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Parents Liable for their Children:
Presumption of Parental Liability under EU Antitrust Law

By Philip Bentley QC and Philipp Werner (McDermott Will & Emery LLP)

Under EU antitrust law, parent companies are presumed liable for antitrust infringement of their wholly owned subsidiaries. While this presumption is rebuttable, it is unclear what a company must do to rebut it successfully. The recent Air Liquide judgment of the General Court of the European Union marks the first time that a company escaped the presumption of liability, if only for procedural reasons. The judgment also sheds some light on the arguments that may work for a parent company.

Under EU antitrust law, parent companies can be jointly and severally liable for antitrust infringements committed by their subsidiaries. In this case, the parent company is also a direct addressee of the European Commission's fining decision. This has far-reaching consequences for parent companies. Given the extraordinary fines amount imposed by the European Commission, this is not a comfortable situation in which to be.

The concept of parental liability in EU antitrust law was first established in Imperial Chemical Industries v Commission (Case 48/69), where the European Court of Justice (ECJ) held that the separate legal personality of the subsidiary does not exclude the possibility of imputing its conduct to the parent company. The ECJ held further that a company can exercise decisive influence on the conduct of a wholly owned subsidiary and, if it does, it is jointly and severally liable for any antitrust infringement of the subsidiary. In AEG-Telefunken v Commission (Case 107/82), the ECJ held that there is a rebuttable presumption that a company does in fact exercise that decisive influence on the conduct of its wholly owned subsidiary.

However, the ECJ seemed to require more than a 100 percent shareholding as evidence in Stora Kopparbergs Bergslags v Commission (Case C-286/98). This led to uncertainty concerning the level of evidence required for the presumption of parental liability. In subsequent decisions, the ECJ rejected this reading of Stora. In Akzo Nobel v Commission (Case C-97/08), the ECJ clarified that in cases of a 100 percent subsidiary, first, the parent company can exercise decisive influence over the conduct of the subsidiary and, second, there is a rebuttable presumption that the parent company does in fact exercise decisive influence over the conduct of its subsidiary. The ECJ said that "it is sufficient for the Commission to prove that the subsidiary is wholly owned by the parent company in order to presume that the parent exercises a decisive influence over the commercial policy of the subsidiary. The Commission will be able to regard the parent company as jointly and severally liable for the payment of the fine imposed on its subsidiary, unless the parent company, which has the burden of rebutting that presumption, adduces sufficient evidence to show that its subsidiary acts independently on the market."

Parent companies which are held liable for the infringement of EU antitrust rules by wholly owned subsidiaries must present relevant and significant evidence to rebut the presumption of parental liability.

This was confirmed in recent judgments, such as General Quimica (Case C-90/09) and Air Liquide (Case T-185/06). Therefore, it is settled case law that the Commission only needs to prove the 100 percent shareholding for the presumption of parental liability to apply. It is then for the parent company to seek to rebut the presumption by adducing sufficient evidence that the subsidiary acted independently on the market.

A Rebuttable Presumption of Parental Liability

In Akzo Nobel and General Quimica, the ECJ made clear that the presumption of liability was rebuttable. However, the Court did not give any precise guidance how and by virtue of which evidence the presumption could be rebutted. The Court ruled that "in order to ascertain whether a subsidiary determines its conduct on the market independently, account must be taken . . . of all the

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relevant factors relating to economic, organizational and legal links which tie the subsidiary to the parent company, which may vary from case to case and cannot therefore be set out in an exhaustive list."

In Air Liquide, the General Court for the first time annulled a Commission decision with regard to the presumption of parent liability. The Commission had adopted a decision against Chemoxal for its participation in a cartel and had held its 100 percent parent company, Air Liquide, jointly and severally liable for the infringement. Air Liquide appealed against the Commission's decision and argued that the Commission had not taken into account the evidence which Air Liquide had presented in order to show that it did not "exercise any influence over the commercial policy" of Chemoxal, and that Chemoxal "acted independently on the market."

The General Court emphasized that the presumption of liability is rebuttable, and therefore the Commission is under an obligation to provide a statement of reasons why it considers the evidence submitted as insufficient to rebut the presumption. The Court concluded that the Commission had failed to adopt a position on the evidence and counter-argument adduced by Air Liquide in rebuttal of the presumption that Air Liquide exercised decisive influence over the conduct of Chemoxal.

Relevant and Significant Evidence for the Rebuttal of the Presumption of Liability

The General Court annulled the Commission's decision in Air Liquide on purely procedural grounds without assessing the evidence put forward by Air Liquide on the merits. However, the Court stated that while the Commission is not obliged to adopt a position on all the arguments relied on by the parties, this did not concern the arguments presented by Air Liquide, because they were not "manifestly irrelevant or insignificant or plainly of secondary importance". It can be concluded that the evidence presented by Air Liquide was indeed relevant and significant.

The General Court focused on two points. First, Air Liquide relied on "the very specific character of Chemoxal's business compared to the group's other activities, the absence of links between the management and the personnel of the companies concerned, a wide definition of the powers of the subsidiary's management, the fact that the subsidiary had its own services concerning its commercial activities and its autonomy in relation to strategic projects" (free translation). Second, Air Liquide backed its statements with concrete evidence.

