

UK Securities Law Update – Q3, 2010

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In this issue of our UK Securities Law update we discuss the Financial Services Authority's latest guidance relating to reverse takeover disclosure obligations and guidance concerning break fees. We also discuss the Alternative Investment Market's latest newsletter, which contains guidance in relation to certain matters, including corporate governance. We look at NYSE Euronext's launch of a new market in London and finally we discuss the implications that the UK government's proposed abolition of the FSA might have for its role as the UK Listing Authority.

This briefing will be of interest to UK and overseas issuers with UK-listed securities, those contemplating UK listing of securities or investors in UK-listed securities.

1. Financial Services Authority: List! Issue 25

On the 30 July 2010, the Financial Services Authority ("FSA") as the UK Listing Authority ("UKLA") published Issue 25 of its guidance newsletter, LIST!. This publication covers a number of topics with the most significant guidance offered being in relation to the disclosure requirements for reverse takeovers and the UKLA's approach as to break fees.

(a) Reverse Takeovers – suspension of securities

Under the Listing Rules, there is a rebuttable presumption that an issuer with a premium listing would have its equity shares suspended following an announcement or leak regarding a reverse takeover. A suspension may be for a significant period of weeks or months until the markets have sufficient information on the target business to properly price the issuer's securities. Where the target business was not subject to public disclosure requirements, the UKLA's position was to allow the information gap to be filled by the issuer releasing fully audited financial information on the target, together with a confirmation that the issuer will continue to keep the market informed, without delay, of any developments concerning the target business that would be required to be released were that target itself listed.

By requiring such a high standard of disclosure to avoid suspension, this position attracted criticism as being too onerous. It is reported that, in practice, this may have discouraged listed companies from considering significant transactions.

The UKLA has now helpfully issued new guidance on what constitutes sufficient information to avoid a listing suspension. The provision of sufficient information now includes the disclosure of financial information on the whole business being acquired covering a 3-year period. Significantly, this information no longer needs to be audited, although the disclosure of the financial information would need to be accompanied by a statement from the directors of the issuer confirming that the issuer's announcement provides sufficient information about the business to assess the target's financial position. Additionally, sponsors will also be required to provide the UKLA with a comfort letter confirming that the issuer's announcement contains sufficient information about the position

of the target business. Issuers will also be required to set out the key differences between the issuer's and the target's accounting policies, relevant non-financial operating or performance measures, a commentary on current trading and a public commitment to keep the market informed of any developments in the target's business.

The UKLA states that it is initially for the issuer and sponsor to be satisfied that any announcement contains sufficient information and it continues to reserve the right to suspend an issuer's securities if it appears that the market could not continue trading on a properly informed basis.

(b) Reverse Takeovers – the use of holding company structures

As an alternative to structuring a transaction as a reverse takeover, the UKLA has previously allowed issuers to avoid the suspension of their securities by using a new holding company to complete the transaction. The position used to be that because a new holding company would make an offer both for the issuer and the target, the transaction was not strictly a reverse takeover by the issuer. One of the last companies to attempt to use this holding company mechanism was Prudential in its aborted \$35.5bn (£22.7bn) bid for AIG's Asian business, AIA.

The holding company loophole has now been closed. The UKLA will look through the legal form of a transaction and consider the substance when determining if a transaction is subject to the reverse takeover regime (a position which is now more consistent with the general approach to the listing regime, which takes a purposive approach). Therefore, going forward, the use of a holding company structure to acquire a larger unlisted target will also give rise to a presumption of suspension until a new applicant prospectus is published or the publication of the information outlined in paragraph (a) above takes place.

The changes in relation reverse takeovers, both regarding the minimum disclosure requirements to avoid suspension, and the use of a holding company structure are effective immediately.

(c) Break Fees

The UKLA has clarified its approach to arrangements designed to serve the purpose of a break fee. Listing Rule 10.2.7R provides that break fees over a certain size agreed to by issuers with a premium listing may constitute a class 1 transaction (requiring, amongst other things, shareholder approval). The UKLA has now confirmed that it considers that if the issuer will be obliged to make payment to the other party in respect of a failed transaction, this will constitute a break fee regardless of the nature of a particular arrangement. If the effect of an arrangement is to replicate a break fee, and this could include costs indemnities as well as 'no shop' and 'go shop' clauses, it should be regulated as a break fee under Listing Rule 10.2.7R.

2. The Inside AIM Newsletter (Issue 2)

The London Stock Exchange ("LSE") has published its second edition of "Inside AIM".

