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This newsletter provides a snapshot of the principal US and selected global governance and securities law developments during the fourth quarter of 2012 that may be of interest to Latin American corporations and financial institutions.

The previous quarter's Governance & Securities Law Focus newsletter is available here.

US DEVELOPMENTS

SEC Developments

In this section, we are covering developments relating to the implementation of provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Reform Act") and the Jumpstart Our Business Startups Act ("JOBS Act") through rulemaking by the US Securities and Exchange Commission ("SEC") as well as other SEC developments.

New SEC Reporting Requirements for Specified Business Activities Relating to Iran

The recently enacted Iran Threat Reduction and Syria Human Rights Act of 2012 (the "Threat Reduction Act") imposes on SEC-registered companies specific additional disclosure requirements concerning certain business activities relating to Iran and other targets of US economic sanctions programs.

Under these new disclosure requirements, which are reflected in a new Section 13(r) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), an SEC registrant must disclose the following business activities in its annual Form 20-F if such activities are conducted by the issuer or its affiliates during the period covered by the Form 20 F:

- Business activities relating to Iran's energy sector and development of weapons of mass destruction as proscribed under the United States Iran Sanctions Act (as amended);
- Certain transactions by financial institutions with the Government of Iran or persons or entities designated on the US Government's Specially Designated Nationals and Blocked Persons List (the "SDN List") as global terrorists or weapons of mass destruction proliferators as proscribed under the United States Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (as amended) ("CISADA");
- Business activities relating to the suppression of human rights in Iran as proscribed under CISADA; and
- Transactions or dealings with: (i) the Government of Iran; or (ii) persons or entities designated on the SDN List as global terrorists or weapons of mass destruction proliferators.

Under the new requirements, the business activities described above must be disclosed if the SEC registrant or any of its affiliates "knowingly" conduct (or conducted during the period covered by the report) such activities. Under US law generally, a person or entity "knowingly" engages in an activity if the person or entity knows (i.e., had actual knowledge), or should have known, that they are engaged in such activity. This suggests that an SEC registrant has an affirmative obligation to review its (including its affiliates') business activities to determine whether such activities are reportable under the new requirements.

For each business activity disclosed in the annual Form 20-F, the SEC registrant must disclose: (i) the nature and extent of the activity; (ii) gross revenues and net profits, if any, attributable to the activity; and (iii) whether the issuer intends to continue the activity.

The requirement to disclose gross revenues and net profits, "if any," suggests that there is no materiality threshold for reporting business activities that fall within one of the four categories described above.

The issuer must also file a concurrent public notice with the SEC that such activity has been disclosed by the issuer in the Form 20-F. The concurrent public notice will trigger a mandatory investigation by the US Government to be completed within 180 days into whether the reported activity is sanctionable under US economic sanctions programs, including extraterritorial sanctions programs administered by the US Secretary of State and US Secretary of the Treasury.

Under the new reporting requirements, an issuer is required to report business activities of its "affiliates." The term "affiliate" is defined in Rule 12b-2 under the

Exchange Act. Rule 12b-2 states that "[a]n 'affiliate' of, or a person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." Accordingly, SEC registrants will need to determine which of their subsidiaries, joint ventures and other related entities fall within the Rule 12b-2 definition and analyze the business activities of such affiliates to determine whether they engage in activities that are reportable under the new disclosure requirements.

Furthermore, any "transaction or dealing" by any of an SEC registrant's affiliates with a person or entity designated on the SDN List as a global terrorist or weapons of mass destruction proliferator, regardless of whether such activity is sanctionable as to the SEC registrant itself under US economic sanctions programs, is now subject to disclosure under Section 13(r) of the Exchange Act.

Compliance with Section 13(r) of the Exchange Act is subject to the certifications made by the Chief Executive Officer and Chief Financial Officer in annual reports on Form 20-F pursuant to Sections 302 and 906 of the United States Sarbanes-Oxley Act of 2002.

Our related client publications are available at:

- http://www.shearman.com/section-219-of-iran-threat-reduction-and-syria-human-rights-act-of-2012--additional-reporting-requirements-for-us-domestic-and-foreign-issuers-registered-with-sec-11-08-2012/,
- http://www.shearman.com/sec-publishes-cdis-for-iran-sanctions-disclosures-required-under-exchange-act-section-13r-12-06-2012/ and
- http://www.shearman.com/the-iran-threat-reduction-and-syria-human-rights-act-of-2012--how-are-you-planning-to-comply-with-section-219s-new-reporting-requirements-12-17-2012/.

Our January 7, 2013 client publication "Sanctions Round-Up: Fourth Quarter 2012" provides a summary of recent developments in US and EU sanctions programs and is available at: http://www.shearman.com/Sanctions-Round-Up-Fourth-Quarter-2012-01-07-2013/.

