

Articles

EU–Brussels Briefing: A Review of Recent Legal and Business Developments in the EU

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Brussels Briefing

A Review of Recent Legal and Business Developments in the EC

By Vasilios Bousis, Mélanie Bruneau, Andrea Hamilton, Benoît Keane, Martino Sforza and Laura Zadunayski (McDermott Will & Emery/Stanbrook LLP)

Finance – State Aid

Commission Approves German Rescue Package for Financial Markets

On 28 October 2008, the European Commission announced its approval, under EC Treaty State aid rules, of a package of measures intended to stabilise Germany's financial markets and to address the malfunction of inter-bank lending. The measures consist of a recapitalisation and guarantee scheme, as well as a temporary acquisition of assets by the State. The German authorities notified the Commission of the package on 14 October. After a series of exchanges and discussions with the Commission on the details of its implementation, on 27 October the German authorities submitted a list of commitments to limit possible distortions of competition. – *Martino Sforza*

Mergers

Public Consultation on EC Merger Regulation

The European Commission has launched a public consultation on the EC Merger Regulation (Council Regulation 139/2004) that took effect in 2004. The Regulation contains rules for merger control in the European Economic Area including, among other things, jurisdictional thresholds for when transactions must be notified, as well as referral mechanisms that allow for the review of a transaction to be referred between the Commission and EU Member States. Under the terms of the Merger Regulation itself, the Commission must report to the EU Council of Ministers on the functioning of these jurisdictional and referral rules by 1 July 2009.

At the outset, the Commission reports that, in its experience, the Merger Regulation has functioned well. The Commission has, however, opened a public consultation on the Merger Regulation and states that comments received from stakeholders through this process will be a key aspect in its ultimate report. Comments on the Merger Regulation's jurisdictional thresholds and the referral mechanisms should be submitted to the Commission by 1 December 2008. – *Andrea Hamilton*

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Public Procurement

Commission Assesses Use of Electronic Procurement in Europe

The European Commission has launched an online survey to: (i) review actual experience of businesses and public purchasers with electronic public procurement ("e-procurement"); (ii) evaluate the use of e-procurement across the European Union; and (iii) guide future EU action in this field. The Commission will also be able to assess the achievements of the "Action Plan for the implementation of the legal framework for electronic public procurement" adopted by the Commission in December 2004. The objectives of the Action Plan were to help EU Member States remove obstacles to cross-border e-procurement and to further increase its efficiency while reducing the administrative burden. The Commission considers that opening up procurement markets across borders and expanding e-procurement is crucial to Europe's competitiveness and the creation of new opportunities for EU businesses. Public procurement is a key sector of the EU economy, accounting for about 16 per cent of GDP. Interested parties can participate in this survey until 18 December 2008. – *Mélanie Bruneau*

Sports & Media – State Aid

Commission Consults on Extension of State Aid Scheme to Film Industry

The European Commission has launched a public consultation on its plans to extend the Cinema Communication until 31 December 2012. The EU State aid rules set out strict rules on the granting of State subsidies to private companies. The Cinema Communication sets out how EU governments can legally provide State support for films produced in the European Union. It also enables national governments to require producers to spend a proportion of the funds made available in the country that provided the aid. In addition, the Commission will consult on how the film industry should be supported in the future. Comments should be sent to the Commission by 30 November 2008. – *Benoît Keane*

Telecommunications – Competition

Commission Requests Stricter Control from Belgian Telecoms Regulator on Market for Fixed Phone Calls

The European Commission has communicated a request for more effective enforcement of telecoms regula-

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tion by the Belgian telecoms regulator, BIPT. In particular, the Commission considers that BIPT has been unsuccessful in implementing the telecoms regulation and this has been the cause for the lack of effective competition and high tariffs on the Belgian market for fixed telephone calls.

In September 2008, BIPT notified to the Commission the results of a national consultation regarding the markets for publicly available local and/or national fixed telephone services. In this notification, BIPT established that the market should be subject to ex-ante regulation because it met the three conditions provided for in the telecoms regulation. These conditions are: (i) there are high and non-transitory entry barriers; (ii) the structure of the market does not tend towards effective competition within the relevant time horizon; and (iii) the application of competition law alone would not adequately address the market failures. BIPT also found that obligations should be imposed on Belgacom, the leader on the national market, requiring it to act in a non-discriminatory, transparent manner, and prohibiting it to charge excessive or predatory prices.

As a response to these draft measures, the Commission agrees with BIPT's analysis that Belgacom is dominant on the market and that ex-ante regulation should be applied. However, it points out that wholesale remedies such as wholesale line rental obligations and (pre-)carrier selection obligations put forward by BIPT on previous occasions have not yet had the desired effect on retail competition. Indeed, the wholesale line rental obligation to alternative operators imposed on Belgacom in 2006 has not yet been enforced. Other obligations, including (pre-)carrier selection obligations and the new price regulation recently imposed upon Belgacom, which should have led to more choice and affordable prices for consumers, appear to be ineffective.

The Commission has thus encouraged BIPT to ensure that all relevant wholesale remedies contribute to sustainable retail competition and, in the meantime, to address the issue of high prices with direct retail remedies. BIPT is also invited to carry out a new market study within a year. – *Laura Zadunayski*

Transport – Competition

Commission Opens Consultations on Review of Block Exemption for Liner Shipping Consortia

The European Commission has opened consultations on a draft regulation revising the exemption that liner shipping consortia currently enjoy from the EC Treaty's ban on restrictive business practices (Article 81). The Consortia Block Exemption Regulation (823/2000) currently allows shipping lines to enter into cooperation agreements for the purpose of providing a joint service (consortia). A

consortium is a group of shipping lines that cooperate to provide joint maritime cargo transport services. Such agreements usually allow shipping lines to rationalise their activities and achieve economies of scale. If consortia are faced with sufficient competition, the users of the services provided by consortia usually benefit from improvements in productivity and quality of service.

The European Commission has launched a public consultation on the EC Merger Regulation that took effect in 2004. The Regulation contains rules for merger control in the European Economic Area including jurisdictional thresholds.

The new draft regulation proposes continuing to allow for such cooperation within a new legislative and economic environment. In order to align the Consortia Block Exemption Regulation with the general EU competition rules, it is proposed that only consortia with a market share below 30 per cent should benefit from the exemption.

Observations on the draft regulation should be submitted by 21 November 2008 at the latest. The Commission will then consult Member States in 2009 and adopt the final block exemption regulation before the current regulation expires in April 2010. – *Vasilios Bousis* □

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Current Status of Emergency Short-Selling Regulation In Major European Union Jurisdictions

By Vladimir Maly, Yasmin Arefin, Marie-Chrystel Dang Tran, Rudolf Haas, Antonio Coletti and Yoko Takagi (Latham & Watkins)

The purpose of this article is to update the status of recently adopted short-selling and short-exposure regulation in major European Union markets – the United Kingdom, Germany, France, Italy and Spain.

The chart and descriptive notes summarize the current status of short-selling and short-exposure regulation in the United Kingdom, Germany, France, Italy and Spain (the chart also summarizes the current status of the short-selling and short-exposure regulations in the United States). Please note that the summaries reflected in the chart below constitute an over-simplification of issues discussed in the Summary Notes that follow. For a more complete description of the relevant regulations, please refer to the text of the Summary Notes (or, in the case of the United States, to the full text of the Client Alert referenced in the footnote to the chart).

Multi-Jurisdiction Summary Notes

United Kingdom

On September 18, 2008, the Financial Services Authority (the "FSA") introduced new rules: (a) prohibiting the active creation or increase of aggregate net short positions in publicly quoted UK financial companies; and (b) a daily disclosure regime where such aggregate net short position is 0.25 percent or greater.¹

Short-Selling

The covered financial companies are FSA-regulated banks or insurers (other than pure reinsurers or limited scope mutual insurers) incorporated in the UK (and their UK parents where the whole group's main business relates to financial services) where such company's shares are traded on a market established under the rules of a UK-recognized investment exchange (such as the LSE and

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AIM) or OFEX. The FSA has provided a non-exhaustive list of such financial companies which it may continue to update.²

The prohibition applies to trades by any investor that (by itself or with other trades) create or increase aggregate net short positions with respect to an economic interest in a covered UK company from within or outside of the UK and is not limited to trades by financial services firms regulated by the FSA.

