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SEC/CORPORATE

Judges Raise Concerns Regarding Conflict Minerals Rule at Appeal Hearing

On January 7, the US Court of Appeals for the District of Columbia Circuit held oral arguments for the lawsuit challenging the Securities and Exchange Commission's conflict minerals rule. According to reports on the hearing, two of the three judges on the panel, David Sentelle and A. Raymond Randolph, expressed concerns regarding the rule. These two judges were reportedly sympathetic to arguments raised by attorneys for the trade groups challenging the conflict minerals rule that the rule went beyond the intent of Congress and forced companies to speak against their will in violation of the First Amendment.

The appellate court did not provide any guidance regarding when they might rule on the case, and unless the rule is vacated, issuers will still be required to comply with the conflict minerals rule for the calendar year beginning January 1, 2013 (regardless of the issuer's fiscal year), with any initial Form SD required to be filed with the SEC no later than May 31, 2014. For additional information, please see the *Corporate and Financial Weekly Digest* edition of August 24, 2012 regarding the release of the conflict minerals rule and the edition of July 26, 2013 discussing the initial ruling in the case challenging the rule.

SEC Division of Corporation Finance Issues Five Additional C&DIs Relating to "Bad Actor" Rule

On January 3, the Securities and Exchange Commission's Division of Corporation Finance issued five new Compliance and Disclosure Interpretations (C&DIs) with respect to Rule 506 under the Securities Act of 1933 (Securities Act). These C&DIs relate to the rule (Rule 506(d)) recently adopted by the SEC (Bad Actor Rule) that disqualifies issuers from relying on Rule 506 of Regulation D for securities offerings involving certain felons and other so-called "bad actors" (the persons subject to the Bad Actor Rule being referred to as covered persons). These are in addition to the C&DIs relating to the Bad Actor Rule released on December 4, 2013, as discussed in the *Corporate and Financial Weekly Digest* edition of December 6, 2013. The new C&DIs include the following interpretative guidance:

C&DI 260.28 provides that a shareholder that becomes a 20% beneficial owner by purchasing securities in an offering is not a "covered person" subject to the Bad Actor Rule with respect to such offering (as that shareholder was not a covered person at the time of the sale). It would, however, be a covered person with respect to any sales of securities in the same offering made after it became a 20% beneficial owner.

C&DI 260.29 and C&DI 260.30 clarify that that the term "beneficial owner" under Rule 506(d) is interpreted the same way as under Securities Exchange Act of 1934 (Exchange Act) Rule 13d-3 (i.e., any person who, directly or indirectly (which includes "looking through" entities to their controlling persons), has or shares: (1) the power to vote and/or (2) the power to dispose of, a security).

C&DI 260.31 clarifies that the analysis for determining beneficial ownership under Rule 506(d) (and, consequently, whether a party or group of parties constitutes a 20% beneficial owner of the issuer and is therefore a "covered person") is conducted the same as it is for purposes of Exchange Act Rules 13d-3 and 13d-5(b). By way of example, C&DI 260.31 provides that shareholders that have entered into a voting agreement under which each shareholder agrees to vote its shares in favor of director candidates designated by another party have formed a group, and the group beneficially owns the shares beneficially owned by its members. Shareholders party to a voting agreement that have the power to vote shares beneficially owned by others party to the voting agreement (e.g., through an irrevocable proxy or the right to designate director nominees) are deemed to beneficially own such shares. Shareholders that do not have the power to vote other parties' shares would not be deemed beneficial owners of such shares solely as a result of entering into the voting agreement.

C&DI 260.31 provides that if a group, such as the group formed by entering into the voting agreement, is a 20% beneficial owner, then disqualification under Rule 506(d) would arise from triggering events involving the group itself. If a party to the voting agreement becomes a 20% beneficial owner (i.e., a covered person) as a result of shares of other parties being added to such covered person's beneficial ownership, disqualification would arise from triggering events involving that covered person.

