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SEC/CORPORATE

Delaware Proposal Banning Fee-Shifting and Permitting Exclusive Forum Provisions

Following the unexpected May 2014 decision of the Delaware Supreme Court in *ATP Tour Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), upholding the validity of fee-shifting bylaws of a non-stock corporation, the plaintiffs' and defense bar in Delaware swiftly prepared legislation to ban such provisions in bylaws and charters. Although passage of the bill had widely been expected, following criticism from the US Chamber of Commerce and some public companies, the issue was tabled until the Delaware legislature's 2015 session.

On March 6, the Delaware Corporate Council, which typically prepares amendments to the Delaware General Corporation Law (DGCL) for consideration by the Delaware bar and then the state legislature, presented its revised proposal. Under the proposal, Sections 102 and 109(b) of the DGCL would be amended to prohibit bylaw and charter provisions that "would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an intracorporate claim." The concern expressed by the Council was that fee-shifting provisions that follow the ATP model effectively barred access to the courts. Under the *ATP* formulation, a stockholder is required to pay the corporation's fees unless the stockholder obtains "a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought." This sets an extremely high standard that makes it economically irrational for stockholders to pursue fiduciary litigation in view of the likelihood of having to pay the corporation's substantial legal costs. Like the earlier proposal to ban fee-shifting, the new proposal has drawn sharp criticism from the US Chamber of Commerce, while being praised by the Council of Institutional Investors.

The Council's proposal does not specifically address the limited universe of Delaware corporations that adopted fee-shifting provisions following the *ATP* decision. As addressed in Claudia Allen's article "Fee-Shifting Bylaws: Where Are We Now?" in *Corporate Law & Accountability Report*, 39 domestic public corporations, of which 30 are incorporated in Delaware, had adopted or proposed adopting such fee-shifting bylaws or charter provisions. Under Section 394 of the DGCL, amendments of the DGCL "shall be a part of the charter or certificate of incorporation of every corporation." Accordingly if the legislation passes, existing bylaw and charter provisions of Delaware corporations mandating fee-shifting in intracorporate litigation may be void, although the issue is not free from doubt since Delaware generally prohibits *ex post facto* laws.

As part of its package of proposed amendments, the Council also added a new Section 115 (Forum Selection Provisions) to the DGCL. Under that section, companies would expressly be permitted to include clauses in their charters and bylaws requiring that intracorporate claims be brought exclusively in Delaware courts. While not obvious from the text, because the new section states that "no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of [Delaware,]" it would also effectively bar mandatory arbitration bylaws, another controversial bylaw concept directed at the issue of frivolous litigation.

While amendments to the DGCL proposed by the Delaware Council are typically on a glide path to enactment, there is vigorous lobbying on both sides focused primarily upon the fee-shifting ban. It remains to be seen what may ultimately be enacted during the current legislative session, which ends on June 30.

For a related fee-shifting bylaw article in this issue, click here.

SEC Charges Insiders for Failure to Update Schedule 13D Disclosures

On March 13, the Securities and Exchange Commission charged eight officers, directors and major shareholders for failing to update material changes in their stock ownership disclosures on Schedule 13D in connection with certain “going private” transactions. The respondents, who neither admitted nor denied the allegations, settled the proceedings by paying to the SEC fines totaling more than $250,000.

Under Section 13(d) of the Securities Exchange Act of 1934 (the Act), certain beneficial owners holding more than 5 percent of a public company’s stock are required to promptly file Schedule 13D amendments following material changes in any previously reported information, including plans or proposals for going private transactions. The SEC’s charges related to outdated disclosures filed by the respondents, who took such steps as determining the form of the going private transaction, obtaining waivers from preferred shareholders and assisting with shareholder vote projections. When viewed together, the SEC argued, such steps resulted in a material change from the disclosures in the respondents’ respective Schedule 13D filings.

“Investors are entitled to current and accurate information about the plans of large shareholders and company insiders,” said Andrew J. Ceresney, director of the Division of Enforcement. “Stale, generic disclosures that simply reserve the right to engage in certain corporate transactions do not suffice when there are material changes to those plans, including actions to take a company private.”