In particular, the following points can be considered as relevant and significant evidence for the rebuttal of the presumption of liability:

- No executive employee of Chemoxal was a member of the board of directors or of any of the governing bodies of Air Liquide. This argument was backed by the submission of payment slips and other documents.
- The director of Chemoxal and the executive director had far-reaching powers to act in the name of Chemoxal. This was backed by minutes of the meetings of the board of directors and circulars.

The judgment in Air Liquide is the first time the European Courts have provided guidance on the kinds of evidence that may help the parent company to escape liability for its subsidiaries.

- Chemoxal had its own units for supply, marketing, accounting, data and human resources, and even had its own research unit with an independent administration. Services provided to Chemoxal by units of Air Liquide and premises rented by Chemoxal from Air Liquide were invoiced. Air Liquide provided the Commission with invoices and the tenancy agreements.
- Chemoxal managed its subsidiaries independently, and links with Air Liquide were only based on tax reasons.
- Chemoxal's business was clearly distinguished from Air Liquide's, and Chemoxal acted independently on the market. To this end, Chemoxal was solely responsible for pricing, strategic business planning, drawing up the budget and managing the relationship with its customers. To back these arguments, Air Liquide submitted circulars, correspondence with customers and internal memos.
- CEFIC, a trade association, regarded Chemoxal as an independent company, which was supported by minutes of meetings.
- Business documents were created in Chemoxal's name. Chemoxal only used Air Liquide's trade name to benefit from its reputation.
- All employees accused of having participated in cartel meetings were employed by Chemoxal and not by Air Liquide, and the Commission file does not contain any evidence of instructions given by Air Liquide to Chemoxal.

Conclusion

Parent companies which are held liable for the infringement of EU antitrust rules by wholly owned subsidiaries must present relevant and significant evidence to rebut the presumption of parental liability. The judgment in Air Liquide is the first time the European Courts have provided guidance on the kinds of evidence that may help the parent company to escape liability for its subsidiaries. ❑

Roundup

By Reuters

EU Slams Ratings Agencies After Portgual Downgrade

European politicians accused credit rating agencies of anti-European bias after Moody's downgrade of Portugal's debt to "junk" cast new doubt on EU efforts to rescue distressed euro zone states without debt restructuring. European Commission President Jose Manuel Barroso said the decision to cut Lisbon's rating by four notches so soon after it became the third country to receive an EU/IMF bailout was fuelling speculation in financial markets.

Barroso said the fact that none of the rating agencies were from Europe could lead to "some bias in the markets when it comes to the evaluation of the specific issues of Europe". German Finance Minister Wolfgang Schaeuble called for limits to be placed on the rating agencies' "oligopoly."

The European Union's executive body is drafting proposals to regulate rating agencies; there has been political talk, but no action so far, about creating a European agency. Michel Barnier, the EU official in charge of regulation, said later he could examine how to suspend the rating of countries that are getting bailout funds from the EU and International Monetary Fund. These are Greece, Ireland and Portugal.

Moody's thumbs-down, coming so soon after a new centre-right Lisbon government announced austerity plans going beyond international lenders' demands, called into question the EU strategy for dealing with the euro zone sovereign debt crisis. Moody's said Portugal may need a second round of rescue funds before it can return to capital markets, just as European governments and banks are haggling over a second 120 billion euro bailout for Greece, which has a much higher debt ratio.

EU Banks Watchdog Has All Stress Test Data, Moody's Say 26 Banks May Need Support

The European Banking Authority said it had received all the extra information it wanted from banks, paving the way for publication of its sector health-check in July. The European Union watchdog is stress testing 91 lenders to see whether they can still stand on their own feet in the face of scenarios such as the economy shrinking for two consecutive years or big drops in house prices.

The EBA planned to publish the result in June but had to ask banks to resubmit information, because it was too optimistic. It also toughened up the impact of a big ratings downgrade on sovereign debt – putting countries like Greece into theoretical default. Officials familiar with the stress test said the need to put further questions to banks could not be ruled out, but that the results are expected to be published in July. Some banks, however, believe the EBA may be forced to delay publication beyond mid-July.

2010's test was judged a flop after only seven lenders failed, none of them from Ireland, even though Ireland's banks later had to be rescued by a bailout from the EU and International Monetary Fund.

Some 26 of the banks being tested for their resilience in bad markets may need some outside support, credit rating agency Moody's said later in the month. Moody's said the overall impact of the stress test on bank ratings would be limited. Of the 91 EU banks subject to the EBA's 2011 stress test, 26 rated banks had a heightened risk of needing extraordinary external support, it said. The agency expected the banks that fail the EBA stress test to be among the lower-rated banks, or among the non-rated banks included in the EBA stress test.

The European Union's executive body is drafting proposals to regulate rating agencies; there has been political talk, but no action so far, about creating a European agency.

