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Briefing note
July 2011

Corporate Update

Welcome to our latest edition of Corporate Update, which provides a round-up of developments in company law and corporate finance regulation over the last six months.

Companies cannot have failed to miss the 1 July 2011 deadline for implementation of the new Bribery Act. Following the publication in March of the Ministry of Justice's final Guidance on anti-bribery compliance procedures, many companies will have spent the last few months examining and refining their internal and external policies on anti-bribery to ensure that they have adequate procedures in place to prevent bribery within their organisation.

On the regulatory front, we examine the decision of the FSA to fine JJB Sports £445,000 for its failures to keep the market properly informed about the true cost of two acquisitions it had made in breach of DTR2.2, and a recent ruling of the Upper Tribunal in the **Massey** case, where the Tribunal was asked to review a decision of the FSA finding Mr David Massey guilty of market abuse. These two decisions raise concerns for both issuers and their advisers as they indicate a potential shift in the FSA's view of how issuers should approach the question of whether information is "inside information" which should be released to the market. See the "Regulatory Update" section for further information.

This year has also seen the first successful prosecution of a company for corporate manslaughter. However, given the defendant was a small company run by a sole director, the scope of the corporate manslaughter legislation, which can result in an unlimited fine for any company convicted under it, has not really been tested. The Crown Prosecution Service has indicated that there are a number of prosecutions involving larger companies with more complex management structures in the offing which are likely to give us a better idea of how the legislation will apply to such organisations.

The above topics and a host of other recent corporate developments relevant to companies and their advisers are examined in this Corporate Update.

Contents

1. Company Law Update 2
2. Corporate Governance Update 10
3. Regulatory Update 18
4. Antitrust Update 23

> "Sources say: 'Clifford Chance is outstanding for corporate work. The network is very expedient and we have had consistently great experiences with the M&A teams throughout Europe.'"
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Company Law Update

Bribery Act finally comes into force

As we go to print, the long awaited Bribery Act 2010 finally comes into force, replacing existing corruption law and opening the door for aggressive criminal enforcement action against UK and overseas corporates involved in bribery. The implementation date of 1 July 2011 was fixed by the publication in March 2011 of Ministry of Justice final guidance to companies on anti-bribery compliance procedures ("**Guidance**"). In our January 2011 Corporate Update, we analysed the draft of this Guidance published for consultation by the Government back in September 2010.

Consideration of the final Guidance is essential for commercial organisations that want to maintain a defence to the new corporate criminal offence under the Bribery Act of failing to prevent bribery. Joint guidance by the Director of the Serious Fraud Office and the Director of Public Prosecutions has also been published ("**Joint Prosecutors' Guidance**").

Offence of failing to prevent bribery

Under section 7 of the Bribery Act, commercial organisations may commit an offence if they fail to prevent persons associated with them committing bribery on their behalf. It is a defence for the organisation to show that it has in place adequate procedures to prevent such bribery. The Guidance, *'Guidance about procedures which relevant commercial organisations can put in place to prevent persons associated with them from bribing (Section 9 of the Bribery Act 2010)'* is intended to inform companies' efforts in this regard.

The final Guidance has corrected some issues of scope presented by the previous draft guidance, and provides additional clarity in some areas. While the purport of the Guidance remains broadly similar, there are also some differences of tone, particularly in relation to corporate hospitality and facilitation payments, where a slightly softer approach is discernible. It also lays greater stress on proportionality, recognising, for example, that, in lower risk situations, commercial organisations may decide that there is "no need to conduct much in the way of due diligence".

The Guidance will be essential reading for anyone tasked with implementing anti-bribery procedures. Although "departure from the suggested procedures … will not of itself give rise to a presumption that an organisation does not have adequate procedures", prosecutors and courts will inevitably look at how corporate procedures stack up in relation to the principles outlined in the Guidance.

The Joint Prosecutors' Guidance offers an additional layer of colour by identifying the factors English prosecutors will take into account in deciding whether to prosecute in circumstances where they have decided there is sufficient evidence to justify a prosecution. It mitigates the severity of the Act by clarifying that conduct that is technically an offence may not always be prosecuted.

> "The final Guidance has … some differences of tone, particularly in relation to corporate hospitality and facilitation payments, where a slightly softer approach is discernible."

Even companies which have procedures in place designed to comply with the US Foreign Corrupt Practices Act (**FCPA**) will want to review these procedures and consider whether they need to be enhanced to address the wider scope of the Bribery Act, for example in relation to facilitation payments, private sector bribery and promotional expenditure.

Some of the key areas addressed by the Guidance include the following:

When is an organisation carrying on business in the UK?

The section 7 offence (failing to prevent bribery) only applies to a commercial organisation which "carries on a business, or part of a business, in any part of the United Kingdom". The Government's view is that charitable, educational and public sector entities will all come within the scope of the offence, if they engage in commercial activities. The Guidance also confirms indications given verbally during the public consultation that a listing on the Official List of the UK Listing Authority would not of itself mean the company was caught by section 7. Similarly, it confirms that

> "Being able to tackle the corrupt foreign company is a high priority...to create a level playing field in terms of competition, so [UK] companies can go out and do business and get business without being met by corruption."
>
> **Richard Alderman, Head of the Serious Fraud Office, May 2011**

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"having a UK subsidiary will not, in itself, mean that a parent company is carrying on a business in the UK, since a subsidiary may act independently of its parent or other group companies". This is certainly helpful though a reference in the Guidance to the courts as the final arbiter may fail to give companies the complete assurance they would like.

Joint ventures, investments and liability for third parties

The Guidance also makes it clear that a company will only be liable for the acts of persons "associated" with it. Employees will be presumed to be associated persons. The Guidance confirms that contractors, sub-contractors, suppliers, joint venture partners or a joint venture entity could all potentially be associated persons, but clarifies that where a joint venture entity pays a bribe, the members of the joint venture will not be liable "simply by virtue of them benefiting indirectly from the bribe through their investment in or ownership of the joint venture".

Where the joint venture is being conducted through a contractual arrangement and an employee of another participant in the joint venture pays a bribe, it will not necessarily be assumed that the bribe was intended to gain an advantage for any party other than the participant employing that individual.

A bribe on behalf of a subsidiary by one of its employees or agents will not automatically involve liability on the part of its parent company, or any other subsidiaries of the parent company, if it cannot be shown the employee or agent intended to obtain or retain business or a business advantage of a parent company or other subsidiaries – even where the parent company or subsidiaries may benefit indirectly from the bribe.

The Guidance gives examples which, it says, will fall outside the scope of section 6 (bribery of a foreign public official): including reasonable hospitality when meeting with senior executives in New York, such as fine dining or attendance at a baseball match.

Corporate hospitality

Gifts and hospitality to private sector individuals, and to UK public officials, will only be an offence where there is some element of impropriety, e.g. an intention to influence the recipient improperly. Gifts and hospitality to foreign public officials remain problematic because this offence does not include any element of impropriety.

> "The guidance … clarifies that where a joint venture entity pays a bribe, the members of the joint venture will not be liable "simply by virtue of them benefiting indirectly from the bribe through their investment in or ownership of the joint venture"."

However, the Guidance recognises that the section 6 offence (bribery of a foreign public official) has been drafted very broadly, and says "it is not the Government's intention to criminalise behaviour where no such mischief [i.e. some form of improper performance] occurs, but merely to formulate the offence to take account of the evidential difficulties".

It stresses that the prosecution must show a sufficient connection between the advantage and the intention to influence and secure business or a business advantage, and says "the more lavish the hospitality or the higher the expenditure in relation to travel, accommodation or other similar business expenditure provided to a foreign public official, then, generally, the greater the inference that it is intended to influence the official to grant business or a business advantage in return". Adhering to market practice or business sector norms will not, it specifies, be sufficient.

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The Guidance gives other examples which, it says, will fall outside the scope of section 6:

- A UK mining company providing "reasonable travel and accommodation to allow foreign public officials to visit their distant mining operations so that those officials may be satisfied of the high standard and safety of the company's installations and operating systems".
- "Flights and accommodation to allow foreign public officials to meet with senior executives of a UK commercial organisation in New York as a matter of genuine mutual convenience, and some reasonable hospitality for the individual and his or her partner, such as fine dining and attendance at a baseball match." This, the Guidance says, would be unlikely to be caught by section 6, unless there was another, less expensive, venue which would have been more convenient.
- "[O]rdinary travel and lodgings to enable a visit [by a foreign public official] to a hospital run by the commercial organisation" in order to provide information on the "organisation's background, track record and expertise in providing private healthcare".

