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CORPORATE & FINANCIAL
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Please note that *Corporate and Financial Weekly Digest* will not be published on April 6. The next issue will be distributed on April 13, 2012.

CFTC

CFTC Approves Final Rule on Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management

On March 20, the Commodity Futures Trading Commission approved a final rule under the Dodd-Frank Wall Street Reform and Consumer Protection Act by a vote of four to one (Commissioner O'Malia, dissenting). The final rule, which was originally proposed through four separate rule filings, addresses three areas: customer clearing documentation, time frames for submission and acceptance for clearing, and clearing member risk management for swap transactions.

Customer Clearing Documentation: The customer clearing documentation portion of the final rule prohibits provisions in customer agreements that would (1) disclose to a futures commission merchant (FCM), swap dealer (SD) or major swap participant (MSP) the identity of a customer's original executing counterparty; (2) limit the number of counterparties with whom a customer may enter into a trade; (3) restrict the size of the position a customer may take with any individual counterparty (apart from an overall credit limit across all of the customer's positions); (4) impair a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or (5) prevent compliance with specified time frames for acceptance of trades into clearing.

Time Frames for Submission and Acceptance for Clearing: The rules related to timing of acceptance for clearing require a clearing member FCM, or a derivatives clearing organization (DCO) acting on its behalf, to accept or reject each trade submitted for clearing as quickly as would be technologically practicable if fully automated systems were used. This standard requires action in a matter of milliseconds or seconds or, at most, a few minutes, not hours or days. The rules also require SDs, MSPs, FCMs, swap execution facilities (SEFs) and designated contract markets (DCMs) to submit swaps that are required to be cleared to a DCO as soon as technologically practicable, but no later than the close of business on the day of execution, and swaps that are not required to be cleared by the close of business on the day after execution or agreement to clear.

Clearing Member Risk Management: Under the risk management portion of the rule, each FCM, SD and MSP that is a clearing member of a DCO is required to: (1) establish risk-based limits in its proprietary and customer accounts based on position size, order size, margin requirements or similar factors; (2) screen orders for compliance with the risk-based limits; (3) monitor for adherence to the risk-based limits intra-day and overnight; (4) conduct stress tests under extreme but plausible conditions for all positions in proprietary and customer accounts; (5) evaluate its ability to meet initial margin requirements at least once per week; (6) evaluate its ability to meet variation margin requirements in cash accounts at least once per week; (7) evaluate its ability to liquidate the positions in proprietary and customer accounts in an orderly manner, and estimate the cost of the liquidation at least once per month; and (8) test all lines of credit at least once per quarter.

The effective date for FCMs, DCMs and DCOs is October 1, 2012. The effective date for SDs and MSPs is the later of October 1, or the date that the SD and MSP registration rules become effective. The effective date for SEFs is the later of October 1, 2012, or the date that the Core Principles and Other Requirements for SEFs rule becomes effective.

For more information click here.

LITIGATION

Third Circuit Court of Appeals Limits Electronic Discovery Costs That Can Be Awarded to Prevailing Party

The U.S. Court of Appeals for the Third Circuit recently addressed the question of whether production costs related to electronically stored information (ESI) are assessable to a losing party under the applicable federal statute, as "[f]ees for exemplification [or] the costs of making copies of any materials where the copies are necessarily obtained for the use in the case." The context was an antitrust case, which was dismissed on summary judgment after extensive electronic discovery. After prevailing, the defendants sought to recover as costs approximately $365,000 to outside ESI vendors in order to collect, process, and produce ESI. The U.S. District Court for the Western District of Pennsylvania ruled that these charges were assessable against the losing party under the statute. The District Court reasoned that since the vendors' services were indispensible and highly technical, it was appropriate to assess the cost of their work against the losing party. The plaintiff appealed this ruling to the Court of Appeals for the Third Circuit, which addressed the issue as a matter of first impression in the Circuit. The Court also noted conflicts between other Circuits that have previously addressed the issue.