Additionally, the SEC charged some of the respondents for failing to timely report their transactions involving company securities under Section 16 of the Act. In some instances, respondents disclosed their transactions in company securities months or even years after the fact, and not within two business days, as required by the Act.

Click here for the SEC press release.

BROKER-DEALER

CBOE Proposes Amendments to Trading Permit Holder and Direct Access Qualifications

On March 11, the Chicago Board Options Exchange (CBOE) proposed new qualifications for Trading Permit Holder (TPH) applicants and direct access users. The proposed amendments require a TPH to be domiciled in (in the case of an individual) or organized under the laws of (in the case of an organization) a jurisdiction expressly approved by CBOE. In addition, the proposed amendments limit direct access by authorized users to CBOE’s trading system from only those jurisdictions approved by CBOE. As reported in the February 27 edition of the Corporate & Financial Weekly Digest, CBOE proposed extended trading hours on certain index option contracts. CBOE expects that the amended TPH and direct access qualifications will accommodate foreign persons and organizations seeking to access CBOE’s trading system during extended trading hours.

CBOE will publish the approved jurisdictions at a later date. The proposed amendments are available here.

CFE Amends Rules on ECRPs and Block Trades

On March 11, the CBOE Futures Exchange, LLC (CFE) extended the reporting window for exchange of contract for related position (ECRP) transactions and clarified when it will provide written confirmations of ECRPs transactions and block trades. CFE Rule 414 currently provides that an authorized reporter for each party to an ECRP must provide the CFE help desk with the terms of an ECRP transaction within 10 minutes after the transaction is executed. The CFE is extending the reporting window for ECRP transactions to 30 minutes.

In addition, the CFE proposes to amend its rules on ECRPs and block trades to clarify that the help desk can provide written transaction summaries for ECRPs and block trades on either the business day when the transaction is submitted for clearing or the calendar date of the transaction. The rules currently imply that the help desk only provides such summaries on the business day when the transaction is submitted for clearing.

The proposed amendments, which take effect immediately, are available here.

FINRA Issues Notice on Background Checks for Registration Applicants

The Financial Industry Regulatory Authority (FINRA) released Regulatory Notice 15-05 to remind member firms of the new consolidated rules on mandatory background checks for individual registration. As first reported in the January 9 edition of the Corporate & Financial Weekly Digest, the Securities and Exchange Commission approved FINRA Rule 3110(e), which requires member firms to conduct independent background checks on candidates applying for registration with the member firm. FINRA Rule 3110(e) also requires member firms to adopt written supervisory procedures designed to verify the accuracy and completeness of a candidate's Form U4.

In addition, the SEC approved FINRA Rule 3110.15, which establishes a temporary program to issue refunds to member firms that were assessed late fees in connection with responses to Form U4 Question 14M (unsatisfied judgments or liens).

FINRA Rule 3110(e) takes effect on July 1. The refund program under FINRA Rule 3110.15 became retroactively effective on April 24, 2014, and ends on December 1, 2015.

FINRA Regulatory Notice 15-05 is available here.

SEC Approves ISE Rules on Information Barriers Between Customer and Proprietary Business

On March 17, the Securities and Exchange Commission approved amendments to the information barrier rule of the International Securities Exchange, LLC (ISE). As reported in the October 17, 2014, edition of the Corporate & Financial Weekly Digest, amendments to ISE Rule 810 will permit certain information to flow to a firm's electronic access member (EAM) unit, which effects transactions on behalf of customers on an agency basis, from its affiliated primary market maker (PMM) and competitive market maker (CMM) units. Specifically, as amended Rule 810 will allow EAMs to know where and at what price their affiliated market makers are either quoting or have orders on the order book and to use such information to influence routing decisions.

The SEC also approved amendments to ISE Rule 717. As amended, Rule 717 will allow EAM unit orders to interact with orders of its affiliated PMM and CMM units within one second, provided that: (1) the customer order is marketable when routed; (2) the EAM unit is not handling the affiliated market maker quote/order; and (3) the affiliated market maker quote/order is entered into the ISE system prior to the customer's order.

Notice of SEC's order of approval is available here.

