SHEARMAN & STERLING LLP

A QUARTERLY NEWSLETTER FOR CORPORATES

Governance & Securities Law Focus

OCTOBER 2014/EUROPE

In this newsletter, we provide a snapshot of the principal European, US and selected international governance and securities law developments of interest to European corporates.

The previous quarter's Governance & Securities Law Focus newsletter is available here.

Financial regulation developments are available here.

Our Twelfth Annual Surveys of Corporate Governance of the largest US public companies are available here.

In this issue (please click on any title to go directly to the corresponding discussion):

EU DEVELOPMENTS

European Commission Launches Public Consultation on Proposals to Improve EU Merger Control

On 9 July 2014, the European Commission launched a public consultation on proposals to improve merger control at the EU level with the publication of a White Paper ("Towards more effective EU merger control"). A key element of these proposals relates to the acquisition of non-controlling minority shareholdings.

The White Paper follows EU public consultations in 2009 and 2013 on the working of the EU Merger Regulation (Regulation 139/2004) and sets out detailed reform proposals to address a number of issues identified as a result of those consultations. Comments are invited on the White Paper's proposals until 3 October 2014.

The most significant of the White Paper's proposals is for the Commission to be given the power to review certain acquisitions of a non-controlling minority shareholding.

Currently, the EU merger rules do not allow the Commission (unlike the position with regards to certain Member States or jurisdictions such as the US or Japan) to examine the effects of the acquisition of minority stakes which might lead to a reduction of competition in the relevant market. The Commission's proposals are designed to catch only those transactions that raise competition issues and not any minority investment or restructuring transactions under which financial institutions may acquire equity stakes for a limited period of time.

The White Paper advocates a "targeted" transparency system under which an undertaking would be required, based on a self-assessment carried out by the acquirer and the target, to submit information to the Commission if it proposes to acquire a minority shareholding that qualifies as a "competitively significant link". This would be defined as requiring:

- An acquisition in a competitor or vertically-related company (the "competitive link"), where:
- The acquired shareholding is (i) around 20% (however, the White Paper also notes that the OFT has set a threshold at 15% above which it may examine any case), or (ii) between 5% and 20%, but accompanied by additional factors such as rights which give the acquirer a "de-facto" blocking minority, a seat on the board of directors or access to commercially sensitive information of the target.

Following the notification, the Commission would decide whether to initiate an investigation and call for further information. There may also be a waiting period (possibly 15 days) following the submission of information during which the parties will not be able to close their transaction. The Commission could also issue interim measures in the case of a transaction that has been fully or partially implemented before an investigation is started. This new system should fit with the merger control regimes currently in place at the EU and national level.

The White Paper also includes proposals designed to make case referrals between Member States and the Commission more business-friendly and effective and also to exclude certain non-problematic transactions from the Commission's merger review powers, such as the creation of joint ventures that will operate outside the EEA and will have no impact on European markets, or at least to simplify the notification requirements for such cases.

The White Paper is available at:

http://ec.europa.eu/competition/consultations/2014_merger_control/mergers_white_paper_en.pdf.

ESMA Publishes Final Guidelines on Enforcement of Financial Information

On 10 July 2014, the European Securities and Markets Authority ("ESMA") published final guidelines relating to financial information enforcement action undertaken by competent authorities of EU member states under the

Transparency Directive and by competent authorities of non-EU member EEA countries, to the extent that the Transparency Directive applies in those countries. The aim of the guidelines is to ensure convergence in existing enforcement practices.

The key provisions in the guidelines include:

- establishing common EU enforcement priorities and reporting with the aim of promoting transparency to market participants;
- ensuring that issuers from third countries using an equivalent GAAP to IFRS are subject to equivalent systems of enforcement and co-ordination;
- using a risk-based approach in combination with a sampling and/or rotation approach to issuer selection; and
- a description of the types of enforcement actions and when they should be used.

The guidelines will become effective two months after their publication on ESMA's website in all the official languages of the EU.

The full report is available at:

http://www.esma.europa.eu/content/Final-Report-ESMA-Guidelines-enforcement-financial-information.

ESMA Consults on Draft Technical Standards and Advice on the Market Abuse Regulation

On 15 July 2014, ESMA published consultation papers on draft technical standards and draft technical advice under the Market Abuse Regulation.

The draft technical standards paper includes discussion of the following areas:

- buy-back programmes and stabilisation;
- market soundings including proposed standards prior to conducting one, timing, obtaining the agreement of a potential investor, record keeping requirements and cleansing;
- technical means for public disclosure of inside information and any related delays;
- insider lists; and
- the format and template for notification and disclosure of managers' transactions.

The draft technical advice paper covers the following areas:

- specification of the indicators of market manipulation;
- determination of the competent authority for notification of delays in public disclosure of inside information; and
- managers' transactions, including the types of transactions that trigger the duty to notify, and trading during a closed period.

ESMA will consider responses received by 15 October 2014 and hold an open hearing on 8 October 2014.

The draft technical standards paper is available at:

http://www.esma.europa.eu/consultation/Consultation-Paper-Draft-technical-standards-Market-Abuse-Regulation-MAR.

The draft technical advice paper is available at:

http://www.esma.europa.eu/content/Consultation-Paper-Draft-technical-advice-possible-delegated-acts-concerning-Market-Abuse-Re.

European Commission Publishes Q&A on Statutory Audit Measures

On 4 September 2014, the European Commission published a non-binding Q&A on both the implementation of the directive (2006/43/EU) amending the Statutory Audit Directive (2006/43/EC) and the new regulation on specific requirements regarding the statutory audit of public-interest entities (537/2014) (see July 2014 edition of this publication).

The Q&A includes guidance on:

- the date of application of the new regime;
- structure of fees on services other than audit;
- prohibition of non-audit services;
- rotation of audit firms;
- International Standards on Auditing (ISAs);
- the presentation of audit report contents (to be defined by Member States); and
- details regarding any exemptions from the requirement to appoint an audit committee.

The Q&A is available at:

http://ec.europa.eu/internal_market/auditing/docs/reform/140903-questions-answers_en.pdf.

European Commission Publishes Consultation on Existing Framework for Cross-border Mergers

On 8 September 2014, the European Commission published a consultation on the existing framework for cross-border mergers in the Cross-Border Merger Directive (2005/56/EC) and a possible framework for cross-border divisions of companies. Included in the consultation are matters such as:

- the application of the Directive to cross-border mergers featuring companies not formed in the EU or EEA but that have since converted to an EU or EEA form;
- whether cross-border mergers should be possible between different forms of companies (*i.e.*, a private limited company and a public limited company);
- a number of possible harmonisations including:
    - the rights of creditors and minority shareholders in a cross-border merger;
    - company requirements when the creditors' protection period (*i.e.*, when they can exercise their rights) is running;
    - the date from which creditor protection runs;
    - the date determining the beginning and length of the period in which minority shareholders can exercise their rights;
    - the date from which the transactions of cross-border merging companies are treated as being those of the company resulting from the cross-border merger for accounting purposes;
    - the date for the publication of the common draft terms of a cross-border merger if no general meeting is necessary;

- how assets and liabilities should be valued when required for a cross-border merger involving the issue of new shares; and
- whether EU-level harmonisation of legal requirements concerning cross-border divisions would lead to an increase in cross-border activities of companies within the EU.

