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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 Commission ("SEC") rulemaking activities and major federal appellate or other decisions relating to the Securities Act of 1933 (the "1933 Act"), the Securities Exchange Act of 1934 (the "1934 Act") and other Federal Securities laws during the third quarter of 2009.

SEC Rulemaking

SEC Proposes Enhancements to Proxy Disclosure and Solicitation Rules

On July 10, 2009, the SEC proposed amendments to the proxy rules to enhance compensation and corporate governance disclosure relating to activities that materially contribute to an issuer's risk profile. **(See SEC Release Nos. 33-9052; 34-60280.)** As proposed, the amendments would enhance disclosure relating to an issuer's overall compensation policies and their impact on risk taking, stock and option awards of executives and directors, director and nominee qualifications and legal proceedings, company leadership structure, the board's role in the risk management process and potential conflicts of interest of compensation consultants that advise companies.

Compensation Discussion and Analysis Disclosure

The proposed amendments would require an issuer to discuss and analyze its broader compensation policies and overall compensation practices for employees generally, including non-executive officers, if risks arising from those compensation policies or practices may have a material effect on the issuer. Potential compensation policies and practices the SEC anticipates would require discussion and analysis include:

- A business unit of the issuer that carries a significant portion of the issuer's risk profile;
- A business unit with compensation structured significantly different than other units within the issuer;

*Member, New York Bar. Of Counsel, Olshan Grundman Frome Rosenzweig & Wolosky LLP. Associates Jason W. Soncini and Christine Wong assisted the author.

- Business units that are significantly more profitable than others within the issuer;
- Business units where the compensation expense is a significant percentage of the unit's revenues; or
- Policies that vary significantly from the overall risk and reward structure of the issuer, such as when bonuses are awarded upon accomplishment of a task, although the income and risk to the issuer from the task extend over a significantly longer period of time.

The SEC also provides examples of issues it believes issuers may need to address regarding compensation policies or practices that potentially give rise to risks that may have a material effect on the issuer. These include:

- The general design philosophy of an issuer's compensation policies for employees whose behavior would be most affected by the incentives established by the policies, as such policies relate to or affect risk taking by those employees on behalf of the issuer, and the manner of its implementation;
- The issuer's risk assessment or incentive considerations, if any, in structuring its compensation policies or in awarding and paying compensation;
- How the issuer's compensation policies relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;
- The issuer's policies regarding adjustments to its compensation policies to address changes in its risk profile;
- Material adjustments the issuer has made to its compensation policies or practices as a result of changes in its risk profile; and
- The extent to which the issuer monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees.

Summary Compensation Table

The SEC is also proposing changes to the Summary Compensation Table including rescinding the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table and corresponding footnote disclosure to the Director Compensation Table and amending Instruction 2 to the salary and bonus columns of the Summary Compensation Table to provide that issuers will not be required to report in those columns the amount of salary or bonus forgone at a named executive officer's election, and that non-cash awards received instead are reportable in the column applicable to the form of award elected.

Enhanced Director and Nominee Disclosure

The proposed amendments also include modifications to Item 401 of

Regulation S-K to require disclosure detailing, for each director and nominee for director, the particular experience, qualifications, attributes or skills that qualify that person to serve as a director and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the issuer's business and structure.

Leadership Structure and Role of an Issuer's Board's in the Risk Management Process

The SEC is proposing new disclosure to appear in an issuer's proxy and information statement relating to its leadership structure and why the issuer believes it is the best structure for it at the time of the filing. Issuers would also be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions.

Disclosure Regarding Compensation Consultants

Under the proposed amendments, if a compensation consultant or its affiliates played a role in determining or recommending the amount or form of executive or director compensation, and also provided additional services, then the issuer would be required to disclose the following:

- The nature and extent of all additional services provided to the issuer or its affiliates during the last fiscal year by the compensation consultant and any affiliates of the consultant;
- The aggregate fees paid for all additional services, and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation;
- Whether the decision to engage the compensation consultant or its affiliates for non-executive compensation services was made, recommended, subject to screening or reviewed by management; and
- Whether the board of directors or the compensation committee has approved all of these services in addition to executive compensation services.

Reporting of Voting Results on Form 8-K

Finally, the SEC is proposing requiring all issuers to disclose vote results on Form 8-K rather than on Forms 10-Q and 10-K.

