

News round-up

Corporate finance

Introduction

Welcome to the latest in our series of regular alerts containing a round-up of news from our capital markets practice. Among other things, we bring you news of recent decisions issued by the Financial Services Authority ('FSA') in cases of breach of the market abuse regime and of the Listing Rules.

In the Exillon case (which we discuss in more detail below), the FSA has, for the first time, fined a company for breach of the Listing Rules governing related party transactions. The fine is also the first for failure by a company to establish and maintain the controls and systems necessary to comply with the Listing Rules. In the Cattles' case (also discussed below), the FSA has, in addition, shown that it is willing to use its powers under section 91(2) of the Financial Services and Markets Act 2000 to penalise directors who are knowingly concerned in a contravention of the Listing Rules, as well as imposing penalties on the issuers themselves.

Corporate governance: the FRC launches a consultation on changes to the UK Corporate Governance Code, the Stewardship Code and the International Standards on Auditing

As part of its programme to promote 'effective company stewardship', the Financial Reporting Council ('FRC') launched a raft of proposals on 20 April 2012. The proposals relate to changes to:

- the UK Corporate Governance Code ('the Code');
- the Guidance for Audit Committees;
- the Stewardship Code; and
- International Standards on Auditing (UK and Ireland).

The UK Corporate Governance Code

The proposed changes include the following:

- FTSE 350 companies should put the external audit contract out to tender every ten years as a minimum;
- boards should explain why they consider their annual reports are fair and balanced;
- audit committees should provide more meaningful reports; and

- additional guidance will be included in the Code on the explanations that a company should give to shareholders when it elects not to follow the Code.

The changes to the Code will, in addition, include the provisions already announced which will require boards to report on their gender diversity policies.

The FRC is also consulting on changes to the Guidance for Audit Committees to support the proposed revisions to the Code.

The UK Stewardship Code

The proposed changes include the following:

- clarification of the meaning of 'stewardship';
- clarification of the respective responsibilities of asset owners and asset managers; and
- the inclusion of a request that investors disclose their policy on stock lending, and whether they recall lent stock for voting purposes.

International Standards on Auditing (UK and Ireland)

The proposed changes are aimed at improving auditor communications and extending auditor reporting.

The next steps

Comments are requested by 13 July 2012 and, subject to the outcome, all proposed changes will apply for financial years beginning on or after 1 October 2012.

Further details

Further details, including links to the various consultation documents, are available from FRC Press Release (PN 359) at the following link: <http://www.frc.org.uk/press/pub2764.html>

Corporate governance: voting at general meetings: ICSA publishes new rules

Amid concerns that there is some confusion in the market about the process of voting at general meetings, ICSA Registrars Group ('ICSA') published new guidance on 16 April 2012 on the practical issues relating to this topic. The areas dealt with in the guidance include:

- notice of meetings;
- proxy deadlines and record dates;

- voting periods; and
- what should happen after the proxy deadline has passed.

Among other things, ICSA recommends that:

- issuers with CREST shareholders should announce their meetings via CREST;
- issuers should allow shareholders to make proxy appointments and give instructions via CREST (where the issuer has CREST shareholders) and the internet;
- issuers should encourage shareholders to submit their votes electronically (either by means of CREST or the registrar's proprietary system) wherever these facilities are available; and
- a shareholder should use the same means for making proxy appointments and giving instructions during a particular voting period (and not, for example, switch between the use of the internet and hard copy documentation).

ICSA Guidance note: practical issues around voting at general meetings available at:

<http://www.icsa.org.uk/assets/files/pdfs/guidance/Guidance%20notes%202012/ICSA%20Registrars%20Group%20Best%20Practice%20Note%20-%20Practical%20issues%20around%20voting%20at%20general%20meetings%20-%20April%202012.pdf>

ICSA Letter to accompany the guidance available at:

<http://www.icsa.org.uk/assets/files/pdfs/guidance/Guidance%20notes%202012/ICSA%20Guidance%20note%20letter,%20April%202012.pdf>

Listing Rule breaches: the FSA fines Exillon Energy plc for breach of the rules governing related party transactions and the rules for maintenance of controls and systems

The Financial Services Authority ('FSA') has, for the first time, fined a company for breach of the Listing Rules governing related party transactions¹. The fine is also the first for failure by a company to establish and maintain the controls and systems necessary to comply with the Listing Rules². The FSA published a final notice on 26 April 2012 imposing a fine of £292,950 on Exillon Energy plc for:

