BLB&G Bernstein Litowitz Berger & Grossmann LLP

The Advocate European Supplement
Fall 2010
FOR INSTITUTIONAL INVESTORS

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Share Buybacks in Sweden

Protecting Minority Shareholders

By Peter Rudman

Share buybacks — the repurchase by a company of certain of its shares — are often described as a simple and flexible way of changing a company's capital structure, and a reasonable and effective way to return capital to the owners. When a company repurchases its shares, the number of shares held by the public is reduced, which after subsequent withdrawal can lead to an improvement in certain key ratios, such as earnings per share. This method of returning capital to owners is not without problems, however, and minority owners in particular must be on guard to protect their interests.

At a minimum, a board should always clarify that, at any point in time, the lowest-priced shares should be purchased on the stock market and that buybacks will not negatively affect owners. Otherwise, boards should abstain from buybacks because there are more suitable methods of returning capital to owners. For example, methods such as dividends or redemption of shares (which normally occurs when a company divides its shares to create a redemption share to be redeemed for a set price as well as an ordinary share that will continue to trade) are preferable alternatives to share buybacks as a means of returning capital to owners. These methods are preferable because shareholders are treated equally by receiving their share of the capital in direct proportion to the number of shares they own, leaving the ownership structure unchanged (depending how redemption rights, if any, are exercised). Redemption and dividends appear particularly advantageous when companies have two classes of shares listed with the same financial rights.

The Risks Of Share Buybacks

Internationally, buybacks have long been in use, and are an accepted method in many markets, but have not always been seen as uncontroversial. Among other things, buyback proposals have

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LEGISLATIVE/REGULATORY AND JUDICIAL UPDATES AND DEVELOPMENTS OF INTEREST TO EUROPEAN INVESTORS

By Katherine Sinderson

U.K. Auditing Industry Reviewed and Found Wanting

Too many audits of U.K.-listed companies are deficient, according to the country's independent regulator of audit quality. The Audit Inspection Unit, part of the Financial Reporting Council, said that 11 percent of the audits it looked at in its 2009/10 review needed "significant improvement," a proportion it said was "too high." There were two main reasons why audits were judged to be unsatisfactory: There wasn't enough evidence to support key audit judgments, and the audit firm signed off on its report before all the audit work had been finished. The regulator said a disproportionate number of the audits it looked at from smaller accounting firms needed significant improvement (six out of 11), causing it to conclude: "Certain firms are undertaking listed or other public interest audits without having the necessary resources and expertise." It suggested that there should be a new "competency test" applied to firms that want to audit listed companies.

>> http://www.frc.org.uk/images/uploaded/documents/AIU%20Annual%20Report%202009-10%20Final1.pdf

U.K. Regulators See Increased Involvement of Organized Crime in Financial Fraud

In the U.K., the Financial Services Authority is now working closely with the Serious Organised Crime Agency (SOCA) following evidence that organized criminals are becoming increasingly involved in financial frauds, such as insider trading. Criminal groups view insider trading as lucrative and, despite increased enforcement by the FSA in the last years or so, low risk. Paul Evans, SOCA's Director of Intervention, stated that law enforcement agencies are looking closely at people such as bankers and lawyers who may be the "facilitators" of links between the worlds of finance and organized crime. "There are people with Janus personalities," he said. "They face the public and they look compliant. But they face the criminals and they look useful."

>> Financial Times, August 17, 2010.

E.U. Temporarily Allows Member Nations to Share Audit Firm Oversight with US Regulators

The European Commission has finally allowed national audit oversight bodies to share intelligence with their U.S. counterparts, but only on a trial basis. The Commission shut U.S. audit regulators out of a deal reached with other countries last September because they would not agree to share their working papers in return. In the European Union, audit firms are regulated by the oversight body in their home nation; regulators in the other nations where the firm does business rely on the quality of that supervision. They only ask for working paper access in "exceptional cases," the Commission said. The U.S. still doesn't support that approach, the Commission said in a statement explaining its change of heart, but is "moving toward it." In the meantime, a "temporary solution" was needed. The Commission will let national oversight bodies share papers with their U.S. counterparts, but only for the next three years. It will then "reassess the situation."

>> http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1083&format=HTML&aged=0&language=EN&guiLanguage=en

Financial Services Authority Fines Goldman Sachs

The U.K. Financial Services Authority has fined the London arm of investment bank Goldman Sachs £17.5 million ($27 million) for a breach of its rules. The regulator penalized Goldman Sachs International (GSI) because it failed to tell it that the U.S. Securities and Exchange Commission was investigating GSI's involvement in a sub-prime mortgage product. The U.S. firm knew about the investigation, but did not inform their compliance colleagues in London, who would have been obliged to tell the FSA. "No one [in the United States or the United Kingdom] considered the potential regulatory implications of the SEC investigation," the FSA said.

