International Securities and Capital Markets*

Walter Stuber, Adriana Maria Gödel Stuber, Jeff Kerbel, Michael E. Burke, Ted Kamman, Raymond Bonci, Hartmut Krause, Pamela A. Fuller, Karen Berg, Jean Paul Chabaneix, Hakki Gedik, Kayra Ucer, Daniel Bushner, Jonathan Parry, Pedro Urdaneta, Aristoteles Tiniacos and Attorneys with Allen & Overy LLP**

I. Developments in Brazil: New Rules on Export Transactions

The Brazilian Executive Branch issued Provisional Measure No. 315 on August 3, 2006 (PM 315), introducing new rules affecting Brazilian exports.[1] The most relevant rules are outlined below.

---

* A more detailed version of this article is available on the ABA International Securities & Capital Markets Committee's homepage: http://www.abanet.org/dch/committee.cfm?com=IC764000 (select the three hyperlinks near the bottom right of the page, under "Newsletters and Publications"—YIR 2006, Parts I-III.

** Section I, Developments in Brazil, was contributed by Walter Stuber and Adriana Maria Gödel Stuber, attorneys with Walter Stuber Consultoria Jurídica in São Paulo, Braz. Section II, Developments in Canada, was contributed by Jeff Kerbel, a partner with Bennett Jones LLP, in Toronto, Can. Section III, Developments in China, was contributed by Michael E. Burke, an attorney with Williams Mullen in Washington, D.C. Section IV, Developments in France, was contributed by Ted Kamman and Raymond Bonci, respectively a partner and associate with Clifford Chance in Paris, Fr. Section V, Developments in Germany, was contributed by Hartmut Krause, a partner with Allen & Overy LLP, in Frankfurt, Germany. Section VI, Developments in Japan, was contributed by Pamela A. Fuller, an attorney based in New York and specializing in international taxation and cross-border investments. Section VII, Developments in the Netherlands, was contributed by Karen Berg, an advocate with De Brauw Blackstone Westbroek N.V. in Amsterdam, Neth. Section VIII, Developments in Peru, was contributed by Jean Paul Chabaneix, an attorney with Rodrigo, Elías & Medrano Abogados in Lima, Peru. Section IX, Developments in Turkey, was contributed by Hakki Gedik and Kayra Ucer, attorneys with Hergüner Bilgen Özeke in Istanbul, Turk. Section X, Developments in the United Kingdom, was contributed by Daniel Bushner and Jonathan Parry, attorneys with Ashurst in London, U.K. Section XI, Developments in the United States, was contributed by attorneys with Allen & Overy LLP. Section XII, Developments in Venezuela, was contributed by Pedro Urdaneta and Aristoteles Tiniacos; the former is a partner and the latter is an attorney with Imery Urdaneta Calleja Itriago & Flamarique in Caracas, Venez.

1. D.O.U. de 04.08.2006. (Brazil). PM 315 has already been approved by the National Congress, sanctioned by the President of the Republic and converted into Law No. 11,371, of Nov. 18, 2006 (Law 11,371). D.O.U. de 29.11.2006 (Brazil). This Law also contemplates several other issues and governs exchange transactions, foreign capital registration, payment in duty free shops located at primary zones in ports and airports, taxation of aircraft lease and novation of agreements entered pursuant to the terms of Section 1 of Article 26 of Law No. 9,491 of Sept. 9, 1997. It also amends Decree No. 23,258 of Oct. 19, 1933, Law No. 4,131 of

As of August 4, 2006—the date on which the Brazilian government published PM 315 in the Federal Official Gazette—Brazilian legal entities and individuals are expressly authorized to maintain part of their revenue obtained from export transactions of merchandise and services (1) within the limit and (2) in the form and conditions established by the Brazilian Monetary Council (*Conselho Monetário Nacional*—or CMN); these provisions specifically address funds which are (1) abroad (i.e., outside Brazil), (2) in foreign currency, and (3) deposited at bank accounts with international financial institutions.[2]

The CMN may also establish simplified forms for contracting simultaneous transactions for the purchase and sale of foreign currency related to funds originating from exports. The funds, however, must transit for their respective full amount, for credit, and for debit at a bank account in Brazil in the name of the exporter. The exchange contract is optional for transactions involving the purchase and sale of foreign currency up to US$3000 or its equivalent.[3]

Regarding the foreign currency proceeds which entered Brazil as receivables from merchandise and service exports, the Central Bank of Brazil (*Banco Central do Brasil*—or Bacen) will only be responsible for keeping records of the exchange contracts. The Federal Revenue Secretariat (*Secretaria da Receita Federal*—or SRF), however, shall exercise control based on the information provided by Bacen. Such an amount cannot exceed 30 percent of the export revenues, though this percentage may be changed, reduced, or increased by the CMN at any moment in accordance with policies intermittently adopted by the Brazilian government.[4] Specifically, the government confirmed the 30 percent maximum amount through Resolution No. 3389, published on August 7, 2006, and introduced on August 4, 2006—the same day PM 315 came into force.[5]

The balance of funds (i.e., at least 70 percent) must enter the country and be converted into Brazilian currency (in *Reais*) by means of an exchange contract made by the exporter with a local intervening bank (i.e., an entity of the Brazilian Financial System duly authorized to deal in the exchange market in Brazil); exceptions must be provided for in the applicable law and regulations. The exchange transaction is settled by delivering the amount of foreign currency to the intervening bank or obtaining documentation evidencing the corresponding amount.[6] The same rule will transitorily apply to the following events, provided they have occurred 210 days before August 7, 2006: (1) any dispatch annotated in the export registry with the Foreign Trade United System (*Sistema Integrado de Comércio Exterior*—or Siscomex) and (2) any services rendered to foreign residents.[7] Notably, this rule is not applied to (1) export amounts arising out of the Settlement and Reciprocal Credits Agreement (*Convênio de Pagamento e Créditos Recíprocos*), (2) finance granted by the Economic and Social Development National Bank (*Banco Nacional de Desenvolvimento Econômico e Social*—or BNDES) or (3) funds from the National Treasury,

Sept. 3, 1962, and Decree-Law No. 1,455 of Apr. 7, 1976. Lastly, it revokes provisions of Provisional Measure No. 303 of June 29, 2006.

2. Decreto No 11.371, art. 1, de 18 de novembro de 2006, D.O.U. de 29.11.2006 (Brazil).

3. *Id.* at arts. 2 & 4.

4. *Id.* at art. 3.

5. Resolution No. 3,389, art. 1 (Brazil).

6. *Id.* § 1.

7. *Id.*

which will be subject to other specific regulations.[8] Ultimately, pursuant to Bacen regulations, the exchange contracts may be entered for immediate or future liquidation, as well as either before or after the shipping of the merchandise or rendering of the services.[9]

Additional guidelines address how to prove that export revenues have entered the country;[10] who, other than the exporter, can enter exchange contracts;[11] how to receive foreign currency from exports;[12] the laws governing credits abroad of any export amounts to third parties;[13] and how to manage receipts processed in advance of exports when neither merchandise is shipped nor services rendered.[14]

II. Developments in Canada

Canada's securities markets were very busy throughout 2006. As in other recent years, more individuals called for reforming the system, the government enacted many significant legislative instruments, and courts handed down important regulatory decisions.

A. Reform Proposals

Two reports published in 2006 called for significant changes in Canadian securities legislation. First, the Crawford Panel on a Single Canadian Securities Regulator produced its final report reiterating the need for one single securities regulator in Canada to eliminate the inefficiencies and increased costs of raising capital inherent in having thirteen separate securities regulators.[15]

Second, the Task Force To Modernize Securities Legislation in Canada reported and recommended (1) approaching securities regulation in new ways; (2) educating investors; (3) adopting the 'well-known seasoned issuer' concept in Canada; (4) adopting a regulatory framework for publicly offering hedge funds; (5) distributing principal-protected notes; and (6) enforcing securities laws.[16]

In light of this, the Canadian Senate Committee on Banking, Trade and Commerce also announced that it will examine Canada's poor record of prosecuting securities violations.[17] This reflects its concern that the government has not vigorously prosecuted securities-related crimes.[18]

8. *Id.* at art. 2.

9. *Id.* at art. 3.

10. *Id.* at art. 4.

11. *Id.* at art. 5.

12. *Id.* at art. 6.

13. *Id.* at art. 7.

14. *Id.* at art. 8.

15. *See* Crawford Daniel on a Single Canadian Securities Regulator, Final Paper—Blueprint for a Canadian Securities Commission (2006), *available at* http://www.crawfordpanel.ca/Crawford_Panel_final_paper.pdf.

16. *See* Investment Dealers Association of Canada Task Force To Modernize Securities Legislation in Canada, Canada Steps Up (2006), *available at* http://www.tfmsl.ca/index.htm.

17. *See* Theresa Tedesco, *Market Crime Fight Failing*, Nat'l Post, Nov. 20, 2006, *available at* http://www.canada.com/nationalpost/financialpost/story.html?id=eob56621-172c-4e75-b647-63576ced930b.

18. *Id.*

B. Legislation

1. *Income Trusts*

In the last five years, Canadian capital markets have been dominated by income trust offerings. Businesses which had reliable cash-flows, but limited growth potential due to modest capital expenditures, originally found this structure quite attractive. Such businesses would either (1) package their assets into an income trust that would then offer its units to the public or (2) convert themselves into an income trust without a follow-on public offering.

In September 2005, the federal Government announced a public consultation process broadly addressing various issues and specifically focusing on the taxation of publicly listed flow-through entities.[19] Ultimately, the Government reduced the existing tax on corporate dividends and consequently eliminated the incentive for taxable Canadian investors to invest in income trusts instead of corporations.[20] The solution, however, did not eliminate the incentive for tax exempt and nonresident investors.

Consequently, several of Canada's largest corporations either converted or announced income trust conversions in 2006. And the federal Government—fearing the wholesale erosion of its corporate tax base—announced legislation taxing income trusts in order to remove the incentive to become an income trust.[21] As a result of the government's announcement, a number of Canadian companies that had indicated that they would convert to income trusts withdrew their plans to do so.[22]

2. *Changes to Prospectus System*

Another legislative development included the government's amendment of the short-form prospectus system. The amendments eliminated both (1) the $75 million market capitalization requirement and (2) the one-year seasoning period for listed issuers before the issuers could use a short form prospectus for non-investment grade type offerings.[23]

19. *See* Press Release, Dep't of Fin. Can., Department of Finance Launches Consultations on Issues Related to Publicly Listed Flow-Through Entities (Income Trusts and Limited Partnerships), (Sept. 8, 2005), *available at* http://www.fin.gc.ca/news05/05-055e.html.

20. *See* Press Release, Dep't of Fin. Can., Minister of Finance Acts on Income Trust Issue (Nov. 23, 2005), *available at* http://www.fin.gc.ca/news05/05-082e.html.

21. *See* Press Release, Dep't of Fin. Can., Canada's New Government Announces Tax Fairness Plan (Oct. 31, 2006), *available at* http://www.fin.gc.ca/news06/06-061e.html.

22. On October 11, 2006, BCE, Inc., the holding company of Bell Canada, announced it would convert to an income trust. *See Bell Canada to Convert to Income Trust*, CBC News, Oct. 11, 2006, http://www.cbc.ca/money/story/2006/10/11/bceincometrust.html. On December 12, 2006, however, BCE reversed its decision. *BCE Drops Plan for Income Conversion*, CBC News, Dec. 12, 2006, http://www.cbc.ca/money/story/2006/12/12/bcetrustconvert.html.

23. *See* Ontario Securities Comm'n, Nat'l Instrument 44-101, Short Form Prospectus Distributions (2005), http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part4/rule_20051223_44-101_sfpd.pdf.

3. *Securities Transfers*

The Ontario and Alberta governments also adopted legislation to modernize the laws governing security transfers, though at the time of writing it is not yet in force.[24] The legislation is designed to reflect current international practice and clarifies the relationship among the different parties involved in holding and transferring securities. Closely based on Article 8 of the UCC, the legislation deals with securities directly held;[25] it also, however, expressly permits the electronic transfer of publicly traded securities held through clearing agencies.[26]

4. *Soft Dollars*

The Canadian Securities Administrators introduced a draft instrument addressing soft dollar payments.[27] The instrument prohibits an adviser from entering into arrangements to accept brokerage commissions as payment for any goods and services *other than* order-execution services or research.[28] Advisers who do use brokerage commissions as payment for order-execution services or research must ensure that the services meet several criteria.[29]

5. *Investment Funds*

Canadian securities regulators adopted a rule requiring an independent review committee for investment funds.[30] This rule is part of the Canadian securities regulators' initiatives to improve investment fund governance. The rule imposes a minimum, consistent standard of governance for publicly offered investment funds.[31] Under the rule, every investment fund that is a reporting issuer must have a fully independent advisory body called the independent review committee (IRC) to oversee all conflict-of-interest matters faced by fund managers operating the fund.[32]

---

24. *See* Ontario Securities Transfer Act, 2006, S.O., ch. 8 (Can.) (enters into force Jan. 1, 2007); Alberta Securities Transfer Act, 2006, S.A., ch. S-4.5, s.1 (Can.) (not yet in force).

25. *See* ERIC. T. SPINK, CAN. INST. FOR THE ADMIN. OF JUSTICE, THE INFLUENCE OF UCC ARTICLE 8 ON CANADIAN SECURITIES TRANSFER LAW: IS THERE ROOM FOR A CANADIAN DIALECT IN GLOBAL COMMERCIAL LANGUAGE?, *available at* http://www.ciaj-icaj.ca/english/publications/LD83Spink.pdf.

26. Ontario Securities Transfer Act, §78(1)(g).

27. *See* CANADIAN SECURITIES ADMINISTRATORS NOTICE OF PROPOSED NATIONAL INSTRUMENT 23-102, USE OF CLIENT BROKERAGE COMMISSIONS AS PAYMENT FOR ORDER EXECUTION SERVICES OR RESEARCH ("SOFT DOLLAR" ARRANGEMENTS) (2006), http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part2/rule_20060721_23-102_pro-softdollar.jsp.

28. *Id.* § 3.1(1).

