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Challenging Times for CDO Trustees p. 16 >>
Third Party Consents in Project Financing Transactions p. 20 >>

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In This Issue

Welcome to the year-end issue of *International News* for 2007. In this edition, we focus on the many facets of the finance sector and how the whole landscape of financing is changing. We also look at a number of other subjects relevant to our clients and colleagues.

In our features section, David Levine and Jay Taylor look at how new regulations for import trade into the United States are starting to take shape. Although the full extent and nature of the new U.S. requirements are uncertain, they will likely be more restrictive than current rules and practices.

Staying in the United States, Andrew Kaizer and Kate Learoyd discuss the increasing prominence of The Foreign Corrupt Practices Act of 1977, which creates substantial reputation and economic risks for transnational business activities and cannot be ignored by any company with business activities in the United States.

Raquel Rodriguez outlines the opportunities offered by the U.S. state of Florida to innovation businesses and research and development facilities. For-profit and not-for-profit entities from all over the world are being invited to apply for U.S.$250 million of incentives to establish new business in the state.

Henry Christensen gives an international overview of the consultation paper issued by the Financial Action Task Force on Money Laundering (FATF) in June 2007. The paper suggests that financial institutions, as well as non-financial businesses and professionals, take risk into consideration when deciding how to comply with the FATF's Recommendations.

Moving on to China, John Huang and Kevin Qian take a look at the country's new Anti-Monopoly Law and discuss its implications for companies active in China.

William Yonge examines the EU Markets in Financial Instruments Directive (MiFID), which came into force in November 2007. MiFID should help transform the landscape for the trading of securities, give investors access to a greater number of trading venues and promote greater competition and efficiency.

Finally, Francesco Mattina looks at the increasing incidence of customs monitoring requests by intellectual property rights holders suspicious of goods entering or leaving Italy. Customs monitoring is proving to be an effective tool in the fight against counterfeiting in Italy.

We turn then to our Finance Focus. The last year has been one of the most volatile for the finance sector. The collapse of the subprime mortgage market in the United States had a substantial impact on the rest of the world. The European Central Bank's injection of U.S.$205 billion into the European financial markets may well have stanched the haemorrhaging, but it is likely that the immediate future will see an increase in the number of restructurings and workouts. However, in adversity comes opportunity, as Eric Reimer explains in his article on the contraction in the credit markets.

Steven Black and Kate Learoyd take a second look at the repercussions of the subprime mortgage crisis. Collateralised debt obligation (CDO) transactions have recently come under scrutiny as a result. Conflicts between participants have increased, and this has particular implications for CDO trustees.

Ted Laurenson and Lisa Avalos examine the U.S. Securities and Exchange Commission's "New Rule", which has implications for advisers to investors in pooled investment vehicles.

Andrea Tempestini examines how the treatment of non-Italian investment funds by Italian tax authorities is potentially in breach of the EU Treaty. There are a number of options for investors looking to place their money in a tax efficient fund and for anyone wishing to challenge the tax regime.

We then move on to project financings. Elliot Hinds reviews the issues surrounding third party consents. A project company that thoughtfully strategises and guides the consent process is likely to be rewarded with a smooth financial arrangement.

Finally, Andrew Watson and Kate Geraghty reveal that infrastructure finance in Europe is experiencing an unprecedented boom as the sector's stable cash flows attract investors and financiers. Further growth is predicted, but investors should be aware of several caveats and pitfalls.

If you have any comments on this issue or would like to contribute to *International News*, please contact me at dryder@mwe.com.

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The Future of Exporting to the United States: Potential New Restrictions

By **David Levine** and **Jay Taylor**

Tainted toothpaste, toys contaminated with lead paint and unwholesome seafood have heightened concerns over import safety in the United States. As legislators focus on protecting U.S. consumers, new regulations for import trade into the United States will soon start to take shape. U.S. businesses and their suppliers and foreign competitors should pay close attention to the ongoing debate and changing landscape of import regulation, and be aware of any potential restrictions that may affect their products. Though the full extent and nature of the new U.S. requirements are uncertain, they will likely be more restrictive than current rules and practices.

Only well-prepared businesses and industries will be positioned to understand the import safety debate, comment on it and quickly restructure their operations to comply with the new system, saving brand identity and valuable market share.

Two recent documents appear likely to influence the structure of the new U.S. import system. The first is a report commissioned by President George W. Bush on improving U.S. import safety, and the second is an import safety bill introduced by John Dingell, the chairman of the House Committee on Energy and Commerce.

The Report to the President

On 10 September 2007, the results of a blue ribbon panel examination of the U.S. import system were released in the Interagency Working Group on Import Safety's Report entitled "Protecting American Consumers Every Step of the Way: A Strategic Framework for Continual Improvement in Import Safety". If implemented, the recommendations of the report will affect foreign exporters to the United States as well as U.S. businesses that depend on imports.

Perhaps of greatest significance, the report proposes a systemic shift in the U.S. import safety regime, from a "snapshot" to a "video" approach. By this, the report's authors mean that importers and their foreign suppliers should be ready to switch from a system where imports are simply inspected at the port of entry (a "snapshot" approach) to a system that looks at the entire "import life cycle" of goods, from production through to sale (a "video" approach).

The practical impact of this change will be significant. Foreign suppliers and exporters will be tasked with developing adequate control systems and making sure, through testing and certification, that they are meeting the terms of their control systems.

U.S. Government oversight of this process is likely to be similar to that of the Hazard Analysis and Critical Control Point, or HACCP systems, currently employed in the U.S. poultry and beef industries. Implementation of these requirements across a complete supply chain could effectively make mandatory the security criteria for participation by U.S. importers in the currently voluntary Customs Trade Partnership Against Terrorism (C-TPAT) program.

The report makes several additional recommendations: more effective government (local, federal and foreign) intervention through risk-based inspection; stronger penalties for bad actors and more effective enforcement of product recalls; connecting the data silos to make sure that there is an effective flow and sharing of relevant information regarding imports between U.S. government agencies; and stronger protection of intellectual property rights and enhanced surveillance for counterfeit products. These last two recommendations are due to concern that harmful imports may enter the United States masquerading as legitimate products.

The Dingell Bill

The Food and Drug Import Safety Act of 2007, introduced by Congressman Dingell, proposes several additional processes for ensuring the safety of imported drugs and food.

The Dingell bill would create a user fee for all imported food and drug shipments. These fees, in turn, would be used to hire more inspectors and to increase analysis of imports by U.S. Food and Drug Administration (FDA) laboratories. In addition, the Dingell bill would grant the FDA mandatory recall authority, require country of origin labelling for imports and require that all food imports enter through ports located in metropolitan areas that have FDA testing laboratories. Further, the bill would prohibit any food imports not originating from a certified foreign facility or a certified country. "Certified" is meant as meeting U.S. standards. Finally, the bill would increase financial penalties for manufacturers and importers who violate the Federal Food, Drug and Cosmetic Act.

Trade Obligations Affecting New Import Measures

As the United States and its trading partners, including EU Member States, seek to strengthen import measures following recent import scares, they will need to ensure that new restrictions comply with their international trade obligations. Two World Trade Organization (WTO) agreements are especially relevant to the types of measures contemplated by the report and the Dingell bill. These are the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) and the WTO Agreement on Technical Barriers to Trade (TBT Agreement).

The SPS Agreement focuses on measures taken by WTO members to protect human, animal and plant life or health. Fundamental to the SPS Agreement are the requirements that measures such as import restrictions not be maintained without sufficient scientific evidence and be based on risk assessments, and be no more trade restrictive than necessary to achieve the importing country's appropriate level of protection. The TBT Agreement deals with technical regulations and standards, imposing on WTO members requirements that imported products be accorded treatment no less favourable than domestic products. Measures cannot be more trade restrictive than is necessary to achieve a legitimate objective, such as national security or the prevention of deceptive practices.

