8) of the CEA and certain reporting obligations under Parts 43 and 45 of the CFTC Regulations; and (3) swap dealers and major swap participants executing swap transactions on Qualifying Australian Licensed Markets from certain business conduct requirements under subpart H to Part 23 of the CFTC Regulations, the confirmation requirement under CFTC Regulation 23.501 and the swap trading relationship documentation requirements under CFTC Regulation 23.504. The letter also clarifies and amends certain conditions of relief outlined in a prior no-action letter, including relaxed trading methodology and reporting requirements.

The no-action letter requires an Australian licensed market to certify to DMO that it will comply with the conditions set forth in the letter. Relief will begin when DMO reviews the applicant's certification and issues a responsive relief letter. The no-action relief will expire upon the effective date of any final rules implementing the CFTC's authority to exempt facilities that contain systems of comparable, comprehensive supervision and regulation by appropriate governmental authorities in the home country of the facility.

In CFTC Letter No. 15-30, DMO extended conditional time-limited relief to Yieldbroker Pty Limited, a multilateral trading platform that operates as a licensed exchange in Australia. Under the relief, DMO will not recommend enforcement action against Yieldbroker for failure to register as a SEF under Section 5h(a)(1) of the CEA or CFTC Regulation 37.3(a)(1) or against any market participant who uses or has relationships with Yieldbroker, so long as Yieldbroker: (1) offers trading only in products that are not subject to a trade execution mandate pursuant to Section 2(h)(8) of the CEA; (2) offers trading only in Australian dollar-denominated or New Zealand dollar-denominated interest rate swaps on its platform during the relief period; (3) maintains its anti-money laundering license and remains an exchange in good standing with ASIC; (4) provides impartial access to its platform consistent with the requirements of CFTC Regulation 37.202(a) and related CFTC guidance; (5) maintains an order book that complies with CFTC Regulation 37.3(a)(3); and (6) provides notice to its participants that each swap transaction executed on or pursuant to the rules of its platform during the relief period is not occurring on a registered SEF and that such counterparties may have swap data reporting obligations pursuant to Parts 43 and 45 of the CFTC Regulations. The relief conferred by Letter No. 15-30 expires October 15.

CFTC Letter No. 15-29 is available here; CFTC Letter No. 15-30 is available here.

LITIGATION

Massachusetts Federal Court Denies Motion to Dismiss Insider Trading Indictment

The US District Court of Massachusetts in *U.S. v. McPhail*, *et. al.*, Case No. 1:14-cr-10201, 2015 WL 2226249 (D. Mass. May 12, 2015), denied the defendants' motion to dismiss an insider trading indictment in the wake of the *U.S. v. Newman* insider trading decision issued by the US Court of Appeals for the Second Circuit in 2014, which requires prosecutors to prove that the tippee had knowledge of the personal benefit received by the tipper who initially conveyed the insider information.

The indictment alleged that the defendant, Mr. McPhail, possessed insider knowledge received from a corporate insider and disseminated material, nonpublic information to his friends and acquaintances. The indictment asserts that Mr. McPhail did so with the intent that his friends would profit from buying and selling shares of an energy company on the basis of the inside information. The *McPhail* defendants argued, based on *Newman's* holding, that there are no allegations that the corporate insider received any benefit, and even if Mr. McPhail could be considered a tipper under insider trading liability standards, there is also no allegation that he received a benefit.

The District Court rejected the defendants' arguments and denied the motion. The District Court found that the indictment sufficiently alleged that Mr. McPhail received a benefit. The District Court also found that the indictment adequately alleged a close relationship between Mr. McPhail and the insider such that Mr. McPhail should have known that the insider's communication should have been kept confidential.

US v. McPhail, et al., Case No. 1:14-cr-10201, 2015 WL 2226249 (D. Mass. May 12, 2015)

Delaware Chancery Awards Attorneys' Fees Without Finding Damages

In *In re Nine Systems Corporation Shareholders Litigation*, the Delaware Court of Chancery awarded the plaintiff attorneys' fees even though the court previously declined to award plaintiff damages for the defendants' breach of duty of loyalty.

The underlying litigation established that the defendants had conducted a self-interested recapitalization. Nevertheless, the court refused to award monetary damages because the ultimate pricing was fair and the plaintiffs suffered no quantifiable damage. The court granted the plaintiffs leave to petition the court for an award of attorneys' fees and costs.

The court found that the unusual circumstances of this case supported an equitable shifting of fees. The plaintiffs held reasonable concerns about the recapitalization, the defendants' actions hindered legal action and the plaintiffs were able to prove that the defendants breached their duty of loyalty. Under these circumstances, the court held that the defendants' conduct supported a shifting of fees. The court also found that the fact that plaintiff's attorney pursed the case solely on a contingency basis was not a reason to deny the request for attorneys' fees.

In re Nine Systems Corporation Shareholders Litigation, C.A. No. 3940-VCN (May 7, 2015)

BANKING

OCC Issues Final Rule to Integrate Licensing Rules for National Banks and Federal Savings Institutions

On May 18, the Office of the Comptroller of the Currency (OCC) adopted a final rule to (1) integrate its rules relating to policies and procedures for corporate activities and transactions involving national banks and federal savings associations; (2) revise some of these rules in order to eliminate unnecessary requirements consistent with safety soundness; and (3) to promote fairness in supervision. The final rule also makes other technical and conforming changes. Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act, transferred to the OCC all functions of the former Office of Thrift Supervision (OTS). The OCC explained that the final rule related to licensing consolidation is part of a broader effort "to reduce regulatory duplication, promote fairness in supervision, eliminate unnecessary burden consistent with safety and soundness, and create efficiencies for both national banks and savings associations, as well as the OCC." Specifically, the agency stated, "In addition, the OCC is in the latter stages of developing an electronic applications filing system capable of handling applications and other filings from both national banks and Federal savings associations. Accordingly, another important objective of this rulemaking is to complete the integration of our licensing rules expeditiously so that we can include these integrated rules in this new applications system."

