THE CITY OF LONDON LAW SOCIETY

COMPANY LAW SUB-COMMITTEE

Minutes of the 228th meeting held at 9.00 a.m. on Tuesday 22 May, 2007 at Slaughter and May, One Bunhill Row, EC1Y 8YY

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1. Apologies for absence

Apologies for absence were received from Neal Watson and Mark Curtis. Oliver Barnes attended as alternate for Neal Watson.

2. Approval of minutes

The minutes of the 226th and 227th meetings of the Sub-Committee were approved.

3. Matters arising

3.1 Companies Act 2006

It was noted that the Law Society response to the DTI consultation on secondary legislation and transitional issues under the Companies Act 2006 (the "Act") has now been submitted. Three points were noted:

(i) Reductions of capital – Should the reserve created on a reduction of capital be distributable?

The Law Society response suggests that on a court approved reduction of capital, the reserve should be distributable, as it is currently. In relation to reductions of capital under the new procedure, where a directors' solvency statement is given, the majority view reflected in the Law Society response was that the same principle should apply.

The minority view expressed in the response was that a director's solvency declaration should not result in the reserve being distributable ipso facto. This view rests on a perceived inadequacy of the solvency statement in dealing with longer-term creditors, particularly long term contingent liabilities. It is also pointed out that the process for reducing capital is also not as robust as that for returning capital, where an auditor's report is required.

The Law Society response had also suggested a variation of the minority position that the reserve should only be treated as distributable if it represented a realised profit applying the existing accounting principles. However, it was noted that the accountants now seemed unwilling to be involved in the assessment.

(ii) Financial assistance

The proposed wording to be included in the Explanatory Notes to the Act in relation to the new financial assistance provisions has now been settled. The Explanatory Notes will make clear that maintenance of capital (*Trevor v Whitworth*) principles, other than those which prohibit financial assistance in relation to the acquisition of shares, remain in force. The Explanatory Notes will not seek to identify the scope of the relevant remaining principles in *Trevor v Whitworth*.

It was noted that it was proposed at the March meeting of the Sub-Committee to establish a joint working party with the Banking Sub-Committee to consider the practical consequences of the changes to the financial assistance rules. It was suggested that once the working party is established, it should consider looking at the US experience in relation to financial assistance as part of its mandate.

(iii) Derivative claims

It was noted that the new rules in relation to derivative actions will apply to all such actions immediately upon implementation of Part 11 of the Act, including those actions relating to facts which occurred prior to implementation of the Act. However, it is proposed that if a shareholder would not have been able to bring a derivative action relating to pre-implementation facts before implementation, then he also should not be able to bring such an action following implementation.

3.2 Davies Review of Issuer Liability

It was noted that both the Sub-Committee and the Law Society had submitted responses to the Davies review. The papers were largely consistent. The Chairman reported the key elements of the Sub-Committee's Davies working group paper to the Sub-Committee:

[Note: Questions posed by the Davies review paraphrased]

Q1: What should be the basis of liability?

In the working group's view fraud was the right basis. This also seems to be Davies' view.

Q2: Should the statutory regime be extended in principle to ad hoc (MAD/DTR) statements?

The working party concluded that MAD/DTR disclosures should be covered by the statutory regime, particularly if liability is limited to fraud only.

Q3: Should liability for dishonest delay be actionable by investors or only by the FSA?

The view of the working party was that dishonest delay should not be actionable by investors, only regulators. It was noted that this was not a universally held view and that certain investor groups had been petitioning Davies for dishonest delay to be actionable directly by investors.

Q4: Should the statutory regime be applied to all RIS announcements?

There seems to be a general consensus that the regime should extend to all announcements. However, in the Sub-Committee's response, the working group sought to distinguish between communications to the market generally and communications to shareholders (albeit recognising that the information contained in each communication may be the same or substantially the same). The working group's view was that shareholder communications should continue to be governed by *Caparo* and should be outside the statutory regime - the information being provided to shareholders serves a different purpose to the information being provided to the market generally. Furthermore, the regime should not touch on any individual duties of care which a company may (choose to) establish with third parties, for example, underwriters.

Q5: Should section 90A apply to non-regulated markets?

The working party's view was that this depends on Davies' opinion of the effectiveness of the regulators of those markets.

Q6: Should the claims of investors for damages under section 90A be subordinated to the claims of other unsecured creditors?

The working party was split on this point. One view was that claims should be subordinated although it was noted that this may lead to difficulties, for example, in relation to underwriters. On the other hand, there was also a view that claims in relation to this kind of default by the company were different from any other and accordingly that claims should not be subordinated.

