

# Equity Capital Markets Update

## Q2 2010

OLSWANG





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(see page 3)

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page 6)

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# Recent Legal Developments

In this quarter's ECM Update, we look at the new UK Corporate Governance Code, the recent consultation on the Takeover Code, the headline-hitting sanction imposed on Brian Myerson and others, the consultation on rights issues fees, some clarification on the availability of the AIM Designated Markets route to admission and a brief analysis of the recent Emergency Budget.

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## CORPORATE GOVERNANCE CODE GETS A MAKEOVER

In May 2010, the Financial Reporting Council (the "FRC") introduced a new corporate governance regime with the UK Corporate Governance Code (the "New Code") replacing the Combined Code for companies in financial years beginning on or after 29 June 2010.

The New Code is likely to affect over 1,000 UK companies and over 300 overseas companies. There is now a requirement for all companies with a Premium Listing of equity securities, whether incorporated in the UK or not, to set out in their annual report the arrangements they have in place to apply, and comply with, the main principles of the New Code providing a reasoned explanation where they do not under the "comply or explain" approach.

### ***"Comply or Explain"***

The "comply or explain" position is intrinsic to the corporate governance regime in the UK and means that, rather than operating as an inflexible series of rules, the New Code comprises a framework of recommendations and guidance set out in main and supporting principles and provisions. Companies are obliged to apply the main principles of the New Code under the Listing Rules and set out how they have done so in their annual report. However, a company may deviate from the main principles where they can demonstrate and explain to the shareholders that good governance is to be achieved through other legitimate means in line with the reasoning behind the principle or provision in question.

### **KEY FEATURES OF THE NEW CODE**

The role and responsibilities of the board dominate the key features of the New Code's main principles, which emphasise the chairman's leadership in encouraging greater interaction and debate with shareholders and in managing risk effectively.

### ***Accountability***

The New Code recommends that to promote greater accountability and engagement with shareholders, all directors of FTSE 350 companies should be subject to annual re-election; under the Combined Code it

was at least every three years. This has proved to be a controversial addition to the New Code provisions - there is concern that annual elections of the board could result in a lack of stability and have an adverse effect on the board's goal of working collectively towards long term objectives. Rather than having a destabilising effect it is hoped that the annual re-election provision will provoke an open and frequent dialogue between shareholders and the board. If companies do not wish to comply with the New Code provisions they may exercise the "comply or explain" approach in connection with this recommendation if they can demonstrate that either their existing arrangements allow for adequate accountability and an effective board or that it would be beneficial for annual re-elections to be introduced at a later date.

### ***Risk Management***

As a specific main principle, the New Code aims to address risk management and internal control systems by placing responsibility on the board to take steps to ensure there are transparent and formal processes in place to create and maintain thorough risk management procedures, together with open engagement in company audit procedures. The outcome of the obligation on boards to take a more proactive stance towards managing risk and the need to reflect this in the company business model is that we are likely to see a rise in the establishment of committees dedicated to monitoring and assessing company risk.

### ***Leadership***

Corporate governance relies on a board dedicated to meeting objectives to bring about long term success for the company. Under another new main principle in the New Code, the chairman plays a crucial role in this, placing an obligation on him to steer the board appropriately to ensure its decision making and performance is both effective and collective. To this end, it is recommended that the chairman provides a personal statement in the company's annual report to set out how the board has performed in respect of its adherence to the New Code's principles. In addition, the chairman must promote a dynamic board environment that encourages debate and strategy development. The composition of the board should ensure that decision taking powers are divided between the executives and the non-executives; no individual should have unfettered ability to take decisions on behalf of the board in relation to the running of the board itself or the management of the business.

### ***Effective and Balanced Board***

The New Code emphasises the importance of diversity within the board, making specific reference to gender. There is now a main principle to ensure the board has an "appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively". To this end, director appointments should be sufficiently transparent and formal to promote a diverse composition and an appropriate gender balance on the board, in accordance with a new supporting principle. Whilst the New Code does not specify a quota, there are concerns that the new recommendations which consciously address the gender balance, may lead to positive discrimination which would only serve to undermine the presence of women on a board and call into question their merit for a seat at the boardroom table. However, it is hoped that increased diversity within a board will serve to promote a more dynamic culture for debate and provide a more varied foundation for policy development and objectives.

