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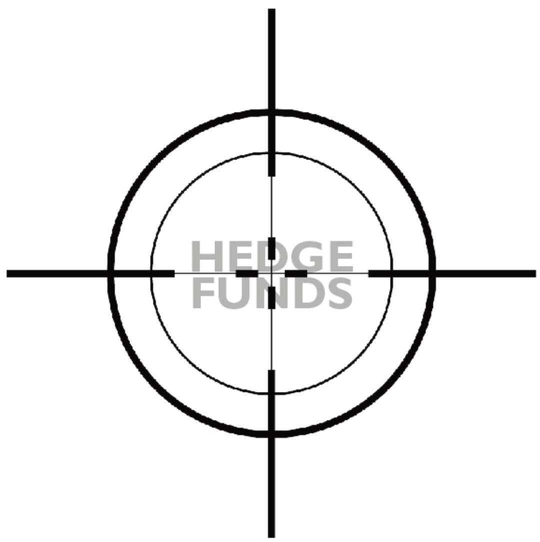
REGULATORY NEWS AND CASE UPDATES FROM BROWN RUDNICK'S EUROPEAN LITIGATION PRACTICE



HEDGE FUNDS IN THE CROSS HAIRS

The regulatory backlash following the ongoing global economic crisis shows no sign of abating with 2010 witnessing what appears to be an increasing focus on hedge funds.

INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS ("IOSCO")

On 25 February 2010, the IOSCO published its agreed template for the global collection of hedge fund data. Its purpose is to increase international cooperation between regulators by encouraging the collection and exchange of similar, comparable hedge fund data, thereby enabling regulators to more effectively pin-point and assess systemic risks. Although eleven categories of information have been proposed covering both supervisory and systemic data, the template is not designed to be exhaustive, therefore regulators will have a great deal of flexibility as to the extent of any additional information they may choose to request in their own jurisdictions. The IOSCO recommendation is that regulators should carry out data gathering exercises twice a year with the first to take place in September 2010.

COMMITTEE OF EUROPEAN SECURITIES REGULATORS ("CESR")

On 2 March 2010, the CESR published its proposals for a two-tier pan-European disclosure regime which sets thresholds at which investors would be required to report net short positions. The regime would apply to all shares admitted to trade on a European Economic Area ("EEA") regulated market and/or an EEA multilateral trading facility, unless the primary market for the shares is located outside the EEA. Under the proposed two-tier regime (i) a private disclosure to the relevant regulator would be required upon any position reaching a threshold of 0.2% of the relevant company's issued share capital, or above; and (ii) for positions of 0.5% or above, in addition to a disclosure to the regulator, a public disclosure to the market would also be required. All changes of positions, in increments of 0.1% up or down, would also be reportable on the same basis. The regime is expressed as covering "any transaction that provided an economic exposure to a particular share", thereby encompassing exchange traded and OTC derivatives. CESR

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is expected to issue further recommendations and will continue to monitor short selling and the operation of the new requirements to see whether further measures, beyond disclosure, may also be required.

U.S. REGULATION AND THE SEC

The United States Congress is thought to be considering proposals to regulate the hedge fund industry including a requirement for SEC registration. The effect of this would be to require hedge fund advisers to abide by, amongst other things, the strict reporting and compliance regimes currently applied to other regulated entities in the US.

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Although it can be said that hedge funds were already a priority for the SEC, over the past year the SEC's enforcement division has been the subject of big changes, many of which may significantly affect the hedge fund industry. Five specialist units have been set up, three of which - the Asset Management Unit, the Structured Product Unit, and the Market Abuse Unit - will have a specific emphasis on hedge funds, or products or conduct likely to be related to them. Each of the units is led by experienced enforcement officers and will be staffed by dozens of lawyers dedicated to investigations and enforcement actions. Each unit will also hire in-market and product experts from the industry, and new technology is to be developed to assist in complex investigations. If new legislation is adopted in the US, this would surely signal the start of further intensification of SEC activity.

EU DRAFT DIRECTIVE: ALTERNATIVE INVESTMENT FUND MANAGERS ("AIFM")

EU leaders are presently debating the AIFM published by the EU Commission in 2009. This directive would not only regulate hedge funds but private equity and various other "alternative" funds as well. Some key measures of the directive include requiring fund managers to: obtain EU authorisation in order to operate; satisfy authorities about their internal risk management arrangements; abide by rules on leverage and custodial standards, and rules for offshore funds and managers located in so-called "third countries". The directive is still to be approved by member states and the EU parliament and its terms continue to be a highly charged political topic between the main EU leaders.

