SHEARMAN & STERLING LLP

FINANCIAL INSTITUTIONS ADVISORY & FINANCIAL REGULATORY GROUP
WEEKLY NEWSLETTER

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Governance & Securities Law Focus

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

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

Financial regulation developments are available here.

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

US DEVELOPMENTS

SEC and NYSE/Nasdaq Developments

New NYSE Rule on Reporting Semi-Annual Financials for Foreign Private Issuers

On 19 February 2016, the US Securities and Exchange Commission ("SEC") approved a New York Stock Exchange ("NYSE") rule change to require foreign private issuers to file semi-annual financial statements on Form 6-K. This rule change is intended to align financial reporting practices of NYSE-listed foreign private issuers with NYSE-listed domestic issuers.

Prior to the change, foreign private issuers were not subject to any SEC rule that specifically requires the filing of interim financial information. However, as a matter of practice or home-country requirements, most foreign private issuers do already comply with semi-annual financial reporting.

The new Section 203.03 of the NYSE Listed Company Manual provides that each listed foreign private issuer must, at a minimum, submit to the SEC a Form 6-K that includes: (i) an interim balance sheet as of the end of its second fiscal quarter; and (ii) a semi-annual income statement that covers its first two fiscal quarters. These must be submitted no later than six months following the end of the company's second fiscal quarter. The new rules have been effective retroactively from 5 February 2016, and apply to companies with a fiscal year starting on or after 1 July 2015.

Nasdaq Proposes New Rule Requiring Disclosure of Third Party Compensation to Directors and Candidates

On 28 January 2016, Nasdaq filed an initial proposal with the SEC to mandate disclosure by listed companies where third parties (usually corporate activist shareholders) make payments to directors and director nominees. The proposed changes in Rule 5250 are intended to improve transparency to investors, shareholders and the public on directors and director nominees incentives.

In recent years, activist shareholders have tried to use monetary incentives to induce directors to push for at least short-term returns for the company, or to induce individuals to act as director nominees in a proxy contest. Such arrangements have raised concerns of conflicts of directors' fiduciary duty to the company and the promotion of certain shareholders' narrow interests.

The new rules will require listed companies: (i) to make reasonable enquiries as to such third-party compensation arrangements; and (ii) to promptly disclose all the salient terms of these arrangements and the names of the parties on the company website and proxy statement filings. The proposed rules are intended to be broadly interpreted, with the exception of payments made to director nominees as reimbursement of expenses and payments which existed before the nominee's candidacy and that are already publicly disclosed elsewhere (such as compensation relating to a pre-existing employment relationship but not in contemplation of the director candidacy).

If approved by the SEC, the new rules will take effect beginning on 30 June 2016. In order to meet the requirements, companies should revisit their director questionnaires and corporate governance policies on directors' disclosure of interests.

US House Of Representatives Passes Bill That Would Expand "Accredited Investor" Definition

On 1 February 2016, the House of Representatives passed HR 2187 "Fair Investment Opportunities for Professional Experts Act," which, if signed into law, would expand the definition of "accredited investor" under the US securities laws. The bill would amend Section 2(a)(15) of the Securities Act of 1933 (the "Securities Act") to include within the definition of "accredited investor": (i) persons in the securities industry licensed by the SEC or the Financial Industry Regulatory Authority ("FINRA") (such as a registered broker or investment adviser), or persons licensed with the securities division of a state or an equivalent state division; and (ii) persons whom the SEC determines by regulation to have demonstrable education or job experience to qualify such persons as having professional knowledge of a subject related to a particular investment, and whose education or job experience is verified by FINRA or an equivalent self-regulatory authority.

The bill also seeks to codify in the definition of "accredited investor" in Section 2(a)(15) of the Securities Act the income and net worth thresholds currently specified in Regulation D and directs the SEC to adjust those financial thresholds for inflation every five years.

The bill would need to be passed by the Senate and signed into law by the President before taking effect.

SEC Expresses Concerns Over Aggressive Adjustments to Earnings

Currently, companies are generally permitted to use profit figures that reflect adjustments to profit measures calculated and presented in accordance with US generally accepted accounting principles ("GAAP") or IFRS, so long as—if such non-GAAP measures are disclosed in SEC filings—they are not misleading and are not given greater prominence than the comparable GAAP measures and a reconciliation is provided to the most directly comparable GAAP (or IFRS) measure. For members of the Dow Jones Industrial Average that reported non GAAP earnings per share in 2015, the adjusted metric was on average 30% above earnings per share under GAAP, according to data from FactSet.

The SEC has recently questioned such aggressive financial reporting practices in comment letters to a number of SEC reporting companies, which have agreed to scale back their use of adjusted measures.

In a recent conference held by the US Chamber of Commerce, SEC Chairman Mary Jo White expressed concern on the use by companies of non-GAAP results, and in particular, reporting aggressive adjustments to earnings. This could result in new rules restricting such non-GAAP metrics.

While the SEC recognises the value of non-GAAP disclosures, such new rules could at a minimum target current loopholes that allow companies to give more prominence to non-GAAP figures on platforms and media not covered by SEC rules, such as websites and press releases. It is unclear if or when any such new rules would be introduced.

SEC Financial Reporting Manual Update

On 17 March 2015, the SEC's Division of Corporation Finance revised its Financial Reporting Manual in three main aspects:

- First, the revised version includes updated guidance on testing significance of equity method investments.
- Second, topic 10 on "Emerging Growth Companies" ("EGCs") has been updated to reflect the requirements of the Fixing America's Surface Transportation Act (the "FAST Act"), including paragraphs on: (i) an EGC's ongoing treatment as an EGC even if such status is lost during the review of its registration statement; and (ii) financial reporting accommodations regarding (a) the omission of financial information for historical periods, (b) the number of periods covered in Management's Discussion and Analysis and (c) the permitted omission of financial statements required by either Rule 3-05 or Rule 3-09 of Regulation S-X if the issuer reasonably believes those financial statements will not be required at the time of the offering.
- Third, topic 11 on "Reporting Issues Related to Adoption of New Revenue Recognition Standard" has been revised to include a summary of the implementation guidance in Accounting Standards Update No. 2014-09 on *Revenue from Contracts with Customers*, as amended by Accounting Standards Update No. 2015-14, and IFRS 15 *Revenue from Contracts with Customers*. The revisions also add a Q&A section addressing the effects of implementation on (i) selected financial data, (ii) supplementary quarterly financial data for an EGC, (iii) the ratio of earnings to fixed charges and (iv) financial statements of other entities and significance.

The revised Financial Reporting Manual is available at:
https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml

First Outsider to Receive Whistleblower Award from SEC

On 15 January 2016, the SEC announced a whistleblower award of more than $700,000 to an individual who did not work for the company in question, but, as an industry expert, produced a detailed analysis leading to a successful SEC enforcement action. This was the first ever whistleblower award to a company outsider since the beginning of the SEC whistleblower programme in 2011.

