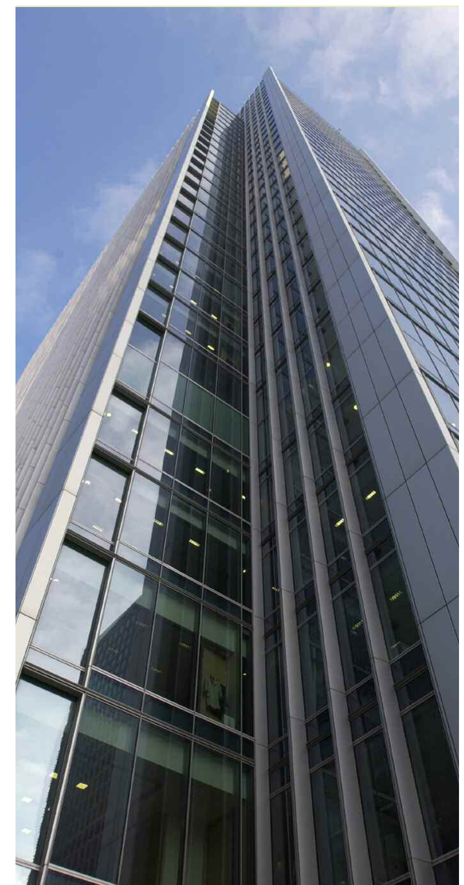
CLIFFORD CHANCE

January 2014

Corporate Update – January 2014

Welcome to our January 2014 edition of Corporate Update, our bi-annual bulletin in which we bring together the key developments in company law and corporate finance regulation which have occurred over the previous six months and consider how these might impact your business. In addition, we look ahead to forthcoming legal and regulatory change.



As previous editions of Corporate Update and our recently published 2014 AGM Update have included features on the new requirements for reporting directors' remuneration, we take a breather from the detail of that particular initiative and look instead at BIS' proposals to require UK companies to identify the beneficial owners of their shares. These plans are not without controversy and include the maintaining of a register of this information, which BIS intend should be open to the public, which will place an additional burden on companies.

On the regulatory front, we consider the FCA's plans to press ahead with the introduction of new Listing Rules to require a written agreement to be put in place between a listed company and its controlling shareholders (30% or more) to ensure that the listed company can act independently of any such shareholders. These plans have now been largely finalised and are expected to be in force by autumn 2014.

Among other items, we also review the new powers granted to the FCA in October 2013 which enable it to publish information about enforcement action against individuals or firms, including their identity, at an earlier stage than was previously the case and, crucially, before the person in question has had an opportunity to formally challenge the case against them. See our Regulatory Update for further information.

Major changes to the UK competition law regime come into effect on 1 April 2014. These changes give effect to the Enterprise and Regulatory Reform Act which was adopted in April 2013. We have highlighted the key changes of which you should be aware. See our Antitrust Update for details.

European Law Firm of the Year
Chambers Europe Awards
2013

Clifford Chance Law Firm of the year for Europe

International Law Firm of the Year
Chambers Global Awards
2013

Clifford Chance International Law Firm of the Year for 2013

Clifford Chance: Corporate and Commercial Firm of the Year

Legal 500 UK Awards 2013

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Company Law Update

BIS proposals to require UK companies to identify beneficial owners of shares

In July 2013, the Department for Business Innovation and Skills (**BIS**) published a discussion paper titled "Transparency & Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business" which followed on from Government announcements at the G8 summit in June 2013 to introduce proposals to enhance the transparency of UK company ownership and increase trust in UK business. Whilst the the vast majority of UK companies abide by the law, the paper acknowledges that companies can be used to facilitate a range of criminal activities – from money laundering to tax evasion, corruption to terrorist financing. The Government hopes that greater corporate transparency will make it more difficult to carry out this abuse and act as a deterrent to crime. These proposals, when implemented, are intended to help prevent serious financial crime, better enable companies to be held to account, and provide businesses, investors, employees and consumers with confidence that companies are acting fairly.

The main proposal in the paper is the introduction of new statutory powers in the Companies Act 2006 to require companies to identify beneficial owners and the establishment of a central registry of beneficial owners of UK companies. A beneficial owner for these purposes is to be defined as a natural person who either: (i) holds an interest in more than 25% of a UK company's shares (or voting rights); or (ii) otherwise has a material influence (correlating with that of a holder of an interest in more than 25% of the shares or voting rights) over the management of a UK company, which would catch some minority veto rights holders. The paper proposes that companies listed on the Main Market of the London Stock Exchange that are already subject to stringent ownership disclosure requirements would be exempt from the requirement to hold information on their beneficial ownership in a central registry.

The paper also proposes a prohibition on the creation of new bearer shares and a requirement to convert all existing bearer shares to ordinary registered shares. In addition, the position of nominee directors is considered. The Government is concerned that nominee directors can be used to facilitate criminal activity by concealing corporate control. The proposal is to increase transparency in this area by requiring nominee directors to disclose the identity of their nominator or by requiring them to be licensed.

The publication of the discussion paper was followed in October 2013 by an announcement by BIS that, in addition to implementing its commitment to create a new central register of company beneficial ownership information, it has also decided to make the new register publicly accessible.

AGM Update 2014 – a brief reminder

In December 2013 you should have received a copy of our annual AGM update for the 2014 AGM season.

With the new directors' remuneration reporting regulations and other proposed changes now in force, the 2014 AGM and reporting season heralds a number of significant changes both to the form and content of the annual report and the resolutions that will need to be put to shareholders. The key changes to bear in mind are:

- the introduction of a new style director's remuneration report, split into (i) the chairman's annual statement and the directors' report on the implementation of the company's directors' remuneration policy for the financial year being reported on; and (ii) a forward looking directors' remuneration policy;
- a business review is no longer required; this has been replaced by a standalone strategic report;
- as part of the directors' report, companies must include a report on their greenhouse gas emissions;
- supplementary financial statements (SFS) should no longer be sent to shareholders; instead companies may send the new strategic report, along with supplementary material, to shareholders who currently receive the SFS; and
- there are new reporting requirements relating to the role and responsibilities of the audit committee under the revised version of the Corporate Governance Code.

For further information on these key changes, plus details of what you need to know about the updated institutional investor guidelines, along with a look ahead to the significant areas of change likely to impact the upcoming reporting season, please refer to our 2014 AGM Update. Download a copy at:

http://www.cliffordchance.com/publicationviews/publications/2013/12/your_2014_agm_-_keydevelopments.html

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Editor Comment: Concerns have been raised by respondents to the discussion paper that these proposals may damage the attractiveness and competitiveness of the UK as a jurisdiction for the incorporation of companies. The effectiveness of such proposals in averting the misuse of companies by persons engaged in financial crime has also been brought into question as it seems doubtful that such persons would comply with the proposals.