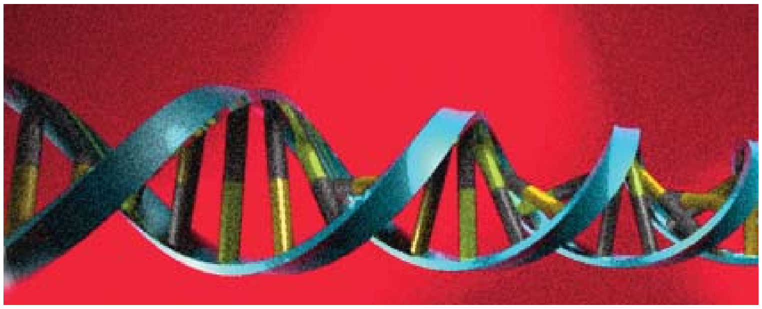
COMMENT

In whatever form the EU and US may choose to adopt new legislation and/or regulation, given the increasing activism across the globe towards the hedge fund industry, managers should probably consider a careful review of their practices, operations, compliance procedures and internal controls to ensure they are adequately prepared for the important changes and increased regulatory requirements that now appear almost inevitable.

RECTIFICATION – DESPERATE MEASURE OR GENUINE REMEDY?

Often tried, but rarely successful, a claim for contractual rectification has, perhaps unfairly, become regarded as the last resort of the desperate claimant. Faced with a contract which has turned out to represent a bad bargain, why not try and change its terms into something more favourable?

Of course, the courts have always been reluctant to find that the parties to a contract intended to agree to anything other than the terms contained in the document which they signed. This is particularly the case where the parties negotiated at length over the terms of the contract and were legally advised in the course of that process.



The requirement for "convincing proof" that the contract does not accurately reflect the parties' agreement has often been the hurdle at which claims for rectification have fallen. However, while such a claim remains difficult to prove and successful claims for rectification are likely to remain the exception rather than the norm, a recent decision demonstrates that, given the right factual case, a claim for rectification of an intensely negotiated commercial contract can be successful.

The test for rectification was recently re-stated by the House of Lords in Chartbrook Ltd v Persimmon Homes Ltd[1] . In short, the parties to the agreement must have had a continuing common intention at the time of signing the contract, evidenced by some outward expression of accord, which, by mistake, was not accurately reflected in the contract.

In the case of Surgicraft Limited v Paradigm Biodevices Inc[2], the parties entered into an agreement for Paradigm to distribute spinal products manufactured by Surgicraft. Prior to signing, the agreement underwent extensive negotiation and numerous re-drafts. Both parties were, at various stages of the process, legally advised.

Immediately prior to signing, Paradigm's representative amended the agreement in manuscript so as to delete provisions which would have provided Paradigm with compensation on termination in the event that Surgicraft was acquired. Paradigm maintained that this deletion was a mistake, deleting as it did a clause for which Paradigm had negotiated long and hard over the preceding months. Surgicraft maintained that the deletion was the result of a last minute re-negotiation of the terms.

Following the acquisition of Surgicraft and termination of the agreement, Paradigm claimed compensation from Surgicraft and, in order to do so, sought an order that the agreement be rectified so as to reflect the terms relating to compensation which Paradigm maintained were actually agreed between the parties.

In the judgment of Mr. Christopher Pymont QC, Paradigm's account of events leading up to the signing of the agreement was accepted without qualification. Surgicraft's attempted explanation of the deletion of the provisions was rejected by the judge who described one key element of the explanation as "fanciful if not untruthful". He concluded that the parties always intended that Paradigm should be entitled to compensation in the circumstances under which the agreement was terminated and ordered that the agreement be rectified as contended for by Paradigm.

The quantum of Paradigm's damages are to be assessed at a further hearing but are expected to be substantial.

Paradigm's success goes to show that, while remaining a difficult claim to win, even in the most extreme of circumstances, if it is genuinely the case that an agreement does not reflect the agreement of the parties, a thoroughly prepared factual case can persuade a judge to rectify even the most carefully negotiated of agreements.

[1] [2009] UKHL 38
[2] [2010] EWHC1291[Ch]

Brown Rudnick's ***Neill Shrimpton*** and ***Olga Bischof*** act for Paradigm.

THE COURT OF APPEAL GRANTS THE FSA DISCRETION ON HOW TO DEAL WITH FOREIGN REQUESTS

In Amro International SA & Creon Management SA v FSA & ors [2010] EWCA Civ 123, the Court of Appeal recently considered a request from the United States' Securities and Exchange Commission ("SEC") to the FSA to assist it in securing the production of documents from a firm of accountants based in England, Goodman Jones, for purposes of SEC proceedings in the US. The Court of Appeal made it clear that it was not prepared to limit the FSA's discretion to comply with such requests from foreign regulators, even where the documents requested were irrelevant and inadmissible and where the target of the request was only tangentially connected to the foreign proceedings.

In April 2006, the SEC instituted proceedings in the District Court for the Southern District of New York against, among others, Andreas Badian, a senior executive of a New York-based company, Rhino Advisors. Rhino was the investment advisor to Amro International SA and Creon Management SA, two financing companies based in Panama and the BVI respectively. None of Amro, Creon and Rhino were defendants in the proceedings.

