BLANK ROME LLP
COUNSELORS AT LAW
PUBLIC COMPANIES AND CAPITAL FORMATION GROUP

SEC NEWS

JANUARY 2012 NUMBER ONE

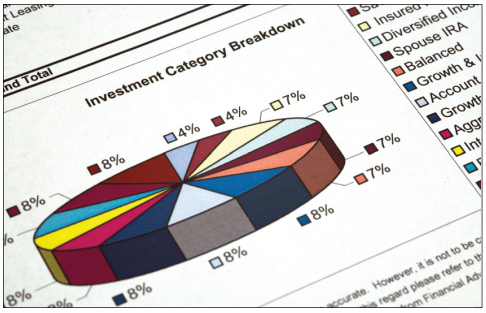
SEC Adopts Amendments to Net Worth Standard for Accredited Investors

On December 21, 2011, the Securities and Exchange Commission (SEC) adopted amendments[1] to the net worth test contained in the "accredited investor" definition. The new rules, which will be effective as of February 27, 2012:

- codified the existing requirements of Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and SEC interpretations of Section 413(a) in SEC rules under the Securities Act of 1933;
- clarified the treatment of increases in mortgage debt during the 60 days before the sale of securities in a private placement; and
- provided for limited grandfathering in connection with the investor's exercise of certain pre-existing rights to acquire securities.

EXISTING REQUIREMENTS AND NEW RULES

The net worth test states that any natural person whose individual net worth,[2] or joint net worth with that person's spouse, exceeds $1,000,000 is considered an accredited investor at the time of purchasing securities in a private placement. Section 413(a) of the Dodd-Frank Act requiring the net worth test to exclude the value of a person's primary residence at the time of the sale of the securities for the purpose of determining whether such person is an accredited investor was effective as of July 20, 2010. At that time, the SEC interpreted Section 413(a) to mean that the amount of indebtedness secured by the primary residence up to its fair market value may be excluded from the net worth calculation and indebtedness secured by the residence in excess of the value of the home should be considered a liability and deducted from the investor's net worth.[3]



Under the new rules, consistent with Section 413(a) of the Dodd-Frank Act and SEC interpretations, the estimated fair market value of the person's primary residence is not included as an asset, and indebtedness secured by the primary residence up to such value is not included as a liability, in the calculation of the person's net worth. Therefore, the amount of any positive equity the person may have in its primary residence is not part of the net worth determination. However, the excess of debt

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secured by the primary residence over its estimated fair market value (i.e., "underwater mortgage") is included as a liability in the net worth calculation and reduces the person's net worth.

SIXTY-DAY LOOK BACK PERIOD

The new rules provide that if the amount of debt secured by the primary residence outstanding at the time of sale of securities exceeds the amount of such debt outstanding during the prior 60 days, the amount of the excess is viewed as a liability reducing the net worth, even if the estimated value of the primary residence still exceeds the aggregate amount of debt secured by such primary residence. This provision is aimed at preventing the artificial inflation of the net worth by converting the home equity, which cannot be included in the net worth calculation, into other assets that can be added to the assets owned by the investor (for example, cash or other assets). The rule provides an exception to the 60-day look back provision if the debt results from the acquisition of the primary residence (i.e., such debt will not be included in the calculation of the net worth as a liability).

Subscription documents for a private placement often include a questionnaire used to determine an investor's status as an accredited investor. For private placements occurring on or after February 27, 2012, the date on which the new SEC rules will be effective, such subscription documents should reflect the amended definition of the term "accredited investor," including questions related to the debt secured by the primary residence that was incurred by the investor within the past 60 days.

GRANDFATHERING

The new rules also include a limited transition provision, pursuant to which former accredited investor standards that included the value of the investor's primary residence in the net worth calculation will apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a prior right to purchase such securities, provided that:

- such right was held by the person on July 20, 2010 (i.e., the day before the enactment of the Dodd-Frank Act);
- the person qualified as an accredited investor on the basis of the net worth standard at the time the person acquired such right; and
- the person held securities of the same issuer, other than such right, on July 20, 2010.

For example, the grandfathering provision applies to the exercise of pre-emptive rights under state law, rights under the charter or other constituent documents of the company, as well as contractual rights, including the right to acquire securities upon the exercise of an option or a warrant or upon the conversion of convertible notes or preferred stock, rights of first offer or first refusal, and contractual pre-emptive rights. ■

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PRACTICE TIPS

"What, Me Worry?" Yes, the Securities Laws Apply to Private Companies!

