Memorandum

To Our Friends and Clients

New French Code of Conduct on Conflicts of Interest in the Field of Investment Research

On September 27, 2004, the French Association of Investment Firms (“AFEI”) and the French Banking Federation (“FBF”) jointly presented a “Code of Conduct on Managing Conflicts of Interest in the Field of Investment Research” (the “Code of Conduct”). The Code of Conduct is binding on the 129 investment firms and 500 banks belonging respectively to the FBF and AFEI networks. N. Y. Attorney General Elliot Spitzer’s investigation of conflicts of interest involving research analysts at US investment banks in 2001 has triggered a proliferation of rules, standards and codes in this field in France and elsewhere. The new Code of Conduct will supplement the French rules.

According to Michel Pédereau, chairman of the BNP Paribas and of the Investment Banking and Market Committee responsible for drafting the Code of Conduct, French investment banking practices have been “neither contested nor contestable,” as in his view French investment firms have not been subject to the types of conflicts of interests faced by US investment firms. The Code of Conduct’s stated objective is to draw “the attention of all interested parties, most notably investors, to the principles developed and applied by investment firms and credit institutions in France”. The Code of Conduct follows closely upon a January 12, 2004 decision of the Paris Commercial Court holding Morgan Stanley liable for 30 million in damages for issuing unfavorable analyst coverage of LVMH while simultaneously providing investment banking services to Gucci, during a hostile tender offer by LVMH for Gucci.

The Code of Conduct, which consists of 34 principles (the “Principles”), aims to identify and prevent conflicts of interests between analysts and bank sales operations. The Code of Conduct does not impose any new restrictions, but reiterates existing rules promulgated by
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The French Market Authority (the “AMF Rules”)¹ while anticipating the implementation into French law of the European Directive on Market Abuse (the “Directive”), ² which will impose an additional set of rules in the same field. The Directive was scheduled to take effect in all EU Member States on October 12, 2004 but implementing legislation has not yet been introduced in France.

The Code of Conduct defines the duties of analysts, compliance officers, and supervisors in dealing with potential conflicts of interest. The AMF requires that investment banks appoint supervisory analysts to monitor the dissemination of information among a bank's research department, transactional teams, and sales force. The Principles are analogous to equivalent NASD and NYSE rules (the “New York Rules”) prohibiting investment banking personnel from supervising analysts or approving research reports, and requiring a firm's compliance department to act as intermediary for communications between researchers and other bank divisions.³

Several of the Principles aim to eliminate incentives that could encourage biased research, including, in particular, a prohibition against linking analyst compensation to the success of investment banking deals. While the Principles follow the general framework of the AMF Rules, they do not go as far as the New York Rules in separating research analyst compensation from investment banking influence.⁴ For instance, the Principles do not require, as do the New York rules, that research analysts' compensation be approved by a special committee reporting to the firm's Board of Directors or a senior executive. Similarly, investment banking personnel are not explicitly barred from seeking to influence the compensation evaluation of research analysts.

The Code of Conduct, following the pattern of the AMF Rules, prohibits research analysts from dealing in the securities of companies covered in their research reports, as well as securities of companies operating in the industry in which they specialize. The restriction imposed by this principle is more stringent than analogous New York Rules, which in

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¹ CMF Decision No 2002-01 regarding investment research by investment services firms. The AMF (successor to the CMF) proposes to integrate CMF Decision No 2002-01 to its new draft General Regulations, until further comprehensive reform of the industry takes place. See also French Financial Security Act (Loi de sécurité financière), dated August 1, 2003.
³ See NYSE Rule 472(b)(1) and (3), and NASD Rule 2711(b)(1) and (3) ("gatekeeper" provisions).
⁴ See NYSE Rule 472(h) and NASD Rule 2711(d).
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genral, only prevent analysts (and their families) from (i) purchasing or receiving an issuer’s securities prior to an IPO, if the company engages in a type of business covered by the analyst, and (ii) trading securities issued by companies the analyst has followed, for the period beginning 30 days prior to the issuance of a research report and ending five days after publication of the report.

The Principles also clarify the AMF Rules governing sharing of information across “Chinese walls.” Such sharing is permitted only with the consent and under the direction of the compliance officer and a supervisory analyst, and when required for the successful completion of a specific deal. The compliance officer must inform the analyst of any breach and prevent him from publishing further research until expressly authorized to do so by the compliance officer and the supervisory analyst.

Participation by analysts in efforts to solicit investment banking transactions, such as through road shows or deal pitches, are subject to procedures established by the compliance officer. The AMF Rules on this topic are vague, and the Principles also stop short of flatly prohibiting analysts’ participation in pitches for investment banking business, as the latest set of amendments to the New York Rules effectively did in the US.5

As is the case under the Sarbanes-Oxley Act of 2002 (“SOA”),6 the Code of Conduct imposes quiet periods during which investment firms participating in a securities offering may not publish or otherwise distribute research reports related to securities. Unlike the New York Rules, however the Code of Conduct does not set out time limits for these quiet periods.7

The Code of Conduct sets out in an annex mandatory disclosures that must be included in research documents in the event of a conflict of interest. The annex reproduces the language of the Directive and may be modified when the Directive is implemented into French law. The Code of Conduct does not include some of the more stringent disclosure

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5 See NYSE Rule 472(b)(5) and NASD Rule 2711(c)(4)
7 See NYSE Rule 472(f) and NASD Rule 2711(f) imposing ten and forty-day quiet periods for the issuance of written research reports and communications in public appearances by managers and co-managers of initial and secondary offerings; and a 25-day quiet period during which broker-dealers who have agreed to participate (or who are participating) as underwriters or dealers (other than a manager or co-manager) of an issuer’s initial public offering are prohibited from publishing research reports and analysts are prohibiting from making public appearances regarding that issuer.
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requirements imposed by the AMF Rules, such as the obligation to provide notice if research coverage of a regularly covered issuer is discontinued, or the requirement to maintain coverage of an issuer for a reasonable time following its IPO, if the coverage was initiated at the time of the IPO. 8

Whether an earnest attempt to improve market practices or a marketing tool to improve the image of investment firms in France, the Principles will at a minimum remind French investment banks of the inherent hazards lurking in the field of analysts’ research. Nonetheless, if the recent ruling of the Paris Commercial Court in the Morgan Stanley case is upheld on appeal, subsequent versions of the Code of Conduct will need to aim higher than a mere compilation of existing law in order for French investment banking practices to remain “neither contested nor contestable.”

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8 See Articles 9 and 10 of CMF Decision No 2002-01.
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