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CORPORATE & FINANCIAL
WEEKLY DIGEST

May 3, 2013

DERIVATIVES

SEC Issues Proposal Regarding Cross-Border Security-Based Swap Activities

On May 1, the Securities and Exchange Commission proposed rules and interpretive guidance with respect to cross-border security-based swap activities. Under this proposal, the requirements of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act would generally apply to any security-based swap transaction entered into with a US person or otherwise conducted within the United States. For this purpose, a US person would include natural persons residing in the United States, entities organized or incorporated or having their principal place of business in the United States and accounts of US persons. Further, a transaction would be conducted in the United States if it is solicited, negotiated, executed or booked within the United States, regardless of the location of the counterparties to the transaction.

The proposal also provides a "substituted compliance" regime under which market participants may, under certain circumstances, comply with foreign regulatory requirements in lieu of complying with comparable Title VII requirements. Under this regime, a foreign market participant would be permitted to comply with its home country regulatory requirements so long as the SEC has determined that such requirements are broadly similar to those of Title VII. The SEC has indicated that it will make this determination by assessing whether a foreign regulatory scheme is comparable to the regulatory scheme set forth in Title VII in any of the following categories: (i) security-based swap dealer registration; (ii) security-based swap data reporting; (iii) mandatory clearing of security-based swaps and (iv) mandatory execution of security-based swaps on certain trading venues. The SEC would make such determination based on a holistic approach that compares regulatory outcomes rather than by making rule-by-rule comparisons.

Under the proposal, foreign market participants that may be security-based swap dealers would only be required to assess their swap dealing activities conducted with US persons or within the United States for purposes of determining whether they exceed the *de minimis* registration threshold. The same principle applies to foreign persons that may be major security-based swap participants, except that they would also be required to take into consideration their transactions with foreign persons guaranteed by US persons when making this determination. Foreign security-based swap dealers and major security-based swap participants would be required to comply with entity-level requirements under Title VII or a substituted compliance regime, whereas such entities would generally be required to comply with transaction-level requirements only with respect to their US business or transactions with US counterparties.

The proposal would provide a rule and interpretive guidance regarding when entities that perform infrastructure functions, such as swap execution facilities and swap data repositories, would be required to register with the SEC, and generally takes a territorial approach with respect to this matter. Thus, for example, a swap execution facility may be required to register as such in the United States if it provides US persons or non-US persons located in the United States with the direct ability to trade or execute security-based swaps on the foreign security-based swap market. The proposal also provides that infrastructure entities may be exempt from such registration if they are subject to comparable regulation in their home countries.

The full text of the SEC proposed rules and interpretive guidance is available here.

CFTC

CFTC Staff Issues No-Action Letters

Commodity Futures Trading Commission staff recently released two no-action letters providing relief relating to the application of business conduct standards to prime brokers and swap dealers and disclosure of pre-trade mid-market mark with respect to certain transactions.

- **Business Conduct Standards**: In CFTC Letter No. 13-11, the Division of Swap Dealer and Intermediary Oversight (DSIO) granted time-limited no-action relief for failure to comply with the CFTC's external business conduct rules (CFTC Regulations 23.400-23.451), which became effective on May 1. The no-action relief, which expires on May 15, 2013, is available solely to prime brokers and executing dealers that are swap dealers (SDs) and that enter into prime brokerage agreements to trade either (1) swaps that are not required to be cleared under Section 2(h)(1)(A) of the Commodity Exchange Act or (2) physically settled foreign exchange forwards and swap agreements. Such entities may continue to claim this no-action relief after May 15 if certain conditions are met, including a condition that all of the external business conduct obligations required by the new regulations be allocated between the prime broker and executing dealer, resulting in no unaccounted-for required business conduct obligations.

  Industry groups are working to develop guidelines to help prime brokers and executing dealers with the allocation of business conduct obligations for such parties to use in satisfying the conditions of this no-action letter.

  CFTC Letter No. 13-11 is available here.

- **Disclosure of Pre-Trade Mid-Market Mark**: In CFTC Letter No. 13-12, the DSIO granted no-action relief that allows an SD or a major swap participant (MSP) to enter into certain transactions without disclosing a pre-trade mid-market mark (PTM) to the other non-SD or non-MSP counterparty to the transaction, as otherwise required by CFTC Regulation 23.431(a)(3)(i). To qualify for relief under this no-action letter, such non-SD or non-MSP counterparty must, among other things, agree in writing in advance of the trade to waive the PTM disclosure requirement and the transaction must be either (a) a foreign exchange swap or forward that is physically settled, in a major currency with a maturity of one year or less, or (b) a vanilla foreign exchange option that is physically settled, in a major currency with a maturity or six months or less. This letter also extends no-action relief to SDs or MSPs for failure to comply with Regulation 23.431(a) and (b) relating to certain required disclosures in connection with an exempt foreign exchange transaction, so long as, among other things, the transaction is initiated on an electronic trading platform and the SD or MSP does not know the identity of its counterparty to the transaction.

  CFTC Letter No. 13-12 is available here.

LITIGATION

Delaware Court Dismisses Securities Fraud Action Against Power Plant Executives

The US District Court for the District of Delaware dismissed a class action for securities fraud against former officers and directors of a geothermal energy company, in which the plaintiffs alleged that the defendants had misrepresented the capacity of a prominent power plant and their ability to construct more plants. In 2008, the energy company completed construction of a geothermal plant and touted the plant in 2009 as an example of their "rapid deployment business model." In late 2009, the company disclosed in public filings that it had encountered unexpected difficulties in developing the plant to full capacity and, in 2010, sought to recognize an impairment loss of $52.5 million to the value of the plant. The court dismissed the complaint for failure to plead scienter and loss causation, rejecting the argument that the energy company had committed securities fraud by waiting too long to record or report the loss incurred after learning of problems at the plant. The court also refused to adopt the "materialization of risk" test for loss causation, which would allow a plaintiff to plead loss causation by showing that the defendant exposed investors to an undisclosed risk which subsequently materialized. Instead, the court held that the absence of any allegation of a corrective disclosure automatically warranted dismissal.

Bartesch v. Cook, No. 11-1173-RGA (D. Del. Apr. 23, 2013).

Gaming Company's Regulatory Delays Insufficient to Give Rise to a Securities Fraud Claim

The US District Court for the Northern District of Illinois dismissed securities fraud claims against WMS Industries (WMS), a gaming and slot machine manufacturer, and certain of its executives, holding that a would-be class representative failed to plead with the heightened requirements prescribed by the Private Securities Litigation Reform Act. WMS issued guidance predicting growth in earnings and margins in fiscal year 2011, despite sluggish sales in the industry. The growth was based on development of a new product named "WAGE-NET," as well as an effort to implement operational improvements to WMS's quarter-end sales. However, WAGE-NET received only limited regulatory approval, ultimately did not launch, and the operational efforts were not undertaken. The court dismissed the proposed class action with prejudice, finding that the plaintiff had failed to demonstrate with sufficient particularity that anticipated launch statements regarding "WAGE-NET" and operational improvements were false at the time they were made. The court also held that the plaintiff had not pleaded scienter with the requisite particularity, holding that the unobtained regulatory approval for WAGE-NET, lack of field trials, new products that did not launch and operational improvements that were not implemented, absent more particularized facts, did not warrant the scienter inference urged by the plaintiff.

Conlee v. WMS Industries, Inc., No. 11C 3503 (N.D. Ill. Apr. 24, 2013).

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