>> http://www.fsa.gov.uk/pubs/final/goldman_sachs_int.pdf

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been formulated to facilitate substantial purchases, to a much larger extent than the current limitation in Sweden of 10 percent of the total number of shares. Share buybacks have also been used as a protective measure in the event of takeover situations. In addition, buybacks bring the risk of insider purchases, improper manipulation of the share price, disputes over the company's management remuneration programmes, and purchases being made at high prices.

Share buybacks have become a common and accepted method of returning capital to shareholders. Buybacks, however, can be problematic in Sweden due to the Swedish system of "A" and "B" shares and the concentrated ownership structure. To avoid the risk of suffering negative consequences, minority owners must carefully evaluate buyback proposals at general meetings.

Special Concerns In Sweden

Aside from cost considerations, the effects of buybacks on voting rights and the market for the remaining shares held by other shareholders must also be considered. With respect to voting rights and ownership structure, the Swedish stock market differs from others, especially from the Anglo-Saxon markets. Companies in these markets are often characterised by diffuse ownership structures, whereas ownership in the Swedish market is often more highly concentrated. Moreover, listed companies in the United States and the United Kingdom generally have only one share class, while almost half of the listed companies in Sweden have two share classes (Class A and Class B) with differentiated voting rights. Several Swedish companies have both share classes listed, with each class trading, resulting in potential price variations. Depending on how the mandate is used, share buybacks can significantly affect corporate ownership structure and voting rights. Controlling owners may come to strengthen their positions of power in connection with buybacks on a stock exchange without having to purchase a single share. Such a change in ownership structure can in itself lead to a lower valuation of the minority's shares.

In addition, buybacks of a particular class of share can reduce the market interest for the remaining outstanding shares of that class. If these shares are traded less frequently, and thus are less liquid, this may also lead to lower market prices for shares of that class. These unique conditions in the Swedish markets must be considered when determining the proper method to return capital to ownership, in order to avoid the risk of adversely affecting minority owners.

Protecting Investors' Rights

Earlier this year, following a changed EU directive, a memorandum from the Swedish Ministry of Justice proposed that listed Swedish companies should have more extensive opportunities for buybacks. With this in mind, it could be more important than ever for minority owners to investigate board proposals for buybacks to make sure that they are not negatively affected.

Companies seldom explain why buybacks have been chosen over other methods for returning capital to shareholders. If board proposals are unclear, we at Nordea Investment Funds consider it proper practice to conduct follow up — through dialogue and/or taking action at general meetings. This occurred recently in connection with Atlas Copco's annual general meeting. Nordea Investment Funds voted against the proposal about buybacks of its listed class A and class B shares, where the purpose was to be able to adjust the capital structure, as it was not made clear that the company at all times should purchase the lowest-priced shares.

All board members have a great responsibility when it comes to proposing suitable methods for returning capital, and likewise in formulating proposals that are beneficial to all of the company's shareholders. The costs related to adjusting the capital structure should be minimised. Moreover, any board considering a buyback proposal must consider the effect of such a buyback on voting rights. In addition, buybacks should not be conducted in a manner that would provide for "A" and "B" shares to be purchased at different prices, as there are other methods that afford equal treatment to shareholders in connection with returning capital such as dividends and share redemptions.

Peter Rudman is Director of Corporate Governance at Nordea Investment Funds. This guest commentary was derived from an article published by the Swedish magazine Balans *(6-7 2010).*

Webcast Series for Institutional Investors

Register at www.blbglaw.com/webcasts

Wednesday, January 26, 2011 2pm EST

A Survey of the RMBS Litigation

The fallout from the collapse of the U.S. housing market is far from over. Institutional investors worldwide have suffered losses on purchases of toxic residential mortgage-backed securities (RMBS) and collateralized debt obligations (CDOs) that were, in many cases, sold by Wall Street investment banks based upon false and misleading disclosures. These alleged securities law violations have already resulted in a wave of investor litigation in state and federal courts throughout the country.

Our webcast program will dissect the RMBS litigation landscape, addressing the origination and securitization process, the litigation claims and defenses in these cases, the litigation scorecard thus far, and the potential exposure for the banks. The discussion will feature a panel of experts deeply versed in this area, including Senior industry analyst **Joshua Rosner**, who has advised regulators and institutional investors on housing and mortgage finance issues; litigator **Talcott Franklin**, the author of the *Mortgage and Asset Backed Securities Litigation Handbook*, who has handled myriad cases related to the sale and securitization of commercial, franchise, and residential mortgage loans; BLB&G partner and moderator **Jerry Silk**, who is representing numerous institutional investors in RMBS related actions; and a noted defense attorney who is advising and representing investment banks and originators in these litigations.

Join us for a discussion of the issues facing RMBS investors and their legal implications.

Panelists include: Talcott Franklin, Esq., Principal, Talcott Franklin P.C., and
Joshua Rosner, Managing Director, Graham Fisher & Co.

Moderator: Jerry Silk, Esq., Partner, Bernstein Litowitz Berger & Grossmann LLP

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