Q7: Should statutory liability for fraudulent mistake be extended to those who make the statement on behalf of the company?

In the view of the working party, statutory liability should not be extended to advisors. The existing law in relation to audit reports (namely, that audit reports are primarily for the benefit of members of the company but liability is subject to the rules in *Caparo*) should continue, but auditors should not have any additional liability as a result of promulgation of audit reports in, for example, prospectuses published by the issuer.

Q8: Should the statutory protection be extended to sellers and holders of securities as well as buyers?

This was a more difficult question than initially thought. The general view of the respondents to Davies seems to be that sellers should fall within the regime. Views differed in relation to holders, the case being made that if a holder can show he did not do something because of a particular statement and that led to a loss, he should be able to bring a claim, although it was recognised that establishing what his loss is may be difficult.

Q9: Should deceit or negligence be the measure of damages adopted in the statutory regime?

The view of the working group was that this is a matter which should properly be left to determination by the courts.

3.3 Accounting for contingent liabilities under IAS 37

The Chairman noted that he attended a meeting with the Law Society on 21 May 2007 to discuss the issue of contingent liabilities discussed at the Sub-Committee's meeting on 27 March 2007. The purpose of the meeting was to update the CLLSCLSC on the outcome of the GC 100 meeting with the IASB and Herbert Smith.

It was reported that the GC 100 had made fairly persuasive representations to the IASB in relation to the proposed amendments to the accounting rules. The GC 100 argued that it is not helpful to consider the issue of contingent liabilities from the standpoint of "is there a liability or not?" because there is not always a clear cut answer to the question.

It was noted that the documents relating to the GC 100 meeting are available on the IASB website. It was also noted that the proposed amendments to IAS 37 were due next year, but it now seems likely that they will be published in 2009.

It was proposed that the Chairman draft a letter of support from the Sub-Committee in relation to the GC 100 papers. The Law Society are preparing a similar letter of support.

3.4 Shareholder voting rights

Nick Janmohamed noted that the European Commission are now considering introducing a recommendation in relation to shareholder voting rights rather than a directive.

It was commented that the most interesting part of the consultation relates to stock lending. From the UK perspective, it seems unnecessary to introduce recommendations in this area in light of the Bank of England best practice recommendations. Furthermore, the consultation paper is a little confused in terms of what current practice is in relation to stock lending.

The Sub-Committee discussed whether they wish to prepare a response to the consultation. It was agreed that the Sub-Committee would do so but that it would not address the issue of whether empty voting is, of itself, a good thing. Nick Jannohamed agreed to prepare the initial draft response.

In the context of shareholder voting rights, the Chairman noted that he had been invited to participate in a roundtable discussion with the SEC in relation to proxy rights. Issues surrounding proxy rights in the US arise from the fact that state law dictates what resolutions can be put to shareholders whereas federal law (the SEC) controls proxy access. The debate focussed on:

(i) who should be able to propose resolutions?

(ii) the US system in relation to precatory (non-binding) resolutions; and

(iii) the US rules that mean resolutions cannot relate to ordinary business of the Company.

It was noted that David Pudge (Clifford Chance) had prepared a very good paper on the UK law position which had been submitted to the SEC and is available on their website. The chairman had suggested at the roundtable that it would be a mistake to use the UK experience to suggest changes to US practice. The systems were in many ways quite different. In general, a UK board is more vulnerable to attack than an US board. This is due to a concentration of shareholder power in fewer institutional shareholders in the UK than in the US; the fact that directors can be voted off the board by shareholders by ordinary resolution in the UK; and the relative ease with which a company can be taken over in the UK.

It was also noted that the SEC was considering whether to require companies to provide a secure website for shareholders. The intention would be that a shareholder should be able to use the site to make comments about the company on a discussion board and propose precatory resolutions to be voted on on-line. It could be made clear that there is no liability on directors arising from the contents of the website and no requirement for directors to act in accordance with shareholder comments on the discussion board, or follow any precatory resolutions.

The Sub-Committee was concerned that if such websites were introduced in the US, there would be pressure to introduce them in the UK but without proper account having been taken of the differences between the US and UK shareholder democracy systems. In the UK, there would be pressure on companies to review their websites continuously and correct erroneous statements from shareholders. Furthermore, companies would find that they needed to encourage institutional shareholders to vote on precatory resolutions so that the Company was not derailed (or perceived to have been derailed) by individual investors with “off-the-wall” ideas.

It was noted that a webcast of the roundtable discussion and copies of the background papers were available on the SEC website.

3.5 Investment companies and "directed minimum" listings

The FSA update was noted.