While in proposed form, the regulation was criticized by the American Bankers Association for going beyond mere integration and imposing new substantive, and in some cases more stringent, requirements on national banks and federal savings associations.

The final rule, which goes into effect on July 1, a relatively short time frame between adoption and effectiveness, consolidates most licensing provisions for federal savings associations into the existing national bank rule in part 5 of the OCC regulations. These combined rules are as follows:

- rules of general applicability (subpart A);
- organizing a national bank or federal savings association (§ 5.20);
- conversion from a national bank or federal savings association to a state bank or state savings association (§ 5.25);
- fiduciary powers of national banks or federal savings associations (§ 5.26);
- business combinations involving a national bank or federal savings association (§ 5.33);
- bank service company investments of a national bank or federal savings association (§ 5.35);
- investment in national bank or Federal savings association premises (§ 5.37);
- change in location of a main office of a national bank or home office of a federal savings association (§ 5.40);
- corporate title of a national bank or Federal savings association (§ 5.42);
- voluntary liquidation of a national bank or Federal savings association (§ 5.48);
- change in control of a national bank or federal savings association; reporting of stock loans (§ 5.50);

- changes in directors and senior executive officers of a national bank or federal savings association (§ 5.51);
- change of address of a national bank or federal savings association (§ 5.52); and
- substantial asset change by a national bank or federal savings association (§ 5.53).

In other cases, the final rule retains separate rules for national banks and federal savings association in part 5 "because the rules do not apply to both charters, are better organized as separate rules, or their differences and complexity make integration difficult." The new federal savings association rules are as follows:

- federal mutual savings association charters and bylaws (§ 5.21);
- federal stock savings association charters and bylaws (§ 5.22);
- conversion to become a federal savings association (§ 5.23);
- establishment, acquisition, and relocation of a branch and establishment of an agency office of a federal savings association (§ 5.31);
- operating subsidiaries of a federal savings association (§ 5.38);
- increases in permanent capital of a federal stock savings association (§ 5.45);
- capital distributions by a federal savings association (§ 5.55);
- inclusion of subordinated debt securities and mandatorily redeemable preferred stock as supplementary (tier 2) capital (§ 5.56);
- pass-through investments by a federal savings association (§ 5.58); and
- service corporations of federal savings associations (§ 5.59).

The remaining rules in part 5 continue to be applicable only to national banks, with the exception of subpart E. The national bank only rules are as follows:

- conversion to become a national bank (§ 5.24);
- establishment, acquisition, and relocation of a branch of a national bank (§ 5.30);
- expedited procedures for certain reorganizations of a national bank (§ 5.32);
- operating subsidiaries of a national bank (§ 5.34);
- other equity investments by a national bank (§ 5.36);
- financial subsidiaries of a national bank (§ 5.39);
- changes in permanent capital of a national bank (§ 5.46);
- subordinated debt issued by a national bank (§ 5.47); and
- payment of dividends by national banks (Subpart E).

In addition to the placement and integration of federal savings association rules, the final rule makes substantive changes to the OCC's licensing rules to eliminate unnecessary requirements and to further the safe and sound operation of the institutions the OCC supervises. The final rule also makes conforming and technical changes, and amends the OCC's licensing rules to direct filings to the institution's appropriate OCC licensing office or appropriate OCC supervisory office.

Read more.

EU DEVELOPMENTS

The CSMAD: Forthcoming Changes to EU Market Abuse and Insider Dealing Rules

On July 3, 2016, the European Union's Market Abuse Regulation (MAR) will replace the EU's Market Abuse Directive (MAD). The directive on criminal sanctions for insider dealing and market manipulation (CSMAD) will be implemented in parallel with MAR and MAD. The CSMAD will introduce mandatory criminal sanctions for those found guilty of market abuse and insider dealing across most of the European Union (with the exception of Denmark and the United Kingdom, where independent legislative efforts are also pending to increase existing criminal penalties).

Any persons anywhere in the world who trade on EU markets or in derivatives and other instruments whose price or value is referable to those instruments trading on EU markets, should be aware of these impending changes, even if they never entered Europe and even if the trades do not take place on the relevant European exchange. All such firms should ensure that their compliance policies and procedures are updated accordingly.

For more information, please refer to the Katten client briefing here.

European Commission Launches Review of EMIR

On May 21, the European Commission (EC) issued a consultation paper (CP) as part of its review of the European Market Infrastructure Regulation (EMIR). Article 85(1) of EMIR requires the EC to prepare a report by August 17 on the implementation of EMIR, with a particular focus on: (1) access to central bank liquidity for central counterparties (CCPs); (2) the impact of EMIR on the use of over-the-counter (OTC) derivatives by non-financial firms and the systemic importance of such firms' transactions; (3) the effectiveness of "colleges" responsible for the coordinated supervision of CCPs with business activities in multiple EU member states; (4) the efficiency of CCP margining requirements to limit procyclicality; and (5) the evolution of CCP policies on collateral and margin.

The CP invites comment on all aspects of the five issues identified in Article 85(1) of EMIR. The EC has also included a series of questions on other aspects of EMIR implementation, including in particular impediments or unintended consequences relating to access to clearing (including indirect clearing arrangements), reporting to trade repositories, bilateral exchanges of collateral for uncleared OTC derivatives and cross-border transactions in OTC derivatives. The EC has also requested comment on significant impediments or unintended consequences relating to any other aspect of EMIR implementation.

The consultation period closes on August 13. The CP can be found here.

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