The SEC has commended whistleblowers who voluntarily provide unique and useful information that leads to successful enforcement action, and incentivises with awards between 10% and 30% of the money collected where the monetary sanctions exceed $1 million. This first outsider award may encourage further claims from potential outsider whistleblowers and may result in situations where the SEC is made aware of problems before the company itself.

SEC Forces Exxon Mobil to Include Climate Change Resolution Proposal in Proxy Upon Request of New York State Comptroller and Shareholders

On 22 March 2016, the SEC ruled that Exxon Mobil must allow its shareholders to vote on a proposal for annual reporting of how the company would be affected by climate change regulations. Nevertheless, it is open to Exxon Mobil to recommend against the proposal through its proxy document.

The ruling follows a request by the New York State Comptroller and four other shareholders who argued that investors need to know how the bottom line of Exxon Mobil will be affected by the global effort on reduction of greenhouse gas emissions and the company's plans in this regard. The SEC did not find the company's public disclosures up to the standards required by the proposal guidelines. Exxon Mobil declined to comment on the SEC ruling, but had earlier indicated that it intended to block a vote on the shareholder resolution, claiming it was vague and asking for metrics difficult to quantify.

Concurrently, Exxon Mobil is facing an inquiry by the New York Attorney General into Exxon Mobil's climate change disclosures (discussed in our client publication here: http://www.shearman.com/en/newsinsights/publications/2015/12/corporate-climate-change-reporting).

Noteworthy US Securities Law Litigation

Tongue v. Sanofi: Supreme Court's Omnicare Decision Does Not Require the Disclosure of Every Fact Counter to an Honestly Held Belief

On 4 March 2016, in *Tongue v. Sanofi*, the federal appellate court based in New York affirmed the dismissal of securities claims arising out of statements of opinion concerning the likelihood that a drug would be approved by the Food and Drug Administration ("FDA"). This decision is an important application of the US Supreme Court's March 2015 decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*. As discussed in a prior edition of this publication, the Court in Omnicare held that a statement of opinion is misleading, even if honestly held, if it omits information that is contrary to what a reasonable investor would assume was the basis for the stated opinion. The court in *Sanofi* held that *Omnicare* does not require a defendant to disclose every single piece of information that might go against its honestly held belief.

The plaintiffs in *Sanofi* held securities whose value depended on the achievement by the defendant biotechnology company of certain milestones, including FDA approval of its multiple sclerosis treatment. According to the plaintiffs, positive statements that the defendants made about the drug, including its high likelihood of receiving FDA approval, were misleading in light of their failure to disclose the FDA's skepticism about the company's use of a "single-blind," rather than "double-blind" test of the drug. The court held that the omission of the FDA's concerns did not render the defendants' statements misleading because "*Omnicare* does not impose liability merely because an issuer failed to disclose information that ran counter to an opinion expressed."

The court in *Sanofi* considered several factors in determining that the omitted information did not render the defendants' statements misleading. First, the FDA's concerns did not conflict with the defendants' statements because the FDA also told the defendants that the company could overcome the FDA's concerns if the drug exhibited an "extremely large effect" on patients. In addition, based on the instruction in *Omnicare* to view allegedly misleading opinions in context, the court here held that because the plaintiffs were sophisticated investors dealing in securities called contingent value rights, which would pay out preset amounts based on the company achieving certain milestones, including milestones established by the FDA, they should have known that it is common in the pharmaceutical industry for the FDA to engage in a dialogue with companies about the drugs for which they seek approval. As such, they should have known that there could initially be discrepancies between the company's views and those of the FDA. Similarly, the court viewed the plaintiffs as being on notice of the FDA's publicly expressed preference for double-blind trials. The court also noted the "numerous caveats" that the defendants made as to the reliability of their projections.

While *Omnicare* opened a new avenue of liability for expressions of opinion, the Sanofi court's application of *Omnicare* takes seriously the Supreme Court's admonition that meeting the *Omnicare* standard for omissions liability "is no small task for an investor." Another notable point is that, whereas *Omnicare* dealt with claims under the Securities Act of 1933 (the "Securities Act"), *Sanofi* applied the same standard to claims under the Securities Exchange Act of 1934 (the "Exchange Act") as well. *Sanofi*, however, addressed only whether the statements at issue were materially misleading, without considering what a plaintiff is required to plead in order to show fraudulent intent for statements of opinion under the Exchange Act. Ultimately, the court held that for an honestly held belief to be misleading, more is required than merely the omission of a fact that has the potential to undermine the opinion.

For more information on the *Sanofi* decision, please see our client note at:

http://www.shearman.com/en/newsinsights/publications/2016/03/second-circuits-first-published-opinion

Lloyd v. CVB Financial Corporation: Disclosure of a Government Investigation Can Support a Showing that the Defendant's Statements Caused the Plaintiff's Losses When Accompanied by a Subsequent Disclosure Connecting the Investigation to the Company's Alleged Misrepresentations

On 1 February 2016, in *Lloyd v. CVB Financial Corporation*, the federal appellate court based in California reinstated part of an action for securities fraud against a financial institution for alleged misstatements concerning the ability of its creditors to repay their loans. The court held that its ruling in 2014 in *Loos v. Immersion Corporation* (discussed in a prior edition of this publication)—namely, that "the announcement of an investigation, standing alone, is insufficient to establish" that the defendant's statements or omissions caused the plaintiff's losses (i.e., "loss causation")—left open the question of whether the commencement of an investigation could support loss causation when the complaint also alleges a subsequent disclosure showing that the government investigation was focused on the defendant's alleged misstatements. In *Lloyd*, the court answered that question affirmatively, and held that a subsequent revelation of an alleged misrepresentation can render the earlier announcement of a government investigation itself a basis for establishing loss causation.

In *Lloyd*, a lender, CVB Financial Corporation ("CVB"), was sued for securities fraud under Section 10(b) of the Exchange Act for saying that it was not aware of credit problems that would "cause serious doubts as to the ability of" borrowers to repay their loans. According to the complaint, however, this statement was false because CVB's biggest borrower had told CVB before CVB made this statement that the borrower could not meet its loan obligations and might file for bankruptcy. The court accordingly held that the plaintiffs—the investors that purchased CVB's stock—had adequately pleaded misstatement by the company.