The prohibition applies to any net short positions that give rise to an economic exposure in the issued share capital of a company and can include any investments traded on overseas exchanges whose price or value is related to that of the share such as swaps, spread bets, options, futures, depositary receipts and dual listed stocks giving rise to a (direct or indirect) exposure in the issued (ordinary and preference) share capital of a company. An economic interest held as part of an index, basket, exchange traded fund (or any derivatives products relating to an index) where the predominance of the components in such investment are covered UK financial companies is also prohibited. The FSA is scheduled to publish a further short-selling Consultation Paper in January 2009.

Disclosure Obligation

Effective September 23, 2008, aggregate net short positions of 0.25 percent or more of the entire issued share capital of a covered UK financial company must be disclosed by the holder no later than 3:30 p.m. on the business day following each day on which the aggregate net short position is held/reached and on the business day following the day on which the net short holding declines below the 0.25 percent threshold. On October 22, 2008, following the completion of the initial 30-day review of the new rules, the FSA announced that it will amend the disclosure obligation to the effect that once an initial disclosure of a net short position has been made, additional disclosures will only be required when that net short position changes. This will mean that daily disclosures will no longer be required unless the relevant net short position has altered.

The FSA suggested that its Form TR4 be used to disclose these short positions. The disclosure must state the full name of the person holding the disclosable short position, the name of the relevant securities issuer, the size of the position as a percentage of the issued share capital and the date that the position reached, exceeded or declined

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below the 0.25 percent threshold and must be made by means of the Regulatory Information Service using the short code "SSD."

The amendments give the FSA broad authority in the event of a breach of any of the new rules.

For the purposes of calculating the net short position, positions across different trading desks of banks and other single legal entities (excluding any market maker positions) will be aggregated. Positions in different legal entities within the same group will not be aggregated and positions in pre-merger entities will not be aggregated until the date of any merger. Financial instruments should be calculated on a delta-adjusted rather than a notional basis and any derivative trades that are either delta-neutral or delta-positive at the time the orders are entered into are permitted and the delta position on the expiration of any rolling derivatives position will not be captured.

There are limited exceptions to the above rules:

- Any market maker which ordinarily as part of its business deals as principal in equities, options or any type of derivative and is not acting in its proprietary capacity is granted an exemption (a) to fulfill or respond to its clients' orders or requests to trade or hedge such positions and/or (b) to provide liquidity to the market on both bid and offers sides of the market in comparable sizes.
- As the rules prohibiting short-selling have no retroactive effect and do not apply to any trades placed prior to September 19, 2008, there is no requirement to unwind pre-existing net short positions (although such positions must be disclosed).
- Although repos and other stock lending activities are not prohibited, the FSA has asked firms to alert the FSA where the firm suspects that stock is being borrowed for the purposes of prohibited short-selling (but has not extended the UK reporting regime in this respect).
- The prohibition does not cover trading in credit default swaps although other OTC transactions are covered.
- Although there is no requirement to disclose intra-day net short positions reduced before close of business, the prohibition prevents a person from actively increasing their net short position intra-day.

Additional Information

The new provisions described previously have taken effect as amendments to the FSA's Code of Market Conduct. The FSA's Code of Market Conduct was concurrently amended to add an evidentiary provision to the effect that a person breaching such rules will be considered to have created a false or misleading impression or market distortion constituting "market abuse," which is a civil offense pursuant to s.118(8) of the Financial Services and Markets Act of 2000.

The amendments give the FSA broad authority in the event of a breach of any of the new rules. Unless the FSA is reasonably satisfied that: (i) the person believed, on reasonable grounds, that his/her behavior did not amount to market abuse; or (ii) the person took all reasonable precautions and exercised all due diligence to avoid breaching the short-selling restrictions or disclosure obligations, the FSA may: (a) apply to the court for a freezing order or an injunction to restrain any continued or threatened market abuse; (b) require a person to take steps to remedy the market abuse and/or the payment of compensation to those persons who have suffered loss as a consequence of the behavior; (c) apply to the court for a restitution order; (d) make a public statement that the relevant person has engaged in market abuse; or (e) impose an unlimited civil fine.³

France

On September 19, 2008, the French Financial Markets Authority ("*Autorité des marchés financiers*" or "AMF"), acting in conjunction with its counterparts from the Euronext College of Regulators, adopted the following provisions to maintain a regulatory framework that is consistent with other financial centers, especially in Europe, and to prevent regulatory forum shopping⁴. The measures apply to equity securities issued by credit institutions and insurance companies traded on French regulated markets (Euronext Paris, MATIF and MONEP).⁵

Short-Selling

In accordance with Article 516-5, paragraph 2, of the AMF General Regulation, any investor giving a sell order for one of the affected securities with instructions for deferred settlement and delivery must hold 100 percent of the securities to be sold in its account with its financial intermediary at the time it gives the sell order. According to Article 570-1 of the AMF General Regulation, any investment service provider receiving a sell order for one of the affected securities must require the client to deposit the securities to be sold in its account with the investment service provider before the order is executed. If the investment service provider is not the custodian of its client's assets, it must obtain assurance from its client that the client holds the relevant securities. Under French law, ownership of borrowed securities is transferred to the borrower. Therefore, borrowed securities are considered to be owned and/or held for the purposes of these rules. Thus, naked short sales appear to be prohibited

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Country	United Kingdom	France	Germany	Italy	Spain	United States ¹
Regulated Activity	Establishment and increase of any economic aggregate net short position in publicly quoted UK financial companies designated by the FSA.	"Naked" short sales and creation and increase of net short positions in approximately 15 publicly quoted financial companies designated by the AMF.	"Naked" short sales of shares of 11 public financial companies included in the DAX and MDAX indices.	Any short sales of shares listed and traded on the Italian regulated markets.	"Naked" short sales in publicly traded companies and short sales in certain publicly traded financial companies.	A temporary ban on short-selling of publicly traded equity securities has been lifted. In lieu of the ban, the SEC has implemented more restrictive rules governing short-selling, including: -- Adoption of specific anti-fraud rules with respect to "naked" short-selling. -- Extension of the "short" position disclosure rules, including certain modifications to the initially issued rules. -- Adoption of a hard delivery settlement requirement for both "long" and "short" sales of equity securities, coupled with the "next settlement day" close out requirement for open positions relating to failures to settle a short sale and the "next 3rd settlement day" close out requirement for open positions relating to failures to settle a long sale (the "next 36th day" for Rule 144 long sales). -- Elimination of the market maker exemption from prior short position close-out requirements.
Derivatives	Affected indirectly; derivatives themselves are not covered directly but the prohibition applies to any short-selling, including hedging done in connection with any derivatives.	Affected directly.	Affected indirectly; derivatives themselves are not covered directly but the prohibition applies to any short-selling, including hedging done in connection with any derivatives.	Affected indirectly; derivatives themselves are not covered directly, but the prohibition applies to any short-selling, including hedging done in connection with any derivatives.	Affected indirectly; derivatives themselves are not covered directly but the prohibition applies to any short-selling, including hedging done in connection with any derivatives.	Affected indirectly; derivatives themselves are not covered directly but revised rules apply to any short-selling, including hedging done in connection with any derivatives.
Relevant Exceptions	Market makers who deal in equities, options or derivatives (i) to fulfill client orders, which would not result in a violation of the rules by that client and/or (ii) as part of their regular activities designed to provide liquidity to the market on both bid and offer sides.	Statutory "investment service providers" acting as market makers, liquidity providers and block trade positioners. Financial intermediaries acting as the investor's counterparty must ensure that the investor does not create a net short position. Short sales with respect to hedging of index and basket trades containing securities on the list, may only be effected if the seller owns securities concerned at the time of the sale (a borrowed security is considered "owned" for these purposes).	Market makers in the course of their regular "market activities." Lead brokers transacting on a "name to follow basis." Fixed-price transactions.	"Specialists" and "liquidity providers" in the course of their regular "market activities."	"Market makers" and "liquidity providers" in the course of their regular activities and in view of their operating needs.	"Naked" Short-Selling Anti-Fraud Rule: market makers engaged in bona fide market-making. Short Position Reporting: (i) positions less than 0.25 percent of the underlying securities or less than \$10 million; or (ii) short sales in connection with a market maker's attempt to execute on a riskless principal basis a sale order of a customer who has a net long position in or a purchase order of a Section 13(f) security. Hard Delivery Requirement: market makers engaged in bona fide market-making activities or not having a fail-to-deliver position at the time of any additional short sales.
Disclosure	Daily net short position reporting requirement by any market participants for positions equal to or in excess of 0.25 percent of the underlying securities.	Daily initial net short position reporting requirement by any market participants for positions in excess of 0.25 percent of the underlying securities and any changes to such net short positions.	None.	None.	Daily net short position reporting requirement by any market participants for positions in excess of 0.25 percent (or increases or decreases above this threshold) of the underlying securities.	Weekly short position reporting requirement by institutional managers (Section 13(f) filers) for short positions equal to or in excess of 0.25 percent of the underlying securities.
Expiration	January 16, 2009. The FSA has announced that it will publish a further Consultation Paper in January 2009 to elicit comments about potential new rules.	December 22, 2008	December 31, 2008	December 31, 2008	Indefinite; until further notice from CNMV.	Short-position reporting requirement will be effective until August 1, 2009 and hard-delivery requirement will be effective until July 31, 2009.