To complement the chairman's leadership role, the new supporting principle to prevent the board being dominated by an individual or any group of individuals is bolstered by the provision that at least half the board should be made up of independent non-executive directors. The chairman's responsibility to ensure the effectiveness of the board is supported by the new main principle that requires all directors to dedicate enough time to perform their company duties fully and to keep their skills and expertise up-to-date.

### **Performance**

Previously, the Combined Code provided that the performance of the board should be reviewed annually, with the chairman holding regular internal meetings with the directors to assess the development and success of the company. The New Code recommends external evaluation at least every three years – initially, this applies only to FTSE 350 companies but with the intention that its scope will become more extensive when external evaluation providers in the market increase both in number and quality.

### **Remuneration to be based on Performance**

In the interests of a company's long term success, the New Code sets out that directors' remuneration should be linked to individual and corporate performance, with the setting of executives' pay packages being subject to transparent and proper procedures. The level of remuneration should be such that it attracts and incentivises high-calibre directors to contribute actively to and promote the success of the business. Non-executive directors, meanwhile, should not receive any performance-linked remuneration.

### **Shareholder Relations**

The financial crisis triggered an extensive review of the corporate governance regime, highlighting the absence of a constructive and effective dialogue between investors and the boards of listed companies. The chairman's role includes leading the board to ensure greater understanding of shareholders' concerns in relation to the running of the company and for the AGM to be used as a platform upon which investors can voice their opinions. Under the New Code, shareholders assume a more central role in corporate governance due to the focus on increasing interaction between board and shareholders, along with the new accountability provision on annual elections for directors. In recognition of the New Code's promotion of shareholder/director engagement, "*The Stewardship Code*" is under development by the FRC to provide institutional investors with directions on corporate governance good practice.

### **ADDITIONAL FRC GUIDANCE**

The FRC is updating further guidance as to how the principles and provisions of the New Code should be interpreted and applied; the revised Turnbull Guidance will offer direction to companies on their risk management and internal control systems and the revised FRC Guidance on Audit Committees (formerly the Smith Guidance) will cover the corresponding section of the New Code on audit committees and auditors. There are also directions on best practice in relation to the role of the chairman and non-executive directors in the form of the Higgs Report, which companies do not have to comply with but may find helpful in determining their application of the spirit and the letter of the New Code.

If you have any questions on matters discussed in this article, please contact David Davies on 020 7067 3197 ([david.davies@olswang.com](mailto:david.davies@olswang.com)).

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## Consultation on the Takeover Code

As the Code Committee of the Takeover Panel (the "**Committee**") had promised following the furore surrounding Kraft Food Inc's takeover of Cadbury plc, it recently held a consultation (which closed on 27 July 2010) on possible amendments to a number of rules in the Takeover Code (the "**Code**"). Whilst the areas for review were determined by the Committee from informal consultations with interested parties, no specific drafting amendments were proposed; instead, the rather novel approach taken (for the Committee at least) was to highlight areas of concern with the takeover process in the UK, provide background and detailed arguments for and against change together with their possible implications and, in doing so, the Committee intends to elicit proposals on these issues for further debate.

The Consultation Paper covered the following areas:

1. Whether the minimum acceptance condition threshold should be raised;
2. Whether the voting rights attached to shares acquired during an offer period should be disenfranchised;
3. Whether current disclosure obligations in relation to shares and other securities is sufficient;
4. Whether more information relating to the financing of the offer (including its implications) should be disclosed in the offer document and whether the offeree board should be obliged to set out in the offer document its views of the offeror's intentions.;
5. Whether shareholders should be given independent advice, whether success fees should be restricted and whether details of advisers' fees and other costs should be disclosed;
6. Whether protection should be offered to shareholders in the offeror;
7. Whether to re-examine the "put up or shut up" regime and the 28-day period to publish the offer document following the making of an announcement under Rule 2.5;
8. Whether restrictions should be placed on inducement fees and other deal protection measures; and
9. Whether safeguards should be reintroduced in relation to substantial acquisitions of shares.