At issue, however, was whether the plaintiffs had met the separate requirement under Section 10(b) of showing that the defendant's misstatement caused their losses. This element of securities fraud is typically established by showing a drop in share price immediately after the revelation of the misstatement. In this case, CVB's stock price dropped when it announced that the SEC was investigating its practices relating to loan underwriting, provisions for credit losses and other accounting practices. The defendants argued that, under the court's prior ruling in *Loos*, the plaintiffs' losses from the company's alleged misrepresentation about borrowers' ability to pay their loans could not be attributed to the drop in the company's stock price that followed the announcement of the SEC investigation, because that announcement did not reveal anything about the company's losses from its largest borrower. The court held, however, that CVB's disclosure of the SEC investigation into its lending and accounting practices, which preceded the only significant decline in CVB's share price, could satisfy the requirement that a plaintiff plead that the defendant's misstatement or omission caused the plaintiff's losses. This finding was supported by the fact that, one month after CVB's disclosure of the SEC investigation, the company announced that it *had* lost millions of dollars on the loans at issue. The court concluded that "any other rule would allow a defendant to escape liability by first announcing a government investigation and then waiting until the market reacted before revealing that prior representations under investigation were false." While the court here reversed the lower court's dismissal of the claims described above, the court affirmed the dismissal of claims concerning other statements by the company that the court agreed were not false.

In *Lloyd*, the court determined that the announcement of a government investigation could support a showing that the defendant's alleged misstatements caused the plaintiff's losses in light of other factors corroborating this theory. Based on public commentary concerning how market participants understood the disclosures at issue, the court reasoned that the fact that "the market hardly reacted at all to CVB's bombshell disclosure about its [losses from its] largest borrower, confirm[ed] that investors understood the" announcement of the SEC investigation as at least a partial disclosure of CVB's prior misstatements about its borrowers' ability to repay their loans. While this case provides an important qualification to the general rule, at least within the jurisdiction of this court, that the announcement of a government investigation cannot by itself support a showing that the defendant's misstatement caused the plaintiff's loss, it also reinforces the "context dependent" nature of this "loss causation" inquiry, which, even at the pleading stage, will often turn on the unique circumstances surrounding the disclosures at issue.

Tyson Foods, Inc. v. Bouaphakeo: Supreme Court Allows Use of Statistical Evidence to Establish Classwide Liability at the Class Certification Stage

On 22 March 2016, in *Tyson Foods, Inc. v. Bouaphakeo*, the US Supreme Court affirmed a lower court's decision to allow plaintiffs to use statistical evidence based on a representative sample of the plaintiffs' employment-related activities at issue in the case to show that liability presented a classwide issue that was appropriate for litigation in a class action context. The Court declined to declare a categorical rule permitting or disallowing the use of statistical sampling at the class certification stage, but held instead that "[i]ts permissibility turns not on the form a proceeding takes—be it a class or individual action—but on the degree to which the evidence is reliable in proving or disproving the elements of the relevant cause of action."

Tyson Foods dealt with a claim by workers in a meat processing plant that they were denied overtime pay under federal and state law for the time they spent putting on and taking off certain protective equipment. The workers used statistical evidence to estimate the amount of time these activities took. In ruling that this evidence was allowed, the Court explained that "where representative evidence is relevant in proving a plaintiff's individual claim, that evidence cannot be deemed improper merely because the claim is brought on behalf of a class." The Court was also persuaded by the fact that the evidence was used to "fill an evidentiary gap created by the employer's failure to keep adequate records" and was therefore the only practical way to present evidence as to the employer's liability. In addition, the Court distinguished *Wal-Mart Stores, Inc. v. Dukes*, a case from 2011 holding that a statistical sample could not be used to establish a class claiming gender discrimination. The Court in *Tyson Foods* explained that, in contrast to this case, the employees making up the putative class in *Wal-Mart* were not "similarly situated" and therefore could not have used the statistical evidence even if they had brought individual suits.

While *Tyson Foods* addressed an issue that does not arise in the typical securities class action (where investors that bought their shares during the class period are generally viewed as similarly situated for purposes of a class action), the Court explained more generally that "[t]he fairness and utility of statistical methods in contexts other than those presented here will depend on facts and circumstances particular to those cases." The factors discussed in *Tyson Foods* will therefore help guide future determinations in a broad range of cases as to whether the use of statistical evidence is appropriate. For example, statistical evidence is commonly used for purposes of determining whether a disclosure revealing the defendant's alleged misstatement caused the defendant company's stock price to drop, as well as in other ways related to the calculation of the plaintiffs' damages. Parties can now be guided in these areas by the Supreme Court's pronouncements in *Tyson Foods* as to the proper use of statistical evidence.

For more information on business cases currently before the Supreme Court, please see our client note at:

http://www.shearman.com/en/newsinsights/publications/2016/03/some-observations-on-the-impact-of-justice-scalias

In re Lions Gate Entertainment Corp. Securities Litigation

On 22 January 2016, in *In re Lions Gate Entertainment Corp. Securities Litigation*, the United States District Court for the Southern District of New York dismissed securities fraud claims alleging that the defendants did not sufficiently disclose SEC enforcement activities. The case was a putative securities fraud class action brought under Section 10(b) of the Exchange Act.

Lions Gate had been investigated by SEC and had received a "Wells Notice" (a letter from the SEC Enforcement Division staff informing the company that it has decided to recommend that the SEC bring an enforcement proceeding). In a similar case, *Richman v. Goldman Sachs Group, Inc.*, which was heard by the same court in 2012, the court held that Goldman Sachs was not liable for failing to publicly disclose the receipt of a Wells Notice. Expanding on its decision in Richman, the court in *In re Lions Gate* held that the defendant had no independent duty to disclose any of the enforcement developments and that they were not *per se* material to investors.

The plaintiffs alleged that Lions Gate should have disclosed publicly the pendency of an SEC investigation, the company's intention to settle with the SEC and Lions Gate's receipt of the Wells Notice. The judge dismissed the case in part because Lions Gate had made no statements about the SEC investigation and therefore did not make any materially incomplete or inaccurate statements, or, in the alternative, the SEC investigation and Wells Notice were not material because the penalty amounted to less than 1% of Lions Gate's consolidated revenues and because the mere possibility that a piece of information may be material to the company's financial condition is not necessarily sufficient to satisfy the plaintiff's burden to plead materiality. In its SEC filings, Lions Gate disclosed that "[f]rom time to time, the Company is involved in certain claims and legal proceedings arising in the normal course of business," and that "the Company does not believe, based on current knowledge, that the outcome of any currently pending claims or legal proceedings in which the Company is currently involved will have a material adverse effect on the Company's financial statements." The court here ruled that Lions Gate's statements were not false or misleading because a Wells Notice may not necessarily culminate in litigation and therefore does not render the company's disclosure inadequate. Lastly, the court held that Lions Gate did not breach Regulation S-K Items 103, 303 and 503.

The case sheds further light on companies' duties of disclosure and confirms that courts will continue to be guided by established principles of quantitative and qualitative thresholds of materiality. The court thus held that the company was not required to disclose the SEC's ongoing investigation or the company's receipt of a Wells Notice, but left open the possibility that the principles described above might require the disclosure of these types of facts in a different set of circumstances.