As the United States and its trading partners seek to strengthen import controls, legislators and regulators alike should take into account the multilateral obligations contained in the SPS and TBT Agreements. The rules of the SPS and TBT Agreements may be particularly relevant in the event that U.S. trading partners seek to retaliate in kind for enhanced import restrictions or denial of access to the U.S. market. It is conceivable that more stringent U.S. requirements will serve as a catalyst for heightened retaliatory restrictions among U.S. trading partners. Businesses with international trade should stay appraised of new trade restrictions and relevant developments at the WTO.

Preparations Measures

Businesses should start to prepare for a much higher level of U.S. import scrutiny. If they have not done so already, businesses should examine their production, distribution and sales models, highlight areas where potential risks exist and work to develop science and standard-based means to reduce that risk.

Businesses with integrated supply chains are likely to be the ultimate winners in the switch to a HACCP-style system of controls. Integrated businesses will be better equipped to impose and enforce requirements on suppliers, and will find a "video" approach less burdensome. Moreover, businesses geared toward supply chain security programs, such as C-TPAT in the United States or the Authorised Economic Operator program in the European Union, may find it easier to convert to whatever new requirements emerge. On the other hand, companies with no culture of supply chain security, or those that ship goods on a piecemeal or drop shipment basis, may find it difficult to establish the necessary measures to satisfy the impending changes to U.S. import safety requirements.

If you would like information on the practical recommendations published by the Interagency Working Group, please contact David Levine or Jay Taylor.

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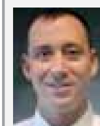

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The Global Impact of the U.S. Foreign Corrupt Practices Act

By **Andrew Kaizer** and **Kate Learoyd**

U.S.-related capital and business activities are increasingly being moved to foreign destinations, in pursuit of ever greater investment returns. Important and challenging regulatory risks, however, accompany those sought-after returns. The Foreign Corrupt Practices Act (FCPA) of 1977, although not new, has become prominent recently. It creates substantial reputation and economic risks for transnational business activities and cannot be ignored.

In April 2007, the U.S. Department of Justice (DOJ) and U.S. Securities and Exchange Commission (SEC) cases against Baker Hughes, Inc., a Texas-based oil field products and services company, set a new record in financial penalties. The company was ordered to pay penalties and disgorgement, *etc.*, exceeding U.S.$44 million. Beyond the penalties, however, Baker Hughes reportedly also spent more than U.S.$50 million on a five-year internal probe, with all the associated disruptions to its operations. It now has a compliance monitor and has replaced virtually every member of senior management involved with the conduct in question. The case is a lesson in the danger to both companies and individual executives that the FCPA now clearly represents.

FCPA, Then and Now

U.S. Congress enacted the FCPA in the wake of the Abscam bribery scandal 30 years ago, in order to criminalise and prevent the payment of bribes to foreign government officials. The FCPA was designed to enforce criminal violations through the DOJ, and civil regulatory violations (of mandatory corporate financial disclosures and internal controls) through the SEC. For years, other countries declined to follow this anti-corruption regime that the United States had unilaterally imposed on its own businesses (to their competitive disadvantage). Thus, the FCPA remained something of a legal backwater and was only sporadically enforced. This began to change in 1999. Following changes to the FCPA itself, the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Overseas Public Officials in International Business Transactions effectively prodded numerous other governments to enact their own anti-corruption laws, similar to the FCPA. This levelling of the anti-corruption playing field, along with the accelerating pace of global business transactions, has led to a recent and noteworthy spike in FCPA enforcement cases. During the past four years, there have been more FCPA enforcement actions than during the prior 26-year period since the FCPA's enactment.

"The FCPA goes beyond just criminalising corrupt payments; it has three arms that make it an effective anti-bribery tool."

The FCPA goes beyond just criminalising corrupt payments; it has three arms that make it an effective anti-bribery tool. First, the anti-bribery provisions prohibit bribery of foreign government officials with the aim of improperly securing business. Second, U.S. or foreign companies with securities traded publicly in the United States are required to keep financial records that accurately reflect their assets and transactions. This "books and records" provision may be violated even if no bribery is recorded in the accounts. The third arm requires issuers to maintain internal controls to prevent FCPA violations. The second and third arms create extensive obligations for companies and are the most frequently violated.

FCPA Impact Outside U.S. Borders

Among other things, the FCPA applies to issuers, defined to include foreign issuers that list their stock on a U.S. securities exchange and their officers, directors, employees or agents. Foreign companies that list American Depository Receipts on a U.S. stock exchange are thus caught by the FCPA. A large number of non-U.S. companies have listed U.S. securities; approximately 153 European companies are presently listed on the New York Stock Exchange alone. These "foreign issuers" and their personnel (which can include non-U.S. citizens and residents), are subject to the FCPA, even where there is no other territorial nexus to the United States. U.S. parent companies can be liable vicariously for FCPA violations by their foreign subsidiaries, agents and business partners, and turning a blind eye can lead to liability, even when the company has no direct knowledge of a violation. The accounting/internal controls provisions of the FCPA apply only to issuers, but, because the term "issuers" encompasses all companies with securities listed in the United States and their personnel, it is a wide group. Wholly owned foreign subsidiaries also must comply with the books and records provision.

Enforcement Against Non-U.S. Companies

In recent years, the DOJ has increased its enforcement efforts outside U.S. borders and appears increasingly willing to bring cases against foreign issuers. However, foreign corporations that are not issuers have also been prosecuted. In February 2007, three wholly owned subsidiaries of the UK-based Vetco International Limited pleaded guilty to violation of the anti-bribery provisions of the FCPA and were fined a total of U.S.$26 million. The DOJ commented, in relation to the earlier Vetco Gray prosecution, that the DOJ "will continue its efforts to assure a level playing field for businesses operating abroad".

Public Versus Private—Where Is the Line?

The anti-bribery provisions of the FCPA criminalise payments to foreign government officials, political party officials and candidates for public office. However, in some countries there is no sharp delineation between public officials and private companies or individuals. In China, for example, many large companies are state owned or controlled, and government officials play an active role in commerce. The difficulty of distinguishing "public" from "private" increases the risk that a payment or gift to an individual in connection with business may be regarded as a violation of the FCPA. Local cultural and legal knowledge are critical to avoiding such problems.

Cultural Differences

Transparency International's 2007 Corruption Perception Index suggests that corruption is perceived to be unacceptably tolerated amongst countries which are well established important trading partners for U.S. companies. Examples include Russia, Brazil, China and Saudi Arabia.

The supply side of corruption is also highly important. Traditionally, European businesses have been more tolerant of overseas bribery payments, which were legal and tax deductible in many European countries until relatively recently. The OECD's efforts notwithstanding, outdated attitudes may linger amongst employees who regard payments to overseas public officials as merely a cost of doing business. Re-education of business executives as to the new rules is critical to any effective compliance program.

> "U.S. parent companies can be liable vicariously for FCPA violations by their foreign subsidiaries, agents and business partners..."

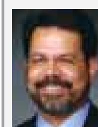
Avoiding Liability in M&A, Investments and Business Transactions

A careful assessment of potential FCPA violations and the robustness of internal accounting controls is now a critical part of due diligence before any acquisition, joint venture or equity investment involving transnational activities. Liability may arise from either acquiring a company with past violations, or by acquiring or joint-venturing with a company without an effective compliance program and which commits violations before the acquirer/partner can institute appropriate controls over the business.

Equity investors such as hedge funds, which may at times have no interest in company management, are also at risk. In July 2007, New York-based Omega Partners Inc. reached a criminal settlement arising from an investment in the privatisation of an Azerbaijani state-owned company. Omega's liability arose merely from the knowledge of one of its former employees that corruption was taking place. Omega agreed to a civil penalty of U.S.$500,000.

> "In recent years, the DOJ has increased its enforcement efforts outside U.S. borders and appears increasingly willing to bring cases against foreign issuers."

The FCPA should be considered in all equity investments, even of minority interests, although the degree of risk will vary depending on several factors. The key to avoiding liability is to identify and thoroughly understand potential weaknesses, immediately implement a robust and effective compliance program, and very carefully consider self-reporting where necessary.