Olswang submitted a response to the Consultation Paper and greater detail on the areas of debate is available [here](#).

Whilst the matters considered by this consultation are not all new topics of debate and some are more wide-ranging than others, when taken in conjunction with the Government's recent Command Paper

published in June 2010 (setting out its response to the report published in April 2010 by the Business, Innovation and Skills (BIS) Committee into Kraft's takeover by Cadbury (see [link](#))), one can definitely sense a desire for change. We watch with interest to see whether the results of this consultation produce any amendments of significance either to the Code or UK legislation.

For further information on this topic, please contact David Davies on 020 7067 3197 ([david.davies@olswang.com](mailto:david.davies@olswang.com)).

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## Consultation on Rights Issues Fees

The Rights Issue Fees Inquiry (*RIFI*), which was established by the Institutional Investor Council to investigate fees for capital raising (following a request by Lord Myners), held a consultation between 5 July 2010 and 6 August 2010. One consequence of the credit crunch was an increased demand for the raising of large amounts of capital in challenging conditions and, whilst market conditions might now have improved, there is a perception that the underwriters' fees have not fallen back to reflect the reduced risk.

As part of its review, the RIFI will consider:

- The role and selection of advisers and underwriters;
- Evolving practices in pricing and structure of capital raising;
- The level of underwriting fees relative to changing exposure to risk;
- Transparency in respect of underwriting fees paid; and
- Practices in relation to sub-underwriting.

RIFI intends to consult on the results of this consultation in October/November 2010 and publish its final report in December 2010.

The RIFI consultation is in addition to the market study to be carried out by the Office of Fair Trading to examine the way that the underwriting market works for the different types of secondary equity fundraisings and to assess whether there is potential for improving the way in which it functions. It will consider:

- how underwriting services are purchased;
- how underwriting services are provided; and
- how the regulatory environment affects the provision of these services.

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## **Myerson gets the Cold Shoulder**

In July 2010, the Takeover Panel ruled against Brian Myerson, Brian Padgett and Daniel Posen in a hearing at which it was found that together they had acted in concert in acquiring shares in Principle Capital Investment Trust and that they had attempted to evade an obligation under Rule 9 to make an offer for the entire company. The sanction was that they each be "cold shouldered" (under MAR 4 in the FSA Handbook), meaning that no company or individual authorised by the FSA can work on a bid or any merger-related business with any of them. This sanction is rarely used (being last imposed in 1992) and acts to impact on an individual's reputation, quickly making them an undesirable in the City. This action is another example of a City watchdog making good on its recent promise to pursue irregularities and to come down hard on wrongdoers. Myerson is considering whether to challenge the ruling.

"The London Stock Exchange has stated that it expects a company to have traded in substantially the same form for 18 months prior to seeking admission via the AIM Designated Markets route."

## **AIM Designated Markets**

The London Stock Exchange has clarified the circumstances in which a prospective AIM company can join AIM via the AIM Designated Markets ("**ADM**") route without the need to publish an admission document. In the latest edition of "*Inside AIM*", the Exchange has stated that it expects a company to have traded in substantially the same form for 18 months prior to seeking admission via ADM. This is so that there has been a sufficient period of disclosures to the home market about the company in the form in which it is seeking to be admitted to AIM.

Where a business has changed substantially, for example carried out the equivalent of a Rule 14 reverse takeover, it is possible that the entity will not be able to take advantage of the ADM admission route. If the applicant has performed smaller transactions or taken other actions to change its business substantially e.g. ceasing a major business unit, the Exchange will need to discuss with the nomad whether the ADM route is available.

