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PUBLIC COMPANIES AND CAPITAL FORMATION GROUP

JOBS ACT COVERAGE

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JOBS Act "Regulation A+" Gets High Marks

Title IV of the Jumpstart Our Business Startups Act (JOBS Act) directs the SEC to write regulations providing for an exemption from Securities Act registration of public offerings of up to an aggregate of $50 million of equity, debt or convertible debt securities in a 12 month period. This provision has been termed "Regulation A+" by some observers because it is designed to be an improvement upon the SEC's Regulation A, which currently permits exempt public offerings of up to $5 million by non-SEC reporting companies.

Under Title IV, the new SEC regulations must provide, among other things, that:

- all securities offered and sold within the prior 12-month period based on the exemption cannot exceed $50 million;
- the securities may be offered and sold publicly;
- the securities sold will not be "restricted securities," meaning that any purchaser will be able to immediately resell the securities without a holding period or other restrictions;
- the issuer may solicit interest in a proposed offering prior to filing an offering statement with the SEC, similar to the "test the waters" provision currently found in Regulation A; and
- the issuer must file with the SEC audited financial statements on an annual basis.

In addition, the JOBS Act gives the SEC the ability to adopt other rules that the SEC determines to be necessary, including rules related to the disclosures to be included in an offering document and disqualification provisions similar to the disqualifications for felons and other bad actors under Section 926 of the Dodd Frank Act.

The SEC may also require the issuer to file with the SEC, and make available to investors, periodic disclosures similar to the disclosures contained in the offering statement.

Securities issued pursuant to Regulation A+ offerings will be deemed "covered securities" under the National Securities Market Improvement Act and, therefore, exempt from compliance with state securities or "blue sky" laws provided that the securities are either:

- offered or sold on a national securities exchange; or
- offered or sold to "qualified purchasers," to be defined by the SEC.

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Regulation A+ should prove useful to smaller, private companies seeking growth capital. The advantages offered by Regulation A+ include:

- the ability to raise greater amounts of capital ($50 million) than afforded by Regulation A ($5 million) or the "crowdfunding" provisions of the JOBS Act ($1 million);
- the ability to raise funds in a public offering directed at all investors (including non-accredited investors) rather than in a private placement such as under Regulation D, which is typically directed only to accredited investors; and
- because the offering is exempt from the registration provisions of the Securities Act, the issuer not becoming subject to the SEC periodic reporting regimen (Form 10-K, Form 10-Q, Form 8-K and proxy statements) provided that the number of shareholders is kept below the recently revised thresholds for mandatory Exchange Act registration (2,000 persons or 500 persons who are not accredited investors).

Unfortunately, the JOBS Act did not establish a deadline for Title IV rulemaking by the SEC. Given the plethora of regulations still required to be written by the SEC under the Dodd Frank Act and JOBS Act, issuers may not be able to use Regulation A+ for quite some time. ■

New SEC FAQs on Emerging Growth Companies

On May 3, 2012, the SEC issued additional FAQs (Questions 18-41) on Title I (IPO on Ramp) of the JOBS Act clarifying various issues related to emerging growth companies (EGCs). Highlights of the FAQs are presented below.

EGC STATUS

Subject to certain conditions, a company may continue to be an EGC until the last day of the fiscal year following the fifth anniversary of its IPO. FAQs explain that this date is determined by looking to the fiscal year during which the fifth anniversary occurs. The last day of this fiscal year will be the first day that the company is a non-emerging growth company, provided that none of the other disqualifying conditions have been triggered. For example, if an issuer with a December 31 fiscal year-end first sold common equity securities in an IPO on May 2, 2012, it would cease to be an EGC no later than December 31, 2017).

A company will cease to be an EGC on the date on which the company has issued more than $1 billion in non-convertible debt during the previous three-year period. FAQs clarify that the SEC will not object if a company does not count debt securities issued in an A/B exchange offer towards the foregoing $1 billion debt limit because these debt securities are identical to (other than the fact that they are not restricted securities) and replace those issued in the non-public offering.

FAQs also provide that the company that conducted its IPO as an EGC may not regain its status as an EGC after losing that status.

