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Executive Editor: Scott P. Studebaker, Esq.
Production Editor: Heather J. Martel
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Waking up a Sleeping Giant

By Wilko van Weert (McDermott Will & Emery LLP)

There hasn't been much comment or debate around the Transfer of Technology Block Exemption Regulation (TTBER) since it came into force in 2004. But this is now about to change. The current TTBER and its accompanying Guidelines on Technology Transfer Agreements (the Guidelines) will expire in 2014. The European Commission has invited stakeholders to make comments via a questionnaire as a first step in the review process for a new regime.

In essence, the current TTBER determines how the EU competition rules on Cartels and the Abuse of Dominance are applied to technology transfer agreements, which are essentially licensing agreements. The TTBER covers bilateral agreements between competitors and non-competitors.

Instead of a plethora of admissible clauses, the current TTBER provides a "safe harbor" for all agreements that fall into its scope and meet its conditions. Any agreements between a licensor and a licensee concerning the exploitation of licensed technology are therefore exempt if the prescribed market share thresholds are not exceeded, and the agreement concerned does not contain any "hard core" restrictions, such as restriction on a licensee to freely determine the prices of products produced under license.

The Guidelines provide for the assessment framework for those agreements that do not benefit automatically from the safe harbor, but that could nevertheless be considered acceptable from a competition law perspective.

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Wilko van Weert is a Partner in the international law firm of McDermott Will & Emery, based in its Brussels office. His practice focuses on EU competition, EU regulatory and EU trade law, with a particular emphasis on the interface between competition and intellectual property law. (wvanweert@mwe.com)

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Waking up a Sleeping Giant *(from page 3)*

They elaborate on the rules and concept of the TTBER while also outlining how to deal with multiparty licensing agreements such as patent pools.

When the Commission instituted a review process for the old 1996 regime in 2001, the feedback on the draft regulation and its accompanying guidelines was very critical. While much of this criticism was taken into consideration in the final document, one of the main issues with the resulting Guidelines was that they created a degree of legal uncertainty for companies. However, when the regime entered into force, its critics grew quiet, getting used to the idea that Guidelines are not meant to provide an all-encompassing set of rules, but that their application to "real" situations remained the responsibility of the companies themselves. While most companies have made a significant effort to model their license agreements upon the new regime, the Commission has not actively enforced compliance with the TTBER, although there may have been some behind-the-scenes consultations with parties, notably on patent pools.

Through its questionnaire, the Commission wants to get a first impression on how the TTBER has been working in practice for the stakeholders and get their ideas on possible enhancements. Besides general questions such as: the impact the current set of rules has on the stakeholders business, problems raised in relation to the application of the regime, suggestions regarding the clarification of the terminology utilized, or the need to keep a block exemption in this field, the Commission addresses very specific issues such as the list of hard core restrictions and restricted restrictions, and the calculation of relevant market shares.

It will be interesting to see whether the Commission is intending to change its view on technology pools. In the framework of the Horizontal Guidelines that were published early in 2011, the Commission provided guidance on standard-setting processes. Increasingly, though, standard-setting processes have been linked to the exploitation of intellectual property rights in the context of technology pools, which suggests that the rules on technology pools may become a focus in this consultation process.

The Guidelines provide for the assessment framework for those agreements that do not benefit automatically from the safe harbor, but that could nevertheless be considered acceptable from a competition law perspective.

Clearly all stakeholders that have worked with the current set of rules will have a real interest in its improvement and should find it worthwhile to take part in the consultation process. As experience shows, the Commission is generally receptive to valid arguments that are made by stakeholders.

It is likely that there will be a second consultation when the Commission has formulated its concrete proposals. However, in order to be involved in the shaping of these proposals and not just in the polishing of them, it is important to submit a completed questionnaire and comments ahead of the February 3, 2012 deadline for the current consultation. ❑

The Review of the EU Data Protection Framework:
A Quick Guide to EU Lawmaking

By Karin G. Retzer and Joanna Lopatowska (Morrison & Foerster LLP)

It has been more than two years since the review of the EU data protection framework officially started. Despite several announcements from the European Commission ("Commission") and growing expectations from the business sector, the publication of the draft law has been continuously delayed. The European Commission has said it plans to publish its proposal by the end of January 2012.[1] Timing has become a key factor in the review. But there is still a long way to go before any proposal becomes law. The process of adopting EU laws is lengthy, complex, and sometimes unclear for businesses established outside the EU.

Below we outline the main stages that govern EU lawmaking procedures to help organizations prepare for when changes to EU data protection laws are likely to become effective.

We also summarize some of the implications of changes considered by the Commission's data protection service. The draft regulation, if adopted "as is," would broaden the geographic scope of EU data protection law and entitle individuals to file complaints at their place of residence, irrespective of the location of the organization holding the data. While leaving many of the principles intact, the regulation would substantially increase liabilities, particularly for service providers, and allow for collective redress. The draft also proposes broad security breach notification requirements for all data types and across sectors.

Who are the players?

There is no single body acting as a legislature in the EU. Instead, the power to adopt laws is spread out among three institutions:

Karin Retzer is Of Counsel in the Brussels office of Morrison & Foerster. Ms. Retzer's practice focuses on the legal aspects of data protection and electronic commerce. She counsels clients on worldwide privacy and data security compliance projects, and assists with questions regarding the international transfer of personal data, the handling of data in sourcing transactions, and e-discovery. (kretzer@mofo.com.) Joanna Lopatowska is an Associate in the Brussels office of Morrison & Foerster. Dr. Lopatowska advises clients regarding their obligations under domestic and international privacy and data security laws. She assists clients regarding compliance with European data protection laws, including in relation to registration with data protection authorities, privacy policies and procedures, data breach, and cross-border data transfers. (jlopatowska@mofo.com)

- The European Commission: a body made of 27 Commissioners (politicians appointed by each EU country) and supporting staff that has the expertise and legal and technical knowledge to prepare draft laws;
- The European Parliament: a directly-elected body composed of 751 members ("MEPs") elected once every five years by voters across the EU;

While leaving many of the principles intact, the regulation on EU Data protection would substantially increase liabilities, particularly for service providers, and allow for collective redress.

- The Council of the European Union: the main decision-making body representing the governments of EU Member States and composed of 27 national ministers. Unlike national governments, it does not have a fixed composition, but depending on the laws to be adopted the composition changes. For example, to adopt the data protection law, Ministers responsible for data protection in their national jurisdiction (most commonly internal affairs or justice) meet.

The Process, Step by Step

In the EU, the Commission has the power to initiate legislation. Thus, the Commission must first prepare, formally adopt, and publish a draft law. Before that happens, it takes months, and sometimes years, to consult various private groups and public institutions, prepare the draft, and assess its potential economic, social, and environmental impact. The Commission is currently still in this first stage of reviewing the EU's data protection law.

Once the Commission has finalized its proposal, it sends the draft law to the Parliament and to the Council, which review the proposal in parallel and suggest amendments.

According to the procedure established in the treaties governing the EU, to adopt data protection laws the Council and the Parliament must reach an agreement on

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the final wording of the text. Unlike national parliaments, the European Parliament does not have self-standing legislative powers; i.e., it cannot pass laws alone, but must act in cooperation with the Council. In this procedure, called the "ordinary legislative procedure" both institutions share equal powers to adopt the law. This means that they must work out a robust compromise. Achieving this may take many months.

There is no time limit to adopt the law. The road to reaching a compromise may, but does not have to, include three stages:

1. In the first stage, the Parliament, voting by a simple majority, proposes to the Council a revised text with amendments.
   a. If the Council approves the Parliament's position, then the law is adopted.
   b. If not (which is usually the case), the Council must propose its own position, adopt an amended text in the form of a so-called 'common position' and pass it back to the Parliament with detailed explanations.

If the Parliament agrees with the Council's proposal, the law is adopted. According to the official Parliament statistics from the previous legislature (2004-2009), 72% of agreements were reached in the first stage, with the average length of the procedure being about 15 months. The longest procedure took almost 48 months (or 4 years).

