

## CORPORATE & FINANCIAL

### WEEKLY DIGEST

March 11, 2011

#### SEC/CORPORATE

##### SEC Division of Corporation Finance Issues Nine New C&DIs

On March 4, the Securities and Exchange Commission's Division of Corporation Finance issued Compliance and Disclosure Interpretations (C&DIs) with respect to several topics under the Securities Act of 1933 and the Securities Exchange Act of 1934.

[C&DI 139.32](#) states that if an Exchange Act reporting company is conducting an exempt offering pursuant to Regulation S and Rule 144A under the Securities Act and includes material non-public information in the offering memorandum, it should not file the complete offering memorandum under Item 7.01 of Form 8-K to satisfy its obligations under Regulation FD. Because the public filing of the offering memorandum is likely to be inconsistent with the offering exemptions, the company could file a Form 8-K that sets forth only the material non-public information included in the offering memorandum along with no more information about the offering than is permitted to be disclosed in accordance with Securities Act Rule 135c.

[C&DI 132.18](#) states that for purposes of Securities Act Rule 144(d)(i), when an investor purchases in a private placement mandatorily exchangeable notes that can be exchanged for a fixed number of shares of common stock of a company that is an affiliate of the issuer, there is deemed to be a concurrent private placement of the affiliated company's common stock, and the investor's holding period for such common stock is deemed to begin on the date of the purchase of the notes. But, if the notes include a provision allowing for the exchange to occur at the investor's option and the investor exercises that option, the Rule 144(d)(i) holding period for such common stock would begin on the date of the exchange. However, if the notes contain such an investor option but the exchange occurs for a reason other than the investor's decision, the Rule 144(d)(i) holding period will be deemed to have begun on the date the investor first purchased the notes.

[C&DI 136.09](#) clarifies that for purposes of Securities Act Rule 144(h), a Form 144 should be transmitted to the SEC on the same day as the placing of a sale order or the execution of the sale.

[C&DI 228.03](#) states that a primary shelf registration-eligible issuer that is not a Well-Known Seasoned Issuer may not register for resale unspecified common shares and then, following the effectiveness of the registration statement, specify the common shares registered. The transaction under which the common shares were initially sold by the company must be completed and the registration statement must identify the initial transaction.

[C&DI 232.13](#) clarifies that the Securities Act Rule 433(f)(2)(i) exemption from filing a Free Writing Prospectus is only available with respect to materials that have been previously *filed* with the SEC. Materials that were *furnished* with the SEC (e.g. under Items 2.02 or 7.01 of Form 8-K) do not satisfy this requirement and accordingly Rule 433(f)(2)(i) is unavailable with respect to such filings.

[C&DI 232.14](#) states that an issuer is not required to file (1) a package of written materials provided in connection with an interview of an officer with unaffiliated and uncompensated media or (2) the media publication containing such interview as a Free Writing Prospectus under Securities Act Rule 433(f)(2)(i) if the written materials provided by such officer include only information that has previously been filed with the SEC.

[C&DI 116.08](#) states that if certain director information under Regulation S-K Items 401(a) and 401(e) is omitted from a proxy statement as permitted by Instruction 3 of Item 401(a), such information is nevertheless required to be included in Part III of an issuer's Form 10-K that otherwise incorporates information from the proxy statement.

[C&DI 116.09](#) states that when a director is appointed to a company's board by the holders of a class of preferred stock, the company must provide the same business qualification disclosure required under Item 401(e) of Regulation S-K about that director as it would other directors nominated by the board or provide Item 401(e) disclosure for such director that is provided by such preferred stockholders.

[C&DI 118.07](#) states that although Instruction 2 to Item 402(b) of Regulation S-K provides that Compensation Discussion and Analysis should cover actions taken with regard to executive compensation after the issuer's last fiscal year end, such requirement only applies to information that could affect the understanding of a named executive officer's compensation in the issuer's last fiscal year.