In light of the announcement by BIS in October 2013 that the register will be publicly accessible, concerns have also been raised about the privacy of the disclosing participants. If the information is required by the authorities to enable them to identify and prosecute financial crime, why is it necessary for such information to be publicly available? This requirement would seem to unfairly remove the right of individuals to protect their privacy where nominee arrangements are used for legitimate purposes. In addition, the requirement to maintain information on beneficial ownership in a central registry will place an additional regulatory burden on both private and unlisted public companies.

BIS is to publish a formal discussion paper in early 2014, which will contain details of the information on beneficial ownership to be held by the company and Companies House. BIS has indicated that there are likely to be some limited exemptions from public disclosure, such as where it is necessary to protect individuals whose safety might be put at risk, but the extent of these exemptions will not be known until this discussion paper is published.

Download a copy of the BIS Discussion Paper at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increaing-trust-in-uk-business.pdf

Review of statutory audit services: introduction of advisory vote for shareholders on audit committee report

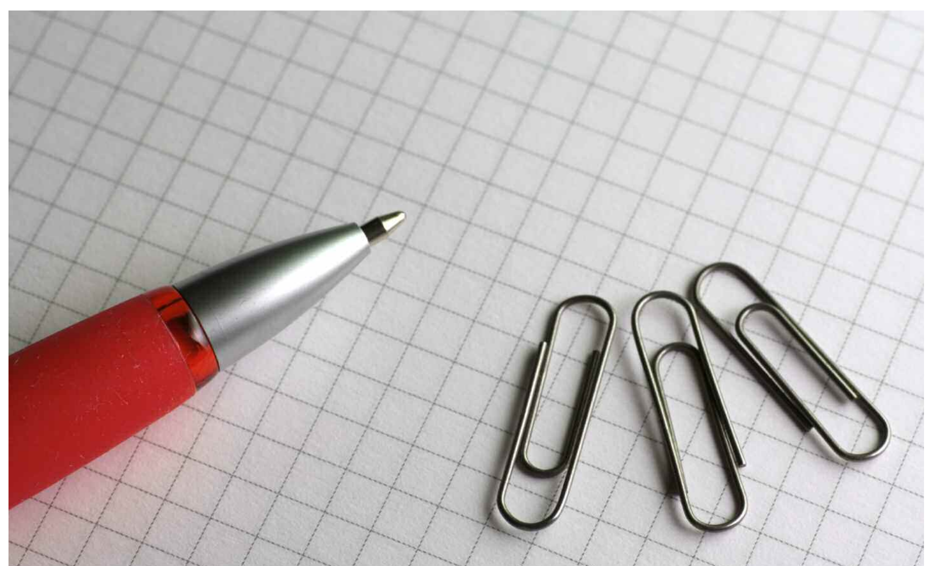
The Competition Commission (**CC**) has published its final report following its market investigation into the supply of statutory audit services to large companies in the UK.

The CC has identified a number of features of the market for the supply of audit services which, it believes, give rise to an adverse effect on competition. These features include: barriers to switching; barriers to entry, expansion and selection as auditors to FTSE 350 companies; the ability of executive management to influence external auditors in how they conduct and report their audit; and shareholders having little information regarding the investigation carried out by the auditors.

The CC was of the view that, as a result of the adverse effect on competition, FTSE 350 companies are offered higher prices, lower quality services (including "less sceptical" audits) and less innovation and differentiation of offering than would be the case in a well-functioning market.

The CC has therefore set out a package of remedies (the remedies) to address these concerns, which include:

- requiring FTSE 350 companies to put their statutory audit engagement out to tender at least every ten years (this is consistent with the best practice recommendation in the Corporate Governance Code);



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- requiring an independent audit quality review of every FTSE 350 audit engagement on average every five years;
- prohibiting clauses in loan agreements which restrict a company's choice of auditor to one of the big four audit firms;
- introducing an advisory vote for shareholders on whether the audit committee report in the company annual report is satisfactory; and
- introducing measures to strengthen the accountability of the external auditor to the internal audit committee.

The CC departed from its earlier provisional decision to require companies to put their statutory audit engagement out to tender at least every five years, instead allowing companies to choose to tender less frequently as long as the audit committee reports to the shareholders in which financial year the company plans to put the audit engagement out to tender and explains why this is in shareholders' best interests.

The CC states that it is aware that the remedies may be affected by measures currently being considered by the European Parliament, Council and Commission in relation to audit reform and that it will be able to amend the remedies, if necessary, in light of any agreed EU measures.

The CC has also indicated that the order to implement the remedies package is expected to come into force in October 2014, subject to the outcome of a public consultation on the draft order in January 2014.

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Case Law Update

Directors must use powers for the purpose they were conferred

In **Eclairs Group Ltd & Glengary Overseas Ltd v JKX Oil & Gas Plc**[1], the Court held that where a section 793 Companies Act 2006 notice requiring the recipient of the notice to disclose information about his interest in shares had not been properly responded to, the only permissible purpose of imposing voting/transfer restrictions on the relevant shares was to extract information. In the Eclairs and Glengary case, the board had imposed the restrictions primarily to restrict the relevant shareholders from exercising their voting rights at the AGM (and to obstruct a perceived raid and protect the company and its shareholders as a whole). The Court held that, in doing so, the board had used its power for an improper purpose and that the exercise of such power should be set aside.

The facts

This case concerned the validity of certain restrictions on voting and transfer imposed by the board of directors of JKX pursuant to its articles on shares beneficially (though not legally) owned by two significant shareholders, Eclairs and Glengary.

The board of JKX believed that it was being "raided" by Eclairs and Glengary who, it was thought, sought to destabilise the company by replacing senior management and obstructing the necessary fundraising processes with the ultimate goal of acquiring the company at less than its proper value.

It was known that Eclairs and Glengary would be likely to oppose certain ordinary and special resolutions proposed at JKX's forthcoming AGM, and, in particular, it was clear that the special resolutions would not be passed if they voted against them. Against this background, the board of directors served a notice in accordance with section 793 and JKX's articles seeking disclosure of interests in shares. The board considered the responses it received to be materially inaccurate and served restriction notices on the shares owned by Eclairs and Glengary which prevented the voting and transfer of such shares.

Immediately on receiving notice of the restrictions, Eclairs and Glengary sought interim relief in advance of the AGM, challenging the validity of the restrictions. This resulted in the Court issuing an order incorporating undertakings by the company, which created a regime under which the AGM could go ahead and Eclairs and Glengary could vote their shares, but with there being no declaration as to the effect of the votes on the resolutions pending determination of this case. When the AGM took place and the votes were ultimately cast, the ordinary resolutions were carried and the Eclairs/Glengary votes made no difference; but the special resolutions were affected – they would be carried if the affected shareholders' votes were disallowed, but would fail if they were allowed. As a result, the issue went to trial.