French Banks Warn Capital Rules Could Hit Growth

The heads of France's two biggest banks told regulators that tougher capital rules could slam the brakes on growth in a region that still depends on banks to provide most of its credit. Global banking regulators decided on June 25 to slap an extra capital charge on the world's biggest banks to make them safer, a move that could hit BNP Paribas and Societe Generale if they are deemed to be "systemically important."

That requirement would come on top of a new 7 percent minimum core capital requirement which all banks across the world will have to hold under new Basel III rules being phased in over six years from 2013.

Both Societe General's chief executive, Frederic Oudea, and BNP Paribas's chairman, Michel Pebereau, have voiced their concerns over the new rules, urging banking regulators to proceed with caution because of the danger that new capital rules could stifle economic growth. Pebereau called for final decisions regarding which banks are considered "too big to fail", and therefore require an

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additional capital cushion, to be postponed until 2015 given that under the current regulatory framework such banks would only need to raise capital between 2016 and 2019.

EU Watchdog to Bolster Consumer Protection Role

The European Union's new markets watchdog may start warning consumers or ban products outright unless local supervisors act quickly enough to crack down on risky financial products.

Securities and Markets Authority (ESMA) is being closely watched by financial firms to see how it will use its sweeping retail powers, an area which traditionally a mainly national regulatory domain.

ESMA might consider issuing investor alerts or consumer warnings relating to specific product types or selling practices or activities, ESMA chairman Steven Maijoor told a conference. ESMA would issue such warnings and even product bans when local supervisors failed to act or took insufficient measures, he said.

Its role in consumer protection and retail financial services is expected to grow further. The EU's Financial Services Chief Michel Barnier is planning legislation to beef up consumer protection and EU powers over retail products such as home loans, which are typically sold by local firms.

EU Sees Delay in Derivatives, Short-Selling Rules

European Union rules to tighten derivatives rules won't be agreed until at least the early autumn, as a global crackdown on the opaque sector faces delays on both sides of the Atlantic. The bulk of world's $600 trillion derivatives are traded in London and New York, but while the EU and United States agree on the objectives, detail is taking more time to finalize.

Banks were hoping for an EU deal by July to lift the fog on how they will have to change the way they do business. But German centre right lawmaker Werner Langen told the European Parliament a complete first reading vote would be held yet so as to give negotiations with EU states, who have joint say, more time. The measure was authored by the bloc's financial services chief Michel Barnier, who kept up the pressure on lawmakers, saying the EU had to respect G20 commitments before the end of 2012.

The EU parliament says the measure should mainly cover only the off-exchange derivatives sector but member states are split, with Britain pushing for the draft law to cover all derivatives, like the U.S. rules, to ensure competition clearing.

Barnier is keen to push through the derivatives law so he can move onto other big measures, such as broadening the bloc's MiFID securities trading rules, which has been delayed until October 2011. But even if the framework law was approved in the EU this autumn, it will take months for the bloc's regulators to thrash out implementing measures.

EU Proposes Overhaul of Data Roaming, Virtual Operators

Retailers such as Tesco and Carrefour may soon find it easier to compete with Vodafone and other established telecoms providers under new EU proposals aimed at opening up the mobile telephony market. The structural changes proposed by the European Commission will pave the way for virtual mobile network operators, which do not have their own infrastructure or spectrum, to piggyback on other providers' networks, a move that could dent the business of companies such as Vodafone and Deutsche Telekom.

The structural changes proposed by the European Commission will pave the way for virtual mobile network operators, which do not have their own infrastructure or spectrum, to piggyback on other providers' networks, a move that could dent the business of companies such as Vodafone and Deutsche Telekom.

The proposals will also allow users travelling abroad to opt for a cheaper mobile roaming contract from a competing provider while using the same phone number from their domestic operator.

The proposals will need to be approved by EU lawmakers and EU governments. The Commission has set a July 1, 2012 target for the network measure and July 1, 2014 for the lower roaming deals to come into force. ❏

German Supreme Court on Antitrust Damages Actions: *Indirect Purchasers Have Standing, Defendants May Invoke Passing-On Defense*

By Johannes Zöttl and Mirjam Erb (Jones Day)

The German Federal Civil Court (Bundesgerichtshof, BGH) has held that both direct and indirect purchasers may sue for antitrust damages, but defendants may raise the passing-on defense.

Through the passing-on defense, defendants try to demonstrate that plaintiffs suffered no financial harm, as they passed on the overcharge to their own customers.

The BGH's decision of June 28, 2011 could spark an increase in antitrust litigation in Germany, as it confirms that indirect purchasers have standing (an issue on which German courts disagreed in the past). The fact that the passing-on defense is now available to defendants is unlikely to deter litigious purchasers, as the key to making pass-on a successful defense is in the evidence, and Germany does not allow discovery.

Lower Court Decisions

The plaintiff in the underlying lawsuit is a printer business that bought carbonless paper at prices allegedly increased by coordination among paper producers. In 2001, the European Commission imposed fines of €313.7 million on producers of such paper for price-fixing and market-sharing agreements. The supplier of the printer business (a wholesaler) was a subsidiary of one of these cartel members and resold that manufacturer's products. The printer business became insolvent and assigned its antitrust claims against the cartelists to the plaintiff, a German savings bank. The bank brought an action against the producer, the parent of its supplier, for a relatively small amount of damages, €224.000.