The Guidance repeats the statement in the draft guidance that in some circumstances hospitality to a foreign public official may not amount to "a financial or other advantage" to the relevant official because it is "a cost that would otherwise be borne by the relevant foreign Government rather than the official him or herself". This seems at odds with the text of the section 6 offence which says that the advantage may be given to another person (in the example given the other person would be the government) rather than directly to the official.

On the other hand a five-star holiday unrelated to a demonstration of the organisation's services is "far more likely" to raise the inference that it was offered with the intention of influencing the official to grant business or a business advantage in return.

On closer reading, the comforting statement that the prosecutor will need to show that hospitality was intended to influence the foreign public official (section 6) or to induce improper conduct (section 1) is undermined by the references to prosecutors considering whether these matters can be inferred (for example, from the lavishness of hospitality).

Facilitation payments

Facilitation payments are payments for expediting routine government actions, such as obtaining permits or licences, or for something that the recipient of the bribe is required to do by law or contract. The Guidance continues to describe facilitation payments as "small bribes" and says that "exemptions in this context create artificial distinctions that are difficult to enforce …".

Nevertheless, the line the Guidance takes is slightly softer than in the draft guidance and the Government recognises "the problems that commercial organisations face in some parts of the world and in certain sectors". The Guidance refers readers to the Joint Prosecutors' Guidance which sets out the factors a prosecutor will take into account when deciding whether or not to prosecute facilitation payments. A prosecution is more likely where there are large or repeated payments, where facilitation payments are "planned for or accepted as part of a standard way of conducting business" and where "a commercial organisation has a clear and appropriate policy setting out procedures an individual should follow if facilitation payments are requested and these have not been correctly followed".

A Case Study (not officially part of the Guidance) sets out a number of steps a business should consider in dealing with hidden or overt facilitation payments. These include:

- building in extra time in project planning to cover potential delays as a result of non-payment;
- questioning the legitimacy of the payments;
- raising the matter with superior officials and/or the UK embassy; and
- the use of UK diplomatic channels or participating in "locally active non-governmental organisations" to apply pressure on the relevant governmental authorities.

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The position under the Bribery Act, where facilitation payments are expressly prohibited is stricter than under the FCPA where an exception exists for small scale payments. This emphasises the need for companies with anti-corruption programmes designed to ensure compliance with the FCPA to review their existing procedures in light of the introduction of the Bribery Act.

Offsets/community advantages

The Guidance is not helpful on the position of offsets or community advantages where there is no specific provision for these in the relevant written local law. Where there is no such local law, the Guidance says "prosecutors will consider the public interest in prosecuting. This will provide an appropriate backstop in circumstances where the evidence suggests that the offer of additional investment is a legitimate part of a tender exercise". Very few would regard providing free medical help, or other community services in developing (or developed) countries as a criminal enterprise, yet UK companies (and others within the scope of the Bribery Act) will now have the added headache of being forced to check whether there is a "written law" requiring or permitting such advantages to be given.

Public procurement

The Guidance makes no reference to the issue of whether a conviction for the corporate offence of failing to prevent bribery will lead to an automatic debarment from public procurement contracts. The Joint Prosecutors' Guidance, however, states that the section 7 corporate offence "is not a substantive bribery offence", which suggests that it would not automatically lead to debarment (this may, however, depend on agreement amongst EU member states).

Action points for companies: the importance of relevant compliance diligence

Many companies have already spent a significant amount of time examining and refining their internal and external policies on anti-bribery to ensure that they have "adequate procedures" in place to prevent bribery within their organisation.

Given the risk of liability for the acts of persons "associated" with them, companies should ensure that they conduct relevant due diligence before entering into new relationships with consultants, agents, and other third parties. This might include checking the reputation of the third party, through public information and reference checks, examining their payment and commission arrangements, checking whether government officials have any direct or indirect beneficial interest, or relevant relationship with, the third party, and the third party's past compliance with anti-bribery and other relevant laws.

On any potential acquisition or investment by a company, an appropriate level of due diligence will need to be undertaken to identify pre-transaction breaches of the Bribery Act or other laws. By way of example, a buyer will want to examine the scope and robustness of a target's existing anti-corruption policies and their implementation and enforcement, along with details of any historic and current corruption issues. Where a target operates in a "red flag" jurisdiction or sector where corruption is a serious risk, a greater focus should be placed on pre-transaction compliance diligence in order to identify and mitigate any risk of liability for pre-transaction violations. Where corruption issues are identified, the buyer and its advisers will need to consider whether sufficient contractual protection can be obtained from the seller and/or the target entity in the acquisition documentation. In addition, consideration will also need to be given to whether new anti-corruption practices and procedures will need to be implemented by the target post completion.

Editor comment: Whether the Guidance has been genuinely helpful for commercial organisations in formulating their internal and external policies and procedures to prevent bribery remains open to debate. Now that Bribery Act has come into force, it is inevitable that there will be teething problems. Given the vagueness of some of the concepts introduced by the Act, companies are likely to err on the side of caution in their dealings and practices. Whether case law develops quickly remains to be seen. Initially at least, it is possible that prosecutions, particularly for the section 7 offence of failing to prevent bribery by non-UK companies, will only be undertaken in circumstances where the prosecutors are highly confident of securing a successful outcome.

Further reading

Clifford Chance has prepared a series of briefings regarding the new Bribery Act. See the back page of this Update for details of how to access our publications.

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First corporate manslaughter conviction

In February 2011, Cotswold Geotechnical Holdings became the first company to be convicted of corporate manslaughter under the Corporate Manslaughter and Corporate Homicide Act 2007 (the "**Act**").

When is an offence committed under the Act?

The Act came into force in April 2008, replacing the common law offence of manslaughter by gross negligence for companies and other organisations. Under the Act, an offence is committed if the way in which the organisation is managed or organised by senior management causes a person's death and amounts to a gross breach of a relevant duty of care owed by the organisation to the deceased (e.g. the duty to provide a safe place of work). A company can face an unlimited fine. It can also be required to publicise the fact that it has been convicted, particulars of the offence and the amount of the fine and may be required to take steps to remedy the related management failure.

Company failings

This case followed the death of one of the company's employees who was killed while taking soil samples from a pit which was under excavation. The prosecution's case was that the company's systems had failed to take all reasonably practicable steps to protect the employee from its unsafe system of work in digging trial pits that were unnecessarily dangerous. Mr Eaton, the sole director, and his employees regularly entered pits that did not comply with industry guidance. The company repeatedly ignored well-recognised industry guidance and, at the time of the employee's death, the company had left him unsupervised on site. To secure the conviction under the Act, the prosecution needed to demonstrate that:

- the company's conduct caused the employee's death and amounted to a gross breach of a relevant duty of care owed to the employee (s.1(1)); and
- a substantial element of the breach was in the way the organisation's senior management managed or organised its activities (s.1(3)).

The jury returned a guilty verdict. The judge acknowledged the guidance issued by the Sentencing Guidelines Council which says that generally a fine for this offence should be no less than £500,000 (but may be unlimited). However, taking into account the "parlous nature" of the company's financial position, the fine imposed was £385,000 payable over 10 years. Nevertheless, the company will now likely be forced into liquidation.

Editor comment: The successful prosecution of Cotswolds Geotechnical Holdings demonstrates the importance for businesses to have a health and safety culture and to ensure that everyone takes responsibility for improving health and safety. However, in view of the fact that this case involved a small company run by a sole director, it does not test the scope of the Act and the extent of the fines. The Act will be tested when a significantly larger company with a complex management structure is prosecuted. The Crown Prosecution Service has said that a number of such prosecutions are in the pipeline.

Kay Review of the effect of the UK equity markets on the competitiveness of UK business

On 23 June 2011, the Government announced an independent review, to be led by respected economic commentator Professor John Kay, to examine investment in the UK equity markets and its impact on the long-term competitive performance and governance of UK quoted companies.

Professor Kay has been asked to examine the way that the investment chain currently works – from company boards, through to pension funds, advisers and fund managers, to the ultimate beneficiaries. In particular, the Review will examine

- how best to make sure that timescales considered by boards in evaluating corporate risks and opportunities, and those of the institutional shareholders and fund managers in making investment and governance decisions match the timescales of the underlying beneficiaries;
- whether the current functioning of the equity markets and government policy sufficiently encourages boards to focus on the long-term development of their business;
- ways to strengthen the engagement between institutional investors and companies, building on the success of the Stewardship Code;
- whether there is sufficient transparency in the activities of fund managers, clients and their advisers and companies themselves;

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- the legal duties and responsibilities of asset ownership in the UK; and
- the impact of increasingly fragmented share ownership on the quality and engagement between shareholders and quoted companies.

