INSIGHTS

THE CORPORATE & SECURITIES LAW ADVISOR

Volume 27 Number 2, February 2013

INSIDE THE SEC

Highlights from the 40th Annual Securities Regulation Institute

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The 40th Annual Securities Regulation Institute (Institute), sponsored by Northwestern University School of Law, was held January 23rd through January 25th, 2013, in Coronado, California. The panels at the Institute covered a number of different topics, including the Jumpstart Our Business Startups Act of 2012 (JOBS Act) developments, SEC enforcement matters, rulemaking and disclosure review, corporate governance and stockholder activism and mergers and acquisitions developments. In addition, panelists at the Institute, including senior Securities and Exchange Commission (SEC) staff, hosted individual luncheon tables for informal roundtable discussions on various topics with attendees.

JOBS Act—IPO Developments

An early panel initiated a dialogue regarding the JOBS Act, a common theme across the panels at this year's Institute. Thomas W. Yang, Managing Director and Associate General Counsel of Bank of America Merrill Lynch, observed that the option for confidential submission has been the Act's most popular provision, although he noted that confidential submissions tend to lower the visibility into the IPO market. As a result, Mr. Yang predicted that investment bankers will be less confident and, accordingly, more cautious in providing market intelligence regarding what is in the IPO pipeline. Lona Nallengara, Acting Corporation Finance Division Director at the SEC, noted that although the SEC had received a number of requests for statistical information regarding the types of companies making confidential submissions, releasing this information would be contrary to the purpose of the confidential submission process and so the SEC does not intend to do so.

The panel observed that the testing the waters feature of the JOBS Act has not been working as well as anticipated. Panelists noted that it has been useful in the very early stages of an IPO, when management seeks feedback on timing and goals from the investment community. However, pre-launch testing the waters aimed at feedback on valuation has resulted in testing the waters fatigue in the investment community, causing companies to use this feature of the JOBS Act judiciously.

Mr. Nallengara addressed the SEC comment process, noting that since the JOBS Act was enacted on April 5, 2012, the SEC has received

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120 to 130 confidential submissions, including confidential submissions by emerging growth companies and foreign private issuers. Mr. Nallengara offered the following practice tips:

- the SEC expects a confidential submission to be as complete as a public filing;
- a confidential submission must name an underwriter;
- a confidential submission does not delay FINRA filing requirements; and
- the SEC will ask for testing the waters materials, not for purposes of providing comments but to track what issuers are doing generally and to confirm consistency with disclosure in the confidential submission.

JOBS Act—Private Company Developments

A later panel focused on private company JOBS Act developments. Mr. Nallengara noted that the SEC has a large amount of rulemaking to do in this area, including creation of a crowdfunding exemption, elimination of the ban on general solicitation in private offerings under Securities Act of 1933 Rules 506 and 144A, and an exemption from registration modeled on Regulation A (which the SEC refers to as "Reg A+").

Thomas J. Kim, Chief Counsel and Associate Director of the SEC, provided an overview of new Rule 506(c) proposed in August 2012, which permits the use of general solicitation when offering securities to accredited investors under Rule 506, provided that the issuer takes reasonable steps to verify that the person is an accredited investor.[1] Mr. Kim explained that instead of creating a bright line rule, the proposed standard provides a framework based on the objective standard of reasonableness, and the proposing release sets forth factors to consider in applying this framework.[2] Mr. Kim noted that the SEC received a large number of comments on this proposal, which highlighted two main issues to be addressed in the final rule: (1) striking the right balance between flexibility/scalability and promoting legal certainty; and (2) ensuring investor protection. Mr. Kim noted that the SEC actively is considering the many comments submitted thus far but has no prediction regarding when the final rule will be issued.

