

**FEDERAL DISTRICT COURT REJECTS SEC STAFF POSITION REGARDING
TREATMENT OF SWAPS UNDER SECTION 13(d)**

On June 11, 2008, Judge Lewis A. Kaplan of the Federal District Court for the Southern District of New York issued an opinion finding that the use of a total return swap had the purpose of preventing the vesting of beneficial ownership of the underlying security and was part of a scheme to evade the reporting requirements of Section 13(d) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).¹ The Court sought, received and then largely disregarded an *amicus* letter from the Securities and Exchange Commission’s Division of Corporation Finance (the “Division”)² addressing the question whether the long party in a cash-settled total return equity swap transaction is the beneficial owner of the underlying security that the short party to the swap transaction purchases to hedge its exposure.

CSX Corporation (“CSX”), in connection with a proxy fight by the defendants to elect nominees to the CSX board of directors, sued The Children’s Investment Fund Management (UK) LLP (“CIFM”) and 3G Capital Partners Ltd. and sought an order precluding the defendants from voting their CSX shares due to, among other reasons, the failure by CIFM to disclose beneficial ownership of the CSX stock referenced in its swap transactions. The Court found that CIFM violated Exchange Act Section 13(d) by failing to file a Schedule 13D once its economic position in CSX, then held completely in swap, exceeded 5%, but that the belatedly filed Schedule 13D was not materially misleading. The Court issued a permanent injunction restraining future violations of Section 13(d) of the Exchange Act but stopped short of enjoining the defendants from voting their CSX shares.

The Division’s letter to Judge Kaplan took the position that “a standard cash-settled equity swap agreement, in and of itself, does not confer on a party ... any voting power or investment power over the shares a counterparty purchases to hedge its position.” The Division recognized that while the short party to a swap transaction may have economic or business incentives to vote or dispose of the shares as the long party wishes, such incentives are not sufficient to establish beneficial ownership in the long party under Rule 13d-3 absent legal rights held by the long party, or an understanding, arrangement or restricting relationship with the short party, in respect of the voting or disposition of the shares. The Division continued by stating that the long party’s motive of avoiding reporting and disclosure generally does not violate Section 13(d) under the Exchange Act unless the transaction is a sham or creates a false appearance.

¹ *CSX Corporation v. The Children’s Investment Fund Management (UK) LLP, et al.*, 08 Civ. 2764 (LAK) (S.D.N.Y. June 11, 2008).

² Letter from Brian Breheny, Deputy Director of the Division of Corporation Finance, to Judge Kaplan (June 4, 2008).

Without determining whether a long party to a swap transaction is a beneficial owner pursuant to Rule 13(d)-3(a) under the Exchange Act, the Court determined that Rule 13d-3(b)³ conferred on the defendants beneficial ownership of the underlying CSX securities, stating that the defendants intentionally entered into the swaps with the purpose and intent of preventing the vesting of beneficial ownership as part of a scheme to evade the reporting requirements of Section 13(d) of the Exchange Act. The Court addressed the Division's letter and stated that because the purpose of Section 13(d) is to alert the market to large accumulations of securities that may represent a potential change in corporate control, Rule 13d-3(b) should apply and therefore confer beneficial ownership where transactions, such as the swaps entered into by CIFM, are intended to create the false appearance, by evading disclosure under Section 13(d) and (g), that there is no large accumulation of securities having the potential for shifting corporate control.

The Court's decision is subject to appeal to the U.S. Court of Appeals for the Second Circuit by the plaintiffs and the defendants. CSX may seek an expedited appeal of the remedy portion of the decision in order to prevent the defendants from voting at the company's annual meeting.

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June 13, 2008

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³ Exchange Act Rule 13d-3(b) states: "Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose of effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of section 13(d) or (g) of the [Exchange] Act shall be deemed for purposes of such sections to be the beneficial owner of such security."