The Court of Appeals rejected the District Court's broad interpretation of the statute, and held that only two narrow categories of electronic discovery costs are assessable. The Court of Appeals ruled that "exemplification," as used in the statute, only covered the production of illustrative evidence or the authentication of public records. Since the electronic vendors' work in this case did neither, none of their charges were taxable on exemplification grounds. With respect to the costs of "making copies" of ESI, the Court of Appeals ruled that only the conversion of native electronic files to TIFF format and the scanning of documents to create digital duplicates should be considered assessable under the statute. In this case, scanning and duplicating costs were estimated at $30,000, which the losing plaintiff would be required to pay. The Court of Appeals held that the remaining electronic discovery costs were not assessable against the plaintiff. Accordingly, the Court of Appeals vacated the District Court's ruling and remanded the case to the District Court to re-assess costs in accordance with this opinion.

Race Tires America, Inc., et. al. v. Hoosier Racing Tire Corp., et. al., No. 11-2316, 2012 WL 887593 (3rd Cir. Mar. 16, 2012).

New York District Court Denies Motion to Dismiss in Corporate Veil Piercing Suit Brought Under Delaware Law

In a consolidated suit in the U.S. District Court for the Southern District of New York relating to litigations concerning aircraft leases spanning over eight years that touched federal, state and bankruptcy courts, the plaintiffs sought to pierce the corporate veil of C-S Aviation, an aircraft leasing company, and hold the defendants, controlling shareholders George Soros and another individual investor liable on a default judgment entered against C-S Aviation in a North Carolina fraud suit. The plaintiffs alleged that any profits C-S Aviation made were transferred to the defendants, that C-S Aviation was at all relevant times undercapitalized, and that those operating C-S Aviation regularly disregarded its status as an entity separate from those controlled by the defendants. As a consequence, according to the plaintiffs, C-S Aviation was merely an alter ego of the defendants. The defendants moved to dismiss the suit, arguing that the plaintiffs had not sufficiently plead the elements required to prevail on an alter-ego veil piercing claim.

The District Court rejected the defendants' motion, ruling that the plaintiffs had met their pleading burden. Under the Delaware law that controlled in this case, to prevail on an alter-ego veil piercing claim, the plaintiffs must establish (1) that C-S Aviation and its controlling shareholders, in this case the defendants, operated as a "single economic entity"; and (2) that an overall element of injustice or fairness is present. With respect to the first element, the Court rejected the argument that abuse of the corporate structure for personal benefit was required. The plaintiffs' allegations of the defendants disregard of corporate formalities and comingling of corporate funds

were sufficient to suggest a “single economic entity,” regardless of the ultimate purpose of the corporate abuse. With respect to the second element, the Court explained that either fraud or injustice must be alleged, but fraud required to justify veil piercing must be distinct from the wrong underlying the original complaint. The Court, however, held that the plaintiffs’ met the unfairness element of the alter ego theory because they pled that the defendants had siphoned funds from C-S Aviation and left it undercapitalized. Having found that the plaintiffs had met the pleading requirements of an alter ego piercing the veil claim, the District Court denied the defendants’ motion to dismiss.

Tradewinds Airlines, Inc, et. al.. v. Soros, et. al., Nos. 08 Civ. 5901 (FK), 10 Civ. 8175(JFK), 2012 WL 983575 (S.D.N.Y. Mar. 22, 2012).

BANKING

Banking Agencies Propose Revisions to Leveraged Finance Guidance

On March 26, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (the agencies) gave notice that they are seeking comment on proposed revisions to the interagency leveraged finance guidance issued in 2001. Transactions that are covered by this guidance are characterized by a borrower with a degree of financial or cash flow leverage that significantly exceeds industry norms as measured by various debt, cash flow, or other ratios.

