CLIFFORD CHANCE

Corporate Update January 2016

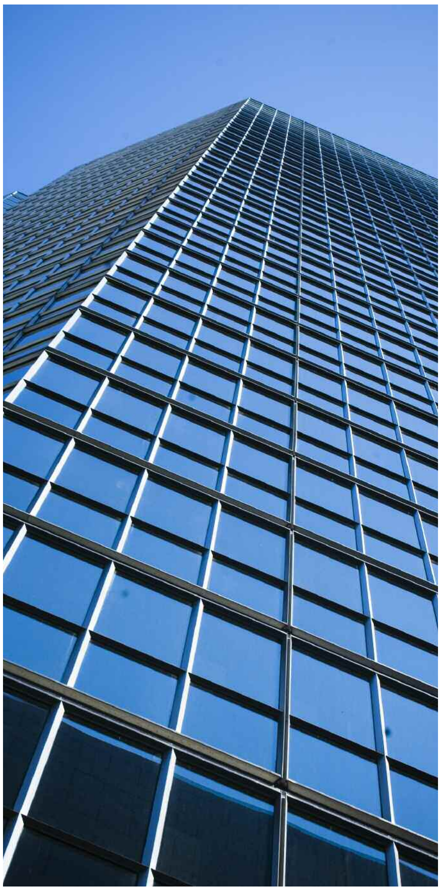
Welcome to our January 2016 edition of Corporate Update, our bi-annual bulletin in which we bring together the key developments in company law and corporate finance regulation which have occurred over the previous six months and consider how these might impact your business. In addition, we look ahead to forthcoming legal and regulatory changes.

In this edition we consider the impact of implementation of the EU Market Abuse Regulation (**MAR**) in July of this year and the changes that all UK premium listed companies will need to plan for and implement during the coming months. With the FCA's consultation into national implementation still ongoing, there remain areas of uncertainty as to how the final regulation will look and its practical impact, but this should not stop companies from taking some preliminary steps now to ensure that both their employees and internal systems are ready for the coming changes.

A new requirement to maintain a register of persons with significant control comes into effect on 6 April 2016. In preparation for this, we look at the key requirements of this regime and consider the current proposals from BIS and ICSA in respect of these requirements.

We also take a look at a number of interesting cases that have been decided by the Supreme Court in recent months, each overturning a decision of the lower courts and requiring that a new focus be given to some key concepts of English law when negotiating and interpreting contracts. In particular, the Supreme Court has (i) upheld the age-old doctrine of penalties but re-written the applicable tests to be applied in assessing the unenforceability of any such provision and (ii) clarified that the courts should not ordinarily intervene to imply terms into a contract where this is not necessary to give it "commercial or practical coherence".

Finally, we also consider a recent decision of the European Court of Justice that finds that facilitators of cartels (in this case a consultancy firm) and not just those parties to an agreement or concerted practices, can be held liable for breaching EU competition law. This decision is the first time that the ECJ has ruled on the conduct of cartel facilitators and has serious and wide reaching implications for service providers who may incur liability if they become aware of, or could have reasonably foreseen, illicit antitrust conduct by a client that is in some way facilitated by the services being provided.



Corporate and Commercial firm of the year
Legal 500 UK Awards 2015

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Company Law Update

Planning for implementation of the Market Abuse Regulation on 3 July 2016

Six months to implementation of a new market abuse regime

In our July 2015 edition of Corporate Update we looked ahead to the changes that will come into effect on 3 July 2016, when the EU Market Abuse Regulation (**MAR**) takes effect in Member States across the EU. Since that Update, a number of developments have occurred, including the publication by the FCA of its consultation on the changes to be made to our domestic regulation to ensure that it is consistent with the requirements of MAR and the publication by the European Commission of a delegated regulation setting out the detail of how certain provisions in MAR should be interpreted. HM Treasury has also made available a draft statutory instrument setting out the changes that will be required to primary legislation as a result of the introduction of MAR.

A significant number of questions still need answering about how certain areas of the new regime will operate in practice and industry groups are continuing to work with the FCA to seek clarification on these issues. Hopefully the position will become clearer over the coming months, but in the meantime we have identified the key issues for you to be aware of and which you will need to plan for over the coming months.

Key changes resulting from MAR

- MAR extends the application of the market abuse regime beyond issuers with shares admitted to trading on a regulated market to include issuers of securities traded on multilateral trading facilities and organised trading facilities.
- Issuers will be required to make an ex post notification to the regulator when the announcement of inside information is delayed: changes to record keeping will be required.
- Unlike the current regime, MAR will expressly prohibit PDMRs from dealing in an issuer's securities in a "closed period", and the range of permitted exceptions will be narrower than under the current Model Code.
- The FCA is advocating that all premium listed issuers must have in place "effective systems and controls" to require PDMRs to seek consent to deal in securities at all times (not just in the "closed periods" required by MAR); changes to share dealings codes will be required.
- Insider lists will require the inclusion of more detailed personal information.
- No notification of PDMR dealings will be required until an annual de minimis threshold is reached.
- Issuers and their advisers will be required to keep detailed records of all market soundings.

What will the market abuse rulebook look like after 3 July 2016?

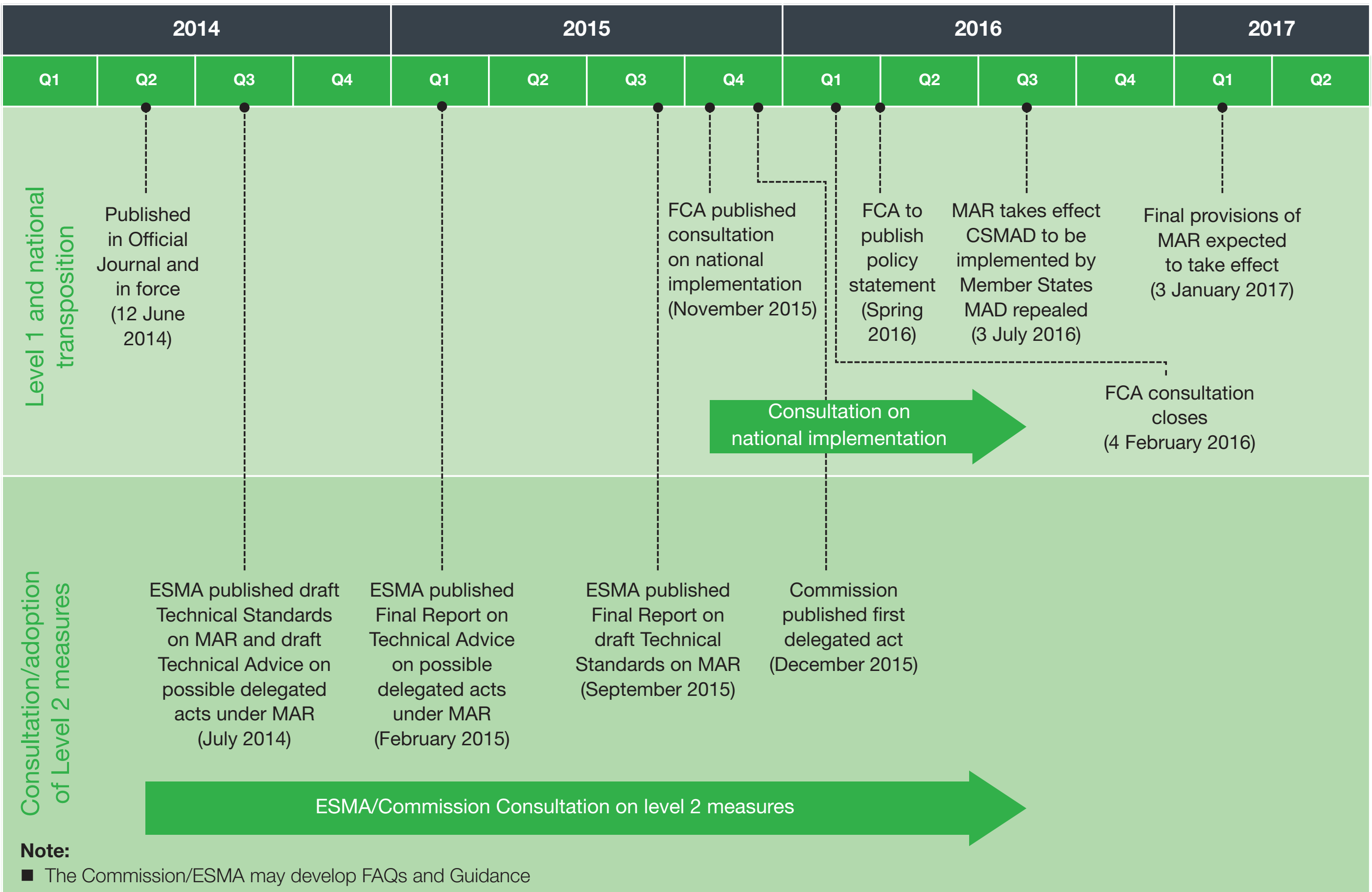
The FCA's consultation paper, CP15/35, addresses how the FCA Handbook will look after 3 July 2016. The answer is – very different! Those parts of the Handbook that will be most affected by implementation of MAR are the Disclosure and Transparency Rules (**DTRs**), the Listing Rules (in particular, the Model Code) and the Code of Market Conduct (**CMC**) (contained in MAR 1 of the FCA Handbook).

Disclosure Rules: The Disclosure Rules will be renamed the Disclosure Guidance. The bulk of the existing Disclosure Rules are to be deleted and readers will be signposted to the relevant provisions of MAR itself. Where possible, the FCA is seeking to retain those parts of the existing guidance in the current Disclosure Rules which offer assistance on the interpretation of the new legislative requirements.