In a case that should serve as a warning to the owners, directors and officers of privately-held companies that offer equity plans to their employees, on December 12, 2011, the SEC filed suit against Stiefel Laboratories, Inc. (at the time of the alleged misconduct, the world's largest privately held manufacturer of dermatology products and now a subsidiary of GlaxoSmithKline PLC) and Charles Stiefel, the then controlling shareholder, chairman and CEO.[4]

The SEC alleges that the defendants defrauded current and former employee-shareholders of the company by buying back their stock at severely undervalued prices from 2006 until shortly before the company was sold in 2009. The employees had acquired the stock through the company's stock bonus plan. The company repurchased shares when employees resigned, died or were terminated and also made a voluntary buyback offer to current employees, ostensibly to permit employees to diversify their retirement holdings. Allegations against the defendants include the following:

- The purchase price of the stock was based on a valuation made by a third party accountant who "used a flawed methodology and was not qualified to perform the valuations." Further, the valuation price was discounted by an additional 35%, which was not disclosed to employees.
- The stock valuations provided by defendants to employees were misleading because they did not take into consideration:
  - offers from five investment firms in 2006 to purchase stock from the company based on a valuations that were 50% to 200% higher than the company valuation provided to employees;
  - the 2007 purchase by a private equity firm of $500 million of preferred stock of the company based on a $2.6 billion valuation of the company that was more than three times higher than the company valuation provided to employees; and
  - that the company had become actively engaged in material discussions in 2008 to sell the company and in 2009 had received offers to purchase the company.

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SEC Adopts Mine Safety Disclosure Rules

On December 21, 2011, the SEC adopted final rules[5] implementing Section 1503 of the Dodd-Frank Act. Section 1503 requires reporting companies that are mine operators or that have a subsidiary (as defined by Exchange Act Rule 12b-2) that is a mine operator to make certain disclosures about mine safety in their periodic reports and to file a Current Report on Form 8-K if the mine operator receives certain orders or notices from the Mine Safety and Health Administration (MSHA). The new requirements apply only with respect to mines located in the United States. While the new rule is effective as of January 27, 2012, Section 1503 of the Dodd-Frank Act became effective as of August 20, 2010, requiring disclosure prior to the adoption of implementing rules.

The new rules add Item 104 to Regulation S-K and require, for the period covered by the report,

- mine-by-mine disclosure of: (i) the total number of various citations and orders issued under the health or safety provisions of the Federal Mine Safety and Health Act of 1977 (Mine Act) and certain flagrant violations of the Mine Act; (ii) the total number of mine fatalities; and (iii) the total dollar value of proposed assessments by MSHA under the Mine Act (regardless of whether an any appeal or challenge is pending);
- a listing of mines that received written notice from MSHA indicating a pattern (or potential to have a pattern) of violation of health or safety standards under Section 104(e) of the Mine Act; and
- disclosure of any legal action before the Federal Mine Safety and Health Review Commission, including total actions pending on the last day of the period covered by the report, the number of actions instituted and the number of actions resolved, as well as additional detail about the legal actions.

Generally, this information is required to be filed as an exhibit to the applicable periodic report with a brief notation in the body of the report that the company has mine safety violations or other regulatory matters to report and that the required information is included in an exhibit to the report. A tabular presentation is encouraged, but not required. Further, the adopting release notes that to the extent mine safety issues are material, disclosure may also be required under other items of Regulation S-K.

In addition, new Item 1.04 has been added to Form 8-K requiring the filing of a Current Report on Form 8-K within four business days of receipt of an imminent danger notice or a notice of a pattern, or potential pattern, of violations under the Mine Act. Failure to timely file a report on Form 8-K with respect to an event reportable under this new Item 1.04 will not disqualify an issuer from using a Form S-3 Registration Statement.

If they have not already done so, mine operators should review and update their internal procedures, including their disclosure controls and procedures, to ensure that all of the required information is gathered and reported in a timely manner for inclusion in the relevant reports. ■

PRACTICE TIPS

"What, Me Worry?" Yes, the Securities Laws Apply to Private Companies! (continued)

- The stock bonus plan and the summary plan description given or made available to employees were materially misleading because they informed shareholders that stock could be sold for its "current fair market value" which the SEC alleges was not done. Additionally, the plan required the CEO, in his capacity as trustee of the plan, to determine the fair market value "from time to time;" a duty the SEC alleges he failed to perform by not requesting updated valuations or providing the valuation firm with material information.