Recent SEC/DOJ Enforcement Matters

In the Matter of Monsanto Company, et al., File No. 3-17107: SEC Settles Claims of Accounting Violations for $80 Million

On 9 February 2016, the SEC settled charges of securities violations against Monsanto Company ("Monsanto") and three of its employees relating to alleged accounting violations from 2009 to 2011 concerning sales of its flagship product, an herbicide called Roundup. Monsanto agreed to pay $80 million and engage in substantial remedial efforts, but neither admitted nor denied the SEC's allegations. The SEC described Monsanto's actions as "the latest page from a well-worn playbook of accounting misstatements" and stated that "[f]inancial reporting and disclosure cases continue to be a high priority for the Commission."

The allegations here arose out of Monsanto's accounting for steps it took to compensate retailers and distributors in the US, Canada, Germany and France that purchased Roundup when Monsanto was planning on soon decreasing the price to compete with lower-cost generic competitors. The SEC alleged that Monsanto encouraged its US retailers to purchase greater amounts of Roundup at the end of Monsanto's fiscal year 2009 by making the retailers eligible for rebates in the following fiscal year to compensate them for Monsanto's upcoming price reduction. Monsanto was also alleged to have encouraged certain of its US distributors to fail to qualify for rebates in Monsanto's fiscal years 2009 and 2010 in exchange for the distributors' being given the opportunity to earn back those rebates in the following years. According to the SEC, accounting rules required Monsanto to recognise the cost of these rebates and similar incentives at the time they were offered, rather than in the following years when they were formally paid. Monsanto's failure to do so increased its revenues in the earlier years in which it did not account for these benefits provided to its customers. In addition, Monsanto was alleged in Canada, France and Germany to have accounted for rebates as business expenses rather than as a reduction in revenues, thereby improperly boosting its revenues.

Monsanto's allegedly improper conduct in managing the programmes described above included making false statements to its auditor concerning when some of these programmes were implemented and extending certain of these incentives even though its customers did not meet the sales and marketing requirements for receiving them. Monsanto has restated several financial statements to correct some of these errors. The SEC alleged that these accounting improprieties violated provisions of the Securities Act and the Exchange Act dealing with the sale of securities, reporting requirements and duties to keep accurate books and records.

In addition to paying an $80 million civil penalty, Monsanto agreed: (i) to engage an independent ethics and compliance consultant to review the company's internal accounting controls relating to the alleged violations; (ii) to report the consultant's findings to the SEC; and (iii) to adopt the consultant's recommendations. The three Monsanto employees who were alleged to have been involved in the practices at issue agreed to pay a total of $135,000 in monetary penalties and two of them were denied the ability to appear as an accountant before the SEC for a limited period of time, after which they could apply for reinstatement. The SEC found no personal misconduct on the part of the company's chief executive officer and former chief financial officer ("CFO"). In addition, the SEC explained that because these top executives reimbursed the company for the relevant portions of the compensation that they received during the period at issue (which totaled approximately $4 million), the SEC did not need to pursue a clawback action under the Sarbanes-Oxley Act to try to recoup their money for the company. The SEC's decision not to pursue these claims against the company's leading executives highlights the more favorable treatment available when such executives voluntarily reimburse their companies and otherwise cooperate with regulatory inquiries. It also underscores, however, that certain senior executives are potentially responsible for securities and accounting violations even if they are not personally involved in the alleged misconduct. Overall, this matter serves as a reminder of the SEC's interest in bringing cases arising from accounting deficiencies in companies' financial statements.

In the Matter of Magnum Hunter Resources Corp.: SEC Charges Company, Officers and External Advisers with Improperly Evaluating and Failing to Maintain Internal Controls

On 10 March 2016, Magnum Hunter Resources Corporation ("MHR"), its CFO, chief accounting officer (the "CAO"), an external audit engagement partner and a consultant reached settlements through cease-and-desist orders with the SEC to resolve charges that they had failed to properly maintain MHR's internal control over financial reporting ("ICFR") between 31 December 2011 and 30 September 2013.

As set forth in the orders containing the terms of the parties' settlements, MHR's rapid growth and significant acquisitions in 2010 and 2011 strained its accounting resources, preventing the company from completing its standard monthly close process on time. On this basis, the SEC found a "material weakness" in MHR's internal control over financial reporting. A "material weakness" is defined in Regulation S-X as a "deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis."

The SEC found that the CFO and CAO were in full knowledge of the stress placed on MHR's accounting department as a result of its rapid growth. Nonetheless, they failed to apply appropriate standards when determining the severity of MHR's internal control deficiency.

Before the SEC commenced this proceeding, MHR had engaged a public accounting firm to provide consulting and internal auditing services. The consulting firm documented and tested the company's controls and identified problems in the accounting department that evidenced "inadequate and inappropriately aligned staffing." Nevertheless, the partner of the consulting firm concluded that the staffing deficiency in the company's accounting department did not rise to the level of a material weakness.

Similarly, MHR's independent auditor recognised during the audit that MHR lacked "adequate internal control over financial reporting due to inadequate and inappropriately aligned staffing," which "increases the possibility of a material error occurring and being undetected." Despite this assessment, the external audit partner concluded that the weakness did not rise to the level of "material weakness." The SEC found that there was inadequate documentary support for such a conclusion, that the independent auditor did not apply the applicable auditing standards appropriately and that the CFO and CAO did not sufficiently consider the independent auditor's findings. Accordingly, the public was not informed that MHR had a material weakness in its ICFR.

SEC rules require company management to evaluate and annually report on the effectiveness of ICFR, including disclosing any identified material weaknesses that create a reasonable possibility that the company will not timely prevent or detect a material misstatement in its financial statements. Management may not conclude ICFR is effective if a material weakness exists.

Without admitting or denying the findings in the cease-and-desist orders, MHR agreed to pay a penalty of $250,000 subject to bankruptcy court approval, the CFO and the partner of the consulting firm agreed to pay penalties of $25,000 and $15,000, respectively, and the CAO and the partner of MHR's independent auditor agreed to be suspended from appearing and practicing before the SEC as an accountant until reinstatement after at least one year. This matter shows the SEC's willingness to initiate an enforcement action against senior executives and outside audit parties for internal control deficiencies even though the practices at issue could be portrayed as not material weaknesses.

EU DEVELOPMENTS

Prospectus Directive: ESMA Publishes Opinion Assessing Turkish Laws and Regulations on Prospectuses

On 8 February 2016, the European Securities and Markets Authority ("ESMA") published an opinion on Turkish laws and regulations on prospectuses. The opinion compares the Turkish and EU requirements set out in the Prospectus Regulation. It considers that:

- a prospectus drawn up according to Turkish laws and regulations can constitute a valid prospectus under the Prospectus Directive; and
- it is not necessary for a Turkish prospectus for shares to be accompanied by a wrap, provided that the prospectus contains financial statements in accordance with International Financial Reporting Standards ("IFRS").