1. For a more complete description of the regulations recently promulgated by the U.S. Securities and Exchange Commission, please see: Client Alert "Update: Current Status of Emergency Short-Selling Regulation in the United States and Major European Union Jurisdictions" available at http://www.lw.com/upload/pubContent/_pdf/pub2352_1.pdf.

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by the resolution but covered short sales are allowed.

Investors are not allowed to use derivatives to create a short position. They may only use derivatives to hedge long positions. In this case, the financial intermediary acting as the investor's counterparty must ensure that the investor does not create a net short position. Trades in index derivatives⁶ including the financial securities concerned, are not prohibited. However, if the hedging for such trades requires the sale of securities on the list, the seller will be required to own the relevant securities at the time of the short sale. As noted previously, borrowed securities would be considered to be owned securities for these purposes.

**To reduce the causes of market
disruption, the AMF also requested that
financial institutions refrain from lending
any of the securities concerned to create
prohibited economic short positions.**

These new measures apply to transactions made for one's own account or on behalf of third parties, including spot and forward transactions and all transactions carried out on MONEP, the Paris options market. They do not apply to transactions made by investment service providers⁷ acting as market makers, liquidity providers or as counterparties for block trades in equities. Intermediaries acting as counterparties for equity block trades may respond to a client order without owning the securities and thus find themselves temporarily in a short position. On the other hand, if the client gives a sell order where the intermediary is likely to act as counterparty, the intermediary must ensure that the client actually owns the relevant securities.

To reduce the causes of market disruption, the AMF also requested that financial institutions refrain from lending any of the securities concerned to create prohibited economic short positions. This does not apply to lending securities to cover existing positions, to meet commitments made before these measures were implemented or, more generally, to transactions that are not related to creating short positions. For example, we believe the transfer of securities as collateral for borrowed cash would be allowed.

Disclosure Obligation

Effective September 22, 2008, any person holding a net short position that represents an economic interest of 0.25 percent or more of the shares of one of the affected companies must disclose it to the AMF and the market by any appropriate means no later than the following day, at the following address: surveillance@amf-france.org.

Short exposures must be calculated daily for the entire position, including positions created before September 22, 2008. If the exposure is based on derivatives positions, the exposure level shall be calculated as a delta value. Positions in the same group must be calculated on a consolidated basis. Portfolio management companies must aggregate all of the short positions in the securities of a given issuer for collective investment schemes⁸ or management accounts.

Additional Information

There have been no updates to the short-selling regulations since the publication of our October 8, 2008 Client Alert. The temporary provisions were effective as of September 22, 2008 for a period of at least three months, during which time the AMF reserves the right to make any adjustments warranted by market developments. At the end of the period, the AMF will decide which measures, particularly those relating to the transparency of short-selling transactions, will remain in force.

As these provisions concern securities admitted for trading on a French regulated market, the AMF deemed that all of the provisions dealing with market abuse shall apply to all investors and all service providers, French and foreign, regardless of whether the transactions take place in France or in another country, or in a regulated market or not. Any person, acting for their own account or on behalf of a third party, who executes a transaction with the purpose or effect of violating or circumventing these provisions will be deemed likely to have committed market abuse and may incur a financial sanction up to 10 million euros or 10 times the amount of profits derived from the prohibited transactions.

Germany

In the context of recent developments in the global financial markets, on September 19, 2008, the German Supervisory Authority for Financial Services ("*Bundesanstalt für Finanzdienstleistungsaufsicht*" or "BaFin") issued an emergency order regarding the prohibition of naked short-selling. The order is intended to combat the unusual volatility observed in the stocks of issuers from the financial sector. It was amended by an additional order issued on September 21, 2008.⁹ At the time of this writing, there have been no additional updates to the short-selling regulations.

Short-Selling

In its original decree, BaFin announced a prohibition

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of the creation or increase of short positions in the shares of 11 issuers from the financial industry.¹⁰ Covered by this order are the shares of all banks, stock exchange operators, insurance companies and other companies from the financial sector that are included in the DAX or MDAX indices. The German emergency order focuses only on naked short-selling and thus requires that short sales be covered by share lending or similar immediately enforceable arrangements at the time of the transaction. Such securities lending must be concluded prior to or at least simultaneously with the short sale order.

Short positions existing before September 20, 2008 are not covered by the decree. Furthermore, netting of long and short positions within one company is permissible. However, only long and short positions in actual shares can be netted.

The ban applies only to transactions in shares and therefore does not directly prohibit the sale of derivatives such as futures or options. There is, however, some impact on the derivative markets, since, as a consequence of the decree, derivatives relating to the shares covered by the decree can only be hedged with other derivatives, but no longer with short sales of shares (unless such short sales are covered). Similarly, naked short sales can no longer be used to remove economically shares covered by the decree from a basket or index product.

Expressly excluded from the application of the emergency order are the activities of brokers who act as market makers or designated sponsors for these securities as long as the short entered into is in performance of the duties under the market maker or designated sponsor appointments. The same applies to transactions on a "name-to-follow" basis ("*Aufgabengeschaeft*") by lead brokers ("*Skontrofuhrer*"). In an additional order dated September 21, 2008, the BaFin reduced the scope of the short sale ban by also permitting so called fixed-price transactions, i.e. transactions agreed by trading participants to settle a transaction in shares concluded with a customer at a fixed or definable price.

Disclosure Obligation

In contrast to some other European securities regulators, the BaFin has not enacted a disclosure obligation. Moreover, there is no additional obligation for the banks to monitor compliance with the ban by their customers. However, the BaFin recommends that banks make their customers aware of the General Decrees dated September 19 and 21, 2008.

Additional Information

The temporary provisions will expire on December 31, 2008, but BaFin has expressly retained the right to extend, amend or revoke the emergency order prior to expiration.

Italy

Short-Selling

On September 22, 2008 and October 1, 2008, the Italian Securities and Exchange Commission ("Consob") adopted two formal resolutions aimed at ensuring the transparency of the markets, the orderly conduct of trading and the protection of investors.¹¹ The provisions of the resolutions expire at 12:00 p.m. on December 31, 2008. As initially adopted, the resolutions applied to the sales of shares issued by banks and securities companies listed and traded on the Italian regulated markets. On October 10, 2008, Consob formally extended the ban on short-selling of shares issued by banks and insurance companies to all shares listed and traded on the Italian regulated markets and on October 30, 2008 it extended the expiration date to December 31, 2008.

In contrast to some other European securities regulators, the BaFin has not enacted a disclosure obligation. Moreover, there is no additional obligation for the banks to monitor compliance with the ban by their customers.