SEC Staff Issues New FAQs on Regulation SHO

On March 17, the staff of the Securities and Exchange Commission's Division of Trading and Markets (Staff) issued three new frequently asked questions (FAQs) relating to Regulation SHO. The current guidance under FAQ 2.5 provides that where a seller is net long 1,000 shares and simultaneously enters multiple orders to sell 1,000 shares owned, only one such order would constitute a long sale. Any additional orders must be marked "short." In new FAQ 2.5(A), the Staff clarified that the guidance in FAQ 2.5 is not limited to scenarios of simultaneous order entry. Specifically, the Staff states that FAQ 2.5 also applies to marking multiple orders that are entered in rapid succession. In addition, in new FAQ 2.5(B), the Staff reiterates that unexecuted orders to sell a security are presumed to decrease a seller's net long position. To the extent that a member believes the guidance on marketing multiple orders in FAQ 2.5 does not apply to sale orders that have no realistic possibility of being executed, the Staff reminds such member to be prepared to demonstrate, upon request, that applicable sale orders are never or rarely executed.

The Staff also published new FAQ 2.6 to clarify when sellers are required to re-mark a pending sell order. If a member accurately marked a sell order based on the seller's net position at the time of order entry, an unchanged, pending sell order would not need to be re-marked to reflect a change in the seller's net position. If such pending sell order is canceled and replaced, any new sell order must reflect the seller's net position at the time the new order is entered. Likewise, an increase in the quantity of a pending sell order will be treated as a new order and thus must be re-marked by the member. However, sellers are not required to re-mark a pending sell order if the seller decreases the quantity of such order.

In addition, the Staff states in new FAQ 2.6 that modifications to the price of an order to sell a covered security should be considered as a new order and thus the member's procedures should prevent new sale orders marked "short" from being executed at a price that is less than or equal to the current national bid. In order to mark the new order "short exempt," the member's procedures would need to identify that the new order is priced above the current national best bid at the time of submission.

The new FAQs are available here.

CFTC

CFTC Approves Final Rule on Residual Interest Deadline for FCMs

On March 17, the Commodity Futures Trading Commission approved a final rule amending CFTC Regulation 1.22 to remove the December 31, 2018 automatic termination date relating to the phased-in compliance period for the Residual Interest Deadline applicable to futures commission merchants (FCMs).

Under CFTC Regulation 1.22, the Residual Interest Deadline is defined as the time each business day by which FCMs must maintain a sufficient amount of residual interest in their customers' segregated accounts to cover customers' undermargined accounts. The regulation sets the Residual Interest Deadline initially at 6:00 p.m. (ET) on the day of settlement. The phased-in compliance schedule, however, would have moved the Residual Interest Deadline to the time of daily settlement. That change was to go into effect no later than December 31, 2018, unless the CFTC took action to set a different Residual Interest Deadline. As a result of the CFTC's removal of that date, the Residual Interest Deadline will remain 6:00 p.m. (ET) on the day of settlement pending further CFTC rulemaking.

More information is available here.

FinCEN Updates List of Jurisdictions with AML/CFT Deficiencies

On March 16, the Financial Crimes Enforcement Network (FinCEN) issued an advisory announcing that the Financial Action Task Force (FATF) has updated its list of jurisdictions that have strategic deficiencies in their anti-money laundering (AML) and counter-terrorist financing (CFT) regimes.

Specifically, FATF has noted that: (1) Indonesia has been removed from FAFT's list that calls for enhanced due diligence and has been moved to the FATF's list of jurisdictions having AML/CFT deficiencies, and (2) Albania, Cambodia, Kuwait, Namibia, Nicaragua, Pakistan and Zimbabwe have been removed from the FATF listing and monitoring process.

These changes may affect US financial institutions' obligations and risk-based approaches with respect to the relevant jurisdictions. National Futures Association (NFA) has issued a notice reminding futures commission merchants and introducing brokers to review the FinCEN advisory to ensure that their AML programs have the most current information on FATF-identified jurisdictions with AML/CFT deficiencies, and revise their AML programs accordingly.

The FinCEN Advisory is available here.

The NFA Notice to Members is available here.

CFTC Issues an Exemption to HKSFC Permitting US Customers to Deal Directly with Hong Kong Brokers

On March 19, the Commodity Futures Trading Commission issued an exemption to Hong Kong Securities and Futures Commission (HKSFC) permitting US customers to deal directly with Hong Kong brokers pursuant to CFTC Regulation 30.10.