[Read more.](#)

## FINANCIAL MARKETS

### **CPSS and IOSCO Publish Principles for Financial Market Infrastructures**

The Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) have released for public comment a report proposing a set of 24 new "principles" intended to ensure the global stability of "financial markets infrastructures" that facilitate the recording, clearing and settlement of financial transactions (including all systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories) in the event of market stress and financial crises. CPSS-IOSCO's goal in issuing the report is to bring consistency to the oversight and regulation of financial market infrastructures. The principles are designed to harmonize and strengthen current risk management standards, in particular: (1) the financial resources and risk management procedures a financial markets intermediary uses to cope with the default of participants; (2) the mitigation of operational risk; and (3) the links and other interdependencies between financial markets intermediaries through which operational and financial risks can spread. The report also introduces new principles with respect to segregation and portability, tiered participation and general business risk. The CPSS-IOSCO cover letter requests comment on a number of issues with respect to the proposed principles.

Comments on the new principles are due by July 29.

The report is available [here](#).

The cover letter is available [here](#).

## OTC DERIVATIVES

### **IOSCO Publishes Report on OTC Derivatives**

The Technical Committee of the International Organization of Securities Commissions published a report on February 18 entitled "Report on Trading of OTC Derivatives." The press release concerning the Report summarizes its substance in the following terms:

The Report concludes that it is appropriate to trade standardized derivatives contracts with a suitable degree of liquidity on organized platforms, and that a flexible approach to defining what constitutes an organized platform for derivatives trading would maximize the number of standardized derivative products that can be appropriately traded on these venues. It identifies characteristics that an organized platform should exhibit in order to fulfill the G-20 Leaders' objectives, as well as the benefits and costs associated with transitioning trading of derivatives from OTC venues onto organized platforms. It also presents a range of actions that regulators may choose to take to increase organized platform trading of OTC derivatives products.

The Report makes some interesting points about the relatively limited liquidity of even the most liquid standardized derivatives. It also provides some helpful terminology for discussing trading platforms by dividing them into the following defined categories: Order Book Systems, Market Maker Systems, Periodic Auction Systems, Bulletin Board Systems and Hybrid Systems.

The report can be accessed [here](#).

## LITIGATION

### **Delaware Chancery Court Rejects Unsupported Fraudulent Inducement Defense**

The Delaware Chancery Court rejected a defendant's fraud in the inducement defense where, at the summary judgment stage, the defendant (a) failed to come forward with specific facts showing that the counterparty knowingly made false statements and (b) did not make a proper showing under Rule 56 as to why additional discovery was warranted.

Plaintiff Corkscrew Mining Ventures, Ltd. sued defendant, Preferred Real Estate Investments, Inc. (PREI), seeking specific performance of an agreement obligating PREI to purchase Corkscrew's remaining 12% interest in a mining quarry business. PREI argued that it was fraudulently induced to enter into that contract because Corkscrew misrepresented facts concerning potential environmental liabilities at the quarry in an earlier but related agreement in which PREI purchased 88% of Corkscrew's interest.

In support of its summary judgment argument, PREI submitted an affidavit from its Vice President asserting that Corkscrew in fact made misrepresentations regarding potential environmental issues at the quarry. The Chancery Court rejected the affidavit as too conclusory because it failed to identify any hazardous substances found at the quarry or any other specific facts that would show a misrepresentation by Corkscrew.

The Chancery Court also declined to allow additional discovery on the ground that the case had been pending for more than a year, and because PREI had not made a proper showing as to why additional discovery should be permitted under Rule 56.

Because PREI had not supported its fraud in the inducement defense, and the agreement was otherwise valid and enforceable, the Chancery Court awarded summary judgment to Corkscrew and ordered specific performance of the contract. (*Corkscrew Mining Ventures, Ltd. v. Preferred Real Estate Investments, Inc.*, C.A. No. 4601-VCP (Del. Ch. Feb. 28, 2011))

### **False Confidential Witness Information Warrants Reconsideration and Dismissal in Securities Class Action**

The U.S. District Court for the Northern District of Illinois granted a motion for reconsideration pursuant to Rule 54(b) of the Federal Rules of Civil Procedure on the ground that the court's previous order denying a dismissal motion relied on false information concerning a confidential witness's position and personal knowledge.

Stockholder plaintiffs asserting Securities Exchange Act claims alleged that The Boeing Company made misrepresentations about the testing and delivery schedule for the 787 Dreamliner commercial aircraft. Plaintiffs' complaint relied on allegations by a confidential witness who was alleged to be a Boeing employee with personal knowledge that adverse test results were circulated to senior Boeing executives.