A report will be delivered to the Government in 2012. To view the Review's terms of reference, see http://www.bis.gov.uk/assets/biscore/business-law/docs/k/11-1015-kay-review-terms-of-reference.

The Government announced at the same time that in July 2011 it will be launching a consultation on changes to company reporting that will propose tougher provisions on disclosure of executive pay and its link to company performance.

Government announcement simplifying narrative reporting for quoted companies

The Government has announced that it has decided to materially simplify narrative reporting for quoted companies.

Narrative reporting is the non-financial information required by statute or regulation to be included in a company's annual report and accounts to provide a picture of a company's business, market position, strategy, performance and prospects. Last autumn, the Government published a consultation on the future of narrative reporting inviting views on the UK narrative reporting framework and how it works in practice. The Government published a summary of the responses to its consultation in late 2010 which showed that although generally UK companies produce high quality reports, there is room for improvement, particularly with companies who comply with legislation technically but give limited helpful disclosure.

The intention is for quoted companies to provide relevant information to investors about strategy, performance and risk in a simple concise report, with supporting information available on its website. The Government will seek views from business by the end of July 2011 on how to proceed.

In March 2011, the Government announced that it has decided to materially simplify narrative reporting for quoted companies. The intention is for quoted companies to provide relevant information to investors about strategy, performance and risk in a simple concise report, with supporting information available on the company's website. The Government has stated that it will seek views from business by the end of July 2011 on how to proceed, by for example removing any requirements which duplicate similar reporting and improving non-regulatory guidance.

Treasury consultation on early implementation of changes to the Prospectus Directive

On 17 March 2011, the Treasury published a consultation document on the early implementation of certain amendments to the Prospectus Directive. Whilst changes do not have to be made in advance of the long stop date for implementation of July 2012, early implementation is seen as desirable in respect of these provisions because of the particular benefit which they will have for small companies.

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Proposed changes

The two changes to the original directive which the Treasury is consulting on for early implementation are:

- increasing the total consideration of the offer for which the Directive does not apply from EUR 2.5m to EUR 5m; and
- increasing the minimum number of investors for which a prospectus is required from 100 to 150 investors.

The suggested date for implementing these provisions is 31 July 2011. The consultation closed on 9 June 2011.

A copy of the consultation is available at: http://www.hm-treasury.gov.uk/consult_amend_prospectus_directive.htm

Consultation at European level

Separately, consultation is currently being progressed at a European level regarding the detailed changes which member states will need to make to their prospectus regimes by July 2012. In June 2011, ESMA launched a consultation on matters such as the format of, and key information to be included in, the prospectus summary and on the reduced prospectus disclosure requirements which will apply where an issuer which already has shares admitted to trading on a regulated market makes a pre-emptive offer of securities. For a copy of ESMA's consultation paper, see http://www.esma.europa.eu/popup2.php?id=7601.

"Deficit for equity swap": Uniq uses a scheme of arrangement to shed its pensions liabilities

In a significant transaction for the pensions' industry, the High Court has recently blessed a deal that sees shareholders relinquishing 90% of their shares in exchange for wiping out the company's £473m pension scheme liability. This is the first restructuring where a scheme of arrangement (one of the techniques contained within the Companies Act 2006) has been used to shed this kind of liability. The case may serve as a blueprint for other companies in need of restructuring and weighed down by the enormous liabilities that are derived from participating in defined benefit pension schemes.

Many companies are struggling to support pension schemes which have rapidly growing deficits as a result of factors such as people living longer and depressed investment returns. Clifford Chance has prepared a client briefing *Deficit for equity swap: Uniq uses a scheme of arrangement to shed its pension liabilities* in which we examine the technique employed by the former milkmen's conglomerate Uniq plc to free itself from its defined benefit scheme, which had liabilities to over 40,000 members and a funding deficit of £473m.

The deal allowed Uniq to leave these liabilities behind and to obtain the court's seal of approval for the deal.

The scheme of arrangement is the first of its kind although the model of a "deficit for equity swap" involving the Pensions Regulator and the Pensions Protection Fund (**PPF**) has been used successfully a number of times before. It required the "buy in" not just of the shareholders, who were sacrificing a significant part of their equity holding, but also the pension scheme trustees, the Pensions Regulator and the PPF. It is a good example of those participants taking a pragmatic and commercial view, not just by accepting the equity stake and facilitating a structure which would mean the scheme remains eligible for entry into the PPF, but also a recognition that the restructuring offered a better solution than other alternatives.

See the back page of this Update for details of how to access our briefing.

Changes to annual return form

The Department for Business, Innovation and Skills has published the Companies Act 2006 (Annual Returns) Regulations 2011 which amend the requirements for a company's annual return under the Companies Act 2006 regarding the information about members and their shareholdings and the classification scheme that companies may use to describe their principal business activities. The Regulations come into force on 1 October 2011 and apply to returns made up to that date or a later date.

Key change to the annual return

The Regulations amend s.856B of the Companies Act 2006, which currently requires a traded company to include in its annual return information about its shareholders and their shareholdings, in particular, the name and address of each person holding at least 5% of the company's shares and the number of shares held. New section 856B requires less information about shareholders and their shareholdings than was previously required under old section 856B. Importantly however, it no longer applies to a company which, throughout the return period, has shares admitted to trading on a regulated market and is a company which is subject to the requirements of Disclosure and Transparency Rule 5 (pursuant to which it

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is required to notify the market of information about acquisitions and disposals of major shareholdings). This is a welcome reduction in the administrative burden placed on listed issuers.

Changes to Companies House filing fees

Companies House introduced changes to its document filing fees as of 6 April 2011. There are fee increases for filing some paper documents. Same day fees for certain services are also being increased (e.g. paper incorporation, certified copies and certificates of incorporation), coupled with fee reductions for documents which are filed electronically.

For more details see the Companies House website at http://www.companieshouse.gov.uk/toolsToHelp/april2011FeeChanges.shtml

ICAEW technical release for directors on accounting records under the Companies Act 2006

The Institute of Chartered Accountants of England and Wales ("**ICAEW**") issued "TECH 01/11 - Guidance for directors on accounting records under the Companies Act 2006" in February 2011. Section 386 of the Companies Act 2006 obliges all companies to have accounting records satisfying the requirements set out in that section. This technical release is an updated version of the guidance originally published on the interpretation of s.221

of the Companies Act 1985. The release reflects changes in companies legislation brought about by the Companies Act 2006.

The Guidance covers areas including: (i) the legal requirements for keeping accounting records; (ii) the accounts to which the requirement to maintain adequate accounting records applies; (iii) content, form and organisation of accounting records; (iv) preservation of accounting records; (v) the requirement that accounting records should be such as to disclose with reasonable accuracy, at any time, the financial position of the company at that time; (vi) the cash records to be kept; and (vii) penalties and disqualification orders.

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Corporate Governance Update

Increasing female representation on listed company boards

In February 2011, Lord Davies published his report entitled "Women on Boards". Whilst acknowledging that the number of woman represented on the boards of leading companies is woefully low, Lord Davies refrained from recommending the introduction of mandatory female representation on boards. Lord Davies' report does however contain a series of recommendations for listed companies, including a recommendation that by September 2011, the chairmen of all FTSE 350 companies announce their aspirational goals regarding the percentage of women they aim to have on their boards by 2013 and 2015.

Following the publication of this report, the FRC has published a consultation on potential changes to the UK Corporate Governance Code ("**Code**") in order to require listed companies to publish their policy on gender diversity in the boardroom and report against it annually. This was a recommendation of the Davies' report.

Key recommendations of Lord Davies' report

In 2010, women made up only 12.5 per cent. of the members of the corporate boards of the FTSE 100 companies. Whilst this number is up from 9.4 per cent. in 2004, the rate of increase is considered to be very slow. As a consequence, Lord Davies was asked to undertake a review of the current situation, to identify the barriers preventing more women reaching the boardroom and to make recommendations regarding what government and business could do

In 2010, women made up only 12.5 per cent. of the members of the corporate boards of the FTSE 100 companies.

to increase the proportion of women on corporate boards. The key recommendations of Lord Davies' report are set out in the box below.

Lord Davies also recommends that UK boards need to be open to recognising and developing two different populations of women in order to meet his recommendations. In particular, UK board's need to consider not just executives from within the corporate sector for whom there are many different training and mentoring opportunities but also women from outside the corporate mainstream, including entrepreneurs, academics, civil servants and senior women with professional service backgrounds for whom there are fewer opportunities to take up corporate board positions.