C&DI 260.32 provides that an order issued by a court or a regulatory authority pursuant to Rule 506(d)(2)(iii), advising the SEC that Rule 506 disqualification should not occur as a consequence of such order, does not waive the disclosure obligations set forth in Rule 506(e), which requires investors to disclose events that would have triggered disqualification under the Bad Actor Rule but for the fact they occurred before September 23, 2013. Rule 506(d)(2)(iii) permits issuers to rely on the self-executing statement of a regulatory authority to avoid Rule 506 disqualification when that regulatory authority advises the SEC in a writing that Rule 506 disqualification should not arise as a consequence of a disqualifying event occurring on or after September 23, 2013. C&DI 260.32 further clarifies that a regulatory authority may, however, determine that an order entered before September 23, 2013 would not have triggered disqualification under Rule 506(d)(1) because the violation was not a final order based on a violation of any law or regulation prohibiting fraudulent, manipulative or deceptive conduct entered within 10 years before such sale.

CFTC

CFTC Requests Comment on Staff Advisory Regarding the Applicability of Transaction Level Requirements

On January 3, the Commodity Futures Trading Commission requested public comment on the Division of Swap Dealer and Intermediary Oversight's Advisory regarding the applicability of transaction-level requirements to non-US swap dealers. The advisory, which was issued on November 14, stated that a non-US swap dealer entering into a swap with a non-US counterparty would nonetheless need to comply with the transaction-level requirements set forth in the CFTC's Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations if the non-US swap dealer regularly used personnel or agents located in the United States to arrange, negotiate or execute the swap.

Comments are due on March 10, 2014.

The request for comment is available here.

CFTC Staff Extends No-Action Relief for Transaction-Level Requirements in Certain Cross-Border Situations

In an action parallel with the request for public comment (see "CFTC Requests Comment on Staff Advisory Regarding the Applicability of Transaction Level Requirements," above), on January 3, the Commodity Futures Trading Commission Division of Swap Dealer and Intermediary Oversight (DSIO) issued a no-action letter extending the relief provided by CFTC Letter No. 13-71. Pursuant to this relief, DSIO will not recommend enforcement action against a non-US swap dealer that uses personnel or agents located in the United States to arrange, negotiate or execute certain swaps with non-US persons for failing to comply with the transaction-level requirements, provided the non-US persons are not guaranteed affiliates or conduit affiliates of a US person. This relief will now be available until September 15, 2014.

CFTC No-Action Letter 14-01 is available here.

NFA Implements Additional Reporting Requirements for Certain FCMs

On January 6, National Futures Association (NFA) issued a notice to members implementing new daily, monthly and quarterly reporting requirements for futures commission merchants (FCMs) for which NFA is the designated self-regulatory organization. Pursuant to the new reporting requirements, FCMs must report certain information related to margin deficiencies, customer and non-customer accounts, counterparties, fees, funding, lines of credit, customer trading activity, outside business activities, new products or services, lawsuits, disciplinary actions, highest-performing associated persons and stress tests. The first daily, monthly and quarterly reports are due January 14, February 3 and April 1, respectively.

More information is available here.

LITIGATION

ArthroCare to Pay $30 Million Fine to Settle DOJ Probe

On January 7, Texas-based surgical instrument maker ArthroCare Corp. entered into a deferred prosecution agreement (DPA) to resolve a six-year-long US Department of Justice (DOJ) investigation into allegations of a $400 million securities fraud scheme.

In conjunction with the DPA, the DOJ concurrently filed a criminal information containing a single conspiracy count to commit wire and securities fraud. Pursuant to the DPA, which runs for two years, ArthroCare agreed to pay a $30 million fine and to maintain an "enhanced" compliance program under which it must report annually to the DOJ.

