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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions

By Victor M. Rosenzweig*

This issue's Survey focuses on Securities and Exchange ("SEC") rulemaking activities and major federal appellate or other decisions relating to the Securities Act of 1933, as amended, (the "1933 Act"), the Securities Exchange Act of 1934, as amended, (the "1934 Act"), and other Federal Securities laws from March 19, 2011 through June 18, 2012.

SEC Rulemaking

The JOBS Act is Signed Into Law

President Obama signed into law the Jumpstart Our Business Startups Act on April 5, 2012. Known as the JOBS Act, it is intended to stimulate job creation and economic growth by giving emerging growth companies greater access to the public capital markets. The JOBS Act will most notably (1) reform the initial public offering ("IPO") process for emerging growth companies, (2) require limited regulatory disclosure for five years following the IPO process, and (3) grant certain exemptions which will allow for greater capital-raising abilities. The pre and post IPO process has historically entailed significant rules with respect to communications in connection with the offer and certain regulatory disclosures that might have appeared burdensome to small and private companies. The JOBS Act aims to relax some of these rules so as to lessen the burden on smaller companies. The SEC must now complete the rulemaking process, with most rules to be completed between 90 and 270 days following the signing into law.

The Pre-IPO Benefits

The IPO process has historically been identical for all companies, regardless of the size of the company. Under the JOBS act, emerging growth companies ("EGC"), which are defined as companies that have less than $1 billion in annual gross revenues during their most

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recently completed fiscal year, will be permitted to undertake a simpler IPO process than those of their larger counterparts. The JOBS Act provides that, in connection with an upcoming IPO, EGCs will be permitted to: (1) confidentially submit a draft registration statement to the SEC for confidential, nonpublic review as long as that submission and any amendments thereto are publicly filed at least 21 days prior to conducting a road show; (2) assess investor interest by communicating with "qualified institutional buyers" and "accredited investors" prior to filing a registration statement; and (3) require reduced disclosure in its IPO registration statement. The SEC has issued guidance explaining that the draft registration statement and all amendments thereto must be substantially complete when submitted to the SEC and that the reserves the right to defer review of the draft registration statement. Further, the draft registration statement may omit details such as pricing. The pre-filing communication is significant in that prior to the JOBS Act, such pre-filing communications were not permitted for any company. Additionally, EGCs are permitted to include less disclosure in their IPO registration statements. This reduced disclosure calls for, among other items, only two years of audited financials, rather than three, the inclusion of selected financial data from the earliest period used in the registration statement, instead of financial data from the previous five years, and reduced disclosure regarding executive compensation.

Regulatory Requirements Following the IPO

Under the JOBS Act, EGCs will benefit from relaxed regulatory requirements for the five years following the IPO. First, EGCs will be permitted to report the executive compensation information required of smaller reporting companies, regardless of whether the EGC qualifies as a smaller reporting company. As previously mentioned, the EGC will be required to present selected financial data that corresponds to the earliest period presented in the registration statement. Third, EGCs will be exempt from several requirements, including Item 404(b) requirements with respect to attestation of the auditor, complying with new or revised US GAAP accounting standards (until those standards become applicable to private companies), complying with new Public Company Accounting Oversight Board rules with respect to mandatory audit firm rotation, and holding say-on-pay votes and disclosing specific executive compensation information.

This period of reduced reporting requirements remains until the earliest of: (1) the date on which the EGC becomes a large accelerated filer; (2) the last day of the fiscal year during which the EGC's annual gross revenues exceeded $1 billion; (3) the last day of the fiscal year after the fifth year anniversary of the IPO; or (4) the date on which

the EGC has issued more than $1 billion in non-convertible debt during the preceding three year period.