For further information on ADM, please contact Max Audley on 020 7067 3484 ([max.audley@olswang.com](mailto:max.audley@olswang.com)).

# Recent Legal Developments

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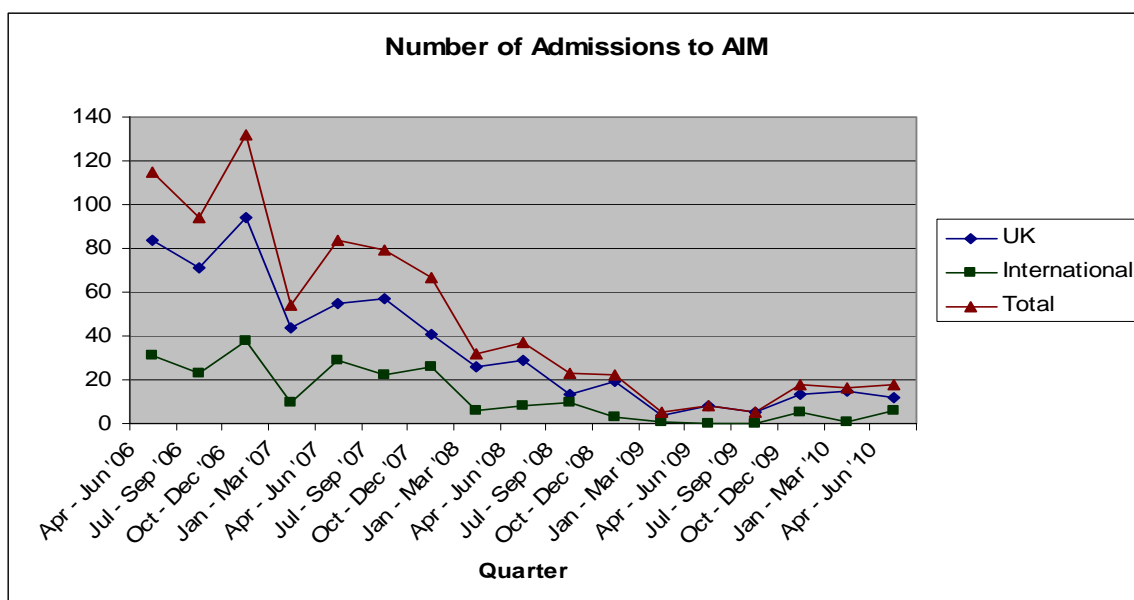
## Emergency Budget Update

On 22 June 2010 the Chancellor delivered the first Budget of the new Coalition Government. It contained details of, amongst other things, the much anticipated increase in capital gains tax rates, together with enhanced entrepreneurs' relief. It also announced a series of annual decreases in the main rate of corporation tax to take effect over the next four years. This, together with the Government's announced aim of simplifying and introducing stability to the UK tax system, should generally be good news for investors in UK companies. See further details at [http://www.olswang.com/pdfs/budget2010\\_gencorp.pdf](http://www.olswang.com/pdfs/budget2010_gencorp.pdf).

