Lovells

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Corporate finance

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DLC merger structures

Two of the biggest mergers announced this year, between Billiton and BHP and between GKN and Brambles, have adopted a dual listed company structure (or DLC structure). This structure has been used on a handful of cross-border transactions, most notably Reed/Elsevier in 1992, RTZ/CRA in 1996 and BAT/Zurich in 1998, although not to date in a UK/US merger. This article discusses some of the factors which may cause a merger to be structured in this way, rather than in a more conventional manner, and explains how the structure works.

THE DLC STRUCTURE IN OUTLINE

The term "DLC structure" is used generically to describe a merger in which there is no acquisition or disposal of shares in the two parent companies which retain their separate corporate existences and listings but enter into arrangements which ensure:

- that shareholders of the two companies are effectively in the same economic position as they would have been if they held shares in a single combined enterprise
- that the two companies are managed on a unified basis
- that it is not possible for a predator to take over one of the two companies without the other.

The most appropriate mechanism for achieving these basic objectives will depend on the particular circumstances of the parties and the jurisdictions involved. However, the structures which have been used to date can be divided into two basic categories:

- In the first category, the business operations of the two companies are merged under one or more intermediate holding companies in which the two listed companies hold shares. The listed companies retain their separate existences and the shares are traded separately. The intermediate holding company (or companies) is the main link which keeps the two listed companies together and ensures unified management. The function of the two listed companies is simply to hold shares in the intermediate holding company, to receive dividends from it and to distribute those dividends to its own shareholders. Variations on this structure were used by Reed/Elsevier and BAT/Zurich.

  The structure raises complex tax issues in relation to the transfer of assets into joint ownership and in relation to dividend flows from the operating subsidiaries through the intermediate holding company to the two parent companies.

- In the second type of structure, the business operations are not jointly owned but remain within the separate ownership of the two listed companies. Unified management is assured by the two listed companies always having identical boards. By agreement between the two companies, the dividends on their shares are equalised and, if necessary, payments are made by one company to the other to ensure that adequate funds are available to pay the equalised dividends. Similarly, on a winding up, shareholders in the two companies have an equal participation in any surplus assets. This is the structure used in both the BHP/Billiton and GKN/Brambles transactions.

  This structure is generally more straightforward from a tax perspective since there is no change in corporate structure and no transfer of assets. However, the tax implications of the equalisation arrangements will require careful consideration.

REASONS TO USE A DLC STRUCTURE

The reasons for using a DLC structure will vary from case to case. Factors which may be relevant include the following:

- If the transaction genuinely is, or (perhaps more importantly) is to be presented as, a "merger of equals", an agreed takeover by one of the other may be considered undesirable. This can be of particular concern in the cross-border context where the question of national identity arises and where the acquiring company's jurisdiction will very probably become not only the venue for future headquarters activity but also the enlarged group's primary listing and the focus for its investor relations activities. Using a new company to acquire both companies and issue its shares as consideration would raise the same issues if the new company was established in the home jurisdiction of either party, while choosing a neutral jurisdiction would inevitably have practical disadvantages, not least the need to establish a presence in the new jurisdiction and move people there.
- In the context of a takeover, target shareholders will normally expect any offer to be at a premium to market value, which they would effectively enjoy at the expense of the bidder's shareholders. This may be unacceptable to the bidder and is also inconsistent with the notion of a "merger of equals" if that is how the transaction is to be presented.
- A takeover of the UK company would require 90% acceptances to allow use of the compulsory acquisition procedure to buy in the minority, while a takeover by the UK company would be likely to face similar obstacles in the relevant overseas jurisdiction (in Holland for example the threshold is 95%). Depending which variation is used, a DLC structure will require only an ordinary or special resolution which will normally be a formality.
- A conventional takeover will involve a change of control of target and its subsidiaries which may require regulatory approvals or cause difficulties with change of control provisions. The DLC structure adopted by BHP/Billiton and GKN/Brambles under which there is no transfer of underlying assets and no change of control at any level, should avoid these difficulties (although contracts will still have to be checked to ensure that the change of control clause is not drafted so as to catch a DLC structure).
- Because the structure involves no disposal of shares by the shareholders of either company, there will be no exposure to any capital gains tax or similar liabilities and no stamp duty or similar taxes on the transfer of shares. In the structure which involves joint ownership there are likely to be stamp duty or transfer taxes on the transfer of assets into joint ownership, but the structure adopted by BHP/Billiton and GKN/Brambles involves no transfer of assets and should therefore avoid stamp duty and similar taxes completely.
- A conventional takeover would result in target's shareholders receiving dividends from a company in a different jurisdiction, which may be tax inefficient. (For example, in the cases of BHP/Billiton and GKN/Brambles the structure preserved the ability of BHP and Brambles to pay dividends to its Australian shareholders which carry valuable franking credits under Australian tax law.) In theory one could try to take account of any adverse tax consequences in agreeing the respective values of the two companies at the outset. In practice, however, this would be extremely difficult as it would depend upon the breakdown of the shareholder base into different taxable categories (individuals, companies, tax exempt shareholders etc) and their geographical locations.