The Steering Committee set up by Lord Davies intends to meet every 6 months to consider progress against the measures set out above and will report

Key recommendations of Lord Davies' Report

- Chairmen of FTSE 350 companies should set out the percentage of women they aim to have on their boards in 2013 and 2015
- FTSE 100 boards to aim for minimum of 25% female representation by 2015
- Chairmen of all FTSE 350 companies should announce these aspirational goals by September 2011
- Quoted companies to make annual disclosure of proportion of women on board, in senior executive positions and female employees in whole organisation (note BIS is expected to consult on this recommendation later in the year)
- FRC should amend the Code to require companies to establish a policy on boardroom diversity, with measurable objectives for implementation and annual disclosure of progress made
- Companies to report on above matters in their 2012 Corporate Governance statements, regardless of whether underlying regulatory changes in place
- Companies to periodically advertise non executive board positions to encourage greater diversity in applications
- Executive search firms to have voluntary code of conduct addressing gender diversity and best practice covering FTSE 350 board level appointments

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annually with an assessment of whether sufficient progress is being made. A copy of Lord Davies' report is available at http://www.bis.gov.uk/assets/biscore/business-law/docs/w/11-745-women-on-boards.pdf

FRC consultation on changes to UK Corporate Governance Code to foster gender diversity on boards

The FRC notes three specific concerns about board effectiveness which are rooted in the lack of gender diversity on boards:

- a lack of diversity may weaken the board by encouraging "group think";
- low percentages of women on boards may demonstrate a failure to make full use of the talent pool; and
- boards with no, or very limited, female membership may be weak in terms of understanding of customers and workforce and offer little encouragement to aspiration among female employees.

Such concerns led the FRC in its 2010 revisions to the Code to add, for the first time, a reference to the benefits of diversity in general, with a specific reference to gender.

As a result of Lord Davies' recommendation that listed companies should establish a policy on boardroom diversity which would include measurable objectives for implementation and that they should report annually against progress made, the FRC published a consultation document entitled "Gender Diversity on Boards" in May 2011 seeking views on whether the Code should be amended to reflect this recommendation.

Additionally, the FRC has asked whether the changes to the Code should go beyond this and whether it would be helpful to set out some of the key elements to be covered by the gender diversity policy, such as the criteria used when recruiting directors, or the steps taken to develop senior executive talent.

If the proposed changes to the Code are implemented, the FRC is of the view that the board evaluation process would provide an important opportunity for boards to review progress on implementing their diversity policy and whether it was increasing the board's effectiveness by ensuring that there was an appropriate balance of skills and experience. As such, it is also seeking views on the inclusion of a new supporting principle which addresses some of the key issues (which would include a review of the board's policy on gender diversity) which a board should consider when carrying out its effectiveness reviews.

The FRC is also seeking views on the timing of any changes to the Code and, in particular, whether the changes should apply to accounting periods beginning on or after either 29 June 2011 or 29 June 2012, or whether such changes should take effect at the same time as any other regulations made by the Government to implement Lord Davies' other recommendations.

> "The FRC notes [that] …boards with no, or very limited, female membership may be weak in terms of understanding of customers and workforce and offer little encouragement to aspiration among female employees."

The consultation closes on 29 July 2011. A decision on whether to amend the Code and, if so, the timetable for doing so will be announced later in 2011. See www.frc.org.uk/press/pub2574.html for the FRC's press announcement.

Editor comment: Gender diversity on boards is a hot topic both at national and EU level. On 1 March 2011 the European Commission challenged publicly listed companies in Europe to sign a "Women on Board Pledge for Europe" by March 2012. The pledge represents a voluntary commitment by publicly listed companies to increase women's presence on corporate boards to 30% by 2015 and to 40% by 2020. In March 2012 the Commission will assess whether this initiative has worked and decide on any further action. Separately, in the April 2011 Green Paper on the corporate governance framework for listed companies (discussed in more detail in the following article) the Commission asked whether listed companies should be required to disclose whether they have a gender diversity policy and report on progress against it. Chairmen of FTSE 350 companies should be considering now, whether, in line with Lord Davies' recommendations, they intend to announce by September 2011 their aspirational goals regarding female representation on their boards.

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EU Commission green paper on corporate governance framework

Just as premium listed issuers are getting to grips with reporting against the new UK Corporate Governance Code, the EU Commission has published a Green Paper seeking views on the need for further improvements to the corporate governance regimes applicable to European listed companies. Premium listed issuers will be relieved to hear however that the proposals set out in the Green Paper are unlikely to result in a need for them to make substantive changes to their current governance practices and reporting. The UK's long established corporate governance regime already addresses many of the areas where the Commission sees a need for improvement.

Premium listed issuers will be relieved to hear that the proposals set out in the EU's Green Paper are unlikely to result in a need for them to make substantive changes to their current governance practices and reporting. The UK's long established corporate governance regime already addresses many of the areas where the Commission sees a need for improvement.

Consultation topics

The Green Paper address three core issues which it identifies as being at the heart of good governance:

- **The composition and effectiveness of the board of directors** – the Green Paper emphasises the impact which the role played by the chairman has on the effectiveness of the board and raises questions about how best to ensure that a broad range of skills and experience are represented on the board, as well as ensuring that gender diversity is addressed. In addition, it asks whether there should be a limit on the number of mandates a non-executive director may hold and whether external evaluation of the board is desirable. For premium listed issuers, the issue of board composition and effectiveness is already firmly embedded in the UK Corporate Governance Code (Main Principle B.1), as is a requirement to ensure that all directors can allocate sufficient time to the role (Main Principle B.3). External evaluation of all FTSE 350 companies is recommended at least every three years (Code provision B.6.2). As discussed above, the FRC is currently consulting on changes to the Code which would require listed companies to publish their policy on gender diversity in the boardroom and report against it annually.

  The Green Paper also highlights the need for companies to develop an adequate risk culture and approach to risk oversight, ideally defined by the board. Again, the Code already addresses this issue, placing responsibility on the board for determining the nature and extent of the significant risks it is willing to take and requiring the board to maintain sound risk management and internal control systems (Main Principle C.2);

- **Shareholder engagement** – the Green Paper debates how best to encourage greater shareholder involvement in corporate governance concerns, in particular whether there should be greater transparency regarding the voting policies of institutional shareholders (including asset owners and asset managers). The EU Commission also raises questions as to the role played by proxy advisers and their influence on voting. From a UK perspective, the Stewardship Code, published in July

2010, already recommends that institutional investors disclose both their policy on voting and their voting activity as well as recommending that they provide information on how they will discharge their stewardship responsibilities. The Green Paper also questions whether there is a need to improve the protection of minority shareholders (particularly where a company has a controlling shareholder) and whether there should be greater transparency in relation to shareholder identification, allowing an issuer to identify more readily the underlying holders of its shares; and

- **Improving the effectiveness of the "comply or explain" approach** – whilst recognising the benefits of the "comply or explain" approach to corporate governance, the Commission takes the view that both the quality of the statements published by issuers and the monitoring of such statements by relevant authorities could be improved. In particular, the Green Paper suggests that formal sanctions for non-compliance with transparency reporting requirements could be considered going forward. This would be a change for premium listed issuers. Whilst the Listing Rules require premium listed issuers to report on their compliance (or explain any non-compliance) with the Code, the UKLA does not actively review the quality or completeness of the disclosures made by issuers. The FRC, the body responsible for oversight of the Code, and the various Investor Protection Committees, do monitor issuers' reporting against the Code in an informal manner but there are no formal monitoring processes or specific sanctions for a failure to report against particular provisions of the Code in a sufficiently informative and comprehensive manner.

The Green Paper raises two further question of interest:

- it considers whether corporate governance should take into account the size of listed companies – this is already a feature of the Code where certain provisions only apply to FTSE 350 companies, recognising that certain corporate governance requirements may place an unnecessary burden on smaller issuers; and
- it invites views as to whether corporate governance guidelines for (larger) unlisted companies should also be promoted at an European level.

The consultation is open until 22 July 2011. The Commission intends to issue a feedback statement summarising the results of the consultation in autumn 2011.

Further reading

For more information about the EU Green's paper, please see our client briefing, *Green Paper on the EU corporate governance framework*. See the back page of this Update for details of how to obtain a copy of this.

