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European Court of Justice Upholds Judgment: EU Legal Professional Privilege Does Not Extend to In-house Lawyers

By Frances Murphy, Johannes Zöttl and Francesco Liberatore (Jones Day)

The Court of Justice of the European Union ("ECJ") recently issued its long-awaited judgment in Akzo Nobel Chemicals Ltd and Akcros Chemicals LTD v European Commission (Case C-550/07 P). This case deals with the question of whether, in the context of European Commission ("Commission") investigations and proceedings, communications with in-house lawyers are protected by legal privilege. The ECJ held that such communications are not protected. As a result of the judgment, no communications between the management and employees of a company and its in-house lawyers is protected from search and disclosure in EU investigations and proceedings, including antitrust investigations and raids.

Background

During a dawn raid at the premises of two Akzo affiliates in the United Kingdom in a 2003 cartel matter, Commission officials copied and placed in its file two e-mails exchanged between the general manager of Akcros and a member of Akzo's in-house legal department, who was admitted as a lawyer to the Netherlands Bar. Akzo and Akcros brought a challenge before the General Court, arguing that the communications were protected by legal professional privilege and therefore that the Commission should not be permitted to have access to them and other privileged documents (Cases T-125/03 and T-253/03). The General Court dismissed this challenge on the basis of an earlier ECJ ruling on the scope of legal professional privilege.

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ECJ Judgment in Akzo

The ECJ rejected Akzo's arguments as follows:

> *"An in-house lawyer, despite his enrollment with a Bar or Law Society and the professional ethical obligations to which he is, as a result, subject, does not enjoy the same degree of independence from his employer as a lawyer working in an external law firm does in relation to his client. Consequently, an in-house lawyer is less able to deal effectively with any conflicts between his professional obligations and the aims of his client." (Akzo, paragraph 45)*

The authority relied upon by the General Court in rejecting Akzo and Akcros' challenge dates back to the 1982 AM&S case (Case 155/79). In AM&S, the ECJ recognized that the confidentiality of a written communication between lawyer and client must be protected only if (i) the communication has a connection with the exercise of the client's right of defense, that is, it was a "communication" made "for the purposes and interests of the client's rights of defense," and (ii) it is a communication with an independent lawyer, that is, a lawyer who is "not bound to the client by a relationship of employment."

The issue considered by the ECJ in Akzo concerns only the second of these criteria, whether privilege depends on the independence of the lawyer with whom communications are exchanged. The ECJ found in Akzo that its position in AM&S is still correct and held that, if internal lawyers cannot act as independently as external lawyers, their correspondence cannot enjoy the same level of protection.

EU Legal Professional Privilege and National Bar Rules

Akzo also made the counter argument that in-house counsel who are admitted to a Bar or Law Society in an EU Member State are subject to professional ethical obligations including confidentiality rules, similarly to external practitioners. The ECJ rejected this argument:

> *"the fact remains that they are not able to ensure a degree of independence comparable to that of an external lawyer … Notwithstanding the professional regime applicable in the present case in accordance with the specific provisions of Dutch law, an in-house lawyer*

European Court of Justice, continued on page 4

European Court of Justice *(from page 3)*

> *cannot, whatever guarantees he has in the exercise of his profession, be treated in the same way as an external lawyer, because he occupies the position of an employee which, by its very nature, does not allow him to ignore the commercial strategies pursued by his employer, and thereby affects his ability to exercise professional independence." (Akzo, paragraphs 46 and 47)*

The ECJ found that an in-house lawyer's economic dependence and the close ties with his employer make it impossible for them to act as independently as external lawyers. It therefore remains the case that communications between in-house lawyers and the management and employees of a company are, in the context of EU competition law investigations and proceedings, not protected by legal professional privilege, even if the in-house lawyer is registered with the local Bar or Law Society of one of the EU Member States.

National Legal Professional Privilege

Some national competition law authorities in the EU, such as Ireland, the Netherlands, and the United Kingdom, respect legal professional privilege for communications with in-house lawyers. In other EU jurisdictions, such as Germany and Austria, legal privilege may be available for communications from in-house lawyers, though this will depend on the scope and organization of the in-house counsel's work and the matters involved.

Akzo and Akcros argued that it is inconsistent with the principle of legal certainty that the protection of a document containing legal advice should depend on which competition authority takes the document during a dawn raid, the national competition authority or the Commission. The ECJ dismissed this argument saying that:

> *"… the undertakings whose premises are searched in the course of a competition investigation are able to determine their rights and obligations vis-à-vis the competent authorities and the law applicable, as, for example, the treatment of documents likely to be seized in the course of such an investigation and whether the undertakings concerned are entitled to rely on legal professional privilege in respect of communications with in-house lawyers. The undertakings can therefore determine their position in the light of the powers of those authorities and specifically of those concerning the seizure of documents." (Akzo, paragraph 104)*

Consequently, according to the ECJ, the fact that in the course of an investigation by the Commission, legal professional privilege is limited to exchanges with external lawyers in no way undermines the principle of legal certainty. Accordingly, in the event of a dawn raid, companies must be very careful to check which authority ordered the search and which authority is conducting the search.

