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Please note that *Corporate and Financial Weekly Digest* will not be published on December 24 or 31. The next issue will be distributed on January 7.

SEC/CORPORATE

SEC Issues Proposed Rules Regarding Conflict Minerals Disclosure

On December 15, the Securities and Exchange Commission issued proposed rules implementing disclosure and reporting requirements regarding the use by issuers of conflict minerals from the Democratic Republic of the Congo and adjoining countries (DRC countries) added as Section 13(p) to the Securities Exchange Act of 1934 by Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 1502(e)(4) of the Dodd-Frank Act defines "conflict mineral" as cassiterite, columbite-tantalite, gold, wolframite, or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the DRC countries. The proposed rules are expected to apply to many more issuers than might have first been expected due to the various uses of conflict minerals and their derivatives and the SEC's broad definition of "manufacture."

The proposed rules would apply to issuers who file reports with the SEC under Sections 13(a) or 15(d) of the Exchange Act and for which conflict minerals are "necessary to the functionality or production of a product manufactured" or contracted to be manufactured by that issuer. The proposed rules would apply to domestic companies, foreign private issuers and smaller reporting companies. If an issuer determines it does not utilize conflict minerals or their derivatives in any production or manufacturing process (which includes components used in assembling a product as well as products manufactured for the issuer under contract), that issuer would not be required to take any action or make any disclosures with respect to conflict minerals.

Issuers that do utilize conflict minerals would be required to determine, after a reasonable country of origin inquiry, whether their conflict minerals originated in the DRC countries. The proposed rules do not provide any guidance as to what constitutes a reasonable country of origin inquiry by an issuer and rely on the issuer to undertake a "reasonable inquiry" at its discretion. If the issuer determines that its conflict minerals did not originate in the DRC countries, the issuer would disclose this determination and the reasonable country of origin inquiry it used in reaching this determination in the body of its annual report on Form 10-K, Form 20-F or Form 40-F, as applicable, under a separate heading entitled "Conflict Minerals Disclosure." The issuer also would be required to make available this disclosure on its website, disclose in its annual report that the disclosure is posted on its website, disclose the Internet address on which this disclosure is posted and maintain records demonstrating that its conflict minerals did not originate in the DRC countries.

If the issuer determines that its conflict minerals did originate in the DRC countries, or if it is unable to conclude that its conflict minerals did not originate in the DRC countries, the issuer would disclose this conclusion in its annual report on Form 10-K and furnish a Conflict Minerals Report as an exhibit to its annual report. The Conflict Minerals Report would be required to provide, among other information, a description (1) of the measures the issuer had taken to exercise due diligence on the source and chain of custody of its conflict minerals which shall include a certified independent private sector audit of its Conflict Minerals Report as well as the identity of the auditor and (2) of any of the issuer's products that contain conflict minerals that it is unable to determine did not "directly or indirectly finance or benefit armed groups" in the DRC countries. "Armed groups" is defined in Section

1502(e)(3) of the Dodd-Frank Act. The issuer would identify such products by describing them as not "DRC conflict free." If any of its products contain conflict minerals that do not "directly or indirectly finance or benefit" these armed groups, the issuer may describe such products as "DRC conflict free." The issuer also would be required to make its Conflict Minerals Report available to the public on its website and disclose in its annual report on Form 10-K that the Conflict Minerals Report is posted on its website and the Internet address on which the Conflict Minerals Report is posted.

Section 1502 of the Dodd-Frank Act requires issuers to provide their initial conflict minerals disclosure and, if necessary, their initial Conflict Minerals Report after their first full fiscal year following the promulgation of the final rules. Assuming the SEC adopts final rules in April 2011, as required by Section 1502 of the Dodd-Frank Act, a December 31 fiscal year-end issuer would first have to provide conflict minerals disclosure or a Conflict Minerals Report after the end of its December 31, 2012, fiscal year.

Comments on the proposed rules should be submitted to the SEC on or before January 31.

Read more.

CFTC

CFTC Publishes Seventh Series of Dodd-Frank Rules

The Commodity Futures Trading Commission has published its seventh series of rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The latest round of CFTC rules and rule proposals relates to an "end user" exception from otherwise-mandatory swap clearing requirements; governance requirements for derivatives clearing organizations (DCOs), designated contract markets (DCMs) and swap execution facilities (SEFs); the reporting of swaps entered into after the enactment of Dodd-Frank but before the effectiveness of the CFTC's swap recordkeeping rules; and business conduct standards for swap dealers (SDs) and major swap participants (MSPs).