This exemption permits HKSFC-licensed corporations to solicit and accept orders and funds from US customers for trading on any exchange subject to HKSFC's oversight without having to register with the CFTC as futures commission merchants. The relief is to be effective as to each foreign firm upon the filing of certain representations with the National Futures Association.

For more information on HKSFC's exemption, as well as a list of other CFTC Regulation 30.10 exemptions, please refer to the List of Foreign Part 30 Exemptions available here.

CFTC Release PR7138-15 is available here.

Global Regulators Push Back Margin Requirements for Non-cleared Derivatives

On March 18, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO) published a "final" policy framework that establishes minimum global standards for margin requirements for non-centrally cleared derivatives. Relative to the initial framework published in September of 2013 (see the *Corporate & Weekly Financial Digest* article from September 13, 2013, here), the revisions delay the beginning of the phase-in period for collecting and posting initial margin on non-centrally cleared trades from December 1, 2015 to September 1, 2016. The full phase-in schedule has been adjusted to reflect this nine-month delay. The revisions also institute a six-month phase-in of the requirement to exchange variation margin, beginning September 1, 2016.

The CFTC, SEC and banking regulators responsible for promulgating margin regulations for US swap market participants are expected to adopt the same phase-in schedule for their own rules in order to ensure consistent implementation across products, jurisdictions and market participants.

The revised margin framework can be found here.

A table showing the new phase-in dates can be found here.

LITIGATION

Delaware Court of Chancery Restricts Board's Ability to Subject Former Shareholders to New Bylaws

The Delaware Court of Chancery recently held, in a case of first impression, that a non-reciprocal fee-shifting bylaw cannot be applied to a claim brought by a former shareholder who had been cashed out of the company before the bylaw was adopted.

In May 2014, First Aviation Services, Inc. completed a 10,000 – 1 reverse stock split at the instigation of the CEO and controlling stockholder. As a result of this transaction, Plaintiff Robert Strougo and other shareholders/putative class members were involuntarily cashed out, thereby making First Aviation a privately owned company. Four days later, First Aviation's Board of Directors adopted a bylaw that applied to current and former shareholders and shifted attorney's fees and litigation expenses to unsuccessful plaintiff-shareholders, but did not impose a parallel obligation on First Aviation or its officers or directors. Strougo filed suit in June 2014 alleging the reverse stock split was a breach of fiduciary duty and challenging the fee-shifting bylaw.

Before addressing the enforceability of the bylaw to the plaintiff, the court observed that the practical effect of the one-way fee-shifting bylaw was to immunize the reverse stock split from review because the risk of an attorney's fee award would deter most rational stockholders (and their counsel) from suing. The court, however, did not need to reach the "serious policy" issues raised by the fee-shifting bylaw because the court held that the bylaw could not apply to Strougo as he was not a shareholder at the time the bylaw was adopted. Starting with the premise that bylaws are contracts among the shareholders, once the reverse stock split terminated Strougo's status as a shareholder, he was no longer a party to the corporate contract. The court, therefore, reasoned that Strougo could no longer be bound by future amendments to the contract, i.e., First Aviation's charter or bylaws. The court distinguished the case from the recent Delaware Supreme Court decision in *ATP Tour, Inc. v. Deutscher Tennis Bund.*, 91 A.3d 554 (Del. 2014), because the non-reciprocal fee shifting bylaw upheld there was not adopted after the plaintiff's stockholder interest terminated.

Strougo v. Hollander, C.A. No. 9770-CB (Del. Ch. Mar. 16, 2015).

District Court Dismisses Data Breach Case for Lack of Standing

The US District Court for the Middle District of Pennsylvania recently dismissed a consolidated class action against Paytime, Inc. arising out of a data breach by hackers who accessed the personal and financial information of more than 230,000 individuals. The court held that the plaintiffs lacked standing. Despite the confirmed security breach, the plaintiffs had not alleged actual or impending harm. The plaintiffs' claim that their personal data was misappropriated was insufficient absent proof the hackers actually viewed, understood, and used the data to the plaintiffs' detriment.