The consultation is due to close on 1 December 2014.

The paper is available at:

http://ec.europa.eu/internal_market/consultations/2014/cross-border-mergers-divisions/docs/consultation-document_en.pdf.

Council Adopts Directive for Disclosure of Non-financial and Diversity Information

On 29 September 2014, the Council of the European Union adopted a directive for disclosure of non-financial and diversity information by certain large companies. We discussed an earlier version of the proposed directive in the April 2014 edition of this publication. The directive will apply to certain large EU companies – in the case of the "non-financial statement" requirements mentioned below, to "public interest entities" with over 500 employees. "Public interest entities" are companies, such as listed undertakings, banks, insurance companies or undertakings which are of significant public relevance because of the nature of their business, their size or number of their employees.

These companies will be required to draw up, on a yearly basis, a statement relating to environmental, social and employee-related matters, respect for human rights, anticorruption and bribery matters. The statement will have to include a description of the policies, outcomes and the risks related to those matters. Where a company does not pursue policies in relation to these matters, it will have to explain why this is the case.

This non-financial statement will have to be included in the management report that companies are required to produce under the Accounting Directive (2013/34/EU). In addition, certain companies will be required to include in their corporate governance statement a description of their diversity policy as applied in relation to their administrative, management and supervisory bodies and covering aspects such as age, gender, educational and professional background.

The directive, which will come into force 20 days following its publication in the Official Journal, will introduce these new requirements for companies' annual reports by way of amendments to the Accounting Directive. Member states will have two years to incorporate the new provisions into domestic law.

A copy of a consolidated text of the directive as published in Brussels on 25 July 2014 is available at:

http://www.esma.europa.eu/content/Consultation-Paper-Draft-technical-advice-possible-delegated-acts-concerning-Market-Abuse-Re.

A copy of the Council's press release announcing the adoption of the directive is available here:

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/144945.pdf.

GERMAN DEVELOPMENTS

German Federal Court of Justice on Takeover of Postbank by Deutsche Bank

After acceptance of the Deutsche Bank takeover offer for Postbank shares, a former Postbank shareholder sued Deutsche Bank for an additional payment based on the argument that the consideration under the takeover offer was inadequate. In its judgment dated 29 July 2014, the German Federal Court of Justice confirmed that shareholders can

claim additional payment if the offered consideration was inadequate within the meaning of Section 31 para. 1 sentence 1 German Takeover Act (WpÜG).

The court further ruled that if the bidder acquires 30 percent or more of the voting rights and thus the control of the target within the meaning of Section 29 para. 2 German Takeover Act prior to the publication of a takeover offer without making a mandatory or a voluntary takeover offer within the time periods set out in Section 35 para. 2 sentence 1 German Takeover Act, the relevant time periods specified in Sections 4 and 5 of the Offer Ordinance (WpÜG-AngVO) are to be extended accordingly.

An attribution of voting rights pursuant to Section 30 para. 1 sentence 1 no. 2 German Takeover Act requires that the bidder bears the material risks and rewards of the relevant shares. Furthermore, the bidder must have the opportunity to influence the exercise of voting rights of the respective share owners. An attribution of voting rights pursuant to Section 30 para. 1 sentence 1 no. 5 German Takeover Act requires that the bidder can acquire ownership of the relevant shares by unilateral declaration without involvement of the contractor or a third party; a contractual claim on transfer of shares is not sufficient.

Legal Quotas for Women on Listed Companies' Supervisory Boards

The German Federal Government announced a ministerial draft bill for legal quotas for women on listed companies' supervisory boards. According to the draft bill, German companies shall be required to allocate 30 percent of their supervisory board seats to women as from January 2016. The new quota shall apply to all listed companies with a co-determined supervisory board which will affect about 120 companies. Companies that do not meet the quota shall be required to leave the respective seats vacant. However, this will not apply to existing mandates as they can be executed up to the regular end of the term.

Furthermore, as from 30 June 2015, listed companies and co-determined companies shall define binding quota targets for their supervisory boards, management boards as well as for their higher management levels. Such quota targets shall not fall below the already achieved share of women and shall not fall below 30 percent if this has been achieved already. These objectives shall be achieved by the deadlines set by the companies and will apply to more than 3,500 companies.

Requirement of Approving Resolution of General Meeting for Taking on a Fine by the Company (Section 93 para. 4 German Stock Corporation Act (AktG))

Pursuant to German Stock Corporation law, the company may only waive or settle claims against its managing board members, where the general meeting has approved such waiver or settlement. The approving resolution may not be resolved earlier than three years following incurrence of the claim and must not be opposed by a minority of shareholders disposing of at least ten percent of the share capital of the company. Literature was controversial whether the requirement of a resolution of the general meeting also applies where the company undertakes to indemnify a member of the management board for fines that result from offenses which at the same time constitute a breach of duties vis-à-vis the company.

The German Federal Court of Justice ruled that Section 93 para. 4 German Stock Corporation Act applies *mutatis mutandis* to the takeover of fines by the company. Hence, (1) the fine may not be paid unless it has been approved by the general meeting, (2) the approval of the general meeting may not be granted earlier than three years after the alleged offense, and (3) the approving resolution has not been challenged by shareholders owning at least ten percent of the share capital of the company.

The judgment only affects German stock corporations. The shareholders of a German Limited Liability Company may grant relief and thereby waive claims or take over a fine against its managing directors without the aforementioned restrictions.

UK DEVELOPMENTS

FRC issues a new edition of the UK Corporate Governance Code

On 17 September 2014, following the various consultations earlier in the year (see July 2014 issue of this publication), the Financial Reporting Council ("FRC") issued a new edition of the Code which will apply to accounting periods beginning on/after 1 October 2014.

