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SEC/CORPORATE

Delaware Legislation Banning Fee-Shifting in Bylaws and Charters

In a swift response to the Delaware Supreme Court's May 8 opinion holding that fee-shifting bylaws are facially valid (*ATP Tour v. Deutscher Tennis Bund*), members of the Delaware bar, representing both plaintiffs and corporations, proposed legislation that would effectively overturn the application of the decision to stock corporations. The policy concerns are that fee-shifting provisions would undermine the limited liability associated with an investment in stock, and "loser-pays" clauses could result in a significant decrease in the number of meritorious (as well as frivolous) cases filed in Delaware, thereby negatively affecting Delaware's preeminence in the field of corporate law. Notably, the amendments are not limited to fee-shifting provisions. Rather, they generally bar clauses in bylaws and certificates of incorporation imposing liability on stockholders.

On May 29, the Corporation Law Section of the Delaware State Bar Association approved the amendments, which have a proposed effective date of August 1. If subsequently approved by the Executive Committee of the Bar Association, the amendments will go to the state legislature. The legislature customarily follows the recommendations of the Bar Association and enactment is widely expected.

While fee-shifting in organizational documents would be barred by the amendments, *ATP Tour* nonetheless represents an effective endorsement by the Delaware Supreme Court of the Delaware Chancery Court's opinion in *Boilermakers*, upholding the validity of board-adopted exclusive forum bylaws. Exclusive forum bylaws and charter provisions, which require that stockholder class actions and other intra-corporate claims be brought exclusively in specified forums (typically Delaware courts for Delaware corporations), also target the phenomenon of frivolous litigation, but without the specter of additional liability. While the adoption and enforcement of board-adopted forum bylaws are subject to situational challenge, such provisions have increasingly been enforced by courts in other states, including California, Illinois, Louisiana, New York and Texas.

Read more.

CFTC

CFTC Proposes to Amend *De Minimis* Threshold for Swaps with Utility Providers

The Commodity Futures Trading Commission has proposed to amend the "special entity" *de minimis* exception from swap dealer designation to exclude certain swaps with public utility providers. The proposed regulations are substantively similar to no-action relief issued by the CFTC's Division of Swap Dealer and Intermediary Oversight on March 21.

As background, the Commodity Exchange Act and CFTC Regulations exempt a person from registration as a swap dealer if the person engages in a *de minimis* quantity of swap dealing. CFTC Regulations specify two *de minimis* thresholds: a "general" *de minimis* threshold, i.e., currently no more than $8 billion in aggregate gross notional amount over the preceding 12 months, and a "special entity" *de minimis* threshold, i.e., no more than $25

million in aggregate gross notional amount over the preceding 12 months. A swap counterparty that would otherwise come within the "swap dealer definition" must register as a swap dealer if it enters into positions exceeding either threshold.

If adopted, the proposed regulations would allow a person to exclude "utility operations-related swaps" with a counterparty that is a public utility provider or "utility special entity" when calculating the aggregate gross notional amount of swap positions for purposes of the "special entity" *de minimis* threshold. A "utility special entity" is a special entity that (i) owns or operates electric or natural gas facilities, electric or natural gas operations or anticipated electric or natural gas facilities or operations, (ii) supplies natural gas or electric energy to other utility special entities, (iii) has public service obligations or anticipated public service obligations to deliver electric energy or natural gas service to utility customers or (iv) is a federal power-marketing agency. A "utility operations-related swap" includes an electric energy or natural gas swap or any swap associated with the operations or compliance obligations of a utility special entity that is (i) used by a utility special entity to hedge or mitigate commercial risk, and (ii) relates to an exempt commodity (e.g., natural gas or power).

While the proposed regulations permit utility operations-related swaps with utility special entities to be excluded for purposes of the "special entity" *de minimis* threshold, any such swaps must be included for purposes of the "general" *de minimis* threshold.

To rely on the exclusion for utility operations-related swaps with utility special entities, a person must file notice electronically with National Futures Association.

The CFTC's proposed regulations are available here.

CFTC Grants Recordkeeping Relief for Certain SEF and DCM Members

The Division of Swap Dealer and Intermediary Oversight and the Division of Market Oversight of the Commodity Futures Trading Commission have issued relief from certain recordkeeping obligations for persons that are not registered with the CFTC in any capacity but which are members of a swap execution facility (SEF) or designated contract market (DCM). Specifically, the no-action letter provides relief to such SEF and DCM members from the requirement to record text messages and the requirement under CFTC Regulation 1.35 to keep other records in a form and manner identifiable and searchable by transaction.

As provided in the no-action letter, the relief will remain effective until the CFTC takes any final action relating to this matter.

The no-action letter is available here.

