STAY CURRENT
A Client Alert from Paul Hastings

PAUL HASTINGS

July 2011

UK Securities Law Update - Q2, 2011

Market Update: The Recent Prominence of Cash Shells

BY RONAN O'SULLIVAN, ROSS MCNAUGHTON & GEORGE WESTON

The record £1.35 billion recently raised by Vallares, a "cash shell" company co-sponsored by Nathaniel Rothschild and former BP executive Tony Hayward, has again put the spotlight on this type of entity and attracted a flurry of comment in the financial media. In truth however, Vallares is merely the latest and most striking embodiment of a market trend of an increasing number of equity offerings and listings of these vehicles over the last few years, which includes a line of precedents such as Justice Holdings, Vallar, Horizon Acquisition, Resolution Limited and Sherborne Investors.

As the profile of this type of structure increases, and at a time when certain institutional investors are finding themselves increasingly constrained, not least by the additional capital requirements imposed by Basel III and the Capital Requirements Directive, we expect this to be a structure of interest to many investment managers going forward. However, the commercial, structural and legal issues arising in the context of these types of listings can be complex and require a careful navigation of the relevant listing regime. This *Stay Current* examines the recent return of cash shells to prominence in the London equity markets and discusses some of the key legal issues associated with this type of entity, as well as the developing market practice arising from recent listings.

The Purpose of Cash Shells

A cash shell is an entity which is listed on a stock exchange but which does not have any business or assets of its own. They are typically "clean", new companies incorporated and listed specifically for the purpose of making investments. The precise objective of the new cash shells entering the market varies, but typically involves buying one or more other companies, or their underlying business or assets, often by using new shares in the cash shell as part of the consideration. By having cash resources and a stock exchange listing to hand, cash shells are able to identify target assets swiftly and, if required, can seek to raise further equity capital to acquire assets at a multiple to their own market value at the time when the transaction takes place. Some cash shells will be looking for a range of opportunities, while others may wish to make only one acquisition, in each case usually (but not exclusively) focused on a particular industry, geographical region or sector. Both investors and the regulator will expect detail on the acquisition strategy to be set out in the offering document.

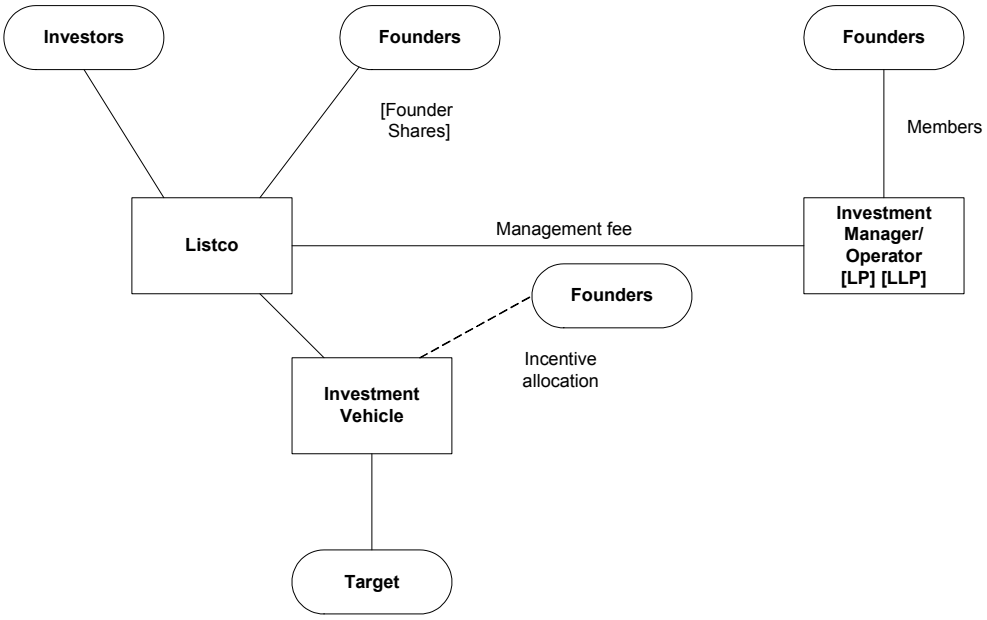
Founders and Sponsors

From a marketing perspective, in order to convince investors to buy shares in a vehicle with no business or assets, cash shells typically need the support and involvement of one or more well-known sponsors. This may be an industry figure, such as Tony Hayward (Vallares) or Clive Cowdery