The court of first instance (Landgericht Mannheim) dismissed the claim. It found that customers of a subsidiary of a cartelist are indirect purchasers and that indirect purchasers may not claim antitrust damages in German courts. Additionally, the court held that the plaintiff should have substantiated that it has not passed on to its own customers the higher prices it paid when it purchased carbonless paper from the wholesaler. The court found that the plaintiff failed to do so.

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On appeal, the Higher Regional Court (Oberlandesgericht, OLG) of Karlsruhe decided that only direct purchasers have standing. The OLG's main argument was that allowing actions by indirect purchasers would make it necessary to also recognize the passing-on defense (which the OLG refused to do). Additionally, the OLG pointed out that German law does not currently have a satisfactory solution to the issue of how various purchasers at various levels of the distribution chain would need to redistribute the recovered damages among themselves.

The court of first instance (Landgericht Mannheim) found that customers of a subsidiary of a cartelist are indirect purchasers and that indirect purchasers may not claim antitrust damages in German courts.

However, the OLG made an exception, if the direct purchaser is a wholly-owned subsidiary of the cartelist. In these circumstances, the OLG assumed that the direct purchaser would be unlikely to enforce its claim for damages. On this basis, and given the evidence the plaintiff submitted, the court awarded damages in a total amount of €100,000. This amount related only to products the plaintiff purchased from the wholesaler, which was affiliated with one of the cartelists.

German Law

Germany has seen a high level of antitrust litigation for damages for many years. One of the reasons is that the 2005 amendment to the German Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen, GWB) confirmed that any infringement of the German or EU antitrust rules may give rise to a claim for damages. In an attempt to deal with the issue of passing-on, the 2005 amendment incorporated the following sentence into the GWB:

> *If a product or service is purchased at an excessive price, damage shall not be excluded on account of the resale of the product or service.*

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Through this amendment, Parliament wanted to clarify that the harm occurs when the customer is overcharged, and that financial harm does not fall away solely because the purchaser resold the product. However, this does not rule out that there is not financial harm for other reasons. In exceptional cases, German civil law allows the judge to consider that the plaintiff has already received certain forms of recovery. The relevant criteria are based on equitable law and essentially rely on considerations of whether a damage award would be fair and appropriate.

The 2005 Amendment intentionally avoided the issue. Parliament wanted to leave the question to the courts. Most commentators are in agreement that the passing-on defense can only be invoked in very narrow circumstances. The German Federal Cartel Office (Bundeskartellamt, FCO) echoed this position. In a 2005 working paper, the FCO argued that the conditions for invoking the defense should be narrowly defined such that

> *they will typically not be satisfied…[unless] the financial harm has indeed been passed on; this did not decrease the revenues of the customer; and passing on the harm has neither created a risk for the customer nor imposed an undue burden on it.*

EU Law

EU law is silent on the issue. Standing and available defenses relate to the laws of torts and the laws of procedures in civil matters. Both areas of the law are member state matters. The EU has not enacted any instrument which would harmonize these matters across member states for antitrust damages actions.

In June 2011, the ECJ addressed another important issue of antitrust damages actions, disclosure of leniency files of antitrust authorities (in that case, the FCO) to plaintiffs. However, the European courts did not yet deal with the passing on-defense. The ECJ found in two decisions that "any individual" who suffered harm by an antitrust infringement must be allowed to claim damages. However, the ECJ also found that the details and conditions are for the member states to define, and the facts of those cases were relatively narrow.

By contrast, there is no shortage of working papers by the Competition Directorate of the European Commission proposing that EU action is required, ranging from a broad Green Paper (2005) and a more specific White Paper (2008) to consultations of the general public on collective redress and quantification of harm (both in 2011). In its 2008 White Paper, the Commission recommended that defendants should be allowed

> *to invoke the passing-on defense against a claim for compensation of the overcharge. The standard of proof for this defense should not be lower than the standard imposed on the claimant to prove the damage.*

The BGH's Decision

The BGH has not published its decision yet. So far, only a press release is available. According to the press release, the BGH took the position that antitrust actions for damages must be permitted at any level of the distribution chain at which an infringement of the competition rules has resulted in financial harm, including indirect purchasers. As a result, the BGH considers it necessary to allow that the passing-on defense is raised, as the cartelist could otherwise be liable to multiple damages awards. Finally, in what could be an obiter dictum, the BGH said that cartelists are also liable to plaintiffs for the injury caused by their purchases of other cartelists' products through wholesalers.

The German courts will have to develop mechanisms that avoid the complications that explain why, in jurisdictions like the United States, indirect purchasers cannot recover damages.

As a result, the courts will have to develop mechanisms that avoid the complications that explain why, in jurisdictions like the United States, indirect purchasers cannot recover damages. In U.S. federal practice, courts have limited the monetary claims of indirect purchasers to avoid duplicative exposure of defendants, avoid the difficulty of apportioning damages among direct and indirect purchasers, and promote private enforcement by reserving damages to direct purchasers. About half of the U.S. States allow indirect actions, where they have had to develop rules to avoid duplicative liability, apportion damages among different levels of distribution, and determine whether the injury claimed is too remote to collect damages. The German courts will have to address these issues in the future.