Practical Implications

The ECJ judgment is of significance to all in-house counsel. Their exclusion from the protection of EU legal professional privilege is increasingly troublesome, given their invaluable role in the daily work of their employers, in particular their intimate knowledge of the business, their ability to meet the needs of their employer for time-critical advice, and their need to be involved in internal compliance programs.

No communications between the management and employees of a company and its in-house lawyers is protected from search and disclosure in EU investigations and proceedings, including antitrust investigations and raids.

The judgment is also of significance for external lawyers who are not admitted in the EU. Legal professional privilege applies only to communications with (external) EU qualified lawyers. It follows therefore that communications with non-EU lawyers are not protected from search and disclosure in EU investigations and proceedings.

The judgment does not call into question the General Court's earlier findings that certain internal documents prepared for the purpose of seeking legal advice from an external EU lawyer are protected by legal professional privilege. Whether or not an internal document will in fact be protected by legal professional privilege will depend on the individual circumstances. Accordingly, it remains good practice to add wording such as 'Privileged and confidential. Prepared for the purposes of obtaining external EU legal advice' to emails and other communications.

One question that remains unanswered is whether legal advice from external EU counsel that does not relate to the subject matter of a Commission investigation is protected. While such legal advice may be safe from Commission inspection on grounds of relevance, it would be useful for the EU courts to clarify that all communications between external lawyers and their clients exchanged for the purposes of obtaining legal advice are privileged. ❏

New EU Capital Rules to Spur Insurance M&A

By Reuters

Europe's new Solvency II capital regime for insurers will trigger a round of takeovers as weaker players are exposed and snapped up by better-capitalized peers, according to a study by Morgan Stanley and Oliver Wyman.

"The pace of strategic change will dramatically increase - with M&A as a key tool to achieve this," Morgan Stanley and Oliver Wyman said.

Solvency II, scheduled to come into force across the European Union in 2013, aims to make insurers more financially resilient by matching capital reserves more closely to risks.

Some smaller players may struggle to comply with the new rules, forcing them to sell themselves to larger competitors, according to the study.

Solvency II, which allows insurers with diverse businesses to hold lower levels of capital, will also put some monoline players under pressure to enter new markets through acquisitions, while others seek to sell capital-hungry units.

M&A activity is likely to pick up next year as insurers start positioning themselves for the formal introduction of Solvency II on January 1, 2013, the study said.

There have been high-profile M&A attempts in the European insurance sector this year, with Prudential launching an abortive bid for U.S. giant AIG's Asian unit in March, and RSA making a 5 billion pound ($7.8 billion) approach for Aviva's general insurance operations last month.

M&A activity is likely to pick up next year as insurers start positioning themselves for the formal introduction of Solvency II on January 1, 2013.

British insurance-focused acquisition vehicle Resolution bought most of French insurer Axa's local business in June, and Netherlands-based Aegon is in the process of selling its U.S. life reinsurance unit.

Overall, Solvency II will impose the toughest capital requirements on non-life insurers, Morgan Stanley and Oliver Wyman said, although reinsurers were likely to benefit from increased demand for reinsurance as a risk mitigation tool. ❑

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Round-up

By Reuters

Global Regulators Eye More Capital, Tax, Surveillance for Big Banks

Global regulators seeking to reduce the systemic risk posed by big banks are studying a mixture of capital buffers, smoother bankruptcy resolution, taxes on risky assets and tighter surveillance, a French official said. Benoit Coeure, deputy director-general of the French Treasury and a member of the international Financial Stability Board, said that additional capital requirements for large banks, as anticipated by FSB Chairman Mario Draghji, were just one aspect of the proposals on the table.

Coeure told Reuters that regulators were considering options including a tax on bank balance sheets, calibrated for risk, but said they did not favor a tax on financial transactions.

Basel Committee Chairman Nout Wellink said banking supervisors were on track to reach an agreement on large-bank rules. He said additional measures being considered by the Basel Committee and Financial Stability Board for the largest banks included "combinations of a capital surcharge, bail-in debt and contingent capital."

French Economy Minister Christine Lagarde warned, however, that an international capital surcharge on big banks would not solve systemic risk problems.

Europe's Top Banks Reject Push to Surcharges

Forcing big banks to hold extra capital so that taxpayers do not have to bail them out in the next crisis will not work, Europe's banks said. As the banking sector tries to head off a second wave of new rules, the Association for Financial Markets in Europe (AFME) said capital surcharges could be counterproductive.

AFME said drawing up a list of systemically important banks and introducing reforms like surcharges aimed solely at them would not create financial stability. Instead, they could create an impression that firms on the list that are subject to surcharges were "too big to fail," with governments as an implicit guarantor.

Global regulators have just agreed on a package of tougher bank capital and liquidity rules for all banks, known as Basel III. Regulators are now turning their attention to what extra measures are needed to make the very biggest banks safer.

Adair Turner, chairman of Britain's Financial Services Authority, signaled it was inevitable that bigger banks would face extra safeguards, though not necessarily only in the form of capital surcharges. He said there could be a combination of higher capital requirements, a bigger layer of subordinated debt, bail-in bonds or a statutory resolution procedure.