(Resolution), or an individual with private equity or asset management experience, such as Nathaniel Rothschild (Vallar and Vallares), Nicolas Berggruen (Justice Holdings) or Edward Bramson (Sherborne Investors). Details of each sponsor's track record would be set out in the prospectus or admission document and during the listing process would be the subject of detailed verification. Investors would usually expect the sponsors to have some "skin in the game", usually in the form of a capital stake, and to give certain undertakings to the company to protect the investors, the latter feature being one which finds support from the new regulatory regime which seeks to bolster investor protection. By way of example, the four Vallares founders provided more than £100 million of capital into their entity and provided undertakings not to compete and to each commit a certain amount of their time to the business. The founders can also expect to be subject to lock up restrictions in relation to a disposal of their interests, which can be both an investor expectation as well as a stock exchange requirement (for example in the context of a listing on the Alternative Investment Market ("AIM")).

Typical Structure of a Cash Shell

In structuring a new cash shell, the founders will need to carefully consider the tax consequences and potential regulatory issues (such as carrying on regulated activities in the UK), as well as the expectations and preferences of investors. Most cash shells have used offshore jurisdictions for incorporation of the issuer, although some, such as Horizon, have used an English plc. The following structure, which in many respects is similar to the way in which a traditional fund is set up, is common:



Standard vs AIM Listing

A cash shell can list in London on the main market maintained by the UK Listing Authority ("UKLA") using the Chapter 14 (Standard) listing process, which was recently opened to UK as well as non-UK issuers, or on AIM. Generally, AIM carries a lower regulatory burden in certain respects and has more relaxed entry requirements whereas Standard listing offers certain marketing advantages and the access to investors of the Main Market. As such, AIM may be more suitable to a more targeted listing,

while market sentiment may favour the Main Market for larger listings and, in practice, the expected amount raised in the offering tends to be a key driver in the choice of market.

Every AIM listed company must appoint a nominated advisor ("Nomad") who will assist with the listing and on-going regulatory maintenance and reporting requirements and is responsible for the company's compliance with the AIM Rules. The Nomad will have to assess the free float and market capitalisation of the issuer to determine whether or not it is suitable for listing. A Standard listed issuer does not require a Nomad although, in practice, one or more investment banks will usually be appointed as global coordinator and/or bookrunner. Instead, a Standard listed issuer must have an anticipated market capitalisation of at least £700,000 and a free float of at least 25% of its shares (calculated to exclude (amongst others) investors connected to the sponsors and those holding over 5% of the company's shares). A Standard listing will typically be a more involved process with higher fees for legal and other advisors, principally due to the requirement to prepare an EU Prospectus Directive compliant prospectus which is approved by the UKLA. AIM listings are usually structured to avoid the publication of an approved prospectus (by making the offering to institutional investors only) though an AIM Admission Document would still be required. Cash shells listing on the Main Market may also need to satisfy the UKLA that they should not be considered an "investment entity" (i.e. an entity whose primary object is investing and managing its assets with a view to spreading or otherwise managing investment risk), as a Chapter 14 (Standard) listing is not generally open to such vehicles. Reporting and corporate governance requirements for Standard listed companies under the Disclosure and Transparency Rules are higher than for AIM, where the AIM rules and expected market practice applies, though it is worth noting that (unlike for AIM listed companies where a transaction size exceeds certain class tests) significant acquisitions made by a Standard listing company would not require shareholder approval.

A Premium listing on the Main Market requires a three year track record, which is clearly impossible for a newly incorporated cash shell to satisfy. However, in practice, many cash shells seek to move to a Premium listing once they have made an acquisition (at which point they seek to relist with a Premium listing off the back of the track record of the target company). In addition, in the interim period, many cash shells with a Standard listing comply on a voluntary basis with some of the more rigorous reporting and governance standards applicable to companies with a Premium listing.