2. If the Council and the Parliament cannot agree upon amendments, the procedure goes into the second reading. The Parliament and the Council can again propose amendments.
   a. If the Parliament approves the Council's proposal in full, or does not express an opinion, the law is adopted.
   b. The Parliament may modify the Council's proposal and pass it back for Council's consideration.
   c. If the Parliament rejects the Council's text, the procedure fails and the institutions must move on to the third stage. This may also happen if the Commission rejects the amendments. In such a case, the Council does have the power to act unanimously to pass the law if it so chooses.

Despite the official deadline to reach a compromise within four months, the Parliament's statistics indicate that 23% of agreements were reached in the second reading and the average procedure took about 31 months; the longest procedure took 108 months (or 9 years).

3. If an agreement cannot be reached, the institutions convene the Conciliation Committee. It is made up of 27 representatives of the Member States, an equal number of MEPs, and the relevant Commissioner. The Committee revises the two positions and draws up a joint text.
   a. If within six weeks there is no agreement on a common text, then the law has failed.
   b. If the Committee approves the text, the Council and Parliament must in addition formally approve it. If either fails to do so, the law is not adopted.

The Parliament statistics indicate that only 5% of agreements went through the conciliation procedure, and the average procedure took about 43 months; the longest procedure took 159 months (or 13 years).

The EU data protection review is likely to impact many different areas within the EU and, as such, will involve many discussions over many months before the EU institutions agree on a common text. It is not yet possible to predict whether agreement will be reached in the first reading or whether the procedure will develop into further stages.

According to the procedure established in the treaties governing the EU, to adopt data protection laws the Council and the Parliament must reach an agreement on the final wording of the text.

Work Behind the Scenes

The final position of the Parliament is adopted during a plenary session gathering all 751 members of Parliament or "MEPs." The Parliament holds twelve full plenary sessions per year in Strasbourg and six "mini-plenary" sessions in Brussels. Not all of these politicians are equally engaged in the process of adopting the laws. This would be extremely impractical, given the number of MEPs and the amount of legislation the EU produces. Instead, one MEP is tasked with preparing the Parliament's position. To prepare this, the MEP, called the 'Rapporteur,' works within a smaller grouping of MEPs in a Committee. For the review of the EU's data protection law, this will most likely be the Committee on Civil Liberties, Justice and Home Affairs.

The Rapporteur will collaborate with other MEPs from other relevant committees (such as Legal Affairs, Industry, Research and Energy, and Internal Markets, for example) who prepare opinions that complement the main report prepared by the Rapporteur. The Rapporteur will also meet with representatives of the Council to ensure that the work that takes place simultaneously in both institutions can be aligned. At this stage, it is a common practice for interested organizations to meet the Rapporteur and other engaged MEPs and present their arguments and ideas for amendments.

Once ready, the draft report is subject to amendments by all other MEPs and must be then approved by the main Committee and voted on by all MEPs at a plenary session. Even at this stage, interested organizations can present their views and influence the draft.

Other Stakeholders

Other stakeholders are also involved in this process, such as:

1. The European Data Protection Supervisor, an independent supervisory authority devoted to protecting personal data and privacy and promoting best practices in the EU institutions and bodies.
2. Article 29 Data Protection Working Party (WP 29), a network composed of representatives of the data protection authorities of each Member State, the European Data Protection Supervisor, and the European Commission.

These bodies have no role in adopting the EU laws, but they are consulted and play a very active role in interpreting and influencing EU laws on data protection.

Directive or regulation: what difference does it make?

In recent months there has been a lot of speculation about the form a new law would take: a directive or a regulation. The first comprehensive EU measure introduced on data protection was a directive (EU Data Protection Directive 95/46/EC). It is now quite clear that the Commission will publish two legislative proposals: a general regulation on data protection and a directive on the processing of personal data by competent authorities for the purposes of criminal justice.

The difference between a regulation or a directive and why one is used rather than another may not always be clear.

- States and are directly applicable in all Member States. This means they do not require any additional implementation in national legislation. Regulations apply in all Member States in the same wording and scope as they are adopted by the EU institutions. Put another way, once a regulation is passed, it is the law across all of the EU Member States exactly as it is written.
- Directives set out specific objectives that must be reached, and Member States need to adopt national implementation legislation. Member States are left with the choice of form and method of implementation. In principle, directives are not directly applicable to organizations. Often language used in the directives is more general and vague in order to allow Member States to adapt the legislation to their particular national context. To date, most legislation adopted in the area of data protection has been via directives; therefore national laws which give effect to the directives often vary and are inconsistent.

Directives usually include a set timeframe by which Member States must have implemented the required measures at the national level. Regulations do not require such deadlines, as they are directly applicable and come into force on the date specified in the regulation or, if no date is specified, on the twentieth day following publication in the Official Journal. Whether a regulation or directive is used will depend on the law's objectives.

A regulation allows a comprehensive approach to be introduced across EU Member States to address issues of fragmentation in the way data protection rules have been implemented. In addition, a regulation is viewed as an appropriate response to new perceived risks that have come about as a result of developments in technology.

The EU data protection review is likely to impact many different areas within the EU and, as such, will involve many discussions over many months before the EU institutions agree on a common text.

Changes Included in the Draft Regulation

The proposals included in the draft regulation that is currently being finalized by the European Commission would substantially strengthen the EU's powers to combat data protection breaches, similar to those it exercises in competition matters.

The draft Regulation would expand the applicability of EU data protection law to any processing of data relating to EU/EEA residents where the processing is "directed" at such individuals or a service to monitor their behavior.

Some of the major changes introduced in the regulation relate to enforcement. The regulation provides for additional sanctions, including granting national data protection authorities with the power to impose fines of up to 5% of a company's annual turn-over. New offences are introduced and the rights of individuals and consumer and similar associations to file complaints are expanded. It introduces mandatory mutual assistance between Member State authorities and a new "consistency" mechanism to ensure uniform application and enforcement of the Regulation. The Regulation replaces the existing consortium of data protection authorities, the Article 29 Working Party, with a new European Data Protection Board, the secretariat of which would be run by the European Data Protection Supervisor.

The regulation also introduces joint and several liabilities for controllers and processors, as well as for joint data controllers. Joint controllers are expected to address their

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respective compliance obligations though appropriate contracts.

A detailed contract is required with all service provides who may only act upon written instruction from customers, and data processors are subject to additional statutory obligations. The Regulation also clarifies that service providers that act outside the strict mandate of the controller will be considered data controllers.

Importantly, the draft regulation provides consumer, privacy, and similar associations with rights to lodge complaints with the DPAs and seek judicial redress, and substantially strengthens the powers of national DPAs.

The regulation also includes a definition of consent, which must be a freely given, informed, and explicit indication of the data subject's wishes. This implies that opt-out consents will not be sufficient to authorize data processing. In addition, consent is no longer a legal basis for data processing in the employment context. Consent from children, that is any minor below the age of 18, is not valid without parental consent or authorization.

A new breach notification requirement is introduced, under which companies have 24 hours to notify data protection authorities and the affected parties in cases where there is a personal data breach. These requirements are similar to (and equally broad as) those included in the ePrivacy Directive for electronic communications service providers.

Impact assessments, extensive documentation requirements, and the obligation imposed on larger organizations to appoint data protection officers add to compliance burdens. Red tape is not likely to go away as national authorities still need to be "consulted" about many activities.

In relation to international transfers of data, additional criteria are also included for the adoption of adequacy decisions, where data transfers to countries outside the EEA are permitted without a specific legal mechanism. The legitimate interest basis for processing data has been added to the list of exemptions to the requirement for data transfers to countries outside the EEA. Critically, requests from "foreign" courts or authorities may not be recognized unless there is a mutual assistance treaty or international agreement allowing for such recognition.

The much debated "right to be forgotten" is expressly included and strengthens data subjects' access rights and rights to request erasure of data.

The proposal provides for additional accountability and "comprehensive responsibility" for data protection and a requirement to "demonstrate" compliance, for example through internal policies. Codes of conduct, certification mechanisms, and data protection seals are given greater importance.

The proposal, to some extent, would replace the requirement to register with national authorities with a requirement to establish specific and detailed internal documentation and to undertake impact assessments prior to any data processing. Where there are particular risks, the DPAs will still require "consultation," including: (i) analytics or ratings based on work performance, credit history, location, health, personal preferences, and behavior; (ii) processing of sensitive data; (iii) CCTV; and (iv) large quantities of data on children and biometric or genetic data. All public sector organizations, as well as larger private sector organizations with more than 250 members of staff or private sector organizations undertaking "risky" monitoring of data subjects, are required to appoint a data protection officer. The officer may be an employee or contractor and must serve a minimum of two years. Appointment of the officer needs to be notified to the authorities, and the public and all individuals should be provided with contact details for the data protection officer.

