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Recent Court Case Confirms the Importance of Well Drafted Forward-Looking Statement Disclosures

Tips for Taking Advantage of the Safe Harbor

*By Corey Chivers and Georgia Quinn**

A recent case from the federal district court for the Northern District of Illinois provides an important reminder that a company's forward-looking statement disclosures, when properly drafted, can provide valuable protection against 10b-5 liability. Although many people consider the cautionary statements that preface or conclude a company's public disclosure to be boilerplate, the case demonstrates that this cautionary language can be a powerful safeguard for public companies and their directors, officers and underwriters.

In *Desai v. General Growth Properties, Inc., et. al.*[1], shareholders alleged that certain public filings, press releases and earnings calls of General Growth Properties, Inc. (GGP) contained material misstatements in violation of Rule 10b-5 under the Securities Exchange Act of 1934. GGP countered that it was protected from liability because the statements that the plaintiffs alleged were misleading were forward-looking statements that fell within the safe harbor provided by the Private Securities Litigation Reform Act.[2] This safe harbor provides that a forward-looking statement cannot carry liability if it is "identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement."

Responding to plaintiff's objection that the forward-looking statement disclosure was "merely broad, redundant boilerplate," the court found that GGP's disclosures identified the exact event that actually occurred. As such, the court concluded that the warning was meaningful and cautionary and shielded the defendants against liability for the related forward-looking statements.

Drafters of the forward-looking disclosure language in press releases, prospectuses and other public filings may in many cases rightly be accused of drafting boilerplate. They often use the same language from document to document, or rely on precedent, giving little thought to the actual disclosure it accompanies or the individual circumstances of the company making the disclosure.

Below we provide tips that we believe will help a company craft disclosures that will more likely benefit from the safe harbor.[3] Like a well drafted set of risk factors, we believe well drafted forward-looking statement disclosures can provide a form of "no-cost" insurance to issuers and their directors, officers and underwriters against certain types of liability.

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- ***Specifically identify examples of forward-looking statements contained in the disclosure document.*** A forward-looking statement must be identified as such to fall within the safe harbor. Typical cautionary language will purport to identify the forward-looking statement by providing a laundry list of key words (e.g., "plans," "expects," "anticipates," "believes") that are viewed as indicating the presence of a forward-looking statement. The *Desai* court indicated that certain types of disclosures accompanied by words such as "currently anticipates" or "currently believes" may be statements of verifiable fact framed in the present, rather than forward-looking statements that benefit from the safe harbor. As a result, rather than relying on a list of key words to identify a forward-looking statement alone, we believe specifically identifying important forward-looking statements will avoid any ambiguity as to whether the provider of the forward-looking statement expected it to be covered by the safe harbor. This may also enable the statement to be covered by the judicial "bespeaks caution" doctrine in the absence of the safe-harbor protection. For example, if a company provides earnings guidance in its quarterly financial results press release, the forward-looking statement disclosure at the back of the release might usefully include a statement as follows: "Forward-looking statements can be identified by words such as 'anticipates,' 'intends,' 'plans,' 'seeks,' 'believes,' 'estimates,' 'expects' and similar references to the future. Examples of forward-looking statements include, but are not limited to, statements we make regarding our guidance for 2010 net income and net income per share."[4]

- ***Provide a bullet-point list of factors that are specifically tailored to the company and the relevant forward-looking statements.*** To satisfy the safe harbor, the forward-looking statement disclosure must include "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statements." These factors should be specifically tailored and relevant to the company's particular business, including key risks identified in the Risk Factors section of the applicable report or document. The *Desai* court provided helpful guidance regarding the meaningful cautionary language that should accompany the forward-looking statement. Citing other cases, the court explained:

  - the language is meaningful "if it puts an investor on notice of the danger of the investment to make an intelligent decision about it according to her own preferences for risk and reward,"

  - cautionary language must be "substantive and tailored to the specific predictions made in the allegedly misleading statement," and

  - although the language need not expressly refer to the risk that ultimately caused the projection to differ from the results, "'boilerplate' warnings won't do."