- *"End-User" Swap Clearing Exemption*: The CFTC has proposed to implement the "end-user" clearing exemption set out in Section 2(h)(7) of the Commodity Exchange Act (CEA), as amended by the Dodd-Frank Act. As amended, the CEA provides an elective exemption from mandatory clearing for swaps where (1) at least one party to the swap is not a "financial entity" (a category which includes SDs, MSPs, commodity pools, private funds and banking entities, among others), (2) such party is using the swap to hedge or mitigate commercial risk, and (3) a notice is provided regarding how such party meets its financial obligations associated with entering into non-cleared swaps. Under the CFTC's proposed rule, "hedging or mitigating commercial risk" would be defined in substantially the same manner as in the CFTC's recently proposed definition of "major swap participant," and would include "bona fide hedging" positions under CFTC rules, positions that qualify for hedging treatment under Financial Accounting Standards Board standards, and certain other positions that reduce commercial risks of the end-user. Swap positions that are held for speculative, investing or trading purposes, or which are used to hedge or mitigate the risk of another swap position (unless such other swap falls within the definition of hedging or mitigating commercial risk) would not be eligible for the exemption. Under the CFTC proposal, the required notice must be provided through a swap data repository (if available) and include information about the methods used by the end-user to mitigate counterparty credit risk and certain other information.

  The CFTC has requested comment as to whether certain small banks, savings associations, farm credit system institutions and credit unions should be allowed to rely upon the end-user exemption, as well as other aspects of the proposed rule.

- *Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets and Swap Execution Facilities*: The CFTC is also proposing new rules to implement the governance standards for DCOs, DCMs and SEFs required by the CEA as amended by Dodd-Frank Act Sections 725(c), 735(b) and 733. The proposed rules include requirements that:

  1) each publicly traded DCM evaluate the breadth and cultural diversity of its board of directors;
  2) non-member market participants agree to become subject to the jurisdiction of the DCM;
  3) each DCO report to the CFTC when its board rejects a recommendation or supersedes an action of its risk management committee, and each DCM or SEF report to the CFTC when its board

rejects a recommendation or supersedes an action of its regulatory oversight committee or the membership or participation committee;

4) each DCO establish governance arrangements that permit the consideration of the views of owners and participants, and each DCM institute a process for considering the opinions of market participants with respect to (i) the functioning of an existing market and (ii) new rules or rule amendments;
5) each DCO or DCM specify and enforce minimum fitness standards for its members, directors, members of any disciplinary panel or disciplinary committee, certain affiliates, and any persons with direct access to a DCM, and annually verify to the CFTC compliance with such standards;
6) the regulatory oversight committee of each DCM or SEF prepare an annual report assessing its regulatory program and make such report available to the CFTC;
7) each DCO, DCM or SEF implement a regulatory program to identify and address existing and potential conflicts of interest;
8) each DCO, DCM or SEF establish limits on the use or disclosure of non-public information by owners, members of the board, members of any committee, officers or other employees;
9) each DCO, DCM or SEF make certain information on governance arrangements available to the public and relevant authorities, including summaries of significant decisions;
10) each DCO, DCM or SEF submit to the CFTC information concerning its board members, including the basis on which a board member is determined to qualify as a "public director" or a "customer representative"; and
11) each DCO, DCM or SEF make publicly available certain governance information, including information relating to access, membership and disciplinary procedures.

Additionally, the CFTC is now proposing to require each DCO to have 10% customer representation on its board. The CFTC formerly proposed requiring each DCO to have customer representation only on a DCO's risk management committee (or a risk management subcommittee), but has since revised its position. In connection with the new proposal, the CFTC is seeking comment on the implications of requiring 10% customer representation on a DCO's board and whether the requirement would be more appropriate at the risk management committee level.