The agencies have indicated in the notice that they observed tremendous growth in the volume of leveraged credit leading up to the crisis and in the participation of non-regulated investors. "While there was a pull-back in leveraged lending during the crisis, volumes have since increased while prudent underwriting practices have deteriorated. As the market has grown, debt agreements have frequently included features that provide relatively limited lender protection, including the absence of meaningful maintenance covenants and the inclusion of other features that can affect lenders' recourse in the event of weakened borrower performance." Further, the agencies indicated that "capital structures and repayment prospects for some transactions, whether originated to hold or to distribute, have been aggressive" and that "[m]anagement information systems (MIS) at some institutions have proven less than satisfactory in accurately aggregating exposures on a timely basis…".

Numerous definitions of leveraged finance exist throughout the financial services industry and commonly contain some combination of the following:

- Proceeds are used for buyouts, acquisitions, or capital distributions.
- Transactions where the borrower’s Total Debt/EBITDA (earnings before interest, taxes, depreciation, and amortization) or Senior Debt/EBITDA exceed 4.0X EBITDA or 3.0X EBITDA, respectively, or other defined levels appropriate to the industry or sector.
- Borrower that is recognized in the debt markets as a highly leveraged firm, which is characterized by a high debt-to-net-worth ratio.
- Transactions where the borrower’s post-financing leverage, when measured by its leverage ratios, debt-to-assets, debt-to-net-worth, debt-to-cash flow, or other similar standards common to particular industries or sectors, significantly exceeds industry norms or historical levels.

The agencies propose replacing the 2001 guidance with revised leveraged finance guidance that refocuses attention to five key areas:

- Establishing a Sound Risk-Management Framework: The agencies expect that management and the board identify the institution's risk appetite for leveraged finance, establish appropriate credit limits, and ensure prudent oversight and approval processes.
- Underwriting Standards: These outline the agencies' expectations for cash flow capacity, amortization, covenant protection, and collateral controls and emphasize that the business premise for each transaction should be sound and its capital structure should be sustainable irrespective of whether underwritten to hold or to distribute.

- Valuation Standards: These concentrate on the importance of sound methodologies in the determination and periodic revalidation of enterprise value.

- Pipeline Management: This highlights the need to accurately measure exposure on a timely basis, the importance of having policies and procedures that address failed transactions and general market disruption, and the need to periodically stress test the pipeline.

- Reporting and Analytics: This emphasizes the need for MIS that accurately capture key obligor characteristics and aggregates them across business lines and legal entities on a timely basis. Reporting and analytics also reinforce the need for periodic portfolio stress testing.

The agencies stated their belief that "the vast majority of community banks should not be affected as they have no exposure to leveraged loans." Comments are due on June 8.

Senate Confirms Three for Seats on FDIC Board; Appoints Curry as Comptroller of the Currency

Before leaving for recess on March 29, the Senate confirmed Martin Gruenberg, Thomas Hoenig and Jeremiah Norton to seats on the board of the Federal Deposit Insurance Corporation, and approved Thomas Curry as Comptroller of the Currency. The Senate, however, refused to confirm Gruenberg as Chairman of the FDIC, preserving flexibility to name a Chairman in the event of a Republican victory for the White House in November. Gruenberg will continue to lead the FDIC in an acting capacity.

For more information, click here.

EXECUTIVE COMPENSATION AND ERISA

Important Deadlines for ERISA Plans to Receive and Report Information on Fees, Expenses

Coming up this summer are a number of reporting and disclosure deadlines under the Employee Retirement Income Security Act of 1974 (ERISA) that deal with fees and expenses paid by plans that are subject to ERISA. Service providers to such plans, including investment managers who manage plan assets, and other entities that provide investment products (such as annuity contracts or collective investment funds), should be aware of their responsibilities and be prepared for requests for information from their ERISA plan clients.

July 1 is the deadline for "covered service providers" to provide plan fiduciaries with disclosure of the direct and indirect compensation they receive in connection with the services they provide to the plan, as required by regulations under Section 408(b)(2) of ERISA. Plan fiduciaries must use this information to determine whether the service provider arrangement is a "reasonable contract or arrangement" as required by ERISA. For more information on these requirements, click here.