It is noted that the ESMA opinion does prevent the national authorities having discretion to request additional information in a wrap or the prospectus.

A copy of the opinion is available here:

https://www.esma.europa.eu/sites/default/files/library/2016-268_opinion_on_equivalence_of_the_turkish_prospectus_regime.pdf

Financial Reporting: Commission Consultation on Guidelines for Reporting Non-Financial Information

On 15 January 2016, the European Commission published a consultation document on the non-binding guidelines for reporting of non-financial information by companies, as required under Article 2 of the Directive amending the Accounting Directive on disclosure of non-financial and diversity information.

The new disclosure requirements of the Directive aim to improve the transparency of EU companies in relation to non-financial information and they are applicable to large public-interest entities with more than 500 employees. The Directive itself is flexible so under Article 2, the Commission is required to produce these non-binding guidelines to assist with interpretation.

The consultation asks a broad series of questions on the approach that should be taken to drawing up the guidelines and on what the scope of the guidelines should be. The consultation will close on 15 April 2016.

A copy of the consultation document is available here:

http://ec.europa.eu/finance/consultations/2016/non-financial-reporting-guidelines/docs/consultation-document_en.pdf

European Union: EU Referendum

On 20 February 2016, it was announced that the UK would hold a vote on their membership of the EU on 23 June 2016.

Please see our EU referendum overview here:

http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/03/Brexit-Options-for-and-Impact-of-the-Possible-Alternatives-to-EU-Membership-FIAFR-032116.pdf

UK DEVELOPMENTS

PSC Register: Register of People with Significant Control Regulations 2016

On 21 March 2016, the Register of People with Significant Control ("PSC") Regulations were published.

The PSC regulations have been amended from the draft published in June 2015 to include:

- a provision that companies who have voting shares admitted to trading on various markets in Israel, Japan, Switzerland and the US are not required to keep a PSC register;

- a more extensive list of legal entities that are deemed subject to their own disclosure requirements in order to cover companies with voting shares admitted to trading on certain markets in Israel, Japan, Switzerland and the US;
- a new Schedule which sets out the amendments that are necessary to be made to the Companies (Disclosure of Address) Regulations 2009 in order to align the 2009 regulations' regime for the protection of director's addresses from disclosure with the regime in the PSC regulations protecting a person with significant control's usual residential address;
- a provision stating that the fee for requesting a copy of a company's PSC register (or any part of it) will be fixed at £12; and
- an extension of the time limits in connection with applications to prevent disclosure of the usual residential addresses or other secured information in relation to the PSC register.

The Register of People with Significant Control Regulations 2016 can be accessed here:

http://www.legislation.gov.uk/uksi/2016/339/pdfs/uksi_20160339_en.pdf

PSC Register: Limited Liability Partnerships (Register of People with Significant Control) Regulations 2016

On 18 March 2016, the Limited Liability Partnerships (Register of People with Significant Control) Regulations were published.

Limited Liability Partnerships ("LLPs") will be required to maintain a PSC register in the same way as UK companies. The regulations apply the relevant provisions of the Companies Act 2006 to LLPs with certain adaptations, for example the criteria for whether someone is a PSC of an LLP are different from the criteria determining whether someone is a PSC of a company.

With regards to an LLP, an individual will be a person with significant control if he directly or indirectly holds the right to:

- more than 25% of the voting rights on matters to be decided by a vote of members of the LLP;
- share in more than 25% of any surplus assets of the LLP on a winding up;
- appoint or remove the majority of persons entitled to take part in the LLP's management;
- exercise significant influence or control over the LLP; or
- exercise significant influence or control over the trustees or members of a trust or firm that is not a legal person, where those trustees or members would meet any of the specified conditions (or would do if they were individuals).

The Limited Liability Partnerships (Register of People with Significant Control) Regulations 2016 can be accessed here:

http://www.legislation.gov.uk/uksi/2016/340/pdfs/uksi_20160340_en.pdf

PSC Register: Statutory Guidance on the Meaning of Significant Influence or Control

On 27 January 2016, the Department for Business, Innovation and Skills ("BIS") published its amended draft statutory guidance on the meaning of significant influence or control in the context of PSC registers, one in relation to companies and the other in relation to LLPs.

For a summary of the previous draft statutory guidance published by BIS on 21 December 2015, please see our Q4 2015 newsletter available on page 1.

The new amendments to the draft statutory guidance include:

- expanding and clarifying the meaning of the right to exercise significant influence or control over a company or LLP; and

- amending and extending the list of excepted roles and relationships with respect to companies and LLPs which will not, on their own, result in a person being considered to be exercising significant influence or control (formerly described as safe harbours) and clarifying that this list is non-exhaustive.

The amended draft statutory guidance was laid before Parliament on 6 April 2016 and can be accessed here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/498275/Statutory_company_PSC_Guidance.pdf

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/495414/LLP_Statutory_Guidance_for_PSC_register.pdf

PSC Register: Non-Statutory BIS Guidance for Companies, SEs And LLPs

On 11 February 2016, BIS published its final non-statutory guidance for companies, Societates Europaeae ("SEs") and LLPs on the register of people with significant control. This guidance was updated on 4 March 2016.

This guidance was broadly similar to the draft guidance for companies which BIS published on 21 December 2015. For a summary of the draft guidance, please see our Q4 2015 newsletter available on page 1.

However, the final guidance does include minor amendments which clarify the guidance. For example, the final guidance inserts several paragraphs clarifying how condition (i) (ownership of shares) applies to companies without share capital, including charitable companies. Additionally, the updated guidance clarifies when rights in a company may be exercisable in certain circumstances, for example situations involving voting rights, rights to appoint or remove directors and options to acquire shares. The revised guidance makes clear that these three examples are not an exhaustive list.

This final guidance can be accessed here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505303/NON-STATUTORY_GUIDANCE_FOR_COMPANIES_AND_LLPS.pdf

PSC Register: BIS Guidance for PSCs

On 23 March 2016, BIS published guidance on the register for PSCs of companies, SEs and LLPs.

The guidance focuses on the obligations of persons who may be PSCs and registrable Relevant Legal Entities. However, it is substantially similar to the guidance for companies, SEs and LLPs.

The guidance can be accessed here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/510011/PSC_guidance_v1.pdf

PSC Register: Ministerial Written Statements

On 26 January 2016, the House of Lords issued a written statement on the draft Register of People with Significant Control Regulations 2016.

The written statement makes clear that the Secretary of State will not use the power to make general exemptions to new information and registration requirements, unless using the exemption would be in the interests of national security, the economic well-being of the UK or the support of the prevention or detection of a serious crime. The Secretary of State will also only grant this exemption if it is clear that the company or LLP is not being run for the personal benefit of any individual and that the exemption was necessary for the person seeking it to achieve their lawful objectives.