Listing Rules: The primary change to the Listing Rules is the removal of the Model Code in its current form. Again, readers will be signposted to MAR which, in a change to the position under the Market Abuse Directive (**MAD**), expressly prohibits persons discharging managerial responsibility (**PDMRs**) within an issuer from dealing during a closed period. See below for further information.

Code of Market: Under current UK law, the FCA is required to issue the CMC which sets out guidance to assist those determining whether or not certain behaviours amount to market abuse. The Treasury is intending to repeal this

EU Market Abuse Regulation Implementation Timeline



requirement as a result of MAR, leaving the status of the CMC unclear. In CP15/35, the FCA has proposed retaining the CMC, in so far as legally permitted, but sadly, much of the existing CMC is to be deleted as it is no longer compatible with MAR. This is concerning as it will leave areas of uncertainty for issuers and other market participants.

Post 3 July 2016, the FCA Handbook should not be treated as a single rule book governing those matters covered by MAR. It will be crucial for market participants to familiarise themselves with the detail of the underlying European legislation, both MAR itself and the supporting level 2 measures (still in draft), which flesh out the detail of some of MAR's key requirements.

New requirement to make ex post notification to the FCA when the announcement of inside information has been delayed

Under MAR, an issuer will still be able to delay announcing inside information so as not to prejudice its legitimate interests. However, there will be a new requirement that when the relevant information is announced, the issuer must also notify the regulator in writing of its decision to delay that announcement.

The notification to the regulator will need to include certain specified information, including the date and time of the decision to delay the disclosure of inside information and the identity of all persons with responsibilities for the decision to delay the public disclosure of such information.

In addition, ESMA draft technical standards (still to be formally adopted by the European Commission) set out details of the internal records that issuers are expected to maintain where the

announcement of inside information has been delayed, including:

- the dates and times when the inside information first existed within the issuer, when the decision to delay announcement was first taken and when the issuer is likely to disclose such information;
- the identity of the persons responsible for (i) determining that the announcement of the information should be delayed, (ii) the ongoing monitoring of the conditions for delay, (iii) deciding when public disclosure should be made, and (iv) providing the requested information about the delay and a written explanation to the regulator;
- evidence of the initial fulfilment of the conditions permitting delay[1]. This will include information about any information barriers put in place internally to prevent access to inside information by those persons not entitled to received it and the arrangements put in place in cases where confidentiality is no longer ensured.

MAR also requires an issuer to provide a written explanation of its decision to delay the announcement of inside information. The FCA has a discretion as to whether to require the written explanation to be provided by an issuer at the same time as the initial notification of delay is given or for it to be provided only on request by the FCA. The FCA is consulting on this issue but has indicated that its preference is for the explanation to be provided only when requested by it.

It will be of critical importance that issuers can keep proper records of the decision making process that led to the delay in disclosure in order that full and accurate explanations can be provided to the FCA upon request. As such, issuers will need to review their existing disclosure policies and make any necessary changes and they should establish a disclosures register in which to record the required information.

Changes to existing share dealing codes will be required

In a change to the current position under MAD, MAR expressly prohibits trading by PDMRs in closed periods, save in very limited circumstances. A closed period is defined as the 30 day period before the announcement of an interim financial report or a year-end report which the company is *obliged to make public* according to the rules of the trading venue on which the company's shares are admitted to trading or national law. For companies with securities admitted to trading on the main market of the London Stock Exchange, they are obliged to publish half-year and full year results[2] but are not required to publish a preliminary results announcement (although may do so voluntarily).

Under the existing Model Code, there would currently be a closed period prior to publication of a preliminary results announcement. However, once the preliminary announcement is made, the company is no longer in a closed period and PDMRs are not prevented from dealing unless they are otherwise in possession of inside information.

Under MAR, publication of a preliminary results announcement will not bring a closed period to an end and the closed

1 That immediate disclosure would prejudice the legitimate interests of the issuer, that the delay is not likely to mislead the public and the issuer is able to ensure the confidentiality of the information.

2 DTR 4.

period will apply up to the publication of the company's annual financial report (often some weeks after the related preliminary results announcement). This could have the practical effect of significantly reducing the "open" period in which PDMRs can deal during the course of a year. In relation to dealings in share plans during a closed period, helpfully the Commission has published a delegated regulation (still in draft) which includes a non-exhaustive list of share plan dealings that will be permitted during closed periods. In broad terms, most of the share plan dealings currently possible during a "prohibited period" under the Model Code should still be permitted but there are some nuances that will need to be worked through.

Premium listed companies are used to restrictions on PDMR dealings as a result of the requirement to have in place a share dealing code which is at least equivalent to the FCA's Model Code. In CP15/35, the FCA has set out its proposals to require premium listed companies to have "effective systems and controls" in order to require PDMRs to obtain clearance to deal in the company's securities *at all times*. This goes beyond the requirements of MAR, which only imposes restrictions on dealing in closed periods.

In determining whether a company has satisfied the requirement to have in place effective systems and controls, the FCA will have regard to whether the systems and controls address the aspects set out in proposed LR 9 Annex 2G. The Model Code in Annex 1 of the Listing Rules is to be deleted. Proposed new Annex 2G retains only certain limited provisions of the Model Code, such as the mechanics of the clearance procedures to be followed to obtain approval to deal. These broadly mirror the clearance procedures set out in paragraphs 4 – 6 of the current Model Code.

A key concern is the current lack of clarity as to what is a "dealing" for these purposes given that the current definitions in the Model Code as to what constitutes a dealing, and what dealings are to be excluded are to be deleted. CP15/35 defines dealing as *"conducting a transaction on a person's own account or for the account of another person"* (mirroring the language used in MAR), but the consultation paper does not expand on what this phrase means or what transactions would not otherwise constitute a dealing. Concerns about this super-equivalent requirement and its lack of clarity have been flagged to the FCA by respondents to the consultation.

Whilst it is clear that companies will need to make changes to their existing share dealing code, given the current uncertainties in this area, it would be prudent to wait to see the outcome of the FCA's consultation before undertaking this exercise.

Insider lists will become more prescriptive

The substance of Disclosure Rule 2.8, which deals with the requirement to draw up an insider list, is to be deleted and readers directed to article 18 of MAR, which contains the underlying obligation to draw up an insider list. Article 18 is supplemented by technical standards prepared by ESMA which prescribe the precise format of the insider list.

In line with current market practice, issuers will be able to continue to split their insider lists into two parts: one for "permanent insiders" such as directors and other PDMRs who, by nature of their position, have (or are permitted to have) access to all inside information within the issuer and, the other for those persons within the issuer who have access to transaction or event-specific inside information.

MAR will require the list to be drawn up and kept up to date in electronic format and, as is currently the case, it must be kept for a period of at least five years after it is drawn up or updated.

However, the content of the insider list will be more prescriptive than is currently the case. The following additional information will be required:

- birth name of insider (if different to current name);
- professional telephone numbers (direct dial and mobile);
- date of birth;
- national identification number (if applicable). It is thought that this requirement will not be applicable to UK insiders who do not have a national identification number; and
- personal telephone numbers (home and mobile).

This will create an additional burden for issuers in collating this information. Note also that MAR requires that issuers take all reasonable steps to ensure that any person on the insider list acknowledges *in writing* the legal and regulatory duties that this entails. It is not necessary under current market abuse legislation for the acknowledgement to be in writing, although in practice most issuers require PDMRs to sign a written acknowledgement.

Despite the FCA's proposals to delete those provisions in the DTRs that allow issuers to make arrangements with their advisers for those advisers to maintain a list of persons working for them with access to inside information about the issuer (rather than require the issuer to maintain such information itself), it is understood that the FCA will still permit this practice to continue.

Issuers of securities traded on MTFs or OTFs are brought within the market abuse regime

Under the current market abuse regime, only securities admitted to trading on a regulated market or for which a request for admission to trading on a regulated market are caught. MAR widens the market abuse regime to apply to other financial instruments, such as those traded on other trading platforms, including MTFs (multilateral trading facilities) and OTFs (organised trading facilities). As such, issuers with relevant securities listed on such platforms will be brought within the scope of the regime and will be subject to the prohibitions on inside dealing, unlawful disclosure of inside information and market manipulation. They will also be required to comply with the provisions in MAR in relation to the maintenance of insider lists, the disclosure of managers' transactions and the maintenance of appropriate records where a decision is taken to delay the disclosure of inside information.

A de minimus threshold will apply for notification of managers' transactions

MAR introduces a de minimis threshold for notification by a PDMR (or a person closely associated with them) of transactions in an issuer's securities of €5,000 per calendar year (to be calculated by adding, without netting, all relevant transactions). Whilst the FCA has a discretion to raise this threshold on implementation of MAR to €20,000, it has indicated in CP15/35 that its preference is not to do so and is consulting on this point.

The impact of the de minimis threshold should mean that fewer PDMR notifications are required, but it will be necessary for each PDMR to keep a detailed record of all transactions in order to be able to identify when the threshold has been tripped and a notification required.

The time limit for notification of dealings by PDMRs is to be reduced to three business days, rather than the current four.

However, as dealing notifications should, in any event, be made as soon as possible, it is to be hoped that this will not raise too many concerns for PDMRs. Issuers will be required to announce such information to the market within the same time frame[3].

Detailed record keeping requirements will apply when conducting market soundings

In contrast to MAD, MAR contains provisions which expressly govern the conduct of market soundings[4] both by issuers and by persons acting on their behalf[5] (e.g. brokers or investment banks), referred to in MAR as disclosing market participants (**DMPs**).

Amongst other obligations, MAR will require any DMP, prior to conducting a market sounding, to consider whether the sounding will involve the disclosure of inside information and to keep a written record of its conclusions and reasoning.

The effect of this is that, even where information is deemed not to be inside information, a written record will need to be kept. These records may be requested by the regulator.

DMPs will also be required to establish procedures prescribing the manner in which market soundings are to be conducted, including procedures to provide to, and request from, persons receiving the market sounding a standard set of information. In particular, the consent of the recipient to receive the sounding must be obtained, they must be reminded that they are prohibited from using the information and that they are subject to obligations of confidentiality with regard to the disclosed information.