- failing to identify the sum of approximately £930,000 of payments to its former Chairman and beneficiary of the major shareholder;

1. Listing Rule 11.1.11R requires listed companies to aggregate transactions with the same related party in 12 month period. Where such transactions exceed 0.25% of any of the percentage ratios contained in Listing Rule 10, the Listing Rules require the company to inform the FSA of the details of the aggregated transactions, provide a written confirmation from an independent adviser that the terms of the transaction were fair and reasonable; and undertake to include details of the transactions in the next published annual accounts: Listing Rule 11.1.11R (3).

2. Listing Principle 2 provides that a listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

- failing to disclose the payments to the FSA in a timely manner; and
- failing to take reasonable steps to establish and maintain systems and controls necessary to comply with the Listing Rules.

FSA Final Notice: Exillon Energy plc available at: <http://www.fsa.gov.uk/static/pubs/final/exillon-energy.pdf>

Listing Rule and market abuse breaches: the FSA issues Final Notices in a case involving publication of false or misleading information in breach of the market abuse regime, the Listing Rules and the FSA's Principles for Business

Cattles plc ('Cattles') was a sub-prime lender and was listed on the London Stock Exchange. In 2008 it was a member of the FTSE 250 (although it has since been delisted). The majority of its business was run through its subsidiary, Welcome Financial Services Limited ('Welcome'). Cattles' Annual Report for 2007 contained misleading arrears, impairment and profit figures³.

Cattles also announced a pre-tax profit of £165.2 million for 2007. However, had accounting standards had been correctly applied, they would have revealed a pre-tax loss of £96.5 million.

The misleading figures from the Annual Report were also included in a rights issue prospectus that Cattles released to potential investors in April 2008. The rights issue was subsequently fully subscribed and raised £200 million. When the true position came to light in 2009, trading in Cattles' shares was suspended. On 2 March 2011, Cattles announced a scheme of arrangement under which its shareholders would receive 1p for each share, compared with the rights issue price of £1.28.

The FSA published Final Notices on 28 March 2012, imposing the following sanctions:

- Cattles: the FSA publicly censured Cattles for:
 - disseminating information likely to give a false and misleading impression to the market as to the value of its shares in circumstances where it could reasonably be expected to have knowledge that the information was false or misleading. It had, therefore, engaged in market abuse contrary to section 118(7) of the Financial Services and Markets Act 2000 ('FSMA');
 - failing to take reasonable care to ensure that information it made available through the FSA and the RIS was not misleading, false or deceptive and did not omit anything likely to affect the import of the information (in breach of Listing Rule 1.3.3R);
 - failing to act with integrity towards holders and potential holders of its listed equity securities (in breach of Listing Principle 3); and
 - failing to communicate information to holders and

3. It reported that £0.9 billion of Welcome's approximately £3 billion loan book was in arrears. If accounting standards had been properly applied, the correct figure would have been approximately £1.5 billion.

potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities (in breach of Listing Principle 4).

- Welcome: the FSA publicly censured Welcome for conduct amounting to market abuse under section 118(7) of FSMA and for breach of Principle 3 of the FSA's Principles for Business in that it had failed to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems.

The FSA would have imposed financial penalties on the two companies had it not been for their financial circumstances.

- James Joseph Corr, then finance director of Cattles: the FSA imposed a fine of £400,000 for conduct amounting to market abuse (under section 118(7) of FSMA) and under section 91(2) of FSMA for being knowingly concerned in Cattles' contravention of the Listing Rules.
- Peter Douglas Miller, then finance director of Welcome: the FSA imposed a fine of £200,000 for conduct amounting to market abuse (under section 118(7) of FSMA) and for being knowingly concerned in Welcome's contravention of Principle 3 of the FSA's Principles for Business.
- The FSA has also issued prohibition orders preventing James Corr and Peter Miller from undertaking any functions in relation to regulated activity on the grounds that they are not fit and proper persons.

The managing director of Welcome, John Blake, has referred to the Upper Tribunal the FSA's Decision of 18 January 2012 to impose a £100,000 fine and prohibition order. No Final Notice has yet been issued.