EGC QUALIFICATIONS

The following companies would **not** qualify as an EGC:

- asset-backed securities issuer;
- investment company registered under the Investment Company Act; and
- a company that is a successor to the company's Exchange Act reporting obligations where the predecessor was not eligible to be an EGC because its first sale of common equity securities pursuant to a registration statement occurred on or before December 8, 2011.

However, a business development company may qualify as an EGC.

CONFIDENTIAL TREATMENT

- ***Staff Comment Letters and Issuer Responses to Such Letters.*** The SEC clarified that it will publicly release its comment letters and issuer responses to staff comment letters on EDGAR no earlier than 20 business days following the effective date of a registration statement. However, to assist the

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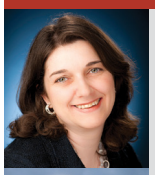

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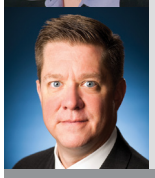

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New SEC FAQs on Emerging Growth Companies (continued from page 2)

SEC in this process, an EGC will have to resubmit, on EDGAR, its response letters to staff comment letters on confidential draft registration statements, using the submission type "CORRESP," when it first files its registration statements on EDGAR.

- ***Information for Which an EGC Intends to Seek Confidential Treatment***. An EGC should identify information for which it intends to seek confidential treatment when it submits its responses to staff comments on confidential draft registration statements. When the company resubmits its responses to staff comments on the confidential draft registration statement on EDGAR, it should follow Rule 83 procedures. Alternatively, the company could follow Rule 83 procedures at the time it submits its response letters to the staff.
- ***Confidential Submission of Form S-4 or F-4***. An EGC may use the confidential submission process to submit a draft registration statement for an A/B debt exchange offer on Form S-4 or on Form F-4, provided its initial public offering date has not yet occurred. An EGC must publicly file the Form S-4 or Form F-4 for its A/B debt exchange offer at least 21 days before its anticipated date of effectiveness.

DISCLOSURE GUIDANCE

- ***Ratio of Earnings to Fixed Charges.*** An EGC will not be required to disclose the ratio of earnings to fixed charges in a registration statement for periods prior to those included in the selected financial data.
- ***XBRL Requirements.*** An EGC is required to comply with XBRL requirements.
- ***Management's Discussion and Analysis.*** An EGC that is not also a smaller reporting company is not permitted to comply with the smaller reporting company version of Item 303 of Regulation S-K. However, the JOBS Act permits an EGC, in its MD&A, to discuss only those audited periods presented in its audited financial statements. Therefore, if in the IPO registration statement, an EGC's audited financial statements cover only two years, then the EGC can limit its MD&A discussion to those two years.
- ***Form 10-K or 20-F.*** For an EGC that is not a smaller reporting company, three years of audited financial statements are required to be included in its Form 10-K or Form 20-F. As a practical matter, the SEC explains, an EGC will not have to provide audited financials for periods earlier than those presented in its IPO registration statement. ■

SEC Provides Updated Instructions for Submitting Draft Registration Statements by Emerging Growth Companies and Foreign Private Issuers

The SEC published new instructions for the submission of draft registration statements by emerging growth companies (as permitted under the JOBS Act) and by foreign private issuers that are not EGCs (under the SEC's policy) for confidential, non-public review by the SEC. Such registration statements, exhibits and correspondence must be submitted to the SEC via a secure e-mail system. Users will be required to create an e-mail account. All draft submissions must be in text searchable PDF format and should include a transmittal letter identifying the issuer and the type of submission. Emerging growth companies should confirm their status as an EGC in their transmittal letters. The registration statement, correspondence and exhibits should each be in a separate file, using simple names to identify them, such as DRAFTS.pdf for the registration statements, LETTER.pdf for the transmittal letter and EXHIBIT10.1.pdf for each exhibit (numbered to correspond to the exhibit number). All SEC comment letters and other correspondence also will be sent via the secure email system. ■

SEC FAQs About Crowdfunding Intermediaries

On May 7, 2012, the SEC Division of Trading and Markets issued FAQs about crowdfunding intermediaries in the JOBS Act. The FAQs provide guidance on the implementation of the crowdfunding intermediary provisions of Title III of the JOBS Act. Highlights of the FAQs are set forth below.