- *Reporting Certain Post-Enactment Swap Transactions*: Section 723 of the Dodd-Frank Act requires that "transition swaps" be reported to the CFTC or a registered swap data repository within certain time periods. The CFTC has published an interim final rule (1) identifying a reporting timetable in accordance with the foregoing requirement, (2) defining the term "transition swap", and (3) establishing requirements for the preservation of information by counterparties to transition swaps. A "transition swap" is a swap executed on or after the date of enactment of the Dodd-Frank Act and prior to the effective date of the CFTC's swap data recordkeeping and reporting rules. The interim final rule provides that transition swap data must be reported within 90 days after July 15, 2011, "or such other time after entering into the swap as the [CFTC] may prescribe by rule." In accordance with this reporting requirement, the interim final rule requires counterparties to a transition swap to retain all documents and information relating to the terms of the transaction. The interim final rule is effective immediately and will remain in effect until the CFTC implements final recordkeeping and reporting requirements. The CFTC is requesting comment on various issues related to the requirements of Section 723 of the Dodd-Frank Act and the interim final rule. Comments are due within 30 days from the date the release is published in the *Federal Register*.

- *Business Conduct Standards for Swap Dealers and Major Swap Participants*: The Dodd-Frank Act provides the CFTC with authority to implement business conduct standards for SDs and MSPs in their dealings with counterparties, including "Special Entities" (i.e., any federal agency, state, state agency, county, city, municipality or other political subdivision of a state, employee benefits plan or government plan under the Employee Retirement Income Security Act of 1974 or endowment). The CFTC has proposed rules that would impose certain requirements and duties on SDs and MSPs with respect to counterparties, including the following:

  1) SDs and MSPs would be prohibited from engaging in "fraudulent, deceptive and manipulative acts and practices," including front running or trading ahead of counterparty swap transactions, and are required to handle counterparty data in a confidential manner (similar to rules applicable to futures commission merchants and introducing brokers).

2) SDs and MSPs would have a number of duties to counterparties including, among other things, the duty to verify that the counterparty meets the eligibility standards for an eligible contract participant in order to enter into swaps transactions (unless the SD or MSP does not know the identity of the counterparty), and to disclose material risks (including sufficient information to enable a counterparty to assess such risks), incentives, conflicts of interest (e.g., compensation the SD or MSP receives from any third party in connection with the swap) and characteristics (e.g., material terms of the swap). SDs and MSPs would also have a duty to communicate in a fair and balanced manner with counterparties, based on "principles of fair dealing and good faith." Further, the CFTC is proposing to impose an "institutional suitability obligation" on SDs and MSPs, "modeled, in part, on existing obligations for banks and broker-dealers dealing with institutional clients," triggered anytime an SD or MSP makes a tailored recommendation to a counterparty regarding a particular swap transaction or trading strategy.
3) Any SD or MSP that "acts as an advisor to a Special Entity" (including recommending a swap transaction or trading strategy involving swaps, but not including providing swap terms in response to a competitive bid request by a Special Entity) must act in the "best interests" of such Special Entity.
4) Before acting as a counterparty to a Special Entity, SDs and MSPs must have a reasonable basis to believe that such Special Entity has an independent representative that, among other things, is sufficiently knowledgeable to evaluate the transaction and risks, and acts in the best interests of the Special Entity.
5) SDs and MSPs that have made political contributions to officials of a "municipal entity" are prohibited from entering into swaps with such municipal entity. This proposal is intended to create consistency with "pay-to-play" prohibitions under federal securities laws.

   The proposal provides that, in connection with these requirements and duties, SDs and MSPs would be permitted to reasonably rely on counterparties' representations. Any such representations and any disclosure obligations of SDs and MSPs could be set forth in a master agreement between the parties and deemed renewed at the time of each swap transaction entered into by the parties. The CFTC has requested comment on numerous issues, both general and specific, in connection with these rule proposals.

Unless otherwise noted, the comment periods for these proposals will expire 60 days from the dates of their respective publications in the *Federal Register*. Information regarding all of the CFTC proposals, including the text of the CFTC releases, fact sheets and Q&As, can be found here.

LITIGATION

Start-Up Company Fails to Recover Profits

A federal court in New York recently ruled that a start-up mineral water company had no recourse to the "wrongdoer rule," which permits a complainant to recover damages in a breach of contract action even if the amount of damages is uncertain, because the company did not have sufficient proof that it suffered any damages at all.