In the *Desai* case, the court found that GGP's cautionary language disclosed the specific risk of the inability to refinance its large amount of outstanding debt when it matured, due to various market conditions. Since this risk was the exact event that occurred and formed the very basis of the plaintiffs' 10b-5 claim, the court found the cautionary language to be meaningful.

- ***Do not simply rely on a cross-reference to the Risk Factors section when the Risk Factors section is contained in a separate document***. We believe that an enumeration of specific factors as part of the cautionary language, including risk factors identified in the Risk Factors section, is preferable to a simple cross-reference to the Risk Factors section, when the Risk Factors section is contained in a different document. To fall within the safe harbor, a forward-looking statement must be "accompanied" by meaningful cautionary language. While the Desai court stated that the cautionary language does not need to accompany the forward-looking statements in the same document, as the information is already in the public domain and available to the investor, other courts have made suggestions to the opposite effect. We therefore believe a "long-form" disclosure is the safer course.

Below is template of sample language that may be used as a framework to incorporate the tips we highlighted above:

Cautionary Note Regarding Forward-looking Statements

This [*prospectus – release – document*] contains "forward-looking statements" [within the meaning of the U.S. Private Securities Litigation Reform Act of 1995][5]. Forward-looking statements can be identified by words such as "anticipates," "intends," "plans," "seeks," "believes," "estimates," "expects" and similar references to future periods. Examples of forward-looking statements include, but are not limited to, statements we make regarding [*insert specific references to types of forward-looking statements actually made – e.g. "our guidance relating to 2010 net income and net income per share," "the expected revenue growth in our _____ segment," "our anticipated levels of capital expenditures during the next year," "our belief that we have sufficient liquidity to fund our business operations during the next 12 months"*].

Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Our actual results may differ materially from those contemplated by the forward-looking statements. We caution you therefore against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future performance. Important factors that could cause actual results to differ materially from those in the forward-looking statements include [regional, national or global political, economic, business, competitive, market and regulatory conditions] and the following:

- [*insert bullet-point list of specific, meaningful factors relevant to the company, including key items identified in the "Risk Factors" section*]
- the other factors that are described in "Risk Factors."

Any forward-looking statement made by us in this [prospectus – release – document] speaks only as of the date on which it is made. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

If you have any questions regarding the above, please feel free to contact your regular Weil Gotshal contact or Corey Chivers at 212-310-8893 (or by e-mail at corey.chivers@weil.com) or Georgia Quinn at 212-310-8352 (or by e-mail at georgia.quinn@weil.com).

1 *Desai v. General Growth Properties, Inc.*, 2009 U.S. Dist. LEXIS 85271, September 17, 2009.

2 Codified in Sections 21E of the Securities Exchange Act of 1934 and 27A of the Securities Act of 1933.

3 We believe these tips are equally applicable to those forward-looking statement disclosures contained in documents (such as private placement offering memoranda of non-public companies) that may not technically benefit from the statutory safe harbor, but instead may benefit from a similar, judicially created doctrine known as the "bespeaks caution" doctrine.

4 Further, under the "bespeaks caution" doctrine, specifically identifying the forward-looking statement will make it easier for a court to conclude that an investor was specifically cautioned that the statement should not be relied upon as a material fact.

5 Insert if relying on Section 27A or Section 21E. Regardless of the availability of the statutory safe harbor, the proposed disclosure is designed to increase the possibility that the forward-looking statements will be covered under the judicial "bespeaks caution" doctrine.

Has Tousa Changed Lending Practice?

*By Kerrick Seay**

On October 13, 2009 the United States Bankruptcy Court in Florida issued a lengthy decision in the Chapter 11 proceeding of homebuilder Tousa, Inc. ("Tousa") which, among other things, avoided certain liens and guaranty obligations granted by Tousa's subsidiaries to its first and second lien lenders. To implement the bankruptcy court's remedy of unwinding the transaction, the first and second lien lenders were ordered to disgorge to the Tousa estate any and all principal, interest, fees and other expenses paid to them in connection with their first and second lien loans. In addition, a separate group of lenders that received the majority of the proceeds of the first and second lien loans were ordered to disgorge over $400 million plus fees to the Tousa estate. Notably, the bankruptcy court found the "savings clauses" commonly found in subsidiary guarantees of parent obligations to be unenforceable for a number of reasons.[1] The decision is being appealed.