SEC Staff Allege Netflix Facebook Post May Have Violated Regulation FD

In December 2012, Netflix, Inc. announced that it had received a notice from the Staff of the SEC indicating its intent to recommend enforcement action for an alleged violation of Regulation FD.

Regulation FD requires all US reporting companies to make a public announcement or filing with the SEC of any material nonpublic information they disclose on a non confidential basis to certain persons outside the company, including securities market professionals and large money managers as well as investors, where it is reasonably foreseeable that the investor would trade on the basis of the information.

The alleged violation involves a Facebook posting by Netflix's CEO in which he disclosed that Netflix's members had enjoyed over one billion hours of content in June. Netflix did not disseminate this information by issuing a press release or filing a Form 8-K.

Netflix's CEO has over 200,000 followers on Facebook, and the statement was picked up by bloggers and in the media. Netflix contends that the Facebook post was "very public" and that in any case the information was not "material" to investors.

This is the first high-profile test of whether social media constitutes adequate distribution of material information for the purposes of the selective disclosure rules.

Although non-US companies are exempted from Regulation FD, the SEC expects such issuers to conduct themselves in accordance with the basic principles underlying Regulation FD and has stated that it may extend the same or similar obligations to such issuers in the future.

This serves as a reminder that a company's disclosure controls and procedures should not be limited to the documents that the company files with the SEC, such as its reports on Form 20-F and 6-K, but should encompass other disclosures attributable to the company and its senior management, including press releases, websites, blogs and postings on social media networks, such as Facebook or Twitter. Given the potential enforcement action against Netflix, until the SEC provides further guidance on the use of social media to disseminate information to the securities markets, companies should use extreme caution disclosing material information through social media and should keep in mind that website postings or the use of social media networks alone may not constitute adequate distribution of material information.

SEC Conflict Minerals Rules – Frequently Asked Questions

The first reporting period for the SEC's new conflict minerals rules began on January 1, 2013. Under the new rules, SEC reporting companies that manufacture products that contain tantalum, tin, tungsten or gold face new reporting requirements. Those companies will be seeking information from private companies in their supply chains. Required by the Reform Act, the conflict minerals rules require disclosure of products that contain conflict minerals originating in the Democratic Republic of the Congo and adjoining countries. SEC reporting companies have been working to put in place controls and procedures to comply with the conflict minerals rules and to ensure that minerals contained in their products are conflict-free.

Our client publication dated December 19, 2012 seeks to provide guidance, as well as to suggest some best practices for compliance. The primary focus in this series of frequently asked questions is on how to get started, including:

- analyzing whether the conflict minerals rules apply to your company,
- what is required by the "reasonable country of origin inquiry," and

- practical considerations for implementing a compliance framework.

Our related client publication is available at http://www.shearman.com/all-that-glitters-may-be-a-reportable-conflict-mineral-12-19-2012/.

Updated Financial Reporting Manual

On January 18, 2013, the SEC's Division of Corporation Finance updated its Financial Reporting Manual. The changes and clarifications in this update relate to significance testing for related businesses, auditor responsibility for cumulative period from inception amounts, PCAOB requirements for auditors of non-issuer financial statements and other changes.

The SEC's Division of Corporation Finance previously updated its Financial Reporting Manual on October 4, 2012. The changes in that update were:

- a note indicating the JOBS Act is not covered by the manual;
- clarification of proxy statement requirements for the disposal of a business;
- clarification of auditor association with amounts from inception in development stage companies;
- clarification of the application of PCAOB auditor requirements pursuant to a reverse merger; and
- clarification of reporting requirements in a reverse acquisition with a domestic registrant that is not a shell company.

The comprehensive updated Financial Reporting Manual is available at: http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml.

SEC Approves NYSE and Nasdaq Listing Standard Changes Governing Compensation Committee Independence and Advisors

On January 16, 2013, the SEC approved new listing standards implementing the SEC's final rules on compensation committee independence and advisors pursuant to Rule 952 of the Reform Act. The listing standards were adopted substantially as proposed with a few amendments including:

- Nasdaq modified the effective dates for its amended listing standards to align with the effective dates of the NYSE rules. The rules relating to compensation advisors will be effective on July 1, 2013, rather than immediately upon SEC approval. The rules relating to the compensation committee independence standards will be effective on the earlier of (i) a company's first annual meeting after January 15, 2014 or (ii) October 31, 2014.
- Both the NYSE and Nasdaq rules expressly provide that a compensation committee is not required to conduct an independence assessment of an advisor whose role is limited to (i) consulting on any broad-based plan that does not discriminate in

scope, terms or operation, in favor of executive officers or directors, and that is available generally to all salaried employees or (ii) providing information that either is not customized or that is customized based on parameters that are not developed by the advisor, and about which the advisor does not provide advice.