Ideally, market soundings should be conducted on recorded telephone lines, but where this is not the case, DMPs must maintain a written record of the communication. ESMA has published draft technical standards which contain templates for the form of the written record which is to be kept by a DMP undertaking a market sounding. Different templates should be used depending on whether or not inside information has been disclosed.

It is usual for a listed issuer to undertake market soundings in conjunction with its financial adviser or broker. The record keeping arrangements referred to above raise concerns as they appear to require all DMPs (i.e. both the issuer and its advisers) to keep records. This issue has been raised at a European level in order that it might be addressed by the

3 The current obligation in DTR 3 is to announce such information as soon as possible and, in any event, not later than the end of the business day following receipt of the information by the issuer.
4 Described in MAR as a communication of information, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as its potential size or pricing, to one or more investors.
5 MAR, article 11.
6 MAR, article 11(6).

European Commission in its delegated measures. In particular, it would be more workable if only one DMP were required to keep a record of the sounding to which the other DMPs would have access.

Issuers, and any financial institutions carrying out market soundings on their behalf, will need to review their existing procedures and ensure they are brought into line with these new requirements. Training is also likely to be required to ensure all employees understand their enhanced obligations.

The test of what constitutes inside information has not changed in substance

The definition of "inside information" is broadly unchanged. It remains the case that information must:

- be precise;
- have not been made public;
- relate, directly or indirectly, to the issuer or its financial instruments; and
- if made public, be likely to have a significant effect on the price of those financial instruments or on the price of related derivative financial instruments.

Information which, if made public, would be likely to have a significant effect on the price of relevant financial instruments means information a reasonable investor would be likely to use as part of the basis of his or her investment decision.

Over the last 18 months we have seen decisions of the UK Upper Tribunal[7] and the EU Court of Justice[8] focusing on what constitutes inside information and, in particular, when information is precise. These decisions will continue to inform the assessment of what amounts to inside information when MAR is implemented.

On 20 November 2015, the FCA published a second consultation paper, CP15/38, on proposed amendments to the provisions in DTR 2 regarding the delay of disclosure of inside information. Under the existing DTRs, an issuer may only delay the disclosure of inside information where not to do so could prejudice its legitimate interests, the delay will not mislead the public, the person receiving the information owes the issuer a duty of confidentiality and the issuer can ensure the confidentiality of the inside information. DTR 2.5.3R sets out a non-exhaustive list of matters that may constitute a legitimate interest, including ongoing negotiations, the outcome of which would be prejudiced by public disclosure. DTR 2.5.5G then sets out the FCA's view that, other than in relation to impending developments or the specific events referred to in DTR 2.5.3R and DTR 2.5.5AR[9], there are unlikely to be other circumstances where delay would be justified.

Based on both the views of the Upper Tribunal expressed in the *Hannam* case and the provisions of MAR, the FCA proposes to amend the guidance in DTR 2.5.5G to clarify that issuers may have legitimate reasons to delay disclosure in circumstances other than the non-exhaustive examples listed in DTR 2.5.3R or the circumstances described in DTR 2.5.5AR. This is extremely welcome news for issuers as, potentially, it creates greater scope to delay the announcement of inside information than is currently the case provided that to do so will not mislead the market or itself create a false market.

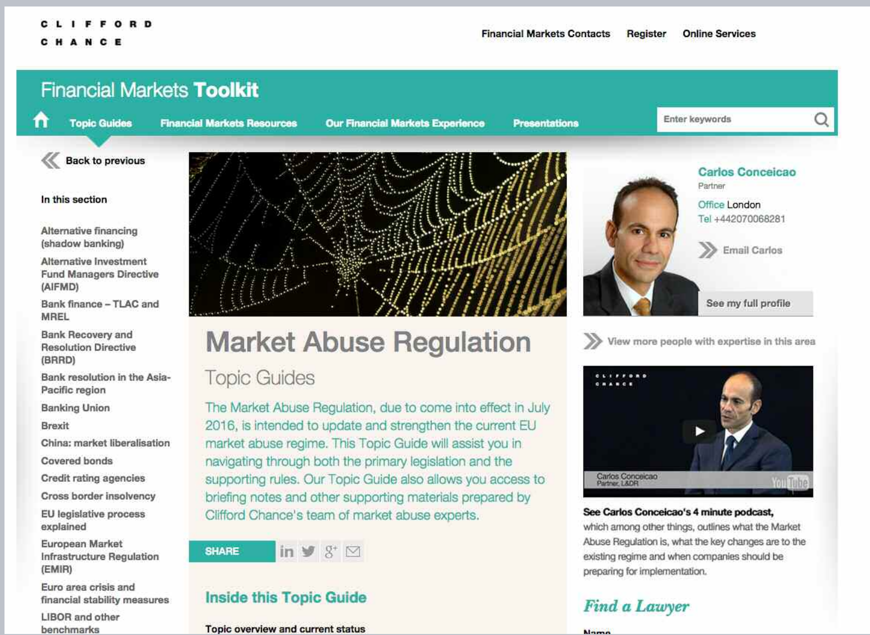
7 FCA v Hannam [2014] UKUT 0233.
8 Lafonta v AMF (case C-628/13).
9 An issuer may have a legitimate interest to delay disclosing inside information concerning the provision of liquidity support by the Bank of England or another central bank to it or a member of its group.

Editor Comment:

The FCA consultation closes on 4 February 2016 and the FCA intends to publish a policy statement (and possibly, further consultation) shortly afterwards. In the meantime, ESMA is expected to start work on Q&A to assist market participants to understand the detail of the new MAR requirements.

Unfortunately, we do not have yet a complete picture of how the regime will look and operate after 3 July 2016. As such, whilst issuers should take steps to familiarise themselves with the forthcoming changes and to prepare to make changes to internal documentation such as their share dealing code, they will not be able to finalise those changes at this stage. Our advice is to plan ahead to ensure that sufficient time is available in advance of July to amend relevant internal policies and record keeping arrangements and to ensure that comprehensive training is provided to those directors and other employees affected by these changes.

For more information about the new market abuse regime, see our Market Abuse Regulation Topic Guide available on our Financial Markets Toolkit. You can access a copy of MAR, the draft ESMA implementing measures and the FCA consultation paper, along with other helpful Clifford Chance briefings and materials, from this online Topic Guide. You can also locate and contact our MAR experts from around our European network via the Guide.
http://financialmarketstoolkit.cliffordchance.com/en/home.html



Keeping a register of people with significant control: update

In our July 2015 Corporate Update we looked in detail at the forthcoming requirement for certain companies to keep a register of people with significant control (**PSC register**). Commencement regulations were published on 9 December 2015 that bring into force the PSC register provisions. Accordingly, all UK incorporated companies that are not exempt companies (see section "*Exempt companies*" below) will need to keep a PSC register from 6 April 2016 and will need to file their PSC information at Companies House when making their confirmation statement (which replaces the annual return) from 30 June 2016 onwards.

Identifying persons with significant control (PSC)

A PSC is an *individual* who satisfies any of the following conditions (**PSC Conditions**):

1. directly or indirectly holds more than 25% of the shares in the company;
2. directly or indirectly holds more than 25% of the voting rights in the company;
3. directly or indirectly holds the right to appoint or remove a majority of the board of directors of the company;
4. has the right to exercise, or actually exercises, significant influence or control over the company; or
5. has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm that is not a legal entity which would itself satisfy any of PSC Conditions 1 to 4 in relation to the company if it were an individual.

The provisions of the Companies Act 2006 that contain the PSC register requirements (**PSC register provisions**) also recognise that a company may also be controlled by a *legal entity*[11] (as opposed to an individual) if such legal entity would satisfy one or more of the PSC Conditions in relation to the company if it were an individual.

In such cases, and only if the legal entity is *subject to its own disclosure requirements,* a company must include such legal entity in its PSC register (if it is registrable). Such legal entities are known as "relevant legal entities" (**RLEs**) in relation to the company that is required to keep the PSC register.

Where a legal entity is not subject to its own disclosure requirements, it cannot be an RLE and, therefore, must not be registered in the company's PSC register. In this case indirect interests may be relevant.

BIS publishes response to consultation on PSC register requirements

On 17 December 2015, BIS published a response to its June consultation paper seeking views on the draft Register of People with Significant Control Regulations. We have not yet seen revised regulations, however, the key points to note from the response are:

- *Exempt companies:* UK incorporated companies that will be exempt from having to maintain a PSC register are companies that: (i) are subject to Chapter 5 of the DTRs (**DTR 5 issuers**), which includes UK companies listed on the LSE, AIM and ISDX; (ii) have voting shares admitted to trading on a regulated market in an EEA state[10]; or (iii) have voting shares admitted to trading on one of the specified markets in Japan, the USA, Switzerland and Israel.
- *Definition of "subject to its own disclosure requirements":* For the purposes of determining whether a legal entity is a relevant legal entity (**RLE**), a legal entity is subject to its own disclosure requirements if: (i) it holds its own PSC register; (ii) it is a DTR 5 issuer; (iii) it has voting shares admitted to trading on a regulated market in an EEA state; or (iv) it has voting shares admitted to trading on one of the specified markets in Japan, the USA, Switzerland and Israel.
- *Recording control in the PSC register:* The statement should indicate which of the PSC Conditions is met and, in the case of holdings of shares or voting rights, to what extent, i.e., over 25% up to (and including) 50%; over 50% up to (but not including) 75%; and 75% or more. If a person or legal entity (if it were an individual) meets PSC Condition 1, 2 and/or 3, the company does not have to record in its PSC register if and how the person or legal entity meets PSC Condition 4.

10 A list of these regulated markets can be found on the ESMA website but includes the LSE and ISDX.
11 A body corporate or firm that is a legal person under the law by which it is governed.

