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Corporate Update

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

As difficult economic conditions persist, questions continue to be asked about the perceived imbalance between executive pay and company performance. This issue has been put firmly in the spotlight by the recent announcement by Vince Cable, Secretary of State for Business, of the Government's new plans for the regulation of executive pay. Two key areas are to be targeted: how executive remuneration is to be determined and how companies must report on remuneration. Whilst the fine detail of the new proposals is yet to be made public, the Government intends that shareholders should have a "binding" vote on (i) future pay policy for the Board as a whole; (ii) notice provisions exceeding 12 months in the contracts of new executives; and (iii) on termination payments in excess of 1 years' salary. The Government also intends to ask the Financial Reporting Council to consult on an amendment to the Corporate Governance Code to require large plcs to include a claw-back mechanism in executive contracts for variable remuneration. With details of these proposals due to be published shortly, there is no danger of the issue of executive pay moving out of the spotlight anytime soon.

There are also developments afoot on the European front which will be of interest and, potentially, concern to issuers. In particular, the European Commission's proposals for a new Market Abuse Regulation contain an expanded definition of what constitutes "inside information" which would not require the information to be either *precise* or *price sensitive*. The breadth of the new definition is likely to raise difficult questions for directors and others privy to company confidential information when trying to identify whether such information is "inside information". See our "Regulatory Update" for more details.

The above issues, along with a host of other recent corporate developments relevant to companies and their advisers are discussed in this edition of Corporate Update.

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> "Clients recommend this magic circle firm for the strength and depth of a corporate team that is "*composed of quality partners and associates that are willing to invest in client relationships and able to tell you how to find solutions to problems*"."
>
> Corporate/M&A, Chambers UK 2012

> "Other sources emphasise that the corporate group provides "*extremely high-quality advice on deals across any sector*" and that its "*commercial acumen is on a par with the best*"."
>
> Corporate/M&A, Chambers UK 2012

> "…Clifford Chance's team is variously praised by clients as '*hungry*', '*focused*' and '*sharp*'."
>
> M&A: upper mid-market and premium deals, 250m+, Legal 500 2011

> "Its well-earned reputation for excellence comes from an ability to advise on the whole range of corporate and M&A-related matters, across industries and across borders - making it a favourite for multinationals."
>
> Corporate/M&A, Chambers Global 2011

Company Law Update

Executive remuneration: Government announces new proposals

After months of speculation, the Government has finally announced its response to last year's consultation on the regulation of executive pay. The response targets two principal areas for reform: how executive pay is determined and how it is reported.

Background

The Government's announcement on 23 January 2012 follows the earlier publication by the Department for Business, Innovation and Skills ("**BIS**") in September 2011 of a consultation paper on the future of narrative reporting. The consultation paper contains proposals to simplify the current reporting structure and considers how companies can provide clearer reporting on remuneration to enable shareholders to examine executive pay and hold companies to account (for details see "*Simplification of narrative reporting*" below). At the same time, in light of increased scrutiny over executive pay, BIS published a discussion paper relating to executive remuneration which, amongst other proposals, considered whether the shareholders' vote on remuneration should be binding.

The Government's new proposals which were announced by Vince Cable, Secretary of State for Business, deal only with the regulation of executive pay. The Government has not yet announced its response on the proposals set out in its September 2011 consultation paper for the simplification of the structure and content of narrative reports.

Regulation of Executive Pay: the new proposals

Enhanced transparency in remuneration reporting: Clearer reporting requirements on executive remuneration will be introduced via secondary legislation later this year. This will (it is hoped by the Government) make it easier for shareholders to scrutinise executive pay and hold companies to account.

The Government had previously indicated that any new **disclosure obligations** will apply to all quoted companies and will come into effect for reporting periods falling on or after **1 October 2012**, but this has not yet been officially confirmed. Unofficially this is the timetable being worked to.

Under the proposals there will be two separate remuneration statements: a forward looking section on proposed future remuneration policy and a backward looking section reviewing the current year.

The 'current year' section of the remuneration report will include the following details:

- The remuneration of each director will be shown as a single cumulative figure. It is thought likely that companies will have to account for share options, LTIP's and pensions in calculating this figure, although the details will not be known until the draft legislation is published;
- A 'distribution statement' showing how executive pay compares with other dispersals such as dividends, business investment, tax, employee costs and so on;
- Details of the use of remuneration consultants, including the disclosure of fees spent on consultants, the consultants used and who they report to;

Vince Cable, Secretary of State for Business Innovation and Skills, announces new proposals on executive pay

- A statement of how overall remuneration relates to the achievement of the company's strategic objectives over the course of the previous year.

The 'future pay policy' section of the remuneration report will include the following details:

- How the remuneration proposals for the year ahead relate to the company's strategic objectives, how performance will be assessed and include estimates of future payouts based on different scenarios;
- An explanation of why the company has used specific benchmarks to determine pay;
- Details of how the Remuneration Committee has taken into account employees' earnings (including pay differentials) when setting future pay policy;

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- Details of how shareholders' views, and the result of previous votes, have been taken into account when setting the policy.

The Government has decided not to take forward its earlier proposals about including an employee representative on the Remuneration Committee. However, companies will be required to explain how they have consulted employees when setting executive pay. In the absence of any existing employee representative forum, companies will have to consider how to achieve such consultation. Whether there is an existing employee forum or not companies will need to assess the nature and timing of employee consultation on this issue.

It is as yet unclear whether consultation is intended to achieve some form of agreement between employee representatives and the Remuneration Committee and/or company or whether it will be more akin to an information process on the part of the company who must give employee representatives the opportunity to express their views without any obligation to act on them. Vince Cable has encouraged employees to use their existing legislative right to set up an information and consultation arrangement in order to receive information and discuss issues about the company "including their bosses' pay".

The Government has also stopped short of requiring companies to publish pay ratios (between the chief executive's earnings and the median earnings of the workforce as a whole), a proposal raised in the September 2011 consultation paper. The rationale for this decision is that the way in which different businesses structure themselves may render mandatory disclosure of such ratios meaningless.

> "The evidence is clear that business and investors recognise that there is a disconnect between top pay and company performance, and that something must be done."
> *Vince Cable, Secretary of State for Business, 23 January 2012*

Say on Pay: greater shareholder power: The Government will also consult on the following measures aimed at giving shareholder's greater influence over executive pay:

- Giving shareholders a "binding" vote on: (a) future pay policy for the Board as a whole (including details of how performance will be judged and specific figures on the pay outs executives could receive); (b) notice provisions exceeding 12 months in the contracts of new appointments; and (c) a vote on termination payments in excess of 1 year's basic salary;
- Giving shareholders an advisory vote on how the company has implemented the approved pay policy in the preceding year including on amounts paid;
- Whether further sanctions are required if a significant number of shareholders dissent in the advisory vote;
- Increasing the threshold for shareholder approval of future pay proposals to 75% of the vote cast for the motion.

Granting shareholders a binding shareholder vote on termination payments and notice provisions is likely to make negotiations with departing executives extremely uncertain (and perhaps therefore more difficult to resolve). It will also be difficult to apply such a rule in a take-over situation (where the new shareholder will potentially have little interest in ratifying a deal for departing executives).

We understand that further details relating to the proposals regarding shareholder votes are likely to be published in a matter of weeks.

Remuneration Claw-back: The Government is to ask the Financial Reporting Council to consult on an amendment to the UK Corporate Governance Code (the "**Code**") to require quoted companies to include "claw-back" mechanisms in contracts to allow variable remuneration to be recovered.

