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July 2012

Corporate Update

Welcome to our July 2012 Corporate Update, our bi-annual newsletter which brings together all the latest developments in company law and corporate finance regulation.

The first half of 2012 has seen a heightened focus on the question of executive pay. Over the last six months, the Government has been honing its plans for the introduction of new regulation in this area. Most notably, shareholders are to be given a binding vote on a company's future pay policy (which would include a say on exit payments). At the same time, we have seen a so-called "shareholder spring" with investors being more vocal than ever during the 2012 AGM season with record numbers of directors' remuneration reports being voted down and a significant number of protest votes. See our Company Law Update for further information.

Also in the news is the issue of "wall crossing", the practice of making a person an "insider" by providing them with inside information. A number of high profile FSA market abuse prosecutions have brought into sharp focus the risks involved for companies and their advisers when engaging with shareholders and other investors about potentially price sensitive matters which are not yet in the public domain. For further details see our Regulatory Update.

These issues, along with a host of other recent legal and regulatory developments of interest to corporates and their advisers, are discussed in this edition of Corporate Update.

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Clifford Chance was ranked top globally by mergermarket in its half-year league tables for 2012 with an impressive 103 deals worth £101,741 million – as well as topping the rankings by value in Europe (specifically in the UK, France, Germany and the Benelux and Nordic regions). The firm also achieved a top ranking in Greater China for deals by volume over this period.

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IFLR Europe Awards, March 2012

Company Law Update

Will a "Shareholder Spring" herald an Autumn upheaval?

Since BIS published a discussion paper on executive remuneration last Autumn, the debate on executive pay has been in the spotlight. "Pay for performance" has dominated the headlines at the 2012 AGM season, with a number of high profile investor assaults on executive remuneration packages. A record number of directors' remuneration reports have been voted down, including WPP (59% vote against), Cairn Energy (67%), Pendragon (67%), Aviva (54%) and Centamin (63%). And even where reports have been approved there have been unprecedented numbers of protest votes.

Consequences have been severe at some companies; three chief executives of FTSE 350 companies have been forced to step down, following shareholder outrage over remuneration. Other companies have bowed to investor pressure and retracted the more controversial elements of proposed remuneration packages.

It is not clear whether the recent public mobilisation of institutional shareholder opposition to executive remuneration has been the result of the Stewardship Code encouraging a more proactive approach or of a concerted effort by institutional shareholders to demonstrate that the current system can and does work in order to forestall some of the more extreme proposals which have been mooted by the Government – or whether it simply reflects growing frustration at seeing remuneration levels increasing year on year irrespective of performance levels in terms of shareholder returns.

Encouraged by the so-called "shareholder spring" rebellions, the Government has over the last six months continued to develop its plans to give shareholders a greater say on pay and to ensure that pay is matched to performance and long-term success.

On 20 June 2012, Vince Cable, Secretary of State for Business, Innovation and Skills announced the key elements of the Government's proposals regarding executive pay. This was followed on 27 June by the publication of a consultation on revised remuneration reporting regulations which set out the details of the Government's proposals for the content of the directors' remuneration report. We are still awaiting publication of the Enterprise and Regulatory Reform Bill which is currently being debated by the House of Commons. Once published, we will be able to see the complete picture of the Government's proposals in this area.

The new regime is intended to promote greater shareholder influence and includes the following proposals:

- the director's remuneration report will consist of two distinct parts: a "Policy Report" and an "Implementation Report";
- the Policy Report will set out the company's future remuneration policy for its directors;
- shareholders will be given a binding vote on the Policy Report and, once approved, payments will only be allowed which are in line with the policy;
- the Implementation Report will set out how the pay policy was implemented in the previous financial year;
- shareholders will be given an annual advisory vote on how the previous year's remuneration policy has been implemented;
- a new obligation to publish director's exit payment details promptly;
- supplementary gold standard guidance on reporting obligations to be produced by business and investor communities;
- the new voting and reporting regime will be introduced for financial years ending after 1 October 2013.

Key features of the new remuneration reporting regime

New format for the Directors' Remuneration Report – The existing regime under which UK quoted companies are required to produce a director's remuneration report will be replaced. Going forward it is proposed that the remuneration report will be comprised of two parts: a Policy Report and an Implementation Report. The Government also proposes that the

> "There is compelling evidence of a disconnect between pay and performance in large UK listed companies and the call for action has been loud and clear....These are the most comprehensive reforms of directors' pay in a decade"
>
> *Vince Cable, Secretary of State for Business, Innovation and Skills, 27 June 2012*

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remuneration report be prefaced by a statement to shareholders from the Chairman of the Remuneration Committee summarising the key messages on remuneration and the context in which decisions have been taken.

Policy Report – The Policy Report is forward looking and will set out the company's future policy on remuneration. Shareholders are to have a new binding vote on the Policy Report; a majority vote only will be required to approve it as the Government has abandoned plans for a 75% majority vote.

Once the policy is approved, a company will only be able to make payments in accordance with the policy or will have to seek express shareholder approval if it wishes to deviate from the policy. Looking ahead, quoted companies will need to be cautious about entering into contractual commitments in relation to pay and termination arrangements as these will be void if they are not endorsed by the future remuneration policy that is approved by the shareholders.

Shareholders will have the opportunity to vote on the remuneration policy set out in the Policy Report annually, unless companies choose to leave their pay policy unchanged, in which case the vote will take place at least once every three years. Where the Policy Report is not approved by shareholders, the company will be obliged to continue using the existing remuneration policy until a revised policy is approved. The company will either have to convene a general meeting to put forward a revised remuneration policy or wait until the next AGM to do so.

Contents of the Policy Report

It is proposed that the Policy Report include the following information:

- A table setting out the key elements of pay and supporting information, including how each element supports the achievement of the company's strategy, maximum potential value and performance metrics.
- Details of service contract provisions in relation to remuneration.
- A graph depicting what directors will receive in various performance scenarios.
- Information on the percentage change in profits, dividends and the overall spend on pay.
- The principles on which exit payments will be made.
- Material factors that have been taken into account when setting the pay policy including employees' pay and shareholder views.

The draft regulations are not prescriptive in terms of the exact format of the pay policy table, the types of pay or the specific disclosures for each element of pay. Instead the Government anticipates that the legislative requirements will be supplemented by guidance on the level of detail and type of information to be disclosed. The guidance is to be agreed jointly between business and investor communities and will be in place before the new regulations come into effect. In its consultation paper, the Government notes that companies who currently adopt best practice are already disclosing information of the nature required by the Policy Report.

Implementation Report – Shareholders will continue to have an annual advisory vote on whether they are satisfied with the actual payment made to directors in the previous year. The vote will continue to be by way of a simple majority. In order to facilitate this vote quoted companies will be required to produce an annual Implementation Report. This will replace the existing reporting regime.

Exit payments – Companies will be subject to a new requirement to issue a statement as soon as reasonably practicable in the event of a director leaving. This statement will have to set out the particulars of the exit payment. In addition, the annual Implementation Report will require the Company to restate the details of the exit payments with the following details:

- the total level of compensation received and the value of each individual element of such total (i.e. in respect of basic pay, bonuses and pension contributions);
- an explanation of how each element of the payment was calculated;
- an explanation of how any decisions made relate to the company's policy on exit payments.

The Government's earlier plans to require a binding shareholder vote on exit payments in excess of 12 months' base salary have been abandoned, however it remains to be seen whether shareholders will use this as a benchmark in any discussions in relation to future remuneration policy.

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Contents of the Implementation Report

The Implementation Report will have to include the following information:

- A single total remuneration figure for each director.
- The single figure must include: salary, all taxable benefits, bonuses (including any amount deferred) and all other awards where the final vesting is determined as a result of achievement of performance conditions that end in the financial year being reported on (e.g. shares under LTIPs).
- Details of performance against metrics for long-term incentives.
- Total pension entitlements for defined benefit schemes.
- Exit payments made in the year.
- Details of variable pay awarded.
- The total shareholdings of directors.
- A graph comparing company performance with CEO pay.
- Information about who has advised the Remuneration Committee.
- The shareholder context (i.e. how shareholders voted in relation to the binding and advisory vote at the previous AGM, the percentage of shareholder base that abstained, reasons for significant dissent where known and action taken by the Remuneration Committee in response).