It is now quite clear that the Commission will publish two legislative proposals: a general regulation on data protection and a directive on the processing of personal data by competent authorities for the purposes of criminal justice.

Is planning for the changes possible?

Before the European Commission finalizes and formally announces any draft law, discussions on timing are pure speculation. The timing of the procedure will also be subject to both the Parliament's and the Council's calendars. These calendars are continuously changed, and, as a result, matters under consideration can be prolonged.

It is reasonable to expect that the discussions will take 2-3 years after the Commission publishes its proposal before the final law will be adopted. There is a common expectation that the law should be adopted before the Parliament's term ends in summer 2014. It may then take several months before any new law will enter into force.

What is certain is that the new proposed framework will be debated in detail, involving not only the interests of the Member States, but also balancing the interests of business and the rights of individuals. The EU institutions will most likely be caught between promoting business and economic innovations to boost the EU economy and attract business, and the protection of the people's right to privacy and personal data. All interested parties will be provided an opportunity to put forward their views. All of which suggests, however, rather long discussions and plenty of time to adapt in advance of any law being introduced. ❑

1. A likely date could be January 25, which is a Wednesday, the day the Commission generally formally adopts its decisions and three days before the sixth annual EU data protection day on January 28, 2012. If all goes according to schedule, the choice of date would be a symbolic mark of the importance of the review.

European Court of Justice Defines the "Informed User" Relevant in Community Design Registration Matters

By Andreas Ebert-Weidenfeller (Jones Day)

On October 20, 2011, the Court of Justice of the European Union ("ECJ") rendered its first substantive decision on a design patent case. The ECJ handed down its decision on an invalidity action in the *Grupo Promer* case (case C-281/10P).

Background

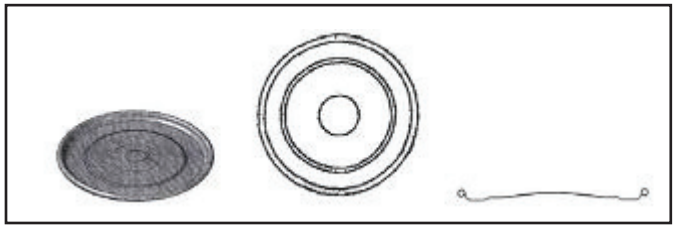
The ECJ, seated in Luxembourg, is the highest judicial authority in the European Union. With regard to intellectual property matters, it is the final resort in construing the Community Design Regulation (and also the Community Trade Mark Regulation); national courts also may refer questions to the court when a case before them relates to harmonized Community law, such as set forth in Directives in the fields of design registrations (and, again, trademarks).

Council Regulation (EC) No. 6/2002 of December 12, 2001 on Community designs (OJ 2002 L 3, p. 1), the Community Design Regulation ("CDR"), provides for a pan-EU design protection for both registered and unregistered designs. Registered designs are administered by the Alicante-based Office for Harmonization in the Internal Market (Trade Marks and Designs) ("OHIM").

Decisions made by OHIM can be appealed before the Boards of Appeal of OHIM. When faced with an adverse decision on appeal, an action against OHIM can be brought before the General Court of the European Union ("GC") in Luxembourg, whose judgment finally can be appealed before the ECJ.

Case History

The case relates to a Registered Community Design ("RCD") for the goods "promotional item[s] for games" represented as follows ("contested RCD"):

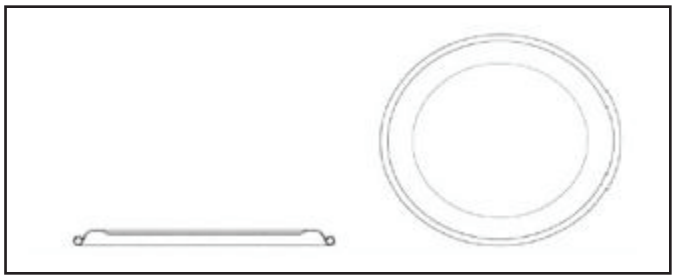


Dr. Andreas Ebert-Weidenfeller is a Partner in Jones Day's Frankfurt office. He has extensive experience in trademark, anticounterfeiting, design patent, and unfair competition law and practice. The scope of his work is centered on intellectual property matters, with a main focus on trademarks and the entire range of laws regarding signs. (aebert@jonesday.com)

An application for a declaration of invalidity was filed against this design, which is for "tazos." By way of background: Among children in Spain, giveaways in the form of tazos (in English, "pogs" or "rappers") are popular. Tazos are circular disks that are often packaged with potato chips or cookies, for example, and the idea behind tazos is that each contains a score value, and a game is played to "win" them from other players.

The case gave rise to two specific issues: Who is the "informed user" whose perception is relevant, and what is his level of attention?

The main basis for the claim was the alleged conflict with a prior RCD of the claimant registered for "metal plate[s] for games" represented as follows ("prior RCD"):



The Invalidity Division of OHIM upheld the application for a declaration of invalidity on the basis of the conflict with the prior RCD. However, on appeal, the Third Board of Appeal of OHIM annulled this decision and rejected the request, mainly on the basis that it negated a relevant conflict of the RCDs in question.

An action against this decision brought before the GC was successful, and in essence the court upheld the plea that a conflict between the RCDs under dispute should be accepted.

The ECJ Decision

In its appeal decision of October 20, 2011, the ECJ confirmed the view of the GC and dismissed the appeal

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with costs. The ECJ confirmed that the contested RCD was in conflict with the prior RCD.

Pursuant to art. 25 (1) (d) CDR, an RCD may be declared invalid if it is in conflict with a prior design. The scope of protection conferred by an RCD includes any design that does not create in the informed user a different overall impression (art. 10 (1) CDR).

The case gave rise to two specific issues: Who is the "informed user" whose perception is relevant, and what is his level of attention?

The Concept of the "Informed User"

The Board of Appeal of OHIM in this case identified two categories of "informed users": a child in the age range of between five and 10 years (the tazo aficionado), and a marketing manager in a company. The General Court pointed out that "informed users" are those that at least know of the phenomenon of tazos.

The ECJ confirmed the view of the GC. The "informed user," according to the ECJ, has knowledge that lies somewhere in an intermediate range. On the one hand, it is exceeding the knowledge and perception of the well-informed and reasonably observant and circumspect average consumer relevant for trademark law questions. On the other hand, it is less than the knowledge of a sectoral expert, which is someone with detailed technical expertise. Therefore, the "informed user" will not observe in detail minimal differences that may exist between designs in conflict:

> *Thus, the concept of the informed user may be understood as referring, not to a user of average attention, but to a particularly observant one, either because of his personal experience or his extensive knowledge of the sector in question. (paragraph 53)*

Direct or Indirect Method of Comparison?

In trademark law conflict matters, it is considered that the relevant average consumer will not necessarily view the mutual trademarks side by side but has to rely on his partially imperfect recollection of them.

It was argued in appeal proceedings that the "informed user" relevant for RCD matters will have a chance to consider the designs under dispute side by side and therefore has the chance to make a direct comparison between them. Therefore, it was argued, the "informed user" would have easily found two significant differences between the mutual designs: the two additional concentric circles clearly visible on the surface of the contested design and the curved shape of the contested design, as opposed to the complete flatness (apart from the brim) of the prior design.

The ECJ considered that the CDR made no direct comment on the question of whether the assessment of RCDs in conflict should be limited to a direct comparison. It concluded that the very nature of the "informed user" means that, when possible, he will make a direct comparison between the RCDs in conflict. This thumb rule, according to the Court, at the same time means that there may be circumstances where there is no direct comparison possible or likely:

> *However, it cannot be ruled out that such a comparison may be impracticable or uncommon in the sector concerned, in particular because of specific circumstances or the characteristics of the devices which the designs at issue represent. (paragraph 55)*

As regards the specific level of attention, the ECJ pointed out:

> *Thus, the qualifier "informed" suggests that, without being a designer or a technical expert, the user knows the various designs which exist in the sector concerned, possesses a certain degree of knowledge with regard to the features which those designs normally include, and, as a result of his interest in the products concerned, shows a relatively high degree of attention when he uses them. (paragraph 59)*

In trademark law conflict matters, it is considered that the relevant average consumer will not necessarily view the mutual trademarks side by side but has to rely on his partially imperfect recollection of them.