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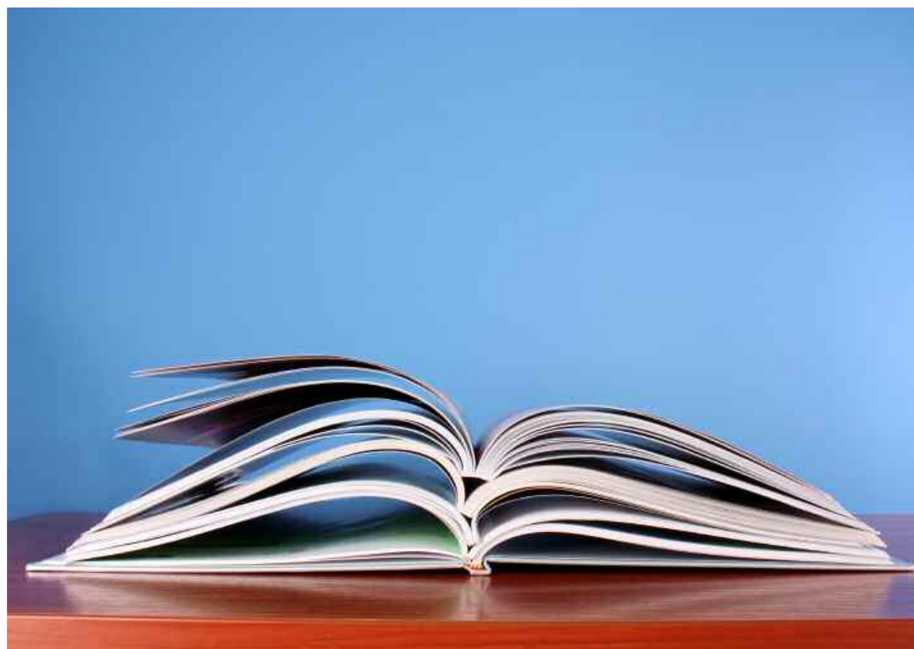
Reporting on risks and uncertainties in the business review



On 1 February 2011, the Financial Reporting Review Panel ("**FRRP**") issued a press announcement highlighting its concern that "too many" companies do not adequately describe in their annual report and accounts the principal risks and uncertainties facing the company.

FRRP concerns

The directors' report section of the annual report and accounts is required by s.417 Companies Act 2006 to contain a business review, which must itself contain a description of the principal risks and uncertainties facing the company. The Companies Act 2006 states that the purpose of the business review is to inform shareholders and help them assess how the directors have performed their statutory duty to promote the success of the company. The FRRP has commented on a number of occasions that it finds it difficult to assess whether directors' reports comply with the requirements of the Act.

The press announcement states that the FRRP has actually challenged a number of companies where:

- the directors' report does not clearly identify which risks and uncertainties the directors believe to be the principal ones facing the company;
- a long list of principal risks and uncertainties is given and the list raises a question as to whether all the risks and uncertainties listed are actually principal ones;
- the description given of a risk or uncertainty is in generic terms and it is not clear how that risk or uncertainty applies to the company's circumstances;
- the disclosure is of a risk framework rather than of the risks or uncertainties themselves;
- the principal risks and uncertainties disclosed are not consistent with other information given in the report and accounts; or
- the directors' report does not state how the company manages its principal risks and uncertainties.

Where a company's accounts or directors' report are defective in a material respect, the FRRP will try to secure their revision by voluntary means. If this approach is unsuccessful, the FRRP can apply to the court under the Act for an order for revision. To date no court applications have been made.

In order to assist directors when making their disclosures, the press announcement lists various questions that the directors should consider. These include considering whether the description of each risk or uncertainty is sufficient for shareholders to understand the nature of that risk or uncertainty and how it might affect the company; whether it has been the subject of recent board discussion; and whether they are described in a manner consistent with the way in which they are discussed within the company.

The FRRP press release can be obtained from http://www.frc.org.uk/frrp/press/pub2503.html

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Updated FRC Guidance on Board Effectiveness

In March 2011, the Financial Reporting Council ("**FRC**") published its Guidance on Board Effectiveness (the "**Guidance**"). The Guidance replaces the Good Practice Suggestions from the Higgs report (known as the Higgs Guidance), which was last issued in 2006. The Guidance is intended to assist companies in applying the principles of the UK Corporate Governance Code (the "**Code**"), in particular Sections A and B of the Code on leadership and effectiveness of the board, and to stimulate thought on how boards may carry out their role most effectively.

Content of guidance

The Guidance is divided into 7 sections dealing with:

- the role of the board and directors (the chairman, the senior independent director, the executive directors and the non-executive directors)
- board support and the role of the company secretary
- decision making
- board composition and succession planning
- evaluating the performance of the board and directors
- audit, risk and remuneration
- relations with shareholders

The Guidance does not seek to address all the issues covered in Sections A and B of the Code, but only those where consultation with companies, individual board members and investors suggested that further guidance would be helpful. The Code focuses on the need for greater leadership and commitment from directors and this change of emphasis is reflected in the Guidance.

> "Boards need to think deeply about the way in which they carry out their role and the behaviours that they display, not just about the structures and processes that they put in place."
> FRC Guidance on Board Effectiveness

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Sharman Inquiry into Going Concern and Liquidity Risk Reporting

The FRC has launched Call for Evidence led by Lord Sharman to identify lessons for companies and auditors addressing going concern and liquidity risks. The FRC last updated its Guidance for Directors of UK Companies on going concern statements and liquidity risk late in 2009, at the height of the financial crisis. Published in May 2011, the Call for Evidence aims to capture lessons learnt since that date and to determine possible improvements to the 2009 guidance.

Remit of the Inquiry

The Inquiry has been tasked with examining the particular challenges faced by directors, management and auditors where companies face going concern and liquidity risks and to consider how such challenges should be addressed in the future. In particular the Inquiry is seeking views on:

- what combination of information regarding robustness of a company's capital, the adequacy of that capital to withstand potential losses from future risks and a company's ability to finance and develop its business model would best enable investors to evaluate the going concern and liquidity risks that a company is exposed to;
- what processes the directors undertake to monitor going concern and liquidity risks for the preparation of their annual and half-yearly financial statements and to assess cash flows and liquidity on a regular basis throughout the year;
- how auditors approach these matters; and
- whether the existing reporting regime and related guidance should be updated.

The Inquiry closed on 30 June 2011. Preliminary conclusions are to be published later in the summer and final recommendations by the end of the year.

A copy of the FRC Press release is available at http://www.frc.org.uk/about/sharmaninquiry.cfm

PIRC publishes 2011 UK Shareholder Voting Guidelines

On 24 March 2011, PIRC published the 15th edition of its UK Shareholder Voting Guidelines (the "**Guidelines**"). The Guidelines are relevant to all the listed companies which PIRC covers on the UK markets (which includes non-UK incorporated companies) and set out what PIRC considers to be corporate governance best practice.

The Guidelines cover matters relating to the board; remuneration; audit and reporting; auditors and shareholders' rights; and corporate action. Set out below are the keys changes from the PIRC 2010 guidelines in relation to the board:

- **BOFIs** - Banks and other financial institutions should include in their business review a detailed and quantifiable explanation of how the financial crisis affected them and measures taken as a result. All companies should stress test business models against the new economic realities.
- **Chairmen** - Chairmen must ensure that the views of shareholders are communicated to the board as a whole and should discuss both governance and strategy with major shareholders. PIRC encourages an active shareholder response to a chairman's re-election in the event of poor governance, or to the report and accounts.
- **Executive chairman** - The appointment of a chairman in an executive capacity is an obstacle to independence. Employing an executive chairman is viewed critically where there is no separate chief executive or no de facto division of responsibilities, and regardless of any former executive role at the company.
- **CEO becoming chairman** - Only under exceptional circumstances may PIRC support the election of the former chief executive as chairman where the company has confirmed in writing that he is being elected ad

The 15th edition of PIRC's *UK Shareholder Voting Guidelines* covers matters relating to the board; remuneration; audit and reporting; auditors and shareholders' rights; and corporate action.

interim for the purposes of completing the separation of roles or to assist the nomination process of a new independent chairman and a firm later date has been set for his departure within 12 months.

- **Executive directors** - Shareholders should be able to vote on contract policy at the pre-appointment stage. If the contract is not finalised there should nevertheless be an opportunity to vote on heads of terms for future executive appointments.
- **Senior independent director** -. Where no SID is appointed, PIRC may consider advising a vote against the chairman or a member of the nomination committee.
- **Shareholder nominees** - PIRC has long held the view that any NED nominated by a shareholder is subject to a likely conflict of interest. However, the ability to reconcile a potential conflict is stronger where it can be demonstrated that the NED has not specifically acted on behalf of the nominator in the past, there is no evidence of a prior material link to the nominating shareholder and, when subjected to existing guidelines, the candidate is still considered independent. In such circumstances, PIRC may consider a shareholder nominee acceptable on a case-by-case basis.
- **Re-election of directors** - PIRC believes that the annual election of directors should not be limited to FTSE 350 companies. To allow companies to prepare for this measure, PIRC has suspended implementation of across the board voting recommendations until 2012. In the meantime, PIRC will study company disclosures on a case-by-case basis.
- **Board evaluations** - PIRC believes that the Code requirement for external evaluations every 3 years for FTSE 350 companies should be extended to the remainder of the FTSE All Share.