The SEC alleged that Mr. Badian and others had engaged in fraudulent and manipulative trading in the shares of Sedona Corporation: namely, the extensive short selling of shares in Sedona designed to suppress Sedona's share value, thereby allowing Amro to acquire a substantial stake. As part of its proceedings, on 24 July 2009 the SEC wrote to the FSA seeking its assistance in securing the production of documents from Goodman Jones, who had acted for Amro and Creon and had documents relating to the deals with Rhino.

The FSA acceded to the request and appointed inspectors under section 169 of the Financial Services and Markets Act 2000 ("FSMA"), who subsequently issued a notice to compel the production of certain documents from Goodman Jones pursuant to sections 171 and 172 of FSMA. Amro and Creon challenged the FSA, accusing it of acting unlawfully in agreeing to appoint inspectors in order to obtain documents through compulsory powers. Amro and Creon also argued that the notice was too wide and non-specific, that the documents sought were both irrelevant and inadmissible in the SEC proceedings, and that the extent of the required production was therefore beyond the powers granted to the FSA.

At first instance, Mr. Justice Collins held that it was wrong for the FSA to require production of such documentation from Goodman Jones, in particular where Goodman Jones was neither a party to the proceedings in the United States nor the advisor to any party.

The Court of Appeal disagreed. It overturned his decision and held that the FSA's right to require the production of documents extended to documents which had "*no possible relevance or admissibility*" in the SEC's proceedings. The FSA was "*not required to satisfy itself of the correctness of what they are being asked to investigate or the basis upon which the investigation was asked for*".

The low hurdle for the production of documents and the wide ambit of documents that can be requested, extending to irrelevant and inadmissible documents, is a significant extension of the FSA's powers. It may result in an expensive and resource intensive burden on those that have to comply with such requests. Even those that are not party to the foreign proceedings, and are only on the periphery of foreign proceedings, may have to comply with these potentially onerous requests.

FINANCIAL SERVICES ACT 2010

The Financial Services Act 2010 received royal assent on 8 April 2010 under the expedited "wash-up" procedure. Notably, and presumably to allow the bill to be passed in the run up to the general election, the provisions in the bill allowing class actions against financial institutions have been removed.

Those provisions would have introduced, for the first time, so called "opt-out" collective actions (that is, actions in which people falling within the class of claimants must actively decide not to participate in the proceedings). They would also have allowed the aggregation of damages, so that damages awards were assessed in appropriate cases by reference to the overall class of claimants rather than to the individual claimants.

A number of major retail banks had been lobbying against the collective action proceedings provisions and will have reacted with relief to their removal in the face of opposition from the Conservative Opposition. As was evident in the recent litigation relating to bank charges, however, collective action rules had advantages for potential collective action claimants and defendants alike. The defendant banks in those proceedings, despite ultimately succeeding before the Supreme Court, experienced real difficulty and added cost in dealing with the large number of claims in circumstances where there was no adequate procedural framework within which those claims could be brought. As a result of the amendments to the bill, claimants will have to use the existing procedures (such as representative proceedings) to deal with multi-party claims.

The amendments may not, however, bring an end to the prospect of collective action in this sphere. The Conservative shadow minister recently indicated that the removal of the collective action provisions would allow the new government to consult further on them and consider how any collective action procedure should be framed, and the Liberal Democrats indicated their support for the proposals during the earlier readings of the bill.

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NEW BRIBERY ACT PRESSURES COMPANIES TO TAKE ACTION

Just a few months ago the Bribery Bill received Royal Assent and has now been passed as the Bribery Act 2010 ("the Act"). It will come into force in October 2010 and will put tremendous pressure on companies to take all possible action to prevent bribery being perpetrated by introducing a new offence of corporate failure to prevent bribery; the first time such an offence has ever existed in the UK.

The new law is wide in its ambit: the new offence applies to a company wherever it may be registered or incorporated or wherever it conducts its main activities, as long as it carries on a business or part of its business in the UK. Even companies that are not UK-registered and do not have offices in the UK could face prosecution for failing to prevent bribery offences committed wholly outside the UK if they are trading or have operations here. Companies can also be charged with the new offence where a third party (associated person) gives a bribe with the aim of obtaining business or an advantage in the conduct of business for that company. The associated person doesn't need to have any formal relationship with the company, or be acting with the consent, or even the knowledge of the company. Company employees will be presumed to be associated persons and agents or subsidiaries can also be considered associated persons for the purposes of the Act.

What makes the offence of corporate failure even more concerning for businesses is the fact that it is one of strict liability, with a defence only being available if the company can show that it had put in place "adequate procedures" to prevent bribery. Statutory guidance is due to be issued on what exactly this phrase means and what it entails, but companies should be warned that, even if they have already adopted stringent policies in order to comply with the US Foreign Corrupt Practices Act ("FCPA"), they may still need to consider whether new compliance procedures will be necessary as, in many respects, the Act is more extensive and comprehensive than the FCPA, and generally addresses more forms of corruption (for example, unlike the FCPA, it contains no exception for facilitation payments).

Although the meaning of "adequate procedures" presumably will not become clear until shortly before the Act comes into force, it is important that companies do not wait too long before examining their internal compliance procedures to ensure that they do not fall foul of the new law.

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