Mr. Nallengara discussed the new crowdfunding exemption, noting that it is a complicated exemption but the SEC is committed to releasing a proposal as soon as possible.[3] Aspects under consideration by the SEC include: (1) how to define investment advice in the context of a crowdfunding offering; (2) what type of stock can be offered; (3) when in the life cycle of a company a crowdfunding offering can occur; and (4) what happens to the stock following the one-year restricted period. The panelists discussed whether the $1 million limit provided a meaningful fundraising opportunity, and Josh Green of Mohr Davidow Ventures indicated that for venture-backed entities, $1 million goes much further than in the past because venture capital firms want to see actual revenues prior to investing. Mr. Nallengara noted that the legislative history of the provision suggests that the $1 million limit applies only to crowdfunding offerings and should not be aggregated with other offerings made in the 12-month period.

Ms. Parratt noted that with respect to the Staff's confidential review of IPOs, at this point there is not a formal process to withdraw a Form S-1 registration statement should the issuer decide not to proceed. Confidential filings will remain on the SEC's internal EDGAR system. As a result, if the issuer later decides to reinitiate the process of going public, Ms. Parratt recommended that counsel contact the Staff regarding their particular facts and circumstances to determine whether the review will be treated as a complete "restart" or simply an amendment that will be reviewed in short order.

The panelists also discussed the impact of the JOBS Act amendments to the Securities Exchange

Act of 1934 Section 12(g) reporting thresholds. Alan L. Beller of Cleary Gottlieb Steen & Hammilton LLP noted that it is now possible for companies to avoid going public indefinitely, and Mr. Green indicated concern with the creation of a "wild west in our shareholder base." However, Vijaya Gadde, Corporate Counsel at Twitter, Inc., observed that in light of the liquidity issues and resources required to track and manage a large shareholder base, it is not practical to stay private, and Mr. Kim concurred.

Enforcement and Criminal Investigations

In a panel including the outgoing Director of the SEC's Division of Enforcement Robert Khuzami and Lorin L. Reisner, Chief of the Criminal Division, U.S. Attorney's Office for the Southern District of New York, the speakers discussed potential problems with Rule 10b5-1 trading plans in light of recent Wall Street Journal articles noting the disproportionate success of people trading under such plans.[4] In a later panel, Mr. Kim noted that the Council of Institutional Investors has requested changes to rules governing 10b5-1 plans, some that are best practices used by most issuers now (*e.g.,* permitting 10b5-1 plans to be adopted only when insiders can otherwise buy/sell) and others that do not seem effective (*e.g.,* prohibition on overlapping 10b5-1 plans).

The panel also addressed investigation and prosecution of FCPA violations, noting that this has been a high priority for the government over the past few years. Mr. Reisner recommended that every issuer review the recent Morgan Stanley prosecution,[5] which underscores transparency as the path to avoiding a charge. "I don't think there has ever been a more risky time to not self-report FCPA violations," said Mr. Reisner.

SEC Rulemaking and Disclosure Review

During the Division of Corporation Finance panel, Mr. Kim noted that all required rulemaking under the Dodd-Frank Act had been adopted or proposed, although some rulemaking with no timeline remains outstanding (*e.g.,* bad actor rulemaking under Rule 506, risk retention rulemaking). Although near-term, the required rulemaking under the JOBS Act will be the Division's highest priority, Mr. Kim identified proxy plumbing, beneficial ownership modernization and a broader review of the Regulation S-K disclosure requirements as the primary areas that the Division intends to focus on in the near term.

Later in the panel, Ms. Parratt reviewed common themes from the Staff's disclosure reviews in 2012 including:

- euro-zone debt crisis issues;
- restrictions on foreign cash repatriation;
- loss contingencies;
- segment reporting;
- goodwill impairment;
- non-GAAP measures;
- performance metrics;
- large financial institution disclosures; and
- cybersecurity matters.

Ms. Parratt noted that the Division has not identified any recurring themes for 2013, but to the extent such themes evolve, the Division will endeavor to communicate them.