The judgment

It was held that the board had reasonable cause to believe that the information provided by Eclairs and Glengary in response to the section 793 notices was false or materially inaccurate and that, accordingy, the board had the power to impose the restrictions. However, it was held that the only permissible purpose of imposing the restrictions was to extract information.

As the board had imposed the restrictions primarily to restrict Eclairs and Glengary from exercising their voting rights at the AGM (with the intent of obstructing the raid and protecting the company and its shareholders as a whole), it was held that the board had used its power for an improper purpose and as such the exercise of the power was set aside.

Editor Comment: Directors must use powers for the purpose they were conferred; the fact that the directors believe that using the powers in a particular way will promote the success of the company is not sufficient. Interestingly, the judge did consider that the directors would have reached the same decision and imposed the restrictions anyway, had they just had the proper purpose in mind, and that this meant that there were good arguments for not setting aside the board's decision. However, procedurally the judge said that the point could not be taken and so it was not considered in detail.

[1] [2013] EWHC 2631 (Ch)

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Fraudulent directors cannot "shield" behind company in an attempt to avoid liability

The Court of Appeal has held that the fraud or other unlawful conduct of a director would not be attributed to a company when the company is itself the intended victim of the conduct[2].

The facts

The claimant company, Bilta, had traded in European Emissions Trading Scheme Allowances (**EUAs**) and was said to have been part of a VAT fraud. The design and effect of the fraudulent scheme was to render Bilta insolvent and unable to discharge its VAT liability to HMRC. Bilta's directors were alleged to have dishonestly breached their fiduciary duties by deliberately arranging Bilta's affairs so that no part of its VAT liabilities would be discharged. The liquidators of Bilta sought damages from the directors for breach of fiduciary duty, conspiracy to defraud and fraudulent trading.

Two of the defendants sought to have the claim struck out on grounds that Bilta's claim was precluded by the maxim of ex turpi causa (the principle that a person knowingly engaged in illegal activity may not claim damages arising out of that activity) and an earlier House of Lords' decision in **Stones & Rolls Ltd (in liquidation)**[3] because the fraud of the directors as Bilta's controllers should be attributed to Bilta. The High Court dismissed the defendents' application.

The judgment

The Court of Appeal upheld the High Court decision on grounds that the fact that a fraudulent director was the directing mind and will of the company had never been regarded as an answer to a claim by a company against its directors for a breach of duty committed against the company. The court drew a distinction between a company not being held to use its own wrongdoing as a defence against a third party victim and circumstances where the company is itself the victim of the directors' wrongdoing. In this latter instance, the Court of Appeal held that the law will not allow the enforcement of that duty to be compromised by the director's reliance on his own wrongdoing. Accordingly, it was held that whether the alleged conspiracy had as its object a VAT fraud on HMRC or was limited to depriving Bilta of the proceeds of sale from the EUAs, in each case the directors would have committed a breach of fiduciary duty and other wrongs against the company for which Bilta could sue. In neither case should it be open to the directors to shield themselves behind the company in an attempt to avoid liability.

[2] **(1) Jetivia S.A. (2) Urs Brunschweiler v (1) Bilta (UK) Ltd (In liquidation) (2) Kevin John Hellard (3) David Anthony Ingram (Liquidators of Bilta (UK) Ltd)** [2013] EWCA Vic 968)

[3] **Stone & Rolls Ltd (in liquidation) v Moore Stephens (a firm)** (2009) UKHL [2009] 1 A.C. 1391

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Regulatory Update

Changes ahead for premium listed issuers with a controlling shareholder

The FCA published consultation paper CP13/15 on 5 November 2013, which contained the FCA's feedback on its October 2012 consultation paper, CP12/25, and commenced a further consultation.

The FCA has confirmed its intention to introduce rules to:

- amend the existing "control of assets" test for eligibility to listing to require a premium listed company to carry on an independent business as its main activity;
- require premium listed companies to put in place an agreement with any controlling shareholders (30% or more) to ensure the company can operate independently from such shareholders; and
- require the election (or re-election) of all independent directors of a premium listed company that has a controlling shareholder to be approved by separate resolutions of all of the shareholders of the company together and of the independent shareholders of the company alone.

In CP13/15, the FCA is consulting on the introduction of a new requirement that the board must make a statement in the company's annual financial report that it has entered into an agreement with its controlling shareholders that will enable the company to satisfy the independence requirement and that the independence provisions in the agreement have been complied with. Where any independent director fails to support the statement this would have to be stated. The FCA intends to allow a transitional period and is seeking views on whether it would be appropriate that these disclosure requirements only apply to premium listed companies with accounting periods starting at least three months after the rule has been implemented.

Only a limited number of proposals in CP13/15 are subject to consultation, with the FCA indicating that it expects the near final text of the amended Listing Rules to be implemented without further amendment. For those limited areas which are being consulted upon, the consultation closes on 5 February 2014 and it is the FCA's intention to publish feedback in the first half of 2014. Depending on the results of the consultation, the FCA intends to implement its full and final package of measures in mid 2014.

Editor Comment: Interestingly, the proposals the FCA put forward in CP12/25 requiring a premium listed company with a controlling shareholder to have a majority of independent directors on the board (or an independent chairman and independent directors who together make up a majority of the board) have been dropped. The feedback on this proposal was that it was disproportionate and that companies would prefer to continue to apply the "comply or explain" approach mandated by the Corporate Governance Code when determining their board composition.

For further details about CP13/15, see our briefing available at http://www.cliffordchance.com/publicationviews/publications/2013/11/fca_publishes_feedbackoncp1225andfurthe.html

FCA proposes to charge issuers for publishing periodic financial reports late

The FCA has published proposals to introduce an administrative charge of £250 to cover its costs of dealing with the late publication by issuers of periodic financial reports pursuant to its Disclosure and Transparency Rules.

In consultation paper, CP13/18, published on 6 December 2013, the FCA has proposed that the charge would apply in circumstances where the issuer has not made its annual financial report or half-yearly financial report public within the respective four and two-month time periods specified in DTR4.

Comments on the proposals are requested by 6 February 2014. The FCA intends to introduce the charge with effect from 1 April 2014.

FCA has new powers to publish information regarding warning notices

The FCA issued a policy statement on 15 October 2013 about the exercise of its new powers to publish information regarding enforcement warning notices.

Previously, publication would only occur **after** a decision notice or a final notice was issued. The FCA has new powers to publish information about enforcement action against firms and individuals, including their names, at an earlier stage than has previously been permitted and, crucially, before the subject of the investigation has had an opportunity to formally challenge the case against it.

The FCA's policy statement, which took effect on 15 October 2013, clarifies that the information will be published in a

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short statement after the warning notice has been issued and will identify the firm or individual involved unless to do so would, among other matters, be unfair to the person involved.