- Nasdaq clarified that companies are only required to consider the six specified factors when evaluating advisor independence. The NYSE rules provide that compensation committees must consider all factors relevant to an advisor's independence including the six factors.
- The Nasdaq proposed rules provide that the independence factors need only be considered with respect to "*independent*" legal counsel. The final rules eliminate the word "*independent*" so that the only exclusion from the independence assessment are in-house counsel. In addition, Nasdaq clarified that the independence factors must be considered when selecting, o*r receiving advice from*, a compensation advisor (emphasis added), clarifying that the analysis cannot be circumvented by simply not "*selecting*" an advisor.

A summary of the proposed listing standards can be found in our client publication available at: http://www.shearman.com/the-nyse-and-nasdaq-issue-proposed-rules-to-implement-the-sec-compensation-committee-independence-and-advisor-rules-10-04-2012/.

Trends to Monitor for the 2013 Proxy Season and Beyond

ISS Publishes 2013 US Corporate Governance Policy Updates

On November 16, 2012, Institutional Shareholder Services Inc. ("ISS") released its US policy updates for the 2013 proxy season (the "2013 US Policies"), having received comments to its draft policies released on October 16, 2012. The most significant 2013 US Policies contain updates on the following matters:

- hedging and pledging of company stock;
- board responsiveness to majority-supported shareholder proposals;
- overboarded directors;
- executive pay-for-performance evaluations;
- say on golden parachute proposals; and
- environmental, social and governance non financial performance compensation related proposals.

The 2013 US Policies will generally be effective for shareholder meetings of publicly-traded companies in the US held on or after February 1, 2013.

Hedging and Pledging of Company Stock. Under current ISS policies (the "2012 US Policies"), ISS may, in extraordinary circumstances, recommend that shareholders vote either "against" or "withhold" from individual directors or the entire board due to material failures of governance, stewardship, risk oversight or fiduciary responsibilities at the company. The 2013 US Policies make explicit that the hedging of company stock or significant pledging of company stock by directors and executives will be considered failures of risk oversight.

Board Responsiveness to Majority-Supported Shareholder Proposals. Under the 2012 US Policies, ISS recommends that shareholders vote either "against" or "withhold" from the entire board of directors, other than new nominees who are considered case by case, if the board failed to act on a shareholder proposal that either (i) received the support of a majority of shares outstanding in the previous year, or (ii) received the support of a majority of shares cast in the last year and one of the two previous years. The 2013 US Policies will give directors less time to respond to shareholder proposals by providing that ISS will issue a negative vote recommendation if the board fails to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year. This change in policy is being implemented on a transitional basis, however, and will only become effective beginning with shareholder proposals appearing on companies' ballots in 2013. In addition, the 2013 US Policies give ISS the flexibility, effective in the 2013 proxy season, to recommend against individual directors or committee members, rather than against the entire board.

Overboarded Directors. Under the 2012 US Policies, ISS recommends that shareholders vote either "against" or "withhold" from individual directors who (i) sit on more than six public company boards, or (ii) are CEOs of public companies who sit on the boards of more than two public companies besides their own (the negative vote recommendation is only with respect to outside boards). Under the 2012 US Policies, ISS does not count service by a director on the board of a parent as well as the board of its publicly-traded subsidiary (where ownership is 20% or higher) as serving on two separate boards. The 2013 US Policies change this approach and provide that service by a parent director on any non-controlled (i.e., where ownership is less than 50%) subsidiary board that is publicly-traded will be counted as service on two separate boards.

Executive Pay for Performance Evaluations: Advisory Votes on Executive Compensation. ISS's general pay for performance alignment evaluation methodology generally remains the same, with the following key changes:

- A company's self-selected benchmarking peer group will be used as an input to ISS's peer group methodology, but ISS will otherwise continue to select peer groups based on company size and market capitalization.

- A comparison of realizable pay to the grant date pay disclosed in the summary compensation table will potentially be incorporated into ISS's evaluation of pay for performance alignment for large cap companies.

Peer Groups. The 2013 US Policies set forth a new methodology for identifying peer groups that focuses on identifying companies that are reasonably similar in terms of industry profile, size and market capitalization, while granting greater deference to a company's self-selected peers.

- Under the 2012 US Policies, a company's peer group was generally comprised of 14-24 companies in the company's Standard & Poor's Global Industry Classification Standard ("GICS") industry group. ISS noted that this methodology did not always reflect multiple business lines in which companies operate, with the result that a company's competitors were sometimes omitted from its ISS peer group. The revised methodology under the 2013 US Policies is intended to minimize such omissions.
- The methodology set forth in the 2013 US Policies incorporates information from both the company's self-selected benchmarking peer group (as disclosed in its proxy statement) and the company's GICS industry group. ISS will prioritize companies that fall in one (or more) of the following categories:
- Companies included in the subject company's disclosed peer group.
- Companies naming the subject company in their own peer group.
- Companies with "numerous" connections to the subject company's disclosed peers or companies that name the subject company as a peer.
- ISS also noted that it will give lower priority to a company's self-selected peer if it is the only peer company in its 6- and 8-digit GICS code. On December 4, 2012, ISS issued FAQs detailing how the new peer groups would be constructed. These can be found at http://www.issgovernance.com/policy/USPeerGroupFAQ.
- Companies were given the opportunity to notify ISS of changes to their compensation peer groups for 2012 by December 21, 2012. ISS will likely default to using the 2011 benchmarking peer group that was disclosed in the company's 2012 proxy for companies that do not submit revisions. Companies that do not use a peer group to set executive pay also had the opportunity to submit a list of peers for ISS's consideration.

