

## SEC CLARIFIES EXEMPTIONS FROM "SHORT SWING PROFIT" LIABILITY IN IPO

Steve Amen of our Omaha office writes:

The SEC intends to adopt final rules clarifying exemptions from liability for short swing profits when corporate insiders convert their preferred shares to common shares prior to an IPO and then sell those shares shortly afterwards.

Traditionally, officers, directors, and large shareholders of pre-IPO companies rely on certain exemptions which allow them to engage in this practice without incurring any short swing profit liability under Section 16(b) of the Securities Exchange Act. However, in 2002, the federal Court of Appeals for the Third Circuit (the circuit that includes Delaware) raised

questions about the applicability of these exemptions by holding that the shares issued to insiders as part of a pre-IPO reclassification were not exempt.

In *Levy v. Sterling Holding Co., LLC*, a shareholder filed a derivative action seeking to recover short swing profits realized by insiders of the company who had converted their preferred shares into common shares shortly before the IPO pursuant to a corporate reclassification. The insider defendants argued that they were exempt from such liability because they acquired and disposed of securities pursuant to exemptions provided by Rules 16b-3 and 16b-7.

The court held that Rule 16b-3 did not exempt the transaction because the stock was not issued for a compensatory purpose. The court also held that Rule 16b-7 did not apply because the insiders acquired common stock in the transaction that had different "risk characteristics" from their preferred stock and because their overall percentage ownership of the issuer increased slightly.

The SEC has long argued that the *Levy* holding misconstrued Rules

**IN THIS ISSUE:**

- SEC Clarifies Exemptions From "Short Swing Profit" Liability in IPO ..... 1
- Reminder: New Overtime Regulations Take Effect in Five Days..... 1
- Google IPO Highlights Key Issues in Stock Offerings..... 2
- Companies Change Governance to Settle Lawsuits ..... 2

16b-3 and 16b-7 and proposed the amendments in June to clarify the uncertainty created by *Levy*. Accordingly, the proposed amendment to Rule 16b-3 clarifies that a "compensatory purpose" is not necessary to use the exemption under that rule. Likewise, Rule 16b-7 as amended would provide that its exemption applies to any merger, consolidation or reclassification meeting the stated conditions of the rule, but that no other conditions need be satisfied.

**Section 16 remains one of the more complex provisions of the federal securities laws. Insiders should always consider the "short swing profit" rule when buying or selling shares of their company's stock. ■**

**SEC RULES GENERALLY REQUIRE INSIDERS TO DISGORGE ANY PROFIT, ALSO KNOWN AS "SHORT SWING PROFIT," ARISING FROM BUYING AND SELLING COMPANY STOCK WITHIN 6 MONTHS OF EACH OTHER**

## REMINDER: NEW OVERTIME REGULATIONS TAKE EFFECT IN FIVE DAYS

On Monday, August 23rd, new overtime rules promulgated by the Department of Labor will come into effect. Designed to be a complete overhaul of the existing overtime rules, the new regulations are intended to broaden those classes of employees eligible for overtime compensation as well as providing clarifications as to specific jobs and their eligibility status.

Despite their intention to make more workers eligible for overtime pay, critics of the new regulations claim that they could result in millions of workers losing existing overtime pay. For a more detailed analysis of these regulations and how they may affect your business, please go to <http://www.kutakrock.com/publication/employmentlaw/FLSA%20newsletter-online.pdf>. ■



Image: budgetstockphoto.com

## **GOOGLE IPO HIGHLIGHTS KEY ISSUES IN STOCK OFFERINGS**

Google, Inc.'s \$1.8 billion initial public offering (IPO), adjusted downward today from \$3.5 billion, highlights three issues that companies should consider in any stock transaction.

- **Dutch Auction vs. Regular Offering** Companies usually set the offering price for their stock. Because Google is using the "Dutch auction" process, investors will help set the price. Investors are allowed to bid for shares within a price range set by Google and then Google selects the specific price that will best allow it to sell its desired number of shares. As of this morning, the expected price range was between \$85-\$95 per share.
- **Stock Buybacks vs. No Stock Activity** During the offering, Google offered to buy back shares it issued earlier but

neglected to first register with the SEC. Because this buyback (or "rescission offering") occurred in the middle of a public offering, Google was subject to the SEC rule that usually prohibits a company from offering to purchase the same kinds of shares that it is trying to sell. While the rule is intended to prevent price manipulation and the creation of an artificial trading market for the stock being offered, the SEC has previously allowed other companies to repurchase stock during an offering with certain restrictions, such as not paying more than the original price for the shares, plus interest, even if it is less than the current market price.

- **Honoring the "Quiet Period"** Finally, on Monday morning, Google had to file another disclosure document with the

SEC to explain the statements made by its top two officers in a magazine interview published just a few days before the stock offering was expected to close. Generally, officers do not give public statements during the "quiet period" of an offering but instead refer persons to the prospectus for the offering. A "quiet period" usually extends from the date that the company files its registration statement with the SEC to the date of closing.

Today, the SEC allowed Google to proceed with its IPO.

**The Google IPO highlights a different way to offer stock and also serves as a reminder of the importance of compliance with the federal securities laws, especially in a public offering. ▢**

## **COMPANIES CHANGE GOVERNANCE TO SETTLE LAWSUITS**

In addition to seeking money settlements, shareholders are also using lawsuits to reform corporate governance of defendant companies. Two recent settlements illustrate corporate governance changes consented to by companies in resolving these disputes.

Broadcom Corporation recently settled a shareholder lawsuit, without admitting liability, in which shareholders asserted that it issued materially misleading information. While Broadcom shareholders received no money in the settlement, the company has consented to several corporate governance changes. Among others things, Broadcom will provide shareholders the right to nominate at least one

candidate for the board of directors, strengthen independence standards, and increase the power of independent directors.

In another recent case, Applied Micro Circuits Corp. consented to increasing the presence and authority of independent directors settling a shareholders derivative case. Applied Micro's board of directors will now consist of two-thirds independent directors and the positions of chairman and chief executive officer will be split between two people.

**As a part of any shareholder lawsuit against a company, directors and officers should expect an increased emphasis on corporate governance changes. ▢**

**Kutak Rock LLP is a national law firm with 16 offices located throughout the US. Our practice areas include:**

- **Corporate Law**
- **Banking and Federal Securities Law**
- **Mergers and Acquisitions**
- **Bankruptcy and Creditor's Rights**
- **Executive Compensation**
- **Commercial Litigation**

**Please visit our website  
[www.kutakrock.com](http://www.kutakrock.com)  
to learn more or contact:**

**Paul Borja ..... 202-828-2310  
[paul.borja@kutakrock.com](mailto:paul.borja@kutakrock.com)**

**Stephen Candelmo .. 202-828-2413  
[stephen.candelmo@kutakrock.com](mailto:stephen.candelmo@kutakrock.com)**

**Jeremy Johnson ..... 202-828-2463  
[jeremy.johnson@kutakrock.com](mailto:jeremy.johnson@kutakrock.com)**