The SEC alleges that the employee-shareholders were defrauded of more than $110 million as a result of the misleading valuations provided by the defendants. The SEC is seeking, among other remedies, disgorgement of ill-gotten gains plus interest, civil penalties and a public company officer and director bar against the individual defendant.

Although the defendants have not yet had their day in court, a number of lessons can be learned from the allegations in the SEC's complaint:

- Privately held companies that offer equity plans to employees should have those plans and the accompanying summary plan descriptions carefully reviewed with respect to provisions permitting or requiring stock repurchases.
- Stock repurchase valuations should be based on commonly accepted methodologies and updated as corporate circumstances require.
- Consider black-out periods when no repurchases of company stock can be effected until updated financial results or corporate events are able to be disclosed.
- Have your D&O insurance policies reviewed to determine whether you have coverage in the event that the SEC or employee-shareholders bring a securities-based action against you. Even if you prevail in the case, the costs of litigation with the SEC or the securities plaintiff bar can make you a loser. ■

SEC NEWS

SEC Limits Non-Public Submissions from Foreign Issuers

On December 8, 2011, the Staff of the SEC announced a change to its foreign issuer non-public submissions policy.[6] Previously, foreign issuers were able to submit to the SEC Staff registration statements and amendments on a non-public basis in connection with their initial registration with the SEC. The SEC Staff would review and comment on disclosure and the issuer would respond to SEC Staff comments before a public filing was made through the EDGAR System. Effective as of December 8, 2011, the SEC Staff will review initial registration statements of foreign issuers that are submitted on a non-public basis only where the registrant is: (i) a foreign government registering its debt securities; (ii) a foreign private issuer that is listed or is concurrently listing its securities on a non-U.S. exchange; (iii) a foreign private issuer that is being privatized by a foreign government; or (iv) a foreign private issuer that can demonstrate that the public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction. The SEC Staff stated that there may be instances where the SEC Staff will request a foreign issuer to publicly file its registration statement even though it may qualify for a confidential filing. ■

SEC Staff to Release Comment Letters and Responses Faster

Since May 12, 2005, the Staff of the SEC has publicly released comment letters and responses. The goal was to release the correspondence "no earlier than 45 days after the review of the disclosure filing is complete."[7] Beginning January 1, 2012, this timing has been changed to no earlier than 20 days following the completion of a filing review.[8] ■

PRACTICE TIPS

SEC Staff Provides Guidance on Disclosures Regarding European Sovereign Debt Exposures

On January 6, 2012, the SEC's Division of Corporation Finance issued "CF Disclosure Guidance: Topic No. 4," outlining the Division's views on registrants' disclosures regarding direct and indirect exposures to the debt of certain European countries.[9] The guidance, which represents the views of the Division of Corporation Finance, does not set out new SEC rules, regulations or disclosure requirements, but seeks to help registrants determine what information they should consider disclosing in respect to their exposure to the European sovereign debt crisis.

PRINCIPLES-BASED DISCLOSURE REQUIREMENTS

The guidance discusses the following existing principles-based requirements which may require enhanced disclosure of European sovereign debt exposures:

- Management's Discussion and Analysis (MD&A) requires registrants to disclose trends, commitments, events, or uncertainties that will or are likely to impact registrants' liquidity or income.
- Industry Guide 3, which governs bank holding companies, specifically addresses foreign holdings, instructing registrants to identify cross-border outstandings to borrowers that exceed one percent of total assets.[10] Industry Guide 3 further mandates disclosure of conditions in a foreign country that may materially impact the repayment of principal or interest on the country's private or public sector debt.
- Risk Factors.
- Quantitative and Qualitative Disclosures about Market Risk.

The guidance emphasizes that registrants should avoid boilerplate disclosures.

COUNTRIES COVERED BY GUIDANCE

The Staff did not specify the countries covered by its guidance. Rather, the Staff stated that registrants should focus on those countries experiencing significant economic, fiscal and/or political strains such that the likelihood of default would be higher than would be anticipated when such factors do not exist. The Staff expects that the countries covered will vary and encourages registrants to disclose the basis used for identifying the countries included in their disclosures.

