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SEC/CORPORATE

SEC Issues FAQs on Conflict Minerals and Payments by Resource Extraction Issuers

On May 30, the Division of Corporation Finance of the Securities and Exchange Commission issued responses to frequently asked questions regarding the disclosure of conflict mineral usage and payments by resource extraction issuers that is required by rules adopted pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (including certain disclosure on new Form SD).

With respect to disclosure of the use of conflict minerals from the Democratic Republic of the Congo or adjoining countries, the Division of Corporation Finance provided the following guidance:

- Conflict minerals disclosure requirements apply to every issuer that files reports with the SEC under Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), even if the issuer is a voluntary filer;
- Conflict minerals disclosure requirements apply to an issuer and each of its consolidated subsidiaries;
- An issuer that engages only in activities customarily associated with mining, including crushing, mixing and smelting ore, is not considered to be "manufacturing" those materials for the purposes of Form SD;
- An issuer that specifies that its logo be etched into a generic product manufactured by a third party is not considered to be "contracting to manufacture" that product;
- An issuer is required to conduct a reasonable country of origin inquiry with respect to conflict minerals included in the products that it manufactures or contracts to manufacture, including with respect to conflict minerals included in generic components purchased for inclusion in such products;
- Packaging or a container sold with a product is not considered to be a part of the product in an issuer's conflict minerals disclosure analysis, even if the packaging or container is necessary to preserve the usability of the product following its purchase (although the packaging or container would be considered a product for an issuer that manufactures and sells packaging or containers independent of the product);
- Services are not considered products for purposes of the conflict minerals disclosure rules, and the equipment used to provide such services is not considered a product;
- Tools, machines and equipment containing conflict minerals that are used in the manufacturing of products of an issuer are not considered products of that issuer, even if the issuer later resells such tools, machines and equipment; and
- Following an initial public offering, an issuer must begin reporting conflict minerals disclosure for its first reporting calendar year that begins no sooner than eight months following the effective date of its initial public offering registration statement.

With respect to the disclosure of payments by resource extraction issuers to foreign governments or the US federal government for the purpose of the commercial development of oil, natural gas or minerals, the Division of Corporation Finance provided the following guidance:

- Resource extraction disclosure rules require disclosure of payments made to governments by the issuer, the issuer's subsidiaries and any entity under the control of the issuer;
- An issuer that only provides services associated with the exploration, extraction, processing and export of a

resource is generally not considered to be a resource extraction issuer;

- An issuer that only provides transportation of a resource across an international border without an ownership interest in the resource as an export would generally not be considered to be a resource extraction issuer;
- Penalties and fines related to resource extraction paid to governmental agencies are not reportable as fees on Form SD;
- A resource extraction issuer is required to report payment information on an unaudited, cash basis for the year in which the payments are made, and is not permitted to report this information on an accrual basis; and
- A resource extraction issuer is required to disclose payments made to governments to further its commercial development activities, but not other payments made to those governments, including taxes.

With respect to disclosure rules pertaining to each of conflicts minerals and payments by resource extraction issuers, the failure to timely file a Form SD will not cause an issuer to lose its eligibility to use Form S-3.

The SEC's disclosure rules on conflict minerals and resource extraction remain subject to lawsuits challenging their validity. Oral arguments are scheduled for July 1 in the suit brought by the National Association of Manufacturers against the SEC in the US District Court for the District of Columbia regarding the conflict minerals rules. With respect to the resource extraction rules, the American Petroleum Institute, the Chamber of Commerce and other plaintiffs brought suit against the SEC in the US District Court for the District of Columbia, and the district court's decision on the plaintiffs' motion for summary judgment is currently pending.

For additional information on conflict minerals, click here.

For additional information on extraction issues, click here.

Delaware Chancery Court Applies Business Judgment Rule to Going Private Transaction with Controlling Stockholder

In *In re MFW Shareholders Litigation*, on May 29, the Delaware Court of Chancery granted summary judgment in favor of MacAndrews & Forbes Holdings Inc. in a class action suit brought by former stockholders of M&F Worldwide Corp. challenging MacAndrews' going private acquisition of M&F. For the first time, the Delaware Court of Chancery held that the business judgment rule applies to a going private merger "conditioned … on approval by *both* a properly empowered, independent committee, and an informed, uncoerced majority-of-the-minority vote."

MacAndrews, which owned approximately 43% of M&F's outstanding common stock, offered to acquire the remaining shares of M&F's common stock for $24 per share pursuant to an all-cash merger. At the outset of MacAndrews' negotiations with M&F, MacAndrews insisted that it would not proceed with any transaction unless it was approved by an independent special committee of M&F's board of directors and subject to a non-waivable condition requiring the approval of a majority of the stockholders unaffiliated with MacAndrews. While the independent special committee rejected the initial $24 per share offer, it ultimately unanimously recommended to the full board the approval of the transaction at a price of $25 per share, and approximately 65 percent of M&F's minority stockholders approved the transaction. In its analysis, the Delaware Court of Chancery emphasized that the independent special committee could and did select its own advisors and was fully empowered to negotiate or reject the transaction.