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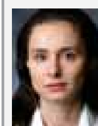

Kate Learoyd is a partner in the Firm's London Dispute Resolution Group. Kate's practice focuses on financial services litigation and contentious regulatory matters. She has particular experience with litigation issues arising from complex financial structures. Kate can be contacted on **+44 207 575 6998** or at **klearoyd@europe.mwe.com.**

Florida Offers Funding Opportunities for Research and Development

By Raquel Rodriguez

The U.S. state of Florida is a serious challenger for pre-eminence in life sciences and technology industries. Collectively, state and local entities have committed more than U.S.$1 billion to attracting research and development institutes to Florida. The state's economic development office is vetting several applications for this year's available funds of U.S.$250 million.

In 2003, former Florida Governor Jeb Bush set out to transform Florida's economy by convincing the Florida legislature to invest U.S.$310 million to attract The Scripps Research Institute. Palm Beach County committed more than U.S.$200 million to build a facility that, when completed in 2009, will house more than 500 scientists and staff.

> Collectively, state and local entities have committed more than U.S.$1 billion to attracting research and development institutes to Florida.

Building on this success, Florida created the Innovation Incentive Program to attract innovation business projects and high-value research and development. Qualifying entities include those engaged in basic and applied research in sciences or engineering, as well as the design, development and testing of prototypes or processes of new and improved products.

Both for-profit and not-for-profit entities may apply. Minimum qualifications differ, depending on whether the applicant is an innovation business or a research and development facility as defined in the enabling law. The funds are available regardless of whether the business is based outside the United States.

An innovation business means a business "that is likely to serve as a catalyst for the growth of an existing or emerging technology cluster, or will significantly impact the regional economy in which it is to expand or locate". An innovation business project must do the following:

- Create 1,000 new direct jobs, or 500 new jobs if it locates in a designated brownfield, enterprise zone or rural area
- Have an activity or a sector that is among those targeted by the state (*e.g.*, biotech, aerospace, corporate headquarters or high-tech)
- Have a cumulative investment (by the business) of at least U.S.$500 million within a five-year period, or exceeding U.S.$250 million within a 10-year period if in a designated brownfield, rural area or enterprise zone
- Be provided with a one-to-one match from the local community, either in U.S. dollars or donations in kind

A research and development facility means "a facility that is predominately engaged in research and development activities". To qualify, a research and development facility must do the following:

- Serve as a catalyst for an emerging or evolving technology cluster
- Demonstrate a plan for significant higher education collaboration
- Provide the state, at a minimum, with a break even return on investment within a 20-year period (measured in terms of taxes generated)
- Be provided with a one-to-one match from the local community (either in U.S. dollars or in kind)

In either case, the jobs created must pay an estimated annual wage (excluding benefits) equal to at least 130 per cent of the average private sector wage in the state or the county where it will be located. This requirement may be waived for a business locating in a designated brownfield, rural or enterprise zone.

> The funds are available regardless of whether the business is based outside the United States.

Funding decisions for the 2008-2009 budget began in December 2007, when the state's governor started to prepare budget recommendations to the legislature. The legislature will decide on funding levels during its 60-day legislative session, which begins on 4 March 2008. Businesses interested in obtaining funding can still apply to Enterprise Florida, the state's economic development arm, at any time. Although applications are already in the queue for the current year's appropriation, businesses that submit an application and identify local matching funds now will have an advantage for the 2008-2009 process and will also inform budget decision-makers that there is demand for the programme.

Raquel Rodriguez is a partner based in the Firm's Miami office. From 2002 to 2007, she was general counsel for former Florida Governor Jeb Bush and was the state's chief negotiator in the Scripps and Innovation Incentive Program agreements.
Her practice includes representing clients before Florida government agencies, including clients interested in accessing economic incentive funds.
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FATF Focuses on Risk-Based Approach

By **Henry Christensen**

The Financial Action Task Force on Money Laundering (FATF) is an inter-governmental body. Its purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. In 2007, China joined the FATF, bringing the number of member countries to 34. In June 2007, the FATF published a consultation paper in which it outlined the risk-based approach to combating money laundering.

In 1990, one year after it was formed, the FATF issued its Forty Recommendations to Combat Money Laundering. These were revised in 2003. The Revised Recommendations set out policies and procedures for countries, financial institutions and gatekeepers (lawyers, accountants, managers of financial institutions, *etc.*) to detect and combat money laundering. The Recommendations focus on transparency, knowing the customer and an obligation to report to government authorities any suspicion that a customer may be laundering money.

> "The risk-based approach should allow banks and others to focus their most intrusive inquiries on customers or transactions that they consider to pose the greatest risk of money laundering."

Recommendations 12 and 16 are of greatest concern to gatekeepers. Recommendation 12 imposes customer due diligence requirements: know your client, know where your client obtained its money, know the purpose of the transaction, know the ultimate beneficial owners and keep all this information in your records for at least five years. Recommendation 16 covers the circumstances in which a gatekeeper might be required to report a client to the authorities on suspicion of money laundering.

In its June consultation paper, the FATF identified the risk-based approach to combating money laundering as a combined effort by financial institutions and government authorities. These entities are advised to allocate their resources to the areas deemed to have the greatest risk of money laundering, rather than spreading their efforts equally across multiple areas. Importantly, Section 1.12 of the consultation paper recognises that one feature of a risk-based approach "will allow financial institutions to exercise reasonable business judgment with respect to their customers". The risk-based approach should allow banks and others to focus their most intrusive inquiries on customers or transactions that they consider to pose the greatest risk of money laundering. The June consultation paper suggests that non-financial businesses and professionals take risk into consideration when deciding how to comply with Recommendations 12 and 16.

At the same time, the FATF states that certain basic obligations can never be eliminated due to a perceived absence of risk. One example is the obligation to freeze assets belonging to individuals or entities suspected of money laundering (section 1.40). Another is that elementary customer due diligence must be undertaken in order to obtain a reasonable basis for deciding whether the risk of money laundering is low.

Factors that affect risk include the following:

- Country. Customers based in a country that doesn't comply with FATF Recommendations or is subject to UN sanctions, for example, are always high risk.
- Industry. Anyone in a cash-intensive business is deemed high risk, as are certain international businesses such as correspondent banking, international private banking and banknote, and precious metals delivery.

> "Customer due diligence must be undertaken in order to obtain a reasonable basis for deciding whether the risk of money laundering is low."

The risk-based approach is promising because it suggests practicality in trying to combat money laundering and a rational allocation of resources, rather than rote application of the same standards to all situations. As the FATF's influence extends to more countries, it is to be hoped that the risk of money laundering decreases exponentially.

Henry Christensen is head of the International Private Client Practice Group and is based in the Firm's New York office. He is also president-elect of the International Academy of Estate and Trust Law. As chairman of the International Estate Planning Committee of the American College of Trusts and Estates Counsel (ACTEC), Terry coordinated ACTEC's efforts to develop and report Recommendations of Good Practices to Combat Money Laundering. He advises individual clients and families and privately held companies throughout the world.
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China Passes Anti-Monopoly Law

By John Huang and Kevin Qian

On 30 August 2007, the National People's Congress, China's highest legislative body, passed the Anti-Monopoly Law (AML). The AML, which comes into effect on 1 August 2008, is an important milestone. It indicates that China, the fourth-largest economy in the world, has moved from being a planned economy to a market economy.

The AML covers the areas of monopoly agreements, abuse of dominant market position, market concentration by business carriers and abuse of administrative powers to restrict competition. The law also stipulates the process for investigating suspicious behaviour and the legal liability for anti-competitive actions. If a violator implements a monopoly agreement or abuses its dominant market position, it will face fines of up to 10 per cent of its annual sales and confiscation of all its illegal gains.