Information can only be published about warning notices where the FCA is proposing to censure, fine, suspend or restrict a firm or individual. The power to publish information does not apply to warning notices which only propose to prohibit an individual, withdraw the approval of an individual or cancel the permission of a firm. The decision to publish information and what to publish will be taken by the Regulatory Decisions Committee rather than the applicable enforcement team, and will only be made after consultation with the affected firm or individual(s).

The FCA will follow a three-stage approach to making a decision about publication.

Step 1 – Whether any information should be published

The FCA will first consider whether any information about the warning notice should be published. It has stated that it expects that in almost every case it will be appropriate to publish some details.

Step 2 – Whether the identity of the subject should be published

The second step is that the FCA will consider whether it is in principle appropriate to identify the subject of the warning notice. The amended Enforcement Guide clarifies that "*The FCA will consider the circumstances of each case but expects normally that it will be appropriate to identify a firm, but that it will not be appropriate to identify an individual.*"

The FCA's presumption is that the potential harm caused to an individual from publication of a warning notice will normally exceed the benefits of early transparency, but that this will not normally be the case in respect of firms.

The presumption against identifying individuals will not apply, however, where:

- it is not possible to describe the nature of its concerns without making it possible to identify the individual;
- it is necessary to avoid other persons being mistakenly believed to be the individual in breach;
- it would help to protect consumers or investors;
- it is necessary to maintain public confidence in the financial system or the market; or
- it is desirable to quash rumours in the market.

Step 3 – Consultation

If the FCA considers it is appropriate to publish information, no final decision (about whether to do so and if so, whether to identify the subject) will be made until the FCA has first consulted with the affected firm or individual.

The affected firm or individual will have the ability to make representations to the FCA where they have been notified that the FCA proposes to identify them in order to establish whether it would be unfair to be identified. The threshold to establish unfairness will differ between individuals and firms and the nature and size of a firm's business.

If, after considering any representations received, the FCA considers it is appropriate to publish information about a warning notice, the information will be published in a warning notice statement which will go on the FCA's website. The statement will make it clear that the warning notice is not the final decision of the FCA and that the person who is the subject of the notice has a right to make representations to the Regulatory Decisions Committee and to refer the matter to the Tribunal. The information will generally be available for 6 years on the website.

Where the FCA publishes a warning notice statement and the FCA subsequently decides not to take any further action, the FCA will make it clear on its website that the warning notice no longer applies. The FCA will normally do this by publishing a notice of discontinuance. But the FCA will not take down a warning notice statement where it subsequently issues a notice of discontinuance (as this is felt to be inconsistent with the objective of increased transparency). Instead, the FCA will amend the warning notice statement so that it includes a prominent message that a notice of discontinuance has subsequently been issued, and a link to that notice of discontinuance.

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Editor Comment: This is a worrying development for individuals and firms that are in receipt of an enforcement warning notice. The affected firm or individual will be given an opportunity to demonstrate that publication should not arise on the basis of the grounds set out in section 391(6), FSMA. These are that either that, in the assessment of the FCA, publication would be: (i) unfair to the person with respect to whom the action was proposed to be taken; (ii) prejudicial to the interests of consumers; or (iii) detrimental to the stability of the UK financial system.

For firms or individuals that wish to demonstrate that publication would be unfair (where the FCA has decided that publication would be appropriate), they are required to provide clear and convincing evidence (within 14 days of being consulted) of how the unfairness may arise and how a disproportionate level of damage could be suffered. Although the thresholds are lower than when seeking to object to publication of a decision notice, they are still not likely to be easily surmountable. Relevant factors could include that publication could: (i) materially affect the person's health; (ii) result in bankruptcy or insolvency; (iii) result in a loss of livelihood or a significant loss of income; or (iv) prejudice criminal proceedings to which he is a party.

The FCA has stated that it is more likely to consider that the negative impact of publication on a person's reputation amounts to unfairness if the person also provides evidence of the harm that they could suffer as a consequence of the damage to their reputation. In assessing unfairness, the FCA will also take into account the extent to which the person has been made aware of the case against them during the course of the investigation. For instance, if a preliminary investigation report had not been issued and the subject had not been given an opportunity to respond prior to the issuance of the warning notice, this will be a factor in the FCA's decision.

Whether the subject of the warning notice is a firm or an individual will also be relevant to the FCA's assessment of unfairness. The FCA's expectation is that it would be more difficult for a firm to demonstrate unfairness than an individual. The FCA have indicated that the size of a firm is a relevant consideration because the impact of publication on a small firm is likely to be of a different nature to the impact on a large firm, and in some cases could resemble the impact on an individual. Larger firms will find it more difficult to demonstrate unfairness than smaller firms.

Find out more about the FCA's approach to this issue in our briefing: http://www.cliffordchance.com/publicationviews/publications/2013/10/fca_publication_ofwarningnotices-16octobe.html

FCA proposes new technical note clarifying obligation for issuers to deal with the FCA in an open and co-operative manner

Since our July 2013 edition of Corporate Update, the FCA has published further editions of its Primary Markets Bulletin, Nos. 6 and 7. The principal purpose of these has been to seek views on proposed new and amended technical notes which are to be included in the FCA's Knowledge Base, the FCA's repository for technical guidance on the Listing Rules, Prospectus Rules and the Disclosure and Transparency Rules.

One proposed new note warrants a mention. In PMB No.6 the FCA has proposed the introduction of a new technical note, UKLA/TN/209.1, which considers the application of Listing Principle 6 (requiring a listed company to deal with the FCA in an open and co-operative manner).

The proposed technical note states that the obligation set out in Listing Principle 6 is broader than simply requiring issuers to ensure that they deal with the FCA in an open and co-operative manner on on-going matters. In particular, the FCA states that Listing Principle 6 also requires companies to approach the FCA when contemplating a significant transaction. The publication of this proposed technical note would appear to stem from the circumstances surrounding the £30m fine issued to Prudential in March 2013 for failing to deal with the FCA in an open and co-operative manner in breach of Listing Principle 6.

The proposed note sets out factors which are likely to be relevant in determining whether a transaction is significant and early contact with the FCA is necessary. In particular, the note provides that issuers need to consider:

(i) whether there is a role for the FCA in relation to the transaction (for example, will guidance be required on the interpretation of a Listing Rule, or a waiver need to be sought?);

(ii) will the FCA's decision be time critical?; and

(iii) does the time of contacting the FCA allow it a sufficient time to disagree with the proposed approach and/or to consider the substance of the matter presented and to form a view?

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A matter considered to be time critical might arise where the issuer becomes aware that a decision will need to be made at a certain point in time; for example, the need to make an announcement at a time when the market is closed. In such cases, the issuer should ensure it contacts the FCA well in advance of making the announcement. With regard to (iii) above, a situation might arise, for example, where an issuer is considering a reverse takeover and knows that at some point it will need to discuss the issue of a share suspension with the FCA. In this instance, the issuer should contact the FCA sufficiently in advance of announcement of the transaction to enable the FCA to assess the facts fully and consider whether a suspension would be appropriate in the circumstances.