Pending publication of draft legislation, the detail of how the claw-back will operate is unclear. Is the intention to impose a 'malus' regime permitting a company to adjust the level of, or extinguish, deferred variable compensation (which has been awarded but not yet received by the executive)? Alternatively if a 'true' claw-back requirement is to be imposed where a cash bonus has been paid or shares under awards have vested this will give rise to practical issues. The executive may not be in a position to repay immediately. The position is also complicated by the fact that the executive will already have paid tax and national insurance on the remuneration.

Greater Board diversity: The Government believes that greater diversity at Board level will help minimize conflicts of interest and give rise to 'fresh thinking'. The Secretary of State has indicated that he would like to see at least two Board members without previous Board experience and has

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> “No proposal on its own is a magic bullet..”
> *Vince Cable, Secretary of State for Business, 23 January 2012*

encouraged the appointment of lawyers, academics and public servants. Changes to the Code take effect later this year which will require companies to report on their policy on boardroom diversity, how they propose to deliver it and what progress has been made.

The Government response suggests that there may be further consultation to amend the Code to prevent serving executives from sitting on other large companies' remuneration committees.

Establishment of a High Pay Centre: A High Pay Centre will be established to monitor executive pay.

Simplification of narrative reporting

BIS' key proposal, set out in its September 2011 consultation paper is to simplify the structure and content of narrative reports by:

- replacing the current Business Review with a new Strategic Report; and
- replacing the current Directors' Report with a new Annual Directors' Statement (“**ADS**”).

BIS intends that these enhanced disclosure requirements will apply to all quoted companies and will come into effect for reporting periods commencing **on or after 1 October 2012**.

Strategic Report: Currently, all companies (except small companies) must include a Business Review in the annual report (s.417 CA 2006). BIS proposes to replace the Business Review with a Strategic Report. The new Strategic Report is intended to provide key strategic information about the company and will include high level disclosures about:

- strategy;
- business model;
- performance (including key financial data);
- risks;
- social and environmental information (where necessary); and
- key information on corporate governance and remuneration.

As with the current Business Review, it is proposed that small companies will be exempt from producing a Strategic Report.

It is unclear whether the “new style” remuneration report (containing both a forward looking section on future remuneration policy and a backwards looking section reviewing the current year) will form part of the Strategic Report. Given its importance, it seems likely that it would form part of the Strategic Report, however, until we have sight of the proposed legislation, this remains uncertain.

Annual Directors' Statement (“ADS”): In contrast to the high level disclosures envisaged under the Strategic Report, the ADS is intended to contain the more detailed disclosures underpinning the Strategic Report and to be the repository for disclosures required by law, regardless of materiality. The September 2011 consultation paper envisages that the ADS will replace the current Directors' Report and will encompass the corporate governance statement and audit committee report, plus any additional disclosures that a company chooses to make. The consultation also envisages that the remuneration report would form part of the ADS, however, as mentioned above, the September 2011 proposals regarding the remuneration report have largely been superseded by the Government's recently announced proposals and the remuneration report may now form part of the Strategic Report.

BIS proposes that the ADS will follow a prescribed lay-out, enabling investors to compare like with like (but which, no doubt, will increase the “tick the box” effect of this type of reporting). It will be produced in an “online-friendly” format, although shareholders will be able to request hard copies if they wish.

Editor Comment: Undoubtedly, these proposals are a step in the right direction. However, it is hard to fully assess the impact of some of the proposals at this stage – the devil, as ever, is in the detail and no draft legislation has yet been published. In particular, it is unclear how the claw-back provisions will work in practice or how companies, in calculating a single cumulative remuneration figure for each director, will be required to value share options, LTIPs and pensions. Once the detail of the proposals is made public, Clifford Chance will publish a separate analysis of their implications for issuers.

What the Government has done is to provide a spring-board for investors to take greater control over the remuneration packages of the executives running the companies in which they invest. Whether shareholders now take up the challenge remains to be seen: in the past, many have not shown a strong inclination to properly challenge excessive pay rewards.

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Second corporate manslaughter prosecution gets underway

Lion Steel Ltd has become the second company to be charged with corporate manslaughter under the Corporate Manslaughter and Corporate Homicide Act. This prosecution follows the successful conviction of Cotswold Geotechnical (Holdings) Ltd in 2011 (reported on in our July 2011 Corporate Update).

Lion Steel will be prosecuted for corporate manslaughter alongside three of its directors, who are charged with the common law offence of gross negligence manslaughter after an employee fell to his death. The CPS will also bring charges for health and safety breaches against both the company and directors. If convicted, the firm can face substantial fines, and the directors a term of imprisonment. After a preliminary hearing in August 2011, a trial date has been set for July 2012.

For a copy of our client briefing on this subject published in July 2011 see http://www.cliffordchance.com/publicationviews/publications/2011/07/second_corporatemanslaughterprosecutionget.html

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Case Law Update

Meaning of "all reasonable endeavours" and "best endeavours"

The High Court recently held that an obligation to use "best" or "all reasonable endeavours" in a contract may require a party to act against its own commercial interests in certain circumstances[3].

This case highlights the risks to a party in accepting a "best endeavours" or "all reasonable endeavours" obligation, and the uncertainty as to what such an obligation may require.

Background

Jet2.com ("**Jet2**") and Blackpool Airport Limited ("**BAL**") entered into an agreement that provided that (1) they would co-operate together and use their best endeavours to promote Jet2's low-cost services from the airport and (2) BAL would use all reasonable endeavours to provide a cost base that would facilitate Jet2's low-cost pricing. For several years Jet2 operated flights outside of the airport's published opening times with BAL's co-operation. However, in October 2010, BAL gave Jet2 one week's notice that it would no longer be accepting departures or arrivals scheduled outside normal hours.

Jet2 claimed that BAL was in breach of its obligations to promote Jet2's services and to provide a suitable cost base by refusing to accept flights outside normal hours. BAL argued that its obligations (to use best or all reasonable endeavours) did not require it to do anything contrary to its legitimate commercial interests.

The court's decision

The judge concluded that the meaning of the expression "all reasonable endeavours" is a question of construction and not to be extrapolated from other cases - hence the expression will not always have the same meaning. Sometimes considerations such as a party's own inclinations and subjectively measured interests will be part of the construction exercise; other times the approach will be objective. When considering an obligation to use all reasonable endeavours to obtain something *from a third party*, the judge noted that it is clear that sacrifice of one's own commercial interests is not required.

On the facts of this case, the judge held that the parties could not have intended that BAL should be able to pick and choose what to do in the light of what suited it financially. The judge noted that it was improbable that the parties would have used an expression in the agreement to mean that one of them could limit or abandon performance once it became commercially undesirable or unprofitable, as this is just the sort of risk that a party expects to undertake when it enters into a contract. In the judge's view any such unusual provision (akin to an exclusion clause) would have to be explicit before being accepted as part of what had been agreed. Accordingly, the judge held that BAL had breached its obligations by its sudden and unilateral decision to refuse to accept flights outside of normal hours.

However, the judge refused to make a declaration that BAL's obligations in the agreement imposed an absolute commitment to provide out of hours services for the remainder of the contractual period, noting that the words "all reasonable endeavours" must impose a lesser obligation. The judge went on to observe that "*the exercise of determining whether or not "best endeavours" have been used is highly fact sensitive and a conclusion reached on one set of facts may be different [to the conclusion reached on different facts], even if those facts change in comparatively minor respects*".