UK Corporate Governance Code

The FRC has announced that it will consult on whether to amend the UK Corporate Governance Code to address a number of issues relating to executive remuneration, in particular:

- whether to extend the Code's existing provisions on clawback arrangements;
- whether to limit the practice of executive directors sitting on the remuneration committees of other companies; and
- whether in circumstances where a substantial minority of shareholders vote against the Implementation Report, the company should publish a statement to the market saying what it will do to address shareholder concerns.

The challenges ahead

Businesses have until 26 September 2012 to respond to the Government's consultation on the new remuneration reporting regulations. Whilst the Government has outlined the key proposals for other changes to the remuneration regime, we are still awaiting sight of draft legislation. Notwithstanding this, quoted companies will been keen to understand now the likely implications of the Government's proposals in order to start planning for future compliance. Already companies will need to take care when entering into new contractual commitments with directors in relation to pay and termination as these will be void if not in accordance with the future remuneration policy that is approved by their shareholders.

The changes to remuneration reporting are not the only changes on the horizon for businesses to get to grips with. In September 2011 the Government undertook a consultation on a new framework for narrative reporting which aims to improve disclosures by companies of their strategy, risks and opportunities. The Government's key proposal 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 (for more details see our January 2012 Corporate Update).

The Government is still developing its proposals in this area and will publish draft legislation in due course. However, it has made clear that the changes to both the narrative and remuneration reporting framework are intended to take place at the same time, that is for financial reporting years ending after 1 October 2013. Accordingly, companies with a calendar year–end will not be *required* to report against the new narrative and remuneration reporting requirements until 2014 (i.e. for the financial year ending 31 December 2013). What remains to be seen is whether companies feel any pressure to adopt elements of the new remuneration reporting regime early. The consultation paper states "*the best companies and investors are already leading the way and acting as early adopters of these reforms*". However, given that the promised guidance, to assist companies to understand the level of detail and type of information which needs to be disclosed, is unlikely to be available until shortly before October 2013, this may make it more difficult for companies to adopt such changes early.

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Editor Comment: Companies and commentators alike will be watching next year's AGM season with interest. With reform on the horizon and no imminent change in shareholder sentiment, we expect that the militant mood among investors will continue well into the Autumn and beyond. With this in mind, companies would be well advised to start their planning early to ensure they are well placed to ensure compliance with the forthcoming changes to the narrative and remuneration reporting regime.

Other AGM trends this year...

Reflecting recent changes to the UK Corporate Governance Code, we are seeing:

- **Almost universal offering up of all directors for annual re-election**. As expected, almost all FTSE 350 companies that have held AGMs so far this year have put the entire board up for re-election.
- **More externally facilitated board evaluations**. A significant number of FTSE 350 companies are complying with the new Code requirement to hold an externally facilitated board evaluation at least once every three years. Commonly reported action points arising out of evaluations include increased board involvement in strategy, greater board role clarity and more effective succession planning.
- **Increased emphasis on board diversity**. Although the relevant provisions of the Code are not yet in force, a significant proportion of FTSE 100 companies have responded to FRC and Government encouragement to report this year on the board's policy on diversity (including gender). Many of these companies have openly supported the aims of the Davies Report, "Women on Boards", and have set targets to achieve a specified percentage of female directors on the board by 2015. The statistics are noticeably lower outside the FTSE 100.

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Case Law Update

Parent company found liable for the health and safety breaches of its subsidiary

A significant area of concern for corporate groups is the potential for group companies (in particular a parent company) to be exposed to liability for the acts and omissions of another group company. In the recent case of **Chandler v Cape plc**[1] the Court of Appeal upheld the first instance decision that a parent company had assumed a tortious duty of care to the employees of its subsidiary. However, both courts emphasised the point that this was not a case which involved piercing the corporate veil and that in general there should be no imposition or assumption of responsibility solely because a company is a parent company of another company.

Facts of the case

Cape plc (**Cape**) was involved in the production of asbestos. Having acquired Cape Building Products Limited (**Cape Products**), Cape installed the necessary plant and machinery to manufacture asbestos products into a factory owned by Cape Products.

The relationship between Cape and Cape Products was a fairly typical parent/subsidiary relationship. Cape Products owned its own assets and handled its own sales and dealings with third parties. However, there were common directors on the boards of both companies, and Cape took an interest in its subsidiary's affairs. In particular, Cape's approval was required for capital expenditure, Cape gave technical directions in relation to the composition of the group's products and Cape employed a group medical adviser who did research into the relationship between asbestos production and asbestosis.

The case concerned a claim by an employee of Cape Products relating to asbestosis contracted by him. Cape Products had been dissolved and asbestosis was not covered by its employer's liability insurance. Accordingly, the employee brought a claim on the basis that Cape should be held jointly and severally liable for damages with Cape Products.

Cape conceded that the system of work at Cape Products was defective. The judge at first instance found that Cape was fully aware of the "systemic failure" which resulted from the escape of asbestos dust from a factory which had no sides. Cape therefore knew that the asbestos business of Cape Products was carried on in a way which risked the health and safety of others, in particular the employees working nearby which included Mr Chandler. In these circumstances, both the judge at first instance and the Court of Appeal felt that it was appropriate to find that Cape had assumed a duty of care either to advise Cape Products on what steps it had to take to provide its employees with a safe system of work in light of the knowledge then available or to ensure that those steps were taken. As the judge held, based on past experience of the relationship between the parent and the subsidiary, Cape could, and did on other matters, give Cape Products instructions as to how it was to operate with which, so far as it was possible to determine, it had complied.

When does a duty of care arise?

Both the judge and the Court of Appeal agreed that it was appropriate to use the three stage test established in the case of **Caparo Industries plc v Dickman**[2] for the imposition of a duty of care. The three elements are that the damage should be foreseeable, "*that there should exist between the party owing the duty and the party to whom it is owed a relationship characterised by the law as one of*

[1] [2012] EWCA Civ 525
[2] [1990] 2 AC 605

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"proximity" or "neighbourhood" and that the situation should be one in which the court considers it fair, just and reasonable that the law should impose a duty of a given scope upon one party for the benefit of the other." On the facts of this case, both the judge at first instance and the Court of Appeal felt that this test had been satisfied and that accordingly there was a direct duty of care owed by Cape to the employees of Cape Products.

When may a parent company incur liability?

This case demonstrates that in appropriate circumstances the law may impose on a parent company responsibility for the health and safety of its subsidiary's employees. The Court of Appeal went on to say that those circumstances include a situation where (1) the business of the parent company and subsidiary are in a relevant respect the same; (2) the parent has, or ought to have, superior knowledge on some relevant aspect of health and safety in the particular industry; (3) the subsidiary's system of work is unsafe and the parent company knew, or ought to have known, this was the case; and (4) the parent knew, or ought to have foreseen that the subsidiary or its employees would rely on it using that superior knowledge for the employees' protection. For the purpose of (4) it is not necessary to show that the parent is in the practice of intervening in the health and safety policies of the subsidiary. The court will look at the relationship between the companies more widely. The court may find that element (4) is established where the evidence shows that the parent has a practice of intervening in the trading activities or other operational capacity of the subsidiary, for example production and funding issues.

Editor Comment: Both courts emphasised that this was not a case which involved piercing the corporate veil and that in general there should be no imposition or assumption of responsibility solely because a company is a parent company of another company. Whilst this case involved a "systemic failure" by the parent company to prevent asbestos dust escaping from a factory when it was aware of the health risks this posed to people working nearby, and so may be considered an extreme example, it still serves as a useful reminder that the separate legal personality of a subsidiary company may not be sufficient to protect a parent company from liability in these types of situations.

Meaning of "all reasonable" and "best" endeavours – High Court decision upheld on appeal

The exact nature of an obligation to use "all reasonable endeavours" or "best endeavours" has long been the subject of legal debate and is often the subject of extensive discussion during contractual negotiations.

The Court of Appeal has recently upheld (albeit only by majority decision) the decision of the High Court in the case of **Jet2.com Ltd v Blackpool Airport Ltd**[3] which held that an obligation to use best endeavours or all reasonable endeavours in a contract may require a party to act against its own commercial interests.

Upholding this decision, Moore-Bick and Longmore LJ agreed that an obligation to use best endeavours, or all reasonable endeavours, should usually be held to be an enforceable obligation unless (i) the object intended to be procured by the endeavours is too vague or elusive to be itself a matter of legal obligation; or (ii) the parties have provided no criteria on the basis of which it is possible to assess whether best endeavours have been or can be used.