The key changes to the Code include:

- Going concern, risk management and internal control
    - Companies should state whether they consider it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to their ability to continue to do so;
    - Companies should robustly assess their principal risks and explain how they are being managed or mitigated;
    - Companies should state whether they believe they will be able to continue in operation and meet their liabilities taking account of their current position and principal risks, and specify the period covered by this statement and why they consider it appropriate. It is expected that the period assessed will be significantly longer than 12 months;
    - Companies should monitor their risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report; and
    - Companies can choose where to put the risk and viability disclosures. If placed in the Strategic Report, directors will be covered by the "safe harbour" provisions under s. 463 of the Companies Act 2006 (essentially, liable only for fraudulent or reckless misstatements or omissions).
- Remuneration
    - Greater emphasis should be placed on ensuring that remuneration policies are designed with the long-term success of the company in mind, and that the lead responsibility for doing so rests with the remuneration committee;
    - The statement in Principle D.1 that remuneration levels should be sufficient to attract, retain and motivate directors has been removed; and
    - Companies should put in place arrangements that will enable them to recover or withhold variable pay when appropriate to do so, and should consider appropriate vesting and holding periods for deferred remuneration.
- Shareholder engagement
    - Companies should explain when publishing general meeting results how they intend to engage with shareholders when a significant percentage of them have voted against any resolution.
- Other issues: the FRC has also highlighted (in the preface to the new Code) the importance of

- Board diversity to help avoid "groupthink", not limited to gender or race but also including differences of approach and experience – the FRC is considering this issue as part of a review of board succession planning and will consider the need to consult on this for the next update to the Code in 2016; and
- The board's role in establishing the 'tone from the top' of the company in terms of its culture and values. The directors should lead by example in order to encourage good behaviours throughout the organisation.

The Code is available here:

https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx.

ABI publishes guidance on members' views on certain aspects of equity capital transactions

On 27 June 2014, the Association of British Insurers ("ABI") published guidance on its members' views on certain aspects of equity capital market transactions – IPOs, secondary offerings and corporate governance issues during corporate transactions. The guidelines build on key recommendations contained in two reports of the ABI published in July 2013 – "Encouraging Equity Investment" and "Improving Corporate Governance during corporate transactions".

In relation to IPOs, the guidelines cover the following primary aspects:

- Syndicate sizes: as a rule of thumb, no more than three book runners should be appointed for transactions above £250m (excluding any over-allotment option) and below that size there should be no more than two book runners;
- Fees: the guidelines reflect a continuing concern about the overall level of fees;
- Prospectuses: the guidelines encourage everyone involved in the IPO to work with the UKLA in reducing the amount of generic information contained in prospectuses; and
- Sponsor regimes: the guidelines call for more clarity on the role of the sponsor in the IPO process.

In relation to secondary offerings, the guidelines' chief concern is with the level of underwriting fees and therefore:

- Issuers are encouraged to use deep discounts in rights issues to reduce underwriting fees;
- There should be disaggregated disclosure of fees as a matter of practice and tendering for both primary and sub-underwriting should only be pursued if unbundling of fees would not lead to a lower overall level of fees;
- Standard sub-underwriting agreements should be developed to help make the process more efficient; and
- Efforts should be made to shorten the pre-emptive timetable for offerings and the UKLA is encouraged to develop a fast-track review process for time critical offerings.

In relation to corporate governance in corporate transactions, the focus of the guidelines is on ensuring that non-executive directors ("NEDs") can maintain and assert independence during corporate transactions, recognising that effective independence is as much concerned with the director's ability to act independently, for example, through the timely supply of appropriate information, as it is with the director's lack of other connections with the company.

The guidelines are available here:

https://www.ivis.co.uk/media/9533/Transaction-Guidelines-June-2014-.pdf.

IMA publishes guidance on share capital management issues

On 28 July 2014, the Investment Management Association ("IMA") (which is to be renamed The Investment Association in January 2015, following IMA's merger with the ABI's Investment Affairs on 30 June 2014) published guidance on share capital management issues.

Following the above merger, the IMA has assumed investor responsibility for similar guidance previously issued by the ABI. The guidance applies to Premium listed companies, but companies traded on AIM or the High Growth Segment of the LSE's Main Market are also encouraged to follow it.

The guidance includes information on:

- Directors' powers to allot shares: the new guidance largely follows the previous ABI guidance, for example, in stating that an authority to allot up to two-thirds of the existing issued share capital (excluding treasury shares) will be regarded as routine by its members provided that any amount in excess of the one-third is only applied for fully pre-emptive issues. The authority should be approved by ordinary resolution at each AGM and treasury shares;
- Share buy-backs: the guidance generally follows the previous ABI guidance, stating that dividends are the preferred method for returning surplus funds to shareholders but that share buybacks are acceptable where a company decides this is in the best interest of its shareholders. Annually renewable special resolutions (rather than an ordinary resolution as now permitted by the Companies Act 2006) should be sought and authorities of up to 10% of the existing issued share capital will generally be acceptable. In addition, no more than 10% of a company's shares should be held in treasury and off-market share buybacks are discouraged; and
- Scrip dividends: because of a concern about the dilutive effects of scrip dividend issues, IMA members prefer the use of dividend reinvestment plans (*i.e.*, the purchase of shares in the market) to funding scrip dividends. Authorities for a scrip dividend plan using newly issued shares should be renewed at least every three years and any arrangements to cancel a scrip dividend offer must be supported by a clear rationale and explanation to shareholders.

The guidance is available here:

https://www.ivis.co.uk/media/9665/Share-Capital-Management-Guidelines-July-2014-.pdf.

FCA publishes consultation paper on competition in wholesale securities and investment markets

On 9 July 2014, the Financial Conduct Authority ("FCA") published a consultation paper on competition in wholesale securities and investment markets (including corporate banking), seeking views on areas in the wholesale sector where competition is not working effectively.

To keep the scope of the review manageable, it will not include certain areas of financial services such as payment systems, credit rating agencies and wholesale insurance; nor will it cover the activities – such as trading practices and benchmarking activities – that fall within the Bank of England/HM Treasury's Fair and Effective Financial Markets Review (see July 2014 issue of this publication). Views are sought by 9 October 2014.

The review covers competition issues in the following areas:

- Financial (*i.e.*, equities, bonds and various derivatives) markets (including access) and market infrastructure;
- Investment banking – the review notes the OFT's 2011 market study on equity underwriting of secondary offerings and requirements for firms engaged in underwriting that MiFID II will introduce and asks whether competition in equity underwriting (and in particular debt issues) should be revisited;

- Asset management – *e.g.*, whether incentives exist for asset managers to negotiate the best deal for investors in relation to a range of services (*e.g.*, governance and dealing and research) utilised by them in their asset management role; and
- Corporate banking – *e.g.*, whether there are competitive or regulatory factors impacting new entry to this market.

The consultation paper is available here:

http://www.fca.org.uk/static/documents/market-studies/wholesale-sector-competition-review-call-for-inputs.pdf.

FCA publishes eighth bulletin for primary market participants

On 6 August 2014, the FCA published its eighth bulletin for primary market participants, summarising feedback received on proposed new and amended technical or procedural notes included in the UKLA's Knowledge Base and consulting on further new and amended notes in the Knowledge Base.

The UKLA's Knowledge Base contains guidance – covering both procedural and technical aspects – on various aspects of the FCA's Listing, Prospectus and Disclosure and Transparency Rules. Following earlier consultations on certain new additional notes and amendments to existing notes, the UKLA Knowledge Base has now been updated with three new finalised notes and revisions to four existing notes.