Editor Comment: This case highlights the risks to a party in accepting a "best endeavours" or "all reasonable endeavours" obligation, and the uncertainty as to what such an obligation may require. In particular interpretation of such obligations may be very fact specific and the same clauses in an agreement could be interpreted in different ways depending on the facts existing at the different times.

[3] **Jet2.com Ltd v Blackpool Airport Ltd** [2011] EWHC 1529 Comm

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Meaning of "gross" negligence

> “one would expect persons to mean something different by the use of the term “gross” negligence rather than the simple use of the term “negligence”. Why else would the word “gross” be used?”

The Irish courts were recently asked to consider whether an alleged breach of contract was gross negligence (and therefore outside of the scope of a clause limiting liability) or not. There exists a long-standing debate as to whether there is any distinction between "gross negligence" and "negligence" under English (or in this case Irish) law.

In this case[4], the judge held that gross negligence meant "*a degree of negligence where whatever duty of care may be involved (either in the tort of negligence or a contractual duty of care) has not been met by a significant margin*".

Background

The European Computer Driving License Foundation (the "**Foundation**") holds the intellectual property in an internationally recognised IT skills certification programme, which operates in many countries, including Saudi Arabia. Initially the Foundation intended to grant a licence in respect of the operation of the programme in Saudi Arabia to a Saudi governmental body, but due to reservations about the terms of the licence, it was instead granted to a company which had close links with the governmental body. The relationship between the Foundation and the company deteriorated and resulted in the Foundation (wrongfully) terminating the original licence and issuing a new one to the governmental body. The original company licensee sued for damages for breach of contract. The licence contained a limitation of liability clause, which capped the Foundation's liability at €50,000, except where the liability was caused by a wilful act or gross negligence by the Foundation. Accordingly, the judge had to consider whether the wrongful termination amounted to a wilful act or gross negligence.

The court's decision

Having concluded that the termination did not amount to a wilful act, the judge turned to a consideration of the various English authorities on the meaning of "gross negligence". Relying on various 19th century authorities, the licensee argued that there was little (if any) distinction between negligence and gross negligence[5].

The Foundation, on the other hand relied on the obiter comments in a more recent case[6] in which Mance J (as he then was) expressed his view that ""*gross negligence*" *is clearly intended to represent something more fundamental than a failure to exercise proper skill or care constituting negligence*".

The judge agreed with the Foundation, noting that as the limitation clause was contained in a commercial contract, it was not important whether the term "gross negligence" was a term of art in any particular area of the law; rather its meaning was a matter of contractual interpretation. The judge's view was that "*one would expect persons to mean something different by the use of the term "gross" negligence rather than the simple use of the term "negligence". Why else would the word "gross" be used? Obviously negligence implies a duty of care. However, anyone involved in negligence litigation would be more than familiar with cases where the margin by which someone has failed to meet the duty of care imposed on them is large. It seems to me that that is the ordinary meaning of the term "gross negligence". It is a degree of negligence where whatever duty of care may be involved has not been met by a significant margin.*"

In fact, the actual breach in question did not involve any breach of a duty of care, it was simply a breach of contract (a wrongful termination). In order to give business efficacy to the contract, the judge found that, as a matter of interpretation, the limitation of liability clause actually covered all breaches of contract (not just a breach of a duty of care) except those resulting from "*a significant degree of carelessness*" i.e. gross negligence. Accordingly, the Foundation was liable to pay damages for wrongfully terminating the licence and the limitation of liability clause did not apply.

[4] **ICDL GCC Foundation FZ-LLC and another v The European Computer Driving License Foundation Ltd** [2011] IEHC 343

[5] **Austin v Manchester, Sheffield and Lincolnshire Railway Company** (1852) 10 CB 454, where the court cited with approval the statement of Lord Denman in **Hilton v Dibber** (1842) 2 Q.B. 646 that "*It may well be doubted whether between gross negligence, and negligence merely, any intelligible distinction exists.*"

[6] **Red Sea Tankers Limited v Papachristidis** [1997] 2 Lloyd's Reports 547

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Editor Comment: Limitation of liability clauses/ indemnities often contain carve outs so that they do not apply where the liability arises from the bad faith, negligence/gross negligence or wilful act/omission/default of the person who would otherwise benefit from the clause/indemnity, as in this case. This case provides helpful guidance on how such terms might be interpreted and provides support to the view that the English courts will give effect to the expression "gross negligence" in a commercial contract. However, as it is an Irish court decision, it does not put the point entirely beyond doubt and the arguments over the distinction may well continue.

Contractual obligation to negotiate in good faith NOT enforceable

The High Court recently held that a side letter outlining the terms of a proposed equity investment was too uncertain to be enforced, and in particular that an express obligation to negotiate the terms of the investment in good faith was unenforceable[7].

The court's decision

The decision in this case follows the traditional position taken by English law, in particular the decision of the House of Lords in **Walford v Miles**[8], that "*an agreement to negotiate, like an agreement to agree, is unenforceable ... simply because it lacks the necessary certainty*".

"It is possible that in the right circumstances a court might be prepared to hold that an express obligation to negotiate in good faith is enforceable."

The judge cited with approval an analysis of the current law by Ed Peel (Oxford academic, editor of Treitel and consultant to Clifford Chance):

"*an agreement to negotiate in good faith is unenforceable and is no more enforceable when it is couched in terms of an agreement to use best or reasonable endeavours to agree. When the parties have entered into an agreement which is otherwise enforceable, it will not become unenforceable simply because the parties have agreed to negotiate any outstanding terms, but the agreement to negotiate is not itself enforceable. Such an agreement may be "enforceable" where the parties have set out objective criteria, or machinery for resolving any disagreement, but the reality is that the agreement to negotiate is then irrelevant and the court simply completes the agreement by reference to such objective criteria or machinery stipulated*".

The judge in **Barbudev** did not consider the more controversial point raised by the Court of Appeal in **Petromec**[9]. In that case, Longmore LJ made some obiter comments that in some circumstances an express obligation to negotiate might be enforceable; in particular he commented that "*it would be a strong thing to declare unenforceable a clause into which the parties have deliberately and expressly entered*".

Commentary

Ed Peel's view (expressed in the conference paper, which contains the analysis cited by the judge in **Barbudev**) is that a limited reform of the law in this area (as advocated by Longmore LJ and Lord Steyn) might be appropriate. In his paper, he considers what might be meant by "good faith" in the context of an agreement to negotiate, and suggests that due to the adversarial nature of the negotiating process, it could only be given the same limited meaning as it has in cases where a contract confers a discretion on one party (i.e. that a discretion must be exercised honestly and in good faith, and not arbitrarily, capriciously, unreasonably or for an improper purpose). Such a reform would be enough to recognise that agreements to negotiate are enforceable, but acknowledges that a breach would be a relatively rare event and that the claimant would most likely be confined to recovering the amount of his wasted expenditure.

Editor Comment: The current position is that an agreement to negotiate is unenforceable. However, it is possible that in the right circumstances a court might be prepared to hold that an express obligation to negotiate in good faith is enforceable following the comments made by Longmore LJ in Petromec and the views of Lord Steyn and Ed Peel. Readers should bear this in mind, if including an obligation of this nature in any agreement.

A detailed briefing on the **Barbudev** case is available at: http://www.cliffordchance.com/publicationviews/publications/2011/07/a_contractual_obligationtonegotiateingoo.html

[7] **Barbudev v Eurocom Cable Management Bulgaria** [2011] EWHC 1560

[8] [1992] 2 AC 129

[9] **Petromec Inc v Petromec Brasileiro SA Petrobras** [2005] EWCA Civ, 891

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Corporate Governance Update

Clifford Chance AGM Update: 2012

With the AGM season fast approaching, Clifford Chance has prepared its annual AGM Update to highlight changes in practice and procedures which those responsible for organising and administering the company's AGM should be aware of. Readers will have recently received our AGM Update.