Conclusion

The details of the BGH's decision are unknown at this point. The BGH overturned certain aspects of the decision and referred the case back to the lower court, the Higher Regional Court (OLG) of Karlsruhe. It is yet to be seen how the OLG will apply the BGH's reasoning to the facts of the case, which is peculiar in many respects.

In particular, it is not clear yet whether the BGH has defined, or the OLG will define, additional criteria that need to be satisfied for defendants to be able to invoke the defense. Once invoked, it is not clear which rules need to be satisfied to make the defense successful. Which party has the burden of proof, and are there exceptions? How detailed does the defendant's submission have to be, and which evidence is required? Which criteria apply if the plaintiff sues not the cartelist (as was the case in the BGH matter) but its direct supplier? Would yet another criteria apply if the value chain upstream of the plaintiff involves manufacturing and not trading?

Moreover, it should be noted that the BGH overturned the OLG Karlsruhe's decision only to the extent that the OLG did not award damages. The OLG, however, awarded approximately 50% of the damages that the plaintiff had requested. It did so on the basis of generic data regarding the value of commerce involved and in light of a relatively plaintiff-friendly interpretation of the relevant standards of proof. In this respect also, the BGH's decision signals that Germany will see even more antitrust litigation in the future than it does already now, and the odds look to be stacked in favor of the plaintiffs. ❑

ITALY

New Italian Disclosure Reporting Regime Aims to Rein in Short-Selling amid Market Turbulence

By Tobia Croff and Emanuele Trucco (Shearman & Sterling LLP)

On July 10, 2011, the Commissione Nazionale per le Società e la Borsa (the Italian securities regulator, "CONSOB") adopted a new disclosure regime for short selling of Italian stocks. The new rules, which became effective on July 11, 2011, require market participants to report their net short positions exceeding certain thresholds.

Resolution No. 17862 adopted by CONSOB on July 10, 2011 (the "Resolution") has introduced temporary reporting obligations of net short positions held in relation to shares admitted to trading on the Italian regulated markets. The measure adopted by CONSOB comes amid exceptional market conditions, in particular the high price volatility and trading trends recorded on June 24, 2011 and on July 8, 2011. According to CONSOB, the Resolution tries to prevent that "the absence of reporting obligations of net short positions increase speculative pressure on shares traded on the Italian regulated markets". The new disclosure regime came into force on July 11, 2011 and will expire on September 9, 2011.

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Disclosure Obligations

Any natural or legal person or any other entity, whether Italian or not, must report to CONSOB any holding of a short position in the share capital of any listed issuer whose main market is an Italian regulated market, if such short position, net of any long positions in the same shares, equals or exceeds 0.2% of the share capital of the issuer. Once a notification has been made, additional disclosure is required for any increase or decrease in the net short position equal to or higher than 0.1%. The net short position is calculated at the closing of each business day and

Any natural or legal person or any other entity, whether Italian or not, must report to the Italian securities regulator any holding of a short position in the share capital of any listed issuer whose main market is an Italian regulated market, if such short position, net of any long positions in the same shares, equals or exceeds 0.2% of the share capital of the issuer.

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disclosure must be made to CONSOB by 3.30 p.m. (CET Time) on the business day following the day on which the position reached, exceeded or fell below the disclosable percentage trigger. End-of-day positions are calculated with reference to the transactions executed on that same day, whether or not settled.

Calculation of the Net Short Position

The size of net short positions is expressed as a percentage of the company's share capital, calculated on the basis of the number of the issuer's shares that constitute the net short positions and the total number of the shares of the company's capital. The Resolution defines "net short position" as a short position calculated with respect to the number of underlying shares of the relevant issuer, taking into account: (i) any short positions – i.e. both actual sales of shares (not yet settled) and potential sales of shares arising from short positions in derivative financial instruments; netted by (ii) any long positions – i.e. shares actually held, actual purchases of shares (not yet settled) and potential purchases of shares arising from long positions in derivative financial instruments, in each case irrespective of the trading venue.

Derivative financial instruments are computed on a "delta-adjusted" basis. In turn, the delta is calculated using the closing price of the underlying shares. Also, in the event that the variation of the delta itself in a given day causes the thresholds to be crossed, the relevant net short position must be reported to CONSOB. In the context of a share capital increase, the shares to be included when calculating net short positions are deemed to be issued on the first trading day following the end of the offering period. Preemptive subscription rights form part of the calculation of net short positions.

Other Provisions

Generally, legal entities must calculate only one net short position. However, different rules may apply in the event of legal entities having different decision-making functions. In particular: (i) Any management company and other legal entity, whether Italian or not, that manages several funds and/or collective investment schemes and that, in relation to the same funds or schemes exercises independent investment strategies, must calculate the relevant net short position with reference to each specific fund, irrespective of the fact that the funds are managed by the same legal entity; (ii) Conversely, the net short positions held by funds and/or collective investment schemes that follow the same strategy determined by the same legal entity must be aggregated for purposes of calculating the total net short position; and (iii) Investment firms and other legal entities that hold positions in financial instruments through two or more business units, operating independently of each other, must calculate the net short positions with reference to each such business unit. Where investment decisions are taken at a group level or where two or more entities that are part of a group act in agreement, the calculation of the net short position must be made at the group level.