Initial Response to the Decision

The initial response from the lending community was generally one of alarm and a flurry of articles about the ramifications Tousa could have on the structure and documentation of syndicated loans — particularly given the finding regarding the unenforceability of savings clauses that are so prevalent in these deals. Now that we are a couple months removed from the Tousa ruling, it may be instructive to examine whether Tousa has manifested itself into any noticeable changes in the structure and loan documentation of deals. Unlike the market reaction to the Lehman lender defaults where the lending community widely adopted enhanced "defaulting lender" provisions in syndicated loan facilities, the

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initial response to the Tousa decision has not been widespread changes to loan documentation or structure. There is little evidence the standard savings clauses found in subsidiary guarantees have been removed or redrafted or of an increased reluctance by financial institutions to lend to non-investment grade companies supported by subsidiary guarantees. Likewise, the adoption of a "Tousa premium" to pricing in order to compensate lenders for the perceived enhanced risk that its loans could later be deemed a fraudulent transfer has not become prevalent.

This "wait and see approach" can be attributed partly to the market's anticipation that the decision will be overturned on appeal and partly to a belief that Tousa involved a unique set of facts and circumstances. Until the appeals are resolved (and thereafter if it is ultimately upheld), the question remains what, if any, long term effect will there be from the Tousa ruling and what, if any, precautionary measures a potential lender can take today to prevent a fraudulent transfer claim.

What Can Be Done by a Lender Today?

While there can be no guaranty that a secured lender will not be subject to a fraudulent transfer claim in a bankruptcy setting, there are a few potential safeguards and/or modifications to the loan documentation a secured lender should consider to protect against its loans later being deemed a fraudulent transfer by a bankruptcy court (and to address the related potential unenforceability of "savings clauses"). None is perfect and each raises its own issues, but in any given transaction these potential safeguards may be worth considering.

- ***Make Each Party to a Loan Agreement a Borrower*** – Recent market practice under syndicated loan agreements has been to require only the parent operating company to be a borrower and the material subsidiaries of the borrower to provide upstream guarantees. An alternative would be to require that both the parent operating company and each other subsidiary become a borrower under the loan agreement in order to avoid having to rely on a savings clause which the bankruptcy court in Tousa found enforceable. The protection against a fraudulent conveyance attack, however, is limited unless intra group cash transfers are recorded in a way that will demonstrate the value received by each "borrower" liable on the loan or granting liens to secure the loan. Given the centralized cash management of most companies this would undoubtedly meet resistance from borrowers. Indeed, even if such a tracking system is implemented it may do more to bolster an argument that a subsidiary "borrower" has not received any value for its liability and liens. It is likely that a bankruptcy court will look through the form of the transaction to its substance and view the label of borrower or guarantor as irrelevant.

- ***Obtain a Solvency Certificate From Each Individual Loan Party*** – Recent market practice has also only required as a condition precedent to entering into a loan agreement a solvency certificate or a representation from the borrower that both immediately prior to and immediately after the effectiveness of the loan agreement, the borrower and its subsidiaries, on consolidated basis, are solvent. The bankruptcy court in Tousa, however, applied a very narrow approach to the circumstances in which testing solvency on a consolidated basis should be permitted. One response would be to require a solvency certificate from each subsidiary guarantor on an individual basis. The value of a solvency certificate or representation is, however, only as good as the analysis supporting it and it may be necessary to preserve this analysis as evidence of solvency at the time of the transaction to counter the "20-20" hindsight a borrower or creditors' committee uses in a fraudulent conveyance attack. While one can again expect significant resistance from a company in providing these, it would provide some additional protection to a lender by providing contemporaneous evidence of solvency.

- ***Tie Guarantees to a Fixed Amount*** – An alternative approach to making each loan party a borrower which may address some of the concerns the Tousa bankruptcy court had with savings clauses in general, is to limit the amount of guaranteed obligations for each individual subsidiary guarantor to a fixed or easily quantifiable amount. From a practical standpoint this creates a whole host of issues for both the lenders and a borrower with a significant number of subsidiaries. The practical nature of a savings clause allows the amount of obligations of a guarantor to adjust automatically over time to an amount that would not render such guarantor insolvent. Due to the inevitable fluctuations in a company's financial condition over time, a guarantor (and the lender) run the risk of being unable to guarantee the full amount of such obligations without rendering it insolvent–an amount that seemed reasonable only a year earlier to both the lenders and the guarantor.