The contract in question

Jet2 and 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 informed Jet2 that it would no longer accept departures or arrivals scheduled outside normal hours, resulting in two of Jet2's flights having to be diverted at short notice. 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.

[3] [2010] EWCA Civ 417

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The Court of Appeal's verdict

In Moore-Bick LJ's view, the obligation to use best endeavours to promote Jet2's business obliged BAL to do all that it reasonably could to enable that business to succeed and grow and this included keeping the airport open to accommodate flights outside normal hours, subject to any right BAL might have to protect its own financial interests. He also agreed with the decision of the High Court that the extent to which a person who has undertaken to use his best endeavours can have regard to his own financial interests will depend very much on the nature and terms of the contract in question.

In this case, because the ability to schedule aircraft movements outside normal opening hours was essential to Jet2's business (i.e. fundamental to the agreement), the Court held BAL should not be able to restrict Jet2's aircraft movements to normal operating hours simply because BAL would be able to avoid incurring a loss by doing so. Accordingly, Moore-Bick LJ agreed that BAL was in breach of contract by suddenly refusing to accept aircraft movements outside normal opening hours. However, he also agreed that the High Court had been right not to grant a declaration in terms that would require BAL to continue handling aircraft outside normal opening hours for the remaining ten years of the contract.

In relation to the obligation to use all reasonable endeavours to provide a cost base that would facilitate Jet2's low-cost pricing, Moore-Bick LJ commented (obiter) that he found it far more difficult to identify its content as the wording was too opaque to enable him to give it the meaning that Jet2 was proposing with any confidence. However, it was unnecessary for him to decide the point.

Editor Comment: What the Jet2 case highlights are the risks to a party in accepting a best endeavours obligation, and the uncertainty as to what such an obligation (or an obligation to use all reasonable endeavours) may require. It is also important to note that the interpretation of such clauses may be very fact specific and that the same clauses in an agreement could be interpreted in different ways depending on the facts existing at the relevant time.

Accordingly, when negotiating a contract, rather than spending valuable time debating the meanings of the different terms, it may be preferable to set out the steps that the relevant party should actually take in order to achieve the required objective or satisfy the relevant obligation.

Court approved reductions of capital: Court shows more flexible approach when considering creditor protection issues

In a petition presented by **Sportech Plc**[4] to the Scottish Court of Sessions for an order cancelling its share premium account, the Court considered the approach to be adopted in circumstances where the company did not propose providing an undertaking in conventional terms for the protection of its existing creditors. In what can be seen as a helpful decision for public companies wishing to utilise the statutory reduction of capital provisions, Lord Hodge chose to follow the approach taken by Norris J in **Liberty International Plc**[5] where the Court held that, in forming a view as to whether there was a "real likelihood" that the reduction would result in the company becoming unable to discharge its debts, it was open to the Court to undertake an assessment of the company's likely future cash flow solvency. In the Sportech case, Lord Hodge was able to conclude that the company had provided sufficient information about its future cash flow and ability to pay its debts when due to enable him to conclude that there was not a "real likelihood" that the cancellation of Sportech's share premium account would prejudice those creditors who had not given their consent to the reduction.

Editor Comment: This case supports the approach adopted by the English Courts in the Liberty International case and highlights the increasingly flexible approach which the Courts are willing to take when determining whether creditors will be adversely affected by a proposed reduction. This is a welcome trend which may enable some companies undertaking a reduction of capital to move away from the traditional approach of providing either an undertaking to the court, a costly bank guarantee or a ring-fenced escrow in relation to the relevant debts.

[4] [2012] CSOH 58
[5] [2010] 2 BCLC 665

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Promises, promises.... agreements to agree: can you enforce them?

In our January 2012 Corporate Update we considered the High Court decision in the **Barbudev**[6] case, where the Court 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 an unenforceable "agreement to agree". This judgement has since been upheld on appeal to the Court of Appeal[7].

Subsequently, the High Court has confirmed in a separate case, **Charles Shaker v Vistajet**[8] that the provisions in a letter of intent for an aircraft purchase which set out an agreement to negotiate in good faith and to use reasonable endeavours to agree are unenforceable.

Editor Comment: The decisions of both the Court of Appeal in **Barbudev** and the High Court in **Vistajet** follow an established line of authority that obligations to negotiate in good faith and to use reasonable endeavours to agree are unlikely to have binding effect. An agreement to negotiate in good faith is inherently inconsistent with the position of a negotiating party who will generally seek to maximise its own position and, as such, the English Courts are not inclined to try and give effect to such agreements.

[6] Barbudev v Eurocom Cable Management Bulgaria [2011] EWHC 1560

[7] Barbudev v Eurocom Cable Management Bulgaria [2012] EWCA Civ 548

[8] Charles Shaker v Vistajet [2012] EWHC 1329 (Comm)

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Corporate Governance Update

FRC publishes report on what constitutes an explanation under "comply or explain" and consultation on changes to the Corporate Governance Code

The Financial Reporting Council (**FRC**) discussed the question of what constitutes an explanation under "comply or explain" with senior company and investor representatives and published the outcome in a report dated 15 February 2012. The FRC subsequently published separate consultations in April on proposed changes to (a) the UK Corporate Governance Code (**Code**) and Guidance on Audit Committees, (b) the Stewardship Code, and (c) International Standards on Auditing (UK and Ireland). The changes proposed to the Code and Guidance on Audit Committees include more guidance on the nature and content of explanations that should be provided to shareholders when a company chooses not to follow the Code.

The future for "comply or explain"

The future of comply or explain has been under debate in Europe in recent months, with pressure from the EU to move towards a more prescriptive approach. In light of this debate and in order to reinforce the effectiveness of its comply or explain approach, the FRC took the opportunity to address the question of what actually constitutes an explanation under comply or explain.

The aim of the FRC's discussions was to ensure that – where companies are required to explain a deviation from the Code rather than having complied with its provisions – the explanation is as full as is necessary to meet shareholder expectations.

> "Explanations should only ever relate to deviations from Code provisions; companies are expected to comply with the main principles of the Code, which are seen as non-negotiable."

It concluded that the key elements of an explanation are that it should:

- set out the context and background;
- provide a clear rationale for the deviation which is specific to the company;
- describe any mitigating action taken to address any additional risk and to maintain conformity with the relevant Code principle; and
- indicate whether the deviation from the Code's provisions is limited in time and when the company intends to return to conformity with the Code.

The FRC's discussions also highlighted the need for an improvement in the general quality of disclosure around corporate governance and a clear articulation by each company of how its governance arrangements support its business model. Explanations should only ever relate to deviations from Code provisions; companies are expected to comply with the main principles of the Code, which are seen as non-negotiable. Participants felt that, used properly, the comply or explain approach can deliver greater transparency and generate greater confidence in relation to governance issues than can be achieved by purely a compliance based system of formal regulation.

FSA consultation on changes to the Code

The following three separate FRC consultations were published in April:

Corporate Governance Code: Proposed changes to the Code and Guidance on Audit Committees include:

- FTSE 350 companies to put audit out to tender at least every 10 years;
- boards to explain why they believe their annual reports are fair and balanced and the audit committee to advise the board on this issue;
- as part of the preface to the Code, additional guidance on the explanation required when a company is not in compliance with the Code; and
- more informative reporting by audit committees, including on the process for appointing the external auditor.

The new version of the Code will also include the previously announced requirement to report on gender diversity policies, but there is no further consultation on this issue.

Stewardship Code: Proposed changes to the Stewardship Code include:

- clarification of what is meant by stewardship, and the respective responsibilities of asset owners and asset managers; and
- disclosure by investors of their policy on stock lending, and whether they recall lent stock for voting purposes.

Auditing standards: The proposed changes to the Auditing Standards are mainly directed at enhancing

auditor communications and extending auditor reporting to reflect changes made to the Code and Guidance on Audit Committees.

Timing: The consultation periods ended on 13 July 2012 and all of the changes are intended to apply to financial years beginning on or after 1 October 2012 (i.e. for companies with a calendar year-end, the changes will apply to the financial year ending 31 December 2013).

The consultations can be accessed via the FRC press release at: http://www.frc.org.uk/press/pub2764.html.