Initiative to Facilitate Raising Capital

The JOBS Act also provides for reforms in private capital raising initiatives. Under the JOBS Act, advertising and general solicitation prohibitions in the private placement context have been lifted, meaning issuers may advertise and engage in general solicitations, provided, however, that they take "reasonable steps" to ensure actual sales of securities are made to qualified institutional buyers and accredited investors only. The SEC has been tasked with identifying what constitutes "reasonable steps" and will amend Regulation D and Rule 144A accordingly. These amendments have not yet been implemented.

Regulation A has also been expanded under the JOBS Act. Regulation A formerly permitted non-reporting companies to publicly offer up to $5 million in securities after filing an offering circular instead of a full registration statement. The offering circular contains less disclosure information than a full registration statement. The JOBS Act now provides for an increased cap of $50 million for offerings made under the Regulation A exemption. As Regulation A intersects with state Blue Sky laws, the JOBS Act also mandates that a study be undertaken to gauge the impact of Blue Sky laws on offerings made pursuant to Regulation A.

Pursuant to the JOBS Act, Section 4 of the 1933 Act has been amended to facilitate "crowdfunding," through which small investors can pool their resources to fund companies seeking capital. As this would otherwise constitute a sale of securities which would require registration unless there was an exemption from registration, the JOBS Act provides that exemption. Under the crowdfunding exemption, companies will be permitted to sell up to $1 million in securities to an unlimited number of investors during a 12 month period. Any individual investor is permitted to invest up to $100,000. Further, securities issued pursuant to crowdfunding are considered "covered securities" and are therefore exempt from registration under state Blue Sky laws. Crowdfunding transactions must be undertaken through a broker or funding portal which will be an intermediary that is exempt from registration as a broker-dealer but must register as a funding portal and will be subject to certain recordkeeping and operational requirements.

Issuers taking advantage of the crowdfunding exemption are subject to certain other requirements. These companies must file certain information with the SEC and provide investors and intermediaries with this information. This information, which is intended to educate

unsophisticated investors, must include a description of the business and its financial condition, certain financial statements (depending on the size of the offering), and a description of the offering which must include risk factors. These companies will also need to provide the SEC with operations reports and financial statements at least annually and may not advertise terms of the offering other than through notices that clearly require that investors go through the intermediary.

Finally, the JOBS Act provides for an increase in public reporting company thresholds. Section 12(g) of the 1934 Act has provided that private companies with more than 500 shareholders of record and more than $10 million in assets are subject to public company reporting requirements. This requirement has resulted in, for example, private companies that issue employee stock options having to report certain financial information. Under the JOBS Act, the threshold has been raised to 2,000 shareholders of record, but remains 500 for shareholders that are not accredited investors, and excludes employees that hold shares pursuant to an equity compensation plan or crowdfunding offering.

SEC Adopts Final Rules Defining "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" And "Eligible Contract Participants."

On April 27, 2012, the SEC, in conjunction with the Commodity Futures Trading Commission ("CFTC"), and after consultation with the Board of Governors of the Federal Reserve System ("Board"), adopted rules further defining "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible contract participant" under the Commodity Exchange Act ("CEA"), and the Securities Exchange Act of 1934 (the "1934 Act"). (**SEC Release No. 34-66868**.) These rules were adopted in compliance with the Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") and will assist entities in determining whether their activities require greater regulatory oversight. While the rules become effective on July 23, 2012, the effective date of CFTC Regulations is December 31, 2012.

Persons that are determined to be swap dealers are subject to statutory requirements related to registration, margin, capital and business conduct. Under the CEA, the SEC adopted a final rule that defines the term "swap dealer" using terms from four statutory tests and excluding swap activities that are not part of a regular business. New Rule 3a71-1 under the 1934 Act defines the term "security-based swap dealer" as someone who (1) holds themselves out as a dealer in security-based swaps; (2) makes a market in security-based swaps; (3)

regularly enters into security-based swaps with counterparties as an ordinary course of business for their own account; or (4) engages in activity causing them to be commonly known in the trade as a dealer or market maker in security-based swaps. The rule also provides an exception from the definition of "security-based swap dealer" for anyone who participates in a de minimis amount of swap dealing. The SEC has determined the de minimis exception based on an entity's activity in security-based swap dealing over the previous twelve months. The de minimis exception for credit default swaps that are security-based swaps, is available to persons who enter into up to $3 billion in notional credit default swaps transactions over the prior 12 months. The threshold is up to $150 million for other types of security-based swaps. The SEC has also determined that whether a person is a swap dealer is based not only on the definition but on the application of rules and particular circumstances.