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ISS Issues White Paper on Pay for Performance Alignment

On December 20, 2011, Institutional Shareholder Services Inc. (ISS) issued a white paper,[11] which explains the new methodology that ISS will use during the 2012 proxy season to evaluate pay for performance alignment.

With respect to companies in the Russell 3000 index, this analysis includes:

- peer group alignment which focuses on:
  - the degree of alignment between the company's total shareholder returns (TSRs) and the CEO's total pay rank; and
  - the multiple of the CEO's total pay relative to the peer group median.
- absolute alignment between the trend in CEO pay and company TSRs.

According to the white paper, the peer group used by ISS will be comprised of 14 – 24 companies selected on the basis of the company's:

- industry—Global Industry Classification Standard (GICS) classification is used to pick companies in the same 2-digit GICS category as the subject company;
- revenue (or assets in case of financial companies)—companies in the peer group should be between 0.45 times and 2.1 times the subject company's annual revenues (or assets); and
- market value—peer group companies should have the market capitalization between 0.2 times and 5 times the subject company's capitalization.

To determine the relative degree of alignment (RDA) measure, the company's percentile ranks for pay and performance are calculated for one- (annual amount) and three- year (average amount) periods. The RDA is equal to the difference between the combined performance rank and combined pay rank.

The multiple of median (MOM) measure is calculated by dividing the company's prior year CEO's pay by the median pay for the peer group and is designed to demonstrate whether the CEO payments are significantly higher than amounts typical for CEOs in the comparison group.

The absolute measure of pay and TSR alignment (PTA) compares the trends of the CEO's annual pay and the value of an investment in the company over the prior five-year period. This measure is intended to answer the question of whether shareholders' and executive's experiences followed the same long-term trend.

Under ISS' new methodology, these three measures (RDA, MOM and PTA) are designed to indicate whether the company has a "pay for performance disconnect." If the foregoing analysis reflects significant unsatisfactory long-term pay-for-performance alignment or, in the case of non-Russell 3000 index companies, misaligned pay and performance are otherwise suggested, ISS performs a qualitative evaluation to determine either the cause of such pay and performance disconnect or factors that could mitigate the misalignment.[12]

ISS' continued focus on evaluating the pay for performance alignment and the new methodology developed by ISS underscore the importance of analyzing the company's compensation programs for executives and evaluating whether there are factors indicating a disconnect between the CEO's compensation and the company's performance. In connection with the preparation for the coming proxy season, compensation committees may want to include the discussion of pay and performance alignment on their agenda. ■

PRACTICE TIPS

SEC Staff Provides Guidance on Disclosures Regarding European Sovereign Debt Exposures (continued)

DISCLOSURE SUGGESTIONS

To increase transparency and ease comparability for investors, the Staff issued the following guidelines for registrants to consider in drafting their disclosures on European sovereign debt exposures:

- ***Hedges.*** Provide information regarding hedges in order to present an amount of net funded exposure.
- ***Gross Funded Exposure.*** Clarify the calculation of gross funded exposure. Identify the basis for countries selected for disclosure, focusing on significant economic, fiscal, or political strains that increase the likelihood of default. Distinguish between exposure by sovereign and non-sovereign counterparties, as well as categorize the exposures of different financial instruments.
- ***Unfunded Exposure.*** Identify the amount of unfunded commitments. Commitments should be listed by country and counterparty, and should highlight the terms and potential limitations of the counterparty to draw down on the facilities.
- ***Total Gross Exposure (Funded and Unfunded).*** Calculate the total gross exposure as of the balance sheet date, separating total by country and counterparty. Registrants may provide footnote disclosure highlighting additional key terms, such as maturity.
- ***Effects of Credit Default Protection to Arrive at Net Exposure.*** Outline the effects of credit default protection to indicate net exposure. List both the fair and notional value of purchased credit protection, the nature of payout or trigger events of the credit protection contract, and the types of and credit quality of the counterparties from which the protection was purchased. Disclose whether the maturity date of the credit protection is shorter than the exposure against which it was purchased, explaining any risks presented by a mismatch.
- ***Other Risk Management Disclosures.*** Disclose management's methods for monitoring and/or mitigating direct and indirect risks in the selected countries. Identify stress testing performed, as well as highlight developments in the selected countries that would affect registrants' financial condition, operations, liquidity or capital resources.
- ***Post-Reporting Date Events.*** Highlight significant developments that have occurred since the reporting date and the effects of those events.

