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BROKER DEALER

CFTC Proposal to Determine the Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades

In December 2010, the Commodity Future Trading Commission (CFTC) proposed a rule (the initial proposal) that set forth: (1) definitions for the terms "large notional off-facility swap" and "block trade"; (2) a method for determining the appropriate minimum block sizes for large notional off-facility swaps and block trades; and (3) a framework for timely reporting of such transactions and trades. The initial proposal also included provisions to protect the identities of swap counterparties by limiting disclosure of information and data relevant to the swap. In December 2011, the CFTC adopted a rule (the final rule) establishing time delays for the public dissemination of block trades and large notional off-facility swaps.

Based on public comments to the initial proposal, and to implement the real-time public reporting regulatory framework established in the final rule, on February 23, 2012, the CFTC voted 3-2 to propose further rules for public comment (the proposal) that: (1) specify the criteria for determining swap categories and methodologies for determining the appropriate minimum block sizes for large notional off-facility swaps and block trades; and (2) protect the identities of market participants that effect these trades.

In the proposal, the CFTC is proposing specific criteria for defining swap categories within the five asset classes established in the final rule: interest rate, credit, equity, foreign exchange, and other commodity. These proposed criteria are intended to address the following two policy objectives: (1) categorizing together swaps with similar quantitative or qualitative characteristics that warrant being subject to the same appropriate minimum block size; and (2) minimizing the number of the swap categories within an asset class in order to avoid unnecessary complexity in the determination process.

The CFTC is also proposing to set appropriate minimum block sizes within each of the asset classes. Under the proposal, there would be a phased-in approach with an initial and post-initial period. During the initial period of one year the CFTC would prescribe an appropriate minimum block size while registered swap data repositories would gather data on each asset class. The CFTC would then analyze the data to establish appropriate minimum block sizes for the post-initial period using a 67 percent notional amount calculation for each swap category.

In addition, the proposal provides increased protections to the identities of swap counterparties and establishes methods to maintain the anonymity of such counterparties' business transactions and market positions with respect to the dissemination of reportable swap transactions to the public. Under the proposal, the CFTC would amend its existing regulations to establish cap sizes for notional principal amounts that would mask the total size of a swap transaction if it equals or exceeds the appropriate minimum block size for a given swap category.

Click here to read the proposal.

LITIGATION

Delaware Chancery Court Upholds Arbitration Clause in Employment Agreement

The Delaware Court of Chancery dismissed several claims in a contract dispute between an employer and its former employee, holding that those claims were subject to the arbitration clause in an employment agreement between the parties. The plaintiffs, two healthcare companies owned by the same doctor, sued the defendant, a former Chief Operating Officer of one of the plaintiff companies, in the Delaware Court of Chancery for breach of fiduciary duty, unjust enrichment, and breach of contract. The defendant moved to dismiss the plaintiffs' claims on the grounds that they were subject to the arbitration clause in the parties' employment agreement. The court found that the arbitration clause at issue was broad in scope and that since the plaintiffs' claims touched upon duties under, or performance of, the employment agreement, the plaintiffs' claims were within the scope of the arbitration clause. The court also rejected each side's argument that the pendency of the litigation before it resulted in a waiver of arbitration rights. The court stated the principle that waiver is only found when the demand for arbitration comes "long after the suit commenced and when both sides have engaged in extensive discovery." Since discovery had not taken place in the present suit, the court held that neither the plaintiffs' filing of the suit nor the defendant's motion to dismiss amounted to a waiver of arbitration rights.

Halpern Medical Services, LLC v. Geary, C.A. No. 6679-VCN (Del. Ch. February 17, 2012).

Illinois District Court Dismisses Action Based on Lack of Personal Jurisdiction Over Individual Corporate Officers

The U.S. District Court for the Northern District of Illinois dismissed certain claims against individual defendants in a fraud suit, holding that it lacked personal jurisdiction over those defendants. The plaintiffs brought several claims under state consumer protection laws and the common law against the defendants in connection with the refinancing of a property loan. Several of the defendants were individual officers of an investment company that allegedly had defrauded the plaintiffs. The officers (Individual Defendants) moved to dismiss the plaintiffs' suit against them for lack of personal jurisdiction. The court rejected plaintiffs' arguments that the court had jurisdiction over the Individual Defendants based on exceptions to the fiduciary shield doctrine and/or based on a veil-piercing theory. The court held that in order for there to be an exception to the fiduciary shield doctrine, which generally protects corporate officers from being sued in connection with their corporate duties, a plaintiff must assert that an individual defendant undertook acts within the relevant jurisdiction that were primarily meant to serve their personal interests. The plaintiffs had failed to allege any actions that warranted the use of the exception to fiduciary shield doctrine. The plaintiffs had also failed to demonstrate that the investment company at issue was a shell corporation that served as the alter ego of the Individual Defendants. Similarly, since the plaintiffs had not shown that there was a unity of ownership and interest between the Individual Defendants and the investment company, the court declined to pierce the corporate veil to assert jurisdiction over the Individual Defendants. Accordingly, the court dismissed all claims against the Individual Defendants.