Comparison of Realizable Pay to Grant Date Pay. Under the 2013 US Policies, ISS may consider an additional factor in its pay-for-performance analysis that compares "realizable pay" to grant date pay for large capitalization companies in the S&P 500.

- "Realizable pay" is intended to reflect how executive pay has been affected by performance. Under the 2013 US Policies, realizable pay consists of the sum of cash paid, equity and long-term cash awards granted and other compensation

provided during the three-year performance period. These amounts are valued based on actual amounts for awards that are earned, vested or exercised and target values for on-going awards. Equity awards will be revalued using the stock price at the end of the performance period.

Say on Golden Parachute Proposals. The 2013 US Policies update ISS's current policy concerning say on golden parachute proposals to provide for the following key modifications:

- ISS will analyze existing change in control arrangements maintained with named executive officers, rather than focusing only on new or extended arrangements;
- While recent amendments that incorporate problematic pay practices[1] will carry greater weight in the analysis, ISS will place further scrutiny on existing change in control agreements that contain more than one problematic pay practice; and
- ISS will focus on excise tax gross-ups that are triggered and payable (as opposed to a provision providing for a gross-up).

Environmental, Social and Governance Compensation Related Proposals. Under the 2012 US Policies, ISS generally recommends against shareholder proposals to link, or report on linking, executive compensation to environmental or social non-financial performance measures. The 2013 US Policies amend this approach by requiring a case-by-case analysis of these proposals based on certain factors (which have not changed from the 2012 US Policies, except that the "significant and persistent controversies or violations" factor has been modified to reference "significant and/or persistent controversies or violations").

Other Updates in the 2013 US Policies. The 2013 US Policies contain a number of other clarifications and updates, including:

- recommending a vote against an individual director, instead of the full board, if proxy disclosure is insufficient to determine whether such director attended at least 75% of board and committee meetings;

[1] Problematic pay practices include: (i) single or modified single trigger cash severance; (ii) single trigger acceleration of unvested equity awards; (iii) excessive cash severance (greater than three times base salary and bonus); (iv) excise tax gross ups triggered and payable (as opposed to a provision to provide excise tax gross ups); (v) excessive golden parachute payments (on an absolute basis or as a percentage of transaction equity value); (vi) recent amendments that incorporate any problematic features (such as (i) through (v)) or recent actions (such as extraordinary equity grants) that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders; or (vii) the company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote.

- revising director categorizations to provide that any director named in the summary compensation table, including any current interim officer, is an inside director, while expanding the exclusion for directors named in the table because they were former interim officers (in the past the exclusion was limited to former interim CEOs);
- establishing overarching principles for evaluating social and environmental proposals for all markets, with emphasis on how the proposal may enhance or protect shareholder value in either the short or long term; and
- in connection with proposals requesting information on a company's lobbying activities, which are considered on a case by case basis by ISS, revising the policy to clarify the scope (all types of lobbying activities) and focus (lobbying policies and procedures as well as lobbying activities) to be considered in developing a recommendation.

Our related client publication is available at: http://www.shearman.com/iss-publishes-2013-us-corporate-governance-policy-updates-11-26-2012/.

PCAOB Developments

SEC Approves PCAOB Proposed Auditor Communications Standard

On December 17, 2012, the SEC approved the Public Company Accounting Oversight Board's ("PCAOB") Auditing Standard No. 16, Communications with Audit Committees ("AS 16"), and related and transitional amendments to PCAOB standards. AS 16 will supersede PCAOB interim auditing standard AU section 380, Communication with Audit Committees, and interim auditing standard AU section 310, Appointment of the Independent Auditor.

AS 16 retains or enhances existing audit committee communication requirements, incorporates SEC auditor communication requirements set forth in Rule 2-07 of Regulation S-X, provides a definition of the term "audit committee" for issuers and non-issuers, and adds new communication requirements that are generally linked to performance requirements set forth in other PCAOB auditing standards. For a summary of AS 16, please refer to our October 2012 Governance & Securities Law Focus newsletter.

The SEC release approving the adoption of AS 16 is available at: http://www.sec.gov/rules/pcaob/2012/34-68453.pdf.

On December 20, 2012, the PCAOB stated that the new rules are effective for public company audits of fiscal periods beginning on or after December 15, 2012. Additionally, the SEC determined that the standard and related amendments will apply to audits of "emerging growth companies" under the JOBS Act.