While discussing the new Section 13(r) Iran Sanctions disclosure requirements and the Staff's C&DI's published last September,[6] Mr. Kim observed that the Staff continues to receive many questions in this area. One recurring issue centers around the application of the disclosure requirements to issuers and their "affiliates" – a term not defined in the statute. Mr. Kim described a hypothetical scenario where two public companies had a director in common. According to Mr. Kim, that fact alone would not give rise to an affiliation between the two companies such that each company would need to diligence the other for purposes of complying with the new Section 13(r) disclosure requirements.

Corporate Governance and Stockholder Activism

Lydia Beebe, Corporate Secretary and Chief Governance Officer of Chevron Corporation, led a panel discussion addressing stockholder activism and governance in 2012. The panelists noted a shift in the focus of stockholder activism to mid-cap companies in an effort to make them follow the lead of large companies. David A. Katz of Wachtell, Lipton, Rosen & Katz noted that companies are increasingly engaging with activists in advance and, as a result, avoiding public confrontation.

The panel also discussed the recent prevalence of political contributions stockholder proposals, and Mr. Katz observed that although no current rule requires disclosure of non-material political contributions, a majority of this information is public and so in response to these proposals some companies have linked this information to their websites. Ms. Beebe noted that she has seen proposals asking not just for disclosure but for a prohibition against making any political contributions. Mr. Nallengara noted that activist rulemaking petitions requiring disclosure of political contributions are now on the SEC's unified agenda, which covers action items for the next period.

M&A Developments

The panelists provided their view on the 2012 M&A market, suggesting that economic uncertainty depressed business combination activity for the first three quarters, and the increased activity witnessed in the fourth quarter was the result of post-election confidence and tax concerns. The panelists predicted that the 2013 M&A market is likely to be more active, noting that the debt markets are completely open and private equity firms are holding $100 billion that must be spent in the next year. Chancellor Leo E. Strine Jr. of the Delaware Court of Chancery cautioned that this environment could lead to mispriced deals and advised company management to undertake a market check before putting deal protections in place.

The panelists provided a number of practice tips for board compliance with fiduciary duties in connection with takeover defenses, financial advisors and standstill provisions and discussed the implications of recent Delaware rulings on "don't-ask-don't-waive" provisions.[7] Chancellor Strine noted that for a company to successfully claim that it used a "don't-ask-don't-waive" provision in a standstill agreement as a strong gavel to obtain the highest value, the record must reflect that it was used for this specific purpose and the board must understand the significance of the provision. The panelists also stressed the importance of negotiating M&A-related confidentiality agreements, which they noted have been thrust into the spotlight by recent Delaware decisions ruling that non-reliance and waiver clauses in confidentiality agreements can preclude fraud claims. In addition, the panelists noted the potential for confidentiality agreements to serve as a backdoor standstill.[8]

Notes

1. *See* SEC Release No. 33-9354, "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings", available at *http://www.sec.gov/rules/proposed/2012/33-9354.pdf*.
2. *See id.* (setting forth factors including the nature of the purchaser, information about the purchaser and the nature and terms of the offering).
3. The crowdfunding exemption will permit private companies to make a public offering to any individual through a new regulated intermediary called a funding portal, with certain restrictions on aggregate amounts raised and invested.
4. *See, e.g.,* Susan Pulliam and Rob Barry, "Trading Focus Is Pushed," Wall Street Journal (January 23, 2013), available at *http://online.wsj.com/article/SB10001424127887323854904578260184043496380.html?KEYWORDS=10b5-1+plans*.
5. *See* DOJ Press Rel. 12-534, "Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA," available at *http://www.justice.gov/opa/pr/2012/April/12-crm-534.html*.

6. *See* Questions 147.01 through 147.07 at *http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm*.

7. *See* In re Ancestry.com Inc. Shareholder Litigation, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

8. *See* RAA Management, *LLC v. Savage Sports Holdings, Inc*., 45 A.3d 107 (Del. 2012); *Martin Marietta Materials, Inc. v. Vulcan Materials Co*., ___ A.3d ___, 2012 WL 2783101 (Del. Supr. July 12, 2012).

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