The new guidance notes: two of these cover procedural and technical aspects of the FCA's new powers to supervise and discipline sponsors (of Premium listed companies) and the third concerns Listing Principle 2 – dealing with the FCA in an open and co-operative manner.

The revised guidance notes: three of these relate to sponsors (ongoing requirements during re-organisations, the impact of uncertain market conditions on their business systems and processes and the adequacy of their resourcing) and the fourth concerns reverse takeovers.

The FCA is also consulting on six new guidance notes, amendments to nine existing notes and the deletion of one note. Comments on the proposed new and amended notes are requested by 1 October 2014.

The proposed new notes cover a number of matters, including:

- Cancellation of listing/transfer between listing categories – waiver of the 20 business day notice period – clarification of the approach of the FCA to such waiver requests (which is that it is reluctant to approve them);
- Share buybacks involving novel/complex structures – the FCA confirms that where the structure replicates the substance of a share buyback, it will apply the relevant Listing Rules to the transaction in a "substance over form" manner;
- Discounted share issues – disclosures required in circulars – this note will make it clear that the circular to shareholders seeking approval for a discount of greater than 10% must set out the rationale for the discount and not simply a resolution approving the relevant discount;
- Disclosure of lock-up agreements – greater disclosure will be required of the circumstances when disposals may be permitted prior to expiry of the lock-up period; and
- Pro-forma financial information.

The bulletin is available here:

http://www.fca.org.uk/static/documents/ukla/primary-market-bulletin-8.pdf.

FCA publishes quarterly consultation on Listing Rules, Prospectus Rules and Disclosure and Transparency Rules

On 5 September 2014, the FCA published its quarterly consultation paper (CP 14/18). It contains proposals for minor changes to the Listing Rules ("LRs"), Prospectus Rules ("PRs") and Disclosure and Transparency Rules ("DTRs").

Included are proposals to:

- narrow the scope of circulars requiring prior approval from the FCA under LR 13;
- enable the FCA to formally review and approve material changes to the investment policy of closed-ended investment funds on a standalone basis in the LRs;
- amend the scope in the LR of the insignificant subsidiary exemption on related party transactions to make it available only where the subsidiary in question has been consolidated in the premium listed company's group accounts for over one full financial year. The exemption applies to an undertaking that contributed less than 10% of the profits and represented less than 10% of the assets of the listed company in each of the previous three years; and
- clarify the accounting policies that can be used in profit forecasts or estimates in Class 1 Circulars under the LR.

The deadline for responses is 5 November 2014.

FCA publishes consultation paper on IMSs

On 23 July 2014, the FCA published a consultation paper on the proposed removal of the requirement under the Disclosure and Transparency Rules for issuers to publish interim management statements ("IMSs") (see July 2014 issue of this publication).

Following the amendment of the Transparency Directive IMSs are no longer mandatory and so HM Treasury has asked the FCA to remove the IMSs from the DTRs as soon as is practical. Responses to the consultation have been called for by 4 September 2014.

The removal of the IMS requirement reflects a widely-voiced concern that IMSs encourage too much of a short-term focus by issuers and investors.

The consultation paper is available here:

http://www.fca.org.uk/static/documents/consultation-papers/cp14-12.pdf.

LSE publishes notice regarding implementation of T+2 standard settlement period and subsequent New Dividend Procedure Timetable

On 5 September 2014, the London Stock Exchange ("LSE") published a market notice reminding member firms of the reduction in standard settlement cycle from T+3 to T+2 (*i.e.*, trade date plus two business days) with effect from Monday 6 October 2014. As a result, the ex-dividend date will change from Wednesdays to Thursdays. Standard settlement will remain T+1 for gilts and rights issue executions for securities that would otherwise settle on T+2 or above.

In light of the changes, the LSE subsequently published a revised Dividend Procedure Timetable.

The notice is available here:

http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/change-and-updates/stock-exchange-notices/2014/n0714.pdf.

The revised 2014 Dividend Procedure Timetable is available here:

http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/dividend-procedures-2014.pdf.

The 2015 Dividend Procedure Timetable is available here:

http://www.londonstockexchange.com/companies-and-advisors/main-market/advisors/dividendproceduretimetable2015.pdf.

Consultation on miscellaneous amendments to the Takeover Code

On 16 July 2014, the Takeover Panel's Code Committee issued a consultation paper with regard to a number of largely technical or minor changes to the Code.

The amendments cover areas such as the deadline by which a competing bidder should clarify its position, the resolution of a competitive situation remaining on Day 46, the disclosure of irrevocable commitments, letters of intent and interests in securities and the rules on "no increase" and "no extension" statements made by bidders. The Code Committee has called for responses to the consultation by 12 September 2014.

The consultation paper is available here:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP2014-1.pdf.

Takeover Panel publishes consultation paper on post-offer commitments and intentions

On 15 September 2014, the Takeover Panel published a public consultation paper on post-offer commitments and intentions in light of the public debate about the value and regulation of "bidder commitments" that Pfizer's ultimately unsuccessful would-be bid for AstraZeneca generated. The paper proposes significant amendments to the Code to distinguish between 'post-offer intention statements' ("POISs") and 'post-offer undertakings' ("POUs"). Both POISs and POUs will be defined as statements made in connection with a bid as to action that a party intends or undertakes, respectively, to take (or not take) for a specified period of time after the end of the offer period.

The key changes relate to POUs and involve:

- Panel consultation before any POU is announced;
- Prescribed content for POUs: they must be identified as such, specify a time limit, and prominently state any qualifications or conditions to which they are subject;
- Requirements for conditions: they must be specific and precise, readily understandable, capable of objective assessment and not depend on subjective judgments of the party to the offer or its directors;
- A requirement for a party to consult with and obtain the Panel's consent and then make a prescribed announcement about the course of action it proposes to take before relying on an 'excusatory' condition;
- Giving the Panel power to require written reports about action that a party has taken (or not) in connection with the POU at such intervals as it may determine. These reports must receive board approval; and
- Giving the Panel power to require an "independent" supervisor to monitor compliance with the POU and submit periodic written reports in relation to such compliance to the Panel.

A new rule for POISs will require POISs to be:

- An accurate statement of the party's intention at the time it is made; and
- Made on reasonable grounds.

As for POUs, if a party making a POIS decides to take (or not take) a course of action different from that specified in the POIS during the period of 12 months from the end of the offer period (or such other period of time as was specified in the POIS), it must consult with the Panel and, unless the Panel allows otherwise, make an announcement about this.

The Panel is not proposing any change to its disciplinary or other powers to deal with any breach of a POIS or POU.

Responses to the consultation are requested by Friday 24 October 2014.