Swaps entered into by an insured depository institution with a customer in connection with originating a loan with that customer, swaps between majority-owned affiliates, swaps entered into by a co-operative with its members, swaps entered into for hedging physical positions as defined in the rule, and certain swaps entered into by registered floor traders are not included for the purposes of defining a swap dealer.

Rules 3a67-1 through 3a67-9 under the 1934 Act define "major security-based swap participant" through a three-part test. A person satisfying any of the three parts is deemed a major security-based swap participant. The test includes those who (1) maintain a "substantial position" in any of the major security-based swap categories, excluding positions held for hedging or mitigating commercial risk and positions maintained by certain employee benefit plans for hedging or mitigating risks in the operation of the plan; (2) have outstanding security-based swaps which create "substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets"; and (3) any "financial entity" that is "highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate federal banking agency" and that maintains a "substantial position" in any of the major security-based swap categories. Security-based swap dealers are excluded from the definition of major security-based swap participant.

A person that is not an eligible contract participant ("ECP") may not enter into a swap or engage in certain swap-related activity. Under the CEA, the definition of ECP has been amended in several ways. First, an ECP is not a commodity pool in which any participant is not itself an ECP. Second, the monetary threshold that governmental

entities may use to qualify as ECPs, in certain situations, has been raised from $25 million in investments owned and invested on a discretionary basis to $50 million in investments owned and invested on a discretionary basis. Finally, for individuals to qualify as ECPs, the standard is based on amounts invested on a discretionary basis.

The SEC Adopts Exemptions For Security-Based Swaps Issued By Certain Clearing Agencies

As a part of the Dodd-Frank regulatory regime, the CFTC and the SEC are tasked with creating and implementing rules regarding mandatory clearing of swaps transactions. Accordingly, the SEC adopted rules that exempt transactions by clearing agencies (defined below) in security-based swaps from all provisions of the Securities Act of 1933 (the "1933 Act"), other than anti-fraud provisions, and further exempt these security-based swaps from 1934 Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met. **(SEC Release Nos. 33-9308; 34-66703; 39-2484.)** The final rules became effective on April 16, 2012.

Clearing agency is broadly defined under the 1934 Act as, subject to exceptions identified therein, "any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates." Clearing agencies may undertake a variety of functions.

Title VII of the Dodd-Frank Act provides, among other things, that the SEC regulate security-based swaps. In accordance with that mandate, the 1934 Act provides that transactions in security-based swaps must be submitted for clearing to a clearing agency if the SEC determines that it must be cleared. Section 3C of the 1934 Act established a clearing requirement for security-based swaps and sets forth a process to determine whether such swap that a clearing agency plans to accept for clearing must be cleared.

Clearing agencies may serve several functions, one of which is to

serve as a central counterparty. A central counterparty places itself between counterparties to a securities transaction, which makes it act as the buyer to every seller and the seller to every buyer. When, for example, a security-based swap between two counterparties belonging to the same central counterparty is executed and submitted for clearing, the central counterparty becomes the buyer to the seller and the seller to the buyer. This process, which is known as novation, entails the offer and sale of securities.

Rule 239 of the 1933 Act exempts the offer and sale of security-based swaps that are or will be issued to eligible contract participants by, and in a transaction involving, a clearing agency that is registered under Section 17A of the 1934 Act, or exempt from registration and all provisions of the 1933 Act, except the anti-fraud provisions of Section 17(a). Therefore, the offer and sale of security-based swaps to eligible contract participants that are or will be issued by, and in a transaction involving, a registered or exempt clearing agency is permitted without compliance with Section 5 of the 1933 Act, which governs registration of securities.