CROWDFUNDING INTERMEDIARY

The JOBS Act creates a new exemption for offerings of "crowdfunded" securities. Specifically, the JOBS Act exempts companies from the requirements of Section 5 of the Securities Act when they offer and sell up to $1 million in securities, provided that individual investments do not exceed certain thresholds and the company satisfies other conditions in the JOBS Act, which will require rulemaking by the SEC within 270 days of the enactment of the JOBS Act on April 5. The SEC

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JOBS ACT COVERAGE

SEC FAQs About Crowdfunding Intermediaries (continued from page 3)

Division of Corporation Finance has reminded issuers that any offers or sales of securities purporting to rely on the crowdfunding exemption would be unlawful under the federal securities laws until the SEC's rulemaking is complete.

One of the crowdfunding conditions is that the companies use the services of an intermediary that is either a broker or a "funding portal" registered with the SEC. A person cannot register with the SEC as a funding portal or act as a crowdfunding intermediary now even if such person is already a registered broker because the SEC must adopt rules regarding crowdfunding. These rules will address the form and process needed to register with the SEC as a funding portal. Funding portals also must become members of the Financial Industry Regulatory Authority (FINRA) in addition to registering with the SEC.

OPERATING RESTRICTIONS

The JOBS Act imposes several restrictions on the activities of a registered funding portal and prohibits a funding portal from:

- providing investment advice or making recommendations;
- soliciting purchases, sales, or offers to buy the securities offered or displayed on its website or portal;
- compensating employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;
- holding, managing, possessing, or otherwise handling investor funds or securities; or
- engaging in any other activities the SEC determines to prohibit in its crowdfunding rulemaking.

In addition, each funding portal and each crowdfunding broker is prohibited from:

- compensating promoters, finders or lead generators for providing the intermediary with the personal identifying information of any potential investor; or
- allowing its directors, officers or partners (or any person occupying a similar status or performing a similar function) to have a financial interest in any issuer using the services of the intermediary.

LEGAL OBLIGATIONS

The JOBS Act requires crowdfunding brokers and funding portals to, among other things:

- provide disclosures that the SEC determines appropriate by rule, including those regarding the risks of the transaction and investor education materials;
- ensure that each investor: (i) reviews investor education materials; (ii) affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear such a loss; and (iii) answers questions that demonstrate that the investor understands the level of risk generally applicable to investments in startups, emerging businesses, and small issuers and the risk of illiquidity;
- take steps to protect the privacy of investors' information;
- take such measures to reduce the risk of fraud with respect to such transactions, as established by the SEC by rule, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person;
- make available to investors and the SEC, at least 21 days before any sale, any disclosures provided by the issuer;
- ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel their commitments to invest;
- make efforts to ensure that no investor in a 12-month period has purchased crowdfunded securities that, in the aggregate, from all issuers, exceed the investment limits set forth in the JOBS Act; and
- comply with any other requirements that the SEC determines are appropriate. ■

SEC NEWS

SEC Charges Deloitte & Touche's Chinese Affiliate with Violating Sarbanes-Oxley

On May 9, 2012, the SEC announced an enforcement action against Deloitte Touche Tohmatsu CPA Ltd. ("DT Tohmatsu") for not providing audit work papers related to an unnamed China-based company under investigation for potential accounting fraud against U.S. investors. While this marks the first time the SEC has brought an enforcement action against a foreign audit firm for failing to comply with a Section 106 request under the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), it is not the first time the SEC has brought an enforcement action against DT Tohmatsu for refusing to release documents related to an SEC fraud investigation. In September 2011, the SEC filed a subpoena enforcement action against DT Tohmatsu for failing to produce requested documents in connection with the SEC's investigation of Longtop Financial Technologies Limited. The SEC later filed charges against Longtop.

Sarbanes-Oxley requires foreign public accounting firms to provide audit work papers regarding U.S. issuers to the SEC upon request.

DT Tohmatsu has refused to provide audit work papers to the SEC based on its interpretation of Chinese law which it believes prevents it from doing so.