A copy of the new Guidelines can be obtained from PIRC's website at www.pirc.co.uk

Executive remuneration: ABI concerns over uncapped incentive plans

The current AGM season has witnessed a series of shareholder revolts over executive remuneration. A number of companies including Thomas Cook, Mitchells & Butler, William Hill, easyJet, Lloyds and WH Smith have seen significant numbers of shareholders expressing their dissatisfaction over executive pay and awards by voting against the company's remuneration report.

Listed companies are required by s.439 Companies Act 2006 to put the directors' remuneration report to a vote each year. The vote is advisory only, and no entitlement of any director to remuneration is made conditional upon the resolution being passed. Notwithstanding this, the vote is an important tool for shareholders, enabling them to consider the company's remuneration policies and the remuneration which is actually paid to directors in the previous financial year.

The Investor Protection Committees, such as the ABI and PIRC, are active in monitoring listed companies' remuneration reports. The issue of 'uncapped incentive plans' has raised particular concerns for the ABI, prompting it, in January of this year, to write to the chairmen of the remuneration committees of listed companies expressing its concerns about such plans. Under these executive share plans, scheme participants receive a number of company shares set by reference to the increase in market capitalization over a pre-determined target level. The vesting of awards may be subject to performance targets. Such plans can offer significant rewards to participants through uncapped allocations of shares. Historically the Institutional Voting Information Service have "amber topped" such incentive plans and left shareholders to make their own judgment when voting on them. The ABI now appears to be taking a stricter line on these plans and, in particular, has made it clear that uncapped incentive plans are not acceptable as standard equity incentive arrangements.

For a copy of the ABI letter see http://www.ivis.co.uk/EXECUTIVE_REMUNERATION_Uncapped_Incentive_Plans.aspx

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Regulatory Update

FSA no longer required to demonstrate intent to prove market abuse

The FSA has made amendments to its Code of Market Conduct ("**CMC**"), effectively removing the requirement for the FSA to provide evidence of intent in order to prove market abuse. Prior to its amendment, the CMC had reflected the FSA's view that it was necessary for it to demonstrate a person's intention in order to prove market abuse. However, following the ECJ ruling in the **Spector**[1] case, the FSA believes proof of intention is no longer required and the CMC has been amended accordingly.

Following the ECJ ruling in the Spector case, the FSA believes proof of intention is no longer required to prove market abuse.

Spector case

The key question in the **Spector** case was whether the mere fact that a person in possession of inside information as set out in the Market Abuse Directive ("**MAD**") acquires or disposes of financial instruments to which that information relates, is sufficient to constitute insider dealing, or whether it is necessary to show that a deliberate decision was made to trade on the basis of the inside information.

Article 2 of the MAD provides that "*Member States shall prohibit any person... who possess inside information from using that information by acquiring or disposing of... financial instruments to which that information relates.*"

In the **Spector** case, the ECJ's view was that Article 2 defines insider dealing in an objective manner without the need to demonstrate that there was intent to use the inside information.

However, the ECJ did go on to say that this interpretation does not necessarily mean that any insider in possession of inside information who enters into a market transaction automatically commits an offence. Article 2 must be analysed in the context of the objectives of the MAD so that market transactions by persons who hold inside information but which do not infringe the integrity of financial markets and investor confidence should not be prohibited.

The ECJ gave some rather limited examples of what would not constitute insider dealing e.g. transactions by market makers and bodies which are authorised to act as counterparties pursuing their legitimate business. However, the ECJ did not make it clear whether there is no offence if the author of the transaction did not intend to use the information, for example by showing that they would have traded anyway.

Prior to being deleted, CMC provision MAR 1.3.4E had stated: *"In the opinion of the FSA, if the inside information is the reason for, or a material influence on, the decision to deal or attempt to deal, that indicates that the person's behaviour is "on the basis of" inside information."*

In its consultation on the deletion of this provision, the FSA's view was that this provision suggested that it was necessary to show that the person intended to use the inside information for the offence to be committed, and that following the **Spector** decision it was no longer

[1] Case C-45/08, Spector Photo Group NV, Chris Van Raemdonck v Commissie voor het Bank, Financie- en Assurantiewezen

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necessary to demonstrate such intent and so the provision should be deleted. This view was implemented and MAR 1.3.4E was deleted with effect from 6 March 2011.

Editor comment: In response to the FSA's consultation, the FSA was asked to provide guidance in the CMC as to how it might be possible to rebut the presumption that a person who holds inside information and deals in the financial instruments to which that information relates has used that information for the purposes of insider dealing. The FSA declined to do, leaving market participants and their advisers in a state of uncertainty. This change in approach by the FSA also comes at a time when practitioners and issuers alike are grappling with the implications of the **Massey** decision (see the article entitled "When is inside information "inside information"?" below) when seeking to determine whether information is "inside information" which needs to be announced to the market.

Given the implications for all Member States, ideally the uncertainties regarding proof of intention should be resolved at an EU level. Sadly however, the European Commission decided in its June 2010 consultation on MAD not to progress this issue, meaning the difficulties in this area are unlikely to be resolved anytime soon.

JJB fined for failure to disclose information to the market

The FSA fined JJB Sports Plc £455,000 for breaches of DTR2.2.1 and Listing Principle 4 for its failures to disclose information to the market about the true cost of two acquisitions which led to the creation of a false market in JJB shares for over nine months. This is the second largest fine imposed by the FSA on a company for breach of the Disclosure and Transparency and Listing Rules.

JJB announcements

In December 2007, JJB announced that it had purchased a retail chain for £5 million in cash. It failed to disclose that, in addition to the cash price, it had to pay for the in-store stock at a cost of £10 million. The following May, JJB announced that it had purchased a second retail chain for £1 in cash but failed to disclose that, as part of the acquisition, it had agreed to settle the company's overdraft prior to completion at a cost of £6million.

In September 2008, JJB published its Interim Results which, for the first time, disclosed the true costs of the two acquisitions. By this time, it had been necessary for JJB to arrange a short-

The FSA has fined JJB Sports Plc £455,000 for its failures to disclose information to the market about the true cost of two acquisitions which created a false market in JJB shares for over nine months.

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term bridging facility to shore up its financial position, and the Interim Results also noted uncertainties about the firm's ability to continue as a going concern. On the day the results were published, JJB's share price fell by 49.5%.

FSA's findings

DTR 2.2.1 obliges an issuer to notify an RIS as soon as possible of any inside information directly concerning it. Listing Principle 4 obliges an issuer to communicate information to shareholders and potential shareholders in such a way as to avoid the creation or continuation of a false market in the issuer's equity shares. The FSA concluded that the cost of each of the acquisitions was inside information and should therefore have been disclosed to the market as soon as possible. At the relevant time the cash positions of listed companies were the subject of increasing investor focus and the firm's failure to disclose gave a false impression of the acquisition costs and of the impact of those acquisitions on the true nature and costs of its strategy. For a copy of the final notice see http://www.fsa.gov.uk/pubs/final/jjbsports.pdf

When is inside information "inside information"?

The Upper Tribunal of the Tax and Chancery Chamber found in **David Massey v the FSA** that David Massey engaged in the market abuse offence of insider dealing contrary to s.118 of the Financial Services and Markets Act 2000 ("**FSMA**") by short selling shares in Eicom on the basis of inside information concerning the availability of discounted shares.

> "In its decision in the Massey case, the Tribunal took a literal approach to the definition of "inside information": if a matter would inform the decision of a reasonable investor then it was price-sensitive, in effect rendering the question of whether the information was itself actually price-sensitive irrelevant."

Massey was fined £150,000 and banned from performing any role in regulated financial services.

The case of is particular interest given the Tribunal's approach to the definition of "inside information" (discussed below) and raises potential concerns for issuers and advisers alike.

What is inside information?

Under s.118C(2) FSMA inside information is defined as information of a precise nature which (a) is not generally available (b) relates to the qualifying investments, and (c) would, if generally available, be likely to have a significant effect on the price of the qualifying investment.

Under s.118C(6), information "would be likely to have a significant effect on price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions".

The Tribunal indicated the phrase "likely to have a significant effect on the price" (in s.118C(2)) had not been used in FSMA in its ordinary sense: "[…] we have to apply the specially extended meaning assigned to this expression by s.118C(6). Whether or not the information was (in the ordinary sense) likely to have a significant effect on the price, we consider it is clear that it was information 'of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions'."