The SEC's guidance clarifies an area of uncertainty in disclosure requirements regarding foreign debt holdings and should assist registrants in providing investors a more complete picture of registrants' exposures. ■

"The Effective Lead Director"—NACD Blue Ribbon Commission Issues Report on Best Practices for the "Leader of Leaders"

The National Association of Lead Directors, or NACD, an independent nonprofit organization devoted exclusively to improving corporate board performance, recently released "Report of the NACD Blue Ribbon Commission on The Effective Lead Director."[13]

In the report, the Blue Ribbon Commission on Board Leadership discussed the current status of the lead director in modern corporate boards, processes for selecting, evaluating and compensating the lead director, responsibilities of the lead director, and practices to enhance the role of the lead director. The report observes that each board member has leadership responsibilities—and that the lead director must function as a "leader of leaders."

The report noted the birth and rise of the lead director concept over the last thirty years as corporate boards moved toward greater independence. This move was further accelerated by the increased emphasis on director independence as a result of the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act. Under current SEC regulations, a public company that has a combined CEO/chairman is required to disclose whether the board has a lead independent director and what specific role that director plays in the leadership of the board.

Among the responsibilities of lead directors cited by the report are:

- calling, setting the agenda for and chairing executive sessions of independent directors; and
- acting as an intermediary between the independent directors and the chairman/CEO in discussing issues, setting the board agenda and ensuring an appropriate flow of information between the company and the independent directors.

In selecting a lead director, the report suggests that the lead director should:

- be independent and free of real or perceived conflicts of interests or strong personal ties to management;
- be free of any strong ego or other need to dominate, while seeking common ground and creating consensus on issues;
- have the respect, and be respectful, of the other directors, have experience in risk management, corporate strategy and financial oversight, understand the company's business and strategy and possess sound business judgment;
- have a forward looking vision regarding changes occurring in the business world and their potential effect on the company;
- have the ability to build collegial relationships with and among the directors and foster candid and effective communications among directors;
- possess the experience and maturity to be able to provide wisdom and insight, particularly during times of crisis; and
- have the extra time, and the personal desire to commit the extra time, required to properly perform the role—estimated by the report to be up to six to ten additional hours per month.

The report recommends that the nominating and corporate governance committee develop the criteria for selection of lead director candidates, identify possible candidates by seeking input from directors, evaluate the strengths and weaknesses of potential candidates and submit the selected candidate to a formal vote by the independent directors in executive session.

The lead director should be evaluated on a regular basis. This evaluation should include both an examination of the functions and responsibilities of the office of lead director, as well as assessing the performance of the person filling the lead director role.

The report recommends that lead directors receive additional compensation for their increased responsibilities and time commitments. A survey conducted by the NACD showed that on average, lead directors received approximately 15% over standard director compensation, typically paid as an additional cash retainer.

A key responsibility of the lead director will be managing communications between the independent directors and management. The lead director must balance the dual responsibilities of being an advisor to, and sounding board for, the chairman while at the same time being able

to offer constructive criticism when needed. The lead director should be able to stay abreast of important issues facing committees of the board and ensure the uninterrupted flow of information to and from the committees. The lead director also may be the logical choice to meet with shareholders when appropriate. Finally, the lead director may play a key role in the selection of and interface with outside advisors.

The report suggested that to enhance the effectiveness of the board, the lead director should:

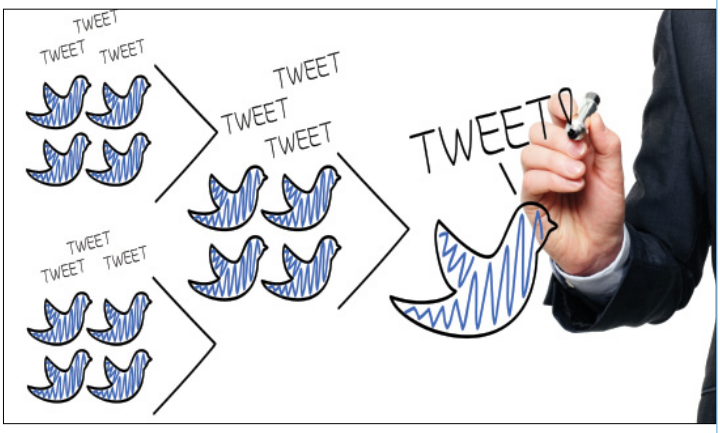
- consider the "big picture" by identifying material and emerging issues and see that they are addressed by the board;
- collect the concerns and views of the other directors and share them with the chairman/CEO when requested or appropriate;
- foster an atmosphere in which each director is comfortable asking questions and sharing views and concerns to avoid "group think";
- conduct effective independent director sessions with and without the chairman/CEO, including informal lunch or dinner sessions to allow the free exchange of thoughts and concerns;
- help indentify underperforming directors, provide the feedback and mentoring they need to improve and work with the nominating and corporate governance committee to ask for his or her resignation if necessary; and
- be prepared to act in a crisis to coordinate the flow of information and viewpoints between the board and management and, if necessary, act a spokesperson or interim CEO if management is involved in the problem.