The resolutions provided that the sale of shares listed and traded on the Italian regulated markets must be covered by the ordering party of the relevant securities, from the moment of the sale order and until the date of the settlement of the relevant trade. The resolutions refer solely to shares. Therefore options, derivatives and other financial products, such as futures, are not directly covered by the resolution. However, Consob specified that securities held by way of securities-lending transactions, carried out in whatsoever technical form, shall not be taken into account for the purposes of the availability and ownership requirements. Derivatives are indirectly impacted by the resolution because the derivatives cannot be hedged by short-selling the underlying securities. Thus, the prohibition applies to any short-selling, whether naked or covered, including hedging done in connection with any derivatives.

The resolutions also provided that clearing and settlement systems are required to adopt any and all measures to prevent speculative maneuvers that may entail an anomalous reduction of the prices of shares issued by banks and insurance companies. The resolution did not

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provide a deadline by which such measures must be adopted. At the time of this writing, Monte Titoli S.p.A., the primary Italian clearing house, had not yet adopted such measures.

Although there are important distinctions among the various rules adopted, many securities regulators in the US and the EU have enacted restrictions on short sales.

There are two exceptions to the restrictions. First, the resolutions do not apply to activities carried out by market makers,¹² in the exercise of their own functions. Second, the resolutions do not apply to the activity carried out by specialists and liquidity providers¹³ in the exercise of their own functions, in regulated markets. The regulated markets are the main markets managed and organized by Borsa Italiana S.p.A., also known as the Italian Stock Exchange.. The two regulated markets for shares are MTA (*Mercato telematico Azionario*) and Expandi.

Spain

The *Comisión Nacional del Mercado de Valores* (“CNMV”), the agency in charge of supervising and inspecting the Spanish Stock Markets, recently adopted measures regarding the transparency of short positions and reinforcing its prohibition on naked short-selling.¹⁴

Short-Selling

The Executive Committee of the CNMV announced that in view of the exceptional market conditions, compliance with the existing prohibition on naked short sales will be monitored closely.

For the purposes of the existing regulation, a “naked short sale” occurs when an investor sells a security that he or she does not “own.” Investors can “own” by means of a previous purchase, stock lending agreement agreed or signed beforehand, or the irrevocable exercise of a convertible security, option or any kind of a derivative instrument. Consequently, covered short sales are allowed while naked short sales are prohibited.

The CNMV recommended that members of the official secondary market only execute trade orders if the client is able to provide evidence that it has sufficient securities at the time of settlement of the transaction. This could be done either by relying on their own registers (should they

act as custodians) or by means of a general or a specific representation given by the client.

Disclosure Obligation

As of September 24, 2008, investors with short positions in certain financial entities are required to disclose them. The CNMV clampdown currently applies to only 20 leading financial companies,¹⁵ and not to the shares of all listed firms. This list, however, may change from time to time at the CNMV’s sole discretion. The rule is due to remain in effect until market conditions change.

Any entity or person having short positions in shares¹⁶ of certain issuers must disclose any short position exceeding 0.25 percent of any issuer’s share capital. Increases or decreases above the 0.25 percent threshold must also be disclosed and disclosure must be made by 7:00 p.m. of the day following the day the relevant transaction was consummated. The disclosure will be made through a statement addressed to the *Dirección General de Mercados* (General Markets Directorate) of the CNMV indicating the date, identity of the short position holder and the net short position. In the case of a group of companies, the entity required to submit the statement will be the ultimate shareholder, though with an indication of the positions of each of its affiliates. The CNMV will publish the disclosures on its website forthwith after their receipt, or in the case of disclosures made after the close of business, the following morning.

For the purposes of this regulation, a short position will be the net result of all positions in financial instruments, including any derivative instruments, giving such an entity a positive exposure to downward movements in the price of shares. Should the exposure be based on derivative instruments, the exposure level shall be calculated as a delta value.

Additional Information

The CNMV may regard failure to comply with this regulation as a sign of market manipulation. Nonetheless, the CNMV will take into account the operating needs of market makers and liquidity providers, namely firms that trade in order to provide liquidity, to hedge positions of their clients or to process clients’ trades.

At the time of adoption of the short-selling rules, the CNMV indicated that a number of additional measures may be introduced by the Spanish regulator in the coming months to improve the flow of information. At the time of this writing, there have been no updates to the short-selling regulations. The short-selling regulations will remain effective until further notice from the CNMV.

Conclusion

Although there are important distinctions among the various rules adopted, many securities regulators in the US and the EU have enacted restrictions on short sales. The regulations are complex, they continue to evolve and

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any transaction that may result in short sales of affected securities by any participant should be discussed with legal counsel. □

1 The new Market Abuse Rules 1.9.2 in the FSA's Handbook of Rules and Guidance are incorporated in the FSA Short-Selling (No 2) Instrument 2008 (available at: http://www.fsa.gov.uk/pubs/handbook/instrument2_2008_50.pdf) and the FSA Short-Selling (No 3) Instrument 2008 (available at: http://www.fsa.gov.uk/pubs/other/short_selling_instrument.pdf) under the Market Abuse Directive (adopted on December 2, 2002).

2 The list is available at http://www.fsa.gov.uk/pubs/handbook/list_instrument200850.pdf and as of September 23, 2008 included: Aberdeen Asset Management plc; Admiral Group plc; Alliance & Leicester plc; Alliance Trust plc; Arbutnot Banking Group plc; Aviva plc; Barclays plc; Bradford & Bingley plc; Brit Insurance Holdings plc; Chesnara plc; Close Brothers Group plc; European Islamic Investment Bank pl; F&C Asset Management plc; Friends Provident plc; HBOS plc; Highway Insurance Group plc; HSBC Holdings plc; Invsetec plc; Islamic Bank of Britain plc; Just Retirement Holdings plc; Legal & General Group plc; Lloyds TS B Group plc; London Scottish Bank plc; Novae Group plc; Old Mutual plc; Prudential plc; Rathbone Brothers plc; Royal Bank of Scotland Group plc; RSA Insurance Group plc; Schroders plc; St. James's Place plc; Standard Chartered plc; Standard Life plc; and Tawa plc.

3 Although the rules do not provide that the transaction itself would be considered void ab initio, violative short sale transactions are unlikely to be enforced by the English courts.

4 The release is available in French at http://www.amf-france.org/documents/general/8423_1.pdf and in English at http://www.amf-france.org/documents/general/8424_1.pdf.

5 The equity securities and securities giving access to shares capital concerned by the ban are the following : Allianz; April Group; Axa; BNP Paribas; CIC; CNP Assurances; Crédit Agricole; Dexia; Euler Hermes; HSBC Holdings; Natixis; Nyse Euronext; Paris Re; Scor; Société Générale

6 While "index derivatives" is not defined in the regulation, we believe it would be those derivatives listed on LIFFE, which can be found at <http://www.euronext.com>.

7 "Investment service providers" is defined in the Monetary

and Financial Code. The investment service providers are the investment firms and credit institutions that have been authorized to provide the following investment services: receipt and transmission of orders on behalf of third parties; execution of orders on behalf of third parties; own-account trading; portfolio management on behalf of third parties; underwriting; and investment.

8 Collective investment schemes are pools of funds invested in financial instruments (equity, bonds, debt securities, etc.) and managed on behalf of investors. All collective investment schemes marketed in France must be approved by the AMF.

9 The orders are available in German at http://www.bafin.de/clin_116/nn_722564/SharedDocs/Artikel/DE/Service/Meldungen/meldung__080919_leerverkauf.html?__nnn=true and in English at http://www.bafin.de/clin_116/nn_720486/SharedDocs/Artikel/EN/Service/Meldungen/meldung__080919_leerverkauf.html?__nnn=true

10 The emergency order lists the following issuers: Aareal Bank AG; Allianz SE; AMB Generali Holding AG; Commerzbank AG; Deutsche Bank AG; Deutsche Börse AG; Deutsche Postbank AG; Hannover Rückversicherung AG; Hypo Real Holding AG; MLP AG and Münchner Rückversicherungs-Gesellschaft AG.

11 The orders are available in Italian and English at <http://www.consob.it/main/index.html?mode=gfx>.

12 "Market makers" are defined in the Italian single financial act. The term covers a "person offering his services to trade directly on regulated markets and multilateral trading facilities on a continuous basis, buying and selling financial instruments at self-established prices."