APPELLATE AND OTHER DECISIONS OF NOTE

Supreme Court Addresses Tolling of Statute of Limitations for Violation of Section 16(b)

On March 26, 2012, the Supreme Court rejected the Ninth Circuit's holding that the two-year limitations period established in Section 16(b) of the 1934 Act begins to run only after the statutory insider makes a mandatory disclosure filing under Section 16(a).

As previously discussed in this space (Vol. 39, number 4), plaintiff originally brought fifty-four separate derivative cases against investment banks that allegedly violated the short-swing profit restrictions in Section 16(b) when they acted as lead underwriters in a number of initial public offerings. The Western District of Washington had dismissed all the cases, holding that nearly half the cases were brought after the two-year statute of limitations had run. The Ninth Circuit reversed, applying its prior precedent and holding that the limitations period was tolled until the insider disclosed the transaction in a mandatory Section 16(a) report.

A unanimous Supreme Court (with the exception of Chief Justice Roberts who took no part in the case) rejected the Ninth Circuit's holding. The Court reasoned that Section 16 itself clearly establishes that the two-year clock begins to run from "the date [the] profit was realized" and not from the date of filing of the mandatory Section 16(a) report. The Court rejected the Ninth Circuit's suggestion that the standard rule of equitable tolling for fraudulent concealment

required tolling until the filing of the mandatory report. The Court noted that, contrary to the Ninth Circuit's decision, under long-settled equitable-tolling principles fraudulent concealment only tolls a limitations period until the time at which a reasonably diligent plaintiff would have learned of the underlying facts.

The Ninth Circuit's position had differed from that applied by the Second Circuit in *Litzler v. CC Investments, L.D.C.*, 362 F.3d 203, 208, Fed. Sec. L. Rep. (CCH) P 92725 (2d Cir. 2004) (abrogated by, Credit Suisse Securities (USA); LLC v. Simmonds, 132 S. Ct. 1414, 182 L. Ed. 2d 446, Fed. Sec. L. Rep. (CCH) P 96764 (2012)), where that Circuit found that the limitations period was tolled until the plaintiff was placed on actual (not inquiry) notice of the insider trading. However, even though the Supreme Court assumed for purposes of the instant opinion that equitable tolling may apply, the Court split 4 to 4 on defendant's contention that the two-year period established in Section 16(b) is actually a statute of repose that is not subject to tolling of any kind. As a result, the Supreme Court expressly left open the question of whether standard equitable tolling can apply to save a Section 16(b) claim.

Credit Suisse Securities (USA) LLC v. Simmonds, 132 S. Ct. 1414, 182 L. Ed. 2d 446 (2012)

Second Circuit Addresses "Debt Previously Contracted" Exception to Section 16(b) Liability and When Shares are "Purchased" Under Conversion of a "Hybrid" Note

On June 4, 2012, the Second Circuit affirmed the grant of summary judgment against a fund for violation of Section 16(b) of the 1934 Act, holding that the "debt previously contracted" exception did not apply and defining when shares acquired through conversion of a "hybrid" note should be considered purchased for Section 16(b) short swing profits analysis.

Defendants were Tonga Partners LP ("Tonga"), a limited partnership, its sole general partner and the general partner's sole managing member. In 2002, Tonga acquired a secured convertible promissory note from plaintiff Analytical Surveys, Inc. ("ASI"). In 2003 Tonga converted some of the Note and ASI and Tonga entered into a new note. In June 2004, after ASI failed to file a registration statement required by the 2003 note, ASI and Tonga entered into a third note, which was largely similar to the 2003 note, but extended the maturity date and dropped a mandatory conversion clause. In November 2004 Tonga proceeded to convert most of the note and sell the shares.