After the dismissal motion was denied, defense counsel learned through an interview that the confidential witness was not a Boeing employee, had no personal knowledge of test results, had never met plaintiffs' counsel prior to being deposed, and was never shown the allegations attributed to him in the complaint.

The court concluded that, under Rule 54(b), it may consider evidence of manifest factual errors for the limited purpose of determining whether orders were procured by fraud, carelessness by counsel, or by the court's own misconception of the facts. The court granted the motion to reconsider and dismiss the complaint because the inaccurate information provided by the confidential witness could have been uncovered through a reasonable investigation by plaintiffs' counsel. (*City of Livonia Employees' Retirement System v. The Boeing Company*, C.A. No. 09 C 7143 (N. D. Ill. Mar. 7, 2011))

## BANKING

### United States Implements Sanctions Against Libya

On February 25, President Obama signed an Executive Order freezing funds and assets of the Government of Libya, the Central Bank of Libya and Moammar Gadhafi and his sons. Financial institutions are particularly affected by these sanctions because they must adjust their normal compliance procedures to screen for transfers involving blocked assets. On March 4, however, the U.S. Office of Foreign Assets Control issued General License No. 1A, which authorizes all transactions involving banks that are owned or controlled by the government of Libya and organized under the laws of a country other than Libya, provided the transactions do not otherwise involve the government of Libya or any person whose property and interests in property are blocked.

A copy of the Executive Order is available [here](#).

A copy of License No. 1A is available [here](#).

## UK DEVELOPMENTS

### FSA and FRC Publish Feedback on the Role of Auditors

On March 10, the UK Financial Services Authority (FSA) and the Financial Reporting Council (FRC) published a joint feedback statement, *Enhancing the auditor's contribution to prudential regulation* FS11/1, summarizing the responses to their June 2010 joint discussion paper, DP10/3, similarly titled.

DP10/3 was intended to stimulate debate on the contribution that auditors make to prudential regulation. It examined several key areas: (a) promoting dialogue and information-sharing between auditors and supervisors; (b) the application of professional scepticism by auditors; (c) the nature and extent of disclosures about management's key judgements; (d) FSA and FRC powers; and (e) the scope of auditors' reporting.

Following the discussion paper and wider work in this area, a number of actions have already been taken to enhance the role of auditors including: (a) development of a draft code of practice by the FSA, alongside the Bank of England, designed to enhance the dialogue between auditors and supervisors (see the [February 11](#) edition of *Corporate and Financial Weekly Digest*); (b) increased dialogue between the FSA and auditors, individually and collectively, to discuss key financial reporting issues; (c) increased and more effective use by the FSA of Section 166 skilled person reporting; and (d) formalization of cooperative arrangements between the FSA and the FRC's Audit Inspection Unit, in a memorandum of understanding.

In addition, on March 10 the FRC also published feedback on its parallel discussion paper: *Auditor Scepticism: Raising the Bar*. The FRC confirms in this paper that it will continue to monitor the extent to which professional scepticism is being applied by auditors. It also announced measures designed to ensure a consistent understanding of the nature and role of auditor scepticism and appropriate support for, and transparency of, its application.

Click [here](#) to read the FSA/FRC joint feedback statement FS11/1.

Click [here](#) to read the FRC's feedback paper.

## EU DEVELOPMENTS

### EU ECON Committee Votes for CDS Naked Shorting Ban

On March 7, the European Parliament's economic and monetary affairs committee ECON approved a measure which could lead to an EU-wide ban on uncovered shorting of credit default swaps (CDS) on sovereign debt of EU member states. Under the measure as currently drafted, investors would be permitted to short a "naked" sovereign CDS if it held a proxy "asset or portfolio of assets" whose prices have a "high correlation" with government bond prices. The European Securities Markets Authority (ESMA) would also need the permission of the government in question in order to ban naked short selling of sovereign CDS linked to its debt.

The measure requires approval by the European Parliament in plenary session and also by the European Council of Ministers before it can become law. The regulation is expected to be in force by July 2012.

[Read more.](#)

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