On 8 March 2007, the Ministry of Commerce issued the Guideline on Filing of Anti-Monopoly Notification Regarding the Takeover of Domestic Enterprise by Foreign Investor. The Guideline, along with the Provisions on Takeover of Domestic Enterprise by Foreign Investor that became effective 8 September 2006, sets forth procedures relating to the Chinese government's review of the effects of both international and domestic mergers and acquisitions. In other words, the Provisions affect not only merger and acquisition activities within China, but also those outside China involving a Chinese entity. Under the Guideline, the Ministry of Commerce has appointed the Anti-Monopoly Review Office to handle all competition-related matters.

The AML defines two types of monopoly agreements. The first is a monopoly agreement between competing business carriers—a horizontal monopoly agreement. The second is a monopoly agreement between the undertaking and certain transaction parties—a vertical monopoly agreement. Both horizontal and vertical monopoly agreements are deemed illegal and invalid upon investigation and recognition by the Anti-Monopoly Enforcement Agency. Generally, if an agreement meets the criteria of a horizontal monopoly agreement, it is considered invalid. This is due to its obviously illegal aim of eliminating or restricting the market competition. However, recognition of a vertical monopoly agreement will be reviewed and made on a case-by-case basis.

Compared to previous drafts of the AML, the version of the AML that was passed makes industry associations that organise and encourage anti-competitive behaviour by their members liable for those members' actions. Any industry association that engages in monopolistic conduct is liable for a fine of up to RMB500,000 and deregistration as a legal association. The background to this regulation is that many industry associations have led or organised several price-fixing cartels for various types of commodities. This had a serious impact on the market.

The AML establishes government authorities to govern monopolistic conduct. These authorities include the Anti-Monopoly Committee and the Anti-Monopoly Enforcement Agency. The Committee is a coordination and research organisation that drafts the national policy and framework of competition-related matters and resolves conflict among various agencies. The Anti-Monopoly Enforcement Agency is the main government authority in charge of daily anti-monopoly affairs.

The provisions in the AML are still very general and not very practical. Given that there are several months until the AML goes into effect, we can expect more specific anti-monopoly rules and regulations to be announced by Chinese authorities during this period.

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MiFID—Its Implementation and Consequences

By William Yonge

The EU Markets in Financial Instruments Directive (MiFID) came into force on 1 November 2007. The United Kingdom, Ireland and Romania were the only Member States to transpose the Directive on time, by 31 January 2007. The following Member States missed the 1 November deadline: Czech Republic, Estonia, Finland, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovenia and Spain.

In a major development under MiFID, EU Member States can no longer require investment firms to route orders only to stock exchanges. This exposes exchanges to competition from the following:

- Multilateral trading facilities, *i.e.*, non-exchange trading platforms (witness the birth of Chi-X and Project Turquoise)
- Systematic internalisers, *i.e.*, banks or investment firms that systematically execute client orders internally on their own account (rather than via exchanges)

> "The list of passportable services and investments has been extended to include investment advice and non-financial derivatives, respectively."

Similar pre- and post-trade transparency requirements will apply across the playing field. This should help transform the landscape for the trading of securities, give investors access to a greater number of trading venues and promote greater competition and efficiency.

MiFID also updates the "single passport" for investment firms, first introduced by the Investment Services Directive (ISD) in 1995. The list of passportable services and investments has been extended to include investment advice and non-financial derivatives such as commodity derivatives, respectively. Entities covered by MiFID will include investment banks, portfolio managers, stockbrokers, corporate finance firms, many futures and options firms, and some commodities firms. Venture capital firms that operate funds and/or provide services exclusively intra-group will likely not be covered.

> "Under MiFID, investor protection rules are strengthened and harmonised at a high level."

Using the single passport, investment firms incorporated and regulated in an EU Member State will be able to establish branches and offer cross-border services in other Member States without having to satisfy local registration requirements in a wider range of cases than under the ISD. MiFID clarifies some of the jurisdictional uncertainties under ISD by delineating the allocation of responsibility between home State and host State.

To ensure a smooth transition from ISD to MiFID, existing ISD passports were recognised as MiFID passports from 1 November 2007. However, MiFID does not provide for a transitional regime in the event of late transposition by either host or home state, or both. The Committee of European Securities Regulators has recently issued guidance in this regard, suggesting that certain MiFID rights might have "direct effect" so as to prevail over any conflicting national law. The Committee has also cited the obligation of Member States and their national authorities to give effect to rights envisaged by a non-transposed directive once the transposition deadline has expired (indirect effect) as best they can.

Under MiFID, investor protection rules are strengthened and harmonised at a high level so that investors can feel confident using the services of investment firms, regardless of where in the European Union they originate. The main areas are as follows:

- Conduct of business requirements for firms, *e.g.*, client classification (eligible counterparty, professional and retail), their obligations towards each category of client, their obligation to assess whether the products and services they provide are suitable or appropriate for their client, and to secure best execution for their clients (*i.e.*, the best possible result with the emphasis on best price for retail investors)
- Organisational requirements for firms and markets, *e.g.*, compliance, risk, internal audit, management of conflicts of interest and limitations on outsourcing, especially outsourcing to non-EU countries
- Transaction reporting
- Transparency requirements for the trading of shares

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Customs Monitoring Programs in Italy

By **Francesco Mattina**

The Italian Customs Agency (the agency) is the body in Italy responsible for taking action against counterfeit goods or those suspected of infringing intellectual property rights (IPR) in relation to Council Regulation (EC) No. 1383 of 22 July 2003 (the basic regulation).

The agency exercises its power of intervention when goods suspected of IPR infringement are released into free circulation, are imported or exported, or are discovered during an investigation or dawn raid on goods entering or exiting the European Union. The temporary suspension from free movement within the European Economic Area (EEA) of such goods is an increasingly popular and cost-effective device to prevent infringing goods from entering the EEA.

> "Customs officers may also ask the right holder to provide them with any kind of useful information they may need to confirm their suspicions regarding the infringing goods."

Applications for Customs Monitoring

According to Article 4 of the basic regulation, the agency may exercise its power of intervention *ex officio* or on the basis of a submission by the IPR holder of an application for a custom monitoring action by the customs authorities.

Right holders, authorised persons or a representative of the right holder may file an application for customs monitoring. The right holder may act to request customs monitoring of trademarks, copyright or related rights, industrial designs, patents and utility models, supplementary protection certificates, plant variety rights, protected designation of origin and protected geographical indications.

An application for intervention by the agency could protect EU and national IPR, or international rights within the European Union. Whatever the aim, the application should contain an accurate description of the goods, any specific information regarding the supposed infringement (such as country of origin and route of the goods), the details of the contact person appointed by the right holder and the applicant's declaration referred to under Article 6 of the basic

regulation to assume civil liability for any possible damages that might be caused to any third parties affected by the actions of customs.

Should the application be limited to Italian trade marks only, the right holder should include a copy of the trade mark registration issued by the Italian Patent and Trademark Office or a copy of the application filed at the time of the trade mark registration. In the case of a Community Trade Mark (CTM), the right holder should file a copy of the CTM registration certificate. The holder of an international trade mark should enclose the copy of the international registration certificate issued by the World Intellectual Property Organization.

"The temporary suspension from free movement within the EEA of such goods is an increasingly popular and cost-effective device to prevent infringing goods from entering the EEA."

The right holder also must file evidence of the registration or deposit of the IPR issued by the relevant authority. With regard to copyright and related rights, or non-deposited or registered design rights (such as the Community non-registered designs), evidence of the authorship should be provided. The holder of a plant variety right must submit a certificate issued by the relevant Community Plant Variety Office or by the relevant national authority. Finally, with regards to protected appellations of origin and protected geographical indications, it must be proved that the applicant is the manufacturer or the controlling association thereof, and that the appellation or indication has been registered. The same rule applies to wines and spirits.

Where the applicant is the owner of a CTM, a Community design, a Community plant variety right or a Community protection of an appellation of origin or geographical indication, the application may seek not only the intervention of the national custom authority of the Member State where it was submitted, but also that of the customs authorities of other Member States (a Community application). In this case, the applicant must nominate the States that it would like included and the details of the contact persons in each of those States.