The Bottom Line

Design law in the EU now has an independent notion of the relevant "informed user." The knowledge of this fictitious person lies somewhere between the knowledge of the average consumer (relevant for trademark law) and the knowledge of the person skilled in the art (relevant for patent law). This underpins the strength of design patents because minimal differences between designs in conflict will not suffice to exclude infringement claims. It also means that design cases will not be overburdened with expert evidence because the "average consumer" will not be the one whose perception is relevant at the end of the day.

Further, it will always be a case-by-case finding whether the designs in conflict will be assessed by the "informed user" side by side or whether the special circumstances will not allow this to be the practical or useful approach of the "informed user." ❑

Conflicting Visions at Core of Euro Zone Crisis

By Paul Taylor (Thomson Reuters)

Same Bed, Different Dreams

Since the inception of the euro, France and Germany have pursued divergent visions of European economic and monetary union. In two decades, the French have become a little more German, the Germans a little more French. But the gulf remains.

With the fate of the 17-nation single currency at stake at a summit this month, 20 years almost to the day since the Maastricht summit at which European leaders agreed to merge their monies, the same battles are still being fought out.

Between sovereignty and federalism; between "stability" and growth; between more solidarity and stricter discipline; between a directorate of big states and a more democratic organization for the continent; and between a tightly-knit "core Europe" and a broader but looser union.

The outcome of this month's 27-nation European Union summit may determine the course of the world's largest trading bloc.

One road leads to a core group of euro zone states forging ahead with closer integration; another to a continuation of the current, multispeed Europe limping along at the pace of the slowest in the convoy; and a third toward a potential breakup of the currency and disintegration of the Union.

Compromise proposals outlined by Chancellor Angela Merkel and President Nicolas Sarkozy on Monday to anchor stricter budget discipline in the EU treaty owed more to Germany's drive for fiscal virtue than to France's push for more "solidarity".

The issues that divided Paris and Berlin were all too familiar - whether to give supranational EU institutions the power to overrule national budgets and punish deficit offenders; whether to mutualize European debts; whether to let the European Central Bank act as a lender of last resort to states and banks.

As always, the French want elected governments calling the shots with political discretion in taking decisions and a subordinated secretariat role for the European Commission, while the Germans want community bodies to have automatic powers to uphold the rule of law.

"European integration will have to advance through intergovernmentalism because Europe will have to take strategic political decisions," Sarkozy said in a major speech last week.

Political or Economic Project?

To the French, monetary union has always been a political project - to regain a share of sovereignty over their currency instead of being dominated by an overmighty Deutsche Mark; to anchor a reunited Germany to Europe after the fall of the Berlin Wall; and to strengthen Europe's political power in the world.

Helmut Kohl, German chancellor at the time, saw the euro as a stepping stone on the way to a federal political union, but the French were reluctant to cede sovereignty then as now. Kohl was the last German leader to espouse a United States of Europe.

His successors, Gerhard Schroeder and Angela Merkel, grew up after World War Two and saw the EU more pragmatically as a vital forum for advancing German interests. But they did not want "Brussels" interfering in their own conduct of government and no longer felt a moral duty to pay for Germany's historical guilt.

Since the inception of the euro, France and Germany have pursued divergent visions of European economic and monetary union. In two decades, the French have become a little more German, the Germans a little more French. But the gulf remains.

Like the French, they are today closer to President Charles de Gaulle's vision of a Europe of nations, than to EU founding father Jean Monnet's supranational community method.

"France and Germany make no secret of wanting less Monnet and more de Gaulle," Charles Grant, director of the Centre for European Reform, wrote in an essay.

As a result, the European Commission has been weakened, its sole right to propose legislation effectively bypassed, and its president, Jose Manuel Barroso, reduced to complaining about the inefficiency of intergovernmentalism to make the euro zone work.

"To come out of this crisis we need to work with and through the European institutions. We need a true Community approach ... It is the only way to build a Europe that guarantees efficiency, fairness and legitimacy. Intergovernmental cooperation is not enough," he said in a September 28 State of the Union address.

To many Germans, the euro was and remains primarily about economics - to lock in exchange rate stability with Berlin's main trading partners; to achieve economies of scale; to impose budget discipline on Europe; and to have an independent central bank run a currency "as strong as the mark".

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Euro Zone Crisis *(from page 11)*

Kohl insisted on a "no bailout" clause in the Maastricht treaty to avoid a "transfer union", in which Germans were forced to pay for the debts of less prudent partners.

When the euro zone debt crisis struck, the German reflex was to tighten enforcement of the budget rules, and for each state to make savings to cut its deficit and debt.

"When the euro was introduced by the Maastricht treaty in 1992, there was a historic compromise," Peter Altmaier, parliamentary business manager of Merkel's conservatives, told Reuters in an interview.

"1) The awfully strong Deutsche Mark was abolished, and 2) German stability culture would be implemented Europe-wide. The first part was implemented. The second part is still valid and binding in the treaty, but it hasn't yet been implemented."

The German discourse carries heavy moral overtones. "Deficit sinners" have to "atone" for their sins and "do their homework" by cutting public spending, wages, pensions and benefits and working longer and harder.

The French believe the right response is for member states to show "solidarity" with the weaker members of the European family and for the European Central Bank to put a floor under all national debt by acting as lender of last resort.

Although Paris is the second largest contributor to the euro zone bailout fund after Berlin, there has been hardly any debate in France on the cost of rescuing Greece, Ireland or Portugal.

Enabling resolutions have slipped almost unnoticed through parliament by consensus in contrast to the fierce debates and cliffhanger votes they have engendered in the Bundestag.

This is partly because the French have a centuries-old tradition of a strong unitary state, entitled to spend "public money" in the national interest, with a weak legislature, a craven judiciary and few checks and balances.

The French, in the words of Thomas Klau, a historian of the euro, are latecomers to fiscal discipline although they have become "a bit more German" in recent months as fear of losing their top-notch AAA credit rating has mounted.

"The French are now at least paying lip service to moving away from deficit financing as the norm. But while the words are there, action is less certain," said Klau, a German who heads the Paris office of the European Council on Foreign Relations.

He compared the French approach to deficit-cutting with Madame du Barry, the last mistress of King Louis XV, who pleaded on the scaffold for "just one more moment, Mr. Executioner".

"The problem is that moment has been going on since 1974 and the executioner is getting a bit impatient," Klau said.

Germany too has had its lapses. Berlin and Paris conspired to tear up the EU budget rules in 2003 to avoid being subjected to disciplinary procedures for exceeding the deficit limit of 3 percent of gross domestic product for the third successive year.

Both countries have a public debt of more than 80 percent of GDP, well above the Maastricht treaty limit of 60 percent.

But Berlin returned to budget rectitude after Merkel took office in 2005, while France has continued to go astray.

Rule of Law

In Germany, the state's powers are strictly circumscribed by the federal system, a strong parliament, an activist constitutional court and an independent central bank to prevent any repetition of the abuses of the Nazi era.

These differences have been projected onto Europe. The Germans believe the answer to the euro zone's policy mistakes is a stricter application of the rule of law, with the European Commission empowered to reject budgets that breach agreed EU rules and the European Court of Justice to punish offenders.

Under the Sarkozy-Merkel compromise, deficit offenders will face automatic sanctions unless a supermajority of euro zone states votes against their application.

The court will be able to rule on whether euro countries have implemented a "golden rule" on balancing their budget properly in national law, but will not sit in judgment on individual national budgets.

Some critics say the proposed treaty changes will weaken democracy at both national and European level, and give bigger member states a veto right denied to smaller countries.

Sylvie Goulard, a French member of the European Parliament's economic and monetary affairs committee, said Sarkozy's insistence on intergovernmental control in the euro zone weakened Europe's institutions and sapped their legitimacy.

"What legitimacy are we talking about?" she asked. "If there is no supranational legitimacy, why should the Greeks or the Portuguese obey what Mr. Sarkozy and Mrs. Merkel decide, since neither of them was elected to govern in Athens or Lisbon."