Editor comment: The FSA's interpretation of FSMA has implications for how companies are to interpret DTR 2.2 when deciding whether information is inside information and, therefore, whether it is required to be made public (subject to an exemption applying). The Tribunal's ruling has caused concerns among practitioners as it seems to be at odds with FSMA and the European Directive on which it is based. This apparent shift in approach leads to the conclusion that where companies now consult brokers as to whether DTR 2.2 requires them to release information publicly, the question is no longer whether the information would be price-sensitive but whether a reasonable investor would take it into account. The FSA took a similar line when fining JJB Sports plc for failure to disclose information to the market (see previous article), concluding in its Final Notice that: "The information was information of a kind which a reasonable investor would be likely to use as part of the basis of his or her investment decisions, and pursuant to section 118C(6) of the Act was therefore information that would, if generally available, be likely to have a significant effect on the price of JJB shares". The FSA did not address the issue of whether the information was itself actually price-sensitive.

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In effect, Tribunal took a literal approach to the definition of "inside information": if a matter would inform the decision of a reasonable investor then it was price-sensitive. This appears therefore to render the question of whether the information was itself actually price-sensitive irrelevant.

First for FSA as it secures final injunction to prevent market abuse

In a first for the FSA, it secured a final injunction from the High Court to prevent market abuse.

Samuel Kahn was fined just over £1m by the FSA for his involvement in a scheme to ramp up the share price of Global Brands Licensing plc whilst conducting trades in the shares of the company.

The FSA sought, and was granted, a High Court injunction to prevent any further market abuse by Mr Kahn, who was known to the FSA already due to his involvement in 2007 in two companies that were closed down for aiding and abetting a boiler room scam. In 2008, he was made bankrupt by the FSA after admitting liability to £3.7m of claims relating to the same boiler room scam. As Mr Kahn is not an authorised individual the injunction provides the FSA with a mechanism to seek a custodial sentence for Mr Kahn if he continues to offend.

A copy of the FSA's final notice is available at http://www.fsa.gov.uk/pubs/final/samuel_nathan_kahn.pdf

Since the Kahn ruling, the FSA has secured a second final injunction against self employed trader, Barnett Alexander, in respect of market abuse activities being carried on by him. In June 2011, the High Court made permanent an earlier temporary injunction which the FSA had taken out against Alexander in May 2010 preventing him from committing market abuse. For a copy of the FSA press release see www.fsa.gov.uk/pages/Library/Communication/PR/2011/053.shtml

FSA secures further successful insider dealing convictions

The FSA continues its successful run of prosecutions for insider dealing. On 2 February 2011, a former senior investment banker, his wife and a family friend were all sentenced for insider dealing contrary to s.52 of the Criminal Justice Act 1993. Christian Littlewood was sentenced to three years and four months custody (the longest sentence imposed to date), Angie Littlewood was sentenced to 12 months in custody suspended for two years and Helmy Omar Sa'aid was sentenced to two years in custody. Sa'aid was also ordered to pay £640,000 in confiscation. Confiscation orders in relation to the Littlewoods are to be dealt with at a later date. The trio pleaded guilty to eight counts of insider dealing related to trading in a number of London Stock Exchange and AIM listed shares between 2000 and 2008.

The FSA is currently prosecuting 12 other individuals for insider dealing.

The FSA press announcement regarding its prosecution of the Littlewoods is available at: www.fsa.gov.uk/pages/Library/Communications/PR/2011/018.shtml

Institutional Investor Committee publishes best practice guidance for issuers when raising equity capital

The Institutional Investor Committee has published best practice guidance

for issuers when raising equity capital. Published in May 2011, the guidance is intended to inform issuers and boards about institutional shareholders' views and best practice when raising equity capital. The guidance draws upon the Institutional Investor Committee's findings in its Rights Issue Fees Inquiry report which it published in December 2010.

Section 1 covers what companies should do as general preparation for the eventuality that they may raise equity in the future. It includes a recommendation that equity capital raising be covered as part of the individual induction process for new directors and also collectively as part of their regular evaluation. It also recommends that shareholder engagement should include discussion about appropriate capital structure, whether shareholders would be prepared to receive price-sensitive information in the event of a capital raising exercise and whether they would in principle have the ability and/or the appetite to act as a sub underwriter when the time comes.

Subsequent sections cover issues the board should consider once they intend to proceed with an equity capital raising and include the following guidance:

- boards should consider whether an independent financial adviser should be appointed;
- institutional investors generally expect material amounts of equity to be raised by way of rights issue. Where the rights shares are issued at a sizeable discount, the reduced risk taken by the underwriter should be reflected in the fees;
- the board should request a full break down of the adviser's proposed fees;
- where the issue is to be made at a deep discount (particularly over 20%), the board should consider whether it is in fact necessary for the issue to be underwritten in whole, in part or at all;
- shareholders who have indicated a willingness to be made insiders should be consulted on the proposed issue, its fee basis, and their commitment to take up their rights and potential appetite for sub underwriting;
- the issuer should review the sub underwriting list. Where any sub underwriters are prepared to accept a lower fee than proposed, the benefit should flow back to the company and not simply be retained by the lead underwriter; and
- the board should publicly disclose details of fees paid to whom and for what via an RIS and subsequently, a full fees breakdown in the annual report and accounts.

For a copy of the guidance see http://www.iicomm.org/docs/bpguidance0511.pdf

Ongoing review of the Takeover Code: current status

In our January 2011 Corporate Update we set out the key proposed Code reforms which were published by the Takeover Panel in Panel Statement 2010/22 in October last year. The Panel published Panel Consultation Paper 2011/1 in May 2011 which included further commentary on the changes being proposed and set out the detailed proposed rule changes. Broadly speaking, the changes set out in PCP 2011/1 are in line with those previously notified to the market in Panel Statement 2010/22 and set out in our January 2011 Corporate Update.

The time for responding to the PCP2011/1 has ended. A Response Statement is expected to be published by the end of July 2011, which will set out the final text of the amendments to the Code. The revised Code is then expected to come into effect on or around 19 September 2011.

A separate Clifford Chance briefing on the final Code changes will be published prior to the changes coming into effect.

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Antitrust Update

Equity underwriting and associated fees – OFT publishes decision not to make a market investigation reference to the Competition Commission

On 17 May 2011, the Office of Fair Trading ("**OFT**") decided not to refer the market for equity underwriting and associated services for a detailed investigation by the Competition Commission.

The OFT's study examined the provision of equity underwriting services for equity issues carried out by FTSE 350 listed firms over the last ten years, including rights issues, placings and other types of follow-on offer, but not Initial Public Offerings.

The OFT had decided to look into these markets as a result of perceived company and institutional shareholder dissatisfaction with recent increases in underwriting fees and discounts on rights issues, in particular since the advent of the financial crisis. The market study examined the provision of equity underwriting services for equity issues carried out by FTSE 350 listed firms over the last ten years, including rights issues, placings and other types of follow-on offer, but not Initial Public Offerings.

In a report issued in January 2011, it concluded that average fees rose to more than 3% in 2009 and average discounts on rights issues rose to nearly 40%, compared with the typical fees of 2-2.5% and discounts of around 30% in the period from 2003 to 2007. Sub-underwriting fees also rose following the onset of the financial crisis and recession, clustering around 1.75% during 2009. While the OFT accepted that such increases can be explained, at least in part, by increased volatility and risk in 2009, subsequent reductions in risk and stock market volatility did not appear to have fed through to lower prices (notwithstanding indications from the limited number of issues in 2010 of a reduction in underwriting fees). The OFT also identified a trend towards greater "clustering" of fees and discounts.

The OFT's report concluded that, in practice, other forms of capital raising, such as internal or debt finance, tend to provide little or no competitive constraint on the equity underwriting market, and that the option of issuing non-underwritten "deeply discounted" shares has been little used since 1999. However, even considered in isolation, the OFT found that the equity underwriting market is not particularly concentrated, with the top three underwriters (Bank of America/Merrill Lynch, Deutsche Bank, and Morgan Stanley) together accounting for 35-40% of supply in 2010. In addition, the OFT found no evidence of anticompetitive agreements or unilateral conduct that might be in breach of the competition rules.

> "… the OFT took the view that the identified market inefficiencies could be tackled most effectively by companies and shareholders doing more to achieve cost effective outcomes, rather than by the imposition of regulatory measures following a costly inquiry."