Robert Khuzami, Director of the SEC's Division of Enforcement has stated, "As a voluntarily registered U.S. public accounting firm, D&T Shanghai cannot benefit from the financial and reputation awards that come with auditing U.S. issuers without also meeting its U.S. legal obligations." Mr. Khuzami further noted, "Foreign firms auditing U.S. issuers should not be permitted to shield themselves from regulatory scrutiny to the detriment of U.S. investors." ■

What Should Funds Expect in SEC Examinations?

Recently, the Director of the SEC Office of Compliance Inspections and Examinations (OCIE), Carlo V. di Florio, addressed the Private Equity International Private Fund Compliance Forum on the following topics:

DATA PROFILE OF NEW REGISTRANTS

Di Florio reported that as of March 30, 2012, there were approximately 4,000 investment advisers managing one or more private funds registered with the SEC. 32% of all registered advisers reported that they advise at least one private fund and 7% of registered private fund advisers are domiciled in a foreign country. Registered private advisers reported that they advise nearly 31,000 private funds with total assets of $8 trillion. Of the 50 largest hedge fund advisers in the world, 48 are now registered with the SEC and fourteen of those are new registrants. Of the 50 largest private equity funds in the world, 37 are now registered with the SEC and 18 of those are new registrants.

EXAMINATION STRATEGY

Di Florio reported that the SEC's National Examination Program (NEP) is preparing for the nearly 4,000 new registrants by identifying unique risks presented by private equity funds and hedge funds. The NEP staff is also developing information management systems to organize and evaluate the information collected on private equity firms on new Form PF and Form ADV to assist the NEP staff in allocating examination resources across existing and new registrants. Additionally, the NEP staff is working on preserving confidential information internally, while developing processes to ensure examiners have access to information necessary for understanding and examining an entity. The staff intends to:

- Initially undertake industry outreach and education, sharing the staff's expectations regarding the highest-risk areas;
- engage in coordinated examinations of a significant percentage of new registrants, focusing on the highest risk areas of their business, and helping the staff to risk-rate the new registrants; and
- publish a series of "after-action" reports on the broad issues, risks and themes identified.

REGULATORY EXPECTATIONS

Di Florio reported that the NEP will focus on clarity and transparency regarding its expectations. Newly registered advisers are expected to, among other things, adopt and implement written policies and procedures, designate a chief compliance officer, maintain certain books and records, file annual updates to Form ADV, implement a code of ethics and ensure that advertising and performance reporting complies with regulatory rules. Advisers are also expected to act as fiduciaries to their advisory clients. Di Florio noted that advisers have a fundamental obligation to act in the best interests of their clients and provide investment advice in their clients' best interests. In their role as fiduciaries, advisers to private equity funds should consider issues regarding fees and expenses, conflicts of interest at the fund-raising, investment, management, and exit stages, and risk management.

MEETINGS WITH PRINCIPALS

The NEP plans to meet with private equity firms' principals, senior investment professionals or general partners. The goal of the meetings is to improve compliance by allowing the NEP to assess the corporate culture being set at the top of organizations, determine whether the Chief Compliance Officer has the full support of senior management and the principals, and examine the firm's approach to enterprise-wide risk management. In addition, this type of meeting will help the SEC identify risks across the industry.

RISK-BASED APPROACH TO EXAMS

OCIE plans to take a more risk-based approach to the way in which it identifies candidates for examination, as well as the scope of individual examinations. OCIE focuses on four categories of inputs for risk identification:

- observations from the NEP examiners, the NEP's tips, complaints, referral system and the OCIE's Risk Assessment and Surveillance Unit;
- other parts of the SEC, including the Division of Risk, Strategy and Financial Innovation, the Enforcement Division's Asset Management Unit, the Office of Market Intelligence, and the Divisions of Trading and Markets and Investment Management;
- other regulators, such as sister federal financial regulators, SROs, state regulators and foreign regulators; and
- external sources, such as trade groups and news media reports.