3.6 DTI consultation on the implementation of the directive on cross-border mergers of limited liability companies

It was noted that the Takeover Working Party had prepared a draft submission in relation to the consultation on the directive on cross-border mergers which would be circulated to members of the Sub-Committee for comment.

It was noted that the government proposed to implement the directive under section 2(5) of the European Communities Act 1972. This has the effect of limiting the companies which can take advantage of the new provisions to those incorporated in the EEA, which is not logical. The Takeover Working Party is not convinced that the new merger provisions will be used much given that the existing methods of combining companies are so well established. An area where they may be contemplated is in transactions involving a US company (given that mergers are common in the US). However, this would not be possible if the restrictions on EEA incorporation remain.

4. Discussion: Transparency directive implementation – issues in practice

Two points were noted by the Sub-Committee:

(i) Stabilisation – the ways in which investment banks ensure that they do not need to make disclosures under the DTRs

It was noted that the complex formulae which had been used to ensure that if the stabilisation position did not have to be disclosed was no longer effective. It was suggested that if stabilisation options included a minimum price there would be no disclosure obligation. However, it was also suggested that investment banks do not find this an attractive option (although no explanation as to why has been given by the banks). The banks seem to prefer to rely on the trading book exemption which exempts trading books of up to 5 per cent. (which could include a stabilisation position) from the obligation to notify. It was also noted that it is unclear whether netting-off is permitted.

(ii) Section 324 Companies Act 1985 references

The UKLA has not tidied up the Listing Rules to remove references to section 324 yet. As there is no longer a requirement to retain a register of directors' interests, the view of the Sub-Committee was that these provisions can have no substance at the moment. It is understood that the UKLA the intends to address this issue in due course.

5. Current problems and recent developments

5.1 Company law and legislation

The Sub-Committee noted the following recent cases:

(A) *Foster Bryant Surveying Ltd v Bryant & Anor*[1] where a director, after tendering his resignation but before actually leaving the company, was approached by the company's major customer with an offer to work for the customer on a fixed retainer basis. The company could not have carried out the work itself. The Court of Appeal decided that, in the particular circumstances, the director was not in breach of his fiduciary duty to the company in accepting the customer's offer;

(B) *Oxus Gold Plc & Anor v Templeton Insurance Ltd*[2] where the High Court decided that, where a company failed to honour its obligation to deliver AIM-listed shares in exchange for share warrants under a warrant deed, the measure of damages was the market price of the shares at the time that delivery should have been made less the contract price. No account was taken of the profit that the warrant holder would have realised had it been allotted the shares and later resold them in the market. In other words, damages were to be assessed by reference to the cost that would have been incurred in purchasing an equivalent number of the shares in the market at the relevant time, not by reference to the profit that would have been made by selling the undelivered shares.

(C) *Gamlestaden Fastigheter AB v Baltic Partners Ltd & Ors (Jersey)*[3] where the claimant, a shareholder and creditor of an insolvent joint venture company, alleged that the company's directors had mismanaged the company's affairs to the claimant's detriment. The Privy Council, following the broad equitable considerations principle confirmed in *O'Neill v Phillips [1999] BCLC 1 HL*, decided that the claimant could, in an application for unfair prejudice under Article 141 of the Companies (Jersey) Law 1991 (substantively equivalent to section 459 of the UK Companies Act 1985 and section 994 of the Act), claim an order for damages to be paid to the company, thereby improving his position as creditor. As long as the relief claimed would be of real financial benefit to the claimant, it did not matter that it would not benefit the claimant in its capacity as a shareholder; and

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[1] [2007] EWCA Civ 200

[2] [2007] EWHC 770 (Comm)

[3] [2007] UKPC 26

(D) *Anglo Petroleum Ltd (2) Paul Sutton v TTFB (Mortgages) Ltd (2007)*[4] where the target company had significant existing indebtedness which was compromised, repaid and refinanced. A significant commitment fee was incurred at the time of the refinancing. It was held that, in the circumstances, the refinanced credit agreement and security agreement entered into by the company did not involve the giving by the company of financial assistance for the purpose of the acquisition of its own shares or to reduce a liability incurred for that purpose contrary to section 151 Companies Act 1985. The initial indebtedness had not been incurred in connection with an acquisition and, therefore, the subsequent refinancing of that debt could also not be financial assistance.

5.2 FSMA

Items 5.2(A) – (C) of the agenda were noted.

5.3 Listing Rules and DTR's

Items 5.3(A) – (E) of the agenda were noted.