ABI publishes new guidelines on executive pay and effective board performance

The Association of British Insurers ("**ABI**") has issued revised Principles of Executive Remuneration and published its first report on Board Effectiveness. The ABI considers that the two reports, published in September 2011, represent best practice in the UK. They follow increased scrutiny of executive pay and board performance, including the recent Government-led discussion and consultation focusing on the link between rewards and performance (discussed on pages 2-5 above).

The ABI has published its first report on Board Effectiveness

Principles of Executive Remuneration

The revised Principles build on previous guidelines issued by the ABI over past years (although they have not changed significantly). The ABI stresses that company boards should support appropriate rewards for exceptional performance and not reward failure with payment. In addition, the ABI believes that boards need to better understand that excessive or undeserved remuneration undermines efficient company performance, has an adverse impact on company reputation and runs counter to shareholder interests.

Report on Board Effectiveness

This Report is the ABI's first report on the effectiveness of boards. It focuses on what the ABI considers to be the three key issues for improving board effectiveness:

- board diversity: including increased female representation in the boardroom (following the February 2011 Davies Report, "Women on Boards");
- succession planning: highlighting the importance of board engagement in planning the succession and replacement of all senior management; and
- regular board evaluation: including reporting on discussions about risk management, corporate strategy, operations and reporting.

In addition, the Report contains a review of best practice by reference to the annual reports of selected FTSE 350 companies.

The ABI's revised Principles on Executive Remuneration is available at http://www.ivis.co.uk/ExecutiveRemuneration.aspx

The Report on Board Effectiveness is available at http://www.ivis.co.uk/PDF/ABI_1684_v6_CS4.pdf

FRC's next steps to promote effective company stewardship

Responding to concerns about the effectiveness of corporate governance, financial reporting and audit in the wake of the 2007/2008 financial crisis, the Financial Reporting Council ("**FRC**") published its paper "Effective Company Stewardship: Next Steps" in September 2011.

FRC conclusions

The paper follows the FRC's January 2011 discussion paper, "*Effective Company Stewardship – Enhancing Corporate Reporting and Audit*". It outlines the responses that the FRC received to that discussion paper and summarises the action that the FRC intends to take:

- **Narrative reporting:** the FRC will support BIS in its consultation on narrative reporting (see page 2 above). It also plans to establish a

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Financial Reporting Laboratory (launched in October 2011), where companies can discuss and trial new approaches to reporting with regulators and investors;

- **Strategy, risk and going concern:** the FRC believes that narrative reporting should focus primarily on strategic risk, rather than operational risks or naturally arising risks like earthquakes. It intends to update the Turnbull Guidance to reflect risk developments and will consider corresponding amendments to the Corporate Governance Code (the "**Code**");
- **Role of the audit committee:** the FRC proposes that the audit committee should report to the whole board and that its report should be published in full in the annual report. It plans to consult on amendments to the Code and Guidance for Audit Committees, with a view to extending the audit committee's remit to include a consideration of the entire annual report; and
- **Audit and the role of auditors:** the FRC proposes more transparency in the audit process and believes that auditors can and should provide increased insight into the audit process. It proposes to review and consult on revisions to the auditing standards governing reporting by auditors to audit committees. It also plans to amend the Code to require companies to put their audits out to tender at least once every 10 years, or explain why they have not done so.

A copy of the FRC paper is available at http://www.frc.org.uk/images/uploaded/documents/ECS%20Feedback%20Paper%20Final1.pdf

Sharman Panel publishes preliminary report and recommendations into going concern and liquidity risk

In May 2011, the FRC launched a Call for Evidence led by Lord Sharman to identify challenges faced by directors, management and auditors where companies face going concern and liquidity risks. The aim was to capture lessons learnt since the FRC's 2009 guidance for directors on going concern statements and liquidity risks (the "**2009 Guidance**") and to determine possible improvements to that guidance and the existing reporting regime. The Panel's preliminary report (the "**Report**") was published on 3 November 2011. The key recommendations of the Report are discussed below.

Learning lessons from failures in the past

The Report recommends that the FRC should establish protocols with BIS and other regulatory authorities that will enable the FRC to take a more systematic approach to learning lessons from the failure of significant companies through assessing the underlying circumstances.

Expectation gap between going concern assessment and financial reporting process

The Panel identified an expectation gap between the going concern assessment and the financial reporting process based on the fact that there are currently two different thresholds relating to going concern: that adopted in the preparation of financial reports and that required by the Code.

The financial statements provide a backwards looking perspective on the issuer. The threshold for disapplication of the normal (going concern basis) requirements of the financial reporting standards is when "*management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so*". Some respondents to the Call for Evidence suggested that going concern disclosures indicating significant uncertainty are intended to contextualise the application or otherwise of the going concern basis of accounting and are therefore only required when the entity is very close to collapse or failure.

In contrast, the requirement of the Code (and Listing Rules) is to state that the entity "…***is*** a going concern", suggesting to some that the absence of any qualifying disclosures can be taken as a 'guarantee' that the entity will not collapse or fail.

In order to address this expectation gap, the Panel recommends that the FRC should harmonise and clarify the common purpose of the going concern assessment and disclosure process in both the Code and accounting standards. As part of this exercise, the FRC should consider whether the language of the Code to the effect that the directors should state that the company ***is*** a going concern is too definitive.

Review of 2009 Guidance

The FRC should review the 2009 Guidance to ensure that the going concern assessment:

- reflects the right focus on solvency risks, not just liquidity risks, regardless of the type of business;
- is more qualitative and longer term in outlook in relation to solvency risk than for liquidity risk; and
- includes stress tests both in relation to solvency and liquidity risks that are undertaken with "an appropriately prudent mindset".

Other recommendations

The Auditing Practices Board should consider amending auditing standards to require a statement in the auditor's report as to whether the auditor is satisfied that, having considered the directors' going concern assessment process, they have anything to add to the directors' disclosures about the robustness of the process and its outcome.

A copy of the Report is available at http://www.frc.org.uk/images/uploaded/documents/The%20Sharman%20Report%20-%20final%20031111.pdf

The Panel's final recommendations are expected to be published in February 2012.

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Regulatory Update

European Commission proposals for new Market Abuse Regulation raise serious concerns for issuers and market participants

The European Commission has published proposals for a new Market Abuse Regulation and Directive which will see the existing Market Abuse Directive ("**MAD**") repealed. Whilst the new Regulation preserves much of the existing market abuse regime, it introduces an expanded definition of "inside information". If implemented in its current form, the breadth of this new proposal is likely to cause both issuers and other market participants concern.

Why do we needs a new market abuse regime?

MAD came into force on 1 July 2005 and introduced a pan-European framework for tackling insider dealing and market manipulation practices. Over the last two years the European Commission has carried out a review of the operation of MAD and identified a number of perceived problems.

In particular, the implementation by each Member State of MAD has not been uniform and has led to an uneven playing field across Europe for the prohibition and enforcement of market abuse offences.

The problems can be broadly categorised as follows

- gaps in the regulation of new markets, new platforms and over the counter trading;
- gaps in regulation of commodities and commodity derivatives;
- regulators cannot effectively enforce MAD;
- lack of legal certainty undermining the effectiveness of MAD; and
- administrative burdens, especially for small and medium sized companies.