CFTC Seeks Additional Comments on Position Limits for Physical Commodity Derivatives

The Commodity Futures Trading Commission is seeking additional comments on its proposed regulations relating to position limits for physical commodity derivatives. The CFTC will accept comments on its proposals regarding position limits and the aggregation of positions subject to common ownership for a three-week period beginning June 12 and ending July 3. Comments should be limited to the following subjects: (i) hedging of a physical commodity by a commercial enterprise, including gross hedging, cross-commodity hedging, anticipatory hedging and the process for obtaining a non-enumerated hedging exemption; (ii) spot month limits in physical-delivery and cash-settled contracts and a conditional spot-month limit exemption; (iii) non-spot limits for wheat contracts; (iii) the aggregation exemption for certain ownership interests of greater than 50 percent in an owned entity; and (iv) aggregation based on substantially identical trading strategies. More information relating to the reopening of the comment period is available here.

CFTC staff will additionally host a public roundtable to discuss these issues on June 19. More information relating to the public roundtable is available here.

LITIGATION

Eleventh Circuit Defines "Instrumentality" Under the FCPA

In a case of first impression for the US Court of Appeals for the Eleventh Circuit, the court interpreted the term "instrumentality" of a foreign government in the Foreign Corrupt Practices Act (FCPA). The court used the decision to provide guidance to the defense bar and the government, explaining that it was "mindful of the needs. . . for *ex ante* direction about what an instrumentality is," as the statute imposes civil or criminal liability for bribing a foreign official, defined only as "any officer or employee of a foreign government or any department, agency, or *instrumentality* thereof" (emphasis added).

The decision arose in the criminal appeal of convictions of the owners of Terra Telecommunications Corp., a Florida company that purchased telephone minutes from foreign vendors and then resold them in the United States. One of Terra's vendors was Telecommunications D'Haiti, S.A.M., which, during the disputed period, was 97 percent owned by the National Bank of Haiti. There was no dispute that defendants had bribed officers of Teleco over several years through a kickback scheme, but the defendants claimed they had no liability under the FCPA, arguing that Teleco was not a government instrumentality and, therefore, its officers were not foreign officials.

The Eleventh Circuit affirmed the criminal convictions, applying a flexible definition of a government instrumentality as "an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own." Whether an entity meets this definition in a given case is fact specific, so the court articulated factors to be considered by courts and juries. The factors to decide if the government controls an entity are: (i) the entity's formal designation, (ii) whether the government controls a majority interest, (iii) the government's ability to hire and fire the entity's principals, (iv) whether profits go to the government, (v) whether the government funds the entity when it does not break even and (vi) the length of time the factors existed. Factors to consider whether an entity performs a government function are: (i) whether the entity has a monopoly on that function, (ii) whether the government subsidizes the cost of providing services, (iii) whether the entity provides services to the public at large and (iv) whether the public perceives the entity to perform a government function. Finding that Teleco met both the government control and function requirements, the Eleventh Circuit affirmed the FCPA charge, among others.

United States v. Esquenazi, No. 11-15331, 2014 WL 1978613 (11th Cir. May 16, 2014).

Eleventh Circuit Clarifies Loss Amount Calculation for Securities Fraud Sentencing

The US Court of Appeals for the Eleventh Circuit recently vacated and remanded a defendant's sentence because the US District Court for the Southern District of Florida inappropriately added a sentencing enhancement after miscalculating the loss amount in the case.

Laurence Isaacson's co-conspirators created a fund that invested in publicly traded shell corporations with no assets that they owned. The fraudsters manipulated the price of the investments by buying artificially high, inflating the perceived value of the fund's assets which convinced investors to buy into the fund. Isaacson first joined the conspiracy when he agreed to help fabricate business plans upon which the inflated values could be justified after auditors became suspicious of the shell companies' growth. In 2010, Isaacson was convicted of conspiracy to commit securities fraud and was sentenced to 36 months in prison and $8 million restitution after applying a loss amount enhancement due to a $15 million investment in the fund in 2002. Isaacson appealed the conviction and sentencing. The Eleventh Circuit upheld the conviction, but vacated the sentence.

The court noted that the District Court narrowly defined Isaacson's criminal conduct as conspiring to defraud the auditors, not investors. The court concluded that holding Isaacson responsible for the $15 million investment would be speculative because the government did not show that the $15 million investment was dependent on the fraudulent report prepared in part by Isaacson. The court vacated the prison sentence and the $8 million restitution order, and remanded to the District Court for resentencing.

United States v. Isaacson, Nos. 11-14287, 12-14703 (11th Cir. May 22, 2014).