Ho Myung Moolsan, Co. Ltd., a Korean-based seller of mineral water, sought $133 million in lost profits based on an alleged breach of contract by supplier Manitou Mineral Water, Inc.. Before trial, Manitou sought to exclude Moolsan's expert's report, on which Moolsan's claim for lost profits was based, because the report was predicated on speculation regarding Moolsan's future earnings and did not reference any actual sales data. Moolsan argued that experts are permitted to rely on assumptions when reaching their conclusions and that under New York's "wrongdoer rule," Manitou—as the alleged breaching party—had the burden of refuting Moolsan's estimated losses.

The U.S. District Court for the Southern District of New York excluded the report, holding that the report did not meet the demanding evidentiary requirements for new ventures seeking to recover lost profits. The court also held that the burden-shifting provisions of the "wrongdoer rule" did not apply. As the court noted, the "wrongdoer rule" only comes into play when the plaintiff has established the existence of damages, but the specific amount of those damages is uncertain. The rule was not applicable in this case because Moolsan was not merely unable to quantify its damages, but had not established with a high level of certainty that it had suffered any damages at all. (*Ho Myung Moolsan, Co. Ltd. v. Manitou Mineral Water, Inc.*, 2010 WL 4892646 (S.D.N.Y. Dec. 2, 2010))

Fiduciary Duty Claim Survives Against Non-Officer

A federal court in Kentucky recently ruled that a former manager at a medical device manufacturer could be liable for breach of fiduciary duty for planning to start a rival business while working at the company despite not serving as either an officer or director of the firm.

FBK Partners, Inc., a manufacturer of medical tubing, changed ownership and saw two high-ranking employees depart to start a rival business. FBK sued the former employees for breach of fiduciary duty for, among other things, allegedly planning to launch their company while working at FBK and for recruiting other FBK employees.

One of the former employees, who had been a plant manager and machine operator at FBK, sought dismissal of the breach of fiduciary duty claim, arguing that he did not owe FBK any fiduciary duties because he was neither an officer nor director. The U.S. District Court of the Eastern District of Kentucky held that while officers and directors are presumed to owe their companies fiduciary duties, other employees can owe fiduciary obligations if sufficient trust or confidence with respect to the particular matter is placed in the employee. To determine if such trust or confidence has been placed in an employee, a court will look to the specific factual circumstances to determine if, for example, the employee had "oversight and control over office operations and access to confidential information" or "acted as a face for the company in public." Because the specific nature of the former employee's duties was not clearly established in the record, the court denied the employee's motion for summary judgment dismissing the breach of fiduciary duty claim. (*FBK Partners, Inc. v. Thomas,* 2010 WL 4940056 (E.D. Ky. Nov. 30, 2010))

BANKING

Banking Agencies Expand Scope of Community Reinvestment Act Regulations

On December 15, the federal bank and thrift regulatory agencies announced changes to Community Reinvestment Act (CRA) regulations to support stabilization of communities affected by high foreclosure levels. The CRA requires the federal banking and thrift regulatory agencies to assess the record of each insured depository institution in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution, and to take that record into account when the agency evaluates an application by the institution for a deposit facility.

The final rule is substantially the same as the proposal published for comment on June 24. It encourages depository institutions to support eligible development activities in areas designated under the Neighborhood Stabilization Program (NSP) administered by the U.S. Department of Housing and Urban Development (HUD). Under the NSP, HUD has provided funds to state and local governments and nonprofit organizations for the purchase and redevelopment of abandoned and foreclosed properties. The new rule encourages depository institutions to make loans and investments, and provide services to support NSP activities in areas with HUD-approved plans. In this respect, the agencies are revising the term "community development" to include loans, investments and services by financial institutions that support, enable or facilitate projects or activities that meet the "eligible uses" criteria described in Section 2301(c) of the Housing and Economic Recovery Act of 2008, as amended, and are conducted in designated target areas identified in plans approved by the HUD under the NSP. The final rule provides favorable CRA consideration of such activities that, pursuant to the requirements of the program, benefit low-, moderate- and middle-income individuals and geographies in NSP target areas designated as "areas of greatest need." Covered activities are considered both within an institution's assessment area(s) and outside of its assessment area(s), as long as the institution has adequately addressed the community development needs of its assessment area(s). Favorable consideration under the revised rule will be available until no later than two years after the last date appropriated funds for the program are required to be spent by the grantees. The agencies believe that allowing banking institutions to receive CRA consideration for NSP-eligible activities in additional NSP-targeted areas serves the purposes of the CRA and creates an opportunity to build upon government programs in areas with high rates of foreclosure and vacancy. CRA consideration is not limited to activities actually receiving NSP funds, and may include other eligible activities in NSP plan areas.