To address these concerns, the Commission has published proposals to replace the MAD with the Market Abuse Regulation ("**MAR**") and a separate Market Abuse Directive ("**MAD2**") which would require all Member States to introduce criminal sanctions for intentional insider dealing and market manipulation.

> "Although the rules of preventing and fighting market abuse offences are in place at EU level... experience shows that the desired effect, i.e. contributing effectively to the protection of the financial markets, has not been achieved by the current system."
>
> *Extract from the Explanatory Memorandum to the European Commission's Proposal for a Directive on criminal sanctions for insider dealing and market manipulation (MAD2)*

As the MAR will have direct effect in Member States, the Commission hopes to eliminate differences between the scope of Member States' market abuse regimes and the sanctions for breach.

Under the Commission's proposals, Member States would be required to introduce criminal sanctions for intentional insider dealing and market manipulation.

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> "The identification of inside information is already a difficult exercise for issuers – these proposals have the effect of making it even more so."

Key proposals

An expanded definition of inside information – MAD defines inside information as non-public information of a precise nature that would be likely to significantly affect the prices of relevant financial instruments. In determining whether information is price-sensitive, issuers should consider whether the information in question is information that a reasonable market participant would be likely to use as part of the basis of his investment decision.

However, MAR extends the definition of inside information to include a new category of non-public information that a reasonable investor would regard as relevant when deciding the terms of a transaction. In other words, there would be no requirement for the inside information to be either *precise* or *price sensitive*. The identification of inside information is already a difficult exercise for issuers – these proposals have the effect of making it even more so.

Those working for a company with access to confidential information about the company may find it extremely difficult to conclude that unpublished information they have is not inside information. This has a number of potential implications: (i) companies may be forced to take a more cautious approach, which is likely to result in more frequent announcements being made to the market; (ii) those individuals privy to confidential information may find themselves unable to deal in the company's securities; and (ii) it may also limit a company's ability to engage with its investors and provide information to them as part of its investor relations programme where such information has not first been announced to the market given the risk that such information may constitute inside information.

A new offence of attempted market manipulation – in order to compliment the existing prohibition on market manipulation, MAR introduces a prohibition against persons attempting to engage in market manipulation on the basis that failed attempts to manipulate the market should also be sanctioned;

Enhanced coverage – MAD applies to financial instruments admitted to trading on an EU regulated market. MAR extends the scope of the market abuse regime to cover financial instruments admitted to trading on multilateral trading facilities ("**MTF**") and organised trading facilities, if they are within the EU. This will significantly extend the scope of insider dealing and market manipulations rules, in particular to cover securities listed outside the EU, many of which are also traded on EU MTFs. This brings with it various concerns for market participants which are discussed in our detailed briefing on the new MAR – see below for details. MAR also extends the market abuse rules to cover EU emissions allowances and related products;

Obligation to notify competent authority of decision to delay market disclosures – MAR includes a new requirement for issuers that delay the disclosure of inside information to inform their competent authority of the decision to delay disclosure once the information has been disclosed to the public;

Protection for whistle blowers – MAR will require competent authorities to put in place arrangements to encourage whistle blowers to alert them to possible breaches of MAR and to ensure that whistle blowers are protected from retaliation;

Notification of PDMR transactions – With regard to notifications of transactions conducted by persons discharging managerial responsibilities ("**PDMRs**") of issuers, MAR provides clarification that the obligation to publish details of PDMRs' transactions includes the pledging or lending of financial instruments and also transactions by another person exercising discretion on a PDMR's behalf. MAR also introduces a threshold below which no notification is required. The obligation to disclose PDMR transactions will not apply to transactions of less than €20,000 over the period of a calendar year;

Enhanced powers for competent authorities – Competent authorities will have enhanced powers to access private premises and seize documents. The Commission is firmly of the view that in order to assist the detection of cases of insider dealing and market manipulation, competent authorities need greater powers of investigation;

Cross border co-operation – MAR places an obligation on competent authorities to co-operate and exchange information with other competent and

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regulatory authorities and with the European Securities and Markets Authority ("**ESMA**") in relation to cross border investigation activities;

Exemptions – Exemptions for buy-back programmes and stabilisation of financial instruments conducted in accordance with the existing buy-back and stabilisation regulation will be grandfathered for one year after the date of coming into effect of MAR. New measures will be put in place to ensure that buy-back programmes and stabilisation activity continue to benefit from an exemption where carried out within the scope of specified parameters; and

Criminalisation of market abuse offences – Under MAD2 insider dealing and market manipulation will be criminal offences where committed intentionally. Inciting, aiding and abetting and attempting such offences will also be criminalised.

Timing

MAR and MAD2 must make their way through the European legislative process. It is intended that MAR will have direct effect in Member States two years after its entry into force. Member States will have the same period to implement the provisions of MAD2 into national law. It reality, it is unlikely that MAR and MAD2 will come into force before the end of 2014.

UK extends super-equivalent market abuse provisions

HM Treasury published The Financial Services and Markets Act 2000 (Market Abuse) Regulations 2011 in December 2011. These Regulations extend sections 118(4) and 118(8) of FSMA until 31 December 2014, the likely date of implementation of MAR and MAD2. These provisions are wider in scope than the market abuse prohibitions contained in MAD and relate to abusive behaviour which would mislead or distort the market.

For a copy of the detailed Clifford Chance client briefing on the new MAR see http://www.cliffordchance.com/publicationviews/publications/2011/10/market_abuse_europeancommissionproposesnewe.html

> "The negative impact which such proposals may have on a company's ability to engage with its shareholders seems fly in the face of other initiatives which the Commission is promoting to increase shareholder engagement."

Editor Comment: The proposals to extend insider dealing to cover a broad range of information which investors find "relevant", even if not precise or price sensitive is currently causing concern to both issuers and other market practitioners. How are issuers to determine whether unpublished confidential information about the company should be treated as inside information when such a open-ended test applies? Notwithstanding the other concerns raised above, the negative impact which such proposals may have on a company's ability to engage with its shareholders seems fly in the face of other initiatives which the Commission is promoting to increase shareholder engagement and participation. Clifford Chance has been participating in initiatives to work with the FSA and HM Treasury to lobby the European Commission to come up with more workable proposals.

European Commission publishes proposals to amend the Transparency Directive

The European Commission has published the provisional wording of a draft directive to amend the Transparency Directive ("**TD**"). The key changes include:

- the abolition of the requirement to publish quarterly financial information or interim management statements for companies with shares traded on a regulated market;
- changes to the requirements to notify major interests in shares and related financial instruments; and
- enhanced powers for competent authorities to impose sanctions for breaches of the transparency regime.

Key requirements of the TD

The TD introduced the following key provisions in January 2007:

- the requirements for issuers to publish periodic financial reports including an annual report, half yearly report and interim management statements (in the UK, these requirements are found in DTR 4);

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- the requirement for major shareholders to disclose holdings of voting rights subject to specified thresholds and an obligation on the issuer to disclose such information to the market (DTR 5); and
- the requirement for companies to release information to investors on a pan European basis (DTR 6.3).

Proposed amendments to the TD

Abolition of requirement to publish interim management statements: the requirement to publish interim management statements is to be abolished for all listed companies. The abolition is intended to reduce the regulatory burden on listed issuers and to encourage a focus on long term investment rather than short term gain. The obligation on issuers to publish inside information under MAD, coupled with the requirement for issuers to prepare a prospectus before undertaking any significant issue of shares, means that investors will not be unduly affected by the removal of this requirement. Issuers remain free to publish interim management statements if there is continued investor appetite for them.