Women on boards: progress one year on

Increasing the number of women on boards remains high on the political and corporate agenda. Following the original February 2011 report "Women on Boards", Lord Davies published an annual progress report on 13 March 2012. The report shows that progress to date in the UK has been positive, although there is still some way to go before the target of achieving 25% female board representation by 2015 is met.

The European spotlight has also turned on this issue, with a new consultation launched on possible action at EU level, including legislative measures to address gender imbalance. Following consultation, the European Commission intends to make a decision on further action later in 2012.

UK Progress

The period since the original "Women on Boards" report was published in February 2011, has seen the largest-ever reported increase in the percentage of women on FTSE 350 boards. According to statistics in the March 2012 annual progress report:

- women now account for 15.6% of all FTSE 100 directorships, up from 12.5% (in the FTSE 250, 9.6% up from 7.8%);
- 47 female appointments have been made to FTSE 100 boards since February 2011 (53 female appointments to FTSE 250 boards);
- 27% of all FTSE 100 board appointments have been taken up by women, up from 13% (26% of all FTSE 250 board appointments); and
- just 11 all-male boards remain, down from 21 (112 all-male boards in the FTSE 250).

The original February 2011 report set a target for FTSE 100 boards to reach 25% female board representation by 2015. The March 2012 update notes that, although positive progress has been made towards reaching this target, the next 12 months will be crucial in terms of maintaining the momentum. The Davies Committee will continue to meet every six months to review progress.

European action

On 5 March 2012, the European Commission launched a consultation on possible action at EU level to address continuing gender imbalance on company boards. The consultation noted that limited progress has been made since October 2010 and asked for views on:

- additional action that should be taken to address gender imbalance on EU boards (whether regulatory or self-regulatory);
- what percentage of board positions should be occupied by women and whether reaching this percentage should be compulsory;
- what companies/board members should be covered by any EU initiative; and
- what sanctions should be applied for failure to comply with any agreed objectives/percentages.

The deadline for comments has now closed and the European Commission intends to decide later in 2012 what further action is necessary in light of the responses to the consultation.

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Regulatory Update

Wall crossing – market abuse risks for issuers and their advisers when engaging in wall crossing activity

There is a tension between active shareholder engagement and the inherent risks of committing market abuse through improper disclosure of inside information. A number of recent high profile actions taken by the FSA have placed this issue firmly in the spotlight.

What is wall crossing?

Confidential pre-soundings and pre-marketing activities regularly take place in advance of capital raisings, refinancings and other transactions prior to their formal announcement by issuers in order to gauge interest in, or support for, a particular transaction (and its potential pricing, where relevant). As part of such activities, inside information is likely to be imparted to market participants. Wall crossing is the act of making a person an "insider" by providing them with inside information.

What is inside information?

The definition of inside information is in essence made up of three limbs. Information must be:

- precise
- not generally available; and
- if generally available, likely to have a significant effect on the price of the securities in question. The FSA interprets this to mean is the information of the sort that a reasonable investor would be likely to use as part of the basis of his investment decisions.

Selective disclosure

The EU market abuse regime prohibits abusive behaviour relating to qualifying investments admitted to trading on a regulated market (extended to cover prescribed markets such as AIM in the UK). Disclosure of inside information to another person otherwise than in the proper course of the exercise of one's employment, profession or duties is a form of market abuse (improper disclosure). The prohibition on improper disclosure of inside information is designed to limit the risk of misuse of such information (insider dealing).

Risks associated with shareholder engagement

Much of the wall crossing of the type referred to above is undertaken by a company's financial advisers and should only be undertaken with the consent of the company and subject to rigorous internal wall crossing procedures being followed, including the receipt of a non disclosure and standstill agreement from the potential recipient of the inside information.

However, issuers must themselves take care when engaging directly with shareholders. For some time now, shareholder engagement has been on the political agenda as a means of promoting good corporate governance. In particular, issuers should ensure that there is a reasonable and legitimate basis for disclosing inside information to select shareholders and that those shareholders are effectively wall crossed prior to disclosure (i.e. have agreed to become insiders and to respect the confidential nature of the relevant information). Companies and their advisers should seek to identify which of their investors are prepared to be wall crossed. Indeed, the FRC proposes that institutional investors that are willing to become insiders should indicate as much in their stewardship statements.

Cleansing announcements

A particular matter of concern arose out of the Decision Notice issued by the FSA in January 2012 to David Einhorn in which it fined Mr Einhorn over £3.5 million for

engaging in market abuse. In that Decision Notice, the FSA implied that, in circumstances where a previously proposed transaction by an issuer does not proceed, a "public" cleansing announcement stating that a transaction has been contemplated but did not proceed would be required before those who had been wall crossed would be free to trade in the issuer's shares. The City of London Law Society (**CLLS**) sought clarification from the FSA about the requirement to issue a cleansing announcement. The CLLS recognised that a party who receives inside information would remain unable to trade for so long as the information disclosed remained inside information but made the point that information imparted may cease to be inside information for a number of reasons, including where it has become stale due to the lapse of time or because of a change of circumstances.

There were particular concerns with the suggestion in the Decision Notice that, in circumstances where an issuer was considering a possible transaction but then decided not to proceed, the issuer would be required to make a cleansing announcement. For example, this could lead to third parties, for example potential placees, refusing to be wall crossed in relation to pre-marketing/soft soundings prior to a potential capital raising unless they received assurances from the issuer that a cleansing announcement would be made if the deal did not proceed.

It is not market practice for issuers to make cleansing announcements if a proposed transaction is no longer on the table and in fact the making of such an announcement could have an unnecessarily untoward impact on the issuer's share price. An announcement may need to be made if the fact that the transaction is no longer going to proceed constitutes inside information (for example, because the issuer is in financial difficulties because of the failed capital raising), however, this would need to be assessed on a case-by-case basis.

Helpfully, the FSA has since confirmed that in circumstances where information is no longer inside information, a cleansing announcement is unnecessary although it did emphasise that it expects advisers to consider carefully whether this is indeed the case.

See our client briefing, Wall crossing – Walking the regulatory tightrope, for further information on this issue. This briefing is available at http://www.cliffordchance.com/publicationviews/publications/2012/05/wall_crossing_walkingtheregulatorytightrope.html

Editor Comment: The confirmation from the FSA that a cleansing announcement is not required where information is no longer inside information is helpful and confirms the general market practice in this area.

More generally, issuers need to ensure that those persons within their organisation who are in receipt of inside information understand clearly the obligations which apply to the handling of such information and take great care over the way in which such information is disclosed on a case-by-case basis.

Two former directors of Cattles plc fined for market abuse

The FSA has fined and banned two former directors of Cattles plc and its FSA-regulated subsidiary Welcome Financial Services Limited, for publishing misleading information to investors about the credit quality of Welcome's loan book and acting without integrity in discharging their responsibilities. Cattles and Welcome have also been publicly censured by the FSA for publishing misleading information and would have been fined but for their financial circumstances.

Background

Cattles was a sub-prime lender and was listed on the London Stock Exchange. It conducted much of its business through its subsidiary Welcome. Cattles' 2007 annual report contained highly misleading arrears, impairment and profit figures. The misleading figures from the annual report were also included in a rights issue prospectus issued by Cattles in April 2008, giving a misleading impression of the firm's financial health. The rights issue was fully subscribed, raising £200 million. When the true state of Cattles' loan book became public in 2009, trading in Cattles' shares was suspended.

FSA's findings

The FSA found that Cattles had engaged in market abuse contrary to s.118(7) of the Financial Services and Markets Act 2000 (dissemination of inside information) and had breached Listing Rule 1.3.3R (misleading information not to be published). In addition, it had breached both Listing Principle 3 by failing to act with integrity towards its shareholders and potential shareholders, and Listing Principle 4 by failing to communicate information in such a way as to avoid the creation or continuation of a false market.

Welcome breached Principle 3 of the FSA Principles for Businesses by failing to take reasonable care to organise and control its

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affairs responsibly and effectively, with adequate risk management systems. Welcome was also found to have engaged in market abuse by disseminating the inaccurate information.

James Corr, Cattles' finance director, has been fined £400,000 and Peter Miller, Welcome's finance director has been fined £200,000. Both men have been banned from performing any functions in relation to any FSA regulated activities. The FSA has also banned John Blake, Welcome's managing director, and fined him £100,000. Mr Blake has referred his case to the Upper Tribunal. All three fines were reduced on account of the directors' current personal financial circumstances. Mr Corr and Mr Miller were held to be personally responsible for the breaches by the companies of which they were directors and to have also committed market abuse.