29. *Id.* § 3.1(2).

30. *See* NAT'L INSTRUMENT 81-107, INDEPENDENT REVIEW COMMITTEE FOR INVESTMENT FUNDS (2006), *available at* http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/rule_20060728_81-107_independentreview.pdf.

31. *Id.* at 6.

32. *Id.*

C. Regulatory and Judicial Decisions

The Ontario Court of Appeal released a decision with significant ramifications in 2006. In *Kerr v. Danier Leather*,[33] the court reversed a trial decision finding for shareholders in a class action for an alleged prospectus misrepresentation. Broadly, the court provided guidance on earnings forecasts included in a prospectus. Indeed, the court determined that one should not view a forecast as a representation that the forecast is objectively reasonable. Rather, one should recognize that (1) the forecast implicitly represents management's best judgment, (2) the forecast was prepared using reasonable care and skill, and (3) management has a subjective belief that the forecast is reasonable. The decision is being appealed to the Supreme Court of Canada.[34]

The Ontario Securities Commission (OSC) also received a significant setback on its enforcement initiatives after an Ontario court overturned a lower court decision sentencing an investment dealer to jail for tipping insider information.[35] Many saw the original sentence as a significant victory for the Commission in the Commission's continuing attempts to enforce Ontario securities laws.

D. Take-Over Bids

The OSC had a very busy time addressing take-over bids in 2006, as well. Indeed, in the context of the battle between Inco and Xstrata for Falconbridge, the OSC upheld the Falconbridge poison pill. Ultimately, the hearing presented a unique set of facts for the OSC and resulted in a different decision from many previous poison pill cases.[36]

Second, the OSC cease-traded a takeover bid by Sears Holdings for Sears Canada.[37] Ultimately, the OSC's holding represented a significant pronouncement on the collateral benefit rule and was the first time the OSC commented on differential tax treatment in a transaction.

III. Developments in China

The People's Republic of China (PRC or China) had an active year in securities market regulation. Indeed, the Chinese government issued: (1) a comprehensive, new Securities Law (SL); (2) revisions to the accounting standards applicable to listed companies; (3) guidance on listed companies providing security for third parties; (4) regulations lifting a one-year-old ban on initial public offerings; and (5) standards on the takeovers of listed companies. Each of these is considered in turn.

---

33. *See* Kerr v. Danier Leather Inc., [2005] 261 D.L.R. (4th) 400.

34. *See* Judgments of the Supreme Ct. of Can., Bulletin of Proceedings (June 23, 2006), *available at* http://scc.lexum.umontreal.ca/en/bulletin/2006/06-06-23.bul/06-06-23.bul.pdf. (granting leave to appeal to the Supreme Court of Canada, June 22, 2006); Kerr v. Danier Leather Inc., [2006] 1 S.C.R. x.

35. *See* R. v. Rankin, [2006] O.J. No. 4579 (Ont. S.C.J.).

36. *See* Ontario Sec. Comm'n, In the Matter of Falconbridge Ltd. (2006), http://www.osc.gov.on.ca/Enforcement/Proceedings/RAD/rad_20060817_falconbridge.pdf.

37. Ontario Sec. Comm'n, In the Matter of Sears Can. Inc. (2006), http://www.osc.gov.on.ca/Enforcement/Proceedings/RAD/rad_20060808_searsholdings.jsp.

A. New Securities Law (SL)

The most significant development affecting securities regulation in China in 2006 was the implementation of China's revised Securities Law (SL) as of January 1, 2006.[38] Containing over 200 articles, the revised SL fundamentally changes securities regulation in China. It also defines securities and public offering for the first time and enables some form of derivatives trading while enhancing investor protection.

B. Revised Accounting Standards

On February 15, 2006, China's Ministry of Finance issued thirty-two new accounting standards and fundamentally overhauled China's Accounting Standards for Business Enterprises (ASBE).[39] From January 1, 2007, the Basic Standard under the revised ASBE

38. Ministry of Commerce of the People's Republic of China, Order No. 43 of the President of the People's Republic of China (promulgating the Securities Law of the People's Republic of China, Feb. 7, 2006), http://english.mofcom.gov.cn/aarticle/policyrelease/domesticpolicy/200602/20060201456152.htm.

39. *See* Enterprise Accounting Guidelines No.32 Interim Financial Reporting *translated and reprinted* at China Law & Practice L3100/06.02.15(32); Enterprise Accounting Guidelines No.31 Cash Flow Statements *translated and reprinted* at China Law & Practice L3100/06.02.15(31); Enterprise Accounting Guidelines No.30 Presentation of Financial Statements *translated and reprinted* at China Law & Practice L3100/06.02.15(30); Enterprise Accounting Guidelines No.29 Events After the Balance Sheet Date *translated and reprinted* at China Law & Practice L3100/06.02.15(29); Enterprise Accounting Guidelines No.28 Changes to Accounting Policies and Accounting Estimates, and Correction of Accounting Errors *translated and reprinted* at China Law & Practice L3100/06.02.15(28); Enterprise Accounting Guidelines No.27 Exploitation of Petroleum and Natural Gas *translated and reprinted* at China Law & Practice L3100/06.02.15(27); Enterprise Accounting Guidelines No.26 Reinsurance Contracts *translated and reprinted* at China Law & Practice L3100/06.02.15(26); Enterprise Accounting Guidelines No.25 Original Insurance Contracts *translated and reprinted* at China Law & Practice L3100/06.02.15(25); Enterprise Accounting Guidelines No.24 Hedging *translated and reprinted* at China Law & Practice L3100/06.02.15(24); Enterprise Accounting Guidelines No.23 Transfer of Financial Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(23); Enterprise Accounting Guidelines No.22 Recognition and Measurement of Financial Instruments *translated and reprinted* at China Law & Practice L3100/06.02.15(22); Enterprise Accounting Guidelines No.21 Leases *translated and reprinted* at China Law & Practice L3100/06.02.15(21); Enterprise Accounting Guidelines No.20 Business Combinations *translated and reprinted* at China Law & Practice L3100/06.02.15(20); Enterprise Accounting Guidelines No.19 Foreign Currency Translation *translated and reprinted* at China Law & Practice L3100/06.02.15(19); Enterprise Accounting Guidelines No.18 Income Taxes L3100/06.02.15(18); Enterprise Accounting Guidelines No.17 Borrowing Costs *translated and reprinted* at China Law & Practice L3100/06.02.15(17); Enterprise Accounting Guidelines No.16 Government Grants *translated and reprinted* at China Law & Practice L3100/06.02.15(16); Enterprise Accounting Guidelines No.15 Construction Contracts *translated and reprinted* at China Law & Practice L3100/06.02.15(15); Enterprise Accounting Guidelines No.14 Revenue *translated and reprinted* at China Law & Practice L3100/06.02.15(14); Enterprise Accounting Guidelines No.13 Contingencies *translated and reprinted* at China Law & Practice L3100/06.02.15(13); Enterprise Accounting Guidelines No.12 Debt Restructuring *translated and reprinted* at China Law & Practice L3100/06.02.15(12); Enterprise Accounting Guidelines No.11 Share-based Payment *translated and reprinted* at China Law & Practice L3100/06.02.15(11); Enterprise Accounting Guidelines No.10 Enterprise Pension Funds Enterprise *translated and reprinted* at China Law & Practice L3100/06.02.15(10); Enterprise Accounting Guidelines No.9 Employee Salaries *translated and reprinted* at China Law & Practice L3100/06.02.15(9); Enterprise Accounting Guidelines No.8 Asset *translated and reprinted* at China Law & Practice L3100/06.02.15(8); Enterprise Accounting Guidelines No.7 Non-monetary Asset Swaps *translated and reprinted* at China Law & Practice L3100/06.02.15(7); Enterprise Accounting Guidelines No.6 Intangible Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(6); Enterprise Accounting Guidelines No.5 Biological Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(5); Enterprise Accounting Guidelines No.4 Fixed Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(4); Enterprise

will be effective for all enterprises, while thirty-eight specific accounting standards will apply to listed companies. The new standards represent a significant convergence of Chinese accounting standards with International Financial Reporting Standards (IFRS). The revised Chinese accounting standards, however, differ from IFRS with regards to both (1) reversing impairment losses and (2) adopting fair value measurement.[40]

C. Provision of Security by Listed Companies

Addressing certain aspects of the revised Securities Law, the CSRC and China Banking Regulatory Commission issued the Circular on Regulation of the Provision of Security to Outside Parties by Listed Companies (Circular), effective January 1, 2006.[41] The Circular provides that any security provisions by a listed company for the benefit of third parties must be reviewed by the listed company's board of directors or shareholders' general meeting. The shareholders' general meeting must review and vote on potential security grants if the security provided: (1) is in excess of 50 percent of the audited net assets of the listed company; (2) would be provided to an entity whose equity-debt ratio exceeds 70 percent; or (3) meets other specified circumstances.[42]

D. Enabling Initial Public Offerings

On May 18, 2006, the CSRC issued Measures for the Administration of Initial Public Offerings of Shares and the Listing Thereof (Measures), ending a one-year ban on initial public offerings (IPOs).[43] After the release of these Measures, the Shanghai Stock Exchange promulgated new rules aimed at improving the quality of listed companies.[44]

Accounting Guidelines No.3 Investment Property *translated and reprinted* at China Law & Practice L3100/06.02.15(3); Enterprise Accounting Guidelines No.2 Long-term Equity Investment *translated and reprinted* at China Law & Practice L3100/06.02.15(2); Enterprise Accounting Guidelines No.1 Inventory *translated and reprinted* at China Law & Practice L3100/06.02.15(1)—each issued by the Ministry of Finance on Feb. 15, 2006, and effective as of Jan. 1, 2007.

40. *See* Enterprise Accounting Guidelines No.23 Transfer of Financial Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(23); Enterprise Accounting Guidelines No.6 Intangible Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(6); Enterprise Accounting Guidelines No.5 Biological Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(5); and Enterprise Accounting Guidelines No.4 Fixed Assets *translated and reprinted* at China Law & Practice L3100/06.02.15(4).

41. China Securities Regulatory Comm'n and China Banking Regulatory Comm'n, *Circular on Regulation of the Provision of Security to Outside Parties by Listed Companies* 3710/05.12.23, China Law & Practice, Dec. 23, 2005, http://www.chinalawandpractice.com/includes/print.asp?SID=4907.

42. *Circular on Regulation of the Provision of Security to Outside Parties by Listed Companies*, issued by the China Securities Regulatory Commission and China Banking Regulatory Commission on Dec. 23, 2005, and effective as of Jan. 1, 2006, *translated and reprinted* at China Law & Practice, 3710/05.12.23.

43. *Measures for the Administration of Initial Public Offerings of Shares and the Listing Thereof* 3710/06.05.17, China Law & Practice, May 17, 2006, http://www.chinalawandpractice.com/includes/print.asp?SID=5097.

44. *See* Shanghai Stock Exchange, Guidelines on Internal Controls of Listed Companies, issued June 5, 2006, and effective as of July 1, 2006, *translated and reprinted* at China Law & Practice 3700/06.06.05/SH.

E. Acquisition of Listed Companies

On July 31, 2006, the CSRC issued the Acquisition of Listed Companies Administrative Procedures (Procedures), effective September 1, 2006.[45] The Procedures impose certain informational requirements and attempt to improve the efficiency of public company takeovers. Specifically, persons increasing their stake in a listed company to 5 percent or more shall report their increased holdings within three days of crossing the 5 percent threshold to the (1) CSRC, (2) relevant stock exchange, (3) company, and (4) public.[46] The Procedures define acquirer as both a specific investor and all persons or entities acting in concert with such an investor.[47]

Prior to launching an offer, the Procedures require potential acquirers to submit an acquisition report to the CSRC.[48] This report must describe any connections between the acquirer and the target, as well as specify whether the acquirer and target compete with one another.[49] The acquisition report must also disclose whether the acquirer purchased any of the target's shares through a stock exchange in the six months prior to filing the acquisition report.[50] An acquirer may withdraw the acquisition report, although such withdrawal would preclude the acquirer from purchasing the target for a period of twelve months following the withdrawal.[51]

The acquirer may commence its acquisition only if the CSRC does not object to the acquisition report within fifteen days of receiving it. After the CSRC either approves or does not object, the offer may be open for between thirty and sixty days. Notably, the offer may not be cancelled by the acquirer, and any change in the terms of the offer requires the consent of the CSRC.[52]

Within twenty days of the offer commencing, the target's Board of Directors must (1) examine the acquirer's motives for the offer, (2) analyze the terms and conditions of the offer, and (3) advise the company's shareholders whether they should accept the offer.[53] Additionally, the target's Board of Directors must retain an independent financial advisor to issue a fairness opinion regarding the transaction.[54] This opinion must be submitted to (1) the CSRC, (2) relevant stock exchange, and (3) shareholders.

The proposed price for the shares must exceed the highest price paid by the acquirer for the target's shares during the six months preceding the submission of the acquisition report.[55] Consideration may be paid in cash, securities, or any means legally authorized. The Procedures, however, specify certain circumstances where consideration must be paid

45. *Measures for the Administration of the Takeover of Listed Companies* 3700/06.07.31, China Law & Practice, July 31, 2006, http://www.chinalawandpractice.com/includes/print.asp?SID=5284.

46. *Id.* at art. 13.

47. Article 5, *Measures for the Administration of the Takeover of Listed Companies*, issued by the China Securities Regulatory Commission as CSRC Order No. 35 on July 31, 2006, and effective as of September 1, 2006, *translated and reprinted* at China Law & Practice 3700/06.07.31.

48. *Id.* at arts. 16-22.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.* at arts. 28, 37 & 40.

53. *Id.* at art 22.

54. *Id.*

55. *Id.* at art 27.

in cash.[56] If this is the case, the acquirer must place at least 20 percent of the cash consideration into an escrow account managed by a designated bank.[57] Alternatively, if consideration will be paid in securities, the securities must be deposited by the acquirer with a securities deposit and clearing company.[58]

IV. Developments in France

A. New Deal Trends

In addition to being an active year for significant IPOs and public M&A transactions, 2006 was characterized by trends towards developing several new types of deals within the French capital markets; these include dual track deals, employee share plans, and SIIC offerings, similar to deals in other jurisdictions.