(a) Corporate Governance on AIM

Following the financial crisis and, amongst other things, the Walker review on corporate governance, the Financial Reporting Council ("FRC") has consulted on, and recently updated the UK Corporate Governance Code ("CGC"). The CGC is considered to be the "gold standard" of corporate governance principles, and compliance with it is only required by UK companies with a premium listing of equity shares (though all others are encouraged to comply so far as possible). With the updated code in mind, the LSE has decided to clarify its approach to corporate governance regarding AIM companies.

Whilst there is no requirement for AIM-listed companies to comply or explain against a particular code, an AIM company does have to have “sufficient procedures, resources and controls in place” and its nominated adviser (“NOMAD”) should “consider, with the directors of an applicant, the adoption of appropriate corporate governance measures”.

The LSE has reiterated that it very much considers that good corporate governance is important for companies listed on AIM. However, given the nature of AIM companies, a “one size fits all”, comply or explain approach (as for example adopted for the main market) is not considered appropriate for AIM given the range and varying size of the companies listed. The LSE supports the use of the Quoted Company Alliance’s Corporate Governance Guidelines for AIM Companies (“QCA Guidelines”) and views the UK Corporate Governance Code as a standard that all public companies should aspire to. With this in mind, the LSE expects to see NOMADs develop their involvement in this area and the LSE will look for evidence of discussion and debate at admission, and on an ongoing basis, of board composition, structure, procedures and controls, using, for example, the CGC or QCA Guidelines as a base.

(b) Other Matters of Particular Note

The second edition of the AIM newsletter also offers guidance on the following topics: i) the cancellation of an AIM admission by a scheme of arrangement; ii) trading companies which have become investing companies; iii) the omission of historical financial data of the target of a reverse takeover; and iv) in respect of companies which have made changes to their business, the fast-track admission process.

The newsletter reports on the NOMAD review program which identifies the need for improved record keeping, the need for increased director awareness of their responsibilities and the need to ensure sufficient due diligence on admission.

The newsletter also offers an update with regard to current investigations and enforcement. It highlights, in particular, the recent censures and fines totaling £275,000 imposed on two companies and two NOMADs. The censures highlight (amongst other things) the importance for issuers of keeping their NOMAD updated and for NOMADs to rigorously monitor a company’s appropriateness for AIM and ongoing compliance with its disclosure obligations.

3. NYSE Euronext Launches a New Market in London

NYSE Euronext has announced the launch of a new market in London operated by LIFFE Administration and Management, which also operates the London exchange-regulated market of NYSE Liffe.

By launching a UK-based platform to attract international company listings, NYSE Euronext London aims to offer an alternative to the LSE with the ability for issuers to have their securities traded on the NYSE Euronext’s Universal Trading Platform.

NYSE Euronext is a “regulated market” (the third in the UK alongside the LSE’s main market and Plus market) and issuers wishing to admit their shares or depositary receipts to trading will also need to admit them to listing on the Official List of the UKLA. As such, for those wishing to have their securities traded on the new market, the process for admission will be comparable to that of the LSE’s main market and an application to the UKLA to be listed on the Official List will be required. In almost all respects the continuing obligations that will apply to issuers with securities admitted to trading on the NYSE Euronext market will be the same as if admitted on the LSE’s main market.

Those issuers that are registered with the United States' Securities and Exchange Commission ("SEC") and are incorporated outside of the UK will still need to go through the UKLA's normal vetting process in order to list since there will be no provision for 'cross-listing'.

4. UK Government's Proposed Merger of the Financial Reporting Council and the UKLA

In our UK Securities Law Update, Q2 2010, we discussed the UK coalition government's proposals to abolish the FSA with macro-prudential supervision being transferred to the Bank of England. Further details have now been released in relation to the plans for the UKLA.

The government believes there is a strong case for the introduction of a powerful companies regulator with responsibilities for regulating corporate governance, corporate information and disclosure and the stewardship of companies by institutional shareholders. The government is therefore proposing that the functions of the UKLA should be merged with other regulatory functions relating to companies and corporate information, notably those of the Financial Reporting Council (the "FRC"). It is not yet clear whether this body would remain within the new CPMA markets division of the Bank of England, when introduced, or whether it should be merged with the FRC under the Department for Business, Innovation and Skills.

The government recognises that there are certain synergies that exist between the UKLA and other market functions, especially market surveillance, and the fact that listings encompass other securities in addition to equities, and it remains unclear whether there will be significant market support for separating the functions of the UKLA from the other functions currently carried out by the FSA. The period for consultation remains open until 18 October 2010 with the responses being used to help formulate detailed proposals and draft legislation to be published for consultation in early 2011.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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