SEC Proposes Rules to Prevent Pay-To-Play Activities By Investment Advisers That Seek To Manage Money For State and Local Governments

On August 3, 2009, the SEC proposed a new rule under the Investment Company Act of 1940, as amended, that would prevent the "pay to play" practices by investment advisers seeking to manage government pension funds and other programs. **(See SEC Release No. IA-2910).** Under the proposed rule, an investment adviser would be prohibited from providing advisory services for compensation to a government client for two years after the adviser or certain of its executives or employees make a contribution to certain elected officials or candidates. Additionally, investment advisers would be prohibited from providing payment to any third party for a solicitation of advisory business from any government entity on the adviser's behalf. The proposed rule would also prevent an investment adviser from soliciting or coordinating contributions to elected officials or candidates or payments to political parties where the adviser is providing or seeking government business. The SEC is also proposing rule amendments that would require a registered investment adviser to maintain certain records of the political contributions made by the adviser or certain of its executives or employees.

The proposed amendments would prohibit investment advisers from providing advice for compensation to a government entity within two years after a contribution to an official of the government entity has been made by the investment adviser or by any of its Covered Associates.[1]

The two year prohibition would be subject to two exceptions, one for *de minimis* contributions and one for certain returned contributions. As proposed, Covered Associates who are individuals would be permitted to make aggregate contributions of $250 or less, per election, to an elected official or candidate, if the person making the contribution is entitled to vote for the official or candidate. Additionally, an exception would be available in certain instances where a Covered Associate inadvertently triggered the prohibition.

SEC Proposes Amendments to Eliminate the "Flash" Order Exception

On September 18, 2009, the SEC proposed amendments to Rule 602 of Regulation NMS to eliminate the exception for the use of "flash" orders by equity and option exchanges. **(See SEC Release No. 34-60684).** Specifically the SEC is proposing to ban the use of "flash" orders on equities and options exchanges and large alternative trading systems.

Generally, exchanges are required to make their best bids and offers in U.S. listed securities available in the consolidated quotation data that is widely disseminated to the public. Currently, bids and offers communicated on an exchange that are executed immediately after communication or cancelled or withdrawn if not executed immediately after communication (i.e. "flash orders") are excluded from this requirement. This exception was originally intended to facilitate manual trading in the crowd on exchange floors by excluding quotations that were impractical to include in the consolidated quotation data.

The SEC is proposing to eliminate this exception such that "flash orders" on an exchange would need to be in the exchange's public quote.

The SEC is also proposing amending the alternative trading systems ("ATS") rules to expand the ATS requirement that if an ATS submits its quotes in an exchange traded stock where it meets a 5% volume threshold, then such quotes must be included in the consolidated quote stream order display and execution access. Specifically, the SEC is proposing applying such requirement to all orders that are immediately executed or withdrawn if not immediately executed.

Finally, the SEC is also proposing applying the restrictions on locking or crossing quotations to "flash orders." Currently national securities exchanges and associations are required to establish, maintain and enforce rules to reasonably avoid displaying locking or crossing quotations. The SEC is proposing that all orders that are immediately executed or withdrawn if not immediately executed be subject to the same locking and crossing quotation restrictions.[2]

SEC Adopts Final Rules of Regulation SHO Regarding Closing Out of Fail to Deliver Positions Resulting From Long or Short Sales

On July 27, 2009, the SEC adopted the final amendments which made permanent the interim final temporary rules of Regulation SHO adopted in October 2008. **(See Release No. 34-60388.)** The final amendments essentially adopt the interim final temporary rule regarding the close-out of fail to deliver positions resulting from long or short sales by clearing firms, subject to modifications. These modifications include:

- Providing participants with the choice to close out fail to deliver positions relating to a documented long sale by borrowing securities in addition to purchasing them;
- Requiring a broker-dealer to purchase or borrow a quantity of securities sufficient to cover the amount of that broker-dealer's fail to deliver position, rather than the amount of the broker-dealer's open short position; and
- Expanding the scope of securities that are entitled to a longer settlement period to include all securities that a person is "deemed to own" pursuant to Rule 200 of Regulation SHO and all securities that such person intends to deliver once all restrictions on that security have been removed;

The amendments became effective July 31, 2009.