B. Comfort Letter Practice

At the end of 2005, France adopted final rules[59] relating to "comfort letters" (CLs or *lettres de fin de travaux*) issued by auditors in connection with the registration of a prospectus by the *Autorité des Marchés Financiers* (AMF) under the European Union (EU) Prospectus Directive.[60] In the CL, the auditors are required to verify the information in the prospectus relating to the audited annual and reviewed interim financial statements. More generally, they must include a statement indicating that they have read the prospectus in its entirety and to reveal any information that appears to be manifestly inconsistent with their general knowledge of the company.

C. Implementation of the Prospectus Directive

In May 2006, France published the decree completing the French implementation of the Prospectus Directive.[61] The decree extends the definition of "qualified investor" to include entities which, according to their last annual financial statements, meet at least two of the following criteria: (1) an average number of employees of more than 250; (2) a total balance sheet exceeding 43 million euros; and (3) a turnover or total income exceeding 50 million euros.[62] Small and medium-sized enterprises and individuals may also

56. Measures for the Administration of the Takeover of Listed Companies, art. 27, issued by the China Securities Regulatory Commission as CSRC Order No. 35 on July 31, 2006, and effective as of Sept. 1, 2006, *translated and reprinted* at China Law & Practice 3700/06.07.31.

57. *Id.* at art. 36.

58. *Id.*

59. *See Règlement général de l'Autorité des marchés financiers* of Dec. 30, 2005, arts. 212-15, Journal Officiel de la République Française [J.O.] [Official Gazette of France], Jan. 18, 2006, p. 675.

60. Council Directive 2003/71/EC of the European Parliament and of the Council of November 4, 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, *available at* http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&numdoc=32003L0071&model=guichett.

61. *See* Decree No. 2006-557 of May 16, 2006, Journal Officiel de la République Française [J.O.] [Official Gazette of France], May 18, 2006, p.7318.

62. Article I. Decree No. 2006-557 of May 16, 2006, J.O., May 18, 2006, p. 7318.

qualify as qualified investors if they comply with certain criteria and are included as qualified investors on a directory kept by the AMF.[63]

D. AMF Position Paper on Earnings Guidance

On July 10, 2006, the AMF issued a statement clarifying its position on the publication of earnings guidance by issuers.[64] It confirms that the Prospectus Directive, and therefore the AMF, requires an accountant's report to accompany projections included in a prospectus.[65] The AMF's statement explains that, given the language and intent of the Prospectus Directive, this requirement cannot be avoided by simply referring to projections as "earnings guidance" or "objectives."[66] However, because the Prospectus Directive does not require earnings guidance included in periodic reports or press releases to be accompanied by an accountant's report, the AMF will allow earnings guidance to be included in these documents without an accountant's report.[67] Nonetheless, if an issuer has chosen to provide earnings guidance, this information is presumed to be material and must be reproduced in a prospectus.

E. Complex Financial Statements

According to Regulation (EC) 809/2004[68] under the Prospectus Directive, issuers are generally required to present audited historical financial information covering the latest three financial years.[69] Most often, this historical financial information will reflect the whole business of the issuer throughout the required period, including significant acquisitions or disposals. In certain instances, however, the issuer will not have prepared its historical financial information as a single business during the period for which this historical information is required. These issuers are therefore considered to have a complex financial history, which has created confusion regarding what they must disclose under Regulation (EC) 809/2004.

F. Securities Litigation and the Development of Class Actions

On September 12, 2006, the criminal court of Paris (*Tribunal de Grande Instance de Paris*) found several former Sidel executives guilty of disseminating misleading information about the company and falsifying the company's accounts prior to its acquisition by Tetra

63. *Id.*

64. *See* Autorite des Marches Financiers, Mise en Oeuvre du Règlement Européen n° 809/2004 du 29 Avril 2004 Concernant les Informations Contenues dans un Prospectus—Précisions Relatives à la Notion de Prévisions, (July 10, 2006), *available at* http://www.amf-france.org/documents/general/7244_1.pdf.

65. This report must state that the earnings guidance has been prepared on the basis of the assumptions set forth in the prospectus, and that the accounting methods used by the company for establishing this earnings guidance conform to the accounting methods used in the preparation of the company's financial statements.

66. *See* Autorite des Marches Financiers, *supra* note 64.

67. *Id.*

68. Commission Regulation 809/2004, Implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectus as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, 2004 OJ (L 149/1).

69. *Id.* § 20.1.

Laval in 2001.[70] The court levied a stiff fine on the former executives in addition to a suspended prison sentence. More importantly, the court found that the 700 shareholders who had joined the criminal proceeding as civil parties suffered a collective harm because of the actions of the executives and the company, and awarded each of them damages of 10 euros per share; this solved the problem of proving damages by applying a "loss of chance" theory. The decision represents a milestone in French jurisprudence, because it is the first real securities litigation where investors have won more than merely symbolic compensation for their losses. The court of appeals may overturn the decision in favor of shareholders.

G. New Proposed Rules to Govern Financial Analysts

On October 31, 2006, the public comment period closed relating to the AMF's new proposed rules for the regulation of financial analysts.[71] These proposed rules emanate from a report commissioned by the AMF in 2005 on ways to strengthen the independence of financial analysts.[72] Among the most important rules likely to be adopted are introducing a mechanism for commission-sharing arrangements,[73] establishing independent criteria for financial analysts,[74] providing equal access to financial information,[75] and expanding oversight duties of persons charged with monitoring investment banking services.[76]

H. New Law on Public Tender Offers

On March 31, 2006, France enacted a new law on public tender offers.[77] The new law aims not only to transpose the EU Takeover Directive[78] into French law (with which existing French law already largely complied), but also to address recent unsolicited or threatened bids from foreign groups on French targets.

Under the new law, the AMF may now require an entity to publicly declare its intentions if market rumors suggest that it is preparing a bid.[79] If a potential bidder refuses or fails to file a declaration of intent with the AMF—or declares that it intends to launch an offer and does not do so within the deadline set by the AMF—it will then be prohibited

70. T.G.I. Paris, Sept. 12, 2006.

71. Proposition de modification du reglement general pour la mise en oeuvre des recommandations I et II du rapport sur l'analyse financiere independante (July 28, 2006), *available at* http://www.amf-france.org/documents/general/7263_1.pdf.

72. Pour un nouvel essor de l'analyse financiere independante sur le marche francais (July 2005), *available at* http://www.amf-france.org/documents/general/6158_1.pdf.

73. Proposition de modification du reglement general pour la mise en oeuvre des recommandations I et II du rapport sur l'analyse financiere independante, art. 322-43 (July 28, 2006), p.14-16.

74. *Id.* at art. 337-4, p. 2-3.

75. *Id.* at art. 321-122, p. 24.

76. *Id.* at art. 337-7, p. 5-6.

77. *See* Law No. 2006-387 of 31 March 2006, Journal Officiel de la République Française [J.O.] [Official Gazette of France], Apr. 1, 2006, p. 4882.

78. Council Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, 2004 O.J. (L 142/12) (EU).

79. Article 1, Law No. 2006-387 of Mar. 31, 2006, J.O., Apr. 1, 2006, p. 4882.

from launching an offer for six months unless it demonstrates substantial changes in circumstances or in share capital.[80]

Second, and perhaps more importantly, the new law provides for a "poison pill" defense, allowing companies to issue warrants to existing shareholders to subscribe for discounted shares, thereby diluting the value of a company's shares and potentially forcing hostile bidders to withdraw their offers.[81]

V. Developments in Germany

The incorporation of the EU Takeover Directive[82] (Directive) into German law following the Takeover Directive Transformation Act of 8 July 2006 comprised the major development in German securities and capital markets law.[83] This legislation introduced a number of important changes to the Takeover Act of 20 December 2001 (Takeover Act or WpÜG).[84] The most salient changes are highlighted below.

A. Defending Hostile Tender Offers

Germany decided to "opt out" of the Directive's regime on defending hostile tender offers. As required by the Directive, German companies are given the option to "opt in" (i.e., accept the stricter rules of the Directive).[85] Only a few companies, however, are expected to utilize this option.

B. Breakthrough Rule

Germany decided to "opt out" of the Directive's regime on suspending structures and devices preventing a bid (i.e., "breakthrough" rule). As required by the Directive, German companies are given the option to "opt in" (i.e., accept the "breakthrough" rule).[86] As before, only a few companies are expected to use this option.

C. Disclosure of Obstacles to Tender Offers

Structures and devices which could prevent the exercise of control shall be published yearly in the company's annual report and consolidated report.[87] This rule will bring a remarkable degree of transparency into matters that a hostile bidder would be interested in ascertaining before launching an offer.

---

80. *Id.*
81. *Id.* at arts. 11, 12.
82. *Id.*
83. Gesetz zur Umsetzung der Richtlinie 2004/25/EG des Europäischen Parlaments und des Rates vom 21. April 2004 betreffend Übernahmeangebote (Übernahmerichtlinie-Umsetzungsgesetz), Bundesgesetzblatt 2006, Part I, at 1426 et seq. (July 13, 2006).
84. Wertpapiererwerbs und Übernahmegesetz, Bundesgesetzblatt 2001, Part I, at 3822 et seq. (Dec. 22, 2001) [hereinafter WpÜG].
85. *Id.* § 33a.
86. *Id.*
87. Handelsgesetzbuch [HGB] [Commercial Code], May 10, 1897 BGBI. I at 2606, §§ 289(4), 315(4) (F.R.G.).

D. The Equitable Price of Takeover and Mandatory Offers

The reference period has been extended from three to six months for ensuring the equal treatment of (1) shareholders accepting a takeover or mandatory bid and (2) shareholders selling their shares to the bidder before the bid.[88]

The rule that the consideration of a takeover or mandatory bid must not be less than the weighted average stock exchange price during the three-month period preceding the announcement[89] remains unchanged.

E. Scope of Application and Supervisory Authority Jurisdiction

The Takeover Act implements the Directive's complex rules determining both (1) the applicable law and (2) the jurisdiction of supervisory authorities in the rare event that a target company is listed on a stock exchange in an EU Member State *other* than the company's state of domicile.[90] Essentially, the rules are designed to prevent regulatory gaps and unnecessary duplications.

F. Squeeze-Out

The new legislation introduces a novel procedure for squeezing-out minority shareholders. While the existing procedure remains, and requires both a shareholder meeting and an audit of the proposed consideration by a firm of chartered accountants, the new procedure no longer requires a shareholder vote and instead simply relies on an application with the Frankfurt District Court.[91] This application must be filed within three months after the end of the offer period; the squeeze-out then becomes effective when the court resolution can no longer be appealed.[92]

G. Sell-Out

If the bidder is entitled to proceed with squeezing out minority shareholders following either a takeover or mandatory bid, every holder of the remaining shares shall be entitled to accept the offer within the three months following the end of the offer period.[93]

VI. Developments in Japan

From both an economic and a legal perspective, the year 2006 may come to be remembered as a watershed in Japan's long journey toward modernization of its capital markets and securities regulatory system. Having finally recovered from a fifteen-year

88. WpÜG-Angebotsverordnung, § 4.
89. WpÜG, §5(1).
90. *Id.* §§ 1, 2.
91. *See id.* §§ 39(a), (a)(5), (b); *see also* Aktiengesetz [Aktg] [Stock Corporation Act], Sept. 6, 1965, BGBI. I at 1089, § 327(a) et seq. (F.R.G.).
92. *See* WpÜG, §§ 39(a), (a)(5), (b).
93. *See id.* § 33c.

recession to complete its longest economic expansion in the postwar period, Japan seems poised in 2006 to begin a whole new era of mergers and acquisitions.[94]

On June 14, 2006, Japan's Diet (national legislature) replaced Japan's outmoded, 1940s-era Securities and Exchange Law[95] with a more comprehensive Financial Instruments and Exchange Law (FIEL),[96] most provisions of which take effect between 2007 and 2008. Meanwhile, most provisions of Japan's sweeping new Companies Law,[97] promulgated in 2005 to replace Part II of Japan's World-War-II-era Commercial Code,[98] took effect in

94. Broad legal reforms have enabled Japan's recent corporate restructuring and economic growth. Since the collapse of its bubble economy in 1990, Japan has been incrementally amending its company laws to legalize pure holding companies, stock redemptions, tax-free spin-offs, a consolidated tax system, employee stock options, stock-splits, and other restructuring and financing tools, in an effort to equilibrate its lagging financial sector, attract more foreign investment, and infuse market principles into its rigid, Germanic-style, corporate governance system. Meanwhile, the equity in Japanese corporations, long locked in cross-shareholding arrangements with affiliated corporations and banks, has become increasingly liquid as the web of reciprocal shareholdings has unraveled.

95. Shokentorihiki Ho [Securities and Exchange Law], Law No. 25 of 1948, as amended [hereinafter SEL]. The SEL, Japan's fundamental securities law, was patterned directly on U.S. federal securities statutes, *see* Securities Act of 1933, 15 U.S.C. § 77(a) (2006) and Securities Exchange Act of 1934, 15 U.S.C. § 78(a) (2006), and thus, at least in form, reflected the classic Berle and Means thesis underlying Anglo-American corporate governance: the notion that widely dispersed shareholders (perceived as inevitable) cede effective control of their firm to professional managers via an agency relationship with independent directors. *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (Transaction Publishers 1991) (1932). But the envisioned Berle-and-Means notion of a modern corporation never materialized in Japan during the half century following World War II. In spite of the Allied Occupiers' exuberant postwar attempts to create "economic democracy" in Japan by dispersing shares of Japanese companies formally held by the powerful *zaibatsu* families (which were thought to have functioned as industrial war machines), outlawing bank holding companies, and importing a U.S.-styled commercial code and securities law, subsequent amendments to Japan's antitrust statute helped facilitate the concentration of shares in cross-shareholding arrangements of affiliated companies known as horizontal *keiretsu*. *See* DAN FENNO HENDERSON, FOREIGN ENTERPRISE IN JAPAN—LAW AND POLICIES 146-174 (The Univ. of N.C. Press 1973) (1973) (describing how foreign antitrust ideology conflicted with Japan's prewar history of government-directed industrial development). Only now, at the beginning of the 21st century, are Japanese firms beginning to exhibit attributes characteristic of the Anglo-American model: activist shareholders, derivative lawsuits, share liquidity and floats, transactional capability, and an emerging market for corporate control that may increasingly serve to monitor manager performance. *See* Pamela A. Fuller, *Whither M&A in Japan?*, N.Y.L.J., Nov. 7, 2005, at 10 (discussing how legal reforms are liberalizing Japan's M&A market and creating a fledgling market for corporate control, which is at risk of being suppressed by unbridled takeover defenses and poison pills launched by the targets' boards). *See* discussion of important new ministry guidelines on takeover defenses, *infra*.