- *Permitted fees:* Companies may charge a fixed fee of £12 per request for providing a copy of some or all of its PSC register to a person who requests a copy for a proper purpose. A company's PSC register must also be open to inspection by any person for a proper purpose free of charge. The draft non-statutory guidance states that "proper purpose" is intended to have a wide interpretation and application as the purpose of the PSC register is to provide transparency of company ownership and control and a company's register is intended to be accessible to that end.
- *Protecting information:* An application process for protecting secured information will be put in place for exceptional circumstances. Protection will only be given to individuals on the grounds of serious risk of violence or intimidation due to the company's activities or to the circumstances specific to an individual and his/her link to the company.
- *Limited partners:* The PSC register provisions provide that a limited partner in a limited partnership registered under the Limited Partnership Act 1907 will not be a PSC or RLE under PSC Conditions 1, 2 or 3 in relation to an underlying company solely by virtue of being a limited partner. This will also apply to participants in foreign limited partnerships/arrangements similar to limited partners in an English limited partnership.
- *Application of regime to LLPs:* The Government intends to apply the PSC register regime to LLPs in the same timeframe as companies. It will draft separate regulations to apply the PSC register provisions for companies to LLPs with any necessary modifications. The current proposal is that a PSC in relation to an LLP will be an individual who satisfies any of the following conditions:
  1. directly or indirectly holds rights over more than 25% of the surplus assets on a winding up;
  2. directly or indirectly holds more than 25% of the voting rights on matters to be decided by the members of the LLP;
  3. directly or indirectly holds the right to appoint or remove the majority of the persons entitled to take part in the management of the LLP;
  4. has the right to exercise, or actually exercises, significant influence or control over the LLP; or
  5. has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm that is not a legal entity which would itself satisfy any of PSC Conditions 1 to 4 in relation to the LLP if it were an individual.

When is a PSC or RLE registrable?

A company must keep a register of its registrable PSCs and RLEs. Once you have identified a PSC or RLE, you need to determine whether the PSC or RLE is registrable or non-registrable. To avoid having to duplicate indirect PSC/RLE information in PSC registers at each level of a corporate chain, PSCs and RLEs are not registrable if they only hold their controlling interests indirectly through a chain of RLEs. Only the first RLE in the chain is registrable, and PSCs/RLEs higher up the chain are not registrable.

Currently these avoidance of duplication provisions only work if there are only RLEs all the way up the chain (and not if there is a non-RLE at any point in the chain). We understand that this is unintentional and these provisions will be changed by regulation so that a company will only need to register a PSC or RLE that holds interests indirectly through one or more legal entities, if *none* of the legal entities are RLEs. Therefore, once a company reaches the first RLE in a chain it only has to register that RLE in its PSC register. In addition, a PSC that holds his/her interest indirectly only needs to be registered if there are no RLEs in the chain. We have not seen any draft regulations dealing with this, however, the draft non-statutory guidance is drafted on this basis.

Meaning of "significant influence or control": ICSA consultation on draft BIS guidance

On 21 December 2015, ICSA launched a short consultation on draft statutory guidance on the meaning of "significant influence or control" in the context of companies and, separately, in the context of LLPs (relevant for PSC Conditions 4 and 5), along with non-statutory guidance for companies and LLPs that explains what they must do to identify and register PSCs and RLEs. Key points to note are as follows:

- The draft guidance does not provide an exhaustive statement of what constitutes "significant influence or control". It provides a number of principles and examples which are indicative of holding the right to exercise, or actually exercising, significant influence or control over a company or an LLP or the activities of a trust or firm which itself would satisfy any of the other specified conditions in relation to the company or the LLP if it were an individual. A right to exercise significant influence or control over a company, LLP, trust or firm may result in an individual being a PSC or a legal entity being an RLE in relation to a company or LLP regardless of whether or not he/she/it actually exercises that right.

- The draft guidance provides a non-exhaustive list of the kind of roles and relationships which a person may have with a company or an LLP or in relation to the activities of a trust or firm which would not, in general, result in that person being considered to have "significant influence or control" for the purposes of the PSC register. The list includes lawyers, financial advisers, suppliers, customers, lenders and regulators. Such a person may, however, still be a PSC if the role or relationship contains elements that exceed the role or relationship as it is usually understood or exercised, or forms one of several opportunities which that person has to exercise significant influence or control.
- The draft guidance states that "significant influence" and "control" are alternatives. A person has "control" if he/she has the power to direct the company's, LLP's, trust's or firm's activities. "Significant influence" enables the person exercising the significant influence to ensure that the company, LLP, trust or firm adopts the policies or activities that are desired by the holder of the significant influence. Note that responses to the consultation have questioned whether this should include some element of materiality.

What details need to be recorded in a company's PSC register?

PSC details: name, date of birth, nationality, country or state (or part of the UK) where the PSC is usually resident, service address, usual residential address, date on which the PSC became a registrable PSC, nature of the PSC's control over the company and details of any restrictions on using or disclosing the PSC's information.

RLE details: name, address of its registered or principal office, the legal form of the RLE and the law by which it is governed, the register of companies in which it is entered and registration number, the date on which the RLE became a registrable RLE and the nature of the RLE's control over the company.

- A right to exercise significant influence or control may be contained, in the case of a company, in the articles of association or a shareholders' agreement or, in the case of an LLP, in the LLP agreement.
- Examples of what might constitute a *right* to exercise significant influence or control include:
  - absolute decision making rights or absolute veto rights over decisions relating to the running of the business of the company or the LLP, for example, adopting or amending the business plan, changing the nature of the business (although responses to the consultation have questioned whether this should state "other than a veto right over fundamental changes", which is a usual minority protection) or establishing or amending any profit-sharing, share option, bonus or other financial incentive scheme. However, absolute veto rights for protecting minority interests in a company or interests as a member of an LLP (for example, in relation to changing the articles of association or LLP agreement, dilution of shares or rights or winding up the company or the LLP) are unlikely, on their own, to constitute significant influence or control over the company or the LLP; and
  - an absolute veto right over the appointment of the majority of, in the case of a company, the directors and, in the case of an LLP, the persons entitled to take part in the management of the LLP.
- Examples of what might constitute a person *actually* exercising significant influence or control include where:
  - a person's recommendations are always or almost always followed by shareholders or members which hold the majority of the voting rights in the company or the LLP when they are deciding how to vote. For example, where a company founder no longer has a significant shareholding or an LLP founder no longer has a formal interest, but makes recommendations to the other shareholders/members on how to vote and his/her recommendations are generally followed; or
  - a director or member, who also owns important assets or has key relationships that are important to

the running of the business (e.g. IP rights), uses this additional power to influence the outcome of decisions related to the running of the business of the company or the LLP.

- In the context of trusts or firms and satisfying PSC Condition 5:
  - A person has the right to exercise significant influence or control over a trust or firm if such person has the right to direct or influence the running of the activities of the trust or firm, for example, an absolute power to appoint or remove any of the trustees (except through application to the courts) or a right to direct the distribution of funds or assets.
  - A person is likely to actually exercise significant influence or control over a trust if he/she is regularly involved in the running of the trust, for example, a settlor or beneficiary who is actively involved in directing the activities of the trust.
  - In the case of a firm, such as an English limited partnership, anyone who controls the management or activities of the firm would be considered a person with significant influence or control over the firm. A general partner would satisfy this condition in the case of an English limited partnership.

Consequences of failure to comply with the PSC register provisions

The PSC register provisions contain obligations that mean that a company required to keep a PSC register must:

- take reasonable steps to identify registrable PSCs and RLEs, including by giving notice to anyone whom the company knows or has reasonable cause to believe to be registrable;
- confirm the details of any PSC (but not an RLE) before such details are registered; and
- ensure that the PSC register is kept up to date, including by giving notice to any registrable PSC or RLE if the company knows or has reasonable cause to believe that any information on the PSC register is incorrect or incomplete.

The company and its defaulting officers will commit a criminal offence if they fail to comply with these obligations. Likewise there are obligations on a PSC and an RLE to notify a company of his/her/its status and keep the company up to date. Failure to comply with such duties, along with failing to respond to any notice from the company requesting information, is a criminal offence. Companies should therefore start thinking about what procedures they should put in place in order to identify PSCs and RLEs and obtain the relevant information. The non-statutory guidance covers what steps a company should typically take to identify its registrable PSCs and RLEs.

The consultation closed on 11 January 2016 and BIS is expected to publish final guidance in early 2016.

Ban on corporate directors to take effect in October 2016

It is also worth noting that the ban on companies appointing corporate directors will not be implemented until October 2016. The ban will be subject to some limited exceptions, however, we are still awaiting a response to the consultation that closed at the end of April 2015 on what those exceptions should be.

Case Law Update

The doctrine of penalties lives on….but in a new guise

On 4 November 2015 the Supreme Court handed down a landmark decision[12] unanimously confirming that the centuries-old doctrine of penalties still has a place in the modern commercial world of contracts, despite calls for its abolition. The decision leaves open the ability of the Court to assess whether a contractual provision should be treated as a penalty, but the Court was divided on the correct test to be employed when considering the application of the doctrine.

Background

Mr Makdessi (**M**), together with Mr Ghossoub (**G**) held 87.4% of the shares in Team Y&R Holdings Hong Kong Ltd (the **Company**). The remaining shares were held by a company in the WPP group. In February 2008, M and G sold 47.4% of the shares in the Company to WPP and put in place put and call options over the remaining 40% of the shares. Accordingly, Cavendish Square Holdings B.V. (**Cavendish**), a holding company within the WPP group, held 60% of the shares and M and G held 40% of the shares.