Exemptions

The disclosure regime set forth by the Resolution does not apply to the activities carried out by (i) market makers acting in their capacity as such; and (ii) specialists, as defined in the listing rules of Borsa Italiana S.p.A. (the Italian Stock Exchange), and institutions acting as liquidity providers, both acting in their capacity as such.

The Resolution provides for an increase in CONSOB's supervisory powers in the current highly volatile market environment, aligning Italian securities laws to the measures adopted by regulators in other major European jurisdictions and the current legislative proposal of the European Commission on short selling.

Conclusions

The Resolution provides for an increase in CONSOB's supervisory powers in the current highly volatile market environment, aligning Italian securities laws to the measures adopted by regulators in other major European jurisdictions and the current legislative proposal of the European Commission on short selling. ❏

UK Bribery Act 2010: Focus on Private Equity Industry

By Robert Amaee, John Rupp and Simon Goodworth (Covington & Burling LLP)

Recent pronouncements by the Serious Fraud Office ("SFO"), the body tasked with enforcing the UK Bribery Act 2010 ("UK Bribery Act"), which entered into force on July 1, 2011, have sought to highlight the exposure that private equity firms face as a consequence of the UK Bribery Act.

Under the UK Bribery Act, companies that do business in the UK will be liable for bribes by "associated" persons -- those performing services for or on behalf of the company -- unless they are able to demonstrate that they have implemented "adequate procedures" to prevent bribery. Unlike the US Foreign Corrupt Practices Act, the UK Bribery Act covers bribes paid in the private as well as the public sectors.

In a speech delivered recently to members of the private equity community entitled "Private Equity and the Bribery Act," Richard Alderman, the Director of the SFO, has made it clear that private equity firms need to ensure that they have implemented adequate procedures to mitigate the risk of bribes being paid on their behalf and for their benefit. Specifically, Director Alderman stated that –

> *[w]e are stressing the responsibility of the owners of companies to ensure proper standards of governance and a proper anti-corruption culture. Owners should not stand aside and say this is nothing to do with them but is an operational issue for the company. It is not. As owners of companies, private equity (as well as the big institutional shareholders) has a responsibility to society to ensure that the companies in which they have a shareholding operate to the right standards. It may even be that it is a condition of investment by fund managers allocating funds to you to invest that you invest only in companies that are FCPA and Bribery Act compliant. This is something you will need to bear in mind. You may also need to look at your exposure * * * if you are directors (whether executive or non-executive) in the companies in which you invest.*

Unlike the US Foreign Corrupt Practices Act, the UK Bribery Act covers bribes paid in the private as well as the public sectors.

Director Alderman emphasized in the same speech that private equity firms that violate the UK Bribery Act also should be cognizant of their potentially consequent exposure under the UK Proceeds of Crime Act 2002 – the primary UK statute addressing money laundering. According to Director Alderman:

> *[Let me turn to the issue of] your responsibility if any of the companies that you own pays bribes. You might at first think that this is nothing to do with you as the owners of the company. It might be that as portfolio owners you are not committing an offence of failing to prevent bribery. But it does not end there. First of all we will be looking at money laundering in order to see what money has been laundered as a result of the criminal conduct and to whom it has gone. It may be indeed that the owners have some knowledge of the contract that was obtained through bribery. We will be thinking about money laundering.*

Even if there was no knowledge within a private equity firm of the bribery that occurred in a portfolio company, the SFO nonetheless would be able in many instances under the UK Proceeds of Crime Act 2002 to seek to recover from the private equity firm the benefit the firm had realized as a result of the bribery. Director Alderman noted in that connection that

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> *[a] feature of the SFO's work that you may hear about in due course is what happens when something goes wrong and the company gets involved in bribery. The owning company or partners may know nothing about this although they will have received the benefit through dividends or other distribution. We are looking at how we recover the benefit.*
>
> *This is something I care about very much because I want to ensure that companies have built a true anti-corruption culture. I am seeing this in many companies at the moment. What I am also seeing is that these companies are ensuring that those who do business with them are also building up that anti-corruption culture * * *.*

There is no special, or distinguishing, treatment for private equity firms or investors under the UK Bribery Act. However the nature of the private equity industry is such that there are certain special issues and complexities which arise. Within the private equity community, private equity managers making direct investments will likely face the broadest set of issues.

Apart from issues arising out of ordinary operations, managers will need to focus on UK Bribery Act compliance in the raising of funds, in the sourcing of deal flow, the undertaking of acquisitions and investments and in relation to the operation of the businesses of underlying portfolio companies.

Buy-out funds, and other funds taking controlling interests in companies, will be most likely to face issues relative to portfolio companies; venture funds perhaps less so.

Buy-out funds, and other funds taking controlling interests in companies, will be most likely to face issues relative to portfolio companies; venture funds perhaps less so.