EU Targets Commodity Market Speculation As Prices Soar

The European Commission is taking aim at growing speculation and volatility in commodity markets. Michel Barnier, the European Commissioner in charge of financial reform services, said at a conference that he wanted to use a planned revision of the Market in Financial Instruments Directive (MiFID) to reform commodity markets.

The Association for Financial Markets in Europe said that drawing up a list of systemically important banks and introducing reforms like surcharges aimed solely at them would not create financial stability. Instead, they could create an impression that firms subject to surcharges were "too big to fail," with governments as an implicit guarantor.

European commodity markets are under pressure to tighten regulation as the United States pushes forward with plans to tame speculative activity. The European Commission said last week it wanted to include commodities in its upcoming revision of derivatives markets but had remained unclear on how it intended to tackle the issue of volatile commodities markets.

France has urged common EU action to regulate commodity markets before it is due to head the Group of 20 economic powers.

EU Agriculture Commissioner Dacian Ciolos said he wanted the EU executive's plan to specifically include the issue of position limits on futures markets.

The Commission also said it intended to review the market abuse directive and extend its field of action to strengthen how raw materials markets are controlled and supervised.

Finally, the Commission wanted the new European authority for securities markets to play an important role in how these markets operate, notably by ensuring common rules for their functioning and a coordinated and homogenous supervision of these rules in Europe, Barnier said.

Banks Must Move Quickly to Meet Basel III

Banks must move to meet tough new rules on capital as soon as possible despite the long-phase in period for some of the requirements, ECB Governing Council member and head of the Basel Committee on Banking Supervision Nout Wellink said.

Wellink told a closed-door meeting of banking supervisors in Singapore that regulators should stop banks from paying out dividends or bonuses if they fall short of the new minimum capital requirement, even if the final deadline to meet the rules has not yet passed.

The new Basel III rules require banks to hold top-quality capital totaling 7 percent of their risk-bearing assets, more than triple what they do now. They will start to take effect in January 2013 but changes to the definition of top-quality capital and the requirement for a capital-conservation buffer will not be fully implemented until 2018.

Wellink rebuffed criticism that the new rules would hit economic growth, saying that they made the whole banking system more resilient to a financial downturn.

Dutch Central Bank Asks IMF for Supervisory Review

The Dutch central bank will ask the International Monetary Fund to conduct a thorough review of the bank's supervisory capabilities, part of a top-down reform after a scathing report was released earlier this year by a commission reviewing the failure of lender DSB Bank.

De Nederlandsche Bank, or DNB, said it would seek an updated review by the end of this year under the IMF's Financial Sector Assessment Program, with a specific focus on the DNB's supervisory role.

The central bank also said it would participate in peer reviews conducted by, among others, the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS).

France Fines Banks $504 Million for Cheque Fee Fixing

The French competition authority has fined 11 banks including Credit Agricole and BNP Paribas a total of 384.9 million euros ($504 million) for collusion on setting cheque charges.

The banks acted in concert to set interbank cheque fees on 80 percent of cheques circulating in France between January 2002 and July 2007 as the system became computerized with the arrival of the euro, the authority said in a statement. The competition authority is also investigating interbank card charges and will deliver a verdict in 2011, it added.

New Bank Rules Pose Cumulative Threat

New banking rules and levies aimed at preventing future financial crises will choke profits and may threaten economic growth, the trade lobby for Germany's big banks said.

The Basel III changes to banking capital rules, taken in context with a raft of other proposed taxes and reforms, vastly increased the burden on lenders in Europe's biggest economy, said the Association of German Banks (BDB), which represents top lenders. Not counting the impact of Basel III, taxes and levies will shave bank profits by 70 percent, compared with 30 percent currently, association head Manfred Weber told a news conference.

European commodity markets are under pressure to tighten regulation as the United States pushes forward with plans to tame speculative activity.

The Bundesbank said earlier that although the new Basel rules and a planned levy in Germany would crimp short-term revenues, lenders would also benefit from increased financial stability. Banks would be able to meet the new capital rules without hurting growth, the central bank predicted. Der Spiegel magazine reported that the Bundesbank had calculated that the country's 10 biggest lenders would need an additional 50 billion euros worth of equity capital to meet the new Basel standards.

The head of Germany's bank rescue fund Soffin cited studies showing that banks in the G20 bloc of developed and emerging market nations might have to find an additional 200 billion euros in equity capital between 2013-2018 to meet the new Basel III rules.

Greece Says Delayed Bank Tests Due To EU-Wide Tests

Greece's central bank postponed a round of bank stress tests planned for autumn because they would fall too close to EU-wide tests conducted in July and likely add no new information. The central bank said the exercise will take place towards year-end as part of its supervisory process.

It said the decision was taken in the summer, in consultation with the International Monetary Fund, the European Commission and the European Central Bank.

Greece's big banks took part in a broader stress test by the Committee of European Banking Supervisors (CEBS) in July with only one, ATEbank, failing to make the grade under the simulation's most adverse scenario. Analysts said the delay in the stress tests would allow for developments in Greek banking to settle, mainly a 2.8 billion euro capital increase by National Bank but also a report by privatization advisers and nine-month results.