Merkel and Sarkozy already stand accused of having forced out the leaders of Italy and Greece last month by summoning them for public reprimands that caused markets to lose confidence.

Now they want decisions in a future permanent euro zone bailout fund taken by a supermajority - 85 percent - instead of unanimity, to prevent small states or parties in those countries' governments from blocking joint action.

That happened when Finland held up an expansion of the euro zone rescue fund agreed in July to demand collateral on loans to Greece, and when a junior coalition partner in Slovakia's ruling coalition opposed boosting the rescue fund, delaying approval of the measure and bringing the government down.

The nearly three-month delay in approving the agreement was cited by analysts as a key cause of markets' loss of confidence in the euro zone's ability to get on top of the debt crisis.

Parliament Sidelined

French efforts to sideline the European Parliament have a long tradition, partly because France's own parliament was reduced to a largely rubber-stamp role by the 1958 Fifth Republic constitution, which enshrined a powerful executive.

Roland Dumas, the French foreign minister at the time of the 1991 Maastricht treaty negotiations, told Reuters later that then President Francois Mitterrand had instructed him to concede "as little as possible" power to the EU assembly.

On that point, Germany has become more French. The German Constitutional Court, in a landmark 2009 ruling on the EU's Lisbon treaty, declared that the EU is not a democratic state and the European Parliament is not a proper legislature.

Hence it enjoined the German parliament to take more of a supervisory role over European affairs and barred it from ceding budget sovereignty to Brussels.

That has placed tight restrictions on the direction in which the euro zone can develop. Government lawyers interpret that judgment and a more recent one on the euro zone's rescue fund as ruling out common euro zone bonds as unconstitutional.

On some other points, the French have become more German. They have a history of inflating their way out of crises and traditionally prefer their currency weak enough to help sales of their airplanes, cars and cereals on world markets.

Yet there has been a striking absence of calls for the ECB to let the euro depreciate, or soften its approach to inflation, among mainstream French politicians since the crisis began. Only the far-left and far-right have aired such views.

In deference to Merkel's domestic problems, Sarkozy publicly rejected the idea of issuing common euro zone bonds again this week, but many French officials privately see them as part of a longer-term solution to the debt crisis.

But in one crucial way, at least, the two different visions of Europe have come closer. Both Paris and Berlin agree there is far too much at stake to let the euro fail.

That is already leading both of them to do things that are not in either country's political tradition - bailouts for Germany, austerity for France - to save the euro. ❑

SPAIN

Spanish Parliament Approves Law Amending the 2003 Insolvency Act

By Victor Casarrubios and Charo de los Mozos (Jones Day)

On October 10, 2011, the Spanish Parliament approved Law n. 38/2011 (the "Amendment"), which amends the Spanish Insolvency Act of 2003 (the "Insolvency Act"). Except for certain of its provisions (which became effective on October 12, 2011), the Amendment will generally come into force on January 1, 2012.

The Insolvency Act, enacted in July 2003, was a milestone in the Spanish legal system, as it implemented a new unitary insolvency system for professionals and enterprises (both individuals and legal entities) governed by a single law and subject to the exclusive jurisdiction of specialized courts (the Mercantile Courts). However, eight years of experience and the current financial turmoil have highlighted certain defects that have prevented the Insolvency Act from achieving its main goal: preservation of an insolvent company as a business concern.

The Amendment does not radically change the legal principles of the Insolvency Act. However, it is a comprehensive update of Spanish insolvency regulations applying the Insolvency Act, implemented to respond to the current European Union economic situation. The main goals of the Amendment are:

(i) To avoid the liquidation of insolvent companies by exploring alternatives to an insolvency proceeding and offering a company a faster and less expensive solution to its financial crisis by means of refinancing agreements;
(ii) To encourage fresh-money infusions by granting priority to fresh credit over the claims of other creditors;
(iii) To offer certain kinds of creditors "insolvency credits," or claims, with full voting rights at the meeting of creditors after a company's declaration of insolvency;
(iv) To simplify insolvency proceedings and assist the overburdened Mercantile Courts;
(v) To improve the professional qualifications of insolvency trustees; and

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Víctor Casarrubios is a Partner in Jones Day's Madrid office. His practice focuses on acquisitions and dispositions of real estate assets, real estate M&A, real estate finance, leases, leaseback transactions, distressed real estate assets/debt, real estate investment structures, planning and administrative approvals, development, and construction and related services. (vcasarrubios@jonesday.com) Charo de los Mozos is an Associate in the firm's Madrid office. She advises domestic and international companies in financing and acquisition transactions of commercial, residential, and industrial real estate assets and portfolios and real estate holding companies. (cdelosmozos@jonesday.com)

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(vi) To clarify the legal regime of insolvency proceedings by regulating, among other things, the order of payment among creditors in cases involving assets that are inadequate to satisfy the claims of all creditors in full.

The provisions in the Amendment addressing each of these six goals are discussed below.

Refinancing Agreements

Under the Insolvency Act, any agreement signed by an insolvent company within two years prior to declaring insolvency is subject to a "claw-back" action (acción de reintegración) if the agreement caused "economic loss" to the company's assets. A loss is presumed (among other cases) in agreements where new "in rem" security was pledged by the company to secure preexisting debt.

However, a refinancing agreement between the insolvent company and its creditors executed within two years prior to a declaration of insolvency is protected from a claw-back action if: (i) the agreement effectuates a significant increase of the funds available to the company or an extension of the maturity or replacement of existing obligations; (ii) the agreement was supported by a feasibility plan aimed at enabling continuation of the business; and (iii) the following conditions are fulfilled prior to the commencement of insolvency proceedings:

(a) The agreement is signed by creditors holding at least 60 percent of the insolvent company's debt;

(b) An independent expert designated by a mercantile registrar issues a technical opinion on the refinancing agreement stating that the information provided by the debtor is sufficient, the plan is reasonable and achievable, and that any new security granted as part of the refinancing is proportionate on the basis of market conditions at the time the agreement is executed. Under the Amendment, if a refinancing agreement applies to a group of companies, a joint opinion covering all related companies may be issued by the expert. If the opinion contains any reservations or limitations, the parties to the agreement must provide a detailed assessment of the relevance of any such caveats; and

(c) The agreement is formalized before a notary in a public deed, which should include all the evidence of compliance with the above-mentioned requirements.

Under the Amendment, it is now possible to obtain judicial approval (homologación) of a refinancing agreement prior to the commencement of insolvency proceedings if, in addition to the requirements delineated above, the following conditions are satisfied:

(a) The refinancing agreement has been executed by creditors holding 75 percent of the insolvent company's debt; and

(b) The refinancing agreement does not represent, in the court's opinion, a disproportionate sacrifice by nonsignatory creditors.

Judicial approval of a refinancing agreement has the following advantages:

(a) Any standstill period under the refinancing agreement is extended to nonsignatory creditors, unless their claims are secured by "in rem" security, such as a mortgage. Affected creditors may object within 15 days of publication of judicial approval of the agreement in the Spanish Official Bulletin and the Public Insolvency Register. However, the grounds for objection are limited to: (i) failure to satisfy the required debt percentage threshold; and (ii) a challenge to the court's conclusion that dissenting creditors would not be disproportionately prejudiced by approval of the agreement. Any objections interposed are adjudicated and resolved in a single proceeding before the court, and the court's final decision is not subject to appellate review. Judicial approval becomes effective on the day following publication of the final decision on objections in the Spanish Official Bulletin.

Under the Insolvency Act, any agreement signed by an insolvent company within two years prior to declaring insolvency is subject to a "claw-back" action if the agreement caused "economic loss" to the company's assets.

(b) The court granting approval of a refinancing agreement may order the suspension of any foreclosure proceedings initiated by any creditor during the standstill period established under the refinancing agreement, which may not exceed three years. However, creditors retain their rights against those jointly obligated with the insolvent debtor as well as any guarantor of the debt; guarantors do not have recourse to the court to oppose payment on their guarantees.

Should the debtor not fulfill the terms of the refinancing agreement, any creditor may request a judicial declaration of breach from the same court that approved the agreement. Once this declaration is issued by the court, creditors may request a declaration of insolvency with respect to the debtor or initiate individual collection actions against it. The debtor may not petition for another judicial approval of a refinancing agreement during the year following its initial request for judicial approval.