July 31 is the due date for calendar year plans to file the Form 5500 Annual Report, or to file for an extension to October 15, 2012. Schedule C of Form 5500 requires detailed disclosure of direct and indirect compensation to service providers. It was reported in the March 29 issue of BNA, Inc. *Pension & Benefits Daily* that the Department of Labor has sent out 3,000 notices to plan administrators of plans that were deemed to have inadequately reported these compensation items on Schedule C of their previous Form 5500 filing.

August 31 is the deadline for plan administrators to provide participants in participant-directed defined contribution plans, such as the typical 401(k) plan with a menu of investment options, with detailed disclosure of fee and performance data on the investment options available under the plan. Service providers are required to provide plan fiduciaries with any information that the fiduciaries reasonably request in order to fulfill this disclosure obligation, as well as to complete Schedule C of Form 5500.

UK DEVELOPMENTS

FSA Fines Coutts £8.75m for AML Control Failings

On March 26, the UK Financial Services Authority (FSA) announced that it had fined Coutts & Company £8.75 million (approximately $14 million) in relation to failures to take reasonable care to establish and maintain effective anti-money laundering (AML) systems and controls relating to high risk customers including politically exposed persons (PEPs). The fine was imposed for breaches of Principle 3 of the FSA's Principles for Businesses ("a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems") and FSA rules relating to Senior Management Arrangements, Systems and Controls (SYSC 6.1.1R and SYSC 6.3.1R).

The FSA described Coutts' failings as serious and systemic and as having resulted in the creation of an unacceptable risk of Coutts handling the proceeds of crime.

The FSA found that Coutts did not apply robust AML controls when establishing relationships with high risk customers, did not consistently apply appropriate monitoring of high risk relationships, and that Coutts' AML team failed to provide an appropriate level of scrutiny and challenge.

The FSA identified specific deficiencies in 73 of the 103 Coutts high risk customer files they reviewed – 71%. These included failing to do one or more of the following in each of the 73 files:

- gather sufficient information to establish the source of wealth and income of prospective PEP and other high risk customers;
- establish the source of funds received at the outset of high risk customer relationships;
- gather sufficient information about prospective high risk corporate customers;
- identify and/or assess adverse intelligence about prospective and existing high risk customers properly and take appropriate steps in relation to such intelligence;
- keep the information held on its existing PEP and other high risk customers up-to-date; and
- scrutinize transactions made through PEP and other high risk customer accounts appropriately.

Tracey McDermott the FSA's acting Director of Enforcement and Financial Crime, said: "Coutts' failings were significant, widespread and unacceptable. Its conduct fell well below the standards we expect and the size of the financial penalty demonstrates how seriously we view its failures."

Coutts agreed to settle at an early stage and therefore qualified for a 30% discount. Were it not for this discount, the FSA would have imposed a financial penalty of £12.5m (approximately $20m).

For more information, click here.

FSA Imposes Bans and Fines for Publishing Misleading Information

On March 28, the UK Financial Services Authority (FSA) announced that it had fined and banned three former directors of Cattles plc (Cattles) and its subsidiary Welcome Financial Services Limited (Welcome) for publishing misleading information to investors about the credit quality of Welcome's loan book and acting without integrity in discharging their responsibilities. The FSA also publicly censured Cattles and Welcome for publishing misleading information.

James Corr, Cattles' finance director, was fined £400,000 (approximately $640,000) and Peter Miller, Welcome's finance director was fined £200,000 (approximately $320,000), and both have been banned from performing any functions in relation to any FSA regulated activities. The FSA has also banned John Blake, Welcome's managing director, and fined him £100,000 (approximately $160,000). (Blake has appealed this penalty to the Upper Tribunal). All three fines were reduced on account of the directors' current personal financial circumstances.