Notification of major interests regime: the rules regarding the notification thresholds for shareholders when they reach a certain stake in a listed company do not currently extend to holdings of certain types of financial instruments that can be used to acquire an economic interest in listed companies shares. Accordingly, the Commission intends to extend the definition of "financial instruments" to cover all instruments of similar economic effect to holdings of shares and entitlements to acquire shares, whether giving right to physical settlement or not. Broadly speaking this will bring the EU requirements in line with the UK's super equivalent rules set out in DTR 5 which require notification of financial instruments creating a long economic position in an issuer's shares.

In addition, in order to create greater harmonisation across Europe, the TD will be amended to require Member States to impose rules which require the aggregation of holdings of voting rights with holdings of financial instruments in order to calculate the thresholds for notification of a major holding. Netting of long and short positions will not be allowed and the notification must include the breakdown by type of financial instruments held in order to provide the market with detailed information on the nature of the holdings.

Member States will however continue to be allowed to set lower national thresholds for the notification of major holdings than those prescribed in the TD.

Storage of regulated information: the Commission acknowledges that accessing financial information about listed companies on a pan European basis remains difficult as each Member State has a different national database which needs to be searched for the requisite information. The Commission recognises that the current network of national storage mechanisms should be enhanced and it is proposed that the Commission receive further delegated powers, to enable it to progress access to regulated information at a European Union level, with the ultimate intention of creating a single European storage mechanism for regulated information.

Sanctions and investigations: it is proposed that competent authorities be given enhanced sanctioning powers for breaches of the TD. Sanctions should be published and authorities will also be given the power to impose fines of up to 10% of a company's total annual turnover or €5 million in the case of an individual. It is also proposed that competent authorities be given powers to suspend the exercise of voting rights attaching to the shares of an entity or an individual where such persons have breached the notification of major shareholding requirements.

FSA and HMT consult on implementation of changes to Prospectus Directive

The Prospectus Directive came into force on 1 July 2005 and provides a pan-European framework for the preparation, approval and publication of prospectuses for public offers of securities and for the admission of securities to trading on an EU regulated market.

Directive 2010/73/EU, which amends the Prospectus Directive came into force on 31 December 2010 (the "**Amending Directive**"). Member States have until 1 July 2012 to implement it into national law. In December 2011, the FSA and HM Treasury published a joint consultation paper on its UK implementation.

Amongst other changes, on implementation of the Amending Directive, issuers conducting rights issues will be able to take advantage of a new proportionate disclosure regime which it is hoped will reduce both the costs of launching a rights issue and the time it takes to prepare a prospectus.

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Key changes to the Prospectus Directive as a result of the Amending Directive

Prospectus Summaries: a key change here is that summaries will need to be prepared in a common format to facilitate comparability. There are also changes to the content of the summary and the liability which attaches to it. Work is still ongoing at an EU level to determine the specific content and format of the summary;

Exemptions and thresholds: changes will be made to the scope of the Prospectus Directive and the exemptions which will determine whether a prospectus is required. In July 2011, the UK implemented some of these changes early[10] in order to try and reduce the cost of equity fund raising for small and medium sized businesses.

One other key change non-EEA issuers will be pleased to see is that the Amending Directive extends the current exemption from the requirement to prepare a prospectus for employee share schemes to benefit non-EEA companies with employees in the EEA;

Retail cascades: the Amending Directive clarifies how the prospectus regime applies where there is a subsequent resale of securities through a financial intermediary (known as a "retail cascade"). A prospectus will not be required so long as a valid prospectus is still available and the issuer has consented in writing to its use by the financial intermediary;

"Measures intended to reduce the regulatory burden for listed issuers raising fresh capital are to be welcomed. However, the benefits of the proportionate regime for rights issue prospectuses may in practice be limited."

Proportionate disclosure regime for pre-emptive issues: issuers conducting pre-emptive offers (which would include rights issues but not open offers) will be able to prepare an abbreviated prospectus. The rationale for this change is that an existing issuer is already obliged to keep the market informed of key developments and to publish periodic financial information and accordingly, it should not be necessary for an existing issuer to publish the same level of information in advance of a share issue as an issuer coming to market for the first time.

In October 2011, ESMA published advice to the European Commission on the proportionate disclosure regime. Regarding the content of the proportionate prospectus, historical financial information will only be required for the last financial year (as opposed to three previous financial years). ESMA has also included in its technical advice a list of disclosures ordinarily required by Annexes I and III of the Prospectus Regulation which will not be required. These include, for example, the Operating and Financial Report, the history of the issuer's share capital, a summary of the memorandum and articles and information on holdings.

The joint FSA/HMT consultation is open until 13 March 2012.

Editor Comment: Measures intended to reduce the regulatory burden for listed issuers raising fresh capital are to be welcomed. However, the benefits of the proportionate regime for rights issue prospectuses may in practice be limited. Any company seeking to access capital from US investors is likely to have to prepare a "full" prospectus in order to better safeguard itself against potential liability under US securities laws.

FTSE tightens free float requirements for UK companies in UK FTSE Index Series

In response to market concerns about certain UK companies (predominantly where a UK holdco has been inserted over a non UK group of companies prior to IPO) with a low free float and accompanying concerns about poor corporate governance, the FTSE has tightened the free float requirements for the inclusion of UK companies in the UK FTSE Index Series.

[10] On 31 July 2011 changes were made to FSMA in order to increase the total size of the offer which may be made to investors before the offer falls within the prospectus regime from €2.5m to €5m and to raise the threshold for the number of investors to whom an offer may be made before a prospectus is required from 100 persons to 150 persons.

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Previously the ground rules for both the FTSE UK Index Series and the FTSE Global Equity Index Series have stipulated a minimum free float of 15% for a company to be eligible for inclusion in either index series (there is an exception for very large companies where a free float of 5% is permissible if the market capitalisation is in excess of $5bn).

Following a brief consultation, the FTSE announced in December 2011 that:

- the free float requirement will be set at 25% for companies in the FTSE UK Index Series;
- in circumstances where the UKLA has granted an exception to its requirements for 25% minimum shares in public hands for companies seeking a premium listing, the FTSE will maintain its 25% free float threshold;
- companies already admitted to the FTSE All-Share with a free float of less than 25% will be given 24 months to increase their free float to 25%.

Editor Comment: This change appears to be driven by market concerns over the recent inclusion of various newly-listed companies in the FTSE 100, despite their having free floats of less than 25%. Investment managers mandated to buy the shares of FTSE 100 companies may be reluctant to be invest in such shares where the reason for the reduced free float is that substantially all of equity is held by one significant shareholder (or group of founders), which of itself may raise governance concerns.

These changes took effect on 1 January 2012.

The minimum free float of 25% only applies to UK incorporated companies. Companies incorporated outside of the UK are already subject to a higher free float threshold of 50%.

FTSE has also announced its intention to consult on the creation of a new set of UK indices “which would impose a higher standard of corporate governance”.

Ken Morrison receives hefty fine for breach of DTRs

On 16 August 2011, the FSA fined Sir Ken Morrison £210,000 for breaching the Disclosure and Transparency Rules ("**DTRs**") by failing to disclose his reduced shareholding and voting rights in Wm Morrison Supermarkets Plc.

While Sir Ken did not financially benefit from these breaches, in the FSA's view his failure to notify Wm Morrison of the changes to his shareholding resulted in the company being unable to update the market in accordance with DTR 5. This resulted in the market being misled as to the ownership of voting rights in Wm Morrison for a period of three years and Sir Ken's shareholding being stated incorrectly in Wm Morrison's annual report of 31 January 2010.