According to Article 8 of the basic regulation, both the national and Community applications for custom monitoring are valid up to a maximum of one year and can be extended. In the case of Community applications, the applicant should forward any relevant documentation to the customs authorities of the Member States that practice custom monitoring.

Detention and Suspension of Free Movement

Even if the right holder has not filed an application for customs monitoring action, if the customs offices have sufficient grounds for suspecting that certain goods infringe an IPR, they may still detain the consignment. This detention is a "suspensive procedure" under Article 84 (1) (a) of the Community Customs Code. The suspected goods can be held for a period of three working days, a period which commences once the IPR holder and the holder of the goods (if known) are notified. This enables the IPR holder to submit an application for custom monitoring. Customs offices may also ask the right holder to provide them with any kind of useful information they may need to confirm their suspicions regarding the infringing goods. If the right holder does not answer this request for information, the suspected goods are released for free circulation.

Both the right holder and the declaring party or holder of the goods are informed of the detention of the goods suspected of infringing the IPR and are requested to appoint an expert to examine them. Following a request by the right holder, the customs officers may take samples of the goods suspected of infringement for analysis in specialised laboratories.

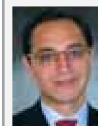
The suspension of the goods, or their detainment, may last 10 working days as of the date of notification. For perishable goods, the detention or suspension period is limited to three working days without any possibility of extension. In the case of goods suspected of infringing industrial design, patents, plant variety rights or supplementary protection certificates, the owner of the goods, the importer or the consignee may obtain the release of the goods on provision of a security, provided that all customs formalities have been carried out and the customs authority has been notified of the commencement of a judicial procedure to ascertain whether IPR has been infringed. Should a criminal prosecution arise out of the investigation, the customs office must inform the judicial authority.

FALSTAFF

In order to make the customs authorities' power of intervention more effective, the agency has initiated the Fully Automated Logical System Against Forgery and Fraud (FALSTAFF). This initiative is intended to implement an information system to manage the selection of goods to be controlled and provide support to customs officers while performing a control operation. Required information will be provided by the relevant trader associations, and right holders will provide information in relation to the infringement of goods.

FALSTAFF will become part of the Italian Customs Information System, AIDA. AIDA involves the automation of more than 400 customs offices in Italy.

Once the FALSTAFF system becomes effective, the applications for customs monitoring will be submitted via electronic data interchange in accordance with the provisions governing the conditions and technical procedures for applications. The system will also allow the management of customs and excise operations, and offer an e-learning system and knowledge base for training purposes.



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Adventures in Acquisition Finance

By Eric Reimer

As more financial buyers have entered the mergers and acquisitions market and auctions have become more prevalent in the sales of companies, financing of acquisitions—primarily the conditions associated with the closing of the financing—has become a focus for sellers and an important component of the competitive process. A seller with fewer conditions associated with its financing has a significant advantage in the auction process.

Prior to the summer 2007 contraction in the credit markets, significant closing conditions had virtually been eliminated from financing commitments. It was a sellers' market for the sellers of companies and a buyers' market for the private equity funds seeking financing for their transactions.

With the collapse of the subprime mortgage market and the collateral damage to the financing markets as a whole, this situation changed, leaving three types of transactions in the market: i) fully underwritten and pre-syndicated deals that contractually had to close; ii) fully committed deals that were not yet syndicated, where lenders were faced with syndicating loans below par; and iii) transactions that had not yet been underwritten, leaving buyers desperately in need of funds to close the deal.

> Pricing in the sales of companies has also been adversely affected as a result of fewer buyers in the market, fewer lenders willing to fund transactions and a higher cost of funds.

In the first instance, there was substantial pressure to close quickly and avoid any risk of a material adverse change or other event that could derail the closing. Sellers were benefiting from substantial up-ticks in price based on the number of buyers in the market, buyers were benefiting from excellent pricing and favourable covenant packages, and lenders were eager to close fully syndicated transactions.

In the second instance, in many cases substantial renegotiations have taken place, including sale price, interest rates, leverage, equity participation and capital structure. Some buyers have been able to obtain a substantial reduction in the cost of the acquisition, while some lenders have been able to require a more significant level of equity, better pricing and additional levels to the capital structure.

> Clearly the contraction in the financial markets created uncertainty in the financing of transactions. However, as is often the case, with uncertainty comes opportunity.

In the last instance, many deals simply did not close because of inability to obtain funding, and for deals that did find funding sources, the conditions, covenants, leverage and pricing were similar to those seen prior to the heated acquisition market of two years ago. Pricing in the sales of companies has also been adversely affected as a result of fewer buyers in the market, fewer lenders willing to fund transactions and a higher cost of funds.

Even with the contraction in the financial markets, there are many remnants of the prior frothiness. Buyers are even more focused on the ability of the seller to obtain its financing and close, with commitment letters still being parsed by both the buyer and seller. In addition, borrowers, sometimes feeling burned in connection with prior deals that failed to close or that were repriced or restructured, are focusing even more on locking in their lenders.

Clearly the contraction in the financial markets created uncertainty in the financing of transactions. However, as is often the case, with uncertainty comes opportunity. The lack of easy financing has put downward price pressure on a number of sellers. Transactions that were caught midstream, with a need for a more creative capital structure, can present well-priced opportunities. In addition, the requirement of a healthier capital structure with more debt below the first-tier lenders is providing opportunities for mezzanine lenders, equity players and other alternate sources of funds. At the end of the day, private equity funds still need to invest funds, lenders still need to book loans and each continues to seek the solid transactions still in the market. As before, the terms and conditions of the financing of those transactions will remain a key component of each transaction.

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The SEC's New Anti-Fraud Rule

By **Ted Laurenson** and **Lisa Avalos**

On 10 September 2007, the U.S. Securities and Exchange Commission (SEC) adopted Rule 206(4)-8 (the New Rule) under the Investment Advisers Act of 1940 (the Advisers Act). The New Rule prohibits fraud against investors active in pooled investment vehicles.

The New Rule was adopted in response to the *Goldstein v SEC* decision, which invalidated the SEC's attempt to require the registration of most hedge fund managers. The decision contained language that the SEC felt created ambiguity concerning its power to bring enforcement actions against investment advisers for defrauding investors in pooled vehicles. The New Rule draws upon the full scope of the SEC's rulemaking authority under Section 206(4) of the Advisers Act and establishes two prohibitions. The first is that an investment adviser to a pooled vehicle cannot make materially false or misleading statements (including omissions) to investors or prospective investors. The second is that the adviser cannot otherwise engage in a fraudulent, deceptive or manipulative act or course of business "with respect to" investors or prospective investors in pooled vehicles.

> "The New Rule prohibits fraudulent activities with respect to both investors and prospective investors."

The Scope of the New Rule

The New Rule applies to all investment advisers—whether or not registered under the Advisers Act—to "pooled investment vehicles" that have U.S. investors. Pooled investment vehicles are investment companies as defined in the Investment Company Act of 1940 (and must be SEC registered) as well as entities that are not investment companies by virtue of the "private investment company" exemptions from that definition (hedge, private equity and venture capital funds, and other privately offered pools that invest in securities).

The New Rule prohibits fraudulent activities with respect to both investors and prospective investors. Advisers must exercise care with regard to placement-related materials (prospectuses and other solicitation materials) and activities, which are already generally covered by other anti-fraud provisions. They also must be cautious regarding communications with, and actions affecting, existing investors.

New Rule Prohibitions

Among other things, the New Rule's prohibitions relate to statements regarding the following:

- A pooled vehicle's investment strategies and policies
- The experience and credentials of the adviser and its personnel
- The risks associated with an investment in the pool
- The valuation of the pool or investor accounts in it
- Administrative, brokerage and dealing practices, and conflicts of interest (such as allocation of investment opportunities, selection of brokers and counterparties, custody and expense allocation)

The New Rule's prohibitions of fraudulent, deceptive or manipulative acts or "courses of business" could potentially cover a wide variety of dishonourable activities.