In 2006, ASI filed suit against Tonga for violation of the short swing

provision of Section 16(b). In 2008, the Southern District of New York granted summary judgment to ASI. The Second Circuit affirmed the grant of summary judgment. The Circuit first adopted the position that to qualify under the "debt previously contracted" exception, the "debt at issue must constitute an obligation to pay a fixed sum certainly and at all events, and be a matured debt which existed apart from any existing obligation to transfer the securities." (internal quotations and alterations omitted) The 2004 note's terms only required acceleration of the debt after declaration by Tonga of an event of default, and because Tonga never declared the failure to file the registration statement an event of default, the debt was not an obligation to pay a fixed sum at the time of conversion and thus Tonga did not qualify under the "debt" exception.

The Circuit also defined when shares converted under a "hybrid" note (*i.e.*, where the conversion could occur at a fixed price or a floating price depending on the circumstances) are "purchased" for purposes of Section 16(b). The Circuit stated that, when a note holder converts a hybrid note at a floating price, there are two purchase dates, first the minimum number of shares that could have been purchased under the fixed price are considered purchased when the note is acquired, then second, the difference between that number of shares and the actual amount of shares purchased at the floating price is considered purchased when the note is converted. So in this case, the 2004 note, when it was purchased in June 2004, had a principal of $1.7 million, and a fixed price option of $2.00 per share at maturity. In November 2004, Tonga purchased 1,701,341 shares. Thus, the Circuit found that the acquisition of the note in June constituted a Section 16(b) purchase of 850,000 shares, and the conversion of the note in November constituted a Section 16(b) purchase of the additional 851,341 shares. Because both of these dates were within the six month window, Tonga violated Section 16(b) when it sold the shares in November.

Analytical Surveys, Inc. v. Tonga Partners, L.P., No. 09-2622-cv (2d Cir. June 4, 2012).

Eighth Circuit Finds that Advisers Did Not Breach their Section 36(b) Fiduciary Duty Regarding their Fees Despite a Flawed Negotiation Process

On March 30, 2012, the Eighth Circuit affirmed a grant of summary judgment in favor of defendant investment advisers, applying *Jones v. Harris Associates L.P.*, 130 S. Ct. 1418, 176 L. Ed. 2d 265, Fed. Sec. L. Rep. (CCH) P 95653 (2010), to find that, despite the advisers' failure to apprise the mutual fund board of all relevant information, the

advisers did not breach their fiduciary duties under Section 36(b) of the Investment Company Act of 1940.

Plaintiffs were shareholders of nine mutual funds that had contracted for the services of defendants, fund advisers associated with Ameriprise Financial, Inc. Plaintiffs argued that the fee negotiations between the mutual funds and defendants was flawed because (1) they were based on external factors such as the fee arrangements of similar mutual funds; (2) defendants provided comparable advisory services to institutional non-fiduciary clients at a lower fee; and (3) defendants misled the funds' board of directors about their arrangements with non-fiduciary clients.

In 2007 the District Court of Minnesota granted summary judgment because defendants' fees were not so disproportionately large that they did not bear a reasonable relationship to the services rendered under the standards set forth in *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, Fed. Sec. L. Rep. (CCH) P 99001 (2d Cir. 1982) (disapproved of by, Jones v. Harris Associates L.P., 527 F.3d 627, Fed. Sec. L. Rep. (CCH) P 94749 (7th Cir. 2008)). In 2009 the Eighth Circuit reversed, finding that Section 36(b) "impose[d] on advisers a duty to be honest and transparent throughout the negotiation process." Thereafter, the Supreme Court decided Jones and reversed and remanded the instant case for further consideration in light of Jones. On reconsideration the District Court again granted summary judgment.