96. Financial Instruments and Exchange Law [FIEL], Law No. 65 of 2006. The FIEL was adopted along with the Coordination Law for Amending the Securities and Exchange Law and other Financial Laws, Law No. 66 of 2006. [Hereinafter, all references to the FIEL will refer to both the FIEL and its companion Coordination Law]. The legislation effectively replaces the SEL, changing its name to the "Financial Instruments and Exchange Law," and consolidating its amended text with a number of other ancillary statutes—four of which are being formally abolished (i.e., the Financial Futures Trading Law, the Law Concerning the Regulation of Investment Advisory Services Relating to Securities, the Law Concerning Foreign Securities Firms, and the Law Concerning the Regulation of Mortgage Business). *See* FINANCIAL SERVICES AGENCY, JAPAN, NEW LEGISLATIVE FRAMEWORK FOR INVESTOR PROTECTION—THE FINANCIAL INSTRUMENTS AND EXCHANGE LAW (Oct. 2006), *available at* http://www.fsa.go.jp/en/policy/fie/20061010.pdf. The various provisions of the FIEL have different effective dates extending from July 4, 2006, to as late as fiscal years beginning on or after April 1, 2008.

97. Kaisha Ho [Companies Law], Law No. 86 of 2005 [hereinafter Companies Law].

98. *See* Sho-ho [Commercial Code], Law No.48 of 1899, Part II (as amended) [hereinafter Commercial Code].

May 2006. Also, in September 2006, Japan's charismatic Prime Minister, Junichiro Koizumi, stepped down after having pushed through a package of bills designed to privatize Japan's US$3 trillion postal system, which runs the world's largest savings bank and life insurance company.[99] All three legislative packages are intended to liberalize Japan's financial markets.

A. New Financial Instruments and Exchange Law

Japan's Financial Services Agency (FSA) proposed the FIEL in 2005, citing a need to more broadly and stringently regulate Japan's entire financial services industry. By broadening the definitions of "security" and "derivative transaction,"[100] the FIEL will regulate not only government and corporate bonds, stocks, investment trusts, and securities derivatives (i.e., the existing SEL categories), but also a much larger class of derivative transactions.[101] The FIEL's definition of security includes any interest in a "collective investment scheme"—a catch-all category that is defined expansively[102] so as to reach many types of commodity and real estate funds, as well as future instruments.

The new FIEL beefs up the criminal and civil penalties for securities fraud, insider trading, and certain types of market manipulation,[103] including *misegyoku*—a deceptive

99. For a discussion of the legislative efforts to privatize Japan Post, *see* elsewhere in this issue, Pamela A. Fuller, *International Legal Developments in Review: 2006—Asia and Pacific Law—Japan* 41 Int'l Law. ___ (2007) [hereinafter Fuller, Japan Developments in Review 2006]. The package of privatizing legislation will not be discussed further in this article.

100. The FIEL greatly expands the scope of the government's regulatory power and solves many of the inherent conflicts that arose under the SEL. For example, the SEL's definitions of "security" and "security derivatives" were narrow and rigid, leaving loopholes and opportunities for nondisclosure, and causing some instruments with identical economic effects and risks to be subject to disparate rules. Due in large part to Articles 43 and 65 of the SEL—Japan's version of the U.S. Glass-Steagall Act—if a financial product qualified as a security as defined by the SEL, investors enjoyed the protections of the SEL, but banks were prohibited from handling the product. Over the years, Japanese banks have successfully pressured the Ministry of Finance (MOF) to restrict the legal definition of securities, at the expense of investor protections such as certain disclosure and anti-fraud protections. Although important amendments to the SEL in 1992 expanded the definition of a security to include "any other security or certificate designated by cabinet order as necessary to ensure the public interest or investor protection, with consideration given to its transferability and other conditions," this statutory change was interpreted much more narrowly than originally envisioned. *See* Hideki Kanda., *Securitization in Japan*, 8 Duke J. Comp. & Int'l L. 359, 369-70 (1998).

101. *See* FIEL, *supra* note 96, art. 2, ¶¶ 20-25.

102. Specifically, the FIEL provides that

> . . . rights concerning any scheme that (1) collects capital or contribution in monetary or other similar form from two or more persons, (2) conducts business or undertakes investments using the money, and (3) distributes profits or properties to investors from the business or investments (collective investment scheme) are deemed to be and treated comprehensively as securities [for purposes of the FIEL], regardless of the legal feature of the scheme; such as contracts for partnerships based on the Civil Law, secret partnerships based on the Commercial Law, limited investment partnerships, limited liability partnerships, or any other form of contracts (but excluding cases where all investors are involved in the business, etc.).

See Financial Services Agency, New Legislative Framework for Investor Protection: Financial Instruments and Exchange Law, at 5, *available at* http://www.fsa.go.jp/en/policy/fiel/20061010.pdf.

103. For individuals, the FIEL raises the penalties for market manipulation to ten years in prison and/or a fine of ten million yen, from the SEL's previous maximums of five years imprisonment and/or a fine of five million yen. For corporations submitting materially false registration statements, the FIEL increases the

practice whereby dummy orders are placed to intentionally create a false impression of active trading, and then are later cancelled before the transaction is closed.[104] The tougher sanctions were promulgated in the wake of some well-publicized securities and accounting fraud scandals, including the spectacular rise and fall of Livedoor Corporation,[105] and the ongoing case involving the high-profile, shareholder activist and eponymous fund manager, Yoshiaki Murakami.[106] In light of the seeming surge in the number and gravity of securities law violations, the effective date of the penalty provisions was moved forward to July 4, 2006—a full year before many of the FIEL's other provisions take effect.

Beginning in 2008, the FIEL will require all listed companies to file quarterly reports with the Ministry of Finance (MOF), including, for the first time, internal control reports substantiating the validity of their financial reporting.[107] The FIEL also expands the disclosure requirements for large institutional shareholders. One rule, which has been heavily criticized as too burdensome and potentially paralyzing, requires institutional shareholders to report any combination of holdings in their portfolios that exceeds 5 percent of a listed company's shares *within two weeks* of the date that the 5 percent threshold is exceeded.[108] Although the new provision is intended to give fair warning to a potential

---

penalty to a maximum fine of 700 million yen from the previous SEL maximum of 500 million yen. For corporations that fail to file registration statements, the maximum fine is raised to 500 million yen from 300 million yen. The maximum penalties for insider trading are being increased to five years in prison and/or a fine of five million yen, from the SEL's previous maximums of three years in prison and/or a fine of three million yen. *See* FIEL, *supra* note 96, at 17.

104. The old SEL did not impose explicit penalties for *misegyoku*, and this type of deceptive market practice often went unpunished. *See id.*

105. The successful 2005 attempt by Livedoor, an Internet startup, to acquire a controlling interest in the old-line media conglomerate, Fuji Television Network, by snapping up shares of Fuji's largest shareholder—Nippon Broadcasting System (NBS)—electronically, after trading hours had closed and without formally announcing a tender offer (thus, taking advantage of a former loophole in the SEL), became one of the most dramatic stories in Japanese business history. For various reasons the envisioned synergistic alliance between Livedoor and Fuji never materialized, and in early 2006 Livedoor's top executives were indicted on suspected accounting fraud—securities violations that resulted in the delisting of Livedoor from the Tokyo Stock Exchange on April 14, 2006, and an eventual sale of Livedoor's once sprawling corporate empire to the investment firm Advantage Partners LLP. As of December 2006, former Livedoor Corporation President, Takufumi Horie, was fighting criminal fraud charges in court, while Livedoor's CFO, Ryoji Miyauchi, had already pled guilty and was awaiting sentencing. For a brief overview of Livedoor's hostile takeover of Fuji, and its possible legacy for securities regulation in Japan, *see* Pamela A. Fuller, *International Legal Developments in Review: 2005—International Mergers & Acquisitions—Japan*, 40 INT'L LAW. 311, 325-27 (2006) [hereinafter Fuller, Japan Developments in Review 2005].

106. The allegations forced the Murakami Fund to liquidate in December 2006 after nearly seven years of operation. *See* Mariko Kodaki, *Market Scramble: Murakami Trial May Help Define Insider Trading*, NIHON KEIZAI SHIMBUN, Sept. 22, 2006.

107. The new quarterly reporting system is effective for fiscal years beginning on or after April 1, 2008. *See* FIEL, *supra* note 96, at 12, 15, 18.

108. Under U.S. federal securities law, for example, institutions are required to report their 5 percent holdings just once per year, and in Europe, regular reporting requirements are generally triggered only for stakes amounting to ten percent of a listed company. If the new two-week disclosure requirement triggers any decline in Japanese equity investments by foreign funds, it could have a dramatic effect on Japan's economy. In 2005, foreign investors accounted for 45.1 percent of all share trading, (by value) on Japan's top three stock exchanges. *See* Yuka Hayashi, *Japan Regulators Aim To Tighten Disclosure Rules —Mutual Find Firms Bristle at Proposed Timeframe on Reporting 5% Stakes*, WALL STREET J., Feb. 21, 2006, at C11, *available at* http://online.wsj.com/PA2VJBNA4R/article_print/SB114038821478878118.html.

target company that a fund may be trying to acquire a controlling interest,[109] critics argue that it is an unrealistic, knee-jerk reaction to a few high-profile takeover attempts, which will ultimately hurt the performance of Japanese markets by discouraging share purchases by foreign funds.[110]

The FIEL substantially revises the rules on takeover bids (TOBs). Under the FIEL, the obligation to make a formal tender offer may be triggered by either traditional acquisition methods through the stock market or by so-called "off-market purchases"—acquisitions made off the trading floor or after the markets have closed. The FIEL requires a potential acquirer to conduct a TOB for at least one-third of the target's outstanding stock when: (1) greater than 5 percent of a target's outstanding shares are acquired via off-market trades, and (2) the acquirer's purchased stake exceeds 10 percent of the target's stock when combined with the acquirer's prior holdings that were purchased through the traditional market.[111] To ensure that minority shareholders have an opportunity to sell their stakes in a successful tender offer, the FIEL imposes a mandatory bid rule: once an acquirer secures more than two-thirds of a target's stock, it is obligated to offer to buy out all remaining holdings of those who participated in the original TOB.[112]

B. New Companies Law

In May 2006, most provisions of Japan's sweeping new Companies Law[113] took effect. The new statute, passed by the Diet on June 29, 2005, constitutes the most extensive revision of Japan's Commercial Code since World War II. The new legislation broadly amends and integrates several existing laws covering Japan's various business entities, including rules applicable to their incorporation, internal governance, and power to flexibly

---

109. If the acquiring institutional investor's objective is to control the target's management or alter its board's composition, then the disclosure time frame is shortened from two weeks to just five business days. *See* FIEL, *supra* note 96, at 15.

110. Although the effective date of the new two-week reporting requirement for institutional investors has yet to be announced, the FIEL requires that it take effect no later than eighteen months following the FIEL's June 14, 2006, enactment date (i.e., no later than Dec. 13, 2007). *See id.* at 18.

111. For purposes of this rule, all acquisitions within a three-month period are treated as a single acquisition. This amendment was made to address the seeming ease with which Livedoor was able to acquire a controlling interest in Fuji's largest shareholder—NBS—electronically after the trading floors had closed, without ever launching a tender offer, and the ensuing panic by Japanese firms to adopt poison pills and other takeover defenses. For an overview of Livedoor's attempted takeover, *see* Fuller, Japan Developments in Review 2006, *supra* note 62. *See also infra* text accompanying notes 119-122 (noting important new Takeover Guidelines recently issued by the Ministry of Economy, Trade and Industry (METI)).

112. Clearly, the mandatory bid rule can greatly increase the total price of a corporate takeover. To prevent a bidder from being put in an unreasonable position, the new rules allow a bidder to lower the price of the bid if the target's management launches a poison pill, diluting the value of the bidder's holdings. The FIEL also contains more flexible rules on withdrawing a TOB in the face of insurmountable takeover defenses. Finally, the FIEL delineates the conditions under which a target's board is required to issue an objective opinion (if that is possible) on the merit of any TOB, and gives the targeted company an opportunity to ask questions of the bidder and extend the bidding period. *See* FIEL, *supra* note 96, at 13-14.

113. See Companies Law, *supra* note 97 (The Companies Law was passed along with an accompanying Coordinating Law). *See also* Seibi Ho, [Law Regarding the Coordination, Etc., of Associated Laws in Connection with the Enforcement of the (New) Companies Law], Law No. 87 of 2005 [Hereinafter, references to the 2005 Companies Law are intended to include a reference to the Coordinating Law].

engage in M&A transactions.[114] The new Companies Law caps off a series of almost annual revisions to Japan's Commercial Code that began in the early 1990s,[115] further liberalizing the mechanics of corporate restructuring and financing, and further promoting the transition of Japan's stakeholder model of corporate governance to a more shareholder oriented one.[116]

1. *Cross-Border Triangular Mergers to Become Legal in 2007*

Many of the restructuring techniques Japan has been authorizing in recent years have not been sanctioned in the cross-border context. Rather, M&A between Japanese and foreign companies has been hindered by the lack of appropriate legal tools to achieve the desired corporate structure. Most OECD countries permit share exchanges with foreign corporations as an acquisition technique. However, stock swaps have not been available to *foreign* investors in Japan. To ameliorate this situation, a controversial provision in the new Companies Law expands the categories of permissible consideration in triangular mergers to include cash, bonds, and shares of foreign corporations.[117] Because the acquiring foreign parent will no longer be limited to using its Japanese subsidiary's shares as consideration, the amendment makes it cheaper and easier for foreign corporations to acquire Japanese companies, and to buy out any dissenting target shareholders.