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Roundup *(from page 7)*

Vatican Bank Head in Money Laundering Probe

The Vatican bank's top two officials are under investigation for suspected money laundering, and police have frozen 23 million euros ($30.21 million) of its funds, Italian judicial sources said.

They said President Ettore Gotti Tedeschi and director-general Paolo Cipriani were being investigated by Rome magistrates in a case involving alleged violations of European Union money-laundering rules.

The Vatican confirmed the Rome magistrates' action in a statement that expressed "perplexity and amazement" at the move and "utmost faith" in the two men who head the bank, officially known as Institute for Religious Works (IOR).

Gotti Tedeschi told financial daily Il Sole 24 Ore the investigation centered around an "error of procedure," and was being used to attack the Vatican.

Britain's Liberal Democrats Warn Banks of Bonus Clampdown

Britain's Liberal Democrats, part of the coalition government, told banks to rein in bonus payments, saying that otherwise they risked being hit with higher taxes.

Business Secretary Vince Cable said that there was a general issue with high executive pay levels and bank bonuses because the financial houses were effectively underwritten by the taxpayer. Cable said bonuses were expected to be generous this year, while the rest of the country was facing big public spending cuts.

His party leader, deputy prime minister Nick Clegg, earlier told BBC 4 radio that taxes could be used if the banks did not show restraint.

Adair Turner, chairman of the Financial Services Authority, said excessive bonuses must be curbed, but added that there was a need to move beyond the "demonization of overpaid traders" to recognize that ill-designed regulatory policy was a more powerful force for harm. Tougher capital requirements, extra measures for bigger banks and better ways of spotting new asset bubbles will all improve financial stability, Turner said.

UK Banks May Shape Up or Ship Out After Probe

A five-person panel will set out its remit for a year-long probe into whether Britain's banks are too powerful and need to be reined in.

Britain's Independent Commission on Banking (ICB) was appointed three months ago by the government to assess the structure of the industry, with a view to reducing systemic risk, mitigating moral hazard and promoting competition. It has until the end of 2011 to report, and will refine its scope this month.

It is unlikely banks will be forced to break up, bankers and analysts said. Most universal banks proved stronger than many narrower lenders during the crisis, and a full break-up could also prompt top firms to shift overseas, they said.

Adair Turner, chairman of the Financial Services Authority, said excessive bonuses must be curbed, but added that there was a need to move beyond the "demonization of overpaid traders" to recognize that ill-designed regulatory policy was a more powerful force for harm.

UK Fraud Police Widen Weavering Fund Probe

Britain's Serious Fraud Office (SFO) has widened its long-running investigation into hedge fund Weavering Capital, drawing in Swedish investigators and overseas creditors, a source familiar with the matter told Reuters.

The SFO, which launched its probe early last year into Weavering's use of interest rate swaps and last May made two arrests, has met with Sweden's economic crime unit as well as creditors in the UK and abroad, the source said.

Liquidators to the Weavering Macro Fixed Income hedge fund were appointed in March last year after the firm told investors it had unearthed a large interest rate swap position where the counterparty was a firm related to Weavering.

The highly complex investigation has focused on the swaps, which "inflated the apparent net asset value of the Macro fund," according to the SFO, and were between the fund and a company registered in the British Virgin Islands, Weavering Capital Fund Limited. ❏

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France - Safeguard Procedure: Shareholders vs. Creditors In "LBOs" - Another Lehman Brothers' Story

By Anne Granger (Fasken Martineau)

In France, Law no. 2005-845 dated July 26, 2005 created a bankruptcy-prevention procedure designed to allow French companies facing financial difficulties to maintain their economic activities, preserve jobs and manage their liabilities. It is similar to the "debtor in possession" procedure under Canadian and US insolvency laws.

This procedure, (known in French as procédure de sauvegarde, which literally translates as "safeguard procedure") allows debtors to place themselves under legal protection so that they can negotiate a plan to save their business, mainly with their creditors and suppliers. Under the watchful eye of the courts, debtors are given exclusive access to a financial management tool that allows them to negotiate payment deadlines or amendments to contracts they have entered into, sometimes impacting third party rights and freely negotiated contracts.

This safeguard procedure has three main features:

1. it is open to any person operating a business activity (commercial or industrial activity);
2. it can only be initiated at the debtors' request;
3. the debtors, though they need not be bankrupt, must show that they are facing " difficulties that they are unable to overcome."

Originally, debtors had to demonstrate that they were facing difficulties leading to bankruptcy. The Order dated December 28, 2008 has modified the eligibility requirements for a safeguard procedure to make it more attractive: now, debtors only need to demonstrate difficulties that they cannot overcome, without defining or qualifying the gravity or extent of those difficulties. These may now be economic, financial, legal or social in nature.

The courts have proven to be flexible in their examination of the eligibility requirements for safeguard procedures, sometimes even to the detriment of the business's creditors.

On February 25, 2010[1], the Paris Court of Appeal severely curtailed this flexibility, described by some as abusive, in the context of a leveraged buyout (or LBO), a transaction structured so as to rely on major financing supported by collateral and other financial conditions.