Secondary investors and fund-of-funds investors who make use of intermediaries to source deals may need to give particular attention to these arrangements.

Private equity firms and investors alike will need to review due diligence procedures as well as organize effective compliance programs. With many private equity transactions taking place in a very competitive environment with often demanding time frames, it is especially important to determine appropriate due diligence procedures in advance.

The vast majority of the largest and most sophisticated private equity firms, particularly those operating or investing in the US, already have implemented policies and procedures to address their exposure under the US Foreign Corrupt Practices Act ("FCPA"). Many private equity firms also already have reviewed and updated their FCPA related policies and procedures in light of the UK Bribery Act.

The private equity firms and investors that have not done so already, despite their UK presence or UK related investments, will need to review their existing policies and procedures to take account of their potential exposure under the Bribery Act and other legislation such as the UK Proceeds of Crime Act 2002. The following steps should be undertaken as swiftly as possible:

Assess your risk - identify the corruption risks that arise by virtue of the nature of your global business activities, portfolio companies and other investments.

Design and implement an appropriate compliance program or modify an existing program to ensure compliance with the Bribery Act. You will need to pay attention in that connection to the principles set out in the "adequate procedures" guidance issued recently by the UK Ministry of Justice. As part of that process, private equity firms should --

- seek to identify the bribery related risks that actually are facing as a result of their operations and the operations of portfolio companies;
- develop targeted approaches to mitigating such risks;
- develop an appropriate due diligence program for use in connection with proposed acquisitions and investments;
- review commercial agreements with third parties (such as intermediaries) whose actions may create liability for them;
- develop a clear policy for dealing with bribery related issues that have been reported to them, whether the information comes from a whistleblower or some other source;
- make sure that those within the firm that can affect the firm's bribery related risk profile understand their legal responsibilities and the firm's expectations of them; and
- periodically reevaluate their bribery related policies and procedures to ensure that they are, and will be deemed to be, fit for purpose in the event their adequacy is called into question. ❑

UK Corporate Insurance and Regulatory Update

By Martin Mankabady and Annemarie Payne (Mayer Brown LLP)

HM Treasury Publishes White Paper Entitled "A New Approach to Financial Regulation: A Blueprint for Reform"

On June 16, 2011, HM Treasury published a White Paper providing further detail on its new approach to financial regulation including a partial draft of its proposed Financial Services Bill and explanatory notes. The reforms to the UK system of financial regulation are the Government's response to the shortcomings of the UK system of financial regulation, which were highlighted by its failure to predict and adequately respond to the financial crisis that started in 2007. The White Paper provides that the Government's primary objective in reforming financial regulation in the UK is "to fundamentally strengthen the system by promoting the role of judgment and expertise".

As has been widely discussed, the Government plans to reform the financial regulatory system by establishing a macro-prudential regulator, the Financial Policy Committee ("FPC") within the Bank of England to monitor and respond to systemic risks; transferring responsibility for prudential regulation of banks, insurers and complex investment firms to a new regulator, the Prudential Regulation Authority ("PRA"), which will be a subsidiary of the Bank of England; and creating a focused new regulator

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for conduct of business, the Financial Conduct Authority ("FCA"), to ensure that business across financial services and markets is conducted in a way that interests all users and participants. These regulators will be judgment-led and empowered to look beyond compliance and supervise proactively.

The draft Financial Services Bill provides for the PRA to be given a specific statutory objective for insurers "to ensure the insurer has a reasonably high probability of meeting claims from and material obligations to policyholders as they fall due."

Under the new system, insurers will be dual regulated. The PRA will be responsible for the prudential regulation of insurers while the FCA will be responsible for supervision of their conduct of business. The Society of Lloyd's and Lloyd's managing agents will be dual regulated firms while Lloyd's members' agents and Lloyd's brokers will be FCA-regulated firms.

Bank of England and FSA Publish Paper on Prudential Regulation Authority's Approach to Insurance Supervision

On June 20, 2011, the Bank of England and the FSA published a joint paper detailing their current views on the approach the PRA will take to insurance supervision. The PRA is currently expected to be created at the end of 2012 as a subsidiary of the Bank of England.

The joint paper is intended to inform public debate and facilitate engagement with relevant stakeholders as the approach the PRA will take in this area is further refined.

It is noted that insurers' liabilities are fundamentally different to those of banks and that, as insurers are less leveraged than banks, they are in general much less vulnerable to a run resulting from a sudden loss of confidence.

The PRA will have two complimentary objectives for insurance supervision. It will:

1. Seek to secure an appropriate degree of protection for policyholders; and
2. As needed, minimalize the adverse impact that the failure of an insurer or the way it carries out its business could have on the stability of the system.

In order to ensure that an insurer is likely to have sufficient financial resources to meet its obligations to policyholders as they fall due, the PRA will assess an insurer's governance processes and whether these involve management making informed, forward-looking assessments of the firm's financial strength.

In tandem with the PRA's supervision of insurers, the FCA will be tasked with ensuring that consumers are treated fairly in all engagements with insurance firms. Arrangements will be put in place so that there is close cooperation between the PRA and the FCA.