The Outlook

Will the recent popularity of cash shells continue? From a commercial perspective, the most significant cash shells of the last few months have held their value since admission reasonably well relative to a turbulent equities market, and out-performed some high-profile traditional IPOs. This certainly seems to provide a structure which is of significant interest to investors both in the UK and internationally. The success and high profile of Vallares and other cash shells will undoubtedly increase interest further in the short term and, in the medium term, the changes to bank capital adequacy rules following the introduction of Basel III and Solvency II may lead to a shift in preference for certain banks and insurance companies respectively away from traditional private equity limited partnership interests to listed vehicles. Looking forward, we expect that the listing of an increasing number of new cash shells will continue to be a major feature of the London equity market.

Appendix
Recent Chapter 14 and AIM Investment Vehicles – Summary of key provisions

Company	Vehicle Type	Where Listed	Date	Amount Raised (including overallotment option)	Investment Policy / Business Strategy	Principal Sponsors/ Key Individuals
Vallares	Jersey company	Official list (Chapter 14)	June 2011	£1,331 million	To acquire or establish a major business or asset with significant operations in the resources sector with an aggregate enterprise value of between £3 billion and £8 billion.	Nathanial Rothschild, Tony Hayward, Tom Daniel, Julian Metherell
Justice Holdings Limited	British Virgin Islands company	Official List (Chapter 14)	Feb. 2011	£900 million	To acquire a target business with an Enterprise Value of between £1 billion and £7 billion, not limited to a particular industry or geographic region.	Nicolas Berggruen. Martin Franklin, William Ackman
Vallar PLC	Jersey company	Official List (Chapter 14)	July 2010	£707 million	To acquire a single major company operating in the global metals, mining and resources sector.	Nathaniel Rothschild, James Campbell
Sherborne Investors (Guernsey) A Limited	Guernsey company	AIM	March 2010	£105 million	To invest in a company publicly quoted on a UK stock exchange which it considers individual as a result of operational deficiencies	Edward Bramson

Company	Vehicle Type	Where Listed	Date	Amount Raised (including overallotment option)	Investment Policy / Business Strategy	Principal Sponsors/ Key Individuals
					and which it believes can be rectified by the company's active involvement, thereby increasing value.	
Horizon Acquisition Company plc	English plc	Official List (Chapter 14)	Feb. 2010	£400.5 million	To identify a single major company or business with significant operations in the UK and an enterprise value of between £1 billion and £3 billion.	Hugh Osmond, Alan McIntosh, Edward Hawkes, Marc Jonas, Edward Spencer Churchill, Matthew Allen
Better Capital Limited	Guernsey company	AIM	Dec. 2009	£142 million	To invest (through a feeder fund) in a concentrated portfolio of distressed businesses, generating returns from capital growth.	Jon Moulton
LXB Retail Properties plc	Jersey company	AIM/ Channel Islands Stock Exchange ("CISX")	Oct. 2009	£110 million	To invest in out-of-town and edge-of-town retail real estate assets in order to actively manage and develop to extract higher than average returns.	Phil Wrigley, Tim Walton
Max Property Group plc	Jersey company	AIM/ CISX	May 2009	£220 million	To invest in UK real estate assets.	Aubrey Adams, Nick Leslau, Mike Brown

Company	Vehicle Type	Where Listed	Date	Amount Raised (including overallotment option)	Investment Policy / Business Strategy	Principal Sponsors/ Key Individuals
Brookwell Limited	Guernsey company	AIM	Feb. 2009	£16.1 million	To invest in a portfolio of AIM securities and listed securities.	Christopher Clark
Resolution Limited	Guernsey company	Official List (Chapter 14)	Dec. 2008	£600 million	To acquire businesses in one or more of the life assurance, asset management, general insurance, banking and diversified general financial sectors in the UK and elsewhere in Western Europe with a view to restructuring the acquired entities.	Clive Cowdery, John Tiner, Ian Maidens, Jim Newman, Brendan Meehan

✧ ✧ ✧

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

London

Garrett Hayes
44.20.3023.5153
garretthayes@paulhastings.com

Tom O'Riordan
44.20.3023.5166
tomoriordan@paulhastings.com

Jonathan Shenkman
44.20.3023.5131
jonathanshenkman@paulhastings.com

Ross McNaughton
44.20.3023.5124
rossmcnaughton@paulhastings.com

Ronan O'Sullivan
44.20.3023.5127
ronanosullivan@paulhastings.com

George Weston
44.20.3023.5142
georgeweston@paulhastings.com