The consultation on PMB 6 closed in September 2013 but a response on the new technical note on Listing Principle 6 is outstanding.

Editor Comment: Judging at what point in time a transaction is sufficiently certain and warrants an approach to the FCA can be particularly challenging. This is an area on which issuers will generally want to seek advice both from the sponsor and their legal advisers. However, in seeking to introduce this guidance, the FCA is making clear that, in considering whether and, if so, when to approach the FCA, issuers have a primary responsibility to comply with Listing Principle 6 and, as such, must give due consideration to their obligations in this regard.

You can access PMB No. 6 at:

http://www.fca.org.uk/static/documents/ukla/primary market bulletin 6.pdf

"The [FCA] expects to have an open and frank relationship with the firms it supervises and with listed companies. It is essential that firms give due consideration to their regulatory obligations at all times. In particular, timely and proactive communication with the [FCA] is of fundamental importance to the functioning of the regulatory system and the integrity of the market."

Tracey McDermott, FCA director of enforcement and financial crime

You can access the FCA Knowledge Base at:

http://www.fca.org.uk/firms/markets/ukla/knowledge base

Securities settlement cycle to be shortened to T+2

The London Stock Exchange has published Market Notice N14/13 in which it has confirmed that the standard settlement period of T+3 (date of trade plus three business days) is to be reduced to T+2 (date of trade plus two business days) with effect from 6 October 2014.

The driver for this change is the European Commission's proposal for a regulation on improving securities settlement in the EU and on central securities depositaries which is intended to harmonise securities settlement cycles across EU member states. This development will be welcomed by companies who will see a consequent one day reduction in the timetable for receipt of funds following a capital raising.

Plans for integrated FRC guidance on going concern, risk management and internal control

The FRC has published a consultation setting out its plans to integrate its guidance on going concern, risk management and internal control into a single document (**Integrated Guidance**). The Integrated Guidance is intended to replace the FRC's Internal Control: Guidance for Directors (2005) (commonly known as the Turnbull Guidance) and the FRC's Guidance for Directors on going concern and liquidity risk (2009).

This latest consultation paper, published in November 2013, builds on work undertaken by the FRC earlier this year regarding the implementation of recommendations from the Sharman Panel relating to its 2009 Guidance on going concern and liquidity risk.

Associated changes to the Corporate Governance Code are also proposed in the consultation paper. If implemented, these will result in the introduction of a new Code provision requiring the board to carry out a robust assessment of the principal risks facing the company and to confirm in the annual report that this has

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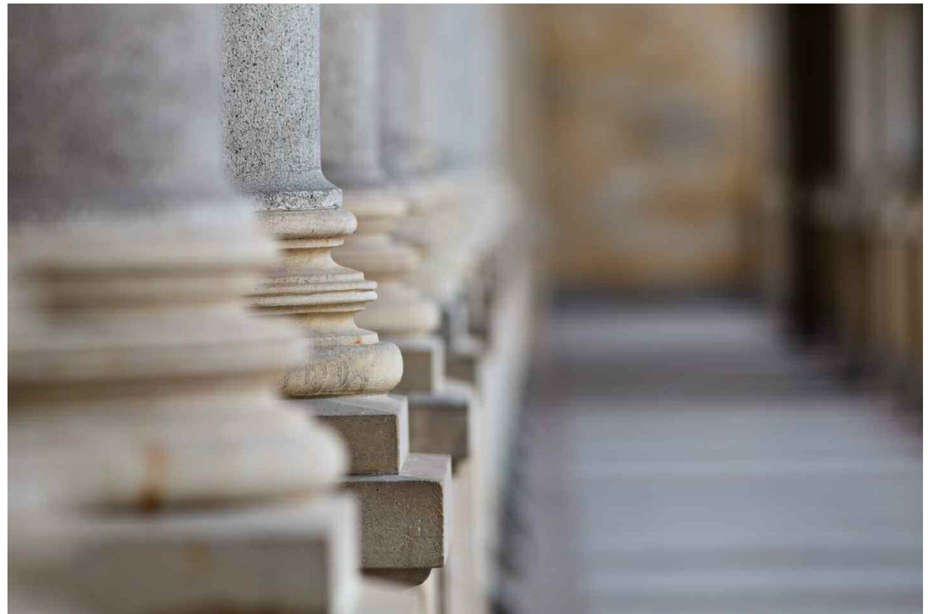
been done and to provide an explanation as to how such risks are being managed or mitigated.

The consultation closed on 24 January 2014. The FRC intends to publish the Integrated Guidance in the first half of 2014, to take effect at the same time as the proposed changes to the Code. In the event that the FRC does not proceed with its Integrated Guidance, it is of the view that the Turnbull Guidance will require updating in any event.



Corporate Governance: Collective Engagement Working Group Report published

The Collective Engagement Working Group, comprised of representatives from the asset management and share ownership community, was set up in April 2013 to take forward the recommendation of the Kay Review to identify how institutional investors can better engage with listed companies. The Working Group published its first report in December 2013.

The Working Group has established an Investor Forum, intended to be operational by June 2014, the main objective of which is to bring about cultural change in the way in which institutional investors engage with companies. Recognising that most British companies are now majority owned by overseas owners, the Forum will ensure participation by both UK and international investors (including sovereign wealth funds). The Forum will provide structure to facilitate collaboration between a wide-range of investors and address any mechanical and legal issues that impact on collective engagement. The Forum is to be supported by its own secretariat and has secured funding for the next two years.

The Working Group's report also recommends that:

- companies should hold an annual strategy meeting with institutional investors;
- institutional investors should seek feedback from the company's non-executive directors on the quality of their engagement;
- when appointing an asset manager, asset owners should ensure the manager's approach to stewardship is aligned to their own interests and that there is a clear policy on engagement; and
- institutional investors should ensure their engagement on governance issues is integrated into the investment process.

The Working Group's December 2013 report is available from:

http://www.investmentuk.org/press-centre/2013/press-release-2013-12-03/

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Takeovers Update

ESMA statement on shareholder co-operation and acting in concert

On 12 November 2013, the European Securities and Markets Authority (**ESMA**) published guidance in the form of a Public Statement (ESMA/2013/1642) on shareholder co-operation and acting in concert under the Takeovers Directive. The guidance contains a "White List" of activities which shareholders may engage in to exercise good corporate governance without that co-operation, in and of itself, leading to those shareholders being regarded as concert parties. If investors are treated as acting in concert, this brings with it the risk of them inadvertently triggering a mandatory bid obligation under the applicable national takeover regime. National takeover regulators will have regard to the White List when determining whether shareholders are acting in concert but will also take into account all other relevant factors in making their decision.