Chancellor Strine recognized that, while Delaware law requires that courts scrutinize a going private transaction with a target company's controlling stockholder under the entire fairness standard of review where the going private transaction is approved either by an independent committee or an uncoerced majority-of-the-minority, the Delaware Supreme Court has not yet decided what standard of review would apply to a transaction subject to both protections. Accordingly, the Delaware Court of Chancery was not obligated to apply the entire fairness standard of review. Chancellor Strine reasoned that a transaction structure that replicates arms' length bargaining by being conditioned from the outset upon both the approval of an independent special committee and a non-waivable condition requiring the approval of a majority-of-the-minority is fundamentally different from a transaction with only one such protection, and that applying the business judgment rule to a transaction subject to both protections would "encourage controlling stockholders to accord the minority this potent combination of procedural protections."

Click here to read the opinion.

BROKER DEALER

CBOE Reminds Trading Permit Holders to Notify Exchange of Disciplinary Actions

The Chicago Board Options Exchange (CBOE) issued a Regulatory Circular reminding Trading Permit Holders (TPH) that CBOE Rule 4.9 requires every TPH to notify the CBOE in writing of any disciplinary action taken by other organizations against the TPH or its associated persons, or any internal disciplinary action (*e.g.*, suspension or termination) taken by a TPH against an associated person. The Regulatory Circular clarifies that, even if a disciplinary action or internal disciplinary action is not eligible for inclusion on an amended Form BD, U4 or U5 filing, the TPH must notify the CBOE's Division of Regulatory Services directly.

Click here for the Regulatory Circular.

CFTC

CFTC Staff Issues New and Extends Current No-Action Relief

The Commodity Futures Trading Commission recently released two no-action letters (i) extending relief provided to futures commission merchants (FCMs) relating to risk-based limits for bunched orders and (ii) providing relief to eligible treasury affiliates from certain swap clearing requirements.

- **Risk-Based Limits for Bunched Orders**: In CFTC Letter No. 13-21, the Division of Clearing and Risk (DCR) issued a three-month extension of the no-action relief granted by DCR on September 26, 2012, which expired on June 1. This extension allows FCMs an additional three months to comply with the provisions of CFTC Rule 1.73(a)(2)(v)(B) (Bunched Order Rule), requiring ultimate clearing FCMs that clear bunched orders on behalf of an account manager to establish risk-based limits for each customer of the account manager and enter into an agreement in advance with the account manager to screen orders for compliance with such limits. This no-action relief is available to the ultimate clearing FCM and is not available to an FCM that initially clears the bunched order. The initial clearing FCM is required to establish risk-based limits for an applicable bunched order and screen such order to ensure it complies with the established risk-based limits.

CFTC Letter No. 13-21 is available here.

- **Clearing Requirement for Swaps Entered Into by Eligible Treasury Affiliates**: In CFTC Letter No. 13-22, the DCR granted no-action relief to eligible treasury affiliates from certain swap clearing requirements. To qualify as an eligible treasury affiliate under the no-action letter, an entity must, among other requirements, (i) be wholly owned by a non-financial parent company, (ii) be unaffiliated with a swap (and security-based swap) dealer, major swap (and security-based swap) participant or a non-bank financial company that has been designated as systemically important by the Financial Stability Oversight Counsel, and (iii) not be classified as one of several types of financial entities. If an entity meets these criteria, it must also satisfy several conditions in order to receive the no-action relief, including entering into the swap for the sole purpose of hedging or mitigating commercial risk. Additionally, for each swap that an eligible treasury affiliate elects not to clear in reliance on this no-action relief, the reporting counterparty to the transaction must provide certain swap data to a registered swap repository.

CFTC Letter No. 13-22 is available here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Money Market Reform

On June 5, the Securities and Exchange Commission proposed major reforms to money market regulations that would significantly alter the way money market funds (MMFs) operate. The proposal sets forth two main alternative reforms, which may be adopted alone or in combination in a single reform package. The first proposed alternative would require all institutional prime MMFs to transition from operating with a stable share price to operating with a floating net asset value. The second generally would require every non-government MMF to impose a 2% redemption fee if its level of weekly liquid assets falls below 15% of its total assets, unless its board determines that the MMF's best interest would be served by eliminating the fee or having a lower fee. The two proposed reforms are intended to, among other things, improve risk transparency in MMFs and reduce the impact of substantial redemptions upon MMFs during times of stress. The proposal also includes reforms designed to enhance MMFs' disclosure, reporting, stress testing, and diversification practices.

For additional information, read more.