The facts in this matter are important because they (1) involve one of the largest real estate acquisitions in France in the past years – "Cœur Défense" – and (2) are commonly seen in many LBOs implemented throughout France.

The courts have proven to be flexible in their examination of the eligibility requirements for safeguard procedures, sometimes even to the detriment of the business's creditors.

For the purposes of acquiring this real estate asset in La Défense, the Lehman Brothers group created a holding company (without employees) in Luxemburg that held a company incorporated under French law (also without employees) which, in turn, held the real estate assets which were managed by third party companies under contracts entered into with the French owner company.

Approximately 1.6 billion Euros in financing (which underwent securitization) was secured by the French company and guaranteed by various securities ("sûretés") and conditions, including two interest rate fluctuation risk coverage agreements with Lehman Brothers International (Europe).

When Lehman Brothers went bankrupt in September 2008, the creditors asked that another financial institution with a rating that met the requirements defined in the loan agreement be selected to replace Lehman Brothers; due to its failing, the creditors would be within their rights to claim default and demand early reimbursement of the financing.

The French company refused to make any such replacement on the grounds that doing so would be too onerous in the context of the financial crisis.

Faced with the threat of being required to reimburse the financing immediately, the Luxemburg "holding" company and French company responded by applying for a safeguard procedure.

The Paris Commercial Court allowed the application

Safeguard Procedure, continued on page 10

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Safeguard Procedure *(from page 9)*

and opened two safeguard procedures, noting, among other things, that the Luxemburg "holding" company was experiencing difficulties " that the debtor did not appear to be able to overcome without the relief afforded by the implementation of a safeguard plan (…) notably in order that it may find financial solutions (…)". Simply put, the companies were entitled to use the safeguard procedure to bring their creditors to the negotiating table and thus avoid being forced into early reimbursement of the financing.

The Paris Court of Appeal did not approve this reasoning of the Paris Commercial Court, and claimed that the French company " failed to demonstrate the least bit of difficulty in its activity as office space lessor, or any difficulty in meeting the specific regulatory obligations incumbent on high-rise buildings owners." According to the Paris Court of Appeal, the company did not allege that entering into new coverage contracts would be impossible, but claim that the cost of doing so would be prohibitive. This additional cost does not constitute a difficulty that cannot be overcome.

The Paris Court of Appeal closed with these words:

That, in light of the binding force of contracts, the company "HOLD" (here the debtor) cannot:

- unilaterally amend the loan contracts it enters into;
- any more than it can, in the absence of any real difficulty affecting its activities, request that a safeguard procedure be opened for the sole purpose of circumventing the legal constraints that are preventing it from unilaterally imposing such an amendment on a lender (…)".

A safeguard procedure, which can only be opened at a debtor's request, therefore cannot be used to coerce a co-contracting party, or to suspend contractual clauses that the debtor did not succeed in amending by contractual negotiations.

The court's reasoning is the same for the Luxemburg "holding" company, which did not really invoke difficulties affecting its security portfolio management activities. The court believes that the safeguard procedure was requested in order to prevent the French company's guarantees from being realized. If early reimbursement of the loans was demanded, the creditors might very well have acquired the real estate assets by realizing of the collateral granted.

A safeguard procedure, which can only be opened at a debtor's request, cannot be used to coerce a co-contracting party, or to suspend contractual clauses that the debtor did not succeed in amending by contractual negotiations.

The Paris Court of Appeal sanctioned the safeguard procedure request as an abuse of process and cancelled the recourse 16 months after it was opened. It did not, however, rule on a point raised by the appellant company, namely whether the two "holding" companies were entitled to that safeguard procedure. Indeed, according to the appellant, the two "holding" companies did not engage in any commercial activities and therefore did not meet the relevant eligibility requirements. Hopefully, the French Supreme Court will rule on this specific issue in such a way as to clear up any legal uncertainty associated with the layers of "holding" companies used in LBOs.

In future, safeguard procedures had best be requested with caution. ❏

[1] A recourse before the Supreme Court is currently pending.

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No Use of Facebook for Background Checks of Job Applicants in Germany

By Dr. Matthias Nussbaum, LL.M. (Baker & McKenzie)

Companies with business in Germany might soon be facing substantial restrictions on the use of social media for hiring decisions. A new German law (Beschäftigtendatenschutzgesetz) is under way that will ban the use of Facebook and similar social networks for background checks of job applicants.

The majority of companies in Germany use facebook and other social networks to collect background information of potential new hires before the hiring decisions are made. The current draft of the new law is aimed at limiting the way and the scope companies may collect and use personal data of applicants. In the future, companies shall lawfully collect only personal data of applicants that is publicly accessible. This shall allow research of background information not only in classical media like newspapers and magazines, but also in internet search engines such as Google. Personal data of applicants available only in privately used social networks shall no longer be deemed lawfully accessible for research purposes under the new German data privacy provisions. The new law shall ban the use of social networks like Facebook as a source of useful background information. It will no longer be permissible for companies to enter Facebook profiles of applicants for the purpose of gathering useful background information that might have an impact on the hiring decision.