13 Specialists and liquidity providers are defined in the Listing Rules of the regulated markets organized and managed by the ISE.

14 The orders are available in Spanish and English at <http://www.cnmv.es/index.htm>.

15 The affected companies are as follows: Banco de Andalucía; Banco de Castilla; Banco de Crédito Balear; Banco de Galicia; Banco Guipuzcoano; Banco Pastor; Banco Popular Español; Banco Sabadell; Banco Santander; Banco de Vasconia; Banco Español de Crédito; Bankinter; Banco Bilbao Vizcaya Argentaria; Caja de Ahorros del Mediterráneo; Grupo Catalana Occidente; MAPFRE; Inverfiat; Bolsas y Mercados Españoles and Renta 4.

16 For these purposes the so-called cuotas participativas (equity interests in Spanish saving banks (Cajas de Ahorro) with limited voting rights) are included in the definition of shares.

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The New Commission Guidance on State Aid and the Financial Crisis

By Till Müller-Ibold and François-Charles Lapr v te (Cleary Gottlieb Steen & Hamilton LLP)

On October 13, 2008, the European Commission released an important Communication regarding the application of its State aid rules to measures taken during the current global financial crisis to support financial institutions. This new guidance is a contribution by the Commission to the efforts taken at the European and world levels to restore confidence in financial markets, which include the Eurogroup statement of October 12 and the coordinated national schemes announced by several European Member States on October 13 to safeguard the financial system. The Commission had already approved (in record time) certain other support schemes triggered by the financial crisis (eight working days for the Northern Rock plan,¹ and 24 hours for Bradford & Bingley's²). Immediately after releasing the Communication, the Commission approved the Irish and British general support schemes on the basis of the principles outlined in the Communication³, which will likely be applied to the other schemes announced by Member States.

General Principles

The key principle of the Communication is the recognition by the Commission that Article 87(3)(b) of the EC Treaty, which allows State aid to remedy "a serious disturbance in the economy of a Member State", is applicable to the current financial crisis. The Commission had until now been very reluctant to apply this provision of the Treaty. For example, it had refused to apply it to approve aid to Germany's new L nder⁴ or, until recently, to support measures in favor of individual banks affected by the subprime crisis.⁵ Accordingly, support measures usually were (until now) cleared in two situations: where the Commission found that no aid had been granted (because the State intervention was made at market prices), or where the Commission found that the aid fulfilled the restrictive conditions of the Rescue and Restructuring

guidelines.⁶ Article 87(3)(b) gives the Commission a new basis to authorize exceptional State aid that goes well beyond its pre-existing guidelines.

The Communication, however, stresses that the Commission will not apply Article 87(3)(b) without restrictions. The Commission intends to make an individual assessment of each case, particularly taking account of the statements of the national authorities responsible for financial stability in confirming the risk of serious disturbances. Furthermore, the Commission insists on the need for general schemes, i.e., schemes available to several or all financial institutions in a Member State, to be reviewed at least every six months, and terminated as soon as the economic situation permits. The Commission also stresses the distinction between, on the one hand, the situation of institutions that face a liquidity problem, but that would otherwise be fundamentally sound (absent the current exceptional circumstances), and, on the other hand, the situation of financial institutions that are more fundamentally affected, and that might require substantial restructuring measures under the Rescue and Restructuring Guidelines. Exceptionally, the Communication mentions that this application of Article 87(3)(b) might cover certain ad hoc interventions for individual institutions. The Commission, however, clearly indicates its preference for aid granted by way of a general scheme.

As a general rule, the Communication indicates that all measures must: (i) comply with the general principle of non-discrimination; (ii) minimize competitive distortions; and (iii) not exceed what is strictly necessary.

Guarantees Covering the Liabilities of Financial Institutions

Over the last few weeks, governments have used guarantees extensively to support financial institutions in difficulty.⁷ While initially focused on retail deposits, these guarantees have been extended to various kinds of liabilities, including interbank loans. Under the current Commission Notice on Guarantees ("the Guarantees Guidelines"),⁸ State guarantees will be deemed to constitute State aid unless they meet strict criteria. For instance, the extent of the guarantee must be properly defined; the guarantee must not cover more than 80% of each liability covered; the beneficiary must pay a premium covering the risks and the overall costs of the guarantee. It is likely that some guarantees schemes developed during the financial crisis would not have met these criteria. The Communi-

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Till M ller-Ibold is a partner and Fran ois-Charles Lapr v te is an associate in the Brussels office of Cleary Gottlieb Steen & Hamilton. Romano Subiotto, partner in the Brussels office, reviewed the memo, and Claire Froitzheim, stagiaire in the Brussels office, also assisted in preparing the memo. Cleary Gottlieb was or is involved in many of the current financial events including Barclays' acquisition of Lehman's assets, BNP Paribas' acquisition of Fortis, Dexia's recapitalization, Bank of America's acquisition of Merrill Lynch, Morgan Stanley's reorganization and the Fannie Mae and Freddie Mac reorganization. Cleary Gottlieb is also advising the Federal Reserve Bank of New York on a number of matters.

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cation explains that the Commission may authorize such guarantees schemes on the basis of Article 87(3)(b).

Regarding the material scope of the guarantees, they may cover liabilities extending beyond retail deposits. In particular, the Commission recognizes that the drying-up of interbank lending may justify guaranteeing certain types of wholesale deposits and even those short- and medium-term debt instruments that are not already adequately protected by existing investor arrangements or by other means. However, such guarantees should not, in principle, include subordinated debt (tier-2 capital) or allow for indiscriminate coverage of all liabilities. If such debt were nevertheless to be covered, specific restrictions might be necessary.

The conditions of eligibility must be objective and non-discriminatory. In particular, the Commission makes clear that there should be no discrimination on the grounds of nationality: all institutions that are incorporated in the Member State (including subsidiaries) and that have significant activities in the Member State should be covered by its guarantee scheme.

The duration and scope of schemes extending beyond retail deposit guarantees must be limited to the minimum necessary. The Commission's approval can (in principle) last for up to two years, but this may be extended further if necessary. The necessity of the scheme must be reviewed by the Member State every six months, under the Commission's control. Additional safeguards (such as quantitative limits, shorter issuance periods or deterrent pricing conditions) will be required for guarantees covering debt of a maturity date later than the expiry of the issuance period under the scheme.

The Communication reaffirms the principle that there must be as much private sector contribution to the scheme as possible in order to ensure that the Member State aid is kept to a minimum. This may be ensured by an adequate remuneration of the guarantee by the beneficiary, a claw-back/better fortune clause, or a rule ensuring that, in case the guarantee is activated, the private sector covers a substantial portion of the outstanding liabilities incurred by the beneficiary.

The scheme should also contain behavioral constraints in order to avoid undue distortion of competition, such as restrictions on commercial conduct, limitations to the size of the balance sheet of the beneficiaries, or the prohibition of the issuance of new stock options or share repurchases.

If the guarantee scheme must be invoked for the benefit of individual financial institutions, payment should be followed within six months by a restructuring or liquidation plan to be assessed by the Commission based on its experience gathered in the application of State aid rules to financial institutions.

Recapitalisation of Financial Institutions

Recapitalizations are a second aid mechanism permitted under the new guidelines. Member States may use it to support financial institutions that may be fundamentally sound but that are experiencing distress because of the extreme conditions in financial markets.

The main innovation of the Communication on this issue is that it allows recapitalization to be launched as an emergency measure. By contrast, under the current Rescue and Restructuring guidelines, the Commission allowed such capital interventions only after a Restructuring plan was presented and assessed by the Commission. Rescue aid, which was meant only to cover emergencies, could include only loans lasting not more than six months.

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The Communication applies the same conditions to these recapitalization measures as those for general guarantees schemes, regarding the objective and non-discriminatory criteria for eligibility (such as solvency requirements or the evaluation of the need for support by the financial supervisory authorities), the duration of the scheme (up to 2 years), the limitation of the aid to what is strictly necessary (for instance, through the maintenance of enhanced minimum solvency requirements or the limitation of the size of the balance sheet), safeguards against possible abuses (including behavioral constraints), and the requirement for a restructuring plan to be presented to and assessed by the Commission within six months.