SEC Proposes Amendments To Proxy Disclosure Relating to Executive Compensation For TARP Recipients

On July 1, 2009, the SEC proposed amendments to the proxy rules under the 1934 Act to set forth certain requirements for issuers that have received financial assistance under the Troubled Asset Relief Program ("TARP"). **(See Release No. 34-60218.)** Companies that have received financial assistance under the TARP are required to provide a separate shareholder advisory vote to approve the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the SEC, during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding. The proposed amendments specify and clarify such disclosure in the context of the federal proxy rules.

Specifically, the proposed amendments, among other things, clarify that the separate shareholder vote required to approve compensation would only be required on a proxy solicited for an annual (or special meeting in lieu of the annual) meeting of security holders for which proxies will be solicited for the election of directors. Additionally, under the proposed amendments issuers would be required to disclose in the proxy statement that they are providing a separate shareholder vote on executive compensation and to briefly explain the general effect of such a vote.

SEC Adopts Amendments Extending Temporary Exemptions for Eligible Credit Default Swaps to Facilitate the Operation of Central Counterparties to Clear and Settle Credit Default Swaps

On September 14, 2009, the SEC adopted amendments to the expiration dates of its interim final temporary rules that provide exemptions under the 1933 Act, the 1934 Act and the Trust Indenture Act of 1939 for certain credit default swaps in order to facilitate the operation of one or more central counterparties for those credit default swaps. **(See Release Nos. 33-9063 and 34-60663.)** Under the amendments, the expiration dates of the interim final temporary rules will be extended to November 30, 2010.

SEC Adopts Regulation S-AM Placing Limits on Affiliate Marketing

On August 4, 2009, the SEC adopted Regulation S-AM, which places limits on the use of certain information received from an affiliate to solicit a consumer for marketing purposes. **(See SEC Release No. 34-60423.)** Under Regulation S-AM, securities firms and investment companies are prohibited from using information received from an affiliate to make marketing solicitations to consumers unless the potential marketing information has been disclosed to the consumer and the consumer has been provided a reasonable opportunity to "opt-out" of receiving the marketing information and has not "opted-out."

The notice and opt-out opportunity must be clearly, conspicuously, and concisely disclosed. It must identify the affiliate providing the notice, or, if it is a joint notice, the company or group of companies providing the notice. The opportunity to opt-out must be reasonable and the method of opting-out must be reasonable and simple. After the expiration of an opt-out period, a consumer who has previously opted out cannot be solicited unless the consumer has been given a renewal notice, and reasonable opportunity to renew the opt out and the consumer does not renew the opt out.

Compliance with Regulation S-AM is mandatory as of January 1, 2010.

APPELLATE AND OTHER DECISIONS OF NOTE

Advisory Firm Not Liable for Securities Fraud in Making Recommendations

On July 14, 2009, the Second Circuit affirmed the district court's holding that an advisory firm may not be held liable for securities fraud in recommending that plaintiff invest in a fund that was allegedly part of a ponzi scheme.

Plaintiff investor alleged violations of Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder against the advisory firm and Section 20 of the 1934 Act against its managing principals as control persons in connection with their failure to learn and disclose that the fund they recommended to plaintiff was part of a ponzi scheme that later collapsed. Plaintiff alleged that defendants assured it that the fund had cleared all stages of the due diligence process and that defendants promised to continue performing due diligence on future investments.

The district court dismissed the securities claims for lack of scienter, pursuant to the Private Securities Litigation Reform Act. Specifically, the district court noted that scienter can be proven by showing reckless disregard for the truth and that defendants' failure to perform due diligence did not prove recklessness as required under Section 10(b) and Rule 10b-5 because such failure did not establish that defendants knew the fund was part of a ponzi scheme or that defendants intended to deceive plaintiff.

Applying the standard articulated in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499, 168 L. Ed. 2d 179, Fed. Sec. L. Rep. (CCH) ¶ 94335 (2007), the Second Circuit concluded that plaintiff's claims rested on whether the allegations of the complaint create a strong inference of scienter and whether an inference of scienter is at least as compelling as any opposing inference. Concluding that the answer to both questions is negative, the Court affirmed the lower court's dismissal of the action.

South Cherry Street, LLC v. Hennessee Group LLC, 573 F.3d 98 (2d Cir. 2009).