5.4 AIM

Item 5.4(A) of the agenda was noted. The NAPF corporate governance policy and voting guidelines for investment companies were discussed. The guidelines are the first attempt to think about corporate governance for AIM companies specifically. It was noted that NAPF was proposing that a 5 per cent. limit on non-pre-emptive share issues should apply.

5.5 Prospectus Rules

Item 5.5(A) of the agenda was noted.

The Sub-Committee discussed whether it wished to submit a response to the European Commission's call for evidence in relation to private placements. Whilst the paper focuses on investments funds, it was noted that it should be of equal application to other companies. Establishing a common approach to private placements seems to represent both an opportunity and a risk: the opportunity to sweep away unnecessary procedural rules and the risk that this may lead to "prospectus–lite" disclosure.

5.6 EU/US overseas company and securities law and practice

Michael Hatchard noted that there had been two recent developments in the US in relation to Rule 14e-5:

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[4] [2007] EWCA Civ 456

(i) Bidder Relief

In a letter dated 2 March 2007 (the "March 2 Letter") the SEC granted class-wide exemptive relief under Rule 14e-5 to bidders that wish to purchase shares of a foreign private issuer target outside of the tender offer in certain prescribed circumstances. The principal conditions to qualify for this relief are:

(a) the target must be a foreign private issuer with no more than 40 per cent. of the subject class of securities held by US residents (Tier 2);

(b) the laws of the target's "home jurisdiction" (i.e. both the jurisdiction of the target's incorporation and the principal non-US market in which the target's securities are listed or quoted, if different) must permit purchases outside of the tender offer and provide that the tender offer price be increased to match any consideration paid outside of the tender offer that is higher than the lender offer price;

(c) jurisdiction(s) must be parties to a bilateral or multilateral memorandum of understanding regarding consultation and cooperation in the administration and enforcement of securities laws;

(d) no such purchases may be made in the United States; and

(e) adequate disclosure must be set forth in the offer document.

(ii) Financial Adviser Relief

In a letter dated 4 April 2007 (the "April 4 Letter") the SEC granted class-wide exemptive relief under Rule 14e-5 for ordinary trading activities of financial advisers and their affiliates during a tender offer.

Trading activities covered include market making activities; purchasing and selling securities as part of ordinary course portfolio and asset management activities for third-party customers (other than other covered persons) as well as for their own account; principal facilitation to buy the securities to facilitate client orders; creation of derivative products; index arbitrage activities; program trading; hedging activities; lending and borrowing securities; purchasing securities to deliver upon exercise of call options or warrants; buying securities to cover short positions entered into after the announcement of the tender offer; and buying securities in a proprietary capacity.

The exemptive relief is subject to several conditions, including the following:

(a) the target must be a foreign private issuer with no more than 40 per cent. of the subject class of securities held by US residents (Tier 2);

(b) the trading activities are only conducted outside the US;

(c) the trading activities are consistent with the financial adviser's normal and usual business practices, and are not conducted to promote or otherwise facilitate the offer, or to create actual, or apparent, active trading in, or maintain or affect the price of, the target company's securities;

(d) the financial adviser and its affiliates and departments maintain and enforce written policies and procedures that are reasonably designed to prevent the transfer of information among the financial adviser and its affiliates and departments that conduct the trading activities that might result in a violation of the US federal securities laws through the establishment of information barriers;

(e) the financial adviser, through its affiliates and departments, conducts the trading activities voluntarily in compliance with the pertinent provisions of the Takeover Code, and the affiliates and departments conduct themselves as if they were connected exempt principal traders as defined in the Takeover Code, including complying with regulations with respect to the establishment and maintenance of information barriers, conflict of interest provisions and other requirements, other than with respect to the notification of relevant trades to the Takeover Panel. The financial adviser will, however, publicly disclose in the United States information regarding the trading activities to the extent that such information is required to be made public in the subject company's home jurisdiction; and

(f) The financial advisors must follow a number of other requirements regarding disclosure of purchases to the SEC.

Furthermore, reliance on the relief in the April 4 Letter does not prevent financial advisers from making purchases of securities outside the tender offer on behalf of the bidder in such tender offer pursuant to the March 2 Letter, so long as, among other things, the financial adviser wishing both to engage in trading activities and to make purchases on behalf of the bidder and its agents outside of a tender offer designates an individual trader or traders to make such purchases on behalf of the bidder and its agents (the “Designated Traders”), and other that such purchases, the Designated Traders do not make any other purchase of target company securities during the offer period.

It was also noted that the Australian Securities and Investments Commission (“ASIC”) has released a policy proposal paper which, if adopted, will limit the circumstances in which a foreign bidder offering share consideration under a takeover offer will be required to prepare an Australian prospectus.