The fundamental questions that NEP seeks to answer in its examinations are: Is the firm's process for identifying and assessing problems and conflicts of interest that may occur in its activities effective? Is that process likely to identify new problems and conflicts in the future? How effective and well-managed are the firm's policies and

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PRACTICE TIPS

A Reminder from Yahoo Resume Blunders

The Yahoo chief executive officer resigned in connection with saying he received a degree in computer science and accounting when he only received a degree in accounting. Additionally, one of Yahoo's directors did not seek re-election as a director after it was discovered that her biographical information said she held a bachelor's degree in marketing and economics when her bachelor's degree was in business administration, with specialties in marketing and economics.

This Yahoo debacle serves as a reminder for Boards of Directors and relevant committees to conduct thorough background checks prior to hiring a senior executive, appointing a new director or recommending for nomination a new director candidate. Additionally, at proxy season or in preparing a registration statement, a company should carefully review and compare information contained in director and officer questionnaires with biographical information contained in the company's Form 10-K, proxy statement or registration statement. There are often changes in a director's or officer's positions with unrelated companies or there are inconsistencies between information in the questionnaire and the biographical information contained in the company's Form 10-K, proxy statement or registration statement that need to be reconciled. ■

What Should Funds Expect in SEC Examinations? (continued from page 5)

procedures, as well as its process for creating and adapting those policies and procedures, in addressing potential problems and conflicts?

Some of the risk areas regarding private equity that might be considered during an examination include:

- What is the fund strategy? Does the fund control portfolio companies or hold only minority positions? Is the strategy to invest with other firms or alone? Does the strategy make general sense? Are investments in easily understandable companies?
- How clear are investor disclosures around ancillary fees, management fee offsets and allocation of expenses? How robust are the processes to ensure compliance with those disclosures?
- Does the firm have a complicated set of diverse products? If so, how are inter-product conflicts managed?
- What risks are posed by the life cycle of the funds?
- How sophisticated and reliable are the processes used by the fund? Is the valuation process robust, fair and transparent? Are there strong processes for compliance with the fund's agreements and formation documents? Are compliance and other key risk management and back office functions sufficiently staffed? What is the quality of investor communications? What is the quality of processes to ensure conflict resolution in disputes with or among investors?
- What is the overall attitude of management towards the examination process, its compliance, obligations, and towards risk management generally, compared to its peers?

CONFLICTS OF INTEREST

Di Florio identified fund professionals who co-invest with their clients or take roles at portfolio companies as two factors that are important sources of conflicts of interest for private equity firms. Additionally, he reported OCIE had identified the following as common conflicts of interests for private equity firms:

- Payment of expenses by the funds instead of the management company and questionable fees charged to portfolio companies;
- Advisers negotiating more favorable discounts with vendors for itself than for the fund;
- Advisers favoring side-by-side funds and preferred separate accounts by shifting certain expenses toward less favored funds;
- Advisers putting one or more funds it manages into both equity and debt of a company;
- One or more of a private equity firm's portfolio companies hiring a related party of the adviser to perform consulting or investment banking services; and
- Conflicts between different business lines, where there may be the potential for confidential information to be improperly shared.

THE EXAMINATION PROCESS

To avoid being selected for an exam, di Florio indicated that firms should be proactive and thoughtful about identifying conflicts. Further, if a firm is selected for an exam, the firm can assist the process by knowing the firm's policies and procedures, as well as how to access data that examiners want to see. Having documented past due diligence on transactions and valuations will also assist a firm. Di Florio further cautioned that firms should be forthcoming about problems they have identified in the past and not try to conceal them from the examiner. ■

SEC Issues New FAQs Related to Form ADV

The SEC recently issued two new FAQs clarifying certain reporting requirements in Form ADV. Highlights of the FAQs include:

- Item 1.O of Form ADV requires an adviser to indicate whether it had $1 billion or more in total assets on the adviser's balance sheet as of the last day of the adviser's most recent fiscal year end. "Assets" refer to the adviser's total assets, not the assets managed on behalf of clients. Therefore, for example, an adviser that has $5 billion in regulatory assets under management, but only $300 million in total assets on its balance sheet for its most recent fiscal year end would answer "no" to Item 1.O.
- An investment adviser registered with the SEC that files an annual updating amendment reporting that the adviser is not eligible for SEC registration must withdraw from registration within 180 days of its fiscal year end, *unless* the adviser then is eligible for SEC registration. Therefore, if a firm is registered with the SEC and reports having regulatory assets under management of less than $90 million on its annual updating amendment, but subsequently obtains $90 million or more in regulatory assets under management during the 180 day period, the adviser may amend Form ADV and check Item 2.A(1) to remain SEC-registered. ■