Court Upholds SEC Order that 1933 Act Registration Statement Requirement Violated

The Court of Appeals for the District of Columbia affirmed the SEC's order that a stock broker and officers of a public company engaged in a scheme to sell securities in violation of Section 5 of the 1933 Act and that plaintiffs must disgorge their profits. The remaining issue of whether the officers' failure to disclose the scheme in the company's annual report violated antifraud and reporting requirements was remanded to the SEC for further explanation.

Plaintiffs held options to buy shares of stock but such a transaction required an effective registration statement pursuant to Section 5 of the 1933 Act. A registration statement was not on file to cover an eventual exercise of the options or disposition of the underlying securities.

Several foreign entities owned shares in the public company, which were purchased and held through Regulation S and could be resold to the public. Further, these foreign entities held warrants to purchase additional shares. These warrants had not been exercised because the purchase price exceeded the market price.

Plaintiffs and the foreign entities then participated in a sale of unregistered stock whereby the foreign entities first sold their original and warrant shares to the public and then, shortly thereafter, replaced those shares with those from plaintiffs' options in a private placement. The number of shares sold by the foreign entities to the public was the same as the number of shares later sold to the foreign entities by plaintiffs, which led the SEC to conclude the transactions were a "swap."

The SEC considered these events as a single transaction and found that plaintiffs sold shares directly to the public. Therefore the SEC concluded that plaintiffs and the foreign entities acted as underwriters, as defined by the 1933 Act, when they exercised their warrants with the intention of distributing them to the public. As underwriters, plaintiffs and the foreign entities were not entitled to any exemptions for the sale of their securities. Therefore, a registration statement was required for the transaction to be legal. Further, the SEC found that the plaintiffs' sales to the foreign entities were a necessary and critical step to the distribution, not a separate transaction. Thus, the SEC concluded that the plaintiffs and their broker violated Sections 5(a) and (c) of the 1933 Act and that their failure to disclose the scheme in the annual report constituted violations of antifraud and reporting provisions.

The Circuit Court agreed with the SEC's finding that plaintiffs and the foreign entities acted as underwriters and noted that a person does "not have to be involved in the final step of the distribution to have participated in it," but rather that a person who was a "necessary participant" or "substantial factor" in a distribution is an underwriter. The Court also held that, contrary to plaintiffs' contentions, there was substantial evidence that plaintiffs knew or should have known that the foreign entities had sold their shares.

Zacharias v. S.E.C., 569 F.3d 458, Fed. Sec. L. Rep. (CCH) ¶ 95256 (D.C. Cir. 2009).

Supreme Court Denies Certiorari Petition Regarding Short Swing Trading Exemption

The Supreme Court declined to review a lower court's ruling that the SEC acted within its authority when it adopted rule changes to clarify the transactions that were exempt from short swing restrictions pursuant to Section 16(b) of the 1934 Act, as previously discussed in this Journal (*Sec. Reg. L.J.*, Vol. 37, No. 1, pp. 85-86) [Vol 37 Issue 1 *Securities Regulation Law Journal* 5 at pp. 85–86]. Section 16(b) imposes strict liability against insiders who buy and sell, or sell and buy securities at a profit within a six-month period.

Plaintiff is a shareholder who brought a derivative suit against two other shareholders for disgorgement of short swing profits. Defendants were holders of preferred stock that was reclassified as common stock as a result of an initial public offering. Defendants then sold some of the common stock at a second offering less than six months later. Plaintiff contended that the reclassification constituted a "purchase" such that defendants are subject to liability under Section 16(b) of the 1934 Act. The district court dismissed the case on the grounds that the transaction fell within an exemption to the rule. On appeal, the Third Circuit held that no exemptions applied and that it lacked guidance from the SEC. The SEC then adopted amendments to clarify the scope of certain exemptions. The amendments made clear that certain reclassifications were exempt from Section 16(b).

Following the amendments, Defendants moved for summary judgment, which the district court granted, relying upon the SEC's clarifications. The Third Circuit then affirmed the lower court's decision; and on June 22, 2009, the Supreme Court denied certiorari.

In his certiorari petition, plaintiff pointed to a Circuit split regarding the proper legal standard for determining when agency rulemaking is retroactive. Plaintiff had also unsuccessfully contended that the rule changes at issue reflected a narrow understanding of the purposes of the statute.

Levy v. Sterling Holding Co., LLC, 544 F.3d 493, Fed. Sec. L. Rep. (CCH) ¶ 94863 (3d Cir. 2008), cert. denied, 129 S. Ct. 2827, 174 L. Ed. 2d 553 (2009).