Furthermore, Member States should receive rights whose values correspond to this contribution in the recapitalization. The issue price of new shares must be fixed using a market-oriented valuation. Instruments such as preferred shares with adequate remuneration or claw-back mechanisms will be looked upon favorably.

Member States must report on the use of the scheme every six months and individual plans for beneficiary undertakings must be reported upon within six months of the date of the intervention. The Commission will assess these reports according to the principles of the Rescue and Restructuring guidelines.

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Controlled Winding-up of Financial Institutions

Member States may initiate a controlled winding-up of the institutions that have benefited from a recapitalization, a guarantee scheme or other aid. In this context, the Communication provides that the assessment of such scheme and individual liquidation measures should follow the same lines, *mutatis mutandis*, as those of guarantees schemes.

In addition, shareholders (and possibly certain types of creditors) should be excluded from receiving the benefits of any aid in the context of a controlled winding-up procedure.

The liquidation phase should be limited to a period strictly necessary for the orderly winding-up. The beneficiary should not be allowed to pursue new activities and its banking license should be withdrawn as soon as possible.

In order to ensure that no aid is granted to the buyers, the Commission reaffirms that it will take into account the following criteria: (i) the sales process should be open and non-discriminatory; (ii) the sale should take place on the market's terms; (iii) the sales price should be maximized; and (iv) any aid granted to support the economic activity to be sold will be examined under the principles of the Rescue and Restructuring Guidelines.

Provision of Other Forms of Liquidity Assistance

Member States often accompany guarantee or recapitalization schemes with liquidity support, including sup-

port from Central Banks. The Commission reasserts that general, non-selective measures open to all comparable market players in the market (for instance open market operations or standing facilities) are not covered by State aid rules.⁹

Dedicated support to a specific financial institution may also not fall under the State aid rules when the following (non-exhaustive) conditions are met: (i) the financial institution is solvent at the moment of the provision of liquidity; (ii) the facility is fully secured by collateral to which haircuts have been applied; (iii) the Central Bank charges a punitive interest rate to the beneficiary; and (iv) the measure was taken on the central bank's own initiative.

The Communication adds that a scheme involving liquidity support from public sources that does not fulfill these criteria may still be considered as compatible aid, provided that it fulfills the principles of the Rescue and Restructuring Guidelines and is reviewed every six months. Again, the approval of the scheme may cover a period of up to two years, with the possibility of further extension.

Rapid Treatment of State Aid and Investigations

The Communication stresses the importance of the Member States informing the Commission of their intentions and of notifying the Commission of plans to introduce such measures as early and comprehensively as possible (and in any event before the measure is implemented). The Communication reasserts the Commission's readiness to take a decision on notified measures within 24 hours if necessary. □

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1 OJ C14-2008, 2 April 2008, United Kingdom Restructuring aid to Northern Rock.

2 State aid: Commission approves UK rescue aid package for Bradford & Bingley, IP/08/1437, October 1 2008.

3 State aid: Commission approves revised Irish support scheme for financial institutions, IP/08/1497, October 13 2008; State aid: Commission approves UK support scheme for financial institutions, IP/08/1496, October 13 2008.

4 Joined cases T-132/96 and T-143/96, 15 December 1999, Freistaat Sachsen, Volkswagen AG and Volkswagen Sachsen GmbH v Commission of the European Communities.

5 See for instance OJ 1998 L 221/28, Crédit Lyonnais or OJ C14-2008, 2 April 2008, United Kingdom Restructuring aid to Northern Rock.

6 See OJ 2004 L244/02, Communication of the Commission – rescue or restructuring guidelines.

7 For instance, guarantees represent € 400Bn out of the € 470Bn of the German scheme announced on October 13 and € 320Bn out of the € 360Bn of the French scheme announced the same day. On October 13, the Dutch government also announced a € 200Bn guarantee on inter-bank loans.

8 Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (OJ C-155, 20 June 2008, p. 10–22).

9 See for instance Northern Rock, OJ C 43, 16 February 2008, p.1.

EU Free Movement of Goods: New Regulation to Improve Mutual Recognition Principle Enforcement

By Bénédicte Raevens (McGuireWoods LLP, Brussels)

The principle of the free movement of goods that implies that national barriers to the free movement of goods within the EU be removed, is one of the cornerstones of the EU internal market.

Many technical barriers have been lifted through harmonization rules at the EU level, such as in the field of vehicles, pharmaceuticals, medical devices, chemicals, construction products, gas appliances, electrical equipment, mechanical equipment, pressure equipment, cosmetics, footwear, textiles, toys, etc. In the absence of legislation harmonization, the provisions of Articles 28 to 30 of the EC Treaty forbid Member States from maintaining or imposing intra-EU trade barriers, except in special circumstances.

These provisions are also the basis of the mutual recognition principle which means in any non-harmonized sector, every Member State must accept on its territory, goods legally marketed in another Member State even when the product does not fully comply with the technical rules of the destination Member State.

This principle's application may only be challenged in cases where, for example, public safety, health or the protection of the environment are at stake. National derogatory measures must then be shown to be necessary and proportionate. In that case, the destination Member State must show a reason for such restriction relating to public interest; the necessity of the restriction in question to reach the pursued objective; and that the restriction is proportionate in relation to the pursued objective. In short, that it is the least trade-restrictive measure.

However, the implementation of the principle of mutual recognition has been hampered by several problems, such as the legal uncertainty and burden of proof regarding the legitimacy of national measures (law, regulation or administrative action) denying the mutual recognition principle.

Therefore, the European Parliament and the Council adopted Regulation (EC) No. 764/2008 of July 9, 2008, laying down procedures relating to the application of certain technical rules to products lawfully marketed in another Member State (O.J. L 218 of 13.08.2008) (the regulation). The regulation aims to strengthen internal market function by improving the free movement of goods.

To this end, the regulation defines the rights and obligations of national authorities, as well as enterprises wishing to sell in one Member State products lawfully marketed in another, when the competent authorities

intend to take restrictive measures about the product in accordance with national technical rules. These include prohibition of placing the product on the market, the modification or additional testing before the product can be placed or kept on the market, or the withdrawal of the product from the market. In particular, the regulation concentrates on the burden of proof imposed on the Member State of destination by setting out the procedural requirements for denying mutual recognition.

The regulation defines the rights and obligations of national authorities, as well as enterprises wishing to sell in one Member State products lawfully marketed in another, when the competent authorities intend to take restrictive measures about the product.

In particular, the Member State that intends to take restrictive measures on a specified product must send prior notification to the economic operator of its intention, specifying the technical rule invoked and setting out technical or scientific evidence to the effect that the intended decision is justified on one of the grounds of public interest, is appropriate for the purpose of achieving the pursued objective, and does not go beyond what is necessary to attain that objective.

The operator may submit comments on the notice. Any subsequent decision of the Member State must take into account the economic operator's comments, and must be notified to the economic operator and the EU Commission.

Moreover, the regulation intends to reduce the risk for enterprises that their products will not gain access to the market of the destination Member State by establishing one or several "Product Contact Points" in each Member State.

Product Contact Points shall provide economic operators and authorities of other Member States with: technical rules applicable to a specific type of product in their Member State; the contact details of the competent authorities of this Member State, by means of which they may be contacted directly; and the remedies generally available in the said Member State, in the event of a dispute between the competent authorities and an economic operator. The regulation will apply from May 13, 2009. □

This article was written by Bénédicte Raevens, partner, McGuireWoods LLP, Brussels.

The Global Financial Crisis: Some Issues for Pension Schemes

By Robert West (Baker & McKenzie LLP)

The financial crisis has created risks and uncertainty throughout the economy. Some effects on pension schemes are clear - for example, the substantial fall in equity prices. Other consequences may be far more difficult to assess.

This article attempts to identify, from a legal perspective, some of the issues which employers and trustees of defined benefit plans are likely to have to consider. Many of those issues may appear obvious. Indeed, the review of such issues should properly form part of the ongoing governance of any plan. However, recent developments mean that employers and trustees will no doubt wish to take stock of the position from their respective viewpoints.