Whether director's conduct attributable to issuer?

Cattles and Welcome made a number of legal submissions. Of particular interest was their submission that the conduct of Mr Corr should not be attributed to them and that, in addition, a company should only be liable for market abuse where it is complicit and culpability is properly made out or where there has been a breakdown in its corporate governance such as to allow the abuse to occur. The FSA firmly rejected these submissions, stating that it does not accept that a company can only be liable for market abuse when it is complicit and that neither intent nor knowledge of matters relating to governance are necessary elements in the provisions of s.118 (market abuse). Such matters may go to mitigation but do not result in the avoidance of liability.

Successful conclusion of parallel investigation into market abuse/insider dealing by FSA and SEC

On 28 May 2012, the FSA announced that three people had pleaded guilty to insider dealing charges brought by the FSA. James Sanders a director of Blue Index, a specialist Contract for Difference (CFD) brokerage, had previously pleaded guilty to a total of 10 charges of insider dealing, his wife Miranda Sanders pleaded guilty to five charges of insider dealing, and James Swallow, a co-director of Blue Index, pleaded guilty to three charges of insider dealing at an earlier hearing. Mr Sanders received a four year sentence and has been disqualified as a director for five years. Mrs Sanders and Mr Swallow were each sentenced to 10 months in custody.

The successful prosecution of Mr and Mrs Sanders and Mr Swallow is the culmination of a parallel investigation by the FSA and the US Securities Commission, with assistance from the FBI. Back in November 2010, it was announced that insider dealing charges had been brought by the SEC against a former Deloitte tax partner, Arnold McClellan, who it was alleged was an 'insider' to a number of mergers and acquisitions in US listed securities. The prosecution case was that inside information was leaked by Mr. McClellan, Mrs Sanders' brother in law, or her sister Annabel McClellan, and passed to Mr and Mrs Sanders who used the information to commit insider dealing in those US securities between October 2006 and February 2008. James Sanders also disclosed information to others including James Swallow, who used that information to commit insider dealing. In addition, Mr Sanders encouraged clients of Blue Index to trade in CFDs on the basis of that inside information. The total profits generated by the defendants were approximately £1.9 million, while the total profits generated by the clients of Blue Index were approximately £10.2 million.

> "This was a case of systemic abuse by approved people of their privileged position in the market – we are determined to stamp out such abuse. Our tough, coordinated approach to insider dealing and our commitment to taking on difficult criminal prosecutions has really begun to pay off."
>
> *Tracey McDermott, acting director of enforcement and financial crime division*

Exillon Energy fined £292,950 for breaches of the Listing Rules

The FSA has fined Exillon Energy plc £292,950 for failing to identify that around £930,000 of payments to Mr Maksat Arip, its former Chairman and a beneficiary of the family trust which is the company's major shareholder were related party transactions, and failing to

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> Companies must have systems and controls that enable them to comply fully with the listing rules from the moment of admission. It is not enough to have detailed compliance procedures drafted by experienced advisors sitting on the shelf."
>
> *David Lawson, FSA acting director of markets*

disclose them to the FSA in a timely manner. The FSA found that the breaches of Listing Rule 11 and Listing Principle 2 occurred because Exillon's policies and procedures to ensure compliance with the Listing Rules did not work in practice because the senior officers responsible were not adequately trained.

Arrangements between Exillon and its Chairman

In the 12 month period following its listing in 2009, Exillon made payments totalling £930,000 to and on behalf Mr Arip. The payments continued an informal arrangement that was in place prior to Exillon's listing whereby Exillon advanced money to Mr Arip for private purposes and then offset those payments against unpaid salary and Mr Arip paid or received the net balance. Between October and December 2010 a reconciliation exercise was undertaken and Mr Arip arranged to repay the sums owing to Exillon, along with interest. It was not until the following February that Exillon realised that such payments were related party transactions pursuant to Listing Rule 11 when Exillon's auditors wrote to Exillon categorising them as such. Shortly thereafter, Exillon's sponsor wrote to the FSA advising it that Exillon had categorised the payments as loans to a related party.

The FSA found Exillon to be in breach of both Listing Rule 11.1.10R(2) in failing to identify the payments to Mr Arip as related party transactions and Listing Principle 2 by failing to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations. Whilst a related party policy had been adopted by the board of directors immediately in advance of the IPO, the FSA concluded that the policy did not work in practice as it relied too heavily on senior officers to identify and take appropriate actions and those charged with this responsibility lacked the experience and training to perform this function. It found that Exillon had not checked that the senior officers understood what was expected from them regarding their compliance roles or that the policies and procedures were effective and had been implemented.

Editor Comment: This case highlights the need for companies and their advisers to ensure that directors properly understand the responsibilities and obligations which come with being a premium listed issuer. It is not sufficient to simply adopt policies on listing without ensuring that officers have received the necessary training to ensure that they understand them, can implement them effectively and, where required, monitor compliance with them on an ongoing basis.

FSA publishes proposals for changes to the Listing Rules

Since our January 2012 Corporate Update, the FSA has published two sets of consultations on changes to the Listing Rules. By far the most ranging is Consultation Paper CP12/2, published in January 2012, which sets out the FSA's proposals for changes to the Listing Rules (and related changes to the Prospectus Rules and Disclosure and Transparency Rules) to reflect recent changes to market practices and to ensure the rules continue to provide appropriate protection for investors. More recently, in June 2012 the FSA published its Quarterly Consultation Paper CP12/11 which contains some more minor proposals for changes to the Listing Rules. Both consultation papers are discussed below.

Consultation Paper CP12/2

In CP12/2 the FSA has identified five principal areas that it believes require change.

Reverse takeovers (LR Chapter 5) – the proposed changes are intended to ensure that reverse takeovers cannot be used as a "back-door" route to a premium listing for companies that would otherwise be ineligible. Currently an acquisition of one listed issuer by another is not treated as a reverse takeover. The FSA intends to narrow this exemption so that only acquisitions by a listed issuer of another listed issuer in the same listing category will not be treated as a reverse takeover.

Where the reverse takeover regime does apply, the FSA wants it to be more

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proportionate. By way of example, it proposes to reduce the information requirements that would need to be met in order for a suspension of listing to be avoided and to reduce the eligibility requirements following a cancellation of a listing. The guidance on reverse takeovers that is currently set out in the FSA's Technical Note on Reverse Takeovers is to be consolidated into the Listing Rules.

Transactions (LR Chps 10 ,11, 12 and 15) – the proposed changes largely codify existing practice, much of which is currently contained in the FSA's Technical Notes. However, the concept of a supplementary circular is to be introduced, allowing issuers to provide, in certain circumstances, further information to shareholders prior to a shareholder vote. The FSA also intends to remove the concept of a class 3 transaction, allowing issuers to rely on their DTR 2 announcement obligations to determine whether an announcement is required. In relation to break fees, the FSA intends to clarify that it is the substance rather than the legal form of any such arrangement which is key.

Financial information (LR Chps 6 and 13) – changes include:

- the clarification of the application of LR 6.1 in relation to the track record requirements for issuers seeking a premium listing;
- the inclusion of detailed requirements in LR 13.5 for the disclosure of financial information for class 1 transactions and disposals of interests in undertakings that are not or have not been consolidated;
- increased disclosure requirements for figures relating to synergy benefits (LR 13.5); and
- widening the scope of LR 13.5.27 to allow targets admitted to certain MTFs and investment exchanges to take advantage of reduced information requirements.

Sponsors (LR Chapter 8) – the key changes proposed are:

- a new requirement on sponsors to provide the FSA with any explanation or confirmation that the FSA may reasonably require to ensure the Listing Rules are being complied with by an issuer;
- extending the remit of sponsor services so that a sponsor will be required to be appointed for other services provided to premium listed issuers, such as, in relation to related party transactions;
- the introduction of a specific principle for sponsors requiring them to act with honesty and integrity in relation to sponsor services; and
- clarification of LR 8.3.7 requiring a sponsor to take all reasonable steps to identify conflicts of interest that could adversely affect its ability to carry out its obligations under LR 8.

Sponsors will also be required to notify the FSA of a number of new specific situations, for example, information that a sponsor reasonably believes could adversely affect market confidence in the sponsor regime.