The law is expected to exceptionally permit the collection of personal data of applicants available in social networks intentionally used by applicants for promoting their professional qualifications and skills. This shall include professional online networks such as LinkedIn or Xing, which are commonly used by potential new hires in Germany as a suitable vehicle of networking and source for headhunters. With this exception the new law intends to respect the specific desire of applicants to find new job opportunities via professional online networks. The collection of personal data of applicants shall in those cases be deemed to be in the best interest of the affected individuals.

The new law shall ban the use of social networks like Facebook as a source of useful background information. It will no longer be permissible for companies to enter Facebook profiles of applicants for the purpose of gathering useful background information that might have an impact on the hiring decision.

Under the new regime, the collection of personal status data including name, address, telephone number and e-mail address shall continue to always be lawful for the purpose of the employment. By contrast, companies shall not longer be allowed to collect other personal data that is not specifically required for the assessment of the qualifications and skills of applicants. The German Government, however, has not adopted the proposal to allow applications on an anonymous basis only. The new law requires companies to notify applicants in advance prior to any collection of publicly accessible personal data. In light of this, it is recommendable for companies and headhunters to include proper notification of personal data collection into future job postings in Germany.

Provided its approval by the German Parliament and the German Federal Council, the new law which was resolved on August 25, 2010 is expected to enter into force by the end of 2010 or early 2011. The new provisions shall be integrated into the existing Federal Data Protection Act (BDSG). ❏

Matthias Nussbaum is a Senior Associate in the Munich office of Baker & McKenzie. Mr. Nussbaum focuses on reorganizations and integrations resulting from cross-border mergers and acquisitions, on international outsourcing projects and on mass redundancies. He also has an emphasis on compensation and benefits, variable remuneration programs, change-in-control plans and international executive transfers. Mr. Nussbaum participates in negotiations with works councils and trade unions on behalf of his clients. (matthias.nussbaum@bakermckenzie.com)

Ireland Rattled By Ratings Agency Warnings

By Reuters

Ireland's borrowing costs hit a record high this month after two credit rating agencies warned its debt is at risk of further downgrades, compounding political jitters over a budget that could break a shaky government.

Ireland is battling to convince investors it can afford to rescue its stricken banking sector and cut the biggest budget deficit in the European Union, given a weak economy and growing risks of a political crisis.

"I cannot pretend that the current rating is totally secure," Chris Pryce, a senior analyst with Fitch, which has Ireland at AA- with a stable outlook, told Reuters.

Dublin is hoping a final bill for dealing with nationalized lender Anglo Irish Bank will clear up fears that the cost will vastly exceed a current estimate of 25 billion euros ($34 billion).

"We will be ... providing a manageable way forward on how that will be dealt with over the longer term," Prime Minister Brian Cowen told reporters.

His coalition's parliamentary majority may have shrunk to two seats after defections, the opposition is upping pressure for an early election, and his Green partners look increasingly uncomfortable in government as harsher austerity measures loom.

"We are determined to do what's necessary to achieve international confidence and build domestic confidence," Cowen said.

Asked whether Dublin might have to resort to the euro zone's rescue fund, he said Ireland had already raised enough funds to meet its needs into the middle of next year.

In Brussels, a European Commission spokesman said emergency funding for Ireland was not under consideration and a senior euro zone source said Dublin had not even held any informal talks on using the safety net.

Standard & Poor's, in a September 14 interview broadcast on Ireland's state broadcaster said its 35 billion euro estimate for Anglo, a figure heavily criticized by policymakers, looked increasingly realistic, and any amount beyond that could trigger rating downgrades.

The ratings agencies' warnings, including Moody's decision to slash its ratings on Anglo Irish's lower-grade debt, sent Irish sovereign spreads and the cost of insuring Irish debt against default to record highs.

The news also drove the premiums on bonds from other economies on the euro zone periphery to new highs.

The premium investors demand to hold 10-year Irish government bonds rather than benchmark German bonds hit a euro lifetime high of 475 basis points, meaning it costs Dublin some 4.75 percentage points more than Berlin to borrow funds.

Ireland's credit rating currently stands at AA- with S&P and Fitch -- seven notches above junk grade -- and Aa2 with Moody's -- 8 above junk.

The OECD's chief economist told Reuters he did not see Ireland heading toward a Greek-style crisis.

Some analysts have said Cowen needs to speed up the budget announcement to convince markets of how the government will find more than an extra 3 billion euros in savings.

Ireland is battling to convince investors it can afford to rescue its stricken banking sector and cut the biggest budget deficit in the European Union, given a weak economy and growing risks of a political crisis.

"The costs are rising because of policy inaction on behalf of the incumbent government," said Ciaran O'Hagan, bond strategist with Societe Generale.

"The French budget is being published this month, the Irish budget is being published in December. They are going to give a pre-budget statement in the second half of October; that's a month away."

Cowen, who recently shook off calls to resign after allegations of a boozy night out, was blasted by Irish tabloids after U.S. talkshow host Jay Leno ridiculed him as a "drunken moron."

Foreign Minister Micheal Martin insisted the government would see out its term until 2012 despite the turmoil.

"We're satisfied that we will go the full distance," Martin told Bloomberg TV.

"Obviously in this economic turbulent period, you will have rocky rides and issues will arise but we are very, very determined to see this through for the benefit of the country."