A copy of the full article is available for purchase from the NACD at www.NACDonline.org/LeadDirector.

Social Media Use by Investment Advisers

On January 4, 2012, the SEC charged Anthony Fields, an Illinois-based investment adviser, with offering to sell fictitious securities on LinkedIn.[14] This case highlights the SEC's concern with the use of social media by investment advisers and the need for advisers to monitor the use of and adopt policies related to social media.

The SEC attached three alerts on social media usage by advisers to its news release about the charges against Fields. One of the alerts issued was a National Examination Risk Alert issued by the Office of Compliance Inspections and Examinations titled "Investment Adviser Use of Social Media."[15] The alert sets forth Staff observations based on a review of various investment advisers that use social media. The alert is not intended to be a comprehensive outline of all rules that must be complied with or all compliance measures that must be implemented. Rather, the alert reviews concerns that may arise from the use of social media by firms and their representatives, and offers suggestions for complying with the antifraud, compliance, and recordkeeping provisions of the federal securities laws.



COMPLIANCE PROGRAM RELATED TO THE USE OF SOCIAL MEDIA

The alert notes that while investment advisers may have overlapping compliance policies that could apply to the use of social media, the lack of specific policies and procedures related to social media use may cause confusion as to the standards actually governing social media use. The alert urges advisers to adopt specific social media use compliance policies and procedures and includes a list of factors that an investment adviser may want to consider when evaluating a compliance program for the use of social media. These include, but are not limited to:

- ***Usage Guidelines.*** Investment advisers may create firm usage guidelines that outline appropriate and inappropriate use of social media;
- ***Content Standards.*** A firm may adopt clear guidelines regarding content and the prohibition of specific content;
- ***Monitoring.*** Investment advisers may consider how to effectively monitor their social media sites or firm use of third-party sites;
- ***Approval of Content.*** A firm may consider pre-approval requirements;
- ***Firm Resources.*** A firm may consider whether it has dedicated sufficient compliance resources to monitor social media activity;
- ***Certification.*** A firm may consider whether to require its representatives to execute certifications confirming that they understand and are complying with the firm's social media policies; and
- ***Information Security.*** Investment advisers may consider any information security risks posed by access to social media sites. These could include dangers from hacking and other breaches of information security.

THIRD-PARTY CONTENT

The Staff states that investment advisers that allow third-parties to post on their social media sites should consider adopting procedures to address such postings. One risk with allowing third-party posts is that those posts may actually constitute a testimonial in violation of the Advisers Act. For example, the use of the 'like' feature on an investment adviser's social media site could be deemed to be a testimonial if it is an explicit or implicit statement of a client's experience with an investment adviser or investment adviser representative.

RECORDKEEPING RESPONSIBILITIES

Finally, the alert discusses investment advisers' recordkeeping responsibilities. The Staff suggests that investment advisers should consider reviewing their document retention policies to ensure the retention of any required records generated by social media use. ■

SEC Questions Qualifications of Financial Reporting Staff

In the summer of 2010, the SEC launched an initiative to determine whether certain companies with foreign operations were accurately reporting their financial results and to assess the quality of the audits of those companies.[16] Apparently, as part of that initiative, the SEC began to question whether the finance and accounting staff of various foreign private issuers and companies with foreign operations had sufficient qualifications and experience with respect to U.S. GAAP.

In a number of comment letters, the SEC made statements such as ". . . it is unclear how you were able to conclude that your internal control over financial reporting was effective considering the apparent limited U.S. GAAP experience of those primarily responsible for maintaining your books and records and preparing your financial statements in accordance with U.S. GAAP." The comment letters generally go on to ask the reporting company to provide very detailed information regarding the U.S. GAAP qualifications and experience of the reporting company's finance and accounting staff.