Externally managed companies (LR Chapter 6, DTR 3.1 and PR 5.5.3) – over the last 18 months, a number of special purpose acquisition vehicles (**SPACs**) have sought a listing. These are cash shells incorporated with the intention of acquiring and running a target business to create value. The FSA calls these companies "externally managed companies" as they tend to outsource significant management functions to an offshore advisory firm. Whilst only a few such firms currently exist, the FSA is concerned that this structure might be more widely adopted. The FSA believes that the structure seriously undermines the ability of shareholders to hold the management to account. To counter act this, the FSA intends to amend the Prospectus Rules to ensure that the principals of the advisory firm will be held responsible for any prospectus published by the listed company. Additionally, such persons will be made subject to the requirements in DTR 3 regarding the disclosure of dealings by PDMRs.

Further proposals – The FSA also intends to insert new rules and guidance into the Listing Rules to prevent SPACs from seeking a premium listing on the basis that their management arrangements and provisions for accountability are not consistent with the high standards expected of a premium listed issuer. The FSA also raises some wider issues for discussion about the nature of the premium listing standard and whether, as currently set out in the Listing Rules, it remains correctly positioned as a benchmark of high standards.

This consultation closed on 26 April 2012. A copy of the consultation is available from http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/cp/cp12_02.pdf

Consultation Paper CP12/11

CP12/11 contains proposed amendments to (a) the cancellation of listing provisions in Chapter 5 and (b) the annual notification requirement for sponsors in Chapter 8 of the Listing Rules.

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The proposed changes to LR 5 would widen the scope of the exemption in LR 5.2.12 (exemption from the requirement to obtain shareholder approval for a cancellation of listing where the cancellation results from a scheme of arrangement etc) so as to apply to all equity shares (not just those with a premium listing), all UK insolvency or reconstruction procedures (not just administration or liquidation pursuant to a court order under the Insolvency Act) and equivalent overseas insolvency or reconstruction procedures.

The proposed changes to LR 8 would require all sponsors to provide their written confirmation (annual notification) in January each year, instead of on the anniversary of the date of their approval as a sponsor and provide the written confirmation by submitting a completed "sponsor annual notification form" to the FSA. It is envisaged that the new sponsor arrangements will come into force on 6 October 2012. Transitional relief would apply to sponsors whose current annual confirmation date falls on or after 6 October 2012. These sponsors would not be required to submit a further confirmation until January 2013.

The consultation period ends on 6 August 2012. No implementation date is set out for the LR 5 changes. A copy of CP12/11 is available at http://www.fsa.gov.uk/static/pubs/cp/cp12-11.pdf

Reminder: Introduction of a new proportionate disclosure regime for pre-emptive offers

Changes to the European Prospectus Directive took effect on 1 July 2012. The key change for companies with listed equity securities is the introduction of a proportionate disclosure regime for prospectuses prepared in connection with a pre-emptive offer (e.g. a rights issue). This new regime recognises that companies with shares already admitted to trading on a regulated market are already subject to disclosure obligations arising from the Market Abuse Directive and the Transparency Directive and that, accordingly, a significant amount of information about the issuer and its securities will already be available to investors.

The new regime will apply to rights issues and "compensatory" open offers (i.e. where the open offer shares not taken up are sold at the end of the offer period for the benefit of those shareholders who do not take up their entitlement). "Standard" open offers will not qualify for the new regime.

Issuers taking advantage of the regime need only provide financial information for the last financial year (as opposed to the current requirement for three years historical financial information). In addition, there will be no need to produce an operating and financial review.

The one fly in the ointment is the situation where an issuer wishes to extend the offer to US investors pursuant to Rule 144A. In such circumstances, the risk of incurring liability under US securities laws may mean that issuers will continue to prepare a "full" prospectus.

Quoted companies to be required to disclose greenhouse gas emissions

On 20 June 2012, the Government announced plans to require all quoted companies to report their levels of greenhouse gas (**GHG**) emissions. This announcement follows a Defra consultation last year which considered a number of options regarding GHG emissions reporting, in particular whether enhanced voluntary reporting or mandatory reporting should be introduced.

The Government has indicated its intention to introduce regulations requiring all quoted companies to report their GHG emissions in the directors' report, which forms part of the annual report. The draft regulations will require companies to report on GHG emissions within their organisational boundaries, including overseas activities. Organisational boundaries will be the same as for the financial report in the annual report. Reporting will be on a comply or explain basis. Where companies are unable to collect all necessary data, they will need to state the extent to which they are able to report. The draft regulations are likely to be published in Autumn 2012 and it is expected that they will take effect in April 2013.

The UK is the first country proposing to make it compulsory for companies to include GHG emissions data for their entire organisation in their annual reports. The Government intends to review the application of the regulations in 2015, following which it will decide whether to extend the reporting requirement to all large companies.

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New FSA Primary Market Bulletin

The FSA has published the first issue of a new Primary Market Bulletin which replaces "List!" and will be used by the FSA to communicate and discuss a range of issues with those who engage with the UKLA, including technical issues such as consultation on amendments to the Technical Notes.

The content of this first Bulletin is described as factual, rather than technical, and is primarily background to the proposed closure of the UKLA Helpdesk. A copy of the Bulletin is available at http://www.fsa.gov.uk/static/pubs/ukla/ukla-pmb-issue1.pdf

Impact of UK Takeover Code Reform – seven months on

Significant changes to the UK Takeover Code were introduced by the Takeover Panel on 19 September 2011 in an effort to address the perceived tactical imbalance which had arisen between prospective bidders and targets. Seven months on from the introduction of these changes, Clifford Chance has undertaken an analysis of over 50 deals announced since 19 September in order to assess the impact of these changes and consider whether the landscape of UK public M&A deals has altered.

Some of the key changes to the Takeover Code included a prohibition on break fees and other deal protection measures, a requirement for targets to identify all known potential bidders in any announcement made to commence the offer period with an automatic 28 day period for a potential bidder to clarify its intentions (the automatic put up or shut up (**PUSU**) regime) and enhanced disclosure requirements in offer documentation.

There was a particular concern that the potential for early identification of potential bidders and the prohibition on break fees would have an adverse impact on the attractiveness of the UK market in terms of deal activity, particularly for those bidders based abroad or on the private equity side. Whilst it is difficult to draw any firm conclusions on the impact of the changes due to the relatively stultified M&A market, the early indications are that these are not insurmountable obstacles.

Many target companies have used the formal sale process as a means of avoiding identification of potential bidders and the imposition of the 28 day PUSU. The formal sale process also allows a target company to agree a break fee with a participant in the process although in most cases to date the target has not sought to avail itself of this particular dispensation. We have, however, seen one example of a break fee being agreed in these circumstances by Cove Energy in favour of our client, Royal Dutch Shell.

As predicted by the Panel, the automatic 28 day PUSU regime has not impacted the ability to implement takeovers where there is target company engagement – this is evidenced by the number of targets that have agreed PUSU extensions and the number of repeat extensions. Enhanced bid financing disclosure has impacted upon disclosure of market flex provisions on debt syndication - although the Panel has agreed that market flex provisions can be put in a separate side letter, disclosure of which can be deferred from announcement until posting of the offer or scheme document, this is not considered a sufficient concession given that debt syndication is unlikely to be completed within the 28 day period between announcement and posting.

For further details of the impact of these changes, please see our client publication, *"Impact of UK Takeover Code Reform – Seven Months on"*, available at:

http://www.cliffordchance.com/publicationviews/publications/2012/05/impact_of_uk_takeovercodereform-sevenmonth.html

New Takeover Panel Consultations

On 5 July 2012, the Code Committee of the Takeover Panel announced the launch of three public consultations proposing changes to the Takeover Code. Details are summarised below.