- ***Increased Use of Third Party Solvency Opinions*** – In conjunction with requiring a solvency certificate from each loan party as discussed above, any third party solvency opinion being provided should ideally also cover each loan party on an individual basis if possible. While the Tousa ruling found fault both in the methodology used by the financial advisors and that the solvency opinion only opined as to Tousa's solvency on a consolidated basis, the bankruptcy court did not diminish the value to a lender in obtaining such a solvency opinion from an independent third party as part of its due diligence. In fact, obtaining a solvency opinion from financial advisors was done as a matter of course in acquisition financings in the 1980's and this may again become market practice. Care should also be taken to ensure that the solvency opinion is being provided by a third party that has recent experience in the company's line of business and is not tied to any sort of "success" or enhanced fee for a determination that the potential borrower will be deemed solvent. Both of these were factors the bankruptcy court in Tousa found particularly troubling in weighing the credibility of the solvency opinion provided by the financial advisors.

Conclusion

The full impact the Tousa decision will have on the syndicated lending market remains to be seen. As expected, multiple parties have appealed the Tousa ruling and as of the date of this article a decision has not been handed down. Regardless of whether Tousa is ultimately overturned, it has brought a heightened awareness of the potential risks to secured lenders in loans in particular to below investment grade companies or in the context of leveraged financings and has highlighted the potentially increased scrutiny by bankruptcy courts in evaluating such loans. Fraudulent conveyance as a serious risk to lenders is alive and well. The potential consequences to a secured lender of a loan later deemed to be a fraudulent transfer are too severe to ignore the lessons of the Tousa ruling.

1 "Savings clauses" generally operate in a manner such that the amount of obligations a guarantor is guaranteeing is automatically reduced to an amount that would not render a guarantor insolvent.

2 The general rule for a loan to be considered a fraudulent transfer would be if the debtor does not obtain reasonably equivalent value in exchange for such transfer or obligation transaction; and either (i) the debtor was insolvent on the date of such transfer was made or such obligation was incurred, (ii) was engaged in a business or transaction, or was about to engage in a business or transaction, for which any property remaining with the debtor was an unreasonably small capital or (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured. 11 U.S.C. §548(a)(1)(B).

3 Although it could be argued that the bankruptcy court's finding on "savings clauses" was dicta since the bankruptcy court found the Tousa subsidiaries to be insolvent prior to the July 2007 transactions.

U.S. House of Representatives Passes Derivatives Legislation

*By Conrad G. Bahlke and Tomasz Kulawik**

On December 11, 2009, the U.S. House of Representatives passed the Derivative Markets Transparency and Accountability Act of 2009 (the "DMA") as part of the Wall Street Reform and Consumer Protection Act of 2009. The DMA is a modified form of legislation drafted by the Obama Administration earlier this year (the "Obama Proposal"). The Obama Proposal was the first comprehensive legislative effort to increase regulation of over-the-counter ("OTC") derivatives and bring them under federal supervision. In addition, Senate Banking Committee Chairman Christopher Dodd's discussion draft on comprehensive financial regulatory reform, Title VII of which focuses on the regulation of the OTC derivatives markets (the "Dodd Bill"), remains outstanding. The Senate will consider financial services reform legislation in the new year. This article describes the key OTC derivatives-related provisions of the DMA and the Dodd Bill (collectively, the "Bills") and the differences between them.

Regulatory Authority of the Commodity Futures Trading Commission and the Securities Exchange Commission Over Swap Agreements

Under the Bills, the Commodity Futures Trading Commission (the "CFTC") would be given jurisdiction over "swaps," which are very broadly defined to include virtually all kinds of OTC derivatives. It should be noted, however, that the CFTC's jurisdiction would only apply to swaps entered into by entities that would be required to register with the CFTC, such as "swap dealers" and "major swap participants," as more fully described below. The Bills would not apply to sales of "nonfinancial" commodities for deferred shipment or delivery if such transactions are physically settled (or, in the case of the DMA, intended to be physically settled). Under the DMA, the Secretary of the Treasury and the CFTC may jointly determine the extent to which foreign exchange

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forwards and swaps would be subject to the DMA (and under the Dodd Bill, they would be exempt from regulation as swaps).