The statement acknowledges agreement among national takeover regulators that national takeover rules should not be applied in such a way as to inhibit legitimate shareholder co-operation. The White List is based on existing laws, regulations and practices in member states and the activities listed include:

- discussions between shareholders about possible matters to be raised with the company's board;
- representations to the company's board about company policies, practices or particular actions that the company might consider taking;
- other than in relation to the appointment of board members, the exercise of shareholders' statutory rights to add agenda items, table draft resolutions or call a general meeting;
- other than in relation to a resolution for the appointment of board members and insofar as such a resolution is provided for under national company law, agreement to vote the same way on a particular resolution which is put to a general meeting, in order to reject a related party transaction, or to approve or reject, for example, a proposal relating to directors' remuneration, an acquisition or disposal of assets, a reduction of capital or share buyback or a dividend.

The guidance makes clear that if shareholders co-operate to engage in an activity which is not included on the White List, that fact will not, in and of itself, mean that those shareholders will be regarded as persons acting in concert. Where shareholders engaging in an activity on the White List are in fact co-operating with the aim of acquiring or exercising control over the company, those shareholders will nonetheless be regarded as concert parties and may trigger a mandatory bid obligation.

Editor Comment: The publication of the White List is a welcome development, given the current market focus on ensuring investors engage with one another and with the companies in which they invest (the work of the Collective Engagement Working Group considered on page 11 is a clear example of investor engagement in action). Interestingly, these developments have each come at a time when shareholder activism appears to be on the increase.

It is worth noting that the ESMA statement does not change the UK Takeover Panel's practice as set out in Note 2 on Rule 9.1 (collective shareholder action), as elucidated further in Panel Practice Statement No. 26: Shareholder activism. In Practice Statement No. 26, the Panel Executive confirms that a mandatory offer may only be triggered by activist shareholders if both of the following tests are satisfied:

- the shareholders requisition a general meeting to consider a "board control seeking" resolution or threaten to do so; and
- after an agreement or understanding is reached between the activist shareholders that a "board control-seeking" resolution should be proposed or threatened, those shareholders acquire interests in shares such that the shares in which they are interested together carry 30% or more of the voting rights in the company (or, if they are already interested in shares carrying 30% or more of the voting rights of the company, they acquire further interests in shares).

For these purposes, a resolution will not normally be considered to be "board control seeking" unless it seeks to replace existing directors with directors who have a significant relationship with the requisitioning shareholders with the result that those shareholders would effectively be in a position to control the board.

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Response Statement 2012/1 - Profit forecasts, quantified financial benefits statements, material changes in information and other amendments to the Takeover Code

On 24 July 2013, the Panel published RS 2012/1 following its consultation on proposals to amend the Takeover Code (**Code**), among other things, to reduce the regulatory burden in relation to ordinary course profit forecasts, impose stricter rules in the context of quantified financial benefits statements and require disclosure of material changes in information on an ongoing basis by way of announcement and not simply if a subsequent document is published. The Code changes took effect on 30 September 2013.

Profit forecasts

The changes to the rules on profit forecasts (in Rule 28 of the Code) provide a more logical framework for the regulation of profit forecasts in order to achieve greater consistency with other legislation, standards and guidance.

Rule 28 still applies to profit forecasts made by targets and securities exchange bidders. The Panel has, however, sought to reduce the regulatory burden of the Rule 28 reporting regime by applying a lighter touch to certain profit forecasts, including (i) ordinary course forecasts; (ii) those forecasts which have been published before an approach has been made to the target; and (iii) forecasts relating to a period ending more than 15 months from the date it is first published (although note that corresponding forecasts for each intervening year must still be prepared and any short term forecast would need to be reported on).

The lighter touch approach avoids the need for accountants and financial adviser reports to be obtained. Instead, the bid party concerned can either (a) repeat the profit forecast and include directors' confirmations that the profit forecast remains valid and has been properly compiled on the basis of stated assumptions and that the basis of accounting policies used is consistent with the company's accounting policies or (b) explain why the forecast is no longer valid. If neither option is chosen, the bid party must prepare a new forecast which would then need to be reported on.

The directors' confirmations route was used by a target company in relation to a forecast published before an approach (*Merck/AZ Electronics*). This allowed the target to deal with the forecast in a more proportionate and cost-effective manner whilst still ensuring its accuracy for the benefit of target shareholders.

In the case of bidder profit forecasts where the securities exchange element is not material relative to the bidder's market capitalisation or a material proportion of the value of the offer, the Panel may grant a full dispensation from the requirements of Rule 28 if the Panel considers that the application of the rule would be disproportionate or otherwise inappropriate.

Merger benefits

The rules on merger benefits statements, which are now called quantified financial benefits statements, have been brought into line with the profit forecasts reporting regime. The rules on quantified financial benefits statements have been incorporated into Rule 28 of the Code. The rules continue to apply to synergy statements made by securities exchange bidders but now also apply to statements made by the target about cost savings which are expected to accrue to the enlarged group as a result of the takeover or from measures to be implemented by the target if the offer lapses or is withdrawn. Quantified financial benefits statements made by a target company are caught by Rule 28 irrespective of the consideration offered pursuant to the bid. It should be noted that the exemption which previously existed in respect of statements made in the context of recommended, non-competitive bids has been removed from the Code.

Disclosure of material changes

The amendments to Rule 27 imposing an ongoing disclosure requirement in the context of material changes in information, also requires bid parties to announce any "material new information" which arises and which they would have been required to publish previously, had such information been known at the relevant time.

Response Statement RS 2012/1 is available at: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/RS201201.pdf and Consultation Paper PCP 2012/1 is available at: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201201.pdf

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Antitrust Update

A lighter load for EU merger filings?

In our July 2013 Corporate Update we reported that the European Commission (**Commission**) had proposed various changes to its filing procedures and forms under the EU Merger Regulation (**EUMR**). Those changes have now been confirmed, subject to some minor modifications, and came into effect for transactions notified on or after 1 January 2014.

In order to make the filing burden more proportionate to the issues raised by notified deals, the Commission has made two sets of changes to its filing procedures.

A broader simplified procedure

First, the Commission has widened the scope of transactions qualifying for review under the Commission's "simplified procedure", which requires the submission of much less information than the standard filing route.

It has done so principally by increasing the market share thresholds below which the procedure is available, from 15% to 20% for markets in which the merging parties compete and from 25% to 30% for vertically related markets (ie where one of the companies sells an input to a market where the other is active). The Commission has also introduced a new threshold which applies simplified treatment to transactions between competitors with a combined market share of up to 50%, where the increase in market share due to the merger is small.

The Commission estimates that 60-70% of all filings will now be subject to the simplified procedure - 10% more than previously the case.

Changes to the filing forms

The second set of changes involves a reduction in the amount of information required by the "Form CO" filing forms, particularly in simplified procedure cases.