The FSA has fined Ken Morrison £210,000 for a breach of its Disclosure and Transparency Rules.

Obligation to notify

Pursuant to DTR 5.1.2 a person must notify an issuer of the percentage of its voting rights which he holds or is deemed to hold (through his direct or indirect holding of financial instruments) if the percentage of those voting rights reaches or exceeds or falls below certain percentages. Disclosure is required not only by the registered holder but also by the beneficial owner.

Shortly after his retirement as Chairman of Wm Morrison, the company announced on 28 March 2008 that Sir Ken had a notifiable holding of voting rights of 6.38%. After that no further shareholding notifications were made concerning Sir Ken's holdings until 1 March 2011, despite the fact that he had reduced his holdings during the previous 3 years to 0.9%. Sir Ken failed to notify Wm Morrison on four separate occasions when his voting rights fell below 6%, 5%, 4% and 3%. The first three failures related to the sale of shares by Ken Morrison in his personal capacity and the fourth arose as a result of his resignation as a trustee of certain share-holding family trusts. Sir Ken's explanation for the failure to notify in good time was that he was not aware of the requirement to do so.

> "This fine highlights the importance of ensuring that relevant changes in shareholdings are notified to an issuer promptly."

Mitigating factors

In setting the level of the fine, the FSA must have regard to its Decisions Procedures and Penalties Manual. In Sir Ken's favour was the fact that he made no profit, nor did he avoid any loss as a result of the breach, there was limited effect on the orderliness of the market and, whilst he should have been aware of the obligations and might have been expected to take legal advice when selling shares, there was no evidence to suggest he was reckless in that regard or that his conduct was deliberate. However, the FSA took Sir Ken's prominent position in the industry into account. Ultimately, a fine of £210,000 was imposed. Sir Ken's co-operation and early settlement meant he qualified for a 30% reduction in penalty (thereby reducing the penalty from £300,000).

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Editor Comment: This fine highlights the importance of ensuring that relevant changes in shareholdings are notified to an issuer promptly. Directors should also be mindful that the shareholder notification rules catch not only personal shareholdings but those arising, for example, where they act as a trustee of a family trust.

Issuers not obliged to verify information set out in major shareholding notification

The FSA has announced details of a change to the Disclosure and Transparency Rules, which will take effect on 1 February 2012. The addition of a new DTR 1A.3.2A is to clarify that the issuer's duty to take reasonable care to ensure that information provided to a RIS is not misleading, false or deceptive (under DTR 1A.3.2R) does not apply to the issuer's obligation under DTR 5.8.12R to make public the information contained in a voteholder notification made to it under DTR 5.1.2R.

Editor Comment: This clarification will be welcomed by issuers. Whilst in practice most issuers do a general "sense check" on the information contained in a voteholder notification, with a view to avoiding publishing information which appears to be obviously wrong, this is done as a matter of prudence rather than duty. It is not considered market practice for issuers to take steps to verify the information unless they spot something which looks obviously wrong.

Market Abuse Prosecutions

The FSA continues to be active in its prosecution of market abuse and insider dealing. Its key prosecutions are discussed below:

FSA imposes largest fine on an individual to date

The FSA has fined Dubai based investor, Rameshkumar Goenka, $9.6m (approximately £6m) for manipulating the closing price of Reliance Industries' securities on the London Stock Exchange in breach of s.118(5) FSMA (market manipulation). This is the largest fine imposed by the FSA on an individual.

On 18 October 2010, Mr Goenka placed orders and executed trades which artificially inflated the closing price of Reliance securities. The trades were carefully planned with the intention of ensuring that Mr Goenka avoided a loss on an over-the-counter structured product which matured on the same day and for which the pay-out depended on the closing price of Reliance securities that day.

The fine of $9.6m comprises a penalty of $6.5m plus $3.1m to be used to reimburse the bank which overpaid Mr Goenka that amount as a result of his market abuse.

FSA focus on "layering" abuses

The FSA initially raised concerns about the practice of layering in its August 2009 newsletter Market Watch.

"*Layering*" or "*spoofing*" is the practice of submitting spoof orders to a stock's order book to improve the price in advance of submitting an order to the other side of the order book (reflecting the client's true intentions). Following execution of the latter order, the spoof orders are rapidly removed from the order book.

"The loss avoided was substantial. Manipulation of prices for ulterior motives poses a very real risk to the orderliness of and confidence in the markets."

FSA Final Notice issued to Mr Goenka, 17 October 2011

In Market Watch the FSA made clear its view that this type of behaviour could constitute market abuse (manipulating transactions) pursuant to s.118(5) FSMA. Despite this, the practice still persists in the markets. The FSA has so far fined one company, Swift Trade (see below), for engaging in layering activities and proceedings are ongoing against a number of other companies and individuals:

Swift Trade: On 31 August 2011, the FSA published a decision notice for Swift Trade Inc indicating that it had fined Swift Trade £8m for layering activities which created a misleading impression as to the supply and demand of various FTSE 100 and FTSE 250 stocks contrary to s.118(5) FSMA.

The FSA believed this to be a particularly serious case of market abuse, in that it was widespread and repeated on many occasions involving tens of thousands of trading orders by many individual traders sometimes acting in concert with each other across many locations worldwide. The trading led to a false or misleading impression of supply and demand and an

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artificial share price in the shares they traded to the detriment of other market participants. Further, in the FSA's opinion, when Swift Trade became aware that the London Stock Exchange had raised concerns about its trading activity it actively sought to evade restrictions on its trading by refining its trading pattern to avoid detection.

Swift Trade has referred the matter to the Upper Tribunal.

Da Vinci Invest: On 12 July 2011, the FSA obtained an interim injunction freezing the assets of three companies - Da Vinci Invest Ltd, a UK-registered but Swiss-based fund manager, a related Singapore-based company Da Vinci Invest PTE Ltd, and Mineworld Ltd, which is registered in the Seychelles. It obtained a further order on 31 August continuing the freezing injunction against the three companies and restraining their market abuse. This second injunction also covered three individuals (all of whom are resident in Switzerland and/or Hungary) who traded on behalf of the companies.

The FSA contends that from August 2010 to July 2011, these companies and individuals committed market abuse by engaging in layering practices. The FSA estimates that they made over £1 million gross profit from this activity. Proceedings are ongoing.

FSA prosecution of Mercurius Capital CEO and CFO

On 15 August 2011, the Upper Tribunal directed the FSA to fine Michiel Weiger Visser £2 million and Oluwole Modupe Fagbulu £100,000 and ban them both from performing any role in regulated financial services for breaching Principle 1 of the FSA's Statements of Principle for Approved Persons and for engaging in market abuse contrary to s.118(5) FSMA (manipulating transactions).

Visser was the CEO and Fagbulu was the CFO and compliance officer of Mercurius Capital Management Limited. Mercurius managed the hedge fund Mercurius International Fund which during the relevant period of July 2006 to January 2008 had approximately 20 investors and €35 million under management. The Fund collapsed and was placed in voluntary liquidation on 11 January 2008.

During the relevant period Visser deliberately misled investors by various means, including by engaging in market manipulation, to disguise the performance of the Fund and to secure continued and increased investment in the Fund.