Other Aspects of the New Rule

The New Rule does not impose filing or recordkeeping requirements and may be enforced only by the SEC; it does not create a private right of action. It does not create new fiduciary duties for pooled vehicle investors, nor does it alter any other duty or obligation of advisers.

In the SEC's controversial view, judicial precedent supports the conclusion that certain practices may constitute a fraudulent, deceptive or manipulative "course of business" without requiring the knowledge or reckless wrongdoing that has traditionally been required under the anti-fraud provisions of the U.S. securities laws.

Recommendations

Although the New Rule may not substantially increase the duties of pooled vehicle advisers to investors or prospective investors, unregistered advisers in particular should take care. All investment advisers should review their communications, operating procedures and codes of conduct, and seek to ensure that they have adequate controls in place to secure both accurate communications and management practices that meet the highest standards.

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Challenging Times for CDO Trustees

By **Steven Black** and **Kate Learoyd**

Collateralised debt obligation (CDO) transactions have recently come under scrutiny as a result of the subprime mortgage crisis. This is because many, although not all, CDO transactions invest in residential mortgages. The U.S. Securities and Exchange Commission (SEC) confirmed in June 2007 that it had begun more than a dozen inquiries into CDO transactions, and there have also been reports of litigation between parties in relation to underperforming CDO transactions. An unreported effect of current market conditions will be increased pressure upon those who act as trustees to the CDO transactions.

CDOs can appear complex even to sophisticated investors. However, at the heart of the structure is a relatively simple relationship whereby an issuing vehicle (the issuer) holds assets and grants security over itself and such assets to a trustee (the trustee) that represents the interests of investors (the noteholders) in the structure.

> "The trustee of a CDO has the difficult task of dealing with the competing interests inherent in the layers of notes."

CDOs pool assets and issue notes supported by the income from those assets. The pool of assets spreads the risk borne by the investors. Fundamentally, however, the structure cannot remove risk, because the CDO is reliant for its performance on the underlying assets. The notes are often layered, with each layer bearing a separate level of risk. Another area of complexity is the number of entities charged with the management of the deal. Each undertakes tasks such as portfolio management, cash payments and numerous other subsidiary roles.

The trustee of a CDO has the difficult task of dealing with the competing interests inherent in the layers of notes. Care must be taken to ensure each participant obtains its due reward. In circumstances where the assets perform well, the underlying contracts are usually sufficient to provide a road map for the deal. Difficult and unforeseen market conditions can, however, give rise to conflicts or situations not expressly dealt with in the contracts.

Competing Interests of Different Classes of Notes

A key feature of CDOs is the layering of the notes, with the highest layer receiving interest payments first, and each layer then being paid in turn. Investors in the different layers of the CDO can often have very different interests. Typically, the trustee will be required to take instructions from the highest class of noteholders and

prioritise higher classes in the event of any conflict of interest. On occasion, however, the documents will provide that the trustee needs to look towards the subordinated noteholders. This is only fair because the subordinated noteholders suffer the first loss if any debt in the portfolio defaults.

Interpretation of the Contracts

The contracts inevitably come under scrutiny when the collateral is underperforming or an unforeseen event occurs. Where there is an uncertainty about the meaning of any contract terms, a senior noteholder may advocate an interpretation which favours its interests, whilst the junior noteholders may have an opposing view. In these circumstances, the trustee cannot favour the contractual interpretation put forward by the senior class even if there are provisions stating it must favour their interests. The trustee must determine which interpretation is legally correct. A court would find that there is only one right answer, and if the trustee chooses the "wrong" interpretation, it may be exposed to the claim that it has allowed a breach of contract to occur.

In circumstances where there is a disputed interpretation, the trustee can protect itself by applying to the courts for a declaration as to the meaning of the applicable provision. The trustee is well advised to ask the court to rule on the correct meaning, because otherwise the trustee can be exposed to a claim for breach of trust.

Claims by the Trustee

The daily management of any CDO is entrusted to numerous contracting parties who manage particular functions. Typically they contract with both the issuer and trustee.

Where a CDO underperforms, investors may seek to blame past decisions on contracting parties such as the portfolio manager. Investors do not have any contractual relationship with entities such as the portfolio manager and may therefore request the trustee to commence litigation to recover damages on behalf of the noteholders.

In these circumstances, the trustee will need to consider the merits of potential litigation. The trustee may face a difficult decision, with some noteholders demanding litigation and others worried that trust assets will be dissipated by litigation costs. The trustee can protect itself by applying to court for a declaration as to whether the litigation should be pursued.

Liability and Indemnification of Trustee

The trustee is not responsible for the performance of the CDO. Only upon enforcement of the security will the trustee take over the issuer's role and take direct responsibility for the relationship with entities such as cash managers and portfolio managers who run the day-to-day activities of the CDO. A properly advised trustee will only assume such a role upon receipt of appropriate indemnities, to which it will often be entitled as a matter of law quite apart from any provision in the trust instrument.

> "... if the trustee chooses the "wrong" interpretation, it may be exposed to the claim that it has allowed a breach of contract to occur."

Finally, it should be noted that the trustee's liability is invariably limited to negligence and wilful default. This is a prudent level of protection given the number of moving parts in the structure and the possibility of a default occasioned by the failure of another party to perform.

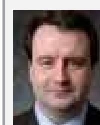
Amendments to the Contracts

The contracts of CDO transactions are frequently amended during the life of the transaction. The diversified portfolio and the complex payment mechanism mean that careful administration is required to ensure each noteholder receives its entitlement. This appears to be a mechanical role, but the complexity and diversity of debt instruments have significantly increased over the past few years, and often an administrator is called upon to make complex judgments. It is, of course, the responsibility of the lawyers who put together the CDO to set clear guidelines for the administrators, but despite careful execution, the debt markets continue to change, and new products or unforeseen circumstances emerge that need to be dealt with in the structure.

CDOs typically allow amendments to occur where the rating agencies and the trustee give their consent. In exercising its discretion to amend the contract, the trustee has a fiduciary duty to the noteholders to consider their interests. The trustee is not entitled to simply rely upon the opinion of the administrator that the amendment should take place. The trustee must exercise its own judgment.

Conclusion

Current market conditions can create conflict between participants in CDOs, and it is likely that the role of the trustee will become more difficult as a result. Seeking the guidance of the court affords the trustee protection when it comes to interpreting contracts or embarking on a course of action. Recently, the administrator in respect of Cheyne Finance's Structured Investment Vehicle (SIV) sought the court's guidance on an insolvency test. SIVs are similar in some respects to CDOs, and there are parallels to be drawn here. The issue at stake with regard to the insolvency was crucial, and the court's decision led to a halt in payments on the vehicle's short-term debt. Trustees should take comfort in knowing that the option of receiving guidance from the court is open to them.



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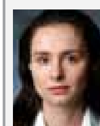

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Italian Tax Treatment of Non-Italian Investment Funds

By **Andrea Tempestini**

One of the issues in the area of finance that most frequently comes to the attention of Italian tax practitioners relates to the tax treatment of non-Italian investment funds—in particular, Non-Harmonised Funds (NHFs) that are not in conformity with EU Directive 85/611.

For an Italy-resident individual, most of the relevant income is included in his or her ordinarily taxable income and is subject to the ordinary progressive tax rates that go up to 43 per cent for income in excess of €75,000, plus local taxes. More precisely, income subject to the progressive taxation is equal to the proceeds distributed by the NHF and the sums received by the individual upon sale or redemption of the quotas, corresponding to the increase in the net asset value of the funds in the period of ownership. Other income in excess of this is taxed at the 12.5 per cent rate and any loss can be offset against income of a similar nature. On the other hand, the same resident individual would be subject to a significantly lower flat taxation of 12.5 per cent with respect to most other incomes, including those relating to certain foreign but harmonised investment funds.