The PCAOB press release announcing the approval of AS 16 is available at: http://pcaobus.org/News/Releases/Pages/12202012_AS16.aspx.

Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act ("FCPA")

In January 2013, we published our bi-annual "Recent Trends and Patterns in FCPA Enforcement" report, part of our renowned FCPA Digest, which together provide an insightful analysis of recent trends and patterns and an invaluable compendium of all FCPA enforcement actions and private actions.

In our July 2012 Trends & Patterns, we noted that the year had been "a fairly slow time" in terms of enforcement actions. The second half of 2012 hasn't changed that story — since July, the US government has brought only five additional enforcement actions — Pfizer/Wyeth, Tyco International, Oracle, Allianz and Eli Lilly. This may be explained by the various pending motions in cases against individuals, and, as we noted earlier, the US Department of Justice, in particular, has been busily clearing away some previous cases with pleas, dismissals and sentencings.

The most significant act of the last half of 2012 was the release of the long awaited US guidance on the FCPA, "A Resource Guide to the US Foreign Corrupt Practices Act," much of which confirms our reading of the tea leaves of previous enforcement action, including some of the more disturbing positions that we have identified in our previous Trends & Patterns.

In this edition of Trends & Patterns, we summarize recent statistics, analyze legal developments and provide insight into the latest legislative and regulatory trends in anti-bribery enforcement in the US and the UK.

Our January 2013 "Recent Trends and Patterns in FCPA Enforcement" report is available at http://www.shearman.com/shearman--sterlings-recent-trends-and-patterns-in-the-enforcement-of-the-foreign-corrupt-practices-act-fcpa--fcpa-digest-2013-01-02-2013/.

Noteworthy US Securities Law Litigation

US Federal Courts Rule that Argentina Breached Pari Passu Clause in Refusing to Honor Bonds not Tendered in Exchange Offer: NML Capital v. Argentina

There were several significant developments in the last quarter of 2012 in the litigation in New York concerning the contentious restructuring of Argentina's sovereign debt, and in particular Argentina's steadfast refusal to honor bonds whose holders have declined Argentina's exchange offers.

As background, the plaintiffs in the case, captioned *NML Capital v. Argentina*, are holders of sovereign bonds issued by Argentina pursuant to a Fiscal Agency Agreement ("FAA") prior to Argentina's 2001 default. The FAA is governed by New York law by its terms. No payments have been made on the plaintiffs' bonds since 2001. In 2005 and again in 2010, Argentina made exchange offers to holders of bonds governed by the FAA, pursuant to which bondholders who tendered such bonds received new bonds ("Exchange Bonds"). As the result of the two exchange offers, approximately 91% of the bonds were tendered, and the Exchange Bonds have been kept current by Argentina. The plaintiffs' bonds were not tendered into the exchange offer. Argentina has made it clear, through multiple means, that it does not intend to make any further payments on the plaintiffs' unexchanged bonds.

The FAA that governs the plaintiffs' bonds contains a Pari Passu Clause, which is virtually universal in sovereign debt instruments and provides, in two sentences, as follows:

(1) "The Securities will constitute … direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank pari passu and without any preference among themselves."

(2) "The payment obligation of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness…."

On October 26, 2012, the Second Circuit Court of Appeals upheld a lower court ruling that "Argentina effectively has ranked its payment obligations to the plaintiffs below those of the exchange bondholders" and that as a result, Argentina breached the Pari Passu Clause of the FAA.

The Second Circuit remanded the case back to the lower court for further proceedings, and on November 21, 2012, a judge of the US District Court for the Southern District of New York held that the plaintiffs were entitled to a "ratable payment" from Argentina equivalent to "100% of what is currently due to plaintiffs" if Argentina pays 100% of what is due to the holders of Exchange Bonds. Additionally, and significantly, the court ruled that The Bank of New York, the Paying Agent on the Exchange Bonds (which are not in default), is subject to the court's orders, meaning that funds paid by Argentina to the The Bank of New York for payment to the holders of Exchange Bonds are potentially available for payment instead to the plaintiffs. In issuing its orders, the court reasoned that although "the indenture trustee, the registered owners, and the clearing system . . . are . . . probably not all agents of Argentina, . . . they surely are 'in active concert or participation' with Argentina in processing the payments from Argentina to the exchange bondholders" and thus, according the court, within the proper scope of the court's orders. The court concluded, "[t]hese third parties should properly be held responsible for making sure

that their actions are not steps to carry out a law violation, and they should avoid taking such steps."

By specifically including The Bank of New York within the ambit of its orders, the court effectively forced Argentina to pay the plaintiff bondholders in full or default on the Exchange Bonds, since any payment by Argentina to The Bank of New York for payment on the Exchange Bonds would have to be withheld or rejected by The Bank of New York absent full payment on the plaintiffs' bonds.