Amicus Briefs Filed in Supreme Court Over Mutual Fund Advisory Fees

On June 15, 2009, the SEC filed an amicus brief urging the Supreme Court to reverse the appeals court's affirmance (*Jones v. Harris Associates L.P.*, 537 F.3d 728 (7th Cir. 2008)) of the lower court's dismissal of an investor's claims that a mutual fund adviser received excessive compensation, as previously discussed in this Journal (*Sec. Reg. L.J.*, Vol. 37, No. 2, pp. 192-193) [Vol 37 Issue 2 *Securities Regulation Law Journal* 6 at pp. 192–193].

The SEC argued that the appeals court erred in finding (i) an investment adviser's fiduciary obligations were limited to providing a board with complete and accurate information and (ii) that the reasonableness of an advisory fee is determined by comparison with fees paid by other mutual funds. Specifically, the government pointed out that "an adviser's fee cannot automatically be declared lawful simply because it is comparable to fees paid by similar mutual funds," particularly in light of the fact that the investment adviser charged its institutional clients half of what it charged the mutual fund client.

The North American Securities Administrators Association ("NASAA") also filed an amicus brief on June 17, 2009, requesting that the Supreme Court provide a clear interpretation of Section 36(b) of the 1940 Investment Company Act.

The briefs can be found at http://www.sec.gov/litigation/briefs/2009/jones0609.pdf and http://www.nasaa.org/content/Files/Amicus_Jones.pdf.

No Breach of Fiduciary Duty Requirement in Section 10(b) Action

The Second Circuit vacated an order of the Southern District of New York on July 22, 2009, denying the SEC's request for a preliminary injunction freezing a computer hacker's trading account and remanded the case to the district court. In its ruling, the Circuit Court held that a computer hacker who used material nonpublic information to trade can be held liable for insider trading, even absent any violation of fiduciary duty in obtaining the nonpublic information.

The SEC obtained a temporary restraining order freezing the proceeds in a brokerage account after the brokerage company reported a suspicious trade. After a hearing, the district denied the request for a preliminary injunction, ruling that computer hacking was not "deceptive" within the meaning of Section 10(b) of the 1934 Act because there was no breach of fiduciary duty. The district court relied on three cases to determine that the meaning of "deceptive" under Section 10(b) included a fiduciary duty requirement.

On appeal, the Second Circuit reviewed the cases cited and held that they stand for the proposition that the deceptive requirement of Section 10(b) is met by nondisclosure if "there is a duty to speak, arising from a fiduciary relationship." Specifically, the Circuit Court noted that the three cases relied upon were fraud cases involving silence or nondisclosure. Citing an affirmative obligation not to mislead in commercial dealings, the Circuit Court held that there is no requirement of breach of fiduciary duty to establish liability under Section 10(b) in a case, such as this, which involved an affirmative misrepresentation.

S.E.C. v. Dorozhko, 574 F.3d 42, Fed. Sec. L. Rep. (CCH) ¶ 95296 (2d Cir. 2009).

No Short Swing Claim If Not an Insider as Defined in Section 16(b)

On August 19, 2009, the Ninth Circuit affirmed the lower court's decision and rejected a former InfoSpace shareholder's claim against AOL for disgorgement, finding that AOL was not an InfoSpace insider. The Court held that plaintiff attempted to disguise a claim for aiding and abetting fraud (which is barred by statutory and Supreme Court precedent) as one for short-swing profits.

AOL and InfoSpace, a web-based telephone directory, entered into an agreement for the operation of the AOL White Pages, which provided for revenue sharing. AOL agreed to suspend the revenue sharing obligations in late 1999 and formalized this suspension in 2000 when InfoSpace realized it would miss its earnings expectations. During this time, AOL sold shares of its InfoSpace stock.

Plaintiff brought this derivative action on behalf of InfoSpace against AOL alleging violations of Section 16(b) of the 1934 Act when AOL sold its InfoSpace stock. The district court granted summary judgment in favor of AOL, holding that there was no evidence that AOL was subject to short-swing profit rules. In reaching its decision, the district court noted that Section 16(b) only applies to three classes of insiders: directors, officers, and beneficial owners of more than 10% of the outstanding equity. As AOL was not a director or officer of InfoSpace, AOL was only liable if it was a beneficial owner of InfoSpace stock. In determining whether AOL was a beneficial owner and therefore an insider, the district court considered whether the parties "agreed to act together for the purpose of acquiring, holding, voting or disposing of" a firm's securities. It found in the negative.