The Insolvency Act provides that a debtor is obligated to initiate an insolvency proceeding no later than two months after it becomes, or should have become, aware that it is in-

solvent. In addition, a creditor may commence an insolvency proceeding against the debtor if the creditor becomes aware that the debtor has become insolvent. Under the Amendment, the two-month deadline is extended if the debtor has initiated negotiations to reach a refinancing agreement and the court is notified of the debtor's situation before the two-month term expires. However, the Amendment provides that the debtor must commence an insolvency proceeding if it is still insolvent three months after delivering the required extension notification to the court.

Priority for Fresh Money

The Insolvency Act did not originally contain any specific protection or priorities for claims based upon fresh-money infusions into an insolvent company. In practice, fresh money was protected with specific additional security (for example, mortgages or pledges) granted in connection with a refinancing agreement. Pursuant to the Amendment (and with effect from October 12, 2011), 50 percent of "fresh money" (i.e., new capital obtained by the company under a refinancing agreement that meets the requirements for protection described above) is conferred with priority in the form of a "credit," or claim (discussed below), against the assets of the insolvent debtor (crédito contra la masa). The remaining 50 percent is conferred with priority in the form of an insolvency credit with priority as a "general privilege."

Claims against the insolvent debtor's estate are satisfied from assets of the insolvent company that are not mortgaged, pledged, or otherwise used as collateral security for specific credits. The remaining assets of the insolvent company are used to pay, in descending order of priority, credits with general privilege, ordinary credits, and subordinate credits.

The new priorities for fresh money under the Amendment do not apply to new capital in the form of either equity or debt financing provided by existing shareholders or affiliated companies holding more than 10 percent in the share capital of the insolvent company or by company directors.

Acquisition of Insolvency Credits

Under the pre-Amendment version of the Insolvency Act, with certain exceptions, creditors that acquired claims after the initiation of an insolvency proceeding had no right to vote at the creditors' assembly convened to vote on the debtor's reorganization plan (convenio de acreedores). Pursuant to the Amendment (which applies to reorganization plans proposed after January 1, 2012), any creditor "subject to financial supervision" that acquires insolvency credits after the initiation of an insolvency proceeding will have the right to vote at the creditors' assembly. The Amendment does not define the phrase "subject to financial supervision," but Spanish law governing this issue provides that the Bank of Spain has control and supervisory authority over, among others, banks, savings banks, credit cooperatives, branches of foreign financial entities, and mutual guarantee companies.

Simplified Insolvency Procedure

In connection with insolvency proceedings to be initiated beginning in 2012, the Amendment implements a simplified insolvency procedure if the court determines that an insolvency is not complex, in accordance with the following criteria:

(a) The list of creditors filed by the debtor with the court includes fewer than 50 creditors;
(b) The initial estimate of aggregate indebtedness is less than €5 million;
(c) The initial asset valuation is below €5 million; and
(d) The debtor files a proposed composition agreement providing for the merger, sale, spinoff, or transformation of the company in a transaction involving a transfer of substantially all of the debtor's assets and liabilities to another entity.

Under the Amendment, the court is obligated to apply the simplified procedure if the debtor submits, in a liquidation plan, a binding proposal by a third party to acquire an operating unit of the debtor or if the debtor has ceased doing business and its employment contracts are no longer in force. At any time, the court may convert the insolvency proceeding from an ordinary proceeding to a simplified proceeding and vice versa, on the basis of a change in circumstances relative to the criteria for eligibility.

Insolvency Trustees

The Amendment increases the scope of liability and qualifications required for insolvency trustees, who are entrusted with examining the bankruptcy estate and existing debts. In addition, the number of members sitting on the panel of insolvency trustees in any particular insolvency proceeding is reduced from three to one, although an ancillary trustee (auxiliar delegado) may be appointed, as discussed below. With certain exceptions, an insolvency trustee must:

(a) Be a practicing lawyer with at least five years of experience and an accredited education specializing in insolvency law; or
(b) Be an economist, chartered accountant, or auditor with at least five years of experience and accredited expertise in insolvency.

Organizations may also be appointed as trustees, provided they include a lawyer, economist, chartered accountant, or auditor who satisfies the requirements set forth above and that they guarantee due independence and dedication in performing their obligations as an insolvency trustee.

The Amendment imposes specific requirements on trustees in insolvency proceedings involving banks, insurance companies, and other regulated entities. Any expert rendering an opinion required for approval of a refinancing agreement is ineligible for appointment as a trustee in any ensuing insolvency proceeding commenced by or against the same debtor.

In connection with an insolvency proceeding of "special significance," the Amendment provides that the court shall appoint, as an additional member of the panel of trustees, a

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creditor holding an ordinary insolvency credit or an unsecured insolvency credit with general privilege. According to the Amendment, insolvency proceedings have special significance if:

(a) The annual turnover of the debtor was €100 million or more in any of the three fiscal years preceding the date of commencement of the insolvency proceeding;
(b) The aggregate indebtedness declared by the debtor exceeds €100 million;
(c) The number of creditors declared by the debtor exceeds 1,000; or
(d) The number of the debtor's employees exceeds 100 or did so in any of the three fiscal years prior to the insolvency-proceeding commencement date.

In addition, in cases involving a single insolvency trustee, the court, after convening a hearing on the issue and concluding that the existing trustee is not a legal entity (i.e., an association, corporation, partnership, proprietorship, trust, or individual that has legal standing under the law), may appoint an additional, or ancillary, trustee. The appointment of an ancillary trustee is mandatory in certain cases specified in the Amendment.

Payment of Claims Against Insolvency Assets (Créditos contra la Masa)

The Insolvency Law and the Amendment provide that certain claims (e.g., claims for legal costs incurred in connection with insolvency proceedings, post-insolvency declaration claims arising from business operations, and salaries payable during the 30-day period prior to the declaration) shall be paid from unencumbered assets of the insolvent company. Eligible assets are therefore reserved or reduced (prior to the payment of any other claims) for the purpose of satisfying this special class of claims (créditos contra la masa). These claims are paid as they mature, but the Amendment gives the trustee(s) the power to alter the order of payment among different claims within this special class, provided the trustee(s) conclude that it is in the best interest of the proceedings and that there will be sufficient eligible assets to pay all claims in the class.

If at any time after the declaration of insolvency, the trustee(s) should determine that eligible assets are not sufficient to pay all the claims in this class, the Amendment provides that the insolvency proceeding will terminate, unless the court finds that the obligations are guaranteed by a third party. In the event of such a termination, claims in this class shall be paid in the following order:

(i) Claims for salaries earned during the final 30 days of employment in an amount not exceeding double the national minimum salary;
(ii) Claims for salaries and other compensation in an amount computed by multiplying triple the national minimum salary by the number of salary days for which payment is due;
(iii) Claims for judicial costs and expenses associated with the insolvency proceeding; and
(iv) Any other claims against the insolvency assets (including claims based upon fresh money). ❑

The Enforcement Regime of the UK Financial Services Authority -- Who's Next?

By Selina Sagayam, James Barabas and Jeffery Roberts (Gibson Dunn & Crutcher LLP)

Overview -- It's Not Just a Numbers Game ...

Since overhauling its financial penalty framework in March 2010, the UK Financial Services Authority (FSA) has gone a long way to dispel views that it has a lacklustre approach towards levying market abuse fines. However, harsher fines are just one feature of its tougher enforcement regime. Recent cases show that the FSA has generally stepped up its enforcement activity, improving the range of resources and evidence available to successfully investigate market abuse. This will particularly be the case due to the introduction of the Zen monitoring system and requirement for firms to tap employee mobile phones.

Ready to Take on the "Tricky" Cases

The regulator has also shown increased willingness to expunge novel/unusual forms of market abuse involving both non-equity securities, and instruments that do not in themselves fall squarely within the ambit of the Financial Services and Markets Act 2000 (the "Act"). The FSA has also levied fines in respect of individuals that live abroad, yet engage in abusive transactions in UK markets. Although in general, the harshest hitting penalties have been issued to high profile individuals, or those involved in very serious cases of market abuse, recent enforcement action has signalled that the FSA has the potential also to come down on firms

that do not take appropriate steps to supervise and manage market abusers. It remains to be seen whether this tougher enforcement regime will transfer to the FSA successor agencies once the regulator is abolished.