Argentina appealed the lower court's November 21, 2012 orders, and on November 28, the Second Circuit Court of Appeals issued a stay of the lower court's orders pending resolution of the appeal. As a result, Argentina was able to safely make several payments due on the Exchange Bonds in December 2012. Oral argument for the appeal will take place on February 27, 2013.

For more information, you may refer to our Argentina sovereign debt webpage at: http://www.shearman.com/argentine-sovereign-debt/.

New York State Appellate Court Overturns Lower Court, Dismisses Claims Brought by Plaintiffs Against a Foreign Corporation on Jurisdictional Grounds under Morrison: Viking Global Equities, LP v. Porsche Automobil Holding SE

In December 2012, a New York State appellate court reversed a lower court's decision to deny a motion to dismiss filed by Porsche Automobil Holding SE based on forum non conveniens. This decision marks the latest chapter in a long-running effort by a group of hedge funds to pursue claims against Porsche in the US based on alleged misstatements that Porsche made regarding its intent to obtain control of Volkswagen AG.

In the first phase of this case, which we summarized in our April 2012 update, a federal court in New York, relying on the US Supreme Court's landmark decision in *Morrison v. National Australia Bank*, dismissed a federal securities fraud lawsuit against Porsche on the grounds that the securities transactions at issue in that case were foreign transactions that were not entitled to the protection of Section 10(b) of the Securities Exchange Act of 1934.

Some of the plaintiffs that lost in federal court initiated a separate action in New York state court, in which they alleged claims of common law fraud and unjust enrichment. Porsche moved to dismiss the state court complaint based on forum non conveniens, but the state court denied the motion.

On appeal, the New York appellate court unanimously reversed the lower court's decision and dismissed the complaint on the ground of forum non conveniens. The appellate court ruled that the only connections to New York were some phone calls and emails between the plaintiffs in New York and a representative of the defendant in Germany. The court found that these connections failed to create a substantial nexus

with New York, particularly because the defendants and most of the plaintiffs were not New York residents, the relevant stock was traded only on foreign exchanges, many of the witnesses and documents were located in Germany, and Germany provides an adequate alternative forum. Based on these facts, the court ruled that Porsche had met its heavy burden to establish that New York was an inconvenient forum.

This decision demonstrates that plaintiffs will face considerable hurdles in their effort to try to circumvent *Morrison* by pursuing common law fraud claims against foreign corporations in state court.

Recent SEC/DOJ Enforcement Matters

UBS LIBOR Investigation

In December 2012, UBS AG and UBS Securities Japan Co. Ltd. entered into agreements with the Department of Justice, the Commodities Futures Trading Commission, the UK Financial Services Authority and the Swiss Financial Market Authority to resolve multi-year investigations into UBS's alleged manipulation of the London Interbank Offered Rate (LIBOR). In the agreements, UBS acknowledged that certain of its employees had worked with co-workers and employees at other banks to manipulate LIBOR in order to enhance the profits they earned from trading derivatives linked to LIBOR.

A particularly noteworthy aspect of the agreements is that UBS Japan agreed to plead guilty to felony wire fraud, and UBS AG agreed to enter into a non-prosecution agreement with the Justice Department. In addition, the Justice Department filed a criminal complaint against two former senior UBS traders for their roles in allegedly manipulating LIBOR.

In addition, UBS agreed to pay more than $1.5 billion in penalties and disgorgement — $700 million in the CFTC action, $500 million in the DOJ action, $259.2 million in the UK FSA action, and $64.3 million in the Swiss FINMA action. UBS also agreed to take certain remedial actions, including implementing firewalls to prevent improper communications between traders and rate submitters, enhancing auditing and monitoring procedures, and making regular reports to the regulators regarding its compliance efforts.

Numerous regulators around the world are currently investigating the alleged manipulation of LIBOR, TIBOR, and EURIBOR rates. UBS is the second financial institution to enter into settlement agreements with the regulators (Barclays was the first in June 2012), and UBS Japan is the first entity to plead guilty to a criminal offense related to LIBOR manipulation.

GLOBAL DEVELOPMENTS

New Rules on Hong Kong IPO Sponsors

On December 12, 2012, the Securities and Futures Commission ("SFC") published the conclusions of its "Consultation Paper on the regulation of sponsors." Other than the proposal to have a limit on the number of sponsors appointed for each IPO and the requirement for all sponsors to be independent of the listing applicant, the SFC has decided to proceed with most of its proposals.

The new rules on sponsor responsibilities, to be included in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code of Conduct"), will apply to listing applications submitted on or after October 1, 2013. The proposed clarification of sponsor liability under the Companies Ordinance, as discussed below, will be subject to a separate legislative process and timetable.

Statutory Reform – Prospectus Liability under the Companies Ordinance

One of the most controversial proposals of the SFC is to remove any ambiguity in the case law by clearly identifying sponsors as being liable, along with directors and others who authorize the issue of a prospectus, under section 40 (civil liability for misstatements in prospectus) and section 40A (criminal liability for misstatements in prospectus) of the Companies Ordinance. Any person who commits an offense under section 40A is liable to a fine of HK$700,000 and imprisonment for three years.