The term "swap" would not include "security-based swaps," which under the Bills would fall under the jurisdiction of the Securities Exchange Commission (the "SEC"). Security-based swaps would be defined as contracts that are primarily[1] based on: (i) a narrow-based security index; (ii) a single security or loan, including any interest therein or based on the value thereof; or (iii) the occurrence, non-occurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer(s). Security-based swaps would not include contracts referencing or based upon "exempted securities" as defined in the Securities Exchange Act of 1934, as amended which would primarily include US government and municipal securities, with certain exceptions. The Dodd Bill would also provide that certain transactions that share characteristics of both swaps and security-based swaps ("mixed swaps") would be considered security-based swaps and therefore would fall under the SEC's jurisdiction.

Clearing Requirement

Generally under the DMA, a swap or a security-based swap would have to be cleared if the CFTC or the SEC determines that the transaction is required to be cleared. Such transaction would be subject to a derivatives clearing organization (registered with the CFTC) or clearing agency (registered with the SEC) accepting the transaction for clearing. Clearing organizations and clearing agencies would submit to the CFTC or the SEC for prior approval each transaction or group of transactions that they plan to accept for clearing. The CFTC and the SEC would have 90 days to respond to such request for approval. The Dodd Bill would impose a general requirement that all swaps and security-based swaps be submitted for clearing. The Bills would require that the rules of such clearing organizations and agencies provide that swaps and security-based swaps with the same terms and conditions are economically equivalent within the derivatives clearing organization or clearing agency and may be offset with each other within such derivatives clearing organizations or clearing agencies. Under the Bills (subject, in the Dodd Bill, to the CFTC or the SEC issuing an exemption), the clearing requirement would not apply to swaps and security-based swaps where one of the counterparties is not, in the case of swaps, a swap dealer or a major swap participant or, in the case of security-based swaps, a security-based swap dealer or a major security-based swap participant. The DMA would additionally provide that the clearing requirement would not apply to swaps or security-based swaps entered into by on of the counterparities to hedge or mitigate commercial risk, including operating or balance sheet risk, if such counterparty notifies the CFTC or the SEC how it generally meets its financial obligations associated with entering into non-cleared swaps and security-based swaps.

Each clearing organization or agency would be required to designate a compliance officer, whose duties, among others, would include resolving any conflicts of interest that may arise and ensuring compliance with commodities and securities laws and regulations. The Bills would also establish "core principles" that the clearing organizations and agencies would be required to comply with, including: (i) having adequate financial resources enabling such an organization or agency to meet its financial obligations to its members and participants under "extreme but plausible market conditions;" (ii) establishing and verifying admission and continuing eligibility standards for its members and participants; (iii) having proper risk management and settlement mechanisms as well as rules and procedures ensuring efficient functioning of the organization if one of the members or participants becomes insolvent and (iv) various reporting, information-sharing and record-keeping requirements. An amendment offered by Rep. Stephen Lynch (D – MA), which was subsequently adopted in the DMA, would prescribe certain prohibitions regarding the ownership of swap execution facilities. No identified financial holding company that is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant or a person associated with any of them would be permitted directly or indirectly to acquire beneficial ownership of interest(s) in a swap execution facility or in persons with a controlling interest in such a facility, to the extent that such an acquisition would result in restricted owners having voting control over more than 20 percent of the votes entitled to be cast on any matter by the holders of the ownership interests.

Mandatory Registration of Major Swap Participants

The Bills would require "swap dealers" and "major swap participants" to register with the CFTC. The DMA would define a "swap dealer" as any person who: (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly engages in the purchase of swaps and their resale to customers in the ordinary course of a business; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market-maker in swaps. An exception would be provided for entities that engage in a *de minimis* amount of swap dealing in connection with transactions with or on behalf of its customers. The Dodd Bill, on the other hand, would define a "swap dealer" more broadly as any person engaged in the business of buying and selling swaps for such person's own account, through a broker or otherwise (not including a person that buys or sells swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business).