Fitch's Pryce said the government's wafer-thin majority was a worry, but Cowen still had time to reassure investors.

"Further downgrades may be avoided," Pryce said. "The Irish government has at least one more shot in its bow."

But O'Hagan said the credibility of the Anglo bill was dependent on the outlook for the Irish housing market, where prices are in some cases half their peak and still falling.

"Even if the government does come out with a number, the only thing that will make it believable is if there is some sort of prospect of stability for the housing market."

The 25 billion euros of aid so far earmarked for Anglo Irish would already push Ireland's 2010 budget deficit to around 25 percent of gross domestic product, compared with an EU limit of 3 percent that Dublin aims to reach by 2014.

Dublin has said the budget blow-out is a one-off due to European accounting rules, and the impact of the Anglo bill would be minimized by spreading the cost over at least a decade.

But investors remain unconvinced about the plan to wind down Anglo via a split into a "funding bank" and "asset recovery bank."

Adding to the nervousness is the ending of a state guarantee on dated subordinated debt on September 30. A guarantee on senior bonds worth 4.2 billion euros in Anglo Irish lapses as well.

Dublin has said the budget blow-out is a one-off due to European accounting rules, and the impact of the Anglo bill would be minimized by spreading the cost over at least a decade.

Ratings agency Moody's downgraded Anglo Irish's unsecured senior debt this month, citing a small residual risk the government might not support this debt.

A Finance Ministry spokesman said recently that Ireland will honor its obligations to senior bondholders.

Analysts expect the government to buy back Anglo's 2.4 billion euros in subordinated bonds at a discount. The paper has been trading at a discount of 70 percent-80 percent in the secondary market. ❑

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UK Financial Regulator Revises the Remuneration Code

By Christopher Fisher, Nicholas Robertson and Bernadette Daley (Mayer Brown LLP)

The Financial Services Authority (the FSA), the regulator responsible for the financial services industry in the UK, has published a consultation paper setting out its proposed changes to the Remuneration Code (the Code). We previously reported on the introduction of the Code in August 2009. The Code was introduced in response to concern that remuneration practices may have been a contributory factor to the global market crisis. The Code currently applies only to 26 of the largest banks, building societies and broker dealing groups in the UK but is now being significantly extended in scope and revised to take account of recent international and EU work on remuneration principles.

The Code is being revised to take account of:

- the coming into force on June 8, 2010 of provisions relating to remuneration within the Financial Services Act 2010;
- the need to take account of recent international work on remuneration principles, most notably the amendments to the Capital Requirements Directive (CRD 3), which come into force on January 1, 2011;
- Sir David Walker's review of corporate governance in UK banks, published in November 2009; and
- lessons learned from the FSA's experience in implementing the Code so far.

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While the consultation paper provides details of the proposals and how these will be implemented, it does not yet provide the full picture. The FSA acknowledge that the timetable moving forwards is tight. The consultation period closes on October 8, 2010, and there are still a number of areas which require clarification over the next few months. The Policy Statement is due to be published in November 2010, effective from January 1, 2011.

Currently the Code applies to 26 of the largest banks, building societies and broker dealer groups in the UK. As a result of CRD3, the FSA is required to substantially increase the scope of the Code to over 2,500 FSA authorized firms.

Which Firms Are to Be Covered?

This is the most significant change. Currently the Code applies to 26 of the largest banks, building societies and broker dealer groups in the UK. As a result of CRD3, the FSA is required to substantially increase the scope of the Code to over 2,500 FSA authorized firms. All banks and building societies, a large number of asset managers, most hedge fund managers and all UCITS investment firms will be in scope, plus some firms which engage in corporate finance, venture capital, the provision of financial advice, brokers, several multilateral trading facilities and others.

The FSA has committed to adopt a proportional approach in applying the rules, reflecting the extent to which the application of the rules is appropriate to a firm's size, internal organization and the nature, scope and complexity of its activities.

Territorial Scope

The following is proposed:

- UK groups should apply the Code globally to their regulated and unregulated entities.
- UK subsidiaries of non-European Economic Area (EEA) parents must apply the Code in relation to all entities within the relevant sub-group, including entities based outside the UK.
- UK subsidiaries of EEA parents, that are regulated entities in the UK, must apply the Code. However,

these entities are likely to be subject to a dual regime as their parent company's home state will need to implement the provisions of CRD3.

- UK branches of firms whose home state is outside the EEA will continue to be caught by the Code.
- UK branches of firms whose home state is within the EEA are not required to apply the Code as their home state will be required to apply equivalent provisions under the CRD3.

Remuneration Principles

The general requirement that remuneration policies must be consistent with and promote effective risk management remains the central tenet of the Code. The FSA has, however, revised and updated the principles of the Code. We set out a summary of the key proposals below:

Fixed/Variable Balance

The FSA wants to ensure that firms have an appropriate balance between fixed and variable elements of total remuneration. The FSA are waiting for the Committee of European Banking Supervisors (CEBS) to set out its specific criteria in its guidelines, which are due in October 2010, before determining ratios.