The importance of cooperation and the sharing of information between employers and trustees is stressed throughout this article. Responsibility for the delivery of pension benefits should best be seen as a partnership between the employer and the trustees. This is particularly critical in the current troubled economic times, when circumstances may change with alarming rapidity.

We begin by identifying some of the issues from the perspective of the trustees. This is, of course, relevant not only to trustees themselves but also to employers who will want to attempt to anticipate and address the trustees' likely concerns. In addition, understanding the respective powers of the trustees and the employer is important in framing discussions.

The Trustees' Perspective

The trustees' prime concerns will be:

- how has the crisis affected the employer?
- how has the crisis affected the fund?
- are the plan's investment arrangements robust?

Reviewing the Employer's Covenant

Trustees need to monitor the continuing strength of the employer covenant (that is, the employer's ability to continue to fund the plan). They need to bear in mind that, while the financial strength of the corporate group is material, it is normally only those employers within the group whose employees participate in the plan which have a direct obligation to contribute to the plan.

Trustees should revisit past analysis of the employer covenant. What information was obtained in the most recent actuarial valuation process? What conclusions were reached? Are they still valid? Is there any aspect of

the employer's financing arrangements which could give rise to concern?

If the valuation showed a deficit, over what period is the employer making it good (the recovery period in the valuation)? Is this now realistic?

The financial crisis has created risks and uncertainty throughout the economy. Some effects on pension schemes are clear - for example, the substantial fall in equity prices. Other consequences may be far more difficult to assess.

Is the employer's covenant supported by any collateral, such as fixed or floating charges, parent company guarantees or bank letters of credit? Has the strength or value of that collateral either diminished or become more difficult to realise? Should additional or alternative collateral be sought?

Alternatively, has any change in an employer's credit rating triggered any payments/security due to the fund under existing arrangements, e.g. funds held in escrow?

The Flow of Information from the Employer to the Trustees

The importance of maintaining a dialogue between the trustees and the employer cannot be over-emphasised. In difficult times, it is particularly important to exchange information so that issues may be addressed jointly and in a spirit of cooperation and trust.

The employer's legal obligation to provide information to trustees and their advisers under the Scheme Administration Regulations is to provide "such information as is reasonably required for the performance of duties as trustees or professional advisers". In practice, the scope of this duty is somewhat uncertain and it is far better to have an understanding - or, better still, an agreement - between the employer and the trustees as to what information should be disclosed.

The employer may be more willing to share information if the trustees enter into a confidentiality agreement. Many trust bodies already have such agreements in place and our experience is that this often assists both the flow

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of information and the relationship between the trustees and the employer.

Does the Pensions Regulator Have a Role?

The Trustees may also receive information by virtue of an application by the employer to the Pensions Regulator (the "Regulator"). The employer may, for example, seek clearance for a corporate sale, reorganisation or refinancing which could have a detrimental effect on the plan. The Regulator will inform the trustees of any relevant clearance application and the trustees may even already be party to it.

The same availability of information does not, however, apply if the employer is merely reporting a "notifiable event" to the Regulator. This could include events which are potentially relevant to the plan, such as: a decision of an employer which will result in a debt to the plan not being paid in full; an employer ceasing to carry on business in the UK; or a breach of an employer covenant with a bank. The trustees should bear in mind that the employer has no obligation to inform the trustees about such a report - and the Regulator is under a statutory duty not to disclose it. This makes it even more important that the trustees and the employer should reach an agreement between themselves to disclose information. In practice, most employers would prefer a concerned set of trustees to approach it first, rather than to approach the Regulator directly.

Regulatory involvement may also arise where the trustees are concerned that the employer (or its wider group) is taking action (such as refinancing) which is detrimental to the plan. In Guidance published in March 2008, the Regulator makes it clear that it is willing to consider approaches from the trustees for guidance even if the employer itself is taking the view that the action is not materially detrimental and hence that an application for clearance is not necessary.

Reviewing the Plan's Funding Position

Trustees should revisit the most recent actuarial valuation and discuss with their advisers whether there are likely to have been significant changes.

Potential changes may include movements in investment values, changes in the strength of the employer covenant and possible future changes in assumptions (such as mortality factors), all of which may be relevant to the overall picture.

What Powers do the Trustees Have in Relation to Funding?

The trustees need to be aware of the scope of their powers to take remedial action.

They have the power, under the legislation, to commission an early actuarial valuation. Regulatory Guidance suggests that this power could be considered where the

actuary advises that the present recovery plan may be significantly inadequate, an employer ceases to participate in a multi-employer scheme or there is a significant fall in the market value of the scheme's assets. Before incurring this expense the trustees would, however, need to be clear as to their objective in obtaining the valuation.

The trustees need to be aware of the scope of their powers under their plan: for example, are they able to impose additional contributions (even lump sum contributions) on the employer unilaterally? Similarly, it is important to examine the triggers under the rules which would put the plan into winding up and potentially trigger a statutory debt.

Investment and Banking Arrangements

Trustees should consider the extent to which they should review their investment and banking arrangements. Areas to consider include:

- reviewing the institutions and counterparties with which they have investment and banking arrangements;
- reviewing their asset allocation strategy;
- reviewing the investment, structural and counter-party risks of any derivative, swap or hedging arrangements; and
- considering their position on stock lending.

The Employer's Perspective

Employers will need to consider many of the same issues as the trustees but from the other side of the coin.

Handling Conflicts of Interest

Conflicts of interest often arise between trustee bodies and the sponsoring employer. It is important for the employer to establish how those conflicts are to be managed, for example in relation to any negotiations between the employer and the trustees which may become necessary in the context of scheme funding. This issue is also topical because new rules on conflicts for directors came into effect on 1 October 2008.

Confidentiality Agreements

Employers may wish to consider inviting the trustees to enter into a confidentiality agreement, so that information may be passed to the trustees more readily in future discussions.

As mentioned above, while the legal obligation on the employer to provide information under the Scheme Administration Regulations is unclear, sharing information with the trustees is generally beneficial. Trustees who have an understanding of the commercial issues faced by the employer are more likely to engage in constructive dialogue.

Possible Areas for Employers to Explore

Employers may also wish to consider the following:

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Financial Crisis *(from page 17)*

- negotiating with the trustees to extend the recovery period, based on the principle of “reasonable affordability”;
- reducing the rate of accrual for future benefits (or switching to other forms of pension provision) if they have not already done so;
- considering whether to explore buyout solutions or liability management in the light of investment volatility; and
- revisiting existing financial arrangements (e.g. contingent funding arrangements, memoranda of understanding) to establish whether any worsening of

the employer’s position such as a rating downgrade triggers the release of money by the employer or a separate arrangement (e.g. an escrow account) into the plan.

Employers will also want to understand how changes in asset values are likely to affect their balance sheets.

Regulatory Involvement

If an employer (or a group) decides to take action which is materially detrimental to the employer covenant, it needs to consider approaching the Regulator for clearance. Relevant actions could include a corporate sale, a reorganisation, paying a dividend, or incurring obligations in refinancing. □

Immigration Rules: Obtaining a Sponsorship Licence

By Lloyd Davey (Osborne Clarke)

Becoming a Sponsor under the Points Based System

The UK’s immigration rules have been radically overhauled by the Home Office. Out have gone over 80 routes to work and study in the United Kingdom and in has come a five tiered “points based system”.

Whilst tier 2 is not the only tier under which an employer must be licenced as a sponsor, it is the tier most employers are likely to focus on as it covers skilled workers with a job offer and intra-company transfers i.e. those individuals for whom the employer would previously have applied for a work permit.

Under tier 2 a licenced sponsor will be able to issue a certificate of sponsorship to a migrant worker instead of applying to the Home Office for a work permit for that person. The individual then quotes the certificate of sponsorship reference number when he or she applies for entry clearance to the UK or further leave to remain in the UK.

This is a radical departure from the previous system as employers will be in a position to make their own assessments as to whether their prospective workers meet the relevant points threshold. However, with that freedom come a number of on-going obligations which the employer must comply with or face losing its ability to sponsor new or existing migrant workers.