Notwithstanding the lack of concentration, the OFT identified a number of ways in which it considers that competition for equity underwriting appointments is lacking. In particular, it concluded that:

- companies prioritise speed, confidentiality and the successful take-up of new shares ahead of pricing of underwriting services. They therefore often award mandates to their existing corporate brokers and advisers with little or no competition taking place at the time of the transaction. Holding a competitive tender for underwriting services is perceived to increase the risk of a market sensitive leak of information. Once work on an issue has begun, it is rarely feasible to remove or replace an underwriter, meaning that companies are typically in a weak position when negotiating fees and discounts;
- institutional shareholders appear to have had little success in persuading companies to act on their concerns regarding fees and discounts. In the OFT's eyes, they could do more (see below);
- there appear to be significant barriers to entering the market, such as the costs of building a reputation and relationships with potential clients;
- as most companies raise capital infrequently, there are asymmetries in information and experience which make it difficult for companies to assess whether they are purchasing services cost effectively; and
- the disclosure of overall fees and discounts in prospectuses tends to result in the perception that there is a general "going rate", rather than stimulating effective negotiation on the basis of the risks and costs associated with the transaction in question.

While the OFT identified certain theoretical areas of conflict of interest between companies and underwriters – for example in respect of pricing the issue, or hedging risk by underwriters in a way that affects a company's share price – it found that, in practice these do not appear to raise significant concerns. In particular, the OFT notes that underwriters are under a general legal obligation to identify and manage conflicts of interest fairly, and that companies raising equity are aware of the potential for conflicts and take steps to address them.

As regards potential conflicts caused by institutional shareholders' twin roles as investors and as potential sub-underwriters, the OFT found that these investors do not have strong incentives to press for higher sub-underwriting fees, and that there is limited evidence of them doing so.

In light of the above findings, the OFT took the view that the identified market inefficiencies could be tackled most effectively by companies and shareholders doing more to achieve cost effective outcomes, rather than by the imposition of regulatory measures following a costly inquiry. The steps that the OFT recommends companies and institutional investors to consider include:

- seeking more advice from internal sources with more experience of the process (such as their institutional shareholders, legal advisers and board members), or by taking independent advice;
- requesting a breakdown of underwriters' proposed fees into constituent components, so that each element of the total fee can be negotiated. However, the OFT held back from pursuing mandatory public disclosure of underwriting fee break-downs, on the basis that such disclosure could also make it easier for investment banks to align their prices;
- awarding and agreeing fees for different aspects of the work at different times;
- holding tenders in which all investment banks with which an existing relationship is held (including corporate brokers and lenders) compete for certain elements of the underwriting work. The OFT notes, however, that there may be potential disadvantages which would need to be taken into account;
- increasing the number of banks that companies have relationships with, so increasing the pool of potential providers and creating greater competitive tension;
- greater pressure from institutional investors on companies to reduce fees, through regular discussions with company executives;
- commitment by institutional investors (where possible) to sub-underwriting issues before they are announced, to reduce the risk borne by the underwriter and (the OFT hopes) the resulting underwriting fee paid by the company; and
- institutional investors indicating a willingness to accept lower sub-underwriting fees, with a view to applying pressure for primary underwriters to reduce their fees in turn.

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Editor comment: The OFT's careful weighing of the substantial costs of a market investigation reference against the outcomes that might realistically be achieved is to be welcomed. Investment banks will be relieved to have avoided the threat of a burdensome inquiry. In contrast, institutional investors may be less pleased with the suggestion that the price increases are partly due to a lack of shareholder pressure on investee companies. That disapproval may yet, however, be tempered if the recent signs of lower prices that the OFT identifies in its report prove to be the start of a sustained return to historically lower prices.

The OFT's conclusions are broadly consistent with those of the Institutional Investor Committee ("**IIC**") which published the results of its Rights Issue Fees Inquiry in December 2010. Whilst concluding that underwriting fees on rights issues had not been reduced commensurate to the risks assumed, the IIC's recommendations focused on companies and institutional investors taking greater responsibility for trying to drive underwriting costs down, rather than addressing the apparent concerns about the practices of the investment banking community on equity underwriting. In May 2011, the IIC published best practice guidance for issuers when raising equity capital, which echoes many of the conclusions of the OFT market study (see "Regulatory Update" above for details).

UK Government sets out options for a major reform of the UK competition regime

A consultation issued by the Department for Business, Innovation and Skills ("**BIS**") on 16 March 2011 contains proposals touching on every area of competition regulation in the UK, including:

- combining the OFT and the Competition Commission ("**CC**") into a single "Competition and Markets Authority" ("**CMA**");
- introducing mandatory filing requirements and standstill obligations into the UK merger control regime and increasing filing fees to as much as £220,000 for the largest transactions;
- removing the requirement for dishonesty in the criminal cartel offence;
- creating an Internal Tribunal within the CMA to act as the decision maker in investigations into breaches of the civil prohibitions on anticompetitive agreements and abuse of dominance, or moving to a more prosecutorial model with the Competition Appeal Tribunal ("**CAT**") adjudicating;
- imposing shorter time limits on market investigations and allowing super-complaints by representatives of small and medium sized enterprises ("**SMEs**");
- imposing stronger obligations on sector regulators to apply competition law in preference to regulatory powers, and giving the CMA a greater role in regulated sectors; and
- plans (separately announced) to transfer the consumer enforcement and advisory functions of the OFT to Trading Standards and the Citizens Advice Bureau.

The consultation explains that the key aims of the reforms are to improve the robustness of decisions and strengthen the regime, support the competition

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authorities in taking forward the right cases, and improve speed and predictability for business. While cost-savings do not feature prominently in the objectives, BIS notes that "reform should wherever possible reduce the cost to business and the public purse".

The deadline for responses to the consultation was 13 June 2011, and BIS is expected to outline its further proposals for reform later this year. For further information on the proposed reforms, see our client briefing, which is available at http://www.cliffordchance.com/publicationviews/publications/2011/04/reform_of_the_ukcompetitionregimewhatso.html

The Commission fined Nintendo and seven of its official distributors in Europe €167.8m for agreements that were allegedly designed to prevent exports from low-priced countries to high-priced countries.

ECJ dismisses Activision appeal in Nintendo distribution agreements judgment

The European Court of Justice ("**ECJ**") has dismissed an appeal by Activision Blizzard Germany GmbH ("**Activision**") against a judgment of the General Court which upheld the decision of the European Commission (the "**Commission**") to fine Nintendo and certain distributors for agreements allegedly aimed at restricting parallel trade.

Background: In October 2002, the Commission imposed fines of EUR 167.8 million in total on Nintendo and seven of its official distributors in Europe (the distributors) for agreements that were allegedly designed to prevent exports from low-priced countries to high-priced countries. CD-Contact Data, now Activision, was fined EUR 1 million while Nintendo was fined EUR 149 million.

Activision (along with Nintendo and another distributor) challenged the amount of the fines before the General Court. On 30 April 2009, the General Court refused to annul the Commission's decision but reduced Nintendo's fine as it considered that the Commission had breached the principle of equal treatment by giving a significantly larger reduction in fine for one of the distributors who had started cooperating with the Commission only eight days before Nintendo had done so. The General Court also reduced the basic amount of the fine imposed on Activision by 50%, in view of Activision's exclusively passive role in the infringement, to EUR 500,000.

Activision appealed the General Court's finding that it had infringed the EU prohibition on anticompetitive agreements (contained in Article 101 of the Treaty on the Functioning of the EU) arguing that:

- the General Court had erred in law by finding there to be an illegal agreement between Activision and Nintendo on an incorrect legal categorisation of the facts. Activision argued that the agreement was perfectly legal under Article 101 as it restricted active sales but did not restrict passive sales, but the General Court did not consider the difference between such restrictions;
- the General Court distorted evidence to show that it intended to pursue an anti-competitive object; and
- the Commission made a manifest error in its assessment of the evidence.

The ECJ dismissed Activision's appeal. It held that Activision's first ground of appeal had no factual basis and that

based on an analysis of the evidence, the General Court had considered that there was a concurrence of wills between the parties with the object not only of limiting active sales but also parallel trade generally.

The ECJ also held that the General Court had not distorted the evidence or made a manifest error of assessment in its assessment of the evidence. It considered that the General Court had provided sufficient reasons for its decision and that the standard of proof required for the purposes of establishing the existence of an anti-competitive vertical agreement is no higher than that required in a horizontal relationship.

Editor comment: This case confirms that although a distribution agreement may on its face be compliant with Article 101, related correspondence showing a "*concurrence of wills*" between parties to limit parallel trade may amount to evidence of an anti-competitive distribution agreement. The Commission has recently adopted revised rules and guidance on distribution agreements.

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This Corporate Update has been produced by the London Corporate Practice and edited by David Pudge.

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