The consultation paper is available here:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201402.pdf.

BIS consultation on UK implementation of Accounting Directive

On 1 September 2014, the Department for Business, Innovation & Skills ("BIS") published a consultation paper on the UK's proposals for the implementation of the EU Accounting Directive (2013/34/EU). BIS is seeking views on the discretionary areas of the Directive including:

- whether the appropriate size thresholds for 'small companies' should be amended and how these thresholds should be calculated;
- the possible introduction of a new small company regime for accounting purposes;
- whether to exclude only companies with securities admitted to trading on a regulated market (as opposed to all public companies) from small, medium-sized and dormant company regimes;
- whether to abolish the requirements for micro-entities to produce directors' reports;
- several audit considerations including how to amend the thresholds for audit exemption pursuant to the aforementioned changes to accounting thresholds and whether to amend the rules for the reporting of fees paid for non-audit services; and
- various accounting issues regarding participating interests and subsidiaries.

The consultation will close on 24 October 2014.

The paper is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/350864/bis-14-1025-implemention-of-eu-accounting-directive-chapters-1-to-9-consultation.pdf.

FRC consultation on UK implementation of Accounting Directive

On 1 September 2014, the FRC published a consultation paper regarding proposed changes to financial reporting standards arising from the proposed implementation of the Accounting Directive (2013/34/EU) in the UK. The proposals covered areas such as the development of a new financial reporting standard for micro-entities, the withdrawal of a specific financial reporting standard for small entities, and proposed amendments to FRS 101 (Reduced Disclosure Framework) in response to changes to company law.

The consultation closes on 30 November 2014.

The paper is available at:

https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Consultation-Document-Accounting-standards-for-sma-File.pdf.

CMA implements Order on audit reforms

On 26 September 2014, the Competition and Markets Authority ("CMA") published a notice confirming the making of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014. The order implements the mandatory tendering of audit services every ten years for FTSE 350 companies and gives an increased role to audit committees. The changes were deemed necessary by the Competition Commission in light of the adverse effects on competition it identified in its investigation into the provision of statutory audit services to large companies. The established 'Big Four' firms dominate this particular market.

The order will come into force on 1 January 2015. It will apply to Financial Years beginning on or after this date.

The final order is available at:

https://assets.digital.cabinet-office.gov.uk/media/54252eae40f0b61342000bb4/The_Order.pdf.

Guidelines Monitoring Group publishes feedback and final advice following consultation on amendments to the Walker Guidelines

On 31 July 2014, the Guidelines Monitoring Group ("GMG") published its feedback and final advice following its consultation on amendments to the Walker Guidelines, recommending certain enhanced disclosures by portfolio companies.

Guidelines for enhanced disclosure by portfolio companies and private equity firms were first developed by Sir David Walker in 2007 and are subject to regular monitoring and review by GMG set up by the British Private Equity & Venture Capital Association. In May 2014, the GMG issued a consultation paper on proposed amendments to the Walker Guidelines to take account of the new requirement under the Companies Act 2006 for directors to prepare a strategic report in place of a business review in the directors' report (see July 2014 issue of this publication). It took the view that no changes to the Guidelines were required to take account of the transparency requirements of the Alternative Investment Fund Managers Directive ("AIFMD").

The revised Guidelines now require UK portfolio companies to include in their annual report a review which meets the requirements of the strategic report required under the Companies Act for quoted companies (other than the disclosures required with respect to greenhouse gas emissions which companies may decide only to include if they consider this to be a significant area for them).

In addition, portfolio companies will also now be required to include in their annual report a specific statement of conformity with the Guidelines. The GMG has also published an updated version of its guidelines on good practice reporting by portfolio companies to illustrate how the revised Guidelines should be implemented.

The revised Guidelines will apply to reporting for accounting periods ending on or after 30 September 2014.

The feedback document is available here:

http://walker-gmg.co.uk/sites/10051/files/gmg_guidelines_feedback_statement-jul14_final.pdf.

EHRC publishes guidance on equality law framework

On 23 July 2014, the Equality and Human Rights Commission ("EHRC") published guidance on the equality law framework within which appointments to boards should be made.

The Guidance is intended to help companies, nomination committees, search firms and recruitment agencies understand what steps are permitted in order to increase the representation of women at board level.

It confirms that appointments to boards must be made on merit, evidenced through fair and transparent criteria and procedures and that, in general, selecting a person for a role because of their gender will constitute unlawful sex discrimination and that positive discrimination in making an appointment or a promotion is not lawful. However, companies may address any disadvantage or disproportionately low participation by a gender on their boards by enabling or encouraging applications from the relevant gender, provided selection is made on merit. According to the guidance, selecting a candidate for appointment to a board on the basis of gender is only lawful when the individual is objectively assessed as being equally qualified as a candidate of the opposite gender, when the individual's gender is under-represented on the board and when certain other conditions are satisfied.

The guidance is available here:

http://www.equalityhumanrights.com/sites/default/files/publication_pdf/Appointments%20to%20Boards%20and%20Equality%20Law%2022-07-14%20final.pdf.

ICC publishes guidance for companies on adopting policies on corporate gifts and hospitality

On 26 June 2014, the International Chamber of Commerce ("ICC") published guidelines for companies concerning the adoption of policies regarding corporate gifts and hospitality. The guidelines take into consideration the most recent international, regional and national rules as well as commercial best practice and guidance.

The guidelines recommend establishing a policy which provides that gifts and hospitality:

- comply with applicable law and international instruments and are appropriate considering the culture and standard of living in the country and region where they are given or received;
- are reasonable, proportionate and business-related;
- are made transparently and so as not to affect the recipient's performance of their duties;
- are neither offered nor received too frequently;
- are not offered with the sole purpose of obtaining or retaining business; and
- are fairly and accurately recorded.

The guidelines are available here:

http://www.iccwbo.org/Data/Policies/2014/ICC-Guidelines-on-Gifts-and-Hospitality/.

US DEVELOPMENTS

SEC Developments

SEC Staff Issues Guidance on Verifying Accredited Investor Status

Last year, the US Securities and Exchange Commission ("SEC") adopted rule changes permitting general solicitation and general advertising in private placements under Rule 506 of Regulation D under the US Securities Act of 1933, as amended (the "Securities Act"), and securities offerings under Rule 144A under the Securities Act.

The rule changes added a new Rule 506(c) that permits the use of general solicitation and general advertising under Rule 506 as long as the issuer takes "reasonable steps" to verify that all purchases are made by accredited investors or by purchasers reasonably believed to be accredited investors at the time of sale. Although Rule 506(c) does not define "reasonable steps", it adopts a principles-based approach as to what steps are "reasonable" and specifies methods an issuer may use as safe harbour alternatives.