Under the deferred prosecution agreement, ArthroCare admitted that several former senior executives inflated ArthroCare's revenue by tens of millions of dollars by shipping extra products to its distributors at the end of financial quarters, even though the shipments were not for actual orders, so that ArthroCare could count the shipments as sales and meet earnings forecasts. In return, ArthroCare's distributors were given substantial cash commissions, extended payment terms or the ability to return product after the end of the quarter.

Former executives John Raffle and David Applegate have pleaded guilty to conspiracy to commit securities and wire fraud, while ArthroCare CEO Michael Baker and former ArthroCare finance chief Michael Gluk are scheduled to go to trial in May.

Alcoa Subsidiary Pleads Guilty to FCPA Charge, Will Pay $348 Million

On January 9, Alcoa World Alumina LLC, a majority-owned and controlled global alumina sales company of Alcoa Inc., agreed to plead guilty and to pay $223 million in criminal fines and forfeitures to resolve charges that it paid millions of dollars in bribes through an international middleman in London to officials of the Kingdom of Bahrain, in violation of the Foreign Corrupt Practices Act (FCPA). According to the acting head of the Justice Department's Criminal Division, Mythili Raman, the company admitted to "involvement in a corrupt international underworld in which a middleman, secretly held offshore bank accounts, and shell companies were used to funnel bribes to government officials to secure business."

Alcoa agreed to plead guilty to one count of violating the anti-bribery provisions of the FCPA in connection with a 2004 corrupt transaction, to pay a criminal fine of $209 million and to administratively forfeit $14 million. As part of the plea agreement, Alcoa Inc. must also implement and maintain an anti-corruption compliance program. Alcoa concurrently settled civil charges with the Securities and Exchange Commission in an administrative proceeding related to the anti-bribery, internal controls, and books and records provisions of the FCPA, and will pay an additional $161 million in disgorgement.

This case marks the fourth-largest overall FCPA settlement with the federal government behind Siemens ($800 million on December 15, 2008), KBR & Halliburton ($579 million on February 11, 2009) and Total S.A. ($398.2 million on May 29, 2013).

BANKING

Lawmakers Introduce Legislation to Resolve CDO-TruPS Controversy

In the latest installment of the Volcker Rule's collateralized debt obligation-trust preferred securities (CDO-TruPS) controversy, on January 8, two House Financial Service Committee members introduced a bill to exempt existing CDOs backed by so-called TruPS from the Volcker Rule. The Volcker Rule provision reportedly would cause banks holding CDO-TruPS to divest them by July 15, 2015, and would additionally cause such institutions to have to mark them to market for the quarter ended December 31, 2013 and thereafter, causing unanticipated losses for many community banks.

The bill, H.R. 3819, entitled the Fairness for Community Job Creators Act, specifically states: "Nothing in this section [of the Dodd-Frank Act] shall be construed to require the divestiture of any 8 collateralized debt obligations issued before December 10, 2013 that as of December 10, 2013 are predominantly backed by trust preferred securities.'' In statements accompanying the bill, the bill's sponsors—Financial Services Committee Chairman Jeb Hensarling (R-Texas) and Financial Institutions and Consumer Credit Subcommittee Chairperson Shelley Moore Capito (R-West Virginia)—made the following statements, respectively:

> For more than three years, those who support the Dodd-Frank Act assured community banks they would not be harmed by the Volcker regulations. Then, in the dark of night, suddenly Washington regulators at the last minute changed the rules and included these products in the Volcker regulations with no time for public comment or review. That's unfair and it will do nothing but undermine the ability of small businesses that create jobs and other bank customers to receive loans from their financial institutions.

> This targeted legislation prevents community banks from being forced to take considerable losses on investments they intend to hold to maturity. Avoiding these arbitrary losses will allow local financial institutions to continue to recover and help nurture the small businesses in their communities.

The agencies that issued the rule—the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Securities and Exchange Commission (the Agencies)—are expected to revisit the CDO-TruPS issue on or before January 15 in response to a lawsuit filed by the American Bankers Association and several small banks.

Depending on what the Agencies do, the bill that was introduced may become moot.

The bill is available here.

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