This article looks at a few examples of FSA enforcement action in 2011 in the market abuse area and considers how this heralds a more robust enforcement regime.

Lacklustre No More

Record Fines: The FSA's tougher financial penalty framework now allows it to impose harsher fines on market abusers in a more credible manner consistent with the stated goals of deterrence, discipline and disgorgement. The full effects of this framework can now be seen, with there being a step change in the frequency and level of fines handed down to market abusers[2]. For instance, a record fine of £6,108,707 (after discount) was imposed on an individual investor based in Dubai, Rameshkumar Goenka, being twice the size of the previous record fine handed down to an individual[3]. Whilst this was a landmark fine, this case has also gone some way to dispel a long standing urban myth that the FSA is not as robust when penalising individuals engaged in market abuse involving non-equity instruments.

Remember -- the net spreads to non-equity instruments: Goenka was found to have manipulated the closing price of global depositary receipts ("GDRs") in Indian company, Reliance Industries Limited ("Reliance"), seconds before the closing bell. This was in order to avoid a loss that he would have otherwise suffered under a structure product that was linked to the price of Reliance GDRs. In addition to fining Goenka, the FSA required him to pay restitution of US$3,103,640 to the counterparty to the structured product. While there were aggravating factors contributing to the level of fine[4], it shows that severe fines will be levied regardless of whether the securities are debt or equity. An individual, Michiel Visser was also fined £2,000,000[5] for engaging in market manipulation in relation to PLUS securities for the purpose of inflating the net asset value of a fund. These sizeable fines followed hot on the heels of a £1,094,900 fine (after discount) imposed on Samuel Khan earlier this year for market manipulation. Goenka, and to a lesser extent Visser, demonstrate that the FSA is equally committed to investigating and levying fines in respect of individuals that live and work abroad, yet commit market abuse on UK markets[6].

Recent cases show that the FSA has generally stepped up its enforcement activity, improving the range of resources and evidence available to successfully investigate market abuse. This will particularly be the case due to the introduction of the Zen monitoring system and requirement for firms to tap employee mobile phones.

"But ... I did not deal!": The FSA has been particularly committed towards cracking down on insider dealing/disclosure, which former FSA enforcement director, Margaret Cole has termed the FSA's "specialist remit"[7] -- a reminder that the scope of the offence goes well beyond pure dealing activities but also covers improper disclosures. This area has seen stringent fines being levied against market abusers, as was seen in the cases of Perry Bliss and William Coppin, both employees of the same firm. The pair was found to have disclosed inside information, and received prohibition orders and fines of £30,000 (after discount) and £70,000 respectively. These fines are particularly large, despite the fact that Bliss and Coppin only disclosed inside information to their customers, and did not themselves deal in the securities. While the FSA accepted that the pair worked for a firm that had a poor regulatory and compliance culture, which encouraged aggressive sales tactics at any cost, it nonetheless took the view that the disclosures allowed the pair to benefit from sales commission, and demonstrated that they were unfit to perform any controlled functions.

Keeping it in the family: Conversely, in another father-son insider dealing case (see the case of the Uberois, Client Update 1 April 2010), Jeff Burley, a 73 year old pensioner, was fined £35,000 after discount for insider dealing. He received inside information from his son Jeremy Burley, in respect of a Ugandan company. Jeremy directed his father to telephone his broker to instruct the broker to dispose of Jeremy's shares in the company. Jeremy was fined £144,200. Notably, Jeff's fine was considerably large, despite the fact that the FSA acknowledged that the dealing was instigated by his son, and did not result in any financial benefit for Jeff.

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Selina Sagayam is an English qualified Partner in the London office of Gibson, Dunn and Crutcher. Ms. Sagayam's practice is focused on international corporate finance transactional work, including public and private M&A, international equity capital markets offerings and advisory work focused on corporate governance and securities law advice. She has particular experience in the financial services and TMT sectors. (ssagayam@gibsondunn.com) James Barabas is an English qualified Partner in the firm's London office. Mr. Barabas has extensive experience in UK City Code governed public takeovers and schemes, and private mergers and acquisitions for a mixture of corporate and private equity clients. (jbarabas@gibsondunn.com) Jeffery Roberts, qualified in England and Wales, is a Senior Partner in the firm's London office. Mr. Roberts has a broad corporate transactional practice that includes public and private M&A, private equity and equity capital markets and joint venture transactions both in the UK and across borders. (jroberts@gibsondunn.com)

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A Novel Analysis

Bring it on …: Recent enforcement cases have also demonstrated that the FSA is both able and willing to successfully investigate more novel and complicated forms of market abuse, even if this means interpreting the Act widely. The confidence of the FSA to take on these trickier cases is seen by some as the benefits of its recent investment in human capital -- senior recruits from industry with greater and sophisticated market experience.

"Layering": This was seen in the case of Swift Trade Inc., a firm that directed its traders to carry out a form of market abuse known as "layering". Traders placed large block synthetic orders of stocks in the LSE order book, creating a false impression of liquidity. The traders would then quickly withdraw their block orders, and make a real trade once the price had moved to their advantage. This was the first successful case involving this type of activity; however, it was particularly interesting as Swift's traders were actually placing orders in respect of swaps and contracts for difference. While the FSA acknowledged that these instruments are not "qualifying investments" for the purposes of the market abuse provisions in the Act, the regulator was of the opinion that they were related to underlying qualifying investments (i.e. shares) and therefore fell within the terms of the Act. As a result, Swift Trade was fined £8,000,000.

Hedge Funds and "unusual" practices: Similarly, the above cases of Swiss Trade, Goenka, Khan and Visser could be seen as indicators that the FSA is widening the scope for penalizing individuals for market abuse further still. In these cases, the FSA acknowledged that while banks often hedge their positions in various ways, these individuals were engaged in "unusual" transactions that were "not in conformity with accepted market practice". It remains to be seen whether this will narrow the scope for traders and other market participants to engage in novel forms of hedging and other trading techniques, without running the risk of being found to have committed market manipulation.

Smart and reasonable regulation: Nonetheless, despite this willingness to tackle novel and complicated forms of market abuse, the FSA has generally taken a fairly measured approach to choosing the appropriate battles to fight -- a shift from its initial approach when it started its "let's get tough" approach to enforcement which saw a number of "easy wins" for the FSA. Generally, it has been initiating the harshest forms of enforcement action only if it will serve as a credible deterrence for others, which in some cases has meant taking action against the most wealthy[8] and high profile[9] individuals in order to maintain market confidence. This more reasonable side of the regulator came through in the case of Jeff Burley, when the FSA chose not to initiate criminal proceedings against the 73 year old due to his health condition; however a less lenient side was shown in the case of Adrian Bancroft, who was imprisoned and given a prohibition order for various financial crimes.

What Next?

Watch Out -- Are you watching your employees?: Interestingly, there have been a string of FSA enforcement cases that indicate that individuals engaging in market abuse may not only be the ones at risk of FSA enforcement action. While the FSA will most certainly commence enforcement action against firms that actively encourage their employees to engage in market abuse[10], it has been recently fining firms[11] that fail to "supervise" its employees, in breach of Principle 3 of the FSA's Principles for Businesses[12]. These cases have tended to be instances when there is general widespread failure to supervise employees, but it is not certain whether the FSA could also begin initiating enforcement action against firms that do not take steps to adequately supervise/prevent employees from engaging in market abuse.

Tools of the Trade -- Taping: However, two new developments are likely to further increase the likelihood of successful FSA enforcement action. As of November 14, firms became required to tape work mobile phones[13], which will provide the regulator with additional crucial evidence when investigating market abuse[14]. However, as firms are only required to keep this information for six months, the FSA will need to be swift in its investigations in order to make use of this additional evidence.

Tools of the Trade -- the Wisdom of ZEN: Further, the FSA has introduced a new monitoring and surveillance system, Zen, which will vastly increase its ability to monitor market abuse transactions across a range of EU member state exchanges, which involve alternative investment instruments such as interest, currency and commodity related products. While the roll out of Zen has the potential to lead to more successful enforcement actions, it remains to be seen whether this will be the case. Zen now requires firms to provide the FSA with daily reports on a wider range of transactions that took place the previous day. Due to the detail of information now required in these reports, there is a risk that a firm's failure to provide accurate reports or failure to provide any reports altogether, will hinder the FSA's ability to effectively monitor market abuse.