PRACTICE TIPS

Margin Call Sales Raise Securities Law Worries, or Wake Up and Smell the Coffee (Burning)

The founder and chairman and the lead independent director of Green Mountain Coffee Roaster (GMCR) both were removed from their leadership positions as a result of margin call sales of company stock earlier this month that the company termed "inconsistent with" the company's insider trading policy. According to the company's press release, Mr. Robert P. Stiller was removed as chairman and Mr. William D. Davis was removed as independent lead director because they had margin call related stock sales totaling 5.548 million shares. These forced sales were related to margin loans, which were secured by pledges of Mr. Stiller's and Mr. Davis' GMCR stock and were triggered by recent GMCR stock price declines (the stock dropped almost 50% after the company released quarterly results and lowered its fiscal year forecast). The sales occurred at a time when the trading window in GMCR stock was closed under the company's internal trading policy. Also, it was discovered that Mr. Davis had pledged shares after the internal trading policy had been amended to prohibit pledges of company stock (existing pledges were grandfathered).

Margin loans and stock pledges by directors and officers raise several issues to consider under federal securities laws:

- ***Insider Trading***. Pledges and margining of securities may be viewed as sales under securities laws; accordingly, stock should never be pledged or margined by insiders when they are in possession of

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SEC COMMENT LETTER TRENDS

PCAOB's Failure to Inspect Your Auditor Is a Risk Factor

Under Sarbanes-Oxley, public company auditors are required to be registered with the Public Company Accounting Oversight Board (PCAOB). The PCAOB is required to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm with Sarbanes-Oxley, SEC and PCAOB rules, and professional standards. PCAOB inspections of audit firms are supposed to be conducted annually for audit firms that regularly audit more than 100 issuers, and at least once every three years for all other auditing firms.

For various reasons, the PCAOB has not been able to conduct examinations of a number of non-US auditors.[1] In at least one comment letter, the SEC staff stated that as a result of the inability of the PCAOB to perform its inspection of the issuer's auditor, "investors in the U.S. markets who rely on your auditor's audit reports are deprived of the benefits of PCAOB inspections of auditors." The SEC required the issuer to include in future filings a separate risk factor explaining how the PCAOB's inability to inspect the non-US audit firm prevents the PCAOB from regularly evaluating the auditor's audits and quality control procedures.

Issuers should be alert for any potential issues with respect to their auditors. If an issuer's auditor has not been inspected in accordance with the PCAOB rules, or the inspection report notes any deficiencies, the issuer should consider whether a risk factor is appropriate. The issuer may want to review the PCAOB's website, www.pcaobus.org, to view information available regarding its auditor. Prior to including any risk factor in SEC filings relating to an auditor, the issuer should first review the matter with its auditor and legal counsel. ■

LEGISLATIVE CORNER

Too Big to Exist and Conflict Minerals

Congress introduced bills in reaction to the financial crisis, such as the Dodd-Frank Act. Additionally, there is a number of other bills that will likely never be considered outside of committee. One such bill is the Too Big to Fail, Too Big to Exist Act, H.R. 4963.

The Act, presently with the Financial Services Committee, defines "too big to fail" as any entity that has grown so large that its failure would have a catastrophic effect on the stability of either the financial system or the U.S. economy without substantial government assistance. Pursuant to the Act, within 90 days after enactment, the Secretary of the Treasury is required to provide to Congress a list of all banks, investment banks, hedge funds, and insurance companies that the Secretary believes are too big to fail. Beginning one year after enactment, the Secretary of the Treasury is required to break up the entities deemed too big to fail.

It is unlikely that the Act will ever become law. Nonetheless, the Act illustrates how a crisis can spawn interesting legislation.