While these inquiries appear to be limited to foreign private issuers and companies based outside the United States, they do serve as a reminder that the quality, training and experience of internal finance and accounting staff should be considered not only when making personnel decisions, but also when evaluating and reporting on internal control over financial reporting and disclosure controls and procedures. ■

Legislation Easing Dodd-Frank Whistleblower Provisions Moves Forward

The House Capital Markets Subcommittee approved a bill[17] to amend the whistleblower provisions of the Dodd-Frank Act to, among other changes, require employee whistleblowers to first report information to their employer before reporting it to the SEC, subject to certain exceptions.[18] Under the current whistleblower regulations adopted by the SEC, whistleblowers *may* report suspected securities law violations to their employer, but are not required to do so. The SEC regulations were the source of some controversy by not making internal reporting a prerequisite to an award, thereby, it was feared, making internal reporting programs obsolete.

Under the proposed legislation, to be eligible for an award, an employee whistleblower is required to report suspected violations to their employer and then to the SEC within 180 days thereafter; however, the employee may report the information to the SEC first if:

- the whistleblower alleges, and the SEC determines, that the employer lacks either a policy prohibiting retaliation for reporting potential misconduct or an internal reporting system allowing for anonymous reporting; or
- the SEC determines in a preliminary investigation that internal reporting was not a viable option for the whistleblower based on (i) evidence that the alleged misconduct was committed by or involved the complicity of the highest level of management; or (ii) other evidence of bad faith on the part of the employer.

The proposed legislation would also, among other things:

- modify the whistleblower award amounts to eliminate the minimum statutory award of 10% of the monetary sanctions recovered—but keep the upper threshold of 30%;
- require the SEC, prior to commencing any enforcement action based on any employee whistleblower tip, to notify the company that it was the subject of such a tip to enable the company to investigate the alleged misconduct and take remedial action; and
- allow an entity notified under the prior clause that responds in good faith, which may include conducting an investigation, reporting the results of such investigation to the SEC and taking appropriate corrective action, to be treated as having "self-reported" the information in accordance with the SEC's policy statements regarding self-reporting by issuers.

The legislation will be considered by the full House Financial Services Committee.

Will the SEC Allow General Solicitations for Rule 506 Offerings?

On January 6, 2012, the Securities and Exchange Commission Advisory Committee on Small and Emerging Companies met[19] and approved a recommendation that the SEC "take immediate action to relax or modify the restrictions on general solicitation and general advertising to permit general solicitation and general advertising in private offerings of securities under Rule 506 where securities are sold only to accredited investors."[20] During the meeting, it was reported that at the Advisory Committee's last meeting, there was broad consensus that for offerings limited to accredited investors, the focus should be less on how the investor came to the company and more on the investor's accredited status.

Recently, a number of bills have been introduced into Congress that would make it easier for companies seeking to raise capital to solicit investments from, and sell securities to, wider audiences than currently permitted under the Securities Act of 1933 and SEC regulations. Included in this group of bills is the Access to Capital for Job Creators Act that would eliminate the prohibition on general solicitation for certain unregistered offerings of securities under Securities Act Rule 506,[21] as well as a series of bills that would permit sales of securities via "crowdfunding," subject to various limitations.[22] The idea of making it easier to raise capital seems to be gaining traction.

There were a number of SEC Staff in attendance at the Advisory Committee meeting and discussion at the meeting indicates that the Advisory Committee worked with the SEC Staff in developing the recommendation. Given that the recommendation has at least some support from the SEC Staff, and that any relaxation of the ban on general solicitation can be made in the name of job creation, there is at least a chance that a relaxation on the ban on general solicitations in Rule 506 offerings may be forthcoming, which is good news. The bad news is, however, that it may be time to update your spam filter—if the SEC approves general solicitations, even if sales are limited to accredited investors, you can expect your inbox to be flooded with all sorts of securities sale offers. ■