The definition of a "major swap participant" has been the subject of much controversy. An amendment was offered by Rep. Scott Murphy (D – NY) during House debate on the DMA and was ultimately adopted. A "major swap participant" would be defined as a person who is not a swap dealer and (i) who maintains a substantial net position in outstanding swaps, excluding positions held primarily for hedging, reducing or otherwise mitigating its commercial risk or (ii) whose outstanding swaps create substantial net counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets. The CFTC and the SEC would define (for major swap participants and major security-based swap participants, respectively) "substantial net position" at a threshold they determine prudent for the effective monitoring, management, and oversight of entities which are systemically important or could significantly impact the financial system. The Dodd Bill would define a major swap participant as any person who is not a swap dealer and whose outstanding swaps create net counterparty credit exposures (current or potential future exposures) to other market participants that would expose those other market participants to significant credit losses in the event of the person's default.

The Bills would also contain parallel definitions of "security-based swap dealers" and "major security-based swap participants" who would have to be registered with the SEC.

The Bills would impose requirements that would have to be met by swap/security-based swap dealers and major swap/security-based swap participants, including: (i) capital and margin requirements prescribed by, in the case of banks, the "prudential regulators" (the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, as applicable)[2] and, in the case of non-banks, the CFTC and the SEC jointly (the Dodd Bill) and by the CFTC and the SEC with respect to the entities required to be registered with them (the DMA); and (ii) reporting and recordkeeping requirements (including maintaining daily trading records). The Bills would provide that upon the request of a nondealer counterparty, a swap dealer would be required to segregate initial margin for a noncleared swap in an account with an independent third-party custodian. The Dodd Bill would provide relief from margin requirements for a transaction with an end-user, where such user is not a swap/security-based swap dealer or major swap/security-based swap participant, is not a firm predominantly engaged in financial market activities and enters into the derivative transaction as a hedge under Generally Accepted Accounting Principles.

The Bills would also require compliance with "business conduct standards" and "business conduct requirements" which would include: (i) avoiding fraud and manipulation; (ii) verifying that the counterparties meet the criteria for "eligible contract participants"; and (iii) disclosure to the CFTC, the SEC and the bank regulators of various kinds of information. Finally, the entities referenced in this section would have to comply with certain documentation standards, monitor their trading and have mechanisms in place that would address potential conflicts of interest.

Trading Requirement and Alternative Swap Execution Facilities

The Bills would require that swaps and security-based swaps that are required to be cleared be traded on a board of trade designated as a contract market or on a swap execution facility,[3] or an exchange or a swap execution facility, respectively, unless they are not accepted for trading. A swap execution facility would be defined as a person or entity that facilitates the execution or trading of swaps between two persons which is not a designated contract market or an exchange, including any electronic trade execution or voice brokerage facility. Every swap execution facility would have to be registered either with the CFTC or the SEC. The Bills set forth certain requirements that would have to be met by the swap execution facilities. They would include: (i) establishing and enforcing trading and participation rules that will deter abuses; (ii) establishing and enforcing trading procedures to be used in entering and executing orders; (iii) ensuring the financial integrity of swaps entered on the swap execution facility; (iv) monitoring and compliance with any of the rules of the facility; (v) permitting trading only in swaps that "are not readily susceptible to manipulation;" (vi) monitoring of trading; (vii) obtaining and providing information to the CFTC or the SEC, as applicable; (viii) adopting position limitations or position accountability for "speculators;" (ix) adopting rules to provide for the exercise of emergency authority; (x) publication of data regarding price, trading volume and other trading data on swaps traded on the swap execution facility; (xi) recordkeeping and reporting; (xii) certain antitrust considerations; (xiii) establishing and enforcing rules to minimize conflicts of interest and (xiv) certain financial resources and system safeguards requirements. Finally, every swap execution facility would be required to designate a compliance officer whose duties would include, among others, preparing an annual report on the compliance of the swap execution facility with the commodities and securities laws, as applicable.