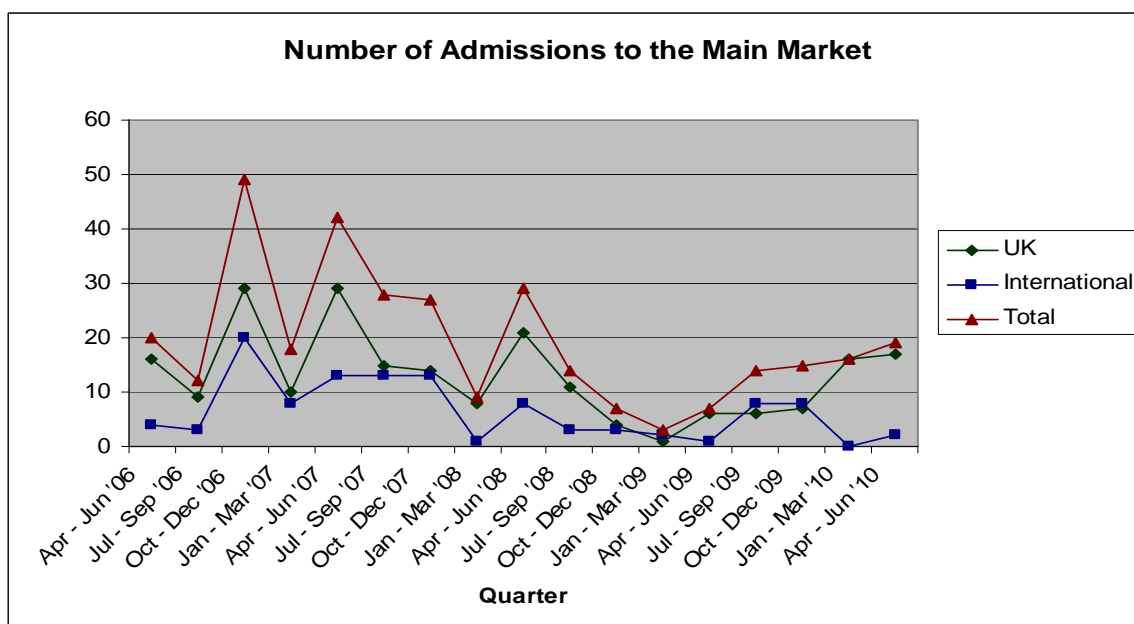
# Market Overview

## Number of Admissions to AIM and the Main Market

On the Main Market at least, domestic IPOs appear to be continuing their resurgence, whilst the number of international companies coming to the Main Market remains exceedingly low. The appetite for IPOs from the larger-cap companies has yet to trickle down to those of small and small caps, although there may be some cold comfort in the fact that of companies coming to the AIM Market, the numbers of domestic and international companies are fairly even.