The written statement can be accessed here:

http://qnadailyreport.blob.core.windows.net/qnadailyreportxml/Written-Questions-Answers-Statements-Daily-Report-Lords-2016-01-26.pdf

PSC Register: Companies Act 2006 (Amendment of Part 21A) Regulations 2016

On 9 February 2016, the Companies Act 2006 (Amendment of Part 21A) Regulations 2016 were published. The regulations amend section 790C of Part 21A to remove the unnecessary requirement to record every company in a chain of companies on a company register of people with significant control over the company. Instead, they allow the registration of just the first company in the chain of ownership which is subject to its non-beneficial ownership disclosure requirements.

These regulations came into force on 8 February 2016 and can be accessed here:

http://www.legislation.gov.uk/uksi/2016/136/pdfs/uksi_20160136_en.pdf

FCA Handbook: Listing Rules and Disclosure and Transparency Rules (Miscellaneous Amendments Instrument 2016 (FCA 2016/6)

On 29 January 2016, the Financial Conduct Authority ("FCA") published an instrument which gives effect to a number of amendments to the Listing Rules and Disclosure and Transparency Rules. These amendments are intended to enhance investor protection and bring the Disclosure and Transparency Rules in line with the EU Accounting Directive. The amendments include increased protection for minority shareholders by making it more difficult for a controlling shareholder to cancel an issuer's listing. The amendments also include a requirement for the management report to give an indication of any important events that have occurred since the end of the financial year, unless those events are reflected in the issuer's profit and loss account or balance sheet, or disclosed in the notes to the issuer's audited financial statements.

These changes are effective as of 29 January 2016 and the instrument can be found here:

https://www.handbook.fca.org.uk/instrument/2016/FCA_2016_6.pdf

Listing Rules, Prospectus Rules and Disclosure and Transparency Rules: FCA Quarterly Consultation No 12

On 18 March 2016, the FCA published its twelfth quarterly consultation paper (CP16/8). This consultation paper sets out the FCA's proposals to make changes to the:

- definition of reverse takeover in LR 5.6.4R to clarify that a transaction cannot be artificially broken up to avoid the reverse takeover requirements. The FCA reminds issuers of its policy of considering the substance of a transaction over its legal form;
- list of documents set out in PR 1.1.6G that need to be considered when determining the effect of the Prospectus Directive as there are now four ESMA opinions relating to prospectuses; and
- rule relating to reports on payments to governments (as required by the Transparency Directive) by inserting a new rule DTR 4.3A.10R. The FCA is proposing that reports under the Transparency Directive should be prepared in the same format and use the same data scheme as required under the Accounting Directive. The FCA is also proposing to require issuers to file reports on payments to governments prepared under the Transparency Directive with the FCA and to upload them to the system identified by the FCA on its website as the national storage mechanism for regulatory announcements and certain documents published by issuers.

This consultation paper can be accessed here:

http://www.fca.org.uk/static/fca/article-type/consultation%20paper/cp16-8.pdf

Admission and Disclosure Standards: Feedback on Amendments to Standards and High Growth Segment Rulebook

On 14 March 2016, the London Stock Exchange published N02/16, which is a notice setting out the revised Admission and Disclosure Standards and High Growth Segment Rulebook. The majority of the amendments to the standards relate to the structure and are of an administrative or clarificatory nature. The High Growth Segment rulebook is now incorporated into Schedule 5 to the standards.

This notice can be accessed here:

http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/change-and-updates/stock-exchange-notices/2016/n0216.pdf

Transparency of Beneficial Ownership of Foreign Companies: BIS Discussion Paper

On 4 March 2016, BIS published a discussion paper setting out various proposals requiring foreign companies to provide information on their beneficial ownership before undertaking certain economic activities in the UK in order to enhance transparency.

The government is considering whether foreign companies wishing to buy land or property in England and Wales, or wishing to enter into public procurement contracts in England, should be under a similar obligation to UK companies that will, from 6 April 2016, have to keep a register of people with significant control or declare that there are no such people.

The closing date for responses was 1 April 2016 and the discussion paper can be accessed here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505546/bis-16-161-beneficial-ownership-transparency.pdf

Corporate Governance: EHRC Guidance on Improving Board Diversity

On 23 March 2016, the Equality and Human Rights Commission ("EHRC") published guidance for companies, among others, on how to improve the diversity of company boards within the framework of the Equality Act 2010 and the UK Corporate Governance Code.

The recommendations include:

- defining the selection criteria in terms of measurable skills, experience, knowledge and personal qualities;
- reaching the widest possible candidate pool by using a range of recruitment methods and positive action;
- providing a clear brief, including diversity targets, to executive search firms;
- assessing candidates against the role specification in a consistent way throughout the process;
- establishing a clear board accountability for diversity; and
- widening diversity in the senior leadership talent pool to ensure future diversity in succession planning.

The EHRC guidance can be found here:

http://www.equalityhumanrights.com/sites/default/files/how_to_improve_board_diversity_web.pdf

Corporate Governance: PIRC Shareholder Voting Guidelines 2016

Pensions Investment Research Consultants ("PIRC"), the shareholder advisory body, has published the 23rd edition of its UK Shareholder Voting Guidelines. These guidelines replace the version published in April 2015.

The new 2016 guidelines make clear that:

- PIRC will not support authorities for the disapplication of pre-emption rights up to an amount equal to 10% of the company's issued ordinary share capital unless the board has made a clear, cogent and compelling case as to why the 10% level is appropriate for the company;
- PIRC will only support future requests for share buyback authorities if the board has made out a clear, cogent and compelling case to demonstrate how the authority would be used to benefit the long-term shareholders and that the directors are not conflicted in recommending the authority;
- in relation to the provision of non-audit services by audit firms, PIRC will normally recommend abstaining where non-audit fees are between 25% and 50% of audit fees and opposing where non-audit fees exceed 50% of audit fees for either year under review or the previous three years;
- PIRC supports the efforts of Lord Davies to increase board diversity and therefore, in line with the updated Davies target, has updated the target in its Guidelines to 33% female board representation by 2020; and
- PIRC continues to oppose excessive remuneration and has added some new criticism of "absurd" retention awards made where there is no indication that a director wishes to move on or that there is outside demand for the director's services. The new Guidelines are also now more prescriptive about who should be allowed to sit on the remuneration committee. PIRC states that remuneration committee members should not be executive directors of other UK listed companies and that, in 2016, PIRC will abstain on the election of any such directors who sit on the remuneration committee.