Second Circuit Holds Mandatory Broker Dealer Arbitration Not Available to Non-Customer

On May 15, the US Court of Appeals for the Second Circuit issued a summary order in a closely watched case regarding the circumstances in which a broker dealer may be compelled to arbitrate with an institutional counter-party which is not a traditional "customer" of the broker-dealer. *SunTrust Banks, Inc. et al. v. Turnberry Capital Management LP*, 13-CV-2075 (2d Cir., May 15, 2014). The Second Circuit's decision in *Turnberry* provides important additional guidance for broker dealers and institutional market participants regarding their respective rights to avoid (or compel) arbitration.

Background

Over the past few years, broker dealers and institutional market participants have been engaged in an increasing number of procedural litigations to determine the governing forum for disputes arising in the course of their relationships. Traditionally, the choice between the courtroom and the arbitration forum had often been viewed as a close call, with each forum offering well-known advantages and countervailing disadvantages. Advocates for arbitration frequently cited perceived cost advantages, freedom from onerous discovery demands, more sophisticated fact finders and an absence of public scrutiny as factors favoring the arbitral forum. Litigation proponents, meanwhile, noted greater opportunities for appellate review, broader injunctive and judgment-enforcement rights, and greater adherence to precedent, evidentiary rules and substantive law as reasons to prefer judicial forums. Historically, these offsetting factors occasionally tilted demonstrably one way or another, but litigants often viewed the increased costs of litigating the governing forum as not worth the fight. In recent years, however, pro-claimant rule changes and perceived pro-claimant sentiment within the arbitration wings of many major self-regulatory organizations have arguably tilted the playing field, rendering arbitration a less-hospitable forum for the defense, relative to the courtroom, than it was traditionally understood to be prior to the Great Recession (2008–2010).

Factual Summary and Decision

Turnberry arose in the context of this broader evolution in the perceived benefits of arbitration for institutional plaintiffs. Turnberry is a hedge fund that commenced a Financial Industry Regulatory Authority, Inc. arbitration against its point-of-sale broker dealer (Raymond James) over the purchase of trust certificates collateralized by cash flows from a pool of residential mortgage loans. Rule 12200 of the FINRA Code of Arbitration Procedure generally obligates broker dealers such as Raymond James to arbitrate disputes with their "customers," and that aspect of the FINRA arbitration was not controversial. However, in addition to naming Raymond James, Turnberry also named SunTrust Robinson Humphrey (STRH), the broker dealer affiliate of SunTrust Banks, which had, through other affiliates, sponsored and/or issued the subject trust certificates. STRH moved to enjoin the arbitration of claims against it, arguing that Turnberry was not its "customer" under Rule 12200 (after all, Turnberry was already Raymond James' customer), and that STRH had no contractual obligation to arbitrate a dispute with Turnberry. In response, Turnberry argued that the "economic reality" of the relationship was such that Turnberry was effectively the "customer" of both Raymond James <u>and</u> STRH, and thus entitled to arbitrate against both of these broker dealers. In support of this argument, Turnberry cited documents allegedly prepared by STRH for provision to Turnberry, a non-disclosure agreement between the parties, Raymond James' alleged role as a mere conduit in a transaction that was effectively between Turnberry and STRH, and post-transaction dealings between the parties. US District Judge Naomi Reice Buchwald roundly rejected Turnberry's contentions, holding that Turnberry was not STRH's customer and enjoining the arbitration of Turnberry's claims. Importantly, the lower court reached this decision after first holding that "doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." Despite this presumption (which arguably misapplied Second Circuit precedent holding that "the presumption does not apply to disputes concerning whether an agreement to arbitrate has been made," (see *Applied Energetics, Inc. v. NewOak Capital Markets, LLC*, 645 F.3d 522, 525 (2d Cir. 2011)), the lower court found that a "customer relationship requires some substantial relationship between the parties, and such a relationship is not present here."

The Second Circuit affirmed under a *de novo* standard (for the issue of arbitrability) and clear error standard (for factual findings made below), sustaining the lower court's finding that there was no indicia of a customer relationship based on a review of a variety of factors. The Second Circuit noted that it was not persuaded by Turnberry's argument that the lower court had defined the term "customer" under FINRA Rule 12200 too narrowly. Rather, the Second Circuit found that the District Court had relied not only on whether Turnberry

acquired goods or services from STRH, but also on whether it received financial advice, whether there was a brokerage agreement, whether a fee was paid and whether STRH made statements evincing a customer relationship.

The *Turnberry* case is only one of several cases before the Second Circuit and other courts concerning the scope of mandatory arbitration. Cases concerning the scope of forum selection clauses and whether bright-line definitional requirements that "customers" maintain accounts and/or transact with the defendant broker dealers will further clarify the scope of mandatory arbitration under FINRA Rule 12200 in months to come.

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