The Sub-Committee understands that, if the proposals set out in the paper come into force, a bidder making a share consideration takeover offer under the Takeover Code will not be required to prepare an Australian prospectus provided that certain criteria are

satisfied and accordingly, rubrics relating to exclusion of an offer in Australia should no longer be necessary. The most significant criteria are likely to be that:

(i) no more than ten per cent of target shares are held by Australian residents; and

(ii) the target's shares are listed on the Official List and traded on the London Stock Exchange, or traded on another "approved foreign market".

In addition, the ASIC has recently issued a class order entrenching the position that a foreign bidder offering share consideration pursuant to a UK scheme of arrangement is not subject to the Australian prospectus provisions.

5.7 Accounting standard and practice

Items 5.7(A) – (G) of the agenda were noted.

5.8 Mergers and acquisitions (public)

It was noted that there seems to have been a change in the Panel's attitude to non-EU regulatory pre-conditions and conditions ("Non-EU Conditions") in takeover offers. At the time of PCP 2004/4 and RS 2004/4, the Takeover Working Group suggested to the Panel that it clarify that Rule 13.2 (which provides that EU regulatory clearances are not subject to the Takeover Code provisions relating to subjectivity and invoking of conditions (Rules 13.1 and 13.4)) also applies to Non-EU Conditions. The Panel confirmed to the Takeover Working Group that Rule 13.2 would apply to Non-EU Conditions but expressed a reluctance to state this in the Takeover Code. However, the Panel seems to have reversed its position on this and is now stating that Rule 13.2 will not apply to Non-EU Conditions.

5.9 Mergers and acquisitions (private)

The Sub-Committee noted the case of *Millam v The Print Factory (London) 1991 Ltd*[5]. In the case, the Court of Appeal held that the employees of a company whose shares had been purchased by its holding company had transferred to the holding company under TUPE. The tribunal's finding that the activities of the subsidiary were being carried out by the holding company was a finding of fact and did not involve any piercing of the corporate veil.

The decision is a reminder that where the intention is to integrate the business of a company acquired into a buyer's existing business, or to integrate key functions of a corporate group, that courts will look at the substance of a transaction in determining

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[5] [2007] EWCA Civ 332

whether there has been a TUPE transfer. It will be a matter of fact as to whether the relevant business has been transferred from one owner to another.

6. Current cases not otherwise reported

The case of *British Vita Unlimited v British Pension Fund Trustees Ltd and Anor*[6] was noted. British Vita ("BV"), which was a FTSE 250 company until acquired by a private equity firm, was the principal employer under two defined benefit pension schemes. At the time of the acquisition, the schemes were fully funded on an FRS17 basis. The trustees of the schemes subsequently demanded payment by BV of, in aggregate, £49.6 million (the "demands") to ensure that the schemes were fully funded on a buyout basis. The demands were purportedly made pursuant to the powers vested in them under the schemes' respective contribution rules. BV claimed that: (i) as a result of the coming into force of the provisions of Pt 3 of the Pension Act 2004 (the "Pension Act") and the Occupational Pension Schemes (Scheme Funding) Regulations 2005, SI 2005/3377 (the "Regulations"), the trustees were, by the time the demands were made, no longer able to exercise the powers conferred on them by the respective contributions rules of the schemes, and (ii) that on their true construction, the respective contribution rules of the schemes did not permit the trustees to demand the stipulated sums from BV alone in the manner in which they did.

The question was whether there was a conflict, within the meaning of s 306 of the Pension Act, between the provisions of Part 3 of the Pension Act and the Regulations on the one hand and the rules of the schemes on the other. If there was such a conflict, the rules were overridden to the extent of the conflict, but if there was no conflict, then BV's submission that the overall scheme of Part 3 provided a complete code did not have any force.

The claim by BV was dismissed. Until the first schedule of contributions was in place, there was no conflict between the legislation and scheme contribution rules. During that period the trustees, in the case of an existing scheme, might continue to operate the scheme contribution rules and were not restricted to recovery of the amounts shown in the minimum funding requirement schedule of contributions; and in the case of a newly established scheme they were not prevented from recovering any contribution at all. The demands for repayment, if otherwise valid, were not invalidated by Part 3 of the Pension Act and the Regulations having been made, and payment having been required, before any schedule of contributions had been in place or been required to have been put in place. The demands were within the scope of the scheme rules. It was a matter to be decided in other proceedings whether the trustees could, acting properly, in fact have adopted the apportionment which they had purported to adopt.

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[6] [2007] EWHC 953 (Ch)

7. Close

There being no further business, the meeting was closed.

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Chairman

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