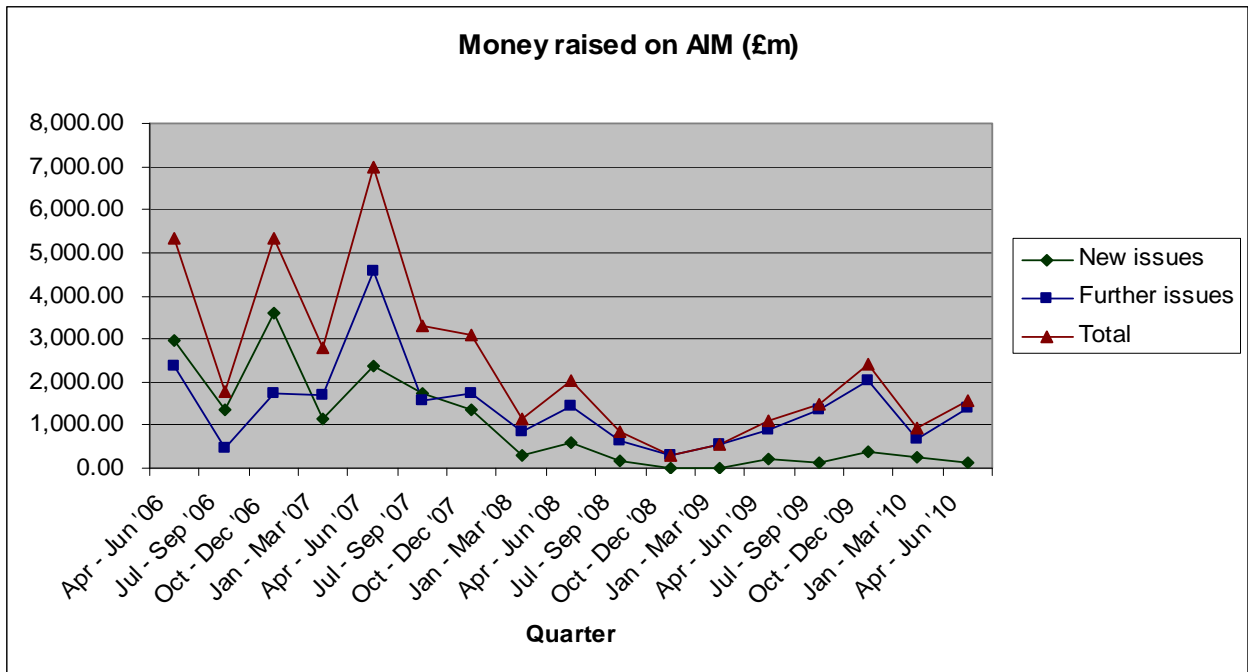
Source of data: London Stock Exchange



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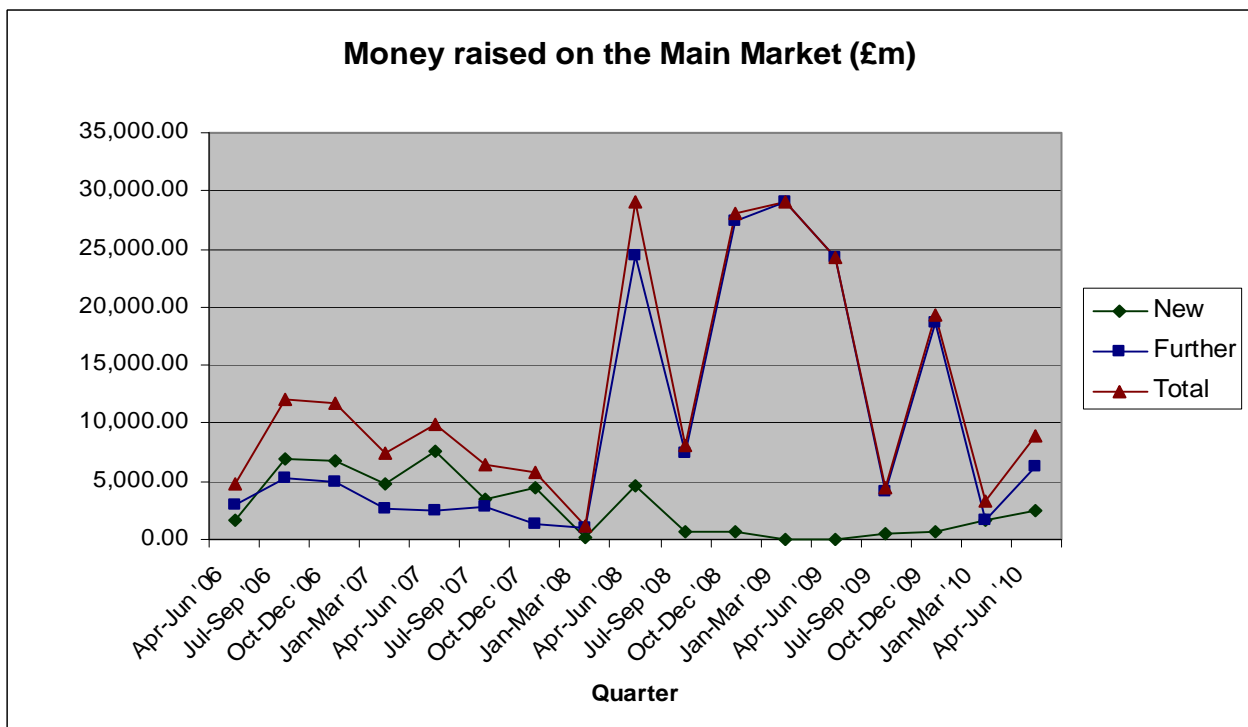
## Fundraising Activity on AIM and the Main Market

On the AIM Market, very little has been raised by way of new issues this quarter but, having seen amounts raised by way of secondary issues fall off during Q1 2010, the numbers have picked up again for Q2 2010.



Source of data: London Stock Exchange

It is a similar picture on the Main Market, albeit that amounts raised by way of new issues have increased steadily quarter-on-quarter over the last four quarters to levels last seen in mid-2008.



Source of data: London Stock Exchange

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