For example:

- parties to joint ventures with no EU activities will need only to provide turnover figures and a brief description of the joint venture and their activities; and
- the market share thresholds above which markets are deemed to be "affected" by a transaction (and therefore subject to additional information requirements) have been increased to the same levels as the simplified procedure thresholds.

It will also be easier, in principle, to obtain waivers from the obligation to provide certain categories of information. Time will tell if this results in quicker pre-notification discussions, as the Commission hopes. For cases in which the parties have no competitive relationships, the Commission considers that no pre-notification contacts will be required at all.

Editor Comment: The move to reduce filing requirements is a welcome step and should result in time and cost savings in a significant number of cases. In some important respects, however, the information burden will actually increase. In particular, the filing forms will now require more internal documents to be submitted. The Commission has responded to criticism of its original plans by implementing a more limited increase in the scope of required internal documents, and narrowing the circumstances in which they must be supplied. Nevertheless, the burden will still be considerably higher than before.

Parties notifying with the standard (non-simplified) form will also now be required to provide information on all markets that might "plausibly" be affected. The Commission considers that this simply reflects pre-existing practice (it already applied in simplified procedure cases), and has sought to give some guidance on how this plausibility criterion will be applied. However, its introduction as a formal requirement is likely to make it even more difficult to resist requests by Commission case teams for information on the basis of market definitions that notifying parties do not consider to be commercially reasonable.

The Commission has yet to announce its intentions with regard to a separate initiative aiming at widening the scope of the EUMR to cover non-controlling minority interests.

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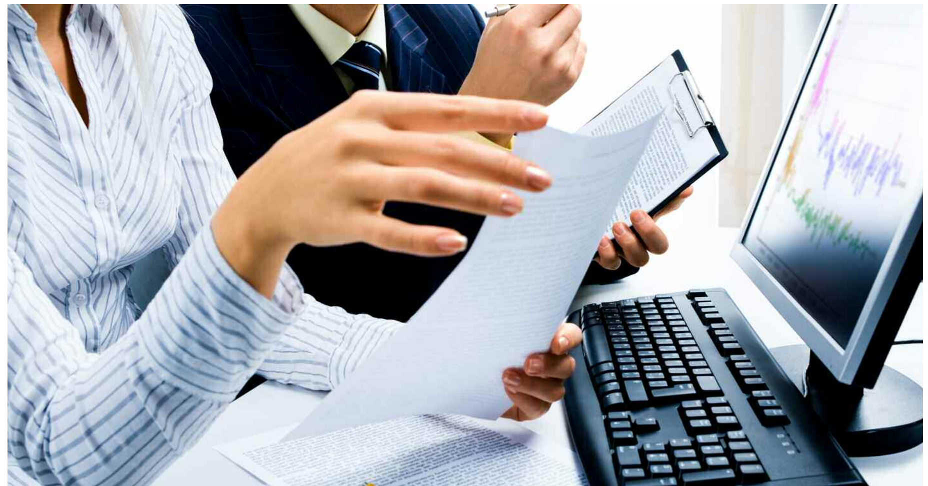
Parent companies' liability for EU antitrust breaches of joint ventures confirmed

The EU Court of Justice (**ECJ**) has confirmed, in two recent judgments, that parent companies can be held liable for infringements of the EU antitrust rules committed by joint ventures over which they exercise decisive influence. Such influence may exist even if the parent did not participate in the breach, knew nothing about the joint venture's infringing conduct, and could only veto - but not determine - strategic business decisions of the joint venture.

In recent years, the European Commission has taken an expansive approach to attributing liability to parent companies for breaches of the EU competition rules that are committed by companies within their corporate group.

Where subsidiaries are wholly-owned, parents can be (and usually are) held liable even if they did not participate in the infringement, were not aware of their subsidiary's conduct, and did not facilitate it in any way. That is the case even if a rogue employee carried out the breach, and a rigorous compliance programme was in place.

The only way a parent can escape such liability is by proving that it did not exercise any decisive influence over the strategic business decisions of the subsidiary. Proving a negative in this way is almost impossible, and no company has succeeded in doing so to date (although some have successfully argued that the Commission did not properly



consider their arguments in this respect). An Advocate General to the ECJ has said that, in his view, parental liability for wholly-owned subsidiaries should now be treated as a legal rule, not just a presumption.

However, where an infringer is jointly controlled by two or more companies, the position is different. There is no presumption that each company exercises decisive influence over the joint venture (**JV**), so the Commission must prove that this is the case. In two judgments of 26 September 2013 - Dow Chemical Company (**Dow**) and EI du Pont de Nemours and Company (**DuPont**) – the ECJ confirmed just how easy it is for the Commission to do so.

The judgments

In 2007, the Commission held Dow and DuPont jointly and severably liable for a €44.25 million fine, in respect of the participation in a chloroprene rubber cartel of a JV in which each had a 50% interest. This fine related to a breach of the EU prohibition on anticompetitive agreements – Article 101 of the Treaty on the Functioning of the EU (**Article 101**). Dow was fined a further €4.25 million so that its total fine reflected the size of its corporate group. Both companies appealed.

The ECJ upheld the Commission's decision, as had the General Court of the EU, previously. It held that the fact that Dow and DuPont were found to have the ability to exercise decisive influence over the JV for the purpose of the EU Merger Regulation (**EUMR**) was relevant for determining whether they could be liable for its actions. In this respect, negative control is enough, i.e. rights to veto strategic commercial decisions, even in the absence of any ability to determine positively the outcome of those decisions. Moreover, parents may be found to have such control even if the JV has a degree of operational autonomy, as is the case for "full-function" JVs that are notifiable under the EUMR. The parents need only to control broadly-defined strategic business decisions, such as approval of the JV's budget and business plan and appointment of senior management.

The ECJ also upheld the finding that Dow and DuPont had actually exercised their decisive influence over their JV, notwithstanding the relatively limited evidence of this. It sufficed that they had appointed some senior managers of the

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JV (not even particularly senior, according to Dow), had participated in a committee that had various powers to manage the JV and had, through that committee, approved the closure of a production plant. The fact that the parents had carried out an internal investigation into the JV's cartel activities was also seen as evidence that they had the power to direct its conduct on the market.

Finally, the ECJ ruled that for the purposes of establishing liability (and only for these purposes), Dow, DuPont and the economic successors of the infringing JV could be treated as all forming part of one and the same "undertaking" for competition law purposes, and could therefore be held jointly and severably liable for the infringement.

Editor Comment: If a parent has the ability to veto strategic business decisions of a JV for the purposes of the EUMR, it seems that the Commission will have little difficulty in establishing that it is liable for the JV's antitrust breaches. This may be the case even if the parent has no day-to-day involvement, and only limited information on the JV's activities. Accordingly, group compliance programmes and policies should always cover such JVs, as well as certain types of agent whose actions can also attract liability for principals.