The final rule will be effective 30 days from the date of its publication in the *Federal Register*, which is expected shortly.

Read more.

FDIC Board Sets a Two Percent Designated Reserve Ratio

On December 15, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted on a final rule to set the insurance fund's designated reserve ratio (DRR) at 2% of estimated insured deposits. The Dodd-Frank Wall Street Reform and Consumer Protection Act set a minimum DRR of 1.35% and left unchanged the requirement that the FDIC Board set a DRR annually. The Board must set the DRR according to the following factors: risk of loss to the insurance fund, economic conditions affecting the banking industry, preventing sharp swings in the assessment rates, and any other factors it deems important.

FDIC Chairman Sheila Bair stated, "Given previous statutory limitations on the ability of the FDIC to build reserves in excess of 1.25%, our resources heading into the financial crisis were woefully inadequate. This new rule will allow us to better prepare for the future. It will also give the industry greater certainty around the premium structure. While the 2% designated reserve ratio established by the board is higher, the trade-off will be lower, more predictable premiums over time. By building higher reserves during the good times, we will significantly reduce the risk of pro-cyclical assessments when the inevitable next downturn occurs."

However, the FDIC in the final rule made it clear that it "views the 2% DRR as a long-range, minimum target."

Read more.

UK DEVELOPMENTS

FSA Chief Executive Gives Speech on Financial Services Reform

On December 13, Hector Sants, Chief Executive of the UK Financial Services Authority (FSA), gave a speech setting out the progress made toward the bodies that will replace the FSA: the Prudential Regulation Authority (PRA) and the Consumer Protection and Markets Authority (CPMA).

Key points covered by the speech include:

- The PRA is to design a risk model to assist with financial stability damage control in the event that a firm fails.
- The CPMA will be given greater powers of intervention than those currently available to the FSA. This will allow the CPMA and the PRA to intervene earlier than the FSA does at present.
- A review of FSA rules will take place, with a view to slimming down prudential rules. While CPMA rules will focus on guidance and principles, there will be a shift to prescriptive requirements.
- The FSA's approach to wholesale conduct will be reviewed, and regulation will be developed where market discipline has proved ineffective.
- The FSA and Bank of England envisage that a high-level memorandum of understanding, with detailed annexes, will be essential to ensure effective coordination between the CPMA and the PRA.
- In April 2011, the FSA will replace its current risk and supervision business units with a prudential business unit and a consumer business unit.

To read the speech in full, click here.

FSA Issues Two Final Notices for Market Abuse

On December 14, the UK Financial Services Authority (FSA) published two final notices imposing fines and prohibition orders on two former employees of Pacific Continental Securities (UK) Limited (PCS). The notices follow a decision by the FSA that William James Coppin and Perry John Bliss contravened Sections 118(3) (improper disclosure) and 123(1)(b) (encouraging another person to engage in behavior which, if engaged in by himself, would amount to market abuse) of the Financial Services and Markets Act 2000.

The two former stockbrokers had used inside information relating to the Alternative Investment Market company Provexis plc to encourage clients to buy its shares. The information, detailing a collaboration agreement made between Provexis and a major food company (which was not named) was emailed to them in the form of an unapproved sales script. Despite the PCS compliance team circulating notices warning against mentioning an agreement made by Provexis during sales calls, Mr. Coppin and Mr. Bliss continued to make such calls to clients.

This amounted to market abuse. As a result of these calls, a number of agreements were made for clients of PCS to buy Provexis shares. Three days later, Provexis announced a collaboration with Unilever.

Mr. Coppin and Mr. Bliss were respectively fined £70,000 (approximately $109,300) and £30,000 (approximately $46,800) (reduced from £60,000 due to Mr. Bliss's financial circumstances).

To read more, click here.

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