Fagbulu was not involved in making investment decisions but was responsible for compliance oversight at Mercurius. He deliberately made or approved communications to investors which contained false information and omitted relevant information, and failed to ensure that the Fund complied with its investment restrictions. The Tribunal determined that Fagbulu's behaviour merited a fine of £350,000 but reduced the amount payable because this level of fine would cause serious financial hardship.

Visser has applied to have the Tribunal's decision set aside.

> "[The Sidhu] verdict should send a clear message to anyone else who might be tempted to do the same. Insider dealers are criminals, no more and no less, and we will treat them as such."
>
> *Tracey McDermott, FSA acting director of enforcement and financial crime*

Insider Dealing Update

In December 2011, the FSA achieved its sixth successful prosecution for insider dealing. Rupinder Sidhu, a management consultant, was found guilty of 22 counts of insider dealing sentenced to two years imprisonment.

Between 15 May 2009 and 22 August 2009, Sidhu was jointly involved with another individual, Anjam Ahmad, an ex-hedge fund trader and risk manager with AKO Capital LLP, in insider dealing in 18 different UK and European listed shares, based on inside information obtained by Ahmad about forthcoming transactions by AKO in those securities. Sidhu placed spread bets in relation to those securities and made approximately £524,000 profit. Sidhu's confiscation hearing will take place on 30 March 2012.

In June 2010, Anjam Ahmad, Sidhu's co-conspirator, was sentenced to 10 months imprisonment, suspended for two years, 300 hours of unpaid work in the community and was fined £50,000.

The FSA is currently prosecuting 16 cases of insider dealing, the majority of which are expected to come to trial in the first half of 2012.

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Antitrust Update

European Union Antitrust investigation procedures - best practices published

TThe European Commission (the "**Commission**") has adopted a series of measures aimed at increasing the Commission's interaction with parties in antitrust proceedings and strengthening the mechanisms for safeguarding parties' procedural rights.

In January 2010, the Commission consulted on earlier versions of a notice on best practices for the conduct of proceedings under Articles 101 and 102 of the Treaty on the Functioning of the European Union ("**TFEU**"), which regulate anti-competitive agreements and abuse of dominance, a working paper on best practices for the submission of economic evidence in such proceedings and a decision on the function and terms of reference of the Hearing Officer in such proceedings. These introduced certain reforms, such as "state of play" meetings at key points of the proceedings to provide opportunities for parties to communicate directly with the Commission.

Following that consultation, the adopted Antitrust Procedures Documents introduce additional procedural improvements, including:

- the provision to parties, by the Commission, of key submissions from complainants and third parties, including economic studies, prior to the issuing of the statement of objections ("**SO**");
- the explanation by the Commission, in the SO, of the parameters by which possible fines will be calculated, to give parties a better idea of what damages they may face;
- the introduction of "state of play" meetings to Article 101 proceedings;
- publishing rejections of complaints, in full or in summary; and
- specific guidance on the minimum standards for consumer survey evidence.

The role of the Hearing Officer (formerly an adjudicator of disputes following issuance of the SO) in the investigative portion of proceedings has been enhanced and now includes the power to intervene where: (i) parties feel that they have not been informed of their procedural status, (ii) deadlines to reply to information requests are disputed, (iii) legal professional privilege issues arise and (iv) parties feel that they should not be compelled to reply to questions which might force them to admit to an infringement.

These procedural reforms were introduced following increasing concerns about the fairness of the Commission's antitrust procedures arising from its combined roles as investigator, prosecutor and adjudicator. Commission Vice-President Joaquín Almunia stated, "*The procedural package demonstrates that we are willing to listen to stakeholders, learn from experience and make improvements, while maintaining efficient procedures.*"

OFT refers audit market to CC

The Office of Fair Trading ("**OFT**") has referred the market for statutory audit services to large companies in the UK to the Competition Commission ("**CC**") for a market investigation.

OFT concerns

The OFT is concerned that the audit market is highly concentrated, with substantial barriers to entry and low levels of switching. The OFT engaged with a wide range of industry participants where it examined, among other things, the potential for overlap with parallel work that is ongoing at the EU level. However, the OFT believed that the nature, content and timing of EU legislation are not settled and that there are a number of important inputs that the CC might make during the legislative process. The OFT considered that the CC's inquiry has the potential to address UK-specific competition concerns that may not be within the scope of the work at the EU level.

The OFT emphasised that it made its decision to make a market investigation reference following extensive public consultation. The CC now has a maximum of two years to conduct its inquiries and publish its report.

United Kingdom: OFT consults on new guidance on penalties and leniency

The OFT is consulting on two revised guidance documents, setting out proposals to update its approach to financial penalties and to awarding leniency in competition cases.

The OFT's guidance as to the size of financial penalties sets out the basis on which the OFT will calculate penalties for infringements of the UK and EU prohibitions on anti-competitive agreements and abuse of dominance (Chapters I and II of the Competition Act 1998 and Articles 101 and 102 TFEU).

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The proposed changes to its penalty guidance are designed to ensure that the OFT sets fines that are sufficient to deter companies from engaging in anti-competitive activity, but are also fair and proportionate. Key proposals include:

- increasing the maximum starting point for the calculation of fines from 10% to 30% of turnover in the market in which the infringement took place; and
- introducing a specific step at which the OFT will consider whether the overall penalty proposed is appropriate. At this step the OFT would be able to decrease the penalty to ensure that it is not disproportionate or excessive.

The OFT's aim is to enhance the transparency and predictability of its approach. The proposed increase in the maximum starting point for the calculation of fines would make the OFT's approach consistent with that of the European Commission and several other competition authorities. This approach was also recently suggested to the OFT for consideration by the Competition Appeal Tribunal (**Kier v OFT** ([2011] CAT 3).

The OFT's guidance on the awarding of leniency in competition cases sets out the circumstances in which the OFT can reduce financial penalties if a party to an illegal agreement or concerted practice alerts the OFT to an infringement and/or assists the OFT with its investigation. The OFT states that many of the proposed changes to its leniency guidance reflect the OFT's existing policies and practices, rather than representing substantive changes. This includes additional detail on the procedure for applying for leniency, the scope of leniency protection and the expected level of cooperation required from leniency recipients.

The consultation has now closed.

> "The proposed revisions to our penalty guidance are designed to give us access to a greater range of fines, in order to better reflect the seriousness of the infringements and deter anti-competitive activities, whilst ensuring that penalties are fair and proportionate. Our leniency guidance is designed to support an active programme of cartel enforcement, ensuring that the UK economy is protected from the harm that results from anti-competitive cartel behaviour."
>
> *John Fingleton, Chief Executive of the OFT*

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

David specialises in corporate finance, domestic and cross-border M&A, public takeovers, listed company and general corporate advisory work. Recent major transactions include advising: RBS on the sale of RBS Aviation capital to Sumitomo Mitsui Banking Corporation for $7.3bn; International Power on its combination with GdF Suez's international energy assets by means of reverse takeover; Man Group on its $1.6bn acquisition of US listed alternative investment manager GLG Partners Inc; and Vale on its $2.5bn acquisition of a controlling interest in a joint venture with BSG Resources Limited to develop iron ore concessions in Guinea, West Africa.

David is a member of the City of London Law Society's Company Law Committee and a contributing author to "A Practitioner's Guide to the City Code on Takeovers and Mergers".

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AGM Update: 2012 – January 2012

Major EU Competition Law Developments and Policy Issues – November 2011

Market Abuse: European Commission proposes new EU Regime – October 2011

Executive Remuneration: Government consults on enhanced disclosure and "say on pay" proposals – September 2011

Impact of UK Takeover Code Reform – September 2011

Corporate Update – July 2011

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