The key clauses

The sale and purchase agreement contained extensive restrictive covenants preventing the sellers, M and G, from competing with the business of the group. If either M or G breached any of the restrictive covenants in any respect, (i) he would not be entitled to receive any outstanding instalment of the consideration (clause 5.1) and (ii) Cavendish could exercise a call option and acquire the relevant seller's shares at a price based on net asset value (i.e. excluding any amount for goodwill) (clause 5.6). The exercise of the call option would prevent the relevant seller from being able to exercise his put option in the future, pursuant to which the seller's shares would be sold at a price which included goodwill.

After the sale, WPP claimed that M had breached the restrictive covenants and sought to rely on clauses 5.1 and 5.6. At first instance, the judge held that the clauses were not penalties and were enforceable. M appealed arguing that they were penal and unenforceable; in particular because their effect was to deprive him of up to US$115 million in circumstances where WPP had suffered no loss recoverable at law (because Cavendish's loss as shareholder was merely reflective of the loss of the Company and as such was irrecoverable). WPP argued that the clauses were commercially justified and that their predominant purpose was to adjust the consideration and de-couple the parties, rather than to deter breach. The Court of Appeal held that the clauses were unenforceable penalties under the penalty doctrine as traditionally understood. The case was brought before the Supreme Court.

A new test for identifying penalty clauses

Historically, whether a clause has been held to be a penalty and therefore unenforceable has centred around an assessment of whether the damages which flow from a breach of that clause are a genuine pre-estimate of the loss the claimant would suffer as a result of such breach. This case has substantially recast the test for identifying penalty clauses, with the Supreme Court confirming that "*the fact that a clause is not a pre-estimate of loss does not… at any rate without more, mean that it is penal.*" [13]

12 *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67.
13 *Ibid*, paragraph 32.

Having regard to the nature and extent of the innocent party's interest in the performance of the relevant obligation (as a matter of construction, not actual intention), the test, as formulated by the majority of the Supreme Court, is whether the clause in question is a pure remedy for breach (i.e. a secondary obligation) or a primary obligation and the Court found that a clause constituting a primary obligation cannot, by its nature, constitute a penalty clause. Therefore the question is whether the obligation is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.

A clause does not offend the rule against penalties simply because it is intended to deter another party from breaching its primary obligations. Deterring a breach seems to be recognised as a legitimate commercial interest: the question whether it is enforceable should therefore depend on whether the means by which the contracting party's conduct is to be influenced are "unconscionable" or (which will usually amount to the same thing) "extravagant" by reference to some norm. In a separate judgment, Lord Mance went on to say that "[I]*n judging what is extravagant, exorbitant or unconscionable, I consider (despite contrary expressions of view) that the extent to which the parties were negotiating at arm's length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor.*"[14] As such, the circumstances in which the contract was made may be relevant and, helpfully, the majority went on to state that where a contract has been negotiated between parties of comparable bargaining power who have been properly advised, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach.

Differing views of the Supreme Court

The Court was unanimous that the doctrine of penalties should not be abolished, but there remains division on its scope and the relevant test to be applied. What is clear is that there has been a shift in focus that the doctrine of penalties should not be abolished, but there remains division on its scope and the relevant test to be applied. What is clear is that there has been a shift in focus from the classic test of "genuine pre-estimates of loss" and concepts of extravagance, unreasonableness and deterrence. Lord Hodge (with whom Lord Toulson agreed) stated that the tests to be applied are in face, those of "legitimate interests" and "exorbitance and unconscionability". Ultimately however, the Court concluded that neither clause 5.1 nor clause 5.6 were unenforceable penalty clauses and Cavendish's appeal was upheld.

> "The correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract."[15]
>
> *Lord Hodge and Lord Toulson*

> Parties who have relied on advice or analysis concluding that a particular contractual clause is or is not enforceable are advised to seek a health check in light of the Cavendish decision.

Editor Comment:

From a practical perspective businesses and individuals may wish to undertake a review of their contracts and contractual toolkits both to:
(i) update them as necessary (assuming that is possible) to reflect the revised approach; and (ii) identify any clauses that may still fall foul of the doctrine.

Clifford Chance is already undertaking reviews of this nature for clients and would be more than happy to assist you in this regard. Please contact Julian Acratopulo, Clifford Chance's litigation partner who acted in this case, or your usual partner contact for any advice.

14 *Ibid,* paragraph 152.
15 *Ibid*, paragraph *255* (Lord Hodge); paragraph 293 (Lord Toulson).

Contractual terms will only be implied out of necessity

The Supreme Court[16] has emphasised that English law takes a strict approach to implying terms into a contract. Terms will not be implied just because it would be reasonable to do so, but only if it is necessary because the contract would lack commercial or practical coherence without the implied term. In addition, the more detailed the contract is, the more reluctant the courts will be to imply a term.

The facts

M&S and BNP Paribas were parties to a lease. M&S exercised a break clause entitling it to early termination of the lease and then sought to recover a refund from BNP of rent, a car parking fee and insurance charges paid in advance that related to the period after M&S vacated the building. There was no express provision to this effect in the lease but, at first instance, the judge held that a term should be implied entitling M&S to recover those sums. The Court of Appeal overturned the first instance decision.

Supreme Court decision

The Supreme Court decided that no term could be implied into the lease, emphasising that implied terms do not depend upon the parties' actual intention but on necessity, i.e. whether it is necessary for business efficacy of the contract in question. Recognising that this involves a value judgment, the test is not absolute necessity but whether, absent the suggested implied term, the contract would lack commercial or practical coherence.

Of particular importance in this decision were the comments of the Court that an earlier decision of the Privy Council in *Attorney General of Belize and others v Belize Telecom Ltd*[17] had been misinterpreted by both academics and the judiciary as diluting this requirement and that the decision in *Belize* had been wrongly understood to mean that a term may be implied if it is merely reasonable to do so. Lord Neuberger was keen to rebut Lord Hoffmann's argument in the *Belize* case that interpretation and implication are part of the same process. At a high level, they both involve determining what a contract means, but they are different processes governed by different rules. Interpretation should come before implication because it is only when the contract has been interpreted that attention can turn to whether it is necessary to imply a term. The Supreme Court also observed that the more detailed a contract was, the less plausible it was to imply a term. If the parties employ lawyers to draft a detailed contract covering a large number of contingencies, it is difficult to infer that the parties must have intended something, but then omitted to provide for it expressly.

Editor Comment:

This is an important decision and provides some welcome clarification on the circumstances in which the Courts will, and will not, be prepared to imply terms into a contract. Going forward, the test is clearer: is it necessary to imply a term on the basis that the contract lacks commercial or practical coherence without it? However, as ever, what remains key is to get the drafting right at the outset and to spend time at that stage ensuring that, so far as possible, the contract clearly caters for all eventualities.

Directors must use powers for the purpose for which they are conferred

Overturning a prior decision of the Court of Appeal, the Supreme Court[18] has held that the rule that directors must use their powers for their proper purpose applies when directors exercise powers contained in a company's articles of association allowing voting/transfer restrictions to be imposed on shareholders in the event of non-compliance with a statutory disclosure notice of interests in shares. In failing to do so, the directors of JKX acted for an improper purpose when they imposed restrictions on shares owned beneficially (although not legally) by the appellants, Eclairs and Glengary, in the context of an upcoming shareholder vote.

The facts

The board of JKX believed that the company was being "raided" by Eclairs and Glengary who, it was thought, were seeking to destabilise the company by seeking to replace the senior management and to obstruct the necessary fundraising processes with the ultimate goal of

16 *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited and another* [2015] UKSC 72.
17 *[2009] UKPC 10.*
18 *Eclairs Group Ltd & Glengary Overseas Ltd v JKX Oil & Gas plc* [2015] UKSC 71.

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 Companies Act 2006 and its articles of association on them 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.

Eclairs and Glengary sought interim relief in advance of the AGM, challenging the validity of the restrictions. This resulted in JKX giving undertakings that created a regime under which the AGM could go ahead and Eclairs and Glengary could vote their shares, but there would be no declaration as to the effect of the votes on the resolutions pending determination of the court case on the validity of the proposed restrictions.

Had the directors acted for a proper purpose?

The Supreme Court had to consider whether the rule that the directors must act for a proper purpose applied to the exercise of the directors' powers under its articles of association and, if so, whether the board acted for an improper purpose when applying the restrictions.

The proper purpose rule, previously an equitable principle and now codified in section 171(b) Companies Act 2006, provides that a director must only exercise his powers for the purposes for which they are conferred. Even if directors exercise their powers validly, the exercise may be attacked on the ground that the power was not exercised for the purpose for which it was granted.

The Supreme Court held that the relevant provision in the company's articles allowing the directors to impose voting and transfer restrictions has three purposes: (i) to induce the shareholder to comply with a disclosure notice; (ii) to protect the company and its shareholders against having to make decisions about their respective interests in ignorance of relevant information; and (iii) to have a punitive effect for failure to comply with a disclosure notice. It held that the proper purpose did not extend to influencing the outcome of resolutions at a general meeting.

The Court went on to hold that the proper purpose rule does apply to the exercise of the powers conferred by the article in question, observing that the rule that the fiduciary powers of directors may be exercised only for the purpose for which they are conferred is one of the main means by which equity enforces the proper conduct of directors. The use of the directors' powers for the purpose of influencing the outcome of a general meeting is an abuse of power and offends the constitutional distinction between the board and the shareholders. These considerations are particularly important when the company is in play between competing groups seeking to control or influence its affairs. On the facts of the case, the Supreme Court held that the directors had exercised their powers for an improper purpose and therefore the restriction notices were set aside.

Editor Comment:

This case serves as a warning to directors that they must use their powers for the purposes they are conferred; it is not enough simply to exercise their powers validly and in a way they consider, in good faith, to be in the company's interest.