But this very possibility has ignited fears and stiff opposition to the merger provision by the Japan Business Federation, which has likened cross-border negotiated mergers to hostile acquisitions. Fearing the provision could trigger a rash of unwanted foreign takeovers of Japanese companies,[118] big-business lobbyists convinced lawmakers to delay the effective date of the provision by one year to May 2007.

---

114. Three separate laws were consolidated into the Companies Law, including: (1) Part II of the Commercial Code, which governs joint stock corporations; (2) the Limited Liability Company Act, which governs nonpublic, closely-held companies; and (3) the Law Regarding Exceptional Rules of the Commercial Code Concerning Auditing, Etc., of Kabushiki Kaisha, which polices the mandatory in-house auditing of stock corporations. *See* Commercial Code, *supra* note 98.

115. *See supra*, text accompanying note 94.

116. More flexible dividend payout plans (the Commercial Code allowed dividends to be paid only once or twice a year), the use of e-mail for board meetings, and online disclosure of financial statements are among the many provisions contained in the new Companies Law. Unlike earlier, piecemeal amendments to the Commercial Code, which often delineated the corporate rules in rigid detail, the Companies Law establishes only the minimum requirements, allowing corporations to formulate more stringent rules in their articles of incorporation if they so choose. This new principles-based approach is expected to transfer more power over corporate affairs to shareholders, since any amendment to a firm's articles of incorporation requires special shareholder approval. Provisions of the 2005 Companies Law Bill are available at http://www.moj.go.jp/HOUAN/KAISYA/refer02.pdf. (Japanese only). For a brief overview of the new Companies Law, particularly its broad revision of Japan's business entities and introduction of American-styled LLCs and LLPs, *see* Fuller, Japan Developments in Review 2005, *supra* note 105.

117. A proposal to authorize stock swaps directly with foreign corporations was eliminated from the bill. *See* Provision of the 2005 Companies Law bill, *supra* note 97.

118. But the fears appear unfounded as mergers are always negotiated and not tantamount to hostile takeover bids. As the controversial provision is presently drafted, a foreign triangular merger will have to be approved by a "special resolution," which, under Japanese company law, means that the proposed transaction would have to be approved by two-thirds of the votes actually cast at the Japanese target company's shareholders' meeting where shareholders, whose combined voting rights constitute a majority of the total, are present. While it is theoretically possible to obtain this level of approval without management's consent, it is highly unlikely, even in a U.S. corporation, much less in a Japanese one. Throughout much of 2006 and early

2. *Takeover Defenses and Ministry Guidelines*

Amid all the consternation stemming from the recent spate of takeover battles in Japan, drafters of the new Companies Law decided to expand the arsenal of takeover weapons available to corporate boards. Many of these defensive strategies have a distinctly "poison pill" flavor in that they can effectively dilute the voting power of an unwanted suitor if activated.[119]

Citing a lack of Japanese legal precedents to deal with Japan's rising number of hostile bids, Japan's Ministry of Economy, Trade and Industry (METI) and Ministry of Justice (MOJ) jointly issued Takeover Guidelines in 2005.[120] The ministries' view is that although takeover defenses should be available to companies to protect against attempts to destroy or devalue the corporation (e.g., a blatant attempt to raid corporate assets), such defenses are excessive if they are used to simply entrench corporate management, perhaps dooming the target company's growth and share price to poor performances. The Guidelines set forth a conjunctive three-part test for determining whether a takeover defense is reasonable. A defense will *not* be deemed "reasonable" unless: (1) the takeover poses pose a genuine threat to corporate value; (2) the chosen defensive measure is proportional to the imminent threat; and (3) the selected defensive measure is taken by the board in an

2007, the powerful and conservative Japan Business Federation (Nippon Keidanren) has been demanding that the Japanese government amend the triangular merger provision, before its May 2007 effective date, by requiring a higher threshold of shareholder approval—specifically, a two-thirds majority of all outstanding voting rights, which is the same approval threshold required for passage of an "extraordinary resolution" under Japanese law. However, on March 9, 2007, the ruling Liberal Democratic Party (LDP) agreed to drop this proposal to introduce tougher approval thresholds, citing concerns that a stricter requirement would make it virtually impossible to execute such mergers, thus further impeding Japan's goal of increasing foreign direct investment (FDI) in Japan. *See LDP Nixes Stricter Triangular Merger Rules*, NIKKEI WEEKLY—NIKKEI NET INTERACTIVE (Mar. 12, 2007), http://www.nni.nikkei.co.jp/cgi-binprint.cgi. In 2006, FDI comprised only about two percent of Japan's gross domestic product (GDP). By comparison, FDI in the United Kingdom was approximately 30 percent of that country's GDP in 2006. *See id.* In lieu of a higher approval threshold, the LDP agreed to require fuller and more meaningful disclosure by the foreign companies implementing the new triangular merger provision. Specifically, the target company's shareholders will have to be apprised of material aspects of the foreign suitor's financial and business data, as well as its corporate charter, before they vote to approve or reject any proposed triangular merger. *See id.*

119. Japan's national judiciary's willingness to hammer out standards without much legislative guidance and only sparse prior litigation was evinced in Livedoor Corporation's 2005 lawsuit to enjoin NBS's issuance of stock warrants to Fuji that would have diluted Livedoor's stake in NBS to less than 20 percent when exercised, thus giving Fuji majority control. Granting Livedoor's injunction, the trial court invalidated NBS's last-ditch warrants as a defense, finding they were issued primarily to lower the shareholding ratio of the acquirer. Affirming on appeal, the Tokyo High Court elaborated, stating that an issuance is "grossly unfair" to shareholders, in violation of the express provisions of Japan's Commercial Code, where its primary purpose is to maintain management's control by diluting the holdings of other shareholders. The High Court echoed Delaware's longstanding doctrine that a defense may be legitimate if it is proportional to the threat. For an insightful analysis of the opinion, *see* Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005). *See also* Fuller, *Whither M&A in Japan*, *supra* note 95.

120. Kigyo Kachi Kenkyu Kai [Corporate Value Study Group], Tekitaiteki Baishu Boei Saku (Kigyo Kachi Boei Saku) no Seibi [Preparing Defensive Measures toward Hostile Takeovers (Measures to Defend Corporate Value)], March 2005, at 2. [hereinafter METI Takeover Guidelines]. An English summary of METI's interim report by the Corporate Value Study Group is available at http://www.meti.go.jp/english/information/downloadfiles/Corporate%20Value.pdf.

independent manner.[121] The Guidelines clearly adopt the familiar threat-and-proportionality doctrine first enunciated by the Delaware Supreme Court in 1985 in *Unocal*,[122] and virtually every doctrinal distinction articulated by the Delaware courts in subsequent cases.[123] The Guidelines thus endorse boards' issuance of poison pills so long as they are revocable and meet the Guidelines' test of reasonableness at the time of the unsolicited acquisition or offer. Although not legally binding, the ministry sponsored Takeover Guidelines clearly influenced the Tokyo District Court in upholding Livedoor's temporary injunction against NBS, and are widely expected to play an influential role in shaping Japan's regulation of hostile takeovers in the future.

VII. Developments in the Netherlands

A series of major developments have occurred in the Netherlands in the last year.

A. Dutch Parliament approves Financial Markets Supervision Act

In the process of restructuring financial market supervision structures, the Dutch Parliament approved the proposed Financial Markets Supervision Act (*Wet financieel toezicht* or FMSA).[124] The FMSA will combine all the Dutch financial supervision acts into one comprehensive framework for financial supervision. Additionally, a proposal for implementing the revised Banking[125] and Capital Adequacy Directives[126] was sent to the Dutch Parliament and may result in implementing the Basel II requirements[127] in the FMSA. The FMSA is expected to take effect January 1, 2007.

---

121. The three criteria are interrelated. Thus, the more unreasonable and disproportionate the measures appear, the greater the company's burden to show it has independent directors or a third-party committee who acted independently of management interests. *See id.* at 7.

122. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

123. *See* Milhaupt, *supra* note 119.

124. Stb. 2006, 475.

125. Council Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), 2006 OJ L 177/1, *available at* http://eu.lex.europa.eu/LexUriServ/site/en/oj/2006/1-177/1_17720060603en00010200.pdf.

126. Council Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions, 2006 OJ L 177/201, *available at* http://eu-lex.europa.eu/LexUriServ/site/en/oj/2006/1-177/1_17720060630en02010255.pdf.

127. Bank for International Settlements, Basel II: Revised International Capital Framework, *available at* http://www.bis.org/publ/bcbsca.htm.

> The Basel II Framework describes a more comprehensive measure and minimum standard for capital adequacy that national supervisory authorities are now working to implement through domestic rule-making and adoption procedures. It seeks to improve on the existing rules by aligning regulatory capital requirements more closely to the underlying risks that banks face. In addition, the Basel II Framework is intended to promote a more forward-looking approach to capital supervision, one that encourages banks to identify the risks they may face, today and in the future, and to develop or improve their ability to manage those risks. As a result, it is intended to be more flexible and better able to evolve with advances in markets and risk management practices.

Id.

B. Disclosure Act 2006 Enters into Force

On October 1, 2006, the initial phases of both (1) the new Act on the Disclosure of Voting Power and Capital Interests in Securities Issuers (*Wet melding zeggenschap en kapitaalbelang in effectenuitgevende instellingen* or the Disclosure Act 2006)[128] and (2) the decree based on the act entered into force. The Disclosure Act 2006 stems partly from the Transparency Directive[129] and replaces the Act on the Disclosure of Voting Power in Listed Companies 1996 (*Wet melding zeggenschap in ter beurze genoteerde vennootschappen 1996*).[130]

C. Takeover Bids Directive Still Pending

By its terms, the Takeover Bids Directive[131] should have been implemented in national legislation on May 20, 2006. Because the proposed implementing legislation is still pending with Dutch Parliament, however, the Netherlands did not meet the Directive's deadline. Consequently, the Minister of Finance published a Temporary Exemption Regulation on Takeover Bids (TER).[132] The TER implemented certain provisions of the Directive, including the European passport for approved offer documents, and it will be effective until the implementing legislation becomes effective.

D. Various Financial Services Act Provisions Take Effect

On May 1, July 1, and October 1, 2006, various additional provisions of the Financial Services Act (*Wet financiële dienstverlening* or FSA)[133] and its underlying rules and regulations became effective. Specifically, these new rules require (1) the AFM to keep a public register including license holders under the FSA;[134] (2) financial service provides to have proper administrative organizations and internal control systems;[135] and (3) new financial leaflets to be produced.[136]

E. Alternext Amsterdam Launch

As of June 1, 2006, Alternext Amsterdam (Alternext) became operational.[137] Euronext Amsterdam created Alternext to help small and midsized companies gain access to the stock market.[138] Consequently, Alternext is a key component of Euronext's program for

128. Stb. 2006, 355.

129. Council Directive 2004/109/EC of the Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, 2004 OJ L 390/38.

130. Stb. 1996, 629.

131. Council Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, 2004 OJ L 142/12.

132. Stcrt., May 19, 2006, no. 98.

133. Stb. 2005, 339.

134. FSA, § 23.

135. *Id.* § 28.

136. *Id.* at ch. 3, para. 2.

137. *See* Euronext.com—Alternext, http://www.euronext.com/alternext/landing/0,5371,1732_203915424,00.html.

138. *Id.*

small and mid-cap stocks, which began with Euronext's forming a single list, "Eurolist," introducing a new range of special indices, and creating Small & MidCap Experts. Ultimately, it aims to become the reference market for small and mid-cap Zone trading.

F. Act on the Supervision of Financial Reporting

The Second Chamber of the Dutch Parliament ratified the Act on the Supervision of Financial Reporting (*Wet toezicht financiële verslaggeving* or ASFR).[139] The ASFR is intended to facilitate the transparency and comparability of financial reporting by listed companies and in 2007 introduces AFM supervision of Dutch issuers' annual financial statements.

VIII. Developments in Peru

The Peruvian government has subjected the Peruvian Stock Market Regulations to some arguably notorious changes over the last year. In some cases, certain statutes have replaced already-existing statutes; in other cases, completely new regulations came into force. Key changes are highlighted below.

On March 4, 2006, the Peruvian Government enacted the New Regulations for Mandatory Tender Offers (OPAs) and Delisting Tender Offers (OPCs), approved by CONASEV (*Comisión Nacional Supervisora de Empresas y Valores*) Resolution No. 009-2006-EF/94.10 (New Regulations).[140] All came into force on May 3, 2006. The main innovations introduced in the New Regulations included: (1) new criteria which defined what comprises a controlling interest (CI) and considers that acquiring or attempting to acquire a CI triggers the obligation to address OPAs;[141] (2) the possibility of launching an "*ex post* OPA," meaning that the obligation to launch an OPA is triggered from the moment one has successfully completed a takeover transaction;[142] and (3) no longer subjecting an OPA's variable percentage of voting shares—or of other securities coupled with the right to subscribe to the securities—to certain, pre-set thresholds, but instead to the results of a formula provided in the New Regulations.[143]

Regarding initial public offerings (IPOs), CONASEV Resolution 041-2006-EF/94.10 introduced the so-called "Fast Track Rule" on July 20, 2006 which introduced the category of qualified investors.[144] Included in this term are both (1) institutional investors (e.g., pension fund managers, financial institutions, and insurance institutions, among others) and (2) high net worth individuals. Essentially, the fast-track procedures lighten the former requirements and create an alternative process which is free of the statutory requirements normally governing offerings addressed to the general public.

In 2006, CONASEV also issued official interpretations of key provisions legally governing the Peruvian stock market. These include the following:

139. Stb. 2006, 569.
140. CONASEV Resolution No. 009-2006-EF/94.10, published in the Official Gazette, Mar. 4, 2006.
141. *Id.* at art. 4.
142. *Id.* at art. 8.
143. *Id.* at Annex 1.
144. CONASEV Resolution 041-2006-EF/94.10, published in the Official Gazette, July 20, 2006.