All in all, while the FSA remains committed to maintaining a tougher enforcement regime in respect of market abuse, it is unclear whether this commitment is capable of continuing after the FSA is abolished, and its various functions transferred to other agencies. There is a real risk that a fragmentation of current FSA functions could impede the ability to seamlessly investigate and impose robust penalties on all market abusers.

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[1] The Four 'Ds': Deterrence, Discipline, Disgorgement ... and Dawn Raids -- Latest on the UK Financial Services Authority's Enforcement Regime

[2] The FSA levied more fines in the first two months of the fiscal year than it did in all of 2009-2010 (the Financial Times 23 June 2011).

[3] Previously a record fine of £2,800,000 was handed down to former broker, Simon Eagle.

[4] Goenka had attempted to manipulate the market in a similar manner on a previous occasion.

[5] Visser was also given a prohibition order.

[6] Goenka lived in Dubai. Visser appears to be Lithuanian, but it is not clear if he also lived in or worked in the UK
[7] Margaret Cole speaking to the Financial Times (23 June 2011).
[8] Such as Goenka.
[9] Although not a market abuse case, this was demonstrated in the enforcement action involving Sir Ken Morrison, who was fined £210,000 after discount for breaching DTR notification requirements in respect of his shareholding and voting rights in WM Morrisons Supermarkets Plc. Despite Sir Morrison being a high profile individual, the FSA demonstrated that it was willing to impose harsh penalties on such prominent individuals and institutional investors in order to achieve credible deterrence.
[10] In the case of Bliss and Coppin, the FSA indicated that had their employer, Pacific Continental Securities not been in liquidation, it would have received a £3,000,000 fine due to the firm's systematic failure to have regard to regulatory and compliance requirements, and its failure to train staff in respect of the same.
[11] For instance Willis Limited was fined £6,895,000 for breaching Principle 3 when failing to supervise staff (e.g. via formal training), and have effective systems of controls to counter the risks of bribery and corruption. Fastmoney.co.uk Limited was also fined £28,000 for amongst other things, failing to ensure sales staff were competent in their sales roles, and received sufficient training, also in breach of Principle 3.
[12] Principle 3 requires firms to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
[13] FSA Policy Statement 10/17: Taping of Mobile Phones – Feedback on CP10/7 and Final Rules.
[14] The importance of such evidence can be seen in the recent controversial US insider dealing case involving Raj Rajaratnam, a former hedge fund manager, whose successful prosecution (and subsequent 11 year imprisonment) was partly secured as a result of extensive phone tapping operations.

UK High Pay Commission Publishes Final Report on 'Excessive' Executive Pay

By Sean Geraghty, Georgina Rowley, Charles Wynn-Evans and Jessica O'Gorman (Dechert LLP)

"There's a crisis at the top of British business and it is deeply corrosive to our economy. When pay for senior executives is set behind closed doors, it does not reflect company success and is fuelling massive inequality. It represents a deep malaise at the very top of our society."
– Deborah Hargreaves, High Pay Commission Chair

The independent High Pay Commission (the "HPC"), a non-governmental interest group established by Compass, concluded its final report on executive pay on November 22, 2011. The report followed a year-long inquiry into high pay and boardroom pay across the public and private sectors in the UK, focusing in particular on executive pay in listed companies (and other publicly quoted companies). In the report, the HPC sets out its analysis and commentary on recent executive pay inflation, in addition to 12 recommendations for reforms to corporate governance and disclosure requirements (including proposals to amend the UK Corporate Governance Code (the "Code")).

Sean Geraghty is a Partner in Dechert's London office. His experience includes mergers and acquisitions (both public and private, for corporate clients and private equity clients), IPOs (on the Official List, AIM and overseas), secondary offerings, joint ventures and general corporate matters. (sean.geraghty@dechert.com) Charles Wynn-Evans, Partner and Head of Dechert's employment practice in London, focuses on all contentious and non-contentious employment-related matters. (charles.wynn-evans@dechert.com) Georgina Rowley deals with a wide range of employment related disputes including litigation in the Employment Tribunal, County Court and High Court. (georgina.rowley@dechert.com) Jessica O'Gorman has considerable experience advising with regard to mergers and acquisitions, joint ventures, public offerings and general corporate matters. (jessica.ogorman@dechert.com)

The HPC inquiry makes similar recommendations to proposals raised in a recent discussion paper entitled "*Executive Remuneration*" published on September 19, 2011 by the Department for Business, Innovation and Skills (BIS) which addressed issues surrounding executive pay (the "BIS Discussion Paper"). The BIS Discussion Paper invited feedback on these issues by November 25, 2011.

Key Findings

The HPC reported that the average wages in the UK have increased 300 percent in the last 30 years, whereas "stratospheric" pay increases to top executives have soared by more than 4,000 percent in that period, undermining productivity and "damaging" trust in British business.The report also pointed out that John Varley, Barclays' top executive in 2010, earned £4.36m last year, constituting 169 times the earning of an average British worker, whereas in 1980 top pay at Barclays was only 13 times the national average.

The HPC report concluded that pay packages have become increasingly complex, damaging relations with shareholders and creating confusion, and it calls for "a radical simplification of executive pay" and additional solutions based on the key principles of transparency, accountability and fairness.

Key Recommendations for the UK Corporate Governance Code

The independent report recommended the following amendments to the Code:

- Simp lification of executive pay: executives should be paid a basic salary, with remuneration committees awarding one additional performance-related element only where absolutely necessary.

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UK High Pay *(from page 19)*

- Companies should publish an anonymized list of their top ten highest paid employees outside the boardroom.
- Remuneration reports should be presented in a standardized format, and companies should publish a single figure for the total package for each executive and the method of calculation.
- All publicly listed companies should publish annually a statement of the distribution of income over a period of three years, showing percentage changes in total staff costs, company reinvestment, shareholder dividends, executive team total package, and tax paid. The HPC proposes that further research be undertaken to consider the extent to which the distribution statement could be subject to a shareholder vote.
- All publicly listed companies should publish fair pay reports as part of their remuneration reports (setting out the ratio of highest to median pay within the company and changes to this ratio over three years).

Other recommendations in the report include:

- Shareholder votes on remuneration should be cast on remuneration arrangements for three years following the date of the vote and that such arrangements include future salary increases, bonus packages and all hidden benefits. The HPC does not consider the vote should be binding at this stage.
- Companies should implement a defined and structured talent pipeline to ensure and all listed companies should publish how they encourage talent in their annual report.
- Recruitment of non-executive directors should be openly advertised.
- Companies should publish the extent and nature of all the services provided by remuneration consultants.
- Full disclosure of all voting decisions on corporate governance should be made by institutional investors and fund managers, including executive remuneration.
- Employees should be represented on remuneration committees. The HPC notes that there are concerns that this will alter the UK's unitary board system, but it considers that the unitary board system is not effectively holding the executives to account in the long-term interests of the company over issues of pay. It proposes that the measure be voluntary, with the threat of legislation or fines if not implemented within a three-year period.
- A permanent national body should be established by government to, among other things, ensure company legislation is effective in ensuring transparency, accountability and fairness in pay at the top of British companies.

Unsurprisingly, the report has received significant media coverage and politicians have been quick to welcome the HPC's findings in a tough economic climate where the general public views executive salaries as 'out of control'.

Next Steps

In general, the HPC recommends that implementation of its proposals should first be attempted through revisions to the Code, or otherwise through voluntary adoption by companies and shareholders, with legislative enforcement only if necessary.

Comment

Unsurprisingly, the report has received significant media coverage and politicians have been quick to welcome the HPC's findings in a tough economic climate where the general public views executive salaries as 'out of control'. Business Secretary Vince Cable commented that many of the options the government is consulting on in connection with the BIS Discussion Paper are reflected in the HPC report and has said repeatedly in recent weeks he would like to introduce legislation next year to curb executive pay. Currently, Cable's office (BIS) are weighing up which of the suggestions contained in the BIS Discussion Paper need fresh legislation or whether the majority of reforms can be simply inserted into codes of practice such as the Code but either way, it is likely that the HPC's recommendations will be implemented in one way or another given the current public disenchantment with top earners in the City. ❑