One of the non-exclusive safe harbour methods of verifying that a purchaser is an accredited investor is by reviewing any Internal Revenue Service ("IRS") form that reports the purchaser's income for the two most recent years. The SEC guidance states that this verification safe harbour cannot be relied upon if the IRS form for the recently completed year is not yet available. However, in that case the issuer may rely on the principles-based verification method by reviewing the IRS forms that report income for the two years preceding the recently completed year and obtaining written representations from the purchaser regarding the purchaser's income. The guidance also states that foreign tax forms cannot be used to satisfy the safe harbour, but may be used as part of the principles-based approach if the foreign jurisdiction imposes penalties for falsely reporting information comparable to the United States.

Under another non-exclusive safe harbour, an issuer can verify that a purchaser is an accredited investor on the basis of net worth by reviewing certain documentation of the purchaser's assets and liabilities dated within the prior three months. The SEC guidance states that the safe harbour would not be available where an issuer reviews an annual tax assessment that is dated more than three months. However, such a tax assessment may be relevant to the principles-based analysis. The guidance also clarifies that, while an issuer can rely on this safe harbour by reviewing a consumer report from one of the US nationwide consumer reporting agencies, a consumer report from a non-US consumer reporting agency would not satisfy the safe harbour.

The SEC staff also issued guidance on the definition of "accredited investor". The guidance clarifies that, for purposes of the income test, where a purchaser's annual income is not reported in US dollars, the issuer may use either the exchange rate that is in effect on the last day of the year for which income is being determined or the average exchange rate for that year. Under the net worth test, assets in an account or property held jointly with a person who is not the purchaser's spouse may be included in the calculation for the net worth test, but only to the extent of his or her percentage ownership of the account or property.

The compliance and disclosure interpretations are available at:

http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#260.35.

http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#255.48.

Our related client publication on the rule changes allowing general solicitation in private placements under Rule 506 of Regulation D is available at:

http://www.shearman.com/en/newsinsights/publications/2013/07/sec-adopts-rule-changes-allowing-general-solicit__.

SEC Charges Ernst & Young with Violating Auditor Independence Rules in Lobbying Activities

On 14 July 2014, the SEC charged Ernst & Young LLP with violations of auditor independence rules that require audit firms to maintain their objectivity and impartiality with clients. Ernst & Young violated the SEC's auditor independence rules by lobbying congressional staff on behalf of two audit clients, which put Ernst & Young in the position of acting as an advocate for those clients. Because Ernst & Young provided legislative advisory services to its audit clients, it incorrectly stated in its audit reports that its audits were conducted in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") and SEC regulations, both of which require an auditor to be independent from its client.

Ernst & Young agreed to pay more than $4 million to settle the charges.

The SEC's order serves as a reminder to public companies to maintain policies and procedures to ensure that any non-audit services proposed to be performed by the company's outside auditors do not impair the auditor's independence.

The related SEC press release is available at:

http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542298984.

SEC Adopts Credit Rating Agency Reform Rules

On 27 August 2014, the SEC adopted new rules for credit rating agencies implementing 14 rulemaking requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new rules are designed to enhance governance, protect against conflicts of interest and increase transparency. The new rules apply to credit rating agencies registered with the SEC as "nationally recognized statistical rating organizations" ("NRSROs").

Among other things, the rules:

- require an NRSRO to establish and document an effective internal control structure to govern the implementation of and adherence to policies for determining credit ratings;
- enacted an "absolute prohibition" against persons in NRSROs that participate in sales and marketing activities, or are influenced by sales and marketing considerations, from participating in, determining or monitoring credit ratings or developing or approving rating procedures; and
- require an NRSRO to conduct what are called "look-back" reviews in any instance where the prospect of future employment by an issuer or underwriter may have influenced a credit analyst in determining a credit rating. If an NRSRO determines that a conflict of interest exists and the employee was influenced in his or her determination of a credit rating, the NRSRO must promptly revise the credit rating in accordance with rules prescribed by the SEC.

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2014/09/sec-adopts-credit-rating-agency-reform-rules.

SEC Compliance Manuals for NYSE- and NASDAQ-Listed Non-US Companies

In September 2014, we published updates to our SEC compliance manuals for non-US companies listed on the NYSE and NASDAQ.

Our two compliance manuals—one for NYSE-listed non-US companies and one for NASDAQ-listed non-US companies—summarise the primary reporting obligations and other duties imposed by the Securities Act, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002 and other US securities laws upon a non-US company as an

SEC registrant and upon its officers, directors and certain of its shareholders. They also summarise the reporting obligations and other duties that are imposed as a result of the company's listing on the New York Stock Exchange or NASDAQ Stock Market. In addition, these manuals provide guidance on recommended best practice for compliance with the various US securities and NYSE or NASDAQ regulations, as applicable, and links to relevant regulatory compliance tools.

The compliance manuals are available at:

http://www.shearman.com/en/newsinsights/publications/2014/09/sec-compliance-manuals-for-nyse-and-nasdaq-liste__.

Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act

In July 2014, we published our bi-annual "Recent Trends and Patterns in Enforcement of the Foreign Corrupt Practices Act ("FCPA") report, part of our FCPA Digest, which together provide an insightful analysis of recent enforcement trends and patterns in the US, the UK, and elsewhere as well as helpful guidance on emerging best practices in FCPA and global anti-corruption compliance programs.

Thus far, although the number of enforcement actions has been lower than we've seen in prior years, 2014 has seen a trio of significant corporate prosecutions and several new individual cases. Among the highlights from 2014 are:

- average corporate fines and penalties of $193.3 million, significantly above the average of previous years due to three enforcement actions including large sanctions;
- the US Department of Justice's use of plea agreements and the SEC's use of administrative proceedings has increased over the use of deferred prosecution and non-prosecution agreements;
- the Eleventh Circuit issued its opinion in United States v. Esquenazi, largely supporting the government's view regarding the definition of "instrumentality" under the FCPA;
- recent paper victories by the SEC could be perceived as setbacks in the SEC's actions against individual defendants; and
- the SEC has continued its practice of pursuing its theory of strict liability against a parent corporation for the acts of its corporate subsidiaries.

Our July 2014 report is available at:

http://www.shearman.com/en/newsinsights/publications/2014/07/recent-trends-and-patterns-fcpa-digest.

Noteworthy US Securities Law Litigation

Parkcentral Global Hub Ltd. v. Porsche Automobil Holdings SE: Morrison's Domestic Transaction Requirement is a Necessary, But Not Sufficient, Element to Jurisdiction Over Securities Transactions

On 15 August 2014, the federal appellate court in New York considered whether the U.S. Supreme Court's landmark decision in *Morrison v. National Australia Bank* precluding extraterritorial applications of Section 10(b) of the Securities and Exchange Act applied to securities-based swap agreements referencing foreign securities. In *Morrison*, the Supreme Court ruled that Section 10(b) does not apply extraterritorially to so-called "foreign-cubed" claims—*i.e.*, claims where "(1) *foreign* plaintiffs [are] suing (2) a *foreign* issuer in an American court for violations of American securities laws based on securities transactions in (3) *foreign* countries." The court in *Parkcentral* held that *Morrison*

precluded the claims at issue based on an application of *Morrison's* underlying rationale to the case-specific facts at hand.