In addition, the judgments create a distinction between the corporate group that is treated as a single "undertaking" for the purposes of attributing joint liability and that which is treated as an undertaking for determining whether the Article 101 prohibition applies (intra-group arrangements being excluded from its scope). By doing so, the ECJ ducked the important question of whether agreements between a parent and JV fall outside the scope of Article 101, on the basis that they form part of the same corporate group. One Advocate General to the ECJ has expressed the sensible view that application of this "group privilege" is the natural corollary of a parent being liable for the conduct of a group company. Unfortunately, however, the ECJ's rulings in Dow and DuPont mean that this issue remains open with regard to joint ventures.

Update on UK Competition Reforms

On 1 April 2014, major changes to the UK's competition law regime will come into effect, following the adoption of the Enterprise and Regulatory Reform Act in April 2013. The reforms touch on all areas of competition law, with the exception of competition litigation, which is the subject of separate, draft legislation that is currently under consideration (in the draft Consumer Rights Bill).

A New, Single Regulator

The biggest change will be the merger of the Office of Fair Trading (**OFT**) and the Competition Commission to create a new, powerful single competition authority – the Competition and Markets Authority (**CMA**). The CMA will have jurisdiction to carry out all reviews under UK merger control laws and all market investigations, and will be the primary enforcer of both civil and criminal competition laws.

For businesses, having a single authority should mean faster and less costly merger reviews and market investigations. In particular, if a detailed "Phase 2" investigation is launched, it is likely that at least some of the Phase 1 case team members will continue to work on the matter. That would mean that companies under investigation would no longer need to spend time re-explaining their business and the issues to a new case team, as they do at present. A potential drawback is that it might become 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"). However, there will be certain checks and balances to mitigate this. In particular, final decisions in merger and market investigations will continue to be taken by "panel" members, who are drawn from business, legal and academic backgrounds and who, under the current system, have a good track record of independent and impartial decision-making.

For antitrust investigations, the CMA has indicated that it will adopt the decision-making mechanisms of the OFT - whereby decisions on infringements, penalties and settlements are made by individuals who are not involved in carrying out the investigation – but has left open the question of whether these individuals will include panel members.

Mergers and acquisitions

The merger control regime will remain voluntary and non-suspensory in nature. However, the CMA will have broader powers to require merging businesses to be operated independently during the CMA's review process, backed up by powers to impose heavy penalties for breach. Guidance issued by the CMA indicates that, in exceptional circumstances, it may issue orders prohibiting parties from closing their transactions during the first phase of its review. As a result, transaction planning will become more complex, and the risks and costs of closing potentially problematic transactions without clearance will increase.

Binding deadlines and information gathering powers will be introduced at Phase I which should ensure shorter reviews, once a filing is made. However, these time savings risk being eclipsed by longer pre-notification periods, as the filing forms that have been published by the new authority give the investigating

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case team a considerable amount of discretion to determine how much information must be provided before the notification is deemed complete, and the binding review timetable starts running.

Anticompetitive agreements and abuses of dominance

For all ongoing and future cases from 1 April 2014, there will be the following main changes:

- new powers for compulsory interviews of current and former employees and management during competition investigations;
- relaxed criteria for the imposition of interim measures; and
- civil fines for non-compliance with the CMA's investigative powers, in place of the (unused) criminal penalties that apply at present.

Compulsory interviews are likely to have the largest impact. Draft guidance issued by the CMA explains that such interviews may be carried out on the spot (e.g. during a dawn raid) and that, for former employees and managers, such interviews may take place without notice to the former employer. Full cross-examination of the individual is permitted, and it remains unclear whether they will be permitted to refuse to answer questions, e.g. because of the possibility of incriminating themselves or their employer. Of particular concern is the statement in the CMA's draft guidance that in certain circumstances it will refuse to allow lawyers acting for the company under investigation to attend the interview, e.g. if it would reduce "incentives for individuals being questioned to be open and honest in their accounts".

Criminal cartel offence

The requirement for dishonesty will be removed from the criminal cartel offence. For conduct taking place after 1 April 2014, it will be enough for prosecutors to show that an individual knowingly participated in one of the categories of criminal cartel agreement (price fixing, market sharing, output restrictions and bid-rigging) and that relevant information about the arrangements was not to be given to customers, or published, before its implementation.

There are also three defences, which are available if the individual in question can show that he or she:

- did not, at the time of the making of the agreement, intend the nature of the arrangements to be concealed from either (i) customers or (ii) (as a separate defence) the CMA; or
- took reasonable steps, before the agreement was made, to ensure that its nature would be disclosed to legal advisers for the purposes of obtaining advice on it, before its implementation.

The CMA has published draft guidance explaining the factors that it will take into account when deciding whether to proceed with a prosecution under the revised offence. While the guidance asserts that the offence is intended only to catch serious, "hardcore" cartel conduct, it offers relatively little assistance in interpreting the scope of the offence, or the availability of the legal advice defence, as, it says, "that is the role of the criminal courts". That is unfortunate, as the imprecise statutory wording of the offence catches a number of seemingly benign arrangements, such as co/re-insurance arrangements, syndicated loans, underwriting agreements and certain forms of exclusive distribution. Companies will therefore need to assess carefully whether to make a precautionary filing or publication when entering into such arrangements.

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, so aligning the treatment of public interest issues in market investigations with that in merger reviews.

Sector Regulators

The sector regulators will retain their concurrent competition powers, but draft secondary legislation will (if adopted in its current form) give the CMA the power to take over competition investigations commenced by sector regulators, and to resolve jurisdictional disputes between them.

Editor Comment: It remains to be seen whether the creation of the CMA will impact enforcement levels. Combining the different working cultures of the OFT and CC is likely to be challenging, and the uncertain transition period together with a demanding initial workload will also have some effect. However, the appointments to the CMA's board, senior executive team and director-level positions represent a strong and experienced team of lawyers and economists, with ample ability to take on the challenges ahead.

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

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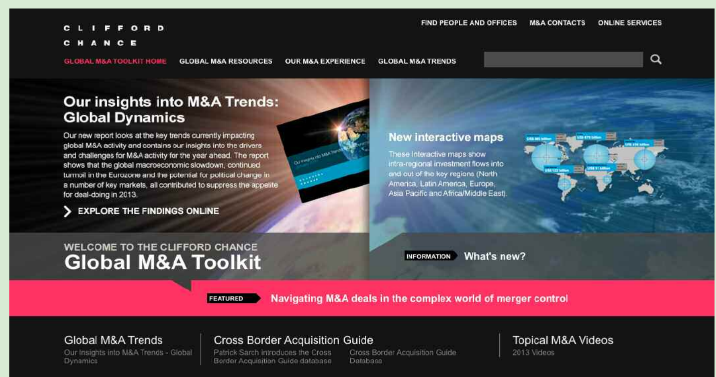

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