In deciding to proceed with its proposal, the SFC acknowledges that the current standard of liability under section 40A may be too onerous. The SFC therefore proposes that criminal liability should only apply if the prosecution can prove that:

- the person knew that, or was reckless as to whether, a statement in the prospectus was untrue; and
- the untrue statement was materially adverse from an investor's perspective.

The SFC also proposes that only sponsor firms, and not individuals, will be subject to the civil and criminal liability under the Companies Ordinance. However, as stated in the Consultation Conclusions, there could be situations where individuals would be held liable under general criminal law, e.g., "aiding and abetting" under the Criminal Procedure Ordinance.

Publication of Application Proof on HKEx's website

With effect from October 1, 2013, the first draft of the listing document submitted to the Hong Kong Stock Exchange ("Application Proof") will be required to be posted on the website of Hong Kong Exchanges and Clearing Limited ("HKEx"). The Hong Kong Stock Exchange will also increase its practice of rejecting poor quality draft

documents and will consider imposing a “cooling-off” period during which the submission of a revised draft will not be allowed.

In response to market concerns that applicants already listed on an overseas stock exchange might face practical difficulties given that any public disclosure in Hong Kong might trigger a corresponding disclosure obligation overseas, the SFC stated in the Consultation Conclusions that it may consider confidential filings for overseas listed companies.

Streamlined Regulatory Commenting Process

Some market participants have commented that disclosures in listing documents are sometimes driven by the rounds of regulators’ comments rather than their relevance or materiality, and the paternalistic approach of the regulatory commenting process has been a contributing factor of sub-standard listing documents. While stressing the regulators are not responsible for the adequacy or accuracy of disclosures, the SFC stated that it will work with the Hong Kong Stock Exchange on measures to streamline and shorten the regulatory commenting process.

Sponsors’ Role – Minimum Appointment Period and Fees

The SFC has also adopted some of the proposals by market participants to enhance the role and authority of sponsors, e.g.:

- a sponsor will be required to be formally appointed for a minimum period of two months before submission of the listing application. Where there is more than one sponsor, each of them will be required to comply with the minimum appointment period; and
- sponsor fees will be required to be specified in terms of engagement and should be based solely on a sponsor’s role. Any “no deal, no fee” arrangement should be avoided.

The Revised Code of Conduct

The SFC has consolidated all existing rules and new obligations and standards governing sponsor conduct in a new paragraph 17 of the Code of Conduct. A key theme of the new rules, as reflected in some of the provisions summarized below, is early completion of comprehensive due diligence:

Work required before submission of listing application. Under the revised Code of Conduct, a sponsor is required to complete all reasonable due diligence on the listing applicant before submitting a listing application, except in relation to matters that by their nature can only be dealt with at a later stage. In addition, before submitting a listing application, a sponsor should come to a reasonable opinion that:

- the information in the Application Proof is substantially complete;

- the applicant has complied with all relevant listing qualifications under the Listing Rules (except to the extent that waivers from compliance have been applied for);
- the applicant has established procedures, systems and controls to ensure compliance with the Listing Rules and other relevant regulatory requirements; and
- the directors individually and collectively have the necessary experience, qualifications and competence.

Standards and responsibility of due diligence. The revised Code of Conduct codifies due diligence obligations and sets out typical due diligence steps and interview practices to be followed. In particular, it provides that a sponsor cannot abrogate its due diligence responsibility. Where a sponsor engages a third party (e.g., lawyer or consultant) to assist in the due diligence exercise, the third party's work, in itself, would not be sufficient evidence that the sponsor has discharged its obligation.

In relation to expert reports to be included in a listing document, the revised Code of Conduct introduces a "negative" test: a sponsor (i) should have no reasonable ground to believe and (ii) should not believe that the information in the expert reports is untrue, misleading or contains any material omissions. A sponsor should carry out due diligence on expert reports covering the following aspects:

- the expert's qualification, experience and competence;
- the expert's scope of work;
- the bases and assumptions underlying the report; and
- the expert's opinion together with the rest of the information in the report.

Provision of information to regulators. A sponsor should reasonably satisfy itself that all information provided to the regulators is accurate and complete in all material respects and not misleading in any material respect. Where a sponsor becomes aware of any change in information provided or any material information which concerns non-compliance with the Listing Rules or other regulations, it should report the matter to the Hong Kong Stock Exchange in a timely manner.

Where a sponsor ceases to act for a listing applicant, the sponsor should inform the Hong Kong Stock Exchange in a timely manner of the reasons for ceasing to act.