Corporate Governance Update

FRC seeks views on succession planning

On 27 October 2015 the FRC published a discussion paper addressing succession planning and processes. The FRC is seeking views from executive and non executive board members of companies to which the Corporate Governance Code applies to gain a fuller picture of the approaches being taken to succession planning. Board evaluations are now common practice, particularly among listed companies and provision B.6.1 of the Code recommends that specific findings from a company's most recent board evaluation are included in its annual report. However, results from the 2015 reporting season indicate that companies still have some way to go to improve their focus on succession planning.

The FRC has requested feedback by 29 January 2016 in respect of six particular areas identified as impacting on succession:

- *Business Strategy and Culture:* the important link between succession planning and development of the business strategy and company culture. The FRC identifies circumstances under which a failure to implement careful strategies for succession planning can pose a serious risk to the long-term success of a company.
- *Nomination Committee:* the FRC believes that clarifying the role and responsibilities of the nomination committee and raising its profile are key factors in promoting the importance of succession planning. The FRC's discussions with stakeholders also raised concerns about the quality of reporting by some nomination committees. As part of the consultation in this area, the FRC is seeking views as to whether the Code is clear enough in setting out the role and responsibilities of the nomination committee and the board and what can be done to improve the standing of the nomination committee.
- *Board Evaluation:* opinions are sought as to how the board evaluation guidelines might be amended to ensure that boards consider succession planning as a part of the annual board evaluation.
- *Pipeline:* the discussion paper seeks to understand different companies' approaches to succession planning and how they consider and assess both internal and external talent. The FRC recognises the importance of identifying both internal and external potential candidates and has asked for information about how companies review internal talent and the development practices they use to support succession planning and also seeks suggestions on what further steps could be taken to establish an external pipeline, particularly for non executive directors.
- *Diversity:* with regard to incorporating diversity into succession planning and the extent to which succession plans also incorporate the firm's diversity objectives, respondents are asked to consider what more could be done to encourage greater diversity on boards.
- *Institutional Investors:* institutional investors have expressed a view that succession planning should be on the agenda when they meet board members, however a cautious approach is taken as there is an understandable reluctance from investors to be involved in

Your 2016 AGM and Beyond

Earlier this month we published our AGM Update for the 2016 AGM season, which highlighted key considerations for listed companies to be aware of as they prepare for their 2016 AGM and move forward into a new financial reporting season. Key areas covered in the update include:

- The new provisions in the Corporate Governance Code requiring companies to make statements in their annual reports as to (i) whether the directors consider it appropriate to adopt the going concern basis of accounting and (ii) the long term viability of the company over a specified period.
- A new requirement for FTSE 350 companies to include a statement of compliance with audit rotation requirements in their audit committee report.
- The ability for companies to seek a disapplication of pre-emption rights of a further 5% of the company's issued ordinary share capital provided that certain conditions apply.
- New reporting requirements applicable to listed companies in the extractive industries sector in respect of payments made to governments.
- A new requirement on listed companies to report on their payment practices and policies from April 2016.

If you have not yet received a copy of our AGM Update, you can access a copy at www.cliffordchance.com/briefings/2016/01/your_2016_agm_andbeyond.html.

management of the appointment process or to be put into a position where the information received may make them 'insiders'. The paper asks how information could be usefully shared with investors to gain helpful input in respect of succession planning and talent development.

Editor Comment:

An industry report[19] published in April 2015 identified succession planning as an issue which continues to be a difficult area for boards and nomination committees, especially with regard to the post of the CEO. We expect an ever increasing focus on succession planning and in due course there may be some regulatory follow up to this consultation. In the meantime companies should assess their internal processes and concentrate on establishing a robust approach to succession planning, particularly with regard to identifying internal and external talent and establishing an effective pipeline. Given the papers' initial findings about nomination committee reporting, companies should also revisit these reports to ensure they are both informative and meaningful for investors.

FRC drive to improve narrative reporting in smaller companies

The FRC has, in recent years, raised concerns with respect to the quality of corporate reporting and accounts, particularly those prepared by smaller listed and AIM companies. In 2014, the FRC began a three year project to drive change in the quality of reporting among such companies.

In June 2015, it published a discussion paper which identified that the incidence of poorer quality annual reports is higher among smaller quoted companies and suggested some possible causes for these discrepancies. In particular it was thought that it may be down to a lesser emphasis being placed on reporting in smaller listed companies, less importance being placed on relevant training and there being a greater strain on resources available to produce high quality reports. The FRC described a perception gap between smaller quoted companies and investors, with companies underestimating the value of their annual reports to investors. The feedback to this discussion paper was received in July 2015.

The FRC has launched a programme of measures to improve the quality of reporting by smaller listed companies and, as part of the programme to improve reporting, announced the following key proposals to address problems identified:

- creating a collaboration between the FRC and accountancy and audit bodies to develop ways of providing more focussed training and reporting requirement updates to finance staff;
- providing practical guidance to audit committees and boards on evaluating the adequacy of the company's financial reporting function and process;
- discussing with the LSE and UKLA possible approaches to ensure that companies understand and have adequate resources to meet their ongoing reporting obligations;
- providing annual guidance to boards on current issues, areas of focus for investors and common errors in annual reports;
- encouraging greater dialogue between smaller quoted companies and investors and putting more pressure on investors and rating agencies to provide feedback on annual reports;
- considering options for a reduced disclosure framework against IFRS in respect of smaller quoted companies.

Following on from this discussion paper and the responses received, in November 2015 the FRC wrote to small listed companies providing advice on improving the quality of their reporting with a particular focus on the key areas of interest to investors. The letter emphasises that investors value high quality reporting even for smaller quoted companies and that all reporting should be company specific and should avoid the use of generic information. In particular, investors expect:

- the Strategic Report to be clear, concise, balanced and understandable and to give a meaningful explanation of the business and business model. In addition, companies should avoid placing inappropriately large volumes of generic information in their annual reports;
- accounting policies provided in the annual reporting to be clear and specific, particularly in relation to revenue recognition and expenditure capitalisation. Investors pay particular attention to policies that are unusually

19 Board Effectiveness – continuing the journey (April 2015) jointly published by EY and The Investment Association.

aggressive or out of line with similar companies in the industry;

- cash flow statements to describe clearly how the company generates cash flow. A company should ensure it has given adequate time to considering whether the classification of operating, investing and financing cash flows is consistent with the business model described in the Strategic Report.

A copy of the FRC's letter is available at: https://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-Letter-Year-end-advice-to-preparers-smaller.pdf

Audit reform: changes taking effect in June 2016

New European legislation in the form of both a Regulation and a Directive[20] entered into force on 16 June 2014 which will apply to public interest companies (companies whose transferable securities are included on the official list or whose equity share capital is officially listed in an EEA state) (**PIEs**) and the statutory auditors and audit firms of PIEs from 17 June 2016.

Background

The legislation will amend the existing EU Statutory Audit Directive and is intended to reflect lessons learned from the 2008 financial crisis and to address weaknesses in the audit system. The reform introduces stricter rules for the audit sector which are intended to improve the independence of auditors and introduce a co-ordinated approach to the supervision of auditors across the EU. BIS published a consultation paper on 28 October 2015, together with further updates in November and December 2015 setting out the government's proposals for the transposition into national law and implementation of the relevant EU legislation. The FRC is also consulting on changes to the Corporate Governance Code and its guidance on audit committees to ensure these are consistent with the new requirements. Further details on the FRC's consultation are available in our 2016 AGM Update (see page 17 above for details).

Key changes for companies

Statutory audits: The new Directive applies to *all* statutory audits and the BIS consultation proposes changes to the Companies Act 2006 to reflect the wider range of entities that must now be audited under EU law; in particular, the amendments will extend the application of the audit rules to additionally cover all entities whose securities are admitted to trading on a regulated market, electronic money institutions, payment institutions, MiFID investment firms, UCITs and AIFs. Unlisted insurers, banks and building societies will also fall within the ambit of the new legislation.

The Directive also covers the following areas:

- *Professional ethics, independence and objectivity:* the Directive clarifies that auditors must maintain professional independence throughout the audit and whilst the primary responsibility for delivery of financial information rests with the management of the company, auditors must remain vigilant as to the possibility of a material misstatement regardless of any past experience as to the accuracy and honesty of the audited entity's management. Auditors should assess and record any threats to their independence and where such threats are too significant, resign or abstain from appointment.

20 European Directive 2014/56/EU and Regulation (EU) No 537/2014.

- *Appointment of statutory auditors:* Pursuant to the Directive, any contractual clause which restricts the shareholder's choice of auditor will be prohibited and any existing clauses to that effect as at the 17 June 2016 will be null and void. Proposed new sections to the Companies Act 2006 require the audit committee of a PIE to make a recommendation in respect of its first and second choice candidates for auditor appointment and the directors must then make their own proposal which includes the recommendation made by the audit committee and an explanation where the directors' proposal does not accord with such recommendation.
- *Appointment and engagement of auditors:* The Regulation deals with the appointment and continuing engagement of auditors by PIEs. Once the Regulation has entered into force in June 2016 (subject to transitional provisions) the following will apply:
  - *Tenure:* PIEs will be required to change their statutory auditor every 10 years. This is not new for listed companies as the Corporate Governance Code recommends that a company rotates its auditors every 10 years and new national legislation was introduced in 2015 requiring the mandatory tender of audits every 10 years. Under the Regulation, the duration of the audit engagement is counted from the date of the first financial year covered by the audit engagement letter. The Regulation permits Member States to elect to allow PIEs to extend the audit engagement period (i) by an additional 10 years upon public tender; or (ii) by an additional 14 years in the case of joint audit. Whilst Member States are given the option to shorten these rotation periods, BIS has indicated its intention to adopt the maximum rotation period for auditors.
  - *Blacklist of non-audit services:* Statutory auditors or the appointed audit firm will not be entitled to provide certain non-audit functions to the audited entity. The Regulation lists various blacklisted non-audit services such as certain tax, consultancy and advisory services related to the internal audit function. Member States have the option to derogate from the blacklist to include additional services that they consider represent a threat to the independence of the auditor or to permit the provision of certain services where it considers that such services will have an immaterial effect on the audited financial statements. A consultation published by the FRC on 29 September 2015 confirms that it does not intend to extend the list of blacklisted services, nor to create a list of permissible non-audit services beyond those allowed by the Regulation.
  - *Cap on non-audit service fees:* The total fees for an audit firm or statutory auditor for the provision of permissible non-audit services may not exceed 70% of the average audit fees paid in the last three consecutive years for the statutory audits of the audited entity. The Regulation also imposes a prohibition on contingent fees, which are calculated based on the outcome of a certain project or the outcome of work performed.