- CONASEV Resolution No. 007-2006-EF/94.10,[145] construes Provision Articles 7(b) and 10 regarding both (1) accessing information on corporate performance and (2) summoning shareholders of limited liability companies for meetings.[146] Regarding the latter, the 5 percent ownership threshold for minority shareholders to summon special shareholder meetings is now calculated by counting only the shares belonging to the relevant class instead of all the outstanding shares of capital stock. Additionally, shares which have had their voting rights suspended will not be included in any calculations.[147]
- CONSEV Resolution No. 024-2006-EF-EF/94.10,[148] construes Article 97 of the General Corporate Act (GCA)[149] addressing the preferential rights over dividend distributions allotted to classes of shares which have no voting rights over such distributions. This interpretation clarifies that the preferential rights of such stock may be either of (1) rank (meaning that the holders of these shares may collect dividends before the common stockholders), (2) quantity, or (3) a combination of both.[150] Ultimately, the guiding principles are determined by the issuer's by-laws.

Finally, in 2006 CONASEV also introduced a set of new regulations governing stock brokers.[151] These regulations completely replace the former regulations addressing the same issue.

IX. Developments in Turkey[152]

The Law on Capital Markets No. 2499[153] (Capital Markets Law or CML) is the main piece of legislation governing the capital markets in Turkey; and the Turkish Capital Markets Board (CMB) is an independent government authority regulating and monitoring capital market activities by issuing regulations and *communiqués*. Last year, CMB prepared a bill amending the existing CML (Draft Law)[154] to bring the CML in line with relevant

145. CONASEV Resolution No. 007-2006-EF/94.10, published in the Official Gazette, 14 February 2006.

146. "Provisions regarding the Access to Information related to Corporate Performance and Summons for Shareholders Meetings in Listed Limited Liability Companies," which were approved by CONASEV Resolution No. 111-2003-EF/94.10 (published in the Official Gazette on Dec. 12, 2003), as amended by CONASEV Resolution No. 16-2004-EF/94.10 (published in the Official Gazette on Mar. 11, 2004) and CONASEV Resolution No. 15-2005-EF/94.10 (published in the Official Gazette on Mar. 15, 2005).

147. The 5 percent equity ownership threshold is envisaged in Article 7 (b) of the "Provisions regarding the Access to Information related to Corporate Performance and Summons for Shareholders Meetings in Listed Limited Liability Companies." The criterion for calculating this threshold was one of the issues addressed by the interpretation made by CONASEV through Resolution No. 007-2006-EF/94.10.

148. CONSEV Resolution No. 024-2006-EF-EF/94.10, published in the Official Gazette, 23 May 2006.

149. Law No. 26887.

150. Reference to preferential rights of nonvoting stock is made under Article 97 of the General Corporate Act. The possible combination of preferential rights is actually one of the issues that has been clarified by the interpretation made by CONASEV thorough Resolution No. 024-2006-EF/94.10.

151. CONASEV Resolution 045-2006-EF/94.10, published in the Official Gazette, July 23, 2006.

152. Only major changes, amendments and enactments between December 1, 2005, and November 27, 2006, are accounted for.

153. Capital Market Law No. 2499, published in the Official Gazette No. 17416 on July 30, 1981, *available at* www.spk.gov.tr.

154. *See* Capital Market Law No. 4487, *available at* http://www.spk.gov.tr/HaberDuyuru/haberduyuru.htm?tur=diger.

EU legislation. Nevertheless, CMB has not yet submitted the Draft Law to the Prime Ministry and some additional time will be needed before the government enacts the Draft Law.

Despite the current Draft Law, CMB has amended its secondary legislation several times to reflect the needs of key market players in addition to monitoring the market during the second and third quarters of 2006. Below are key examples of new regulatory acts.

A. Intermediary Institutions (Broker Companies)

The government made several amendments to the *Communiqué* regarding the Principles on Intermediary Activities and Intermediary Institutions (IIs).[155] Provided that IIs obtain the CMB's permission, the IIs can engage in intermediary activities *vis-à-vis* foreign derivative markets. Furthermore, the limit on IIs' commission fees is abolished; essentially, the IIs are free to agree contractually with their clients on the commissions that IIs charge over share sale and purchase transactions.[156]

B. Investment Funds

For the purposes of investment and risk management, investment funds and partnerships are allowed to include option, forward, and derivative transactions based on foreign exchange and precious metals interests in their respective portfolios.[157]

C. Central Registry Agency

The government created the Central Registry Agency (CRA) to ensure that shares of listed publicly held companies are registered and maintained electronically.[158] Consequently, the *IMKB Takas ve Saklama Bankasi* (the ISE Settlement and Custody Bank) transferred all its accounts and shares to the CRA and canceled physically maintained share certificates (PMSCs).[159] PMSCs of publicly held corporations that are not listed should be registered with the CRA within a certain period of time.

155. The Communiqué Regarding the Principles on Intermediary Activities and Intermediary Institutions (Serial V, No. 46), published in the Official Gazette No. 24163 on Oct. 7, 2000; the Communiqué on Amending the Communiqué Regarding the Principles on Intermediary Activities and Intermediary Institutions (Serial V, No:86), published in the Official Gazette No. 26097 on Mar. 3, 2006. *See* http://www.cmb.gov.tr.

156. The Communiqué on Amending the Communiqué Regarding the Principles on Intermediary Activities and Intermediary Institutions (Serial V, No. 86), published in the Official Gazette No. 26097 on Mar. 3, 2006, art. 53, para. 3. *See* http://www.cmb.gov.tr.

157. The Communiqué on Amending the Communiqué on Principles Regarding the Investment Funds (Serial VII, No. 27), published in the Official Gazette No. 22852 on Jan. 21, 2006, art. 1/b (in the Turkish language, on file with author).

158. The Regulation Concerning Incorporation, Operation and Supervision of the Central Registry Agency, published in the Official Gazette No. 24439 on June 21, 2001. *See* http://www.mkk.com.tr/MkkComTr/en/mkk/mev_yonetmelik.jsp.

159. The Communiqué About Terms and Conditions Governing Book-entry Recording of Dematerialized Capital Market Instruments (Serial IV, No. 28), published in the Official Gazette No. 24971 on Dec. 22, 2002. *See* http://www.mkk.com.tr/MkkComTr/en/mkk/mev_teblig.jsp.

D. International Financial Reporting Standards

The *Communiqué* on Accounting Standards Series XI No. 25 has been issued requiring all listed corporations to prepare their consolidated financial tables in accordance with International Financial Reporting Standards (IFRS).[160] Following the *Communiqué*, new standards have been set to meet the IFRS's scope.[161]

E. Real Estate Investment Companies

The government amended the *Communiqué* on Principles of Real Estate Investment Companies in several ways to increase the use of Real Estate Investment Companies (REICs) in financing real estate investments.[162] Major amendments: (1) decreased the minimum share capital amount;[163] (2) abolished the "leading partner" concept and allowed individuals to become shareholders;[164] (3) required REIC general managers to work solely for REICs under the loyalty principle;[165] (4) allowed financial support to be given to construction companies for REICs' investments abroad;[166] and (5) eased investment restrictions based on ownership requirements by allowing investments based instead on a "promise to sell a real estate" contract structure.[167]

F. Portfolio Management

The government amended the Portfolio Management *Communiqué* to allow portfolio management companies to operate solely as private equity investors.[168] The amendments also enhance the criteria sought for portfolio managers in line with EU directives.

X. Developments in the United Kingdom

A. The Transparency Obligations Directive

On December 15, 2004, the European Parliament and the Council of the European Union adopted the Transparency Obligations Directive[169] (Directive). The Directive forms part of the EU's Financial Services Action Plan, which aims to create a single mar-

160. Communiqué Serial XI No. 25, published in the Official Gazette No. 25290 on Nov. 15, 2003.
161. The Communiqué on Amending the Communiqué on Accounting Standards (Serial XI, 27), published in the Official Gazette No. 25677 on Dec. 21, 2004, (in the Turkish language, on file with author).
162. The Communiqué on Amending the Communiqué on Principles Regarding Real Estate Investment Companies (Serial VI, No. 20), published in the Official Gazette No. 26226 on July 12, 2006. *See* http://www.cmb.gov.tr.
163. *Id.* at art. 6/A-c.
164. *Id.* at art. 7/d.
165. *Id.* at art. 19.
166. *Id.* at art. 25/i.
167. *Id.* at art. 25/c.
168. The Communiqué on Amending the Communiqué on Principles Regarding Portfolio Management Operations and Portfolio Management Intuitions (Serial V, No. 87), published in the Official Gazette No. 26232 on July 18, 2006 (in the Turkish language, on file with author).
169. Council Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, 2004 O.J. L390/38.

ket in financial services for the EU and must be implemented in the United Kingdom by January 20, 2007.[170]

1. *Periodic Financial Reporting*

The Directive requires companies with shares listed on a EU regulated market (such as the main market of the London Stock Exchange) to publish annual and half-yearly reports as well as interim management statements; the latter will be similar to quarterly reports.[171]

2. *Annual Reports*

Annual reports must be published within four months of the year end.[172] This reduces the current six-month period set out in the FSA's Listing Rules. An annual report should consist of (1) audited accounts, (2) a management report, and (3) a responsibility statement.[173]

3. *Half-Yearly Reports*

Half-yearly reports must be published within two months of the first six month period in a financial year,[174] reducing the current ninety-day period set out in the FSA's Listing Rules. These reports should consist of: (1) the financial statements; (2) an interim management report; and (3) a responsibility statement (in similar terms to that set out above).[175] The interim management report must indicate important events that have occurred during the first six months of the year, as well as describe both (1) the principal risks and uncertainties for the remaining six months of the year and (2) details of major related party transactions.[176]

4. *Interim Management Statements*

Interim management statements need to be made neither earlier than week eleven nor later than week twenty in any six-month period.[177] The statements should (1) explain material events and transactions during the relevant period and their impact on the issuer's financial position, and (2) describe generally the financial position and performance of the company during the relevant period.[178]

5. *Equivalence of Accounting Standards*

The Directive will require annual and half-yearly reports to be prepared in accordance with International Financial Reporting Standards (IFRS), unless the reports are prepared

170. Further information about the Financial Services Action Plan is available at http://ec.europa.eu/internal_market/finances/actionplan/index_en.htm.
171. *See* Council Directive 2004/109/EC, supra note 90, at arts. 4-6.
172. *Id.* at art. 4(1).
173. *Id.* at art. 4(2).
174. *Id.* at art. 5(1).
175. *Id.* at art. 5(2).
176. *Id.* at art. 5(4).
177. *Id.* at art. 6(1).
178. *Id.*

in accordance with third country accounting standards that are considered equivalent to IFRS.[179] The Committee of European Securities Regulators (CESR) has been mandated to provide guidance on which sets of GAAP should be considered equivalent and will focus in particular on this issue in the context of United States, Canadian, and Japanese GAAP.[180]

B. Real Estate Investment Trusts

As part of the United Kingdom 2005 Pre-Budget Report, the Government announced on December 5, 2005, that it would bring forward legislation for introducing real estate investment trusts (REITs) in the United Kingdom to improve the efficiency of the commercial and residential property investment markets.[181] The REIT regime in the United Kingdom will take effect on January 1, 2007.[182]

In terms of legal structure, a REIT must be a company which is tax resident in the United Kingdom and publicly listed on a recognized stock exchange (i.e., (1) the main market of the London Stock Exchange, (2) its equivalent in the other Member States of the EU, and (3) the New York Stock Exchange).[183] A REIT may only issue ordinary shares and only one class of such shares.[184] Furthermore, a REIT cannot be a close company (i.e., broadly, a company which is controlled by five or fewer shareholders).[185]

Other conditions with which a REIT must comply include that (1) it must distribute 90 percent of its taxable profits to its shareholders, (2) its ratio of profits to finance costs must be at least 1.25, and (3) it must take steps to avoid paying distributions to holders of more than 10 percent of its issued share capital.[186]

In return for this favorable tax status, any company that wishes to convert to a REIT must pay a conversion charge equal to 2 percent of the gross value of its qualifying properties.[187]

C. Financial Service Authority Listed Investment Companies Review

In March 2006, the FSA published a consultation paper[188] in which it outlined proposed changes to the regulatory regime applicable to investment companies listed on the FSA's Official List and traded on the main market of the London Stock Exchange. The definition of an investment company in this context is a company whose object is to invest its

179. *Id.* at arts. 4-5.

180. *See, e.g.*, The Committee of European Securities Regulators, Technical Advice on Equivalence of Certain Third Country GAAP and on Description of Certain Third Countries Mechanisms of Enforcement of Financial Information, CESR/05-230 b (July 2005).

181. *See* HM Treasury, Pre-Budget Report 2005, *available at* http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr05/prebud_pbr05_index.cfm

182. Finance Act 2006, pt. 4, §§ 103-45.

183. *Id.* § 106.

184. *Id.* § 106(7).

185. *Id.* § 106(6).

186. *Id.* § 107.

187. *Id.* § 112.

188. Financial Services Authority, Implementation of the Transparency Directive & Investment Entities Listing Review, Consultation Paper 06/04 (March 2006), *available at* www.fsa.gov.uk/pages/Library/Policy/CP/2006/06_04.shtml [hereinafter Consultation Paper 06/04].

funds wholly or mainly in investments (as defined in the Regulated Activities Order[189]) with the object of spreading investment risk and managing its portfolio for the benefit of its shareholders.