For further information, Lloyd Davey, Senior Associate, Employment Pensions and Incentives Department, Osborne Clarke may be contacted by phone: +44 118 925 2108 or by email: lloyd.davey@osborneclarke.com. These materials are provided for general purposes only. Osborne Clarke does not accept liability for the contents of these materials and legal advice should be taken in respect of a particular matter. The firm’s website is: www.osborneclarke.com.

Obtaining a Sponsor’s Licence

Before a certificate of sponsorship can be issued the employer must first register as a sponsor. The application process can be broken down into three steps:

- **Online Application** - The first step is to make an online application for which there is a fee of £1,000 or £300 for small employers. Before starting the online application employers should consider a number of factors such as the type of licence they require, who will hold key roles on their behalf and whether an audit of their HR systems and files should be conducted before the application is submitted;
- **Supporting Documentation** - The employer then submits various supporting documentation within 10 days of completing the online application. Rather than miss this deadline, employers should ensure that all the supporting evidence is prepared before submitting the online application;
- **Compliance Check** - Officials from the UK Border Agency (UKBA) will visit the employer to check the validity of the information submitted, interview key personnel and attempt to satisfy themselves that the employer has the HR systems in place to keep track of its migrant workers and comply with the monitoring and reporting obligations.

Choosing the Right Licence

It is possible for an employer with several offices, locations or branches to register each as a separate sponsor or to register the head office as a single sponsor covering the group. Large employers will want to strike a balance between having centralised control over the recruitment of migrant workers in compliance with the rules and running the risk

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Sponsorship Licence *(from page 18)*

of the entire group's sponsorship status being adversely affected by non-compliance at a single outpost.

Employers who might want to transfer staff from overseas offices to the UK as well as recruiting new migrant workers in the UK must ensure their licence covers both activities.

Employers will be asked to specify the number of certificates of sponsorship they think they will need to issue in a year. An application can be made later to increase this quota. Conversely, if the employer does not issue as many certificates of sponsorship as it said it would, the quota may be reversed downwards by UKBA.

Key Personnel

The sponsorship system requires 4 roles to be filled by each employer: Authorising Officer, Level 1 User, Level 2 User and Key Contact. A single person can fill each of these roles, or they can be assigned to a number of individuals.

Authorising Officer

The Authorising Officer is responsible for the staff who will use the online Sponsorship Management System to issue certificates of sponsorship and comply with the reporting obligations placed upon sponsors. Since a sponsor will be fully responsible for the actions of the Authorising Officer, the role should be filled by a senior and competent person who is a permanent UK employee or officer. The Authorising Officer will not have access to the Sponsorship Management System by default. If access is required the Authorising Office must also be appointed as a Level 1 or Level 2 user.

Level 1 User

Only Level 1 and Level 2 Users will have access to the Sponsorship Management System. A Level 1 User has a more important role than a Level 2 User and will be responsible for setting up the accounts and permissions for other staff members who will access the Sponsorship Management System. He or she will be able to:

- Issue certificates of sponsorship;
- Report migrant activity;
- Request an increase in the sponsor's quota of certificates of sponsorship;
- Change the sponsor's details;
- Notify UKBA of a change in the sponsor's or migrant worker's circumstances;
- Withdraw a certificate of sponsorship.

Each Level 1 User must be UK based. A legal representative can be a Level 1 User.

Level 2 User

Like the Level 1 User, the Level 2 User will have day to day access to the Sponsorship Management System. However, the Level 2 User has more of an administrative role and restricted to:

- Assigning certificates of sponsorship;
- Reporting to UKBA on a migrant worker's activity.

As with Level 1 Users, Level 2 Users must be UK based and can be legal representatives.

Key Contact

The Key Contact is the main point UKBA will have with the sponsor. He or she will not have access to the Sponsorship Management System unless he or she is also made a Level 1 or 2 User.

The Key Contact must be UK based and can be a legal representative.

A and B Ratings

Each sponsor will be given a rating, "A" or "B", dependent upon the scores allocated by UKBA in relation to the sponsor's human resource systems, suitability of its nominated key personnel and any previous non-compliance with immigration law. Employers will want to attain an "A" rating at the first attempt since a "B" rating will require the employer to comply with a UKBA-imposed action plan intended to transition the employer up to an "A" rating. However, failure to improve and achieve an "A" rating could result in the withdrawal of the employer's sponsor's licence altogether.

UKBA will assess suitability against four criteria:

1. Whether the employer has adequate HR systems in place;
2. Whether the employer has previously incurred any penalties for immigration offences;
3. Whether the key personnel have any criminal convictions;
4. Whether the employer has previously complied with immigration rules.

A score of 1 to 3 (1 being highest) will be given against each criterion and an A rating will only be awarded if the sponsor scores 1 against each. A B rating is likely to be awarded if any criterion is given a 2 score. A score of 3 against any criterion may mean that the licence application is refused, though if the 3 is scored against HR systems the employer is likely to be first given an improvement plan by UKBA.

For this reason, employers may wish to conduct an internal audit of their systems before applying for their licences. UKBA will look at the employer's:

1. Ability to monitor the immigration status of its workers and prevent illegal employment;
2. Maintenance of migrant workers' contact details;
3. Recordkeeping;
4. Ability to track and monitor its migrant workers;
5. Recruitment practices.

Monitoring Immigration Status and Preventing Illegal Employment

UKBA expects employers to keep copies of all employment records.
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Sponsorship Licence *(from page 19)*

ees' passports and immigration employment documents (e.g. work permits). Any employer who does not already have a practice of undertaking the relevant document checks before employment begins should do so without delay and introduce a means of checking those documents every 12 months. Employers should also establish a method of monitoring visa expiry dates.

Maintaining Migrant Contact Details

Full contact details for migrant workers should be kept including address, home phone number and mobile number. UKBA will expect to see either an electronic system whereby employees can update their contact details themselves, a periodic instruction to employees to update their contact details if necessary or a policy informing employees they must notify HR of any changes to their contact details.

Recordkeeping

UKBA will look for evidence of general good HR house-keeping. Personnel files should contain copies of references, qualifications, professional accreditations and the original advertisement for the position and personnel file should be easily accessible upon request.

Migrant Tracking and Monitoring

UKBA will want to be satisfied that the employer has sufficiently robust internal systems to ensure it becomes aware of and can report the following to UKBA via the Sponsorship Management System:

- The migrant worker does not turn up for work on the first day of employment for any reason;

- The migrant worker is absent without leave for more than 10 days;
- The termination of the migrant worker's employment plus notification of the name and address of the new employer if known;
- If the employer ceases to sponsor the migrant worker e.g. if the migrant no longer needs sponsorship because he or she has obtained a tier 1 (general) licence (formerly HSMP);
- Significant changes to the migrant worker's circumstances e.g. changes to the migrant worker's job or salary, other than a change in job title or pay rise;
- Any suspicions that the migrant worker is breaching the conditions of his or her permission to remain in the UK;
- Details of any third party or intermediary, whether in the UK or abroad, that has assisted in recruitment of the migrant worker.

For those employers whose migrant workers work off-site, at a number of sites, at client premises or from home, it is particularly important that adequate systems are in place to monitor their activities and whereabouts.

Recruitment Practices

UKBA will want to see that employers have been checking and keeping copies on file of any relevant professional accreditations before the migrant worker starts work. Expiry dates should be monitored and subsequent checks undertaken to ensure that any accreditations have been renewed as appropriate. For new hires it will be important to keep documentation that proves the sponsor has satisfied the Resident Labour Market test i.e. that there was no suitable EEA or Swiss national who could have filled the role.

Compliance with Immigration Rules

UKBA will also look for evidence of any non-compliance with immigration rules and give a rating based on full compliance, partial compliance or non-compliance:

- Full compliance (rating 1)—fully compliant with all immigration rules;
- Partial compliance (rating 2)—for example, the employer may not have informed UKBA of any technical changes of employment such as the work permit holder working at a different branch of the company or the job role or salary do not reflect those on the work permit application form;
- Non-compliance (rating 3)—for example, previous work permit applications were refused, or no explanation can be given for inconsistent salaries or job roles.

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