The Eighth Circuit, after analyzing Supreme Court's opinion in Jones, affirmed the District Court's grant of summary judgment. The Circuit concluded that "after Jones, a process-based failure alone does not constitute an independent violation of Section 36(b)" and that a flaw in the process of approving the fees only affects the level of deference to be given to a Board of Directors decision to approve the fees. Here, the Circuit concluded that because of defendants' actions during the negotiations, that process was flawed and less deference was to be given to the board's judgment. As a result, the court had to "take a more rigorous look at the outcome of the negotiations." Nonetheless, applying Jones and Gartenberg, the Circuit concluded that plaintiffs failed to set forth additional evidence that the fees were outside of the appropriate arms-length range and thus did not form the basis for a breach of fiduciary duty under Section 36(b).

Gallus v. Ameriprise Financial, Inc., 675 F.3d 1173, Fed. Sec. L. Rep. (CCH) P 96776 (8th Cir. 2012).

Second Circuit Holds that Company Should Have Disclosed in its Secondary Offering Known Uncertainties Regarding Defects in Products Sold to its Largest Customers

On May 25, 2012, the Second Circuit held that, based on defendant's alleged non-compliance with Item 303 of Regulation S-K, plaintiffs had stated plausible claims under Sections 11, 12(a)(2) and 15 of the 1933 Act that the defendant company had failed to disclose in its secondary offering known uncertainties regarding an increasing trend of defects in chips sold to its largest customers.

Plaintiffs are a putative class of shareholders in defendant Ikanos Communications Inc. Ikanos developed and marketed semiconductor chips. In 2005, Ikanos derived 72% of its revenue from its two largest customers. According to plaintiffs, in the weeks prior to Ikanos' March 2006 secondary offering, the company received an increasing volume of complaints from its largest customers about defects in its chips. Plaintiffs further alleged that, at the time, Ikanos knew it was unable to identify which chips were defective. As a result of the defects, in June 2006, three months after the secondary offering, Ikanos agreed to replace, at its expense, all of the chips sold to its two largest customers. Then the company proceeded to report progressively decreasing revenues throughout 2006 resulting in its stock price dropping by more than 40%. Plaintiffs filed their first complaint in late 2006 alleging that Ikanos had violated Sections 11, 12(a)(2) and 15 when, in contravention of Item 303 of SEC Regulation S-K, it had failed to disclose in its secondary offering the "known uncertainty" that the chips may have been defective and could result in a serious impact on the company's revenues.

In 2008, the Southern District of New York dismissed plaintiffs' first amended complaint, refused to consider its first proposed second amended complaint, and denied plaintiffs leave to re-plead. The Second Circuit affirmed the dismissal, but vacated the Southern District's refusal to grant leave to re-plead. On remand, the Southern District dismissed plaintiffs' second proposed second amended complaint.

On appeal, the Second Circuit vacated the Southern District's dismissal of the second proposed second amended complaint. The Circuit applied its holding in *Litwin v. Blackstone Group, L.P.*, 634 F.3d 706, Fed. Sec. L. Rep. (CCH) P 96033 (2d Cir. 2011), cert. denied, 132 S. Ct. 242, 181 L. Ed. 2d 138 (2011), previously discussed in this space,

stating that under Item 303 a company is required to disclose "the manner in which [a] then-known trend[], event[], or uncertaint[y] might reasonably be expected to materially impact [the company's] future revenues." The Circuit then noted that plaintiffs had alleged that because Ikanos was unable to identify the defects, the company was aware "of the 'uncertainty' that it might have to accept returns of a substantial volume, if not all, of the chips it had delivered to its major customers." The Circuit found that such a known uncertainty clearly could materially impact the company's revenues. As a result, it concluded that plaintiffs had adequately alleged violations of Sections 11, 12(a)(2) and 15 due to the company's failure to comply with Item 303.

Panther Partners Inc. v. Ikanos Communications, Inc., 681 F.3d 114 (2d Cir. 2012)

District of Minnesota Holds that Section 12(g) of the 1934 Act does not Authorize a Private Right of Action

On March 30, 2012 the District of Minnesota dismissed a declaratory judgment action for lack of subject matter jurisdiction because it found that Section 12(g) of the 1934 Act does not authorize a private right of action.