The PRA's role will not be to guarantee that policyholders are protected in all circumstances, nor will the PRA seek to ensure that no insurer fails. However, policyholders will be protected through a combination of the PRA's supervisory approach, mechanisms by which insurers can exit the market in an orderly manner, and the existence of the Financial Services Compensation Scheme's insurance compensation scheme.

The PRA will seek to identify those insurance companies likely individually to pose risk to the stability of the system, and to supervise those companies in a way that reduces that risk.

Under the new system, insurers will be dual regulated. The Prudential Regulation Authority will be responsible for the prudential regulation of insurers while the Financial Conduct Authority will be responsible for supervision of their conduct of business.

The PRA's style of supervision will be judgment based. The nature and intensity of the supervision will be commensurate with the level of risk a firm poses to policyholders and the stability of the system. There will not be a one-size-fits-all approach, but when potential threats are identified the PRA will take supervisory action at an early stage to reduce the risk to its statutory objectives.

It is thought that much of the PRA's proposed approach will be achieved in practice through the application of Solvency II.

The PRA will ensure that major judgments involve its most senior and experienced individuals, using a process that is both rigorous and well-documented, and the PRA will recognize that accountability to the public is of the utmost importance.

International Association of Insurance Supervisors: Issues Paper on Resolution of Cross-Border Insurance Legal Entities and Groups

In light of the fact that there is no international insolvency framework for insurance entities and very few practical examples of successful resolutions, the International Association of Insurance Supervisors ("IAIS") has published a paper identifying the issues involved in the winding up of cross border insurance entities/groups aimed at encouraging international discussion on the resolution of complex cross-border insurance insolvencies/restructurings.

A major objective of the IAIS is to develop by-laws to contribute to the broader stability of the financial system. IAIS Insurance Core Principle 16 covers the winding up of insurance entities. The issues paper highlights the areas necessary to be explored in order to flesh out ICP16, undertaking a preliminary exploration of the issues while recognizing a need for further analysis and consideration within the IAIS and internationally. The paper highlights the main causes of non-viability of insurance entities, the major challenges to the successful resolution of non-viable cross-border insurance entities and the different approaches to resolution together with areas of conflict that currently present obstacles to successful resolutions.

The paper does not put forward solutions but identifies key areas that need to be explored in order to enable the satisfactory resolution of non-viable cross-border insurance entities: the harmonization of restructuring and insolvency laws; the acknowledgement and recognition of other insolvency laws and regulations in various jurisdictions; insurance regulation and supervision in any insolvency/restructuring context; cross-border cooperation, including supervisory and crisis colleges and plans; ring-fencing; consistent priority to be given to the policy holder; and necessary licensing. The paper also briefly compares resolution frameworks in Australia, Canada, Japan, Switzerland, the UK and the US and provides an overview of two case studies.

FSA Proposed Guidance on the Selling of General Insurance Policies through Price Comparison Websites

The Financial Services Authority ("FSA") published a consultation on June 8, 2011 on guidance for selling general insurance policies through price comparison websites. The guidance relates to firms who sell regulated insurance products and services online both through price comparison websites and "white-label" websites.

The FSA's guidance is the result of thematic work conducted between June and September 2010 which looked into how firms sell insurance online. The conclusions of the thematic work were that there was a lack of understanding within the insurance industry about what regulated activities were being conducted by firms selling insurance online, and that this has consequently led to a number of failures to comply with FSA rules.

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The FSA had concerns in three areas:

1) Potential breaches of the general prohibition and restrictions on financial promotions

The FSA considers that firms who use price comparison tools are likely to be carrying out the arranging activities under Articles 25(1) and 25(2) of the Financial Services and Markets Act 2000 (Regulated Activities) Order ("RAO"), and may also be advising on insurance under Article 53. In addition, firms that use a third party's price comparison tool on a white-labeled basis may also fall within Article 25(2).

2) Non-compliance with the FSA's 'Insurance: Conduct of Business sourcebook' ("ICOBS")

As firms tended to consider that they were merely 'introducing' customers to authorized firms, the FSA found that they had not complied with the FSA's ICOBS requirements. In particular, those requirements relating to customer eligibility, status disclosure, suitability of advice, statement of demands and needs and ensuring that customers buy policies under which they are eligible to claim benefits.

3) Non-compliance with the 'Senior Management Arrangements, Systems and Controls sourcebook' ("SYSC")

The FSA was keen to remind firms that SYSC gives them a responsibility to have policies and procedures in place to ensure compliance with the FSA rules and to counter financial crime.

The FSA has also written to firms who sell general insurance policies through price comparison websites, and asked them to ensure that they have appropriate regulatory permissions (or are otherwise exempt) for the activities they carry out, ensure that they only enter into contracts with firms with appropriate regulatory status, review their sales documentation to ensure it complies with FSA rules, and establish appropriate systems and controls to prevent breaches of the appropriate FSA rules.

The FSA found that there was a lack of understanding within the insurance industry about what regulated activities were being conducted by firms selling insurance online, and that this has consequently led to a number of failures to comply with FSA rules.

The FSA invites comments on the consultation until August 8, 2011. ❑