Alternative Structures

Because of their different qualification for tax purposes, other financial instruments (carrying a yield which mirrors in whole or in part that of an underlying NHF) have access to the 12.5 per cent flat rate of tax ordinarily provided under Italian legislation. This therefore allows a significantly more advantageous tax treatment in the hands of an Italian individual investor than in relation to a direct investment in an NHF.

Such instruments should be carefully reviewed on a case-by-case basis before their implementation in order to assess (i) any possible tax inefficiencies that may affect the structure and therefore eliminate or significantly reduce the relevant tax potential, and (ii) the risk of possible challenges by the Italian Tax Authorities based on the current anti-avoidance provisions or certain anti-abuse doctrines. The Italian Tax Authorities are devoting increasing attention to the area of finance, especially in a cross-border context.

The most common structures are Italian fund of fund investments in quotas of NHF, unit linked/index linked insurance policies and structured bonds (see table).

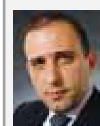
Possible Breach of the EU Treaty and Potential Remedies

The treatment of NHFs, when compared to other investments of a similar nature, may be reasonably viewed to be in contrast with the EU principles of the freedom of establishment and the free movement of capital. In fact, the regime makes the tax treatment of returns on investments contingent upon the fact that they relate to an NHF or other type of fund eligible for the 12.5 per cent flat taxation. As a result, an Italian individual is heavily influenced by this tax factor in his or her choice of investment and is "forced" to prefer other types of investments or channel the purchase of NHF quotas through more efficient structures. The taxation rules for NHFs seem not to have any rationale other than that of dissuading investors from purchasing the NHF, thus giving rise to a significant distortion of the market and/or competitive advantages for some operators.

All these considerations offer a reasonable ground for claiming a breach of the EU Treaty by the Italian tax rules on NHF, at least in the case of EU-based NHFs. Suitable routes for pursuing this claim are either (i) a formal submission of the case to the European Commission asking to open an infringement procedure against Italy, or (ii) the filing of a tax refund request, followed, in the case of a denial, by litigation (and, if the Italian Judge so wishes, by the submission of the case to the European Court of Justice). Professional investors and private bankers, typically involved in the management of investment portfolios on behalf of individuals, should seriously consider such a course of action.

Announced Reform

Although there is no formal evidence of any specific intervention in this area, it is to be hoped that the current discrimination of NHFs could be removed by the legislator as part of the announced reform of the Financial Income, effective as of 1 January 2008. The reforms would mainly be targeted at rationalising the rules of taxation and increasing the relevant flat rate from 12.5 per cent to 19 or 20 per cent.



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	Italian Fund of Funds	Insurance Policies	Structured Bonds
General Features	Italian investment fund investing all or part of its funds in the purchase of quotas of NHF	Insurance policies providing a return linked to that of a certain portfolio, including NHFs Typical insurance features to be structured in a flexible way	Bonds issued by, *e.g.*, an Italian Bank that has • A fixed minimal yield (optional) • An aleatory yield linked to that of certain funds (including NHFs) that may be purchased by the bank • Maturity longer than 18 months • Lack of bondholder management rights • Unconditional obligation to repay the principal
NHF Income Tax Treatment	Levy of a 12.5 per cent final tax at source No additional taxation at the level of the Italian Fund No additional taxation at the level of the Italian individual	Neutrality at the level of the insurance company, apart from the income earned on the transaction Final taxation in the hands of the individual at the 12.5 per cent rate	Issuer: see below Income on the bonds subject to 12.5 per cent final taxation in the hands of the individual (deferral of aleatory yield until realisation)
Issues	Taxation at source of the NHF's income prevents the set-off of losses accrued by the Fund on other investment. Appropriate planning may then be required.	Any loss in the value of the NHF (and subsequently in the insurance policy) is not deductible in the hands of the Italian individual. Losses realised by the individual on the direct investment in NHF, on the other hand, would be deductible.	Room for structuring the transaction in a tax neutral way for the issuer. However, certain implications of the International Accounting Standards (IAS/IFRS) must be carefully considered. Protection of the interests of the issuer (in case of loss in the underlying NHF) through stop loss or buy-back clauses is possible under certain conditions.

Third Party Consents in Project Financing Transactions

By **Elliot Hinds**

In a typical project financing, important project counterparties, such as the power purchaser; fuel supplier; landlord; or Engineering, Procurement, Construction (EPC) contractor, are asked to sign a consent and agreement with the project's lenders. These agreements often address weighty commercial issues. Understanding the inherent tensions in these agreements and having the tools available to manage them can be invaluable for achieving satisfactory resolution.

Common Project Consent Issues

Extended cure periods, standstill obligations and a broad ability to assign the project entity's assets in a foreclosure scenario are the most common subjects addressed in project consents. The consent also should clearly describe which of the project entity's obligations must be satisfied in order for the project counterparty to continue performing or recognise a third party transferee. When determining an acceptable cure period, the project counterparty should consider that it may be required to continue performing under the project agreement, even though the payments it receives may be irregular or incomplete during the cure period.

Lenders regularly refuse to assume liabilities for the project other than past-due scheduled contract payments and liabilities incurred after the lender exercises its enforcement remedies. Therefore, the project counterparty's only recourse for payment of liabilities incurred before the lenders step in may be to seek recourse against the defaulted project, which may then be in bankruptcy. There are variants on how to allocate this risk, and that allocation generally occurs in the consent.

Assignment restrictions are prominent and detailed in project agreements, as most project counterparties insist on controlling the identity of their business partners. Depending on the circumstances, counterparties may insist on retaining consent rights over transfers or require a potential transferee to satisfy requirements of minimum creditworthiness, operational competence or competitive status. Of the three most common requirements imposed on transferees, competitor restrictions might be the most difficult, especially in projects that are unique because of their location, technology, fuel supply or other attributes. Competitor restrictions are most common in "inside the fence" type projects where the project counter-party wants to protect against com-petitors operating "in its backyard". However, not wanting to unnecessarily limit the pool of potential purchasers should there be a foreclosure, lenders

insist upon a specific objective definition of competitor. Their appetite for competitor restrictions will be inversely proportionate to the number of likely purchasers of the project. In any case, defining "competitor" can be very challenging, particularly in today's markets where acquisitions and disposals have become commonplace.

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In the eyes of the lenders, the counterparty's desire to control its business partners presents an uncomfortable limitation on the lenders' attempts to be in a position to obtain the highest price for the project assets in a foreclosure or other liquidation scenario. Lenders want everyone involved in the project to view a foreclosure as an undesirable method of last resort, as they are likely to receive only a fraction of the total fair market value of the project. Therefore, at the project financing stage, the counterparties must engage in a discussion with the lenders about the assignability of the project and their particular concerns about marketability of the project in a distressed sale scenario. Furthermore, lenders typically try to protect themselves against the sponsor of a troubled project gaining an opportunity to benefit from, or unduly affect, decisions on how the lenders can recover their lost investment.

Sponsors with Dual Roles as Key Third Parties

The landlord, EPC contractor, customer or other project counterparty with a key contractual relationship with the project always has legitimate commercial issues to protect. This is no different when the project sponsor is also the project counterparty. But the project sponsor that serves in this dual role presents both a benefit and a challenge to the lenders. On the positive side, a sponsor will naturally be more strongly incentivised than a disinterested counterparty to exercise patience, relax its commercial goals and otherwise extend itself if these efforts will support the project. On the other hand, the sponsor is in the unique position of affecting the project and could allow its commercial considerations to influence the decisions it makes on behalf of the project. The lenders' goal should be to use the consent to strike the appropriate balance between the sponsor's legitimate commercial interests as a project counterparty and the interests of the project.

Most sponsor-counterparties are successful in obtaining cure periods and standstill provisions that are within the norm for project consents. However, by virtue of the sponsor's relationship with the project, they are commonly on the higher side of the range. Sponsor-counterparties tend to experience difficulty obtaining shorter cure periods, for example, because the lenders want to incentivise the sponsor to use available avenues to cure the project company's default rather than relying on punitive tools.