Rather than transacting directly in Volkswagen AG ("VW") shares, the plaintiffs in *Parkcentral* engaged in synthetic transactions tied to the value of VW shares that were the economic equivalent of short sales. Plaintiffs, who claimed that their swap agreements took place to varying degrees in New York, brought claims under Section 10(b) alleging that Porsche misleadingly denied its intent to acquire VW while secretly amassing large positions in VW shares and then announced its intent to acquire VW.

The court held that while *Morrison* "unmistakably made a domestic securities transaction (or transaction in a domestically listed security) necessary to a [Section 10(b) claim], such a transaction is not alone sufficient to state a properly domestic claim." Even though a literal reading of *Morrison* might lead to the conclusion that a transaction occurring in the U.S. is sufficient to be subject to Section 10(b) liability, the court here explained that such a reading would go against the Supreme Court's intent in *Morrison* to avoid conflicts between U.S. and foreign securities laws. Because the transaction at issue involved "statements made primarily in Germany with respect to stock in a German company traded only on exchanges in Europe," and the plaintiffs engaged in synthetic transactions that did not involve the foreign-issuer defendants, the court held that plaintiffs should not be allowed to pursue their claims against defendants in U.S. courts.

In holding that Section 10(b) did not apply to the claims at issue here, the court emphasized that in a world of complicated and novel financial transactions, *Morrison* cannot be applied mechanically. Rather, the nature of the specific transaction at issue must be assessed in light of the underlying reasons for the *Morrison* decision. While the predominantly foreign nature of the transaction at issue here motivated the court's decision, it made clear that a future case dealing with a different set of facts will need to be analyzed anew to determine how the transaction should be characterized. *Parkcentral* thus establishes that, even where a transaction takes place in the U.S., the federal appellate court in New York will look at the specific nature of the transaction to determine whether *Morrison's* bar on the extraterritorial application of Section 10(b) applies.

Loos v. Immersion Corporation: Announcement of an Internal Investigation Does Not, Without More, Establish Loss Causation

On 7 August 2014, the federal appellate court in California affirmed the lower court's dismissal of securities fraud claims against an electronics company related to its declining earnings, internal investigation, and subsequent earnings restatements. The court in *Loos v. Immersion Corporation* ruled that "the announcement of an investigation, standing alone, is insufficient to establish loss causation."

The plaintiff in *Loos* alleged claims under Section 10(b) of the Securities and Exchange Act of 1934, as well as other claims that were dependent on that underlying cause of action. The court explained that one of the elements a plaintiff must show under Section 10(b) is "loss causation," which at the pleading stage requires a plaintiff to "allege that the decline in the defendant's stock price was proximately caused by a revelation of fraudulent activity rather than by [...] other unrelated factors."

The court in *Loos* held that while the announcement of an investigation shows the risk of potential future disclosures of fraudulent conduct, the investigation itself does not demonstrate fraud because "the market cannot possibly know what the investigation will ultimately reveal." In addition, the court rejected the plaintiff's claims related to declining earnings because those disclosures revealed nothing more than that the company experienced disappointing results. And the court rejected claims related to the company's earnings restatements after the investigation was complete because the plaintiff failed to tie those events to an effect on the company's stock price.

At least within the jurisdiction of the *Loos* court, the announcement of an internal investigation is now plainly not sufficient by itself for a plaintiff to establish loss causation in a securities fraud claim. The court, however, focused on the impact of an investigation standing alone. This opinion leaves open the question of whether the announcement of an internal investigation will suffice to plead loss causation when other factors are also present.

Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW: Garner Doctrine Allows for Limited Discovery of Privileged Materials

On 23 July 2014, the Delaware Supreme Court affirmed a lower court ruling that Wal-Mart must provide certain documents sought by the plaintiff pursuant to a provision of Delaware law allowing for shareholders to inspect the books and records of a corporation. The court further held that the exception to the attorney-client privilege that a federal appellate court set out in 1970 in *Garner v. Wolfinbarger* is the law in Delaware and required production of certain privileged communications.

In 2012, after the New York Times published a story claiming that Wal-Mart executives knew about allegations of bribery in the company's Mexican subsidiary, the plaintiff filed an action seeking Wal-Mart's documents related to the bribery allegations and the related investigation. The court affirmed the lower court's ruling that certain documents related to the company's internal policies and investigation of the bribery allegations were "necessary and essential" (as required under Delaware law) to the plaintiff's purpose of investigating those issues and the plaintiff's potential claims related to them. The court then held for the first time that the *Garner* doctrine applies under Delaware law in both plenary proceedings and efforts by shareholders to inspect a corporation's books and records.

The court explained that, under *Garner*, a stockholder may "invade the corporation's attorney-client privilege in order to prove fiduciary breaches by those in control of the corporation upon showing good cause." Even though this "fiduciary exception" is narrow and very difficult to satisfy, *Garner*'s "good cause" factors were met because the plaintiff had a colorable claim, the documents were not otherwise available, the plaintiff was not on a fishing expedition, the documents concerned Wal-Mart's actions at the time of the conduct at issue, the plaintiff was a legitimate stockholder, no trade secrets were at issue, and the allegations implicated potential criminal activity. In addition, the company had to produce work product because the *Garner* "good cause" factors were also relevant to whether there was a "substantial need" under the work product doctrine.

While the express application of the *Garner* doctrine under Delaware law is a significant new development, it is not a dramatic shift in the law because the Delaware courts have cited the doctrine favorably in the past. In addition, the court's opinion here and the *Garner* doctrine are fairly narrow. First, *Garner* stems from the corporation's fiduciary duties to its shareholders and applies to claims that the company acted against shareholder interests. The lower court here thus exercised its discretion to require the plaintiff to maintain the confidentiality of privileged documents. This case was also based on a unique set of facts that the court said supported a colorable claim. While companies should anticipate that privileged communications, including those made as part of internal investigations, might be subject to disclosure to shareholders under some circumstances, the limited nature of this ruling should also guide parties in assessing the likelihood of such disclosures and how widely they might be disseminated.

Recent SEC/DOJ Enforcement Matters

SEC v. Jackson, et al.: Defendants Settle FCPA Claims On Eve Of Trial On Favorable Terms

On 3 July 2014, the SEC reached settlements with the two remaining defendants in its Foreign Corrupt Practices Act ("FCPA") enforcement action against parties related to the Noble Corporation. This resolution has generally been viewed as favorable to the settling defendants.