The Ninth Circuit affirmed the lower court's decision, finding "no probative evidence" suggesting an agreement to act that would satisfy the beneficial ownership standard, which was fatal to plaintiff's Section 16(b) claim.

Dreiling v. America Online Inc., 578 F.3d 995, Fed. Sec. L. Rep. (CCH) ¶ 95331 (9th Cir. 2009).

SEC Files Amicus Brief in Mayer Brown Case

The SEC filed an amicus brief to the Second Circuit on August 7, 2009, to address the issue of liability in an investor action under Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder, brought against Mayer Brown LLP over the law firm's alleged role in the Refco fraud. The district court dismissed the action on the grounds that the law firm could not be held liable as a primary violator because none of the misstatements could be attributed to the firm and the firm was not the "maker" of the misstatements. Plaintiff investors appealed to the Second Circuit.

In its brief, the SEC argued that a party can be a primary violator by intentionally creating a misstatement as well as by attribution: "a person who, acting with the requisite scienter, creates a misstatement is a primary violator regardless of whether the victim knows of the person's identity." Such a party creates a misstatement by writing or speaking the statement, or by providing false or misleading information that is put into the statement. Further, the SEC contended that the district court's ruling "would unduly restrict private actions" by shielding "significant misconduct from liability." Finally, the SEC argued that if the Court were to find that attribution is essential for private actions, it should make clear that the requirement does not apply to government law enforcement actions.

Several law firms have since filed an opposing amicus brief, arguing that the SEC's position would create ethical conflicts for lawyers and adversely affect an attorney's ability to provide legal advice to issuers of securities.

The SEC brief can be found at http://www.scribd.com/doc/18588471/Pacific-Mgmnt-LLC-v-Mayer-Brown-LLP-8709-Amicus-Brief.

Limited Partnership Units Fall Within Definition of Securities Under Federal Law

Plaintiff Republic Property Trust, a real estate investment trust, or REIT, established several subsidiary entities, including plaintiff Republic Property Trust LP. Through these subsidiaries, the REIT acquired property and contracts in exchange for shares and/or limited partnership units. Defendant, Republic Properties Corporation, is owned and controlled by two of the same principals, also defendants, who established the REIT.

Defendant entered into a contract with the City of West Palm Beach for a real estate development. During this time, defendant also paid a city commissioner to consult on the project. While the commissioner was receiving consulting fees, he was also voting on city matters. Defendant then assigned the contract in exchange for limited partnership units. The commissioner was subsequently charged with accepting bribes, and the city then terminated its contract with defendant.

Plaintiffs sued defendant and two of its principals for violations of Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder. Specifically, plaintiffs alleged that defendants failed to disclose the consulting arrangement with the city commissioner before the contract was assigned and that such information was material. The district court dismissed the case, holding that the limited partnerships units sold were not investment contracts and therefore not securities within the definition of Section 10(b).

On August 21, 2009, the Circuit Court disagreed, finding that the units were "investment contract" securities. In reaching its decision, the Circuit Court applied the standard articulated by the Supreme Court in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244, 163 A.L.R. 1043 (1946), that an investment contract is a "contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." In reaching its decision, the Court noted that other circuits have addressed this very issue.

Defendants' argued that because the principals stood on both sides of the transaction, they could not be held liable for failing to disclose information to themselves. The Court disregarded this argument and accepted plaintiffs' argument that disregarding the formalities of corporate structure results in piercing the corporate veil and held that "having taken advantage of the corporate form to purchase the limited partnership interests, the defendants may not disregard that form to avoid liability for the same transaction."

Liberty Property Trust v. Republic Properties Corp., 577 F.3d 335,
Fed. Sec. L. Rep. (CCH) ¶ 95328 (D.C. Cir. 2009).

NOTES:

[1]As proposed, "Covered Associates" would include the investment adviser's general partners, managing members, executive officers, or other individual with a similar status or function, employees who solicits government entity clients and any PAC controlled by the investment adviser or any of its Covered Associates.

[2]A "locking" quotation has a price that equals the price of the previously displayed contra side national bid best offer. A "crossing" quotation has a price that is higher or lower than the price of the previously displayed contra side national bid best offer.