Paytime is a national payroll service company offering web-based payroll submissions to employers. Employees of Paytime's customers provided confidential personal and financial information to their employers, which was then forwarded to Paytime. In April 2014, hackers gained access to Paytime's computer systems, and in May 2014, Paytime confirmed the breach. In June 2014, two separate class actions were filed seeking damages for the monetary and opportunity costs of monitoring their credit in light of the data breach. The district court consolidated the cases in February.

The court held that the plaintiffs did not have standing to sue Paytime because they had not suffered actual harm, nor was harm imminent. Applying Third Circuit law in the data breach context, the court held that the plaintiffs must allege actual misuse of the hacked information or specifically allege how misuse is impending. The court further held that costs incurred as a reasonable reaction to a risk of identity theft was insufficient because there was no certainty that identity theft was impending. The court pointed out that one year after the breach no plaintiff had become a victim of identity theft. The court also rejected the plaintiffs' theory that they had alleged an actual injury because a single class member's commute to work allegedly increased due to security clearance issues arising from the data breach. The court saw these as "prophylactic costs" that were an attempt to manufacture standing rather than an actual cost of the data breach.

Storm v. Paytime, Inc., No. 14-cv-1138 (M.D. Pa. Mar. 13, 2015).

TAX

Due Date for FATCA Reporting of US Accounts Is Approaching

The deadline to report US accounts by offshore funds that are organized in Model 2 Intergovernmental Agreement (IGA) jurisdictions, such as Bermuda, as required by Foreign Account Tax Compliance Act (FATCA), is quickly approaching. The first report by such funds on IRS Form 8966 is due by March 31. However, an automatic 90-day extension is being granted for this year.

Reporting foreign financial institutions in Model 1 IGA jurisdictions, such as the British Virgin Islands and the Cayman Islands, will need to adhere to the reporting timelines established by their respective jurisdictions. The reporting of US accounts for funds organized in the British Virgin Islands and the Cayman Islands funds is due by May 31. Cayman Islands funds will need to notify the Cayman Islands government by April 30 that they have US accounts to report.

UK DEVELOPMENTS

UK Regulator Announces Its Approach to Financial Promotions in Social Media

On March 13, the UK regulator, the Financial Conduct Authority (FCA) published finalized guidance on its supervisory approach to financial promotions in social media (the "Guidance"). The range of social media within the FCA's consideration includes: blogs, microblogs (e.g. Twitter), social and professional networks (e.g. Facebook, LinkedIn, Google+), forums, and image and video-sharing platforms (e.g. YouTube, Instagram, Vine, Pinterest), though the FCA states that the Guidance covers any "websites and applications that enable users to create and share content or participate in social networking."

The FCA consulted on the proposed Guidance in August 2014 and the finalized published guidance is intended to help FCA-authorized firms understand how they may use social media in compliance with the FCA's strict rules on the promotion or advertising of financial products or financial services. (The Guidance is a follow-up to guidance issued in September 2011 setting out the FCA's previous expectations on prominence and providing examples of good and poor practice.)

The FCA recognizes that social media is a particularly powerful channel of communication and therefore of significant value to firms. The FCA does not want to prevent its use as such media allows firms to contact their customers, and vice versa, both pre- and post-sale. However, FCA-authorized firms (and others whose communications are directed at UK persons) must remember that any form of communication (including through social media) is capable of being a financial promotion, depending on whether it includes an invitation or inducement to engage in financial activity and, if it is a financial promotion, must be in compliance with FCA rules.

Within the Guidance there is a summary of feedback that the FCA received from industry participants during the consultation process. The summary highlights how most people responding to the FCA considered that the FCA's approach was helpful, but the Guidance goes on to provide visual examples and it also clarifies certain areas in response to the feedback, including:

- when re-tweets, forwarding and sharing can be considered to be a financial promotion, and circumstances when this can be done;
- a clarification that the inducement and balancing statement or risk warning needs to be within an inserted image;
- a discussion on "click-throughs," and how the FCA assesses such processes in the social media context;
- an explanation of how certain media is viewed as a whole for stand-alone compliance;
- the difference between personal and business-related posts or tweets;
- the FCA's stance on using hashtags to distinguish tweets as promotions; and
- a reminder that the FCA's existing requirements apply equally to social media.

Click here for the latest Guidance.

Click here for the September 2011 guidance.

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