The PIRC UK Shareholder Voting Guidelines 2016 are available to purchase from PIRC and can be accessed here:

http://pirc.co.uk/news-and-resources2/guidelines

Corporate Governance: FRC Report on Developments in Corporate Governance and Stewardship

On 14 January 2016, the Financial Reporting Council ("FRC") published a report on developments in corporate governance during 2015 which reviewed the impact and implementation of the UK Corporate Governance and Stewardship Codes during the last 12 months. The report highlights the FRC's views on performance by companies and stakeholders during 2015 and addresses areas for potential improvement. The report also sets out the statistical findings of several reports conducted by professional associations and advisers.

The key points that the report makes in terms of the UK Corporate Governance Code are as follows:

- The FRC does not intend to make any substantial revisions to the Code before 2019;
- Strict compliance with all Code provisions has dropped slightly due to newly listed companies not yet having observed all governance requirements and due to FTSE 100 companies awaiting finalisation of implementation of the EU Statutory Audit Directive and Regulation and, in particular, as regards audit rendering;
- The FRC intends to focus on corporate culture and practices that embed good corporate behaviour over the next year; and
- The FRC is assessing feedback to its consultation on implementation of the EU Audit Directive and Regulation and plans to release revised versions of the Code and Guidance later in 2016.

The key points that the report makes in terms of the Stewardship Code are as follows:

- The FRC encourages investors to notify companies in advance of votes against or abstentions, following a decrease in these notifications in 2015;
- The FRC intends to ensure that its activities capture the perspectives of long-term investors and international investors active in the UK market; and

- The FRC intends to scrutinise the Stewardship Code signatory statements and then contact firms to allow for improvements, before making its assessments public in summer 2016.

This report can be accessed here:

https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Developments-in-Corporate-Governance-and-Stewa-(1).pdf

Financial Reporting: FRC Publishes Thematic Review on Audit Quality Monitoring

On 5 January 2016, the FRC published a thematic review of audit firms' internal quality control procedures. Of particular interest are a number of suggestions proposed to audit committees to help maintain the key role they play in reviewing and monitoring the effectiveness of the audit process. The report states that this should help to build investor confidence in the quality of external audits and therefore, by extension, the reliability of financial statements.

The suggestions to audit committees proposed by the FRC include:

- requesting audit firms to provide an overall annual report of their monitoring activities which will be more detailed than that which is contained in the annual Transparency Reports required by the Statutory Audit Directive to be published by auditors of UK companies with securities admitted to trading on a UK regulated exchange;
- discussing the findings of any audit review, together with any necessary remedial action, with their auditor;
- discussing with their audit partner the scope of the firm's audit monitoring to ascertain whether any UK components were included or if the review was restricted to work at group level; and
- asking whether the audit team have received any feedback from the monitoring performed by network firms responsible for audit work on overseas companies.

The full FRC report is available here:

https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Firms-audit-qualit.pdf

Financial Reporting: New Draft Regulations Published Regarding Accounting Regulatory Framework for LLPs

On 8 March 2016, draft regulations (the Limited Liability Partnerships, Partnerships and Groups (Account and Audit) Regulations 2016) were published and laid before Parliament, which introduce changes to the accounting regulatory framework for LLPs. Broadly, these changes reflect those introduced for companies in the Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

The key changes included in the draft regulations include:

- an increase in the turnover and balance sheet thresholds used to determine whether an LLP or group qualifies as "small" or "medium" sized;
- a limit for small LLPs on the number of mandatory notes to the accounts;
- provisions which enable LLPs to adapt the formats for profit and loss accounts and balance sheets;
- permitting abridged balance sheets and profit and loss accounts for small LLPs in circumstances where this is approved unanimously by the members of the LLP; and
- permitting the use of the equity method of accounting in individual LLP accounts.

The regulations apply to financial years commencing on or after 1 January 2016. They will come into force on the seventh day after they are made.

The draft regulations are available here:

http://www.legislation.gov.uk/ukdsi/2015/9780111127896/pdfs/ukdsi_9780111127896_en.pdf

Financial Reporting: FRC Publishes Letter of Advice to Audit Committee Chairs Regarding Volatile Asset Prices and Uncertainty Over Interest Rates for Corporate Reporting Season

On 8 March 2016, the FRC published a letter of advice to audit committee chairs containing guidance in relation to how issues such as volatile asset and oil prices, uncertainty over interest rates in certain jurisdictions and the UK's EU membership referendum should be dealt with in annual reports and accounts.

The letter highlights that:

- the strategic report in particular provides an opportunity to provide the most current view of prospects and, as such, it should be carefully reviewed by the board to ensure that statements which may have been drafted some time ago in preparation for the reporting season remain pertinent;
- key to the understanding of a company's prospects will be the disclosure of the directors' judgements as to the principal risks and their potential impact and, therefore, more disclosure as to sensitivities may be required to aid understanding;
- accounts should be drawn up on the basis of the conditions existing at the balance sheet date but events or information that come to light at a later date which affect valuations need careful consideration and may need to be disclosed;
- Financial Reporting Standards require companies to disclose material post-balance sheet events, including the nature of each event and its estimated financial impact or a statement that such an estimate cannot be made; and
- audit committee chairs may need to consider whether the events have a material impact on the preparation of the accounts on a going concern basis of accounting and/or whether there are material uncertainties relating to that assessment requiring disclosure.

The letter is available here:

https://www.frc.org.uk/FRC-Documents/Audit-and-Assurance-Council/Letter-to-ACC-on-relevant-reporting-considerations.pdf

Narrative Reporting: BIS Publishes Consultation Paper on UK Implementation of the EU Non-Financial Reporting Directive

On 16 February 2016, BIS published a consultation paper requesting feedback on the best approach for implementing the requirements of the EU Non-Financial Reporting Directive (Directive 2014/95/EU) (the "NFR Directive") into UK law. The aim of the NFR Directive is to bring consistency and conformity across Europe in relation to non-financial disclosure requirements in order to provide investors and other stakeholders with a comprehensive picture of a company's performance.

BIS has invited feedback on a number of issues, including whether:

- companies should be permitted to meet the NFR Directive's non-financial reporting requirements in a separate statement outside the annual report;
- there should be a reduction in scope of the existing UK non-financial reporting requirements for all quoted companies and a limitation on those required by the NFR Directive; and
- the UK should require non-financial statements to be independently verified by assurance service providers.

In addition, BIS has consulted on a number of other issues that fall outside the scope of implementation of the Directive, including whether:

- companies should be permitted to provide their separate non-financial statement on their website and, if so, the additional legislative protections that might be required to facilitate this;
- the definition of "senior manager" as set out in the Companies Act 2006 should be improved and, if so, how, particularly in relation to requirements for gender balance reporting by quoted companies in their strategic reports; and
- any existing narrative reporting requirements can be repealed due to being redundant or of little use.

The consultation closes to responses on 15 April 2016.