Profit forecasts etc

In PCP 2012/1 (Profit forecasts, quantified financial benefits statements, material changes in information and other amendments to the Takeover Code), the Code Committee is proposing:

- the introduction of a revised Rule 28 in relation to profit forecasts, with the aim of applying more proportionate requirements than exist at present to certain profit forecasts and adopting a more logical framework for the regulation of profit forecasts than existing Rule 28;
- the incorporation into Rule 28 of the current requirements of Note 9 on Rule 19.1 in relation to merger benefits statements (which would be renamed "quantified financial benefits

statements") and, at the same time, the adoption of more detailed requirements and the extension of the application of those provisions to statements made by the target with regard to measures providing cost saving or other financial benefits that it proposes to implement if the offer does not succeed (in addition to the current application of those provisions to statements made by the parties to an offer with regard to the financial benefits expected to arise if the offer is successful); and

- as proposed in Response Statement 2011/1 (Review of certain aspects of the regulation of takeover bids), the amendment of Rule 27 in relation to the disclosure of material changes in information published in an offer or scheme document or a target response circular, so as to require a bidder and target to disclose any such material changes promptly after their occurrence on an ongoing basis, and not only in the event that a subsequent document is published.

Note that the Code Committee has asked the Executive to undertake a more comprehensive review of the purpose and operation of Rule 29 (asset valuations) following the finalisation of the amendments to Rule 28 proposed in PCP 2012/1. Once it has had an opportunity to discuss that review with the Executive, the Code Committee intends to publish a separate consultation on proposed amendments to Rule 29.

Pension scheme trustees

In PCP 2012/2 (Pension scheme trustee issues), the Code Committee proposes (following comments from certain respondents in its earlier Response Statement 2011/1 (Review of certain aspects of the regulation of takeover bids)) to extend those provisions of the Code which relate to target employee representatives to the trustees of target's pension scheme(s) including:

- information rights for pension trustees (i.e. provision of prescribed documentation);
- the ability to append the opinion of the trustees to the bid document (or publish on a website if received too late for inclusion in the bid document); and
- bidder and target board disclosure in the bid document regarding the bidder's intentions as regards the target's pension scheme(s) and any impact on them.

Whilst the proposed Code changes will require the target to pay for the costs of publication of the pension trustees' opinion, it is not intended that the Code will require the target to pick up the costs of advice sought by trustees to verify the content of the opinion which may require detailed actuarial and valuation analysis (though note that in practice, a sponsoring company will normally be responsible for paying costs reasonably incurred by the trustees of its scheme(s)).

Removal of residency test

In PCP 2012/3 (Companies subject to the Takeover Code), the Code Committee proposes the removal of the residency test in section 3 of the Introduction to the Code such that the Panel's determination of a company's place of central management and control will no longer be relevant to the application of the Code.

Under the proposals the Code will apply to all public companies and certain private companies whose securities have been available for subscription or purchase by members of the public at some point during the preceding 10 years (referred to as the ten year rule) which have their registered offices in the UK, the Channel Islands or the Isle of Man. The Code Committee also proposes certain minor clarifications to the ten year rule.

Responses to all three consultations must reach the Code Committee by 28 September 2012.

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Antitrust Update

In this edition of Corporate Update, we focus on two announcements for major reform of the UK competition law regime. The first is the announcement of the final decision of the UK Government on the reform of the enforcement of competition law by the UK's competition authorities and sectoral regulators. The second is the announcement of a consultation on the proposed reform of private actions for competition law infringements.

> "The CMA will build on the best of the OFT and CC to become a world-leading competition authority, advocating competition both at home and abroad....Resource allocation will be improved, and business will benefit from having just one streamlined organisation to deal with."
>
> *Vince Cable, Secretary of State for Business, Innovation and Skills and President of the Board of Trade*

Reform of the Enforcement of UK Competition Law

The Department of Business, Innovation and Skills (**BIS**) announced its final plans for reform of the UK competition regime on 15 March 2012.

The most far-reaching reform will be the merger of the Office of Fair Trading (**OFT**) and the Competition Commission into a new regulator: the "Competition and Markets Authority" (**CMA**). However, that move was widely expected and, indeed, had seemingly been decided even before the BIS consultation in March 2011.

Of the other options for reform, the Government has, in most cases eschewed the most extreme proposals that were contained in its consultation, with one exception: it will no longer be necessary to prove dishonesty in order to secure an individual's criminal conviction, and imprisonment, for the cartel offence under the Enterprise Act.

The reforms are to be implemented in the Enterprise and Regulatory Reform Bill, which is currently under debate in Parliament.

A new, single regulator

The CMA will have jurisdiction to carry out all reviews under UK merger control laws and all market investigations. It will also be the primary enforcer of both civil and criminal competition laws (although in a separate announcement, the Government has decided that the CMA will not inherit the OFT's role in pure consumer protection issues).

For businesses, this should mean faster and/or less costly merger reviews and market investigations. In particular, if a detailed "Phase 2" investigation is launched, it is likely that they will no longer need to spend time re-explaining their business and the issues to a new case team, as they do at present.

The big question, however, is whether this will make it more difficult to change the mind of the case team, given the considerable time they will have already invested in a Phase 1 investigation (so called "confirmation bias"). While there will be certain checks and balances to mitigate this – such as independent "panels" of final decision makers – it remains to be seen whether they will operate effectively within a single institution.

Mergers and acquisitions

While the Government consulted on the introduction of mandatory filing obligations for qualifying transactions and a prohibition on closing prior to merger control clearance, it has decided not to pursue those options. Instead, the CMA will have broader powers to require merging businesses to be operated independently during the CMA's review process.

Binding deadlines (of 40 working days) and information gathering powers will be introduced at Phase I, which should ensure faster reviews. Parties will be afforded a statutory window of 50-90 working days from the announcement of a decision to the opening of a Phase 2 investigation, within which to offer, negotiate and finalise remedies to avoid that fate.

In Phase 2, there will be a 12 week statutory time limit from date of the final report - which can be extended by six weeks - for the CMA to implement remedies.

Filing fees are to rise dramatically from 12 October 2012, to as much as £160,000 for deals involving targets with a UK turnover in excess of £120 million. Even deals involving a target with a UK turnover of less than £20 million will be subject to a filing fee of £40,000.

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Anticompetitive agreements and abuses of dominance

Breaches of the (non-criminal) competition laws will not be prosecuted before the courts, as had been mooted by the Government. Instead, while the current administrative procedure will remain in place, the investigation and decision-making functions will be separated within the CMA with the aim of achieving objective and efficient decision making. The OFT is currently consulting on revised procedures to implement this separation. Current proposals are that a three-member "decision group" – separate to the official leading the investigation – will be appointed to decide on the liability for an alleged infringement of the parties under investigation.

There are also intended to be more robust administrative timetables, with a power for the Government to impose statutory deadlines, if reductions in the time cases take are not forthcoming. There will also be new powers for compulsory interviews during competition investigations and relaxed criteria for the imposition of interim measures.

Criminal cartel offence

The requirement for dishonesty will be removed from the criminal cartel offence. Subject to any changes introduced in the legislative process, it will be enough for prosecutors to show an individual's intentional participation in one of the categories of criminal cartel agreement (price fixing, market sharing, output restrictions and bid-rigging) and that the parties did not agree to publish the relevant agreement before its implementation.

Market investigations

Binding deadlines and wider information gathering powers will be introduced for Phase 1 market investigations, and the Phase 2 deadline will be shortened, with a further deadline introduced for implementation of remedies. The CMA will also have enhanced powers to impose remedies and to conduct investigations into practices spanning a number of different markets.

The Secretary of State will be able to ask the CMA to investigate public interest issues alongside competition issues, but small businesses will not be given powers to trigger automatic investigations of issues that concern them.

Sector Regulators

The sector regulators (e.g. Ofcom, Ofwat, the Rail Regulator) will retain their concurrent competition powers, but the CMA will be granted powers to take over competition investigations commenced by sector regulators, in certain circumstances. The CMA will not, however, be required to undertake regular reviews in the regulated sectors.

Implementing the reforms

The reforms are currently under consideration by Parliament in the form of the Enterprise and Regulatory Reform Bill. BIS has stated that its aim is to have the CMA operational by April 2014.

The Government's proposals are set out in its response statement, which is available at http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/g/12-512-growth-and-competition-regime-government-response.pdf

> "The proposed removal of the dishonesty criterion from the cartel offence remains controversial. It amounts to widening the goal posts in the hope that the regulator's scoring record in criminal cases will improve."

Editor Comment: While there should be some efficiencies for businesses in the merger of the OFT and the Competition Commission, it remains to be seen whether the proposed checks and balances will be sufficient, and in particular whether the current "fresh pair of eyes" of the Competition Commission can be replicated within a single institution.