FSA Final Notice: Cattles Limited available at: <http://www.fsa.gov.uk/static/pubs/final/cattles-ltd.pdf>

FSA Final Notice: Welcome Financial Services Limited available at: <http://www.fsa.gov.uk/static/pubs/final/welcome-financial-service.pdf>

FSA Final Notice: James Joseph Corr available at: <http://www.fsa.gov.uk/static/pubs/final/james-joseph-corr.pdf>

FSA Final Notice: Peter Douglas Miller available at: <http://www.fsa.gov.uk/static/pubs/final/peter-douglas-miller.pdf>

FSA Decision Notice: John Blake available at: <http://www.fsa.gov.uk/static/pubs/decisions/john-blake.pdf>

Market abuse: the FSA clarifies its position on 'cleansing statements' following the Einhorn Decision Notice

The Financial Services Authority ('FSA') has, in a letter of 23 March 2012, clarified its position regarding 'cleansing statements' following concerns raised by the City of London Law Society Regulatory Law Committee ('CLLS') about a statement made by the FSA in its Decision Notice of 12 January 2012 in the David Einhorn case⁴. The statement in

question is contained in paragraph 3.11 of the FSA's Decision Notice and is set out below:

Quote:

3.11. Once a third party agrees to be wall crossed, it can be provided with inside information and it is then restricted from trading. The party is only able to trade in the company's shares again once the information it has been given is made public. In the context of a transaction, the information will be made public either when the transaction is announced to the market, or in cases where a transaction does not proceed, when an announcement is made to the market stating that a transaction was contemplated, but did not proceed. This announcement may be referred to as a cleansing statement.

Unquote.

In a letter of 2 March 2012 to the FSA, the CLLS had noted with concern the proposition that there should in all cases be a cleansing statement when information is provided about a possible transaction: it agreed that a recipient of inside information will be unable to trade for as long as that information remains inside information but did not believe that it will always necessarily be the case that the fact that a capital raising is not going ahead will remain inside information.

The FSA has now confirmed its position as follows:

- in some situations, the fact that a previously proposed capital raising is no longer proceeding will not necessarily constitute inside information: each case will depend on its own facts and circumstances;
- the statement about cleansing announcements in paragraph 3.11 of the Einhorn Decision Notice must be read in the context of the Notice as a whole and the particular facts of that case; and
- in circumstances where information is no longer inside information, a cleansing announcement will not be necessary. However, the FSA expects advisers to consider carefully whether this is, in fact, the case.

FSA Decision Notice: David Einhorn: 12 January 2012 available at: <http://www.fsa.gov.uk/pubs/decisions/dn-einhorn-greenlight.pdf>

CCLS letter dated 2 March 2012 available at: <http://www.citysolicitors.org.uk/FileServer.aspx?oID=1166&iID=0>

FSA letter dated 23 March 2012 available at: - <http://www.citysolicitors.org.uk/FileServer.aspx?oID=1167&iID=0>

Market abuse: the FSA publishes its Decision Notice in an improper disclosure case

On 3 April 2012, the Financial Services Authority ('FSA') published a Decision Notice (dated 27 February 2012) for Ian Hannam, the Chairman of Capital Markets at J P Morgan. Ian Hannam has referred the matter to the Upper Tribunal for the Tribunal to determine the appropriate action for the FSA to take. The Tribunal may uphold, vary or cancel the FSA's decision and will publish its decision on its website.

4. For details on this case, see our March 2012 edition, issue no. 3/2012

In the Notice, the FSA records its decision to fine Ian Hannam the sum of £450,000 for two instances of market abuse (improper disclosure in breach of section 118(3) of the Financial Services and Markets Act 2000). In the FSA's view, Ian Hannam had disclosed inside information in two emails sent in September and October 2008 to a prospective client regarding an existing J P Morgan client, Heritage Oil Plc ('Heritage'), for which Ian Hannam was the lead adviser. The September email contained information about a possible bid for Heritage, while the second contained information about a new oil discovery by Heritage. The FSA accepted that Ian Hannam did not set out to commit market abuse but viewed his actions as serious given his experience and seniority.

FSA: Decision Notice: Ian Hannam: 27 February 2012 available at: <http://www.fsa.gov.uk/static/pubs/final/ian-hannam.pdf>

How Squire Sanders can help

We would be pleased to discuss with you in more detail any of the matters raised in this article.

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