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PRACTICE TIPS

Margin Call Sales Raise Securities Law Worries, or Wake Up and Smell the Coffee (Burning)
(continued from page 6)

material, nonpublic information. Similarly, if the insider fails to meet a margin call or defaults on the underlying loan, such securities could be sold at a time when the insider is aware of material, nonpublic information and potentially result in an insider trading law violation. Best practices suggest that an issuer's insider trading policy prohibit the holding of the issuer's securities in a margin account or the pledging of such securities as collateral for a loan. Exceptions to this policy should rarely be given and then only if the insider is able to provide evidence of sufficient current and future financial ability to repay the loan without resorting to the sale of the margined/pledged stock.

- ***Section 16 Issues.*** Generally, depositing stock in a margin account or a bona fide pledge to secure a loan is not a "sale" for purposes of Section 16 of the Exchange Act and is not reportable.[2] However, the sale of stock as a result of a margin call or foreclosure is viewed as a sale by the insider for Section 16 purposes and is reportable within two business days on a Form 4 report. The insider also will be liable for any profit under Section 16 if the sale is within six months of a matchable purchase of the same class of stock.[3]
- ***Proxy and Registration Statement Disclosures.*** Issuers must disclose in the stock ownership table in any proxy statement and registration statement they file the amount of shares that have been pledged (including in margin accounts) by directors and executive officers.[4]
- ***Schedule 13D.*** If the insider is required to file a Schedule 13D, pledges of securities are required to be disclosed as well as "material" sales[5] that result from any margin call or foreclosure. SEC Rule 13d-2(a) provides that acquisitions or dispositions of 1% or more of the outstanding class of securities will be deemed material, although lesser amounts may be deemed material depending upon the facts and circumstances.
- ***Form 8-K Report.*** Under more extreme circumstances, the sale of margined or pledged securities of an insider could result in a change of control of the issuer, requiring the filing of a Current Report on Form 8-K under Item 5.01.[6] ■

LEGISLATIVE CORNER

Too Big To Exist and Conflict Minerals (continued from page 7)

Recently, there has also been Congressional activity with respect to the conflict minerals provisions contained in Section 1502 of the Dodd-Frank Act. Generally, Section 1502 requires the SEC to adopt rules requiring SEC-reporting companies to disclose their use of "conflict minerals" that originate in the Democratic Republic of the Congo (DRC) or an adjoining country. If the reporting company uses any conflict minerals originating in the DRC or an adjoining country, the company is required to submit a report to the SEC of the due diligence conducted on the source and chain of custody of such minerals to ensure that the company's products do not contain conflict minerals that directly or indirectly finance or benefit armed groups in the DRC or an adjoining country.

On May 10, 2012, a House Financial Services Panel led by Congressman Gary G. Miller held a hearing to examine the consequences of Section 1502. During the hearing, a variety of views were expressed, ranging from concern about the impact Section 1502 may have on jobs in the United States to support for the provision as necessary to address the continuing violence in the DRC. Subsequent to the hearing, Congressman Miller's May 11, 2012 Weekly Washington Update stated that "[w]hile Section 1502 is well-intended, it was added to Dodd-Frank during late-night conference negotiations, without the benefit of any prior congressional hearings or the potential impact on American jobs and global competitiveness."

Section 1502 required that the SEC issue rules implementing Section 1502 no later than April 15, 2011, a date that has long since passed. The SEC did issue its proposed rules on December 15, 2010. Thereafter, the SEC held a roundtable discussion on the proposed rules on October 18, 2011. However, the SEC has yet to publish a final rule. ■

ENDNOTES

1. *See, e.g.,* Issuer Audit Clients of Non-U.S. Registered Firms in Jurisdictions where the PCAOB is Denied Access to Conduct Inspections, *available at* http://tinyurl.com/dx4qx74.
2. *See* Securities Exchange Act Release No. 34-18114, n. 64 (1981).
3. *See* Alloys Unlimited, Inc. v. Gilbert, 319 F. Supp. 617 (S.D.N.Y. 1970).
4. Rule 403(b)(3) of Regulation S-K, 17 CFR §229.403(b)(3).
5. Rule 13d-2(a), 17 CFR §240.13d-2(a).
6. *See e.g.,* Current Report on Form 8-K of CBS Corporation, (May 5, 2009), *available at* http:/www.sec.gov/Archives/edgar/data/813828/000081382809000180/form_8k.htm.

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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