As discussed above, the parties may be unable to arrive at mutually acceptable definitions of competitor or operational competence that the transferee must satisfy. This challenge in relation to transferability can be overcome by granting the sponsor-counterparty purchase or early termination rights.

Lenders accepting purchase rights typically require that they apply to a buyout of the entire project, rather than the specific contract, because the project assets are worth much more as a whole than separately. Of the purchase structures, lenders tend to favour a right of first offer (where the lender can propose a purchase price to the sponsor-counterparty even without having received an outside offer) rather than right of first refusal (which contemplates an outside offer). The right of first offer is favoured because it enables the lender to conduct an auction more freely, or enter into negotiations with a third party, without the looming risk that the sponsor-counterparty may step in after the sale has been negotiated, as is the case with the right of first refusal. A sponsor-counterparty that wants to prevent competitive or other sensitive information about its contracts or the project from becoming widely available also might prefer the right of first offer.

An early termination right would allow the sponsor-counterparty to terminate the key project contracts that it does not want to be transferred, while allowing the lender to retain and transfer to outsiders other project contracts and assets that may have independent value. However, the main challenges with the selective termination right are that from a practical perspective, most project assets are worth far less independently than they are as a package, and calculating a price for the terminated contracts can pose a significant challenge.

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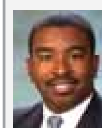
Conclusion

Although typically addressed in the later stages of the financing process and relegated to less experienced business persons and lawyers, consents often contain important issues that, especially in the case of the sponsor-counterparty, should be addressed with considered respect for the underlying commercial issues. A project company that carefully strategises and guides the consent process is likely to be rewarded with a smooth financial closing rather than one that is contentious and extended.



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Opportunities and Pitfalls in European PPP

By **Andrew Watson** and **Kate Geraghty**

Infrastructure finance in Europe is experiencing an unprecedented boom as the sector's stable cash flows attract investors and financiers. Further growth is predicted as European countries construct facilities to meet renewable energy targets and upgrade transport and social infrastructure. Central and Eastern Europe (CEE) and the Balkans region expect significant growth for infrastructure financing as their governments seek to redress years of under-investment in transport, utilities, schools and hospitals. There is a huge need for funding, and many countries have chosen to establish public-private partnership (PPP) initiatives to support development.

The Current Position

The various countries of the CEE and Balkans region are at different stages of maturity in relation to PPPs. For example, Greece is building on its experience with projects such as the Attiki Odos toll road PPP. In 2001, the government launched a €7 billion nationwide PPP programme to build new motorways and upgrade existing motorways to EU standards. To date, financing documentation has been signed for six projects under that programme, with financial close being achieved on the first (the Thessaloniki Submerged Tunnel) in August 2007. In 2005, the Greek Parliament passed legislation known as the PPP Law, setting the framework for future smaller scale Greek PPPs.

The PPP market in many countries, however, is not so well-developed. Romania, for example, has little experience of successful PPPs. Over the past 10 years, the Romanian government has abandoned three separate attempts to build new roads by PPPs, and confidence among potential investors is low. However, Romania has now joined the European Union, and the Romanian Government has created a new body to promote PPPs. It has announced that more than half of its 1,300 kilometres of planned new motorways will be built by PPP.

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Issues

Given that many CEE and Balkans PPP markets are still developing, there are various potential pitfalls for players, including the following:

- High political risk levels
- Uncertain or unsophisticated legal frameworks
- Compliance with local and EU procurement laws and directives, including those related to State aid
- Quirks of local law, *e.g.*, implied warranties and interest rate caps
- Inexperienced local professionals and conceding authorities
- Requirements of multilateral institutions such as the European Investment Bank and the European Bank for Reconstruction and Development
- Local resistance to paying tolls

Issues such as these are time consuming and add to the complexity of any PPP.

The Way Forward

Despite the additional risks for investors and financiers and the various difficulties along the road to maturity of a project, for many investors and international banks already involved in the CEE and Balkans region the economic rewards have proven more than worthwhile. With a multitude of new infrastructure projects and PPP programmes planned across the CEE and Balkans, there are opportunities for potential players who have patience, know-how and the benefit of experienced advisers to help navigate past the potential pitfalls.

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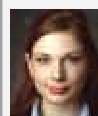

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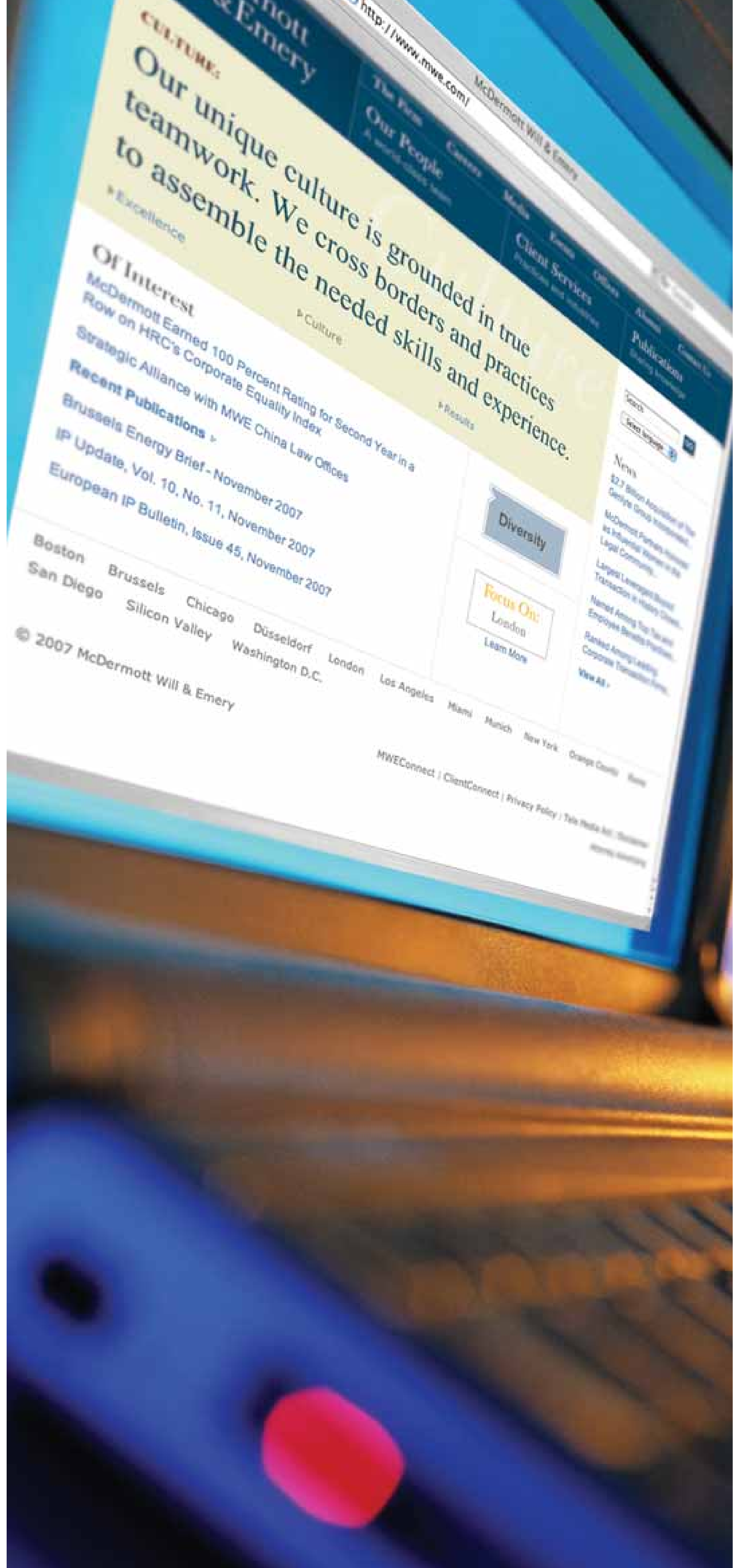

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