Editor Comment:

With the introduction of new national rules at the beginning of 2015 on audit rotation, many UK companies have already started planning for their next audit tender and have already disclosed when they intend to undertake this process. However, there will be further regulation to get to grips with when this EU legislation becomes law. In particular, audit committees will need to revisit the fees that the company pays its auditor for non-audit services and check that the non-audit services that the audit firm provides are not blacklisted.

Regulatory Update

A move away from voluntary quarterly updates?

Whilst quarterly trading updates are no longer required, to date we have seen many companies continue to publish them on a voluntary basis. In June 2015 it was reported that the fund management arm of Legal & General had written to all FTSE 350 boards to urge them to stop quarterly reporting and to focus on the long-term. Changes to the Disclosure Rules introduced in November 2014 by the FCA mean that it is no longer compulsory for listed issuers to publish quarterly reports on financial performance.

Legal & General itself announced in December 2015 that from 2016 it would no longer publish quarterly updates and it has further been reported that a number of other companies including United Utilities, Diageo, National Grid, Admiral and G4S intend to take a similar approach and minimise reporting. It remains to be seen how many other companies will follow this lead. Where they do, companies will still need to monitor any potentially price sensitive information and their own performance against market expectation in order to make any necessary market announcements under the Disclosure Rules.

Editor Comment:

Not issuing quarterly trading updates certainly reduces the reporting burden on companies but may make it more difficult for companies to regulate the market's expectations. Companies should weigh up the benefits of taking advantage of the reduced reporting burden versus the potential effect of reducing communication with investors and maintaining reporting channels throughout the year.

FCA granted new powers in relation to DTR 5 breaches

Changes to national legislation as a result of changes to the EU Transparency Directive mean that, as of 26 November 2015, the FCA has new powers to sanction persons for non-compliance with the major shareholding regime set out in DTR 5. In particular, new powers introduced in the Financial Services and Markets Act 2000 (as amended) mean that where a person fails to make the necessary notifications of a significant shareholding, the FCA may apply to the court for an order suspending some or all of that person's voting rights if the contravention of DTR 5 is serious enough. In determining the seriousness of the contravention, the court may have regard to whether contravention was deliberate or repeated, the time taken for remediation, whether the vote holder ignored warnings or requests for compliance from the FCA, the size of the holding, the impact of the contravention on the integrity of the UK financial system and the effect of the contravention on any company merger or takeover. The order can be made for a specified period or an indefinite period.

Note, this suspension of voting rights will only be applicable to shares traded on a regulated market and therefore will not apply to shares in AIM companies.

Deadline extended for half-yearly financial reports

Effective from 26 November 2015, the timeframe for publication of half-yearly reports has been extended from two months to three months from the end of the period to which the report relates[21].

21 DTR 4.2.2.

Annual reports and half-yearly reports to remain publicly available for 10 years

As from 26 November 2015, annual reports and half-yearly reports must now remain publicly available on company websites for 10 years (as opposed to five years as previously required). With regard to existing reports that were published in the last five years, they will now need to remain available for the full 10 years period (in other words, the 10 year period applies from the date of publication of the relevant report and not from the date of the rule change).

European Commission proposals to amend the prospectus regime

On 30 November 2015, the European Commission published its proposals to repeal the existing Prospectus Directive and replace it in full with a new regulation. The driver for change in this area is the belief that prospectuses are unwieldy “liability management” tools with summaries which are confusing to the reader and risk factors which are too generic. Despite the changes to the prospectus regime which were introduced three years ago to create a proportionate disclosure regime, small and medium sized entities (**SMEs**) still find it difficult to access the capital markets.

Under the draft new regulation, the fundamental premise of the existing regime – that an approved prospectus is required for a public offer of securities or admission to trading on an EU regulated market – is unchanged. For equity issuers, the real changes are around the prospectus content. In particular, summaries will be shortened to a maximum of six pages, risk factors are to be shortened and must be made more specific to the issuer and a broader category of information will be permitted to be incorporated by reference.

There will be a new concept of a lighter disclosure regime for SMEs and certain secondary issues by issuers with existing securities admitted to trading.

With publication of the draft new regulation, the EU parliamentary process will begin. This project is to be expedited and as such, fast turn-arounds are expected. However, once finalised, the new regulation will only come into effect 12 months after it enters into force and it is therefore not expected that the new regulation will come into effect prior to the end of 2017. We will continue to update readers as these proposals take shape and move towards finalisation.

In the meantime, please refer to our publication *PD3 – At a glance (Key features to monitor during the legislative process)* which is available from the Prospectus Directive Topic Page of our online Financial Markets Toolkit.

FCA and PRA impose public censure for publishing misleading statements

On 11 August, the FCA and PRA announced the imposition of a public censure on the Co-operative Bank PLC (**Co-op Bank**). The FCA based its action on breaches of Listing Rule 1.3.3 through publication of misleading information in its 2012 Financial Statements regarding its capital position and on findings of failures to be open with its regulators, by failing to notify the FSA (and then the FCA) of intended changes to two senior positions. The FCA said that the failings merited a substantial financial penalty, but that following serious consideration about the impact of such a penalty (in particular with regards to Co-op Bank's turnaround plan to ensure the adequacy of its capital resources) it had decided that a public censure was appropriate and proportionate.

The PRA imposed a public censure for failings in Co-op Bank's control and risk management framework during the period July 2009 to December 2013. In a finding mirroring that of the FCA, the PRA also found that Co-op Bank had not been open with its regulators. The PRA said that it considered the failings to be sufficiently serious to warrant a financial penalty of around £120 million but that it had concluded that imposing such a penalty would not advance its statutory objective to promote the safety and soundness of the firms it regulates. The PRA noted that following changes to its board and senior management in 2013, Co-op Bank began to properly address concerns around its risk management framework and policies.

High Court imposes £7m penalties for market abuse

In August 2015, the High Court decided that the FCA was entitled to permanent injunctions against five separate defendants to restrain market abuse and additionally imposed penalties of over £7 million.

In July and August 2011 the FCA successfully applied for an interim injunction to prevent the five defendants from committing market abuse and sought to freeze the assets of the three defendant companies. The market abuse claim was made in relation to trading activities between 2010 and 2011 and the claim was brought on the grounds that the defendants' actions amounted to an abusive trading strategy known as 'layering' whereby orders were entered into and traded on the electronic trading platform of the LSE and multi-lateral trading facilities, in such a way as to create a false or misleading impression as to the supply and demand for those shares, which in turn enabled the defendants to trade the shares at an artificial price.

In 2015, the FCA asked the High Court to impose a permanent injunction restraining market abuse and a penalty. Four of the five defendants were incorporated or resident abroad in Switzerland, the Seychelles and Hungary. Mr Justice Snowden found the allegations of market abuse to be proven by the FCA and granted injunctions in the form proposed by the FCA. The Court also imposed penalties upon the defendants totalling £7 million.

English judiciary establishes a specialist court for the financial markets

On 1 October 2015, the High Court in London established the Financial List, a specialist court that will be staffed by judges with experience of financial disputes. The Financial List covers financial markets transactions where over £50 million is in issue, disputes that require particular expertise in the financial markets and those that raise issues of general importance to the financial markets. The Financial List will also offer the possibility of deciding hypothetical test cases of importance to the financial markets even though there is no live dispute.

Takeovers Update

Salutary reminder to consult the Panel in cases of doubt

On 5 November 2015, the Panel on Takeovers and Mergers (the **Panel**) published a rare statement of public criticism of certain legal and financial advisers relating to their conduct when advising on the Bumi plc deal, which involved the acquisition of interests in two Indonesian coal mining companies from Bakrie Group and from Bukit Mutiara. In its statement the Panel emphasised that the need to consult with it in cases of doubt is particularly acute where there are doubts as to whether parties may be acting in concert. It also stated that to take legal or other professional advice as to whether parties are acting in concert, or to rely on warranties or representations from those parties to the effect that they are not acting in concert, can never be an alternative to such consultation.

Changes to the Takeover Code

On 23 October 2015, the Panel published responses to various consultation papers on dividends, restrictions and suspensions of voting rights and additional presumptions to the definition of acting in concert. The changes to the Code, which took effect on 23 November 2015, include:

- *Dividends:* The Code was amended to require a bidder, in a possible offer announcement, a firm offer announcement and an offer document, to state that it will have the right to reduce the offer consideration by the amount of any dividend (or other distribution) which is paid or becomes payable by the target to its shareholders, unless, and to the extent that, the bidder expressly states that target shareholders will be entitled to receive all or part of a specified dividend in addition to the offer consideration.

  Where a bidder makes a no increase statement and a dividend is subsequently paid by the target to its shareholders, the bidder will normally be required to reduce the offer consideration by an amount equal to the dividend unless the bidder has expressly stated that target shareholders will be entitled to retain all or part of a specified dividend in addition to the offer consideration.

- *Restrictions and suspensions of voting rights:* The definition of "voting rights" in the Code was amended to make it clear that shares (other than treasury shares) which are subject to a restriction on the exercise of voting rights, or to a suspension of voting rights, will normally be regarded for the purposes of the Code as having voting rights which are currently exercisable at a general meeting. This amendment has no impact on the treatment under the Code of non-voting shares, even if those shares are convertible into voting ordinary shares, but simply codifies existing practices and eliminates the scope for a company to issue suspended voting shares as a means of avoiding the normal application of Rule 9, including the requirement to obtain a whitewash.

