

**SETTLEMENT OF SECTION 16(b) ACTION
BASED UPON EQUITY SWAP POSITIONS**

On December 16, 2008, The Children's Investment Fund Management (UK) LLP ("TCI"), 3G Capital Partners Ltd. ("3G") and certain of their affiliates agreed to pay CSX Corporation ("CSX") an aggregate of \$11 million to settle a "short-swing profits" action (the "Section 16(b) Action") under Section 16(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Section 16(b) Action alleged that the defendants realized \$137.6 million in short-swing profits from trades in CSX stock and cash-settled total return equity swaps referencing CSX shares.¹

The plaintiff's theory of liability in the Section 16(b) Action was based on the June 11, 2008 opinion issued by Judge Lewis A. Kaplan of the Federal District Court for the Southern District of New York in *CSX Corp. v. The Children's Investment Fund Management (UK) LLP, et al.*, 08 Civ. 2764 (LAK) (the "Section 13(d) Action"). In the Section 13(d) Action, which arose out of a proxy contest by TCI and 3G to elect nominees to CSX's board of directors, the court considered whether equity swaps entered into by TCI and 3G months before they purchased any CSX shares made them beneficial owners of CSX stock for purposes of Section 13(d) under the Exchange Act. Without determining whether a long party to a swap transaction is a beneficial owner under the Rule 13d-3(a) definition of beneficial ownership (which focuses on voting and investment power), the court determined that the "anti-evasion" provision of Rule 13d-3(b) caused the defendants to beneficially own the CSX stock referenced by the swaps, stating that they 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 also determined that TCI and 3G had acted as a "Section 13(d) group" long before deciding to launch the proxy contest.

Based on these determinations in the Section 13(d) Action, the Section 16(b) Action alleged that TCI and 3G had become subject to Section 16(b) when their swap positions exceeded 10 percent of the shares outstanding and that subsequent purchases and sales of CSX common stock and subsequent transactions in equity swaps referencing CSX common stock could be "matched" to yield disgorgeable profits of \$137.6 million. Although the Section 13(d) Action is on appeal to the U.S. Court of Appeals for the Second Circuit, TCI and 3G decided to settle the Section 16(b) Action in order to avoid the risks and uncertainties of the appeal.

¹ Section 16(b) of the Exchange Act provides for the disgorgement of "profits" derived by directors, officers and 10 percent beneficial owners from trading in a company's equity securities, as well as "security-based swap agreements" referencing that company's equity securities, within a period of less than six months. The SEC's rules under Section 16 define "beneficial ownership," solely for purposes of determining whether a person is a 10 percent beneficial owner, by reference to the beneficial ownership definition under Section 13(d) of the Exchange Act.

The settlement of the Section 16(b) Action is an important reminder of the many significant Section 16(b) issues that may arise when investors put on large swap positions in public companies. Before Judge Kaplan's ruling in the Section 13(d) Action, many investors and their counsel comfortably assumed, with the backing of the SEC's staff, that equity swap positions would not, in the ordinary course, be viewed as conferring beneficial ownership of the referenced shares. Although the background of this case — an activist shareholder campaign — may not be ordinary course, there was ample reason to believe that TCI's and 3G's swaps would not make them Section 16 insiders, and in the course of the Section 13(d) Action the SEC staff argued in a letter to the court, albeit unsuccessfully, that the plaintiff's theory of Section 16(b) liability was wrong. Although the Section 13(d) Action was decided on narrow factual grounds, much of the opinion was devoted to making the broader case (which was not part of the holding) that equity swaps confer beneficial ownership under Section 13(d) in circumstances where the anti-evasion provision does not apply. Pending clarification of the Section 13(d) Action in the Second Circuit, investors are well advised to exercise caution when they acquire large economic positions in public companies through swap transactions.

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If you have any questions regarding this memorandum, please contact Michael A. Schwartz (212-728-8267, mschwartz@willkie.com), or the attorney with whom you regularly work.

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