The current rules will only permit an investment company to engage in derivative strategies (e.g., short selling, employing relative value strategies, and using synthetic products) when these strategies ensure that portfolios are managed efficiently. The FSA interprets this to mean that derivative strategies may only be employed to guard against risk (e.g., interest rate and currency fluctuations), rather than for investment purposes. However, the proposed changes will permit the use of derivative strategies for investment purposes, provided that the investment company maintains an adequate spread of risk and properly discloses the use of such strategies to its shareholders.[190]

The final change relates to the current rule requiring investment companies to be passive investors. This rule restricts the extent to which an investment company can become involved in the management of the companies in which it invests. The FSA has proposed that this restriction be removed so that an investment company may exercise influence in their capacity as shareholders in the same way as other shareholders. Certain limits will remain: an investment company, for example, will be permitted to provide strategic advice and may have representatives on the board of companies in which it invests; this is only possible, however, as long as it does not take control of the board or become actively involved in the day-to-day management of these businesses.[191]

XI. Developments in the United States of America

A. Hedge Fund Rule Struck Down

On June 23, 2006, the U.S. Court of Appeals for the District of Columbia vacated SEC Rule 203(b)(3)-2 (Hedge Fund Rule or the Rule)[192] under the Investment Advisers Act of 1940 (Advisers Act)[193] in *Goldstein v. Securities and Exchange Commission*.[194] Effective February 1, 2006, the Rule had amended the terms of the so-called private adviser exemption, which had exempted investment advisors who had advised fewer than fifteen "clients" during the preceding twelve-month period from SEC registration requirements. The amendments redefined client so as to embrace *all* the investors in a fund and not merely the fund itself, subjecting most hedge fund advisers to SEC regulation for the first time. Ultimately, the Rule reversed more than thirty years of prior practice and was adopted amidst significant controversy, as well as in the face of strong opposition from two of the five SEC commissioners.

1. *The SEC's Post-Goldstein Approach*

Although the SEC decided not to appeal *Goldstein*, hedge funds and their advisers will remain high on the SEC's agenda. In his statement of August 7, 2006, Chairman Cox

189. Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).
190. Consultation Paper 06/04, *supra* note 188.
191. *Id.*
192. 17 C.F.R. § 275.203(b)(3)-2(a) (2006).
193. 15 U.S.C. § 80b-1, et seq. (2000).
194. Goldstein v. Securities and Exchange Commission, 451 F.3d 873 (D.C. Cir. 2006).

clearly indicated that the SEC was working aggressively to reverse some of the effects of *Goldstein*, including enacting a new rule that would "look through" the hedge fund to its investors for anti-fraud purposes only.[195] Furthermore, Chairman Cox outlined additional proposals regulating hedge fund advisers, including that the SEC take emergency steps to ensure that investment advisers who had relied on and registered under the Rule were not suddenly deemed noncompliant with SEC regulations. On August 10, 2006, the SEC issued a No-Action Letter stating that it would not take action against advisers who had relied on either (1) the Rule's regulations of performance fees or (2) the qualified exemption from recordkeeping for newly registered advisors.[196] Additionally, the Letter stated that the provisions of "SEC-lite" would remain in effect, allowing non-U.S. resident fund advisers to consider the client to be the fund itself—and not the underlying investors, as is the case for U.S. resident registered investment advisors. Finally, Chairman Cox stated that the SEC would consider raising the minimum net worth thresholds that individuals must meet before investing in hedge funds or being considered an accredited investor from $1 million to $1.5 million.[197]

2. *Non-SEC Regulation of Hedge Funds*

In addition to introducing new rules reinstating certain provisions of the Rule, hedge fund advisers may be subject to further SEC regulation through legislation or regulation by other U.S. government agencies. On June 29, 2006, members of Congress introduced a bill, the "Securities and Exchange Commission Authority Restoration Act of 2006,"[198] designed to reverse *Goldstein* by giving the SEC the authority to require the registration of hedge fund advisers under the Investment Advisers Act of 1940. Although hedge fund investment advisers may now rely on the private adviser exemption as it stood prior to the SEC's enacting the Rule, any currently unregistered or registered investment adviser that has decided to deregister with the SEC should proceed with caution.

B. Lessons from WorldCom

Following the discovery of accounting irregularities in the summer of 2002, WorldCom, Inc., then one of the largest providers of long-distance telecommunications services in the United States, announced a restatement of its financials. Shortly after the announcement, WorldCom filed the largest bankruptcy case in U.S. history.[199] The re-

195. Press Release, The United States Securities and Exchange Commission, Statement of Chairman Cox Concerning the Decision of the U.S. Court of Appeals in Phillip Goldstein, et al. v. SEC (Aug. 10, 2007), *available at* http://www.sec.gov/news/press/2006/2006-135.htm.

196. Am. Bar Ass'n., SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) (Aug. 10, 2006).

197. Am. Bankers Ass'n Trust Letter, SEC Response to Goldstein Decision Vacating Hedge Fund Rule, 13 (Sept. 2006), *available at* http://www.aba.com/NR/rdonlyres/932C3298-5F64-11D5-AB86-00508B95258D/45392/TrustLetter906.pdf.

198. H.R. 5712, 109th Cong., (2d Sess. 2006).

199. For a discussion of the WorldCom bankruptcy filing generally, *see* Shawn Young et al., *Leading the News: WorldCom Files for Bankruptcy—Debt, Scandal Overwhelm; Operations Set to Continue During a Reorganization*, WALL ST. J., July 22, 2002, at A3; *see also* Joshua Chaffin & Peter Thal Larsen, *WorldCom Board Agrees to File for Bankruptcy*, FIN. TIMES, U.S. ed. 2, July 22, 2002, at 1; *WorldCom's Bankruptcy Mess*, ECONOMIST.COM, July 23, 2002, http://www.economist.com/agenda/displaystory.cfm?story_id=E1_TNQGTJQ.

sulting litigation has produced several interesting opinions from the trial and appellate courts.

1. *Conflicting State and Federal Jurisdiction*

The Court of Appeals for the Second Circuit has addressed issues of conflicting state and federal jurisdiction arising during the WorldCom litigation.[200] When an Alabama state court judge put a WorldCom-related case on a trial path that conflicted with the federal case, Judge Denise Cote of the Southern District of New York issued an injunction[201] under the All Writs Act,[202] enjoining the state court proceeding until after the federal trial was complete. The Second Circuit discharged the injunction, holding that it was precluded by the federal Anti-Injunction Act.[203]

2. *Reliance and Due Diligence Defenses*

At the trial level, the District Court for the Southern District of New York has written extensively about the reliance and due diligence defenses to claims under Section 11 of the 1933 Securities Act.[204] To meet their due diligence burden, the court held, in *In re WorldCom, Inc. Securities Litigation*, that underwriters must conduct a thorough and searching inquiry, with systematic attention to detail.[205] It is clear this can require extensive investigation, including detailed conversations with the issuer and its auditor. Cursory inquiries and formulaic answers are insufficient.[206] The completion of legally adequate due diligence in the compressed timeframe allowed by shelf registrations presents real issues for underwriters. The *WorldCom* court held that any information that strips an underwriter of its confidence in the accuracy of audited financial statements is a red flag and renders the underwriter unable to rely on the audited statement, whether or not it suggests accounting fraud or an audit failure.[207]

Although un-audited quarterly financial statements may be considered as part of due diligence, the court held that underwriters cannot blindly rely on them, even if supported by a comfort letter from the auditor.[208] The court recognized that the practical effect may be that underwriters have to retain independent accountants in some circumstances.[209]

200. Retirement Systems of Alabama v. J.P. Morgan Chase & Co., 386 F.3d 419 (2d Cir. 2004).

201. *See* In re WorldCom, Inc. Securities Litigation, 315 F.Supp.2d 527 (S.D.N.Y.2004).

202. 28 U.S.C. § 1651 (2000).

203. *Retirement Systems of Alabama*, 386 F.3d at 420. For a further discussion of the Alabama and federal district and federal appellate cases, *see* Ted Allen, *Second Circuit Refuses to Block Alabama's WorldCom Suit*, Institutional Shareholder Services, Nov. 8, 2004, *available at* http://slw.issproxy.com/2004/11/000464print.html.

204. 15 U.S.C. § 77a et seq. (2000).

205. 346 F.Supp.2d 628, 678 (S.D.N.Y. 2004). Quoting Webster's dictionary, the District Court reasoned that the word investigate is defined as to inquire and examine into with systematic attention to detail and relationship.

206. *Id.* at 683.

207. *Id.* at 672.

208. *Id.*

209. *See id.* at 662.

3. *Holder Action*

The *WorldCom* court has also had to grapple with the concept of the so-called "holder" action—an action brought by a class of plaintiffs alleging not that they bought or sold securities as a result of fraud, but that fraudulent financial statements caused them to retain their securities, which became worthless when the issuer collapsed. Since the *WorldCom* decision, however, the Supreme Court has held the federal securities laws provide no remedy for "holder" plaintiffs, pre-empting any remaining state recognition of holder claims.[210]

The *WorldCom* case has also revealed that the existing statutory framework of judgment credits—which was designed to encourage settlement—actually makes it very difficult for directors—who are usually relatively impecunious compared with their co-defendant underwriters and accountants—to settle securities actions before the "deep-pocket" defendants.

C. SEC and PCAOB Announce Plans for Further SOX 404 Implementation

On May 17, 2006, the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) each announced plans for further implementation of internal control reporting under Section 404 of the Sarbanes–Oxley Act of 2002 (SOX).[211] The announcements followed the May 10, 2006, joint SEC/PCAOB roundtable[212] on second-year experiences with internal control reporting and auditing requirements, as well as written comments received in connection with the roundtable and recent reports by each of the SEC Advisory Committee on Smaller Public Companies and the U.S. Government Accountability Office addressing the implementation of SOX 404 for smaller companies. The next steps announced by the SEC and PCAOB relate principally to:

- issuing additional SOX 404 guidance to issuers and auditors, particularly smaller companies and their auditors, and revisiting the appropriate role of auditors in the SOX 404 reporting process;
- revising PCAOB Auditing Standard No. 2 (AS 2), relating to audits of internal controls, to promote audit efficiency;
- refocusing PCAOB inspections of auditing firms on audit efficiency;
- extending compliance dates for non-accelerated filers to meet internal control reporting requirements.

210. *See* Merrill Lynch v Dabit, 126 S. Ct. 1503 (2006).

211. Press Release, Securities and Exchange Commission, SEC Announces Next Steps for Sarbanes-Oxley Implementation (May 17, 2006), *available at* http://www.sec.gov/news/press/2006/2006-75.htm; Press Release, Public Company Accounting Oversight Board, Board Announces Four-Point Plan to Improve Implementation of Internal Control Reporting Requirements (May 17, 2006), *available at* http://www.pcaobus.org/News_and_Events/News/2006/05-17.aspx.

212. For a transcript of the Roundtable discussion, *see* Securities and Exchange Commission, Roundtable Discussion on Second-Year Experiences with Internal Control Reporting and Auditing Provisions (May 10, 2006), *available at* http://www.sec.gov/spotlight/soxcomp/soxcomp-transcript.txt; *see also* Press Release, Public Company Accounting Oversight Board, PCAOB and SEC Roundtable on Internal Control Reporting Requirements, *available at* http://www.pcaobus.org/News_and_Events/Events/2006/05-10.aspx.

The steps outlined by the SEC and PCAOB appeared aimed at addressing both the application of SOX 404 to smaller companies, which was a focus of the May 10, 2006, roundtable, as well as the principal criticisms of the SOX 404 reporting process voiced at the roundtable, including that SOX 404 reporting remains far too costly. On July 11, 2006, the SEC published a Concept Release outlining the expected scope of additional guidance the SEC is considering issuing on SOX 404 compliance and seeking public feedback on thirty-five questions related to risk and control identification, management's evaluation, and documentation requirements.[213] Comments had to be submitted on or before September 18, 2006.[214] Although both the SEC's May 17, 2006, announcement and the Concept release indicated that the SEC expected to postpone compliance with SOX 404 reporting requirements for non-accelerated files, neither indicated any similar expectation for foreign private issuers that qualify as accelerated files.

D. PCAOB Inspections to Focus on Audit Efficiency

The PCAOB issued a statement on May 1, 2006,[215] that inspections in 2006 of auditing firms would focus on auditing firm efficiency in conducting audits of internal control over financial reporting, particularly on how well audit firms are implementing guidance issued by the PCAOB on May 16, 2005.[216] The PCAOB statement indicated that inspectors would specifically evaluate:

- the degree to which the audit of internal control over financial reporting and the audit of financial statements were performed as a single, integrated, and mutually reinforcing process;
- whether auditors use a top-down approach in which company-level controls were identified as the first step in planning the audit;
- whether auditors properly assessed risk and used a risk-based approach to determine the nature, timing and extent of internal control testing;
- whether auditors took full advantage of the opportunities available to use the work of others, such as the company's internal audit staff.

E. SEC Staff Issues Fact Sheet on Cross-Border Mergers of Stock Exchanges

In the wake of recently announced cross-border mergers of stock exchanges and concerns regarding the applicability of U.S. regulations to non-U.S. exchanges and securities listed on these exchanges as a result of such mergers, the SEC's Office of International

213. SEC Release No. 34-54122 (July 11, 2006), *available at* http://www.sec.gov/rules/concept/2006/34-54122.pdf.

214. Concept Release Concerning Management's Reports on Internal Control Over Financial Reporting, Exchange Act Release No. 54122 (July 11, 2006), *available at* http://www.sec.gov/rules/concept/2006/34-54122.pdf.

215. Press Release, Public Company Accounting Oversight Board, Board Issues Statement Regarding 2006 Inspections (May 1, 2006), *available at* http://www.pcaobus.org/News_and_Events/News/2006/05-01a.aspx.

216. Press Release, Public Company Accounting Oversight Board, PCAOB Issues Guidance on Audits of Internal Control (May 16, 2006), *available at* http://www.pcaobus.org/News_and_Events/News/2005/05-16.aspx.