- *Definition of "acting in concert" broadened:* Three new presumptions to the definition of "acting in concert" were added to the Code in relation to each of the following categories of persons:

a) a person, the person's close relatives, and the related trusts of any of them, all with each other;

b) the close relatives of a founder of a company to which the Code applies, their close relatives, and the related trusts of any of them, all with each other; and

c) shareholders in a private company who sell their shares in that company in consideration for the issue of new shares in a company to which the Code applies, or who, following the re-registration of that company as a public company in connection with an IPO or otherwise, become shareholders in a company to which the Code applies.

A new definition of "close relatives" was also added to the Code. Once again, these amendments codify existing practices.

Panel publishes two new Practice Statements

On 8 October 2015, the Panel published two new Practice Statements:

- *Offer-related arrangements:* Practice Statement No 29 provides guidance on the Panel's interpretation and application of Rule 21.2 in relation to certain of the exclusions to the prohibition on offer-related arrangements and circumstances under which inducement fees may be payable by a target to a bidder where there are competing bidders or during a formal sale process. It confirms that bid conduct agreements are offer-related arrangements and should only contain those provisions permitted by Rule 21.2(b)(i) – (vii). It also includes suggested drafting for bid conduct agreements pursuant to which parties agree that where the Panel determines a relevant provision is not permitted by Rule 21.2, that provision shall have no effect.
- *Equality of information:* Practice Statement No 30 explains how the Panel considers that the requirements of Rule 20.2 (equality of information to competing bidders) may be complied with in circumstances where a target has provided commercially sensitive information to certain lawyers and economists advising a bidder on an "outside counsel only"/"clean team" basis, for the purposes of enabling them to consider the need for and, where necessary, obtain the consent of a competition authority or other regulatory body, but does not want to provide such information directly to the bidder or any competing bidder. In essence, the information has to be made equally accessible to any other bona fide potential competing bidder under similar "outside counsel only"/"clean team" basis but cannot be made subject to any other, more onerous, restrictions.

Antitrust Update

European Court of Justice confirms that facilitators of cartels can be held liable for breaching EU competition law

The European Court of Justice (**ECJ**) has confirmed that facilitators of cartels can be held liable for breaching EU competition law.

The facts

In November 2009, the European Commission fined AC Treuhand, a consultancy firm, a total of €348,000 for facilitating a cartel relating to tin stabilisers and a cartel relating to heat stabilisers, in breach of the prohibition on anticompetitive agreements contained in Article 101 of the Treaty on the Functioning of the EU (**Article 101**). According to the Commission, between 1993 and 2000, AC Treuhand was remunerated for organising regular cartel meetings, monitoring agreements, supplying sales data and offering to act as a moderator between suppliers in the event of tensions.

On 6 February 2014, the General Court dismissed AC Treuhand's appeal against the Commission's decision. AC Treuhand appealed to the ECJ arguing that the conduct of a consultancy firm that provides assistance to a cartel is not caught by Article 101 which, it claimed, is directed only at parties to agreements or concerted practices. AC Treuhand emphasised that it was not active, vertically or horizontally, on any related markets and could therefore not be considered a party to a restrictive agreement.

ECJ decision

The ECJ dismissed the appeal. It held that AC Treuhand had played an essential role in the infringements. The ECJ confirmed that the service agreement between AC Treuhand and the suppliers constituted an illegal agreement under Article 101, irrespective of whether the consultancy firm operated as a supplier in the affected market.

The ECJ held that, under 2006 fining guidelines, the Commission has the power to have regard to both the total turnover of an undertaking and the turnover accounted for by the infringing goods and services. The ECJ noted that the 2006 fining guidelines allow the Commission to depart from this methodology if the particular facts of the case, or the need to achieve a deterrent effect, justify a departure. The Commission was therefore entitled to use a lump sum as the basic amount of the fine.

Editor Comment:

This is the first time that the ECJ has ruled on the conduct of cartel facilitators. It expressed the test for liability as a facilitator as being satisfied when (i) an undertaking intends to contribute to the common objectives of an infringing cartel; and (ii) the undertaking is aware of the actual conduct planned or put into effect in pursuit of the common objectives, or could reasonably have foreseen it and was prepared to take that risk. The judgment confirms the potential for any service provider to attract liability if it becomes aware of – or could "reasonably have foreseen" – illicit antitrust conduct by its clients that is in some way facilitated by the services being provided.

Acquittals in water tanks criminal cartel prosecution

On 24 June 2015, two directors – Clive Dean and Nicholas Stringer – were acquitted of charges relating to an alleged criminal cartel brought under section 188 of the Enterprise Act 2002: the criminal cartel offence. One other director pleaded guilty and on 14 September 2015 was sentenced to six months imprisonment and ordered to do 120 hours community service. However, his prison sentence was suspended for 12 months, and he was not disqualified from acting as a director.

For conduct occurring before April 2014 (as was the case here), that offence consisted of any "dishonest" agreement by individuals to engage in certain types of cartel activity, such as price-fixing, limiting supply or production, market-sharing and bid-rigging (the cartel offence).

The Office of Fair Trading (**OFT**), the predecessor to the Competition and Markets Authority (**CMA**), opened an investigation into a suspected cartel relating to the supply of galvanised steel tanks for water storage in the UK. In June 2014, the OFT announced that Peter Nigel Snee had pleaded guilty to charges under section 188 for dishonestly agreeing to divide up customers, fix prices and rig bids between 2004 and 2012. Two further individuals, Clive Dean and Nicholas Stringer, were also charged with the same offence, but they pleaded not guilty.

On 24 June 2015, Mr Dean and Mr Stringer were acquitted by the jury of the charges against them. Mr Snee, who cooperated with the CMA and was a witness for the CMA at the trials of Mr Dean and Mr Stringer, was subsequently sentenced to six months imprisonment, suspended for 12 months, and ordered to do 120 hours community service.

Editor Comment:

There was clear and undisputed factual evidence that the defendants had engaged in cartel conduct. The principal question for the jury, then, was whether they had done so dishonestly. The jury thought not, having seemingly been persuaded by arguments that the defendants were simply trying to maintain standards and to stave off bankruptcy and redundancies. The relatively light sentence imposed on Mr Snee (who could have been sentenced to up to five years in prison), was explained by the sentencing judge as being in recognition of his early guilty plea and his voluntary cooperation with the CMA. The fact that he would probably have been acquitted had he pleaded not guilty may well have also been a factor. This is likely to be one of the last cases in which a jury is asked to come to a view on the honesty of accused cartelists. The cartel offence was amended with effect from 1 April 2014, so that for conduct occurring after that date it is not necessary to prove that individuals acted dishonestly to commit the cartel offence.

Voluntary redress schemes: CMA guidance

The CMA has published guidance on a new power to approve voluntary redress schemes that aim to encourage companies in breach of competition law to voluntarily pay compensation to victims.

As reported in our July 2015 Corporate Update, the CMA (as well as sectoral regulators with concurrent competition powers) acquired new powers to approve voluntary redress schemes under the Consumer Rights Act 2015, which amends the Competition Act 1998 (**1998 Act**). The CMA has now issued guidance setting out how it and the concurrent regulators may approve redress schemes in accordance with relevant regulations[22] (the **2015 Regulations**), which came into force on 1 October 2015.

The guidance states that redress schemes eligible for consideration by the CMA (or concurrent regulator) include infringements of the EU and UK prohibitions on anticompetitive agreements and abuse of dominance[23]. Applications to the CMA (or concurrent regulator) can be submitted where an infringement decision has been issued by the European Commission, or a UK competiton authority, or during an ongoing investigation by one of those bodies. If applications are made during an investigation, formal approval will be delayed until the relevant regulator makes its infringement decision but a preliminary, non-binding indication of an intention to approve a voluntary redress scheme is permitted.

One important incentive to setting up a voluntary redress scheme for companies under investigation by a UK competition authority is the possibility of a reduction of up to 20% in the fines that would otherwise be imposed for the infringement. That reduction will not, however, be available to companies that are under investigation by the Commission or other non-UK regulators.

Applicants are required to appoint a chairperson who will, in turn, appoint a board to devise the redress scheme and recommend it to the CMA. If applicants have provided the authority with information about when and how the scheme will comply with the 2015 Regulations, the CMA (or concurrent regulator) may approve an outline scheme, subject to conditions. Conditional approval is not permitted, however, for schemes relating to existing infringement decisions of the CMA, concurrent regulator or the Commission. Once the CMA (or concurrent regulator) receives an application, it has discretion whether or not to consider it for approval. If it does proceed to consider it, it will aim to notify applicants of the outcome within three months.

Editor Comment:

By allowing the CMA to approve binding, voluntary undertakings in relation to a compensation scheme, parties in breach of competition law are encouraged to grant swift compensation to those harmed by the infringement and to avoid lengthy court proceedings. However, creating a "CMA approved" voluntary redress scheme entails a considerable loss of control over the compensation process in comparison with court proceedings. Accordingly, it remains to be seen whether the potential discount in fines of up to 20% will be a sufficient incentive for infringers to create such schemes.

22 The Competition Act 1998 (Redress Scheme) Regulations 2015 *(SI 2015/1587).*
23 Chapter I and Chapter II of the Competition Act 1998 and Articles 101 and 102 of the Treaty of the Functioning of the European Union.

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 National Australia Bank on the proposed demerger and IPO of Clydesdale Bank; Booker Group plc on its acquisition of the Londis and Budgens store businesses and on its recent "B" share scheme; Man Group on its acquisition of Numeric Holdings LLP (a class 1 transaction under the listing rules); and RBS on the sale of its European locomotive and electric passenger train leasing business to Alpha Trains.

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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