The consultation is available here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/500760/BIS-16-35-non-financial-reporting-directive-consultation-February-2016.pdf

Takeover Code: Code Committee Publishes Consultation on Communication and Distribution of Information

On 15 February 2016, the Code Committee of the Takeover Panel published a consultation (PCP 2016/1) on *The communication and distribution of information during an offer*. The paper seeks feedback on proposed amendments to the Takeover Code relating to the communication and distribution of information and opinions during an offer by or on behalf of an offeror or offeree.

The proposed amendments to certain rules of the Takeover Code include:

Equality of Information to Shareholders (Rule 20.1)

Information about an offer will have to be made available to offeree shareholders and persons with information rights via a RIS.

In addition, any offer information, whether presentations or documents, made available to (or used in meetings with) any shareholder or other relevant person, or any article, letter or other written information provided to the media, must be published on a website promptly after it is released, whether or not it contains any material new information or significant new opinion.

Meetings and Telephone Calls with Shareholders, etc. (Rule 20.1, note 3)

The existing chaperoning rule (requiring a financial adviser to be present at meetings) in note 3 to Rule 20.1 is being replaced by new rules which:

- clarify that the rule applies as much to telephone calls as to physical meetings;
- subject to prior consultation with the Panel, remove the chaperoning requirement for recommended offers after the announcement of a firm offer and where there is no competitive situation. Instead, a senior representative of the offeror or offeree who attended the meeting or call can provide to the Panel confirmation that no new material was released, etc.;
- remove the requirement for post-meeting financial adviser confirmation relating to meetings or calls attended by advisers (other than the financial adviser or corporate broker), e.g. the PR advisers, and one or more "sell-side" investment analysts. Instead, the confirmation that no new material information was provided can be provided by a senior adviser who attended the meeting;
- require that, where the above rules allow the post-meeting confirmation to be provided by someone other than the financial adviser, the financial adviser must have provided an appropriate briefing to the representatives or adviser attending the meeting or call about what can and cannot be provided at the meeting; and

- disapply the "confirmation" requirement to any meetings or calls only attended by the financial advisers/corporate brokers.

Videos, Social Media and Websites (New Rules 20.3 and 20.4)

A new rule is proposed requiring any videos published by offeror or offeree relating to the offer to receive the consent of the Panel and only to comprise a director or senior executive reading from a script or participating in a scripted interview. Videos have to be published on a website and a RIS announcement with a link to the website has to be published.

Social media can only be used to publish offer information if it is being used to publish the full text of a RIS announcement, a document which has been published on a website in accordance with the Code or a link to a webpage on which the announcement or document has been published.

Advertisements and Other Amendments

Various other related changes are proposed that are not so significant, other than a change that will mean that advertisements will no longer have to include a director's responsibility statement.

The consultation closes to responses on 15 April 2016.

The full text of the consultation is available here:

http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201601.pdf

First UK Corporate Conviction for Failure to Prevent Bribery

As previously reported in our January 2016 edition, on 18 December 2015, Sweett Group PLC ("Sweett") pleaded guilty to failing to prevent an associated person bribing another in order to obtain or retain a business advantage for Sweett contrary to section 7(1)(b) of the Bribery Act 2010. Sweett was sentenced on 19 February 2016. This represents the first successful prosecution and conviction by the Serious Fraud Office ("SFO") of a corporate for that offence.

The Sweett offence relates to payments totalling about £680,000 between January 2013 and July 2014 made by Cyril Sweett International Limited ("CSI"), a Cypriot incorporated company and a wholly owned subsidiary of Sweett which was responsible for Sweett's Middle East operations, under a sub-contract, to a company owned by the Vice Chairman of the Board, and Chairman of the Real Estate and Investment Committee, of Al Ain Ahlia Insurance Company ("AAAI"). The payments were made to secure the award of a £1.6 million contract by AAAI to CSI for the building of a luxury hotel in the UAE. The payments represented about 1.08% of the overall value of the project (£63 million). There was no suggestion that Sweett's senior management were aware that the sub-contract was a sham until it began its own internal investigations into CSI's practices in 2013.

Sweett was ordered to pay £2.35 million, comprising a fine of £1.4 million, £851,152 in confiscation and the SFO's prosecution costs of around £95,000. The SFO did not seek, and the English Court did not order, Sweett to pay compensation. The Court ordered Sweett to pay the confiscation monies by 19 May 2016. Half the fine is due by 19 February 2017, with the balance payable by 19 February 2018. The penalty represents almost 18% of Sweett's market capitalisation as on the date of sentencing (around £13 million).

Despite being a separate legal entity, distinct from Sweett, the Court considered that CSI was not independent of Sweett and that Sweett treated and ran CSI as an internal department. It is a useful example of the circumstances in which a foreign-registered subsidiary may be considered an "associated person" of its UK parent company for the purposes of the Bribery Act.

It is notable that the SFO refused to enter into a Deferred Prosecution Agreement ("DPA") with Sweett, despite having entered into one in November 2015 with Standard Bank ("SB"). It appears that the differences between Sweett's and

SB's conduct before and during the SFO's investigations were a key factor in determining the different outcomes to each prosecution.

For example, whilst SB reported itself to the SFO promptly once it became aware of the circumstances surrounding its sister company's illegal payments to a local partner in Tanzania, Sweett only self-reported in December 2014 (the SFO began its investigation into CSI's Middle East practices in July 2014) after it was notified that the Wall Street Journal was going to publish allegations linking it and CSI to bribery offences rather than of its own volition. The Court criticised Sweett's failure to cooperate fully and openly with the SFO, for deliberately attempting to mislead the SFO as to the illegal nature of the payments, and for attempting to 'spin' the findings of its own internal investigation when it presented them to the SFO. The Court was also critical of Sweett's inadequate internal procedures, finding that Sweett had made "no real effort" to put in place adequate anti-corruption and bribery safeguards and procedures, having been aware since at least 2011 that its and CSI's systems were unfit for purpose and "willfully" choosing to ignore these failings.

Sweett's conviction is particularly significant because it sets down the SFO's clear serious intention to pursue any corporation with connections to the UK for bribery offences, regardless of where the offence(s) took place. Internal anti-bribery and corruption procedures should be monitored (and, where appropriate, updated) periodically with regular mandatory training provided to all staff, agents and contractors, not just senior management, executives and officers.

The importance of early and voluntary self-reporting to, and together with full cooperation with, the SFO cannot be overstated: the SFO was deeply critical of Sweett's decision both to continue its internal investigation after the SFO had begun its investigation and to withhold disclosure of certain documentation covered by Legal Professional Privilege. Companies should be aware that the SFO may consider them to be uncooperative—or at least not sufficiently cooperative—and so refuse to offer a DPA if they do not waive legal privilege over all documentation pertaining to the investigation and continue with their internal investigation after the SFO begins its own investigation.

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.

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This memorandum 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.

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