Affairs and Divisions of Market Regulation and Corporation Finance released a fact sheet on June 16, 2006, to help clarify the U.S. regulatory impact of such mergers. The fact sheet notes, among other things, that:

- many forms of exchange integration would not result in mandatory registration of a non-U.S. exchange with the SEC or in mandatory registration of the non-U.S. exchange's listed companies with the SEC;
- joint ownership of a U.S. exchange and non-U.S. exchange would not result in automatic application of U.S. securities regulation to the non-U.S. exchange;
- a non-U.S. exchange party to a cross-border merger would only become subject to U.S. securities laws if it operates within the United States.[217]

F. AICPA Publishes Exposure Draft on Auditor Communication with Audit Committees

The American Institute of Certified Public Accountants (AICPA) Auditing Standards Board published a proposed Statement on Auditing Standards (SAS) to replace SAS 61 Communication With Audit Committees.[218] The AICPA Auditing Standards Board indicated that in developing the proposal, it had considered the March 2005 communication requirements of the *Proposed International Standard on Auditing 260 (Revised): The Auditor's Communication with Those Charged with Governance issued by the International Auditing and Assurance Standards Board.* In addition to including matters that are generally consistent with SAS No. 61, the proposed SAS identifies additional matters, such as: (1) an overview of the planned scope and timing of the audit and communication of the representations requested from management, and (2) additional guidance on the communication process. The comment period for the exposure draft ended on May 31, 2006, and comments will be available for inspection through June 30, 2007.[219]

G. U.S. Federal Court Provides Guidance on the Application of SOX 402 to Indemnification Advances

In *Envirokare Tech v. Pappas*,[220] a U.S. District Court held that an advance of defense costs pursuant to state law and corporate by-laws is not a "personal loan" within the meaning of Section 402 of the Sarbanes-Oxley Act of 2002. The court stated that the U.S. Congress "surely would have made its purpose evident in explicit terms" if it had intended the "radical step" of prohibiting such advances.[221] SOX 402 prohibits certain issuers, including those subject to SEC reporting, from extending or arranging credit in the form of

217. Press Release, The United States Securities and Exchange Commission, SEC Office of International Affairs and Divisions of Market Regulation and Corporation Finance Release Fact Sheet (June 16, 2006) *available at* http://www.sec.gov/news/press/2006/2006-96.htm.

218. Am. Inst. of Certified Pub. Accountants, Proposed Statement of Auditing Standards: The Auditor's Communication With Those Charged With Governance (Exposure Draft, May 2006), *available at* http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Exposure‡rafts+of+Proposed+Statements/Proposed_Statement_of_Auditing_Standards.htm.

219. *Id.*

220. Envirokare Tech v. Pappas, 420 F. Supp. 2d 291 (S.D.N.Y. 2006).

221. *Id.* at 293.

a personal loan to directors and executive officers. There has been much uncertainty regarding the scope of the SOX 402 prohibition as a result of its ambiguous language and a lack of regulatory or judicial interpretation.

H. PCAOB Advisory Group Focuses on the Effect on Auditor Independence of Certain Engagement Letter Terms

The Standing Advisory Group of the PCAOB held meetings to discuss whether auditor independence is impaired by various types of dispute resolution and liability limitation provisions being included by auditors in engagement letters.[222] The established SEC position has been that indemnification impairs independence;[223] however, the SEC has not addressed matters other than indemnification. The AICPA ethics rules currently state that independence is not impaired by any such provisions, including indemnification.[224] Recently, the AICPA proposed rules that would suggest independence is impaired in limited situations. In addition, various U.S. bank regulatory agencies published an advisory notifying banks that the agreement to certain of these types of provisions is not a "safe and sound" practice.[225] A number of U.S. companies have begun to include disclosure of such engagement letter provisions in their proxy statements filed with the SEC.

I. NASD Revises Shelf Offering Proposal

On April 28, 2006, the National Association of Securities Dealers, Inc. (NASD), filed a fourth revision to the NASD's proposed amendments to its Corporate Financing Rule with the SEC.[226] The proposed amendments, which were originally filed on February 3, 2004, and updated on November 29, 2004,[227] address various matters, such as the filing requirements applicable to shelf offerings pursuant to SEC Rule 415. Proposed key amendments, as revised, include:

---

222. For a briefing paper discussing the Standard Advisory Group's meeting on this topic, *see* Public Company Accounting Oversight Board, Standing Advisory Group Meeting, Emerging Issue—The Effects on Independence of Indemnification, Limitation of Liability, and Other Litigation-Related Clauses in Audit Engagement Letters (Feb. 9, 2006), *available at* http://www.pcaobus.org/standards/standing_advisory_group/meetings/2006/02-09/indemnification.pdf.

223. Item 510 of Regulation S-K (18 C.F.R. 229.510).

224. Am. Inst. of Certified Pub. Accountants, Proposed Interpretations on Indemnification/Limitation of Liability Provisions and Forensic Accounting Services (Sept. 15, 2005), http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Exposure‡rafts+-+Standard+Setting/2005_0915_omnibus_ED.htm.htm.

225. Advisory from the Department of the Treasury, Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters (Feb. 1, 2006), *available at* http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060203/attachment.pdf.

226. NASD, Shelf Registration Amendments (to be codified as NASD Rules 2710, 2810, IM-2440, and Schedule A to the NASD By-Laws), *available at* http://www.nasd.com/RulesRegulation/RuleFilings/2004RuleFilings/NASDW_001039; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendments to Rule 2520 (Margin Requirements), Exchange Act Release No. 53743 (Apr. 28, 2006), *available at* http://www.sec.gov/rules/sro/nasd/2006/34-53743.pdf.

227. Notice of Filing of Proposed Rule Change Relating to the Corporate Financing Rule and Shelf Offerings of Securities, Exchange Act Release No. 50749 (Nov. 29, 2004), *available at* http://www.sec.gov/rules/sro/nasd/34-50749.pdf.

- a new exemption from the NASD filing requirements for shelf offerings by Well Known Seasoned Issuers (WKSIs);
- a new exemption from the NASD filing requirements for offerings of securities by a foreign government whether or not the issuer has investment-grade debt securities;
- a new exemption from the NASD filing requirements for sales of securities that are more in the nature of ordinary market transactions than offerings, subject to conditions relating to the reporting history of the issuer, volume limitations, and the absence of certain types of agreements with the issuer or selling security holder.

The NASD has not proposed to amend the substance of the filing exemption available to seasoned issuers, retaining the eligibility requirements applicable to SEC Forms S-3 or F-3 in 1992 (including a three-year reporting history requirement).[228]

J. Stock Option Backdating

A number of public companies have recently reported that they are the subject of internal or governmental investigations—including those by the SEC and Federal prosecutors—into their stock option granting practices. The investigations are concerned primarily with whether the companies backdated stock option grants to executives and other employees.[229] Stock options are typically granted with a per share exercise price equal to the trading price of the company's stock on the date the option is granted. An option is backdated when the exercise price is set (whether inadvertently or through deliberate manipulation) at the trading price on a date prior to the grant date, when the stock traded at a lower price. As a result, the backdated option is in-the-money on the date of grant and conveys value to the employee even if the company's stock price does not subsequently increase. While the grant of in-the-money stock options is not illegal, the backdating of options creates a variety of issues. Most importantly, companies that backdate options may not have properly disclosed the practice in their public filings or reflected the expense of such options in their U.S. GAAP financial statements or reconciliations, and they may have improperly claimed certain tax deductions. The SEC is also investigating whether companies may have forward dated grants of stock options, which occurs when the timing of stock option grants is manipulated to precede the release of favorable news that is expected to result in an increase in the company's stock price.

228. For the complete NASD proposal filed with the SEC, *see* SR-NASD-2004-022—Shelf Offering Amendments (proposed Feb. 3, 2004), *available at* http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_000045.pdf.

229. Press Release, Securities and Exchange Commission, SEC Settles Options Backdating Case Against William F. Sorin, Former General Counsel of Comverse Technology, Inc., (Jan. 10, 2007), *available at* http://www.sec.gov/litigation/litreleases/2007/lr19964.htm; Press Release, Securities and Exchange Commission, SEC Files Actions Against Former CFO and Former Controller of Engineered Support Systems, Inc. Relating to Options Backdating Scheme (Feb. 6, 2007), *available at* http://www.sec.gov/litigation/litreleases/2007/lr19990.htm. For a discussion of the SEC's formula for punishing companies that improperly backdated stock options, *see* Jeremy Grant & Brooke Masters, *SEC Near to a Formula for Options Fines Backdating Scandal*, Fin. Times, Feb. 7, 2007, at 24.

K. NYSE Proposes Rule Changes Relating to Annual Financial Statement Distribution

On June 21, 2006, the SEC published notice that the New York Stock Exchange, Inc. (NYSE) had filed proposed rule changes with the SEC relating, among other matters, to the NYSE's annual financial statement distribution requirements.[230] As proposed by the NYSE, the amendments would:

- eliminate the current requirement that a listed company distribute an annual report to shareholders;
- require each listed company to maintain a website;
- require each listed company to post on its website its annual report and Form 10-K, 20-F, 40-F or N-CSR filed with the SEC (simultaneously with such filing), together with an undertaking to provide hard copies of its audited financial statements free of charge upon request, and simultaneously issue a press release announcing such filing and noting such undertaking;
- require each listed company to post on its website any (1) required committee charters, (2) corporate governance guidelines and ethics code, and, in the case of foreign private issuers, (3) required disclosure regarding its home country corporate governance practices.

The elimination of the NYSE requirement to distribute annual financial statements would likely have the greatest practical significance for foreign private issuers that distribute annual financial statements with U.S. GAAP reconciliations in addition to complying with home country requirements. Companies domestically listed in the United States would remain subject to the distribution requirements of the SEC's proxy rules. The comment period for the proposal ended on July 20, 2006.[231]

XII. Developments in Venezuela

According to the Venezuelan National Securities Commission (*Comisión Nacional de Valores* or CNV), 2005 ended with favorable growth figures.[232] The CNV predicted the trend to continue in 2006; and this prediction had proven true as of November. In 2006, the CNV's intense work focused on swiftly approving public offerings. The CNV also created new rules and amended others.

---

230. Notice of Filing of Proposed Rule Change Relating to Annual Financial Statement Distribution Requirements and Listed Company Manual Sections 103.00, 203.00, 203.01, 203.02, 203.03, 204.00-204.33, 303A.14, 313.00, 401.04, and 703.09, Exchange Act Release No. 54029 (June 21, 2006), *available at* http://www.sec.gov/rules/sro/nyse/2006/34-54029.pdf.

231. *See* Notice of Filing of Proposed Rule Change Relating to Annual Financial Statement Distribution Requirements and Listed Company Manual Sections 103.00, 203.00, 203.01, 203.02, 203.03, 204.00-204.33, 303A.14, 313.00, 401.04, and 703.09, Exchange Act Release No. 54029 (June 21, 2006) *available at* http://www.sec.gov/rules/sro/nyse/2006/34-54029.pdf.

232. *See* Comision Nacional de Valores, El Mercado de Capitales Venezolano es Seguro y Transparente, Mar. 22, 2006, *available at* http://www.cnv.gob.ve/InformacionPublico_ArtEspeciales.php.

A. New 2006 CNV Rules on Money Laundering

The year began with a set of rules aimed at avoiding money laundering from unlawful activities,[233] such as drug trafficking and organized crime. Capital market operators welcomed the Rules on Money Laundering (the Rules), even though the Rules create a new compliance burden. The Rules place a range of duties on companies and persons working directly or indirectly in capital markets, including drafting codes of ethics and embracing more effective models of corporate governance.

B. New 2006 CNV Amended Disclosure Rules

The CNV amended the disclosure rules[234] to establish the policies, periods, and types of information that must be filed by capital markets operators.[235]

The amendments' main objective is to generate more corporate information; consequently, Investment Companies, Administrator Companies, Brokerage Companies, and Stock Exchanges must be ready to provide additional information to the CNV.

C. New 2006 CNV Multilateral Entities Public Offering Rules

During 2006, the CNV established the framework for Multilateral Entities (ME) to seek funding in Venezuelan capital markets. Under the ME Public Offering Rules,[236] MEs can venture into the Venezuelan capital markets through debt financing. The debt instruments which MEs may issue include: (1) debt securities, (2) commercial paper, and (3) participation securities in underlying assets.[237]

---

233. *Normas para la Prevención, Control y Fiscalización de las Operaciones de Legitimación de Capitales Aplicables al Mercado de Capitales Venezolano, Gaceta Oficial de la República Bolivariana de Venezuela Nº 38.354 de fecha 10 Enero 2006* [Rules on the Prevention, Control, and Taxation of Money Laundering Transactions, Applicable to the Venezuelan Securities Market, Official Gazette N° 38.354, Jan.10, 2006].

234. *Reforma de las Normas Relativas a la Información Periódica u Ocasional que deben Suministrar las Personas Sometidas al Control de la Comisión Nacional de Valores, Gaceta Oficial de la República Bolivariana de Venezuela N° 5.802 Extraordinario de fecha 8 Marzo 2006* [Amended Rules on Periodic and Occasional Information to be Disclosed by the Persons Under the Control of the National Securities Commission, Official Gazette N° 5.802 Extraordinary, Mar. 8, 2006].

235. *See* Amended Disclosure Rules (ADRs), arts. 1-2.

236. *Normas Relativas a la Oferta Pública y Oferta Primaria de Obligaciones, Papeles Comerciales y Títulos de Participación por parte de Entes Multilaterales, Gaceta Oficial de la República Bolivariana de Venezuela Nº 38.428 de fecha 3 Mayo 2006* [Rules on First Public Offering of Debt Securities, Commercial Paper, and Participation Securities in Underlying Assets by Multilateral Entities, Official Gazette N° 38.428, May 3, 2006].

237. The Rule mentions that the debt instruments issued by MEs must be short term securities. In addition debt securities, commercial paper, as short-term securities may only last 360 days. Notwithstanding, participation securities in underlying assets may last longer, since they depend on the underlying assets. *See id.* at art. 9.

D. New 2006 CNV Amended Brokerage Rules

The amended brokerage rules (ABR)[238] increased the capital standard for agents mediating capital markets. In this respect, new standards were set for paid-in legal capital, minimum cash capital, and guaranteed first risk (i.e., level 1) capital.[239]

Additionally, the legislation includes an article to establish the debt levels and overall leverage of Brokerage companies; effectively, brokerage companies and stock exchanges must have debt-equity ratios of eight or less.[240] (ABR art. 96).

238. *Reforma de las Normas Sobre Actividades de Intermediación de Corretaje y Bolsa, Gaceta oficial de la República Bolivariana de Venezuela N° 38.567 del 20 Noviembre 06* [Rules on brokerage Activities, Official Gazette N° 38.567, Nov. 20, 2006].

239. *Id.* at arts. 92, 94-95.

240. *Id.* at art. 96.