Noble Corporation is an international offshore drilling contractor. In 2010, the SEC and DOJ charged Noble with FCPA violations growing out of a Noble subsidiary's procurement of drilling permits in Nigeria. In 2012, the SEC (but not the DOJ) charged three Noble employees with similar violations. After Noble settled the charges in 2010 and one of the individual defendants settled in 2012, two individual defendants remained in the case. One had been the CEO. The other had held management positions at Noble's Nigerian subsidiary.

The SEC and these two defendants engaged in extensive litigation involving a motion to dismiss, two amended complaints, and competing motions for summary judgment. This motion practice raised several complicated legal and factual issues, including how the statute of limitations applied to the SEC's claims; whether the alleged bribes were permissible "facilitating payments"; the level of the defendants' intent; the applicability of aiding and abetting liability; and whether defendants could be subject to liability for failing to implement internal books and records procedures. The defendants' intent was particularly important at the summary judgment stage, where their reliance on various advisors and the proper interpretation of Nigerian law was at issue. The court denied both sides' motions for summary judgment from the bench in May 2014. Then, within a week of trial, both defendants reached settlements whereby they agreed to permanent injunctions related to only some of the remaining charges, did not admit guilt, and did not pay any monetary penalties. The terms of these settlements were more favorable than the settlements that the government had reached early on with the company and one of the individual defendants.

At the time of the settlements, many issues in the case remained open, to be decided at trial. But the settlements in this matter, combined with the uncertainties in the SEC's claims against the last two Noble defendants, suggest that parties charged in FCPA enforcement proceedings should carefully assess the strength of legal and factual issues when deciding whether to settle at the outset or proceed with litigating against the government.

SEC Charges Corporate Insiders and Issuers for Violations of Beneficial Ownership Reporting Obligations

On 10 September 2014, the SEC announced enforcement proceedings against officers, directors and major shareholders and publicly traded companies for violations related to beneficial ownership filings. The broader lesson of these enforcement actions is that, consistent with Chair White's "broken windows" enforcement philosophy, the SEC's threshold for pursuing violations of the securities laws has been lowered.

The charges stem from an SEC enforcement initiative focusing on two types of ownership reports that give investors the opportunity to evaluate whether the holdings and transactions of company insiders could be indicative of the company's future prospects. Form 4 is a report that corporate officers, directors, and certain beneficial owners of more than ten percent of a registered class of a company's stock must use to report their transactions in company stock within two business days. Schedule 13D and 13G are reports that beneficial owners of more than five percent of a registered class of a company's stock must use to report holdings or intentions with respect to the company. SEC enforcement staff used quantitative data sources and ranking algorithms to identify these insiders as repeatedly filing late. Some filings were delayed by weeks, months, or even years.

The charges against the publicly traded companies were for contributing to filing failures by insiders and for failing to report their insiders' filing delinquencies. The SEC noted that some of these companies had voluntarily agreed to perform certain tasks on behalf of insiders, including the preparation and filing of Section 16(a) reports, but that these reports were not filed on a timely basis on numerous occasions, even though the companies had received timely notification of all necessary information. Some of the companies also failed to comply with Item 405 of Regulation S-K, which requires disclosure about delinquent Section 16(a) filings by insiders in an issuer's annual report on Form 10-K or proxy statement.

The SEC's enforcement sweep resulted in charges against 34 individuals and companies. Thirty-three individuals and companies settled the charges, accepted cease-and-desist orders and agreed to pay civil penalties ranging from $25,000 to $150,000.

Public companies and other filers should make certain that they have robust policies and procedures in place to ensure that their filings comply with all applicable SEC disclosure requirements and are made within the required deadlines. Companies should also have policies requiring compliance with reporting obligations by their officers, directors and major shareholders, particularly if the company has agreed to provide assistance to insiders, such as the preparation and filing of Section 16(a) reports on behalf of officers and directors. Public companies should view the announcement of these enforcement actions as an opportunity to remind their officers, directors and major shareholders of their reporting obligations.

The related SEC press release is available at:

http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542904678.

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2014/09/broken-windows-sec-enforcement-reminds-officers.

ASIAN DEVELOPMENTS

HKEx releases Concept Paper on Weighted Voting Rights

On 29 August 2014, The Stock Exchange of Hong Kong Limited (the "Stock Exchange") published a Concept Paper on "Weighted Voting Rights" (described as governance structures that give certain persons voting power or other related rights disproportionate to their shareholding). As has been widely reported in the press, the Stock Exchange suffered the loss of Alibaba when the company chose to list in New York, as the Securities and Futures Commission and Stock Exchange were unable to compromise on the principle under Rule 2.03 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") that all shareholders of listed companies must be treated fairly and equally. Alibaba has a structure in place whereby Jack Ma and his business associates are able to appoint a majority of the company's board, notwithstanding that they are only minority shareholders. Rule 8.11 of the Listing Rules has stated categorically for almost 25 years that, unless otherwise agreed with the Stock Exchange in exceptional circumstances, the share capital of companies that seek listing must not include any shares of which the proposed voting power does not bear a reasonable relationship to the equity interest of such shares.

The Concept Paper is unique in that it does not seek views on proposed rule changes but rather solicits views on whether Weighted Voting Right structures should be permissible for companies listed or seeking to list in Hong Kong. Once the Stock Exchange has heard back from stakeholders on their views, it will then determine whether a full blown

consultation is appropriate. Whilst regulators in Hong Kong have held firm to the principle of one share one vote to date, it has undoubtedly affected Hong Kong's competitiveness for global Chinese listings. According to the Concept Paper, as at 31 May 2014, 102 Mainland Chinese companies were primary listed in the US (on the New York Stock Exchange ("NYSE") or NASDAQ), almost a third of which had Weighted Voting Right structures in place. These companies represent approximately 70% of the market capitalization of all US listed Mainland Chinese companies. The US Exchanges' approach to companies with Weighted Voting Right structures is also touched on in the Concept Paper, where it is highlighted that NYSE only allowed flexibility, in terms of allowing Weighted Voting Rights, owing to increased competition from NASDAQ, which never outlawed Weighted Voting Rights. NYSE historically did not permit companies with Weighted Voting Right structures to list.

The Stock Exchange has been keen to stipulate that it has formed no views and the Concept Paper is intended to be neutral so as to provide a formal opportunity for an informed debate on the topic. It seeks views on whether Weighted Voting Right structures should be allowed for new applicants or all listed entities and whether such structures should be limited to particular industries, or solely in exceptional circumstances. Views are also sought on whether listed companies with Weighted Voting Right structures should be subject to additional restrictions or whether any changes to the regulatory and corporate governance frameworks in Hong Kong are necessary. Responses to the Concept Paper must be submitted by 30 November 2014.

The Concept Paper is available at:

http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082.pdf.

CONTACTS

This newsletter is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this publication, you may contact your usual Shearman & Sterling representative or any of the following:

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