LITIGATION

Delaware Court of Chancery Finds Exculpation Clause Does Not Bar Concealment Claim

The Delaware Court of Chancery recently upheld a buyer's claim that a seller fraudulently and actively concealed material information, even though the buyer had agreed to an exculpation clause in the stock purchase agreement (SPA). The buyer contracted with the seller to purchase all the stock of two companies wholly owned by the latter. The buyer claimed that, despite targeted inquiries made during the due diligence process, the seller had failed to disclose that (i) a key customer of one of the purchased companies had threatened to move half of its business to a competitor and (ii) the same key customer had negotiated a five percent discount from the company, to take effect after the stock purchase transaction had closed. The seller countered that, because the SPA contained an express disclaimer of the buyer's reliance on extra-contractual representations, the buyer was precluded from claiming reasonable reliance on such representations. The court denied the seller's motion to dismiss the buyer's concealment claim on the ground that the buyer had never agreed that the seller had made no representation as to the "accuracy and completeness" of the information provided to the buyer; nor had the buyer disclaimed reliance on extra-contractual *omissions*. However, the court granted the seller's motion to dismiss the buyer's fraudulent and negligent misrepresentation claims, as well as portions of its conspiracy claims, on the ground that the buyer had failed to prove that the seller's representations were "half-truths" that constituted an actionable misrepresentation under Delaware law.

TransDigm Inc. et al. v. Alcoa Global Fasteners, Inc., C.A. No. 7135-VCP (Del. Ch. May 29, 2013).

Delaware Supreme Court Upholds Good Faith Presumption in Limited Partnership Agreement

The Delaware Supreme Court recently affirmed the lower court's dismissal of a derivative and class action complaint against the general partner and other managers of a limited partnership because the plaintiff failed to overcome a good faith presumption in the limited partnership agreement (LPA). The plaintiff holds limited partnership units of Enbridge Energy Partners, L.P. (EEP), of which defendant Enbridge Energy Company (EEC) is the general partner. Canadian corporation Enbridge, Inc. (Enbridge), also a defendant, indirectly owns all of EEC. In early 2009, EEP decided to build and operate a portion of an oil pipeline from Canada to Wisconsin. To finance the project, Enbridge proposed a joint venture with EEP. Given the relationships between and among Enbridge, EEC and EEP, EEC's board created a special committee to evaluate whether the terms of the proposed joint venture were fair and reasonable to EEP. To review the joint venture and negotiate on behalf of EEP, the special committee hired various advisors, determined that the terms of the joint venture were fair and reasonable, and ultimately recommended that EEP accept Enbridge's proposal. After the project was completed in April 2010, the plaintiff sued, alleging, among other things, that the defendants had breached their express and implied duties under the LPA by accepting the joint venture, the terms of which, the plaintiff alleged, were not fair or reasonable. The Court of Chancery granted the defendants' motion to dismiss, and the Delaware Supreme Court affirmed, holding that the plaintiff's claim against EEC was barred by the terms of the LPA on the ground that the LPA afforded EEC, as general partner, a conclusive presumption of good faith if it relied on the opinion of a consultant, provided the opinion was within the consultant's area of expertise. Moreover, although the good-faith provision did not cover EEC's affiliates, the Delaware Supreme Court affirmed the lower court's holding that the plaintiff failed to plead sufficient facts alleging the affiliates' bad faith.

Brinckerhoff v. Enbridge Energy Co., Inc., et al., C.A. No. 5526 (Del. Supr. May 28, 2013).

BANKING

Federal Reserve Equalizes Treatment of Foreign Banks Under Dodd-Frank Push Out Rules

On June 5, 2013, the Federal Reserve Board approved an interim final rule designed to give uninsured US branches and agencies of foreign banks the same treatment as domestic depository institutions under section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. That section of Dodd-Frank generally prohibits the provision of certain types of federal assistance, such as discount window lending and deposit insurance, to banks that are swap dealers unless they “push out” or limit their swap activities in approved ways. The provisions of Section 716 become effective on July 16, 2013. US insured depository institutions that are swaps dealers are eligible for a transition period of up to 24 months (plus a possible further extension of one year) to comply and for certain statutory exceptions. The interim final rule clarifies that, for purposes of Section 716, uninsured US branches and agencies of foreign banks will be treated in the same manner as US insured depository institutions. They will consequently now be eligible to apply for a transition period and other relief under Section 716.

Since the Dodd-Frank Act was passed, foreign banks have argued that Congress did not intend to prescribe different treatment of foreign and domestic banks under Section 716.

The new rule and the related Federal Reserve Press Release can be found here.

For more information, contact:

SEC/CORPORATE

David S. Kravitz	212.940.6354	david.kravitz@kattenlaw.com
Mark J. Reyes	312.902.5612	mark.reyes@kattenlaw.com
Mark D. Wood	312.902.5493	mark.wood@kattenlaw.com

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
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@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
Christopher T. Shannon	312.902.5322	chris.shannon@kattenlaw.com
Peter J. Shea	212.940.6447	peter.shea@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Robert Weiss	212.940.8584	robert.weiss@kattenlaw.com
Gregory E. Xethalis	212.940.8587	gregory.xethalis@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
Tenley Mochizuki	212.940.8568	tenley.mochizuki@kattenlaw.com

BANKING

Jeff Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Guy Dempsey	212.940.8593	guy.dempsey@kattenlaw.com

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Katten Muchin Rosenman LLP www.kattenlaw.com

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