Kouakou, et. al. v. Sutton Funding, LLC, et. al., No. 09 C 7132, 2012 WL 581179 (N.D. Ill. February 22, 2012).

UK DEVELOPMENTS

UK Supreme Court Lehman Client Money Decision

On February 29, the UK Supreme Court handed down its decision upholding, in part unanimously and in part by a 3-2 majority, the Court of Appeal's November 2010 decision in the LBIE client money case - *Re Lehman Brothers International (Europe) (in administration)*.

The Supreme Court held unanimously that the statutory trust under the UK Financial Services Authority's client money rules arises at the time of receipt of monies required to be treated as client money.

It was held by a majority, first, that the client money pool should include money required to be treated as client money which was held in house accounts as well as money held in segregated client money bank accounts; and second, that clients with a contractual right to have their money treated as client money were entitled to share in the client money pool - that entitlement was not restricted to clients for whom client money had actually been segregated. Accordingly, the client money pool will be distributed *pro rata* to all clients entitled to claim against the pool.

The Supreme Court decision may be viewed here.

FSA Reports on Assessing Possible Sources of Systemic Risk from Hedge Funds

On February 29, the UK Financial Services Authority (FSA) produced its latest biannual report *Assessing Possible Sources of Systemic Risk from Hedge Funds*. This report sets out the results of the FSA's latest (September/October 2011) performance of its two regular hedge fund surveys: the Hedge Funds As Counterparties Survey (HFACS) and the Hedge Funds Survey (HFS). The FSA conducts these surveys every six months to assist it in understanding potential sources of systemic risk in the hedge fund sector. (For an article on the most recent previous HFS and HFACS, see the July 29, 2011 edition of *Corporate and Financial Weekly Digest*.)

The February 29 report's conclusions include the following:

- The footprint of surveyed hedge funds is generally small when measured by the value of their exposures and by turnover. Potential exceptions are the markets in convertible bonds, commodity derivatives and interest rate derivatives.

- In aggregate, hedge funds reported that they are able to liquidate their assets more quickly than when most of their liabilities fall due. Nearly all surveyed funds reported the ability to suspend investor redemptions or create side pockets. However, the risk of a sudden withdrawal of funding during stressed market periods is likely to remain, with an associated risk of fire sales of assets.

- Counterparty credit exposures to hedge funds remain fairly concentrated among five counterparty banks. From the perspective of the banks, by tightening their financing terms they have increased their resilience to possible fund defaults.

- Leverage, measured in aggregate, has not changed significantly relative to previous surveys. It remains highest for fixed income strategies.

- Most surveyed hedge funds reported negative returns for the survey period.

The FSA stated that it intends to repeat the HFS and HFACS in March/April 2012. It also intends to continue to work closely with the International Organization of Securities Commissions and other national regulators with a view to achieving a consistent and proportionate global approach to systemic risk data collection for hedge funds.

For more information, click here.

For more information, contact:

FINANCIAL SERVICES		
Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Wendy E. Cohen	212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey, Jr.	212.940.8593	guy.dempsey@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Maureen C. Guilfoile	312.902.5425	maureen.guilfoile@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Joseph Iskowitz	212.940.6351	joseph.iskowitz@kattenlaw.com
Carolyn H. Jackson	44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Kathleen H. Moriarty	212.940.6304	kathleen.moriarty@jkattenlaw.com
Raymond Mouhadeb	212.940.6762	raymond.mouhadeb@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Peter J. Shea	212.940.6447	peter.shea@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com
LITIGATION		
Michael S. Gordon	212.940.6666	michael.gordon@kattenlaw.com
Joseph E. Gallo	212.940.6549	joseph.gallo@kattenlaw.com
EU/UK DEVELOPMENTS		
Edward Black	44.20.7776.7624	edward.black@kattenlaw.co.uk

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Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK OAKLAND SHANGHAI WASHINGTON, DC

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