In the short-term, the institutional upheaval involved in the merger creates, in itself, a significant risk that the volume and quality of decision making will be adversely impacted. Some of the more radical reforms under consideration would have greatly exacerbated that risk and in this respect the final reforms are to be welcomed.

The proposed removal of the dishonesty criterion from the cartel offence remains controversial. It amounts to widening the goal posts in the hope that the regulator's scoring record in criminal cases will improve. This, despite the fact that the OFT has not yet brought a single case before a jury. As a result, it will become even more important that employees who are potentially at risk of inadvertently engaging in wrongful behaviour are carefully trained in what they can and cannot do when it comes to communications with competitors.

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Reform of Private Actions for Competition Law Breaches

The UK Government is consulting on proposals to introduce "opt-out" class actions for claims involving breaches of competition law. Other proposals would see a presumption that cartel damages are 20% of prices, a fast track claims procedure for small and medium sized businesses (**SMEs**) (including caps on liability for costs) and jurisdiction for the Competition Appeal Tribunal (**CAT**) to hear standalone claims and grant injunctions. However, features of the US system – such as treble damages, contingency fees and jury trials - would not be imported.

"Opt out" collective actions

One of the most significant proposals put forward in the consultation – which closes on 24 July 2012 - is the introduction of "opt out" collective actions, whereby claims for damages for competition law breaches could be brought on behalf of an entire class of claimants without their express consent.

Jurisdiction to hear such claims would lie solely with the CAT, which would certify that the claim has merit, that collective action is appropriate, that the claimant is an adequate representative for claimants, and that the claimant or claimants have sufficient funds to cover the defendants' costs if the case is lost.

Damages that remain unclaimed after a fixed period would go to a scheme such as the Access to Justice Foundation.

Opt-out claims would be accompanied by the possibility of opt-out collective settlements, subject to judicial oversight and certification by the CAT. In addition, in order to ensure that increased exposure to collective damages claims does not erode whistle-blowers' incentives to apply for immunity, the Government is proposing to confer protection from disclosure of leniency documents, and to protect whistle-blowers – and potentially other leniency applicants – from joint and several liability for damages, limiting their exposure to damage that they have directly caused.

The table below summarises the differences between the Government's proposals for opt-out actions and the class action system in the US.

Damages presumption

The Government is considering introducing a presumption in cartel actions that the infringing conduct affected prices by a fixed amount, such as 20%. This would be rebuttable if evidence shows that actual damages were higher or lower. The aim is to facilitate damages claims, in part by shifting the burden of proof to those likely to possess the data required to assess accurately the quantum of price increases, i.e. the defendants.

The Government is not minded to address the availability of the passing-on defence in legislation.

Key Differences between the US and proposed UK regimes

Aspect	US Regime	Proposed UK Collective Actions
Type of case	Many different areas of law, including personal injury and employment law.	Competition law only.
Damages	Treble damages – defendant pays three times the damage caused.	Actual damages – defendant only pays what was lost or unjustly gained.
Costs	No loser pays rules – each side pays own legal costs so no disincentive to bring cases.	Loser pays – if you bring a case and lose, you pay for both sides.
Fees	Contingency fees – lawyers can take % of damages.	No contingency fees.
Who hears the case?	Jury trials – can be unpredictable in such a technical area as competition.	Cases heard in by a panel of judges of the specialist Competition Appeal Tribunal.
Unclaimed money?	Unclaimed money distributed via 'cy-près': i.e. given to an institution thought to be relevant to the claimants.	No 'cy-près' – unclaimed money given to a named charity, the Access to Justice Foundation.

Source: BIS consultation document

Powers for the CMA to impose redress schemes

Under this proposal, the new competition regulator – the Competition and Markets Authority – would be given powers to require infringing companies to take steps to offer redress to those that have suffered loss as a result of their actions. The CMA could also certify the voluntary introduction of such a settlement scheme. Victims of anticompetitive behaviour would have no obligation to make use of the scheme, but if they did they would give up their right to sue, or benefit from any future collective settlements.

Use of these powers would be at the CMA's discretion, and would not in general result in any reduction in the fine otherwise payable by the undertaking in breach, although the Government accepts that there may be circumstances in which a modest 5-10% discount may be appropriate.

It is anticipated that such powers would be most relevant for cartels involving high-volume consumer products (such as those claims which were found to exist for milk or football shirts).

> "We are seeking to identify reforms that will bring meaningful change to small businesses and consumers. These reforms must provide appropriate safeguards against spurious or unfounded claims, but also ensure swift access to justice for those with a genuine case."
>
> *Norman Lamb, Minister for Employment Relations, Consumer and Postal Affairs*

Jurisdiction of the CAT

At present, actions for damages before the CAT cannot be initiated until a competition authority has issued an infringement decision ("follow-on" actions). As a result, many damages claims are brought as standalone claims before the High Court instead. The Government considers that this situation fails to exploit the full potential of the CAT. It therefore proposes to allow standalone actions to be brought before the CAT, as well as applications for injunctions.

The CAT's procedural rules would also be amended to better facilitate the use of formal settlement offers.

Fast track claims for SMEs

The consultation contains details of a proposed fast track claims procedure for SMEs. As well as providing for a shorter case timetable and the swifter grant of interim injunctions, the fast track process would allow the CAT to cap the SME's liability for the defendant's costs (up to a maximum of £25,000) and to waive or limit any obligation on the SME claimant to provide a cross-undertaking to compensate for damages suffered by the defendant as a result of any interim orders granted by the CAT.

A copy of the consultation paper is available at http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/p/12-742-private-actions-in-competition-law-consultation.pdf

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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 (including public takeovers), listed company matters and general corporate advisory work. Recent major transactions include advising Man Group plc on the acquisition of FRM to create a fund of hedge funds business with approximately US$19bn of assets under management; RBS on the sale of RBS Aviation Capital to a consortium led by Sumitomo Mitsui Banking Corporation for $7.3bn; Banco Santander on the sale of its shareholding in Thames Water to China Investment Corporation; and International Power on its combination with GDF SUEZ's international energy assets by means of a reverse takeover and on the subsequent offer by GDF SUEZ to acquire the shares in International Power not already owned by it. 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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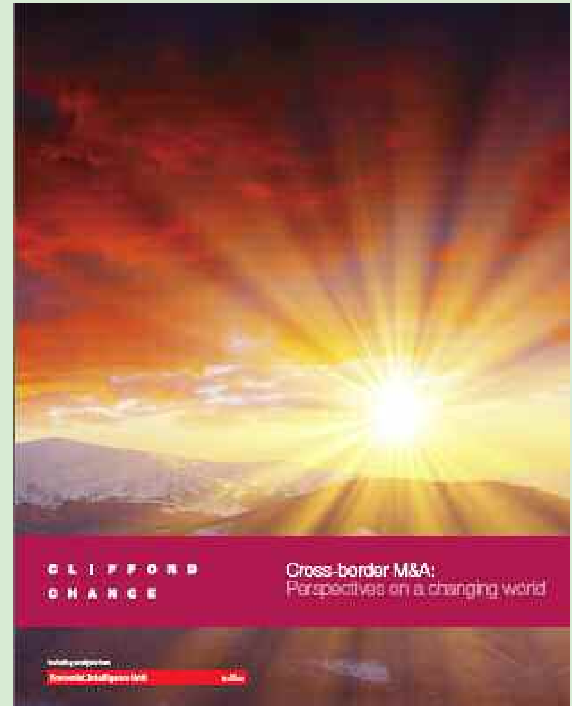
M&A insights and views from 350+ industry practitioners



Clifford Chance has recently commissioned the Economist Intelligence Unit to undertake research for us around the opportunities and challenges in cross border M&A. The research explores the strategies, priorities and concerns of major companies across all regions, their views on the key opportunities for inorganic growth, and their perceptions of the risk and barriers to cross-border M&A.

More than three-quarters (78%) of respondents to our *Cross-border M&A: Perspectives on a changing world* survey of large global companies are looking for growth outside of their domestic market. The research study also found that over half of companies surveyed (56%) are focusing their growth strategy on the high growth economies.

The Economist Intelligence Unit surveyed nearly 400 companies with revenues of more than US$1 billion, including 80 chief executives and 185 other C-level executives from a wide range of industries and regions. Respondents were asked to rank their top strategic drivers and perceived risks and barriers to cross-border M&A activity.

To register and receive a copy of this report, please visit www.cliffordchance.com/GlobalM&AReport.

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