Swap Repositories

Under the Bills, the counterparties to a swap or a security-based swap that is not accepted for clearing by any derivatives clearing organization or clearing agency would be required to report such a swap or security-based swap to a "swap repository" or a "security-based swap repository," respectively. Such repositories would be required to register with the CFTC or the SEC, as applicable. The repositories would accept and maintain swap and security-based swap-related data and provide to the CFTC and the SEC information that those agencies might require. Persons who enter into swaps that are not cleared and are not reported to a swap repository would also be subject to certain reporting and recordkeeping requirements. The Bills would also give the CFTC and the SEC the authority to make available to the public, in a manner that would not disclose the business transactions and market positions of any person, aggregate data on swap and security-based swap trading volumes and positions.

Changes to Eligible Contract Participant Definition

Under the Bills, any transaction with a person that is not an eligible contract participant would have to be traded on an exchange. The Bills would also revise the definition of eligible contract participant. Previously, governmental entities owning and investing on a discretionary basis $25 million or more in investments were considered eligible contract participant. This threshold would now be $50 million or more. Further, an individual would be an eligible contract participant if s/he has in excess of $10 million invested on a discretionary basis and not total assets in excess of $10 million, as the Commodity Exchange Act now provides.[4]

Position Limits

The DMA would require the CFTC (and the Dodd Bill would give the CFTC the authority) to establish limits (including related hedge exemption provisions) on the aggregate number or amount of positions in contracts based on the same underlying commodity that may be held by any person across contracts listed by designated contract markets, contracts traded on foreign boards of trade and swap contracts that "perform or affect [sic] a significant price discovery function with respect to regulated entities." In determining whether certain swap contracts perform this function the CFTC would analyze various factors, including: (i) the extent to which such swap contract relies in valuation and settlement on daily or settlement prices of another contract based upon the same commodity; (ii) whether such swap contract's price is sufficiently linked to the price of another contract based on the same underlying commodity as to allow arbitrage; (iii) the extent to which the price of such swap contract is used to price other contracts; (iv) the extent to which the volume of swaps being traded in the commodity is sufficient to have a material effect on another contract traded on a regulated market; and (v) other factors as the CFTC may later prescribe.

The Bills would also give the SEC the authority (but would not require it to do so) to establish limits (including related hedge exemption provisions) on the size of positions in any security-based swap that may be held by any person. There would be no requirement that the security-based swaps in question perform a significant price discovery function. The SEC could also require that self-regulatory organizations prescribe position limits for their members or persons for whom a member of such organization effects transactions in security-based swaps. The Dodd Bill tracks the Obama Proposal in that it would give the SEC the authority to establish position limits with respect to securities traded on national securities exchanges and would also provide that the security-based swaps would need to perform a significant price discovery function in order for a position limit to be imposed.

Foreign Boards of Trade

The DMA would give the CFTC authority not to permit a foreign board of trade[5] to provide its members and other participants located in the United States direct access to its electronic trading or order matching system with respect to contracts that settle against any price of contracts traded on a registered entity unless the CFTC determines that the foreign board of trade: (i) makes public daily trading information with respect to such contracts that is comparable to the information that is made public with respect to the applicable contracts traded on the registered entity; (ii) adopts position limits comparable to those adopted by the respective registered entity; (iii) has the authority to require the market participants to limit, reduce or liquidate any position that might be necessary to prevent or reduce the threat of price manipulation, distortion, disruption of delivery, the cash settlement process or excessive speculation; (iv) agrees with respect to contracts settling against contracts traded on the registered entity to notify the CFTC of any changes regarding information that the foreign board of trade will make publicly available, position limits that will be adopted and enforced, position reductions mentioned above and any other matters of interest to the CFTC; (v) provides information regarding large trader positions in such contracts to the CFTC; and (vi) provides the CFTC with information necessary to publish reports on aggregate trader positions for contracts traded on the foreign board of trade that are comparable to such reports for U.S. contracts against which they settle.

1 The Dodd Bill does not contain the word "primarily".

2 The Dodd Bill would give such authority to a newly created Financial Institutions Regulatory Administration.

3 The Dodd Bill uses the term "alternative swap execution facility."

4 The Dodd Bill would amend the definition in certain other respects as well; for example, the $50 million requirement for governmental entities will not take into account any proceeds from any offering of municipal securities.

5 The Dodd Bill would additionally give the CFTC the authority to require foreign boards of trade to register with the CFTC.

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