ENDNOTES

1. *See* SEC Release No. 33-9287, Net Worth Standard for Accredited Investors (Dec. 21, 2011), *available at* http://www.sec.gov/rules/final/finalarchive/finalarchive2011.shtml.
2. Net worth is generally determined by calculating the difference between the value of a person's assets and the value of the person's liabilities.
3. *See* Securities Act Rules Compliance & Disclosure Interpretations, Question Nos. 179.01 and 255.47 (July 23, 2010) *available at* http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.
4. *Securities and Exchange Commission v. Stiefel Laboratories Inc. and Charles W. Stiefel,* No. 1:11-cv-24438, S.D. FL (Dec. 12, 2011), *available at* http://www.sec.gov/litigation/complaints/2011/comp22187.pdf.
5. *See* SEC Release No. 33-9286, Mine Safety Disclosure (Dec. 21, 2011), *available at* http://www.sec.gov/rules/final/finalarchive/finalarchive2011.shtml.
6. *See* Non-Public Submissions From Foreign Private Issuers (Dec. 8, 2011), *available at* http://sec.gov/divisions/corpfin/internatl/nonpublicsubmissions.htm.
7. SEC Release No. 2005-72, SEC Staff to Begin Publicly Releasing Comment Letters and Responses (May 9, 2005), *available at* http://www.sec.gov/news/press/2005-72.htm.
8. *See* SEC Staff to Release Filing Review Correspondence Earlier (Dec. 1, 2011), *available at* http://www.sec.gov/divisions/corpfin/cfannouncements/edgarcorrespondence.htm.
9. CF Disclosure Guidance: Topic No. 4, "European Sovereign Debt Exposures," Division of Corporation Finance, Securities and Exchange Commission (Jan. 6, 2012), *available at* http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic4.htm.
10. While Industry Guide 3 governs only bank holding companies, Staff Accounting Bulletin Topic 11:K instructs that where recommendations in Guide 3 are relevant to entities involved in similar lending and deposit activities, such entities should also follow the recommendations.
11. *See* Evaluating Pay for Performance Alignment: ISS' Quantitative and Qualitative Approach (Dec. 20, 2011), *available at* http://www.issgovernance.com/docs/EvaluatingPayForPerformance2012.
12. For additional information on ISS' qualitative factors, see Up to Date: Current Developments in Securities Laws (No. 3) (Nov./Dec. 2011), *available at* http://www.blankrome.com/index.cfm?contentID=37&itemID=2674.
13. Barbara Hackman Franklin and Irv Hockaday, Co-Chairs, *Report of the NACD Blue Ribbon Commission on The Effective Lead Director,* National Association of Corporate Directors (2011), *available at* http://www.NACDonline.org/Lead-Director.
14. *See* SEC Release No. 2012-3, SEC Charges Illinois-Based Adviser in Social Media Scam, (January 4, 2012), *available at* http://www.sec.gov/news/press/2012/2012-3.htm.
15. *See* National Examination Risk Alert, Volume II, Issue 1, Investment Adviser Use of Social Media (Jan. 4, 2012), *available at* http://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf.
16. *See* SEC Release No. 2011-235, SEC Approves New Rules to Toughen Listing Standards for Reverse Merger Companies (Nov. 9, 2011), *available at* http://www.sec.gov/news/press/2011/2011-235.htm.
17. Whistleblower Improvement Act of 2011, H.R. 2483, 112th Cong. (2011), *available at* http://thomas.loc.gov/cgi-bin/query/z?c112:H.R.+2483:.
18. For additional information regarding whistleblower issues, *see* Frederick D. Lipman, *Whistleblowers, Incentives, Disincentives, and Protection Strategies* (2012).
19. A recording of the webcast of the meeting is *available at* http://www.sec.gov/news/otherwebcasts/2012/acsec010612.shtml.
20. *See* Recommendation Regarding Relaxing or Modifying Restrictions on General Solicitation in Certain Private Offerings of Securities, *available at* http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-010612.pdf.
21. Access to Capital for Job Creators Act, H.R. 2940, 112th Cong. (2011), *available at* http://thomas.loc.gov/cgi-bin/query/z?c112:h2940:.
22. Entrepreneur Access to Capital Act, H.R. 2930, 112th Cong. (2011), *available at* http://thomas.loc.gov/cgi-bin/query/z?c112:h2930:; Democratizing Access to Capital Act of 2011, S. 1791, 112th Cong. (2011), *available at* http://www.govtrack.us/congress/billtext.xpd?bill=s112-1791; and Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2011, S. 1970, 112th Cong. (2011), *available at* http://thomas.loc.gov/cgi-bin/query/z?c112:s1970:.

QUESTIONS: If you have a question regarding the issues raised in this newsletter, you may obtain additional guidance from the authors and other members of our Public Companies Group.

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