Resources, systems and controls. A sponsor should maintain sufficient resources and effective systems and controls to ensure that it is able to meet its obligations. In respect of each assignment, a sponsor should ensure that it has sufficient staff with appropriate levels of knowledge, skills and experience to devote to the assignment. The management of a sponsor must be ultimately responsible for supervision of the sponsor work, and there must be clear and effective reporting lines so that decisions on critical matters are made not by the transaction team but by the management.

Record keeping. A complete set of sponsor's records should be retained in Hong Kong for at least seven years after completion or termination of a listing assignment. A sponsor should keep a record of all sponsor work and maintain adequate records to demonstrate that it has complied with the Code of Conduct.

Impact of the Reform

As shown in the *Hontex* case where the SFC imposed a HK$42 million fine and revoked the license of Mega Capital for failure to discharge its sponsor's obligations, the SFC will not hesitate to take action against sponsors and exercise its disciplinary power to the full extent. With the revised Code of Conduct and the potential civil and criminal liability, the SFC will be vested with further powers. It is therefore important for sponsors to get prepared for the new regime.

The new rules will have significant impact on the ways IPOs are conducted in Hong Kong. Sponsors will be concerned about potential criminal liability and will look for additional safeguards and comforts during the listing exercise to ensure that they will not be tainted with any allegation of "recklessness." The tightened regulations under the revised Code of Conduct will front load many tasks, and sponsors and all professional parties involved will be working on a much longer and intensive pre-A1 timetable. To offset the increased workload under the new regime, it is important that the SFC and the Hong Kong Stock Exchange streamline the regulatory commenting process, as promised in the Consultation Conclusions. We look forward to the announcement of the new measures and hope that the streamlined procedure will mean not only fewer rounds of regulators' comments, but also a change in the overall vetting approach.

The Consultation Paper and the Consultation Conclusions are available at:

http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=12CP1

http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=12CP1

Deferred Prosecution Agreements in the UK

Following a consultation period, on October 23, 2012 the UK Ministry of Justice ("MoJ") announced that legislation would be introduced to allow Deferred Prosecution Agreements ("DPAs") in the UK for economic crimes committed by commercial organizations. Similar to the practice in the US, the UK version of a DPA (as contemplated by the MoJ) will be an agreement between a prosecutor and a commercial organization under which the prosecutor will bring, but not immediately proceed with, criminal charges against the organization. Certain agreed terms and conditions will be imposed on a company as a requirement of a DPA, which are likely to include financial penalties, reparation to victims, confiscation of the profits of

wrongdoing, and measures to prevent future offending. Although the MoJ recognizes that the parties will need a level of certainty and confidentiality to be able to negotiate the details of a DPA, the public interest in ensuring that the DPAs are part of a robust prosecutorial approach requires that the final DPA will be made public in open court to ensure openness and transparency.

The MoJ has noted that even if the proposed legislation is passed, DPAs will have to be applied in a clear and practical manner and supported by guidance to ensure that all parties have a thorough understanding of how they operate. Thus, the Director of Public Prosecutions and the Director of the SFO will be required to develop and publish a "DPA Code of Practice for Prosecutors," setting out the factors to which prosecutors ought to have regard when considering whether to enter into a DPA; the Sentencing Council will need to produce sentencing guidelines on offences likely to be encompassed by DPAs, providing transparency and certainty for the parties and the court; and Criminal Procedure Rules will have to be developed to enable the DPA process to operate effectively and efficiently.

UK Bribery Act Update

In March 2011, the UK Ministry of Justice ("MoJ") issued comprehensive guidance on the Bribery Act 2010, mostly in relation to the new corporate offense (section 7 of the Bribery Act) and its adequate procedures defence. The SFO and the Crown Prosecution Service also issued joint enforcement guidance addressing the policies they would follow in evaluating issues such as facilitation payments (which are violations of the UK's general prohibition on corrupt payments). The SFO also published on its website some of its own guidance on its approach to certain issues arising under the Bribery Act.

However, in September 2012 the SFO removed from its website its previous guidance, replacing it with statements referring to the Code for Crown Prosecutors, the Joint Prosecution Guidance of the Director of the SFO and the Director of Public Prosecutions, and the Joint Guidance on Corporate Prosecutions. The SFO also withdrew its guidance in respect of corporate self-reporting, which had suggested that the SFO might settle through a civil remedy, as opposed to criminal prosecution, if a company self-reported bribery and corruption issues. Subsequently, on December 6, 2012, David Green QC (the new Director of the SFO) published an open letter on facilitation payments, re-emphasising that such payments are illegal under English law, regardless of their size or frequency.

These developments show a definite shift in approach by the SFO. The SFO appears to have made a conscious effort to step away from its previous stance, particularly with regard to self-reporting. Notably, Mr. Green has emphasised in his recent appearance before a House of Commons Justice Committee that the SFO is a "crime-fighting

agency" as an investigator and prosecutor of serious fraud, bribery and corruption, not an adviser to companies. If actions follow rhetoric, this may presage an increase in prosecutions under the Bribery Act in the near future.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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