The FSA found numerous breaches of its market abuse, listing and disclosure rules and its Principles for Businesses.

At the relevant time, Cattles was a sub-prime lender listed on the London Stock Exchange. Most of its business was conducted through Welcome. Cattles' 2007 Annual Report contained highly misleading arrears, impairment and profit figures. It stated that £900 million (approximately $1.4 billion) of Welcome's approximately £3 billion (approximately $5 billion) loan book was in arrears. If accounting standards had been properly applied the correct arrears figure would have been about 50% higher. Cattles also announced a pre-tax profit of £165.2 million for 2007 (approximately $265 million). If accounting standards had been correctly applied Cattles would have suffered a pre-tax loss of £96.5 million (approximately $155 million) – a difference of £261.7 million (approximately $420 million).

The misleading figures from the Annual Report were also included in a rights issue prospectus released by Cattles in April 2008. It was likely that investors would have regarded this as highly material when subscribing under the rights issue which was fully subscribed. When the true state of Cattles' loan book emerged in 2009, trading in Cattles' shares was suspended. On March 2, 2011 Cattles announced a scheme of arrangement under which its shareholders would receive only 1p for each share, less than 1% of the rights issue price.

The FSA found that Cattles breached the FSA's Listing Principles by failing to act with integrity towards its shareholders and potential shareholders, and failing to communicate information in such a way as to avoid the creation or continuation of a false market. Welcome breached Principle 3 of the FSA Principles for Businesses by failing to take reasonable care to organize and control its affairs responsibly and effectively, with adequate risk management systems. Both companies engaged in market abuse by disseminating the inaccurate information. Corr, Miller and Blake were personally responsible for the breaches by the companies of which they were directors and also committed market abuse.

The FSA has publicly censured Cattles and Welcome and stated that it would have imposed substantial financial penalties on the two companies had it not been for their financial circumstances.

Tracey McDermott, the FSA's acting Director of Enforcement and Financial Crime, said: "The consequences for shareholders of the misleading statements issued by Cattles and Welcome have been devastating. These directors failed to act with integrity in discharging their responsibilities. They failed in their obligations to shareholders, the wider market and the regulator."

For more information, click here.

EU DEVELOPMENTS

European Parliament Adopts EMIR

Following the February 9 announcement that the European Parliament Council and Commission had reached agreement on the European Market Infrastructure Regulation (EMIR) on over-the-counter (OTC) derivative transactions, central counterparties (CCPs) and trade repositories, as reported in the February 24, 2012, edition of *Corporate and Financial Weekly Digest*, the European Parliament adopted EMIR on March 29.

The press release issued by the Parliament announcing EMIR's adoption is headlined "Clamping Down on the Derivatives Trade." It highlights areas where the Parliament considers that it influenced the final text of EMIR including:

- EMIR requires all derivative contracts (not only OTC derivatives) to be reported to trade repositories, which will publish aggregate position data by class of derivatives.
- The European Securities and Markets Authority (ESMA) will be able to block the authorization of CCPs, and there is a binding mediation procedure for disputes about CCP authorization.
- CCPs from third countries will only be recognized in the EU if the legal regime of the relevant third country provides for an effective equivalent system for reciprocal recognition.

- The European Commission will evaluate the implementation of EMIR by reporting to the Parliament and the Council of the EU within three years of EMIR coming into force. The report will in particular address the effectiveness of CCP supervision and ESMA's role in CCP authorization.

- A temporary exemption from the clearing obligation will apply to pension funds, initially for three years.

The text of EMIR has now been published together with FAQs. The FAQs indicate that ESMA will submit proposed technical standards to the Commission by September 30 and that the Commission should adopt standards by the end of 2012. CCPs will have to apply for authorization within six months of the standards being adopted. The date from which reporting and clearing obligations will apply will be include in the technical standards when they are published.

The FAQs can be found here.

The text of EMIR adopted by the Parliament can be found here.

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