Section 12(g) requires any company with more than $10 million in assets and more than 500 shareholders to register with the SEC. In 2010, the board of directors of plaintiff, Medafor, Inc., realized that the company was approaching the Section 12(g) limit and determined that it desired to avoid registration. To avoid having to register, Medafor undertook a reverse/forward stock split to eliminate all shareholders owning less than 5,000 shares, thereby reducing the total number of shareholders. Defendant, CryoLife Inc., realized that, due to deposit agreements it had with other owners, following the reverse/forward stock split, approximately 12,000 of its shares would be canceled. It, therefore, threatened to sue Medafor and to report the company to the SEC for violation of Section 12(g). Medafor filed a declaratory judgment action against CryoLife seeking a judicial determination as to whether it must register pursuant to Section 12(g).

The District Court granted defendant's motion to dismiss the declaratory judgment action pursuant to Fed. R. Civ. P. 12(b)(1) for lack of subject matter jurisdiction. The District Court reasoned that, in order to show the existence of a valid case or controversy and thereby maintain a declaratory judgment action, plaintiff had to first show that Section 12(g) grants a private right of action that defendant could have sued under. In what the District Court stated was a matter of first impression in the Eighth Circuit, it held that neither the

language of the Section, nor its legislative history, provided any definitive evidence that Congress contemplated a private right of action arising under Section 12(g). Thus, under the precedent established in *Touche Ross & Co. v. Redington*, 442 U.S. 560, 99 S. Ct. 2479, 61 L. Ed. 2d 82, Fed. Sec. L. Rep. (CCH) P 96894 (1979), absent evidence that Congress intended to provide for a private right of action, the District Court was precluded from creating one.

Medafor, Inc. v. CryoLife, Inc., Fed. Sec. L. Rep. (CCH) P 96805, 2012 WL 1072340 (D. Minn. 2012)

Fifth Circuit Affirms that Company has Private Right of Action Under Section 14(a) to Exclude Shareholder Proposal

On June 11, 2012, the Fifth Circuit affirmed that a company has a private right of action under Section 14(a) of the 1934 Act to ask for a declaration that it could exclude a shareholder proposal from its proxy statement, and that such a declaratory action did not lack "sufficient immediacy and reality" just because the shareholder stipulated that he would not sue if his proposal was excluded.

Activist John Chevedden submitted a proposal to KBR Inc. ("KBR") for its 2011 proxy materials calling on the company to replace its staggered board with annually elected directors. However, following repeated requests from KBR, Chevedden was unable to submit sufficient materials to show that he was a qualified shareholder under Rule 14a-8(b), promulgated under Section 14(a). Rather than request no-action relief from the SEC, KBR brought a declaratory judgment action asking for an order allowing it to exclude Chevedden's proposal. The Southern District of Texas granted summary judgment to KBR. Chevedden appealed, arguing (1) that Section 14(a) does not create a private right of action; and (2) that the dispute "lacked sufficient immediacy and reality" to be justiciable under the Declaratory Judgment Act.

The Fifth Circuit, in an unpublished per curiam opinion, affirmed the grant of summary judgment. First, the Circuit held that the Supreme Court recognized a private right of action under Section 14(a) in *J. I. Case Co. v. Borak*, 377 U.S. 426, 84 S. Ct. 1555, 12 L. Ed. 2d 423 (1964) to allow a company to "enforce SEC regulations controlling the conditions under which proxies are submitted." Second, the Circuit found that the controversy at issue was sufficiently immediate and real because "Chevedden's proposal put KBR to a choice between spending a significant sum to revise its proxy statement, or excluding Chevedden's proposal and exposing itself to potential litigation." Chevedden's assertion that he would not sue if his proposal was

excluded did not change this analysis because KBR has duties to all of its shareholders and would still face a potential SEC enforcement action if it improperly excluded Chevedden's proposal.

KIST v.Chevedden, WL 2094081 (5th Cir. June 11, 2012), Rehearing denied, July 9, 2012 (No. 11–20921).