Deferral

In relation to large bonuses, which will be those in excess of £500,000, at least 60% should be deferred, rather than 40% which was previously set out in the Code. Firms should also consider whether smaller amounts should be considered to be 'particularly high' and therefore should be subject to the 60% deferral.

Proportion in Shares

A new rule is proposed requiring at least 50% of any variable remuneration to be made in shares, shares linked in instruments, or other equivalent non-cash instruments, subject to the legal structure of the firm. The FSA's view is that firms can decide whether this 50% forms part of the non-deferred payment, or the deferred element, or a mixture of both. The FSA does recognize that for firms that are unable to issue shares, such as building societies, this requirement will not be as easily applied and the FSA is sensitive to the difficulties in implementing suitable alternatives to shares and share linked instruments.

Performance Adjustment

The Code will be amended to state that all deferred variable remuneration which has not yet vested should be subject to an appropriate form of performance adjustment. The FSA suggests that performance adjustment should be applied in the following situations, namely, where:

- there is evidence of employee misbehavior or material error;
- the firm and/or the business unit subsequently suffers a material downturn in its financial performance; and
- the firm and/or the business unit in which the employee works suffers a material failure of risk management.

Guarantees

The FSA has confirmed a continuing ban on guaranteed bonuses other than, in exceptional circumstances, to new hires for the first year of service only, which should also be subject to deferral. Sign on/ buy-out bonuses should not exceed the terms offered by the previous employer (being bought out) and should be subject to performance adjustment requirements. Retention bonuses will only be permitted in exceptional circumstances. The FSA has proposed that it will be good practice to extend the guarantee rules to all employees.

In relation to large bonuses, which will be those in excess of £500,000, at least 60% should be deferred, rather than 40%, which was previously set out in the Code.

Severance Pay

The FSA is proposing a new rule in relation to severance pay to ensure that payments related to the early termination of a contract reflect performance and do not reward failure.

The Financial Services Act 2010 has given the FSA the power to be able to prohibit a firm from remunerating its staff in a certain way. The FSA can render void a provision of an agreement that contravenes the Code and recover payments. The FSA have proposed that this power will only be used in relation to deferral arrangements and guaranteed bonuses.

Which Staff Are Covered?

The revised Code will apply to any staff that have a material impact on the firm's risk profile, the "Code Staff ." The individuals covered may be slightly different to the staff, known as "P8 staff ," to which the Code previously applied. There are three categories of individuals who the FSA would expect to see on a firm's list of Code Staff:

(a) a person who performs a significant influence function for the firm;
(b) a senior manager;
(c) all staff whose total remuneration takes them into the same bracket as senior management and risk takers.

In addition to heads of the business, the FSA has confirmed that, subject to the nature of their duties, the potential list of Code Staff would also normally include

Remuneration Code, continued on page 16

Remuneration Code *(from page 15)*

heads of support and control functions, such as human resources, legal, compliance and information technology. The FSA is considering the position of individual proprietors and general partners. However, it has confirmed that limited partners whose position is more akin to employees will not be excluded from the scope of Code Staff.

It is for the relevant firms to determine a defensible list of Code Staff for the FSA, ahead of bonus allocations. The staff on the list will need to be notified that they are subject to the Code. In relation to non-Code staff, the FSA proposes that firms should consider the Code principles on a firm-wide basis under a general rule, subject to proportionality.

There is a proposed de minimis exemption for Code Staff whose bonus is less than 33% of total remuneration and whose total remuneration is less than or equal to £500,000. For such persons the FSA would not generally consider it necessary to apply the rules relating to deferral, performance adjustment, proportion of remuneration paid in shares and guaranteed bonuses. This proposal will be reviewed following the publication of the CEBS Guidelines later this year.

Proportionality

The FSA has confirmed that it will apply the Code in a proportional way, in accordance with the flexibility given by CRD3. This will not mean that there is a complete exemption from the Code for any firm, but it is recognized that applying the full Code may be inappropriate and/or overly burdensome for some. The FSA have proposed an approach which provides that: there are minimum requirements which all firms are expected to comply with;

- there are rules which could be applied proportionally in line with a firm's nature, scale, scope and complexity; and
- there are rules that could be applied on a "comply or explain" basis.

The FSA has confirmed a continuing ban on guaranteed bonuses other than, in exceptional circumstances, to new hires for the first year of service only, which should also be subject to deferral.

The FSA Consultation Paper provides tables setting out where each of the proposals falls within the proportionality principles, but there will need to be further clarification on this issue. In addition, the CEBS is considering several issues relating to proportionality and a report is expected in October 2010.

Implementation

Firms in extended scope: The FSA expects the extended scope firms to begin planning for the implementation of suitable remuneration structures, policies and practices as soon as possible. Whilst they state that it is desirable that such arrangements are in place by January 1, 2011, the FSA will not expect such firms to have achieved this until later in 2011.

Firms currently in scope: The review of remuneration arrangements will be divided into two parts. The first part will take place in the last quarter of 2010 through meetings and discussions and will address the issues of governance, controls, performance measurement and risk adjustment. The second part will review the proposed plans for 2010 awards against the rules that will come in on January 1, 2011. The FSA will request such information in the weeks before each firm's proposed announcements of bonus awards. ❏

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