KEY FEATURES

The key features of the structure adopted by BHP/Billiton and GKN/Brambles are as follows:

- **Equalisation:** The purpose of the equalisation arrangements is to put shareholders in the same economic position as they would have been in if they held shares in a single combined entity. The provisions are contained in an agreement between the two companies and in their respective articles of association or equivalent constitutional documents. The starting point is for the two companies to agree valuations for the two companies and, based on those valuations and the respective numbers of shares in issue, an equalisation ratio which reflects the relative values of each company's shares. (In the case of BHP/Billiton, for simplicity, BHP made a bonus issue of shares on a basis such that the ratio became 1:1, that is to say, one BHP share is equivalent to one Billiton share. There is, however, no need for the ratio to be 1:1 - the equalisation arrangements will work whatever the ratio.) The basic principle is then that the dividends paid by each company on each share and the capital returns on each share should be in the same proportions as the equalisation ratio.

The equalisation ratio is adjusted in the event of an equity issue where the terms may benefit the shareholders of one company but not the other. For example, there would be no adjustment in the case of an issue of shares by one company to fund an acquisition since (because of the dividend and capital equalisation provisions) both sets of shareholders would benefit equally from the results of the acquired business regardless of which parent company acquired the business and issued the consideration shares. However, if one company made a rights issue at a discount to the market price then shareholders of that company would receive the benefit of the discount which would not be available to shareholders of the other company. The equalisation ratio would therefore be adjusted to reflect the bonus element of the rights issue price. The equalisation ratio would also be adjusted in the event of certain other actions affecting the share capital of one company but not the other, such as a capitalisation issue or a consolidation or sub-division of shares.

- **Shareholder voting procedures:** Because the economic interests of the two sets of shareholders after the merger are identical, in most cases their interests as shareholders will not diverge. The structure therefore involves putting in place a procedure under which decisions which affect the combined group as a whole are taken by both sets of shareholders voting together as a joint electorate. This was achieved by the issue of a special voting share by each company. Under the articles of association of each company, resolutions which are to be the subject of the joint electoral procedure must be put to separate general meetings of both companies. The special voting shares are then used at each meeting to reflect the votes of the shareholders of the other company. The effect of these procedures is that the results of the voting on the equivalent resolutions at each meeting will be exactly the same. The special voting shares are held by special purpose vehicles owned by a nominee company and subject to agreements which ensure that the votes attached to the shares can only be cast so as to give effect to the agreed voting arrangements.

  The joint electoral procedure applies to all matters which affect both sets of shareholders equally. If there is a matter on which the interests of the two sets of shareholders could differ (for example on proposed amendments to the merger arrangements) then, for each company, the approval of the shareholders of the other company, voting at a separate meeting without the use of the joint electorate procedure, is required as well as that of its own shareholders. This is achieved through the rights attaching to the special voting shares which provide that any such action is deemed to be a variation of those rights. The agreements relating to the special voting shares then go on to provide that the holder of the special voting share can only consent to such a variation if the shareholders of the other company have separately voted and approved the relevant matter.

- **Management:** As noted above, a key element of the DLC structure is that the two companies are managed on a unified basis. This can be achieved by including provisions in the articles of association of each parent company which ensure that no person can be a director of one company unless that person is at the same time a director of the other. Care needs to be taken to ensure that the composition of the boards and the arrangements for meetings do not result in either parent company being resident in the other's jurisdiction for tax purposes.

- **Takeovers:** It is fundamental to the DLC structure that it should not be possible for a predator to take over one company without the other. If this was possible, shareholders of one company could be disadvantaged, for example, if they did not receive the benefit of an offer made for the other at a premium to market price. The precise method of preventing such a situation will depend upon the rules governing takeovers in the relevant overseas jurisdiction and how these interact with the Code. However, the basic procedure adopted is to include additional provisions in the articles of association of the two companies which impose sanctions on any person who obtains more than a specified percentage of the voting rights which may be cast on a joint decision. These include the withholding of dividends, disenfranchisement and an obligation to sell the excess holding. The sanctions would not apply to a person who made a bid on comparable terms for both companies.

- **Accounting:** Following the merger, each company will present the same set of combined financial statements as its consolidated accounts (that is, there is a single set of combined accounts for both companies). The rationale for this is that since the two sets of shareholders were in the same position that they would be in if they owned shares in a combined entity, to present the accounts separately would be misleading and would fail to give a "true and fair view".

All these features were present in the type of DLC structure used by Reed/Elsevier and BAT/Zurich although the mechanics are different.

Lovells acted for JP Morgan, financial advisor to Billiton on the BHP/Billiton merger.

Code of market conduct

INTRODUCTION

In April, following a period of consultation, the Financial Services Authority (the "**FSA**") published the final text of the Code of Market Conduct (the "**Code**"). The Code is made under the Financial Services and Markets Act 2000 (the "**Act**") which introduces a new financial penalties regime to tackle market abuse. Broadly speaking, market abuse is defined in the Act as the misuse of information, the giving of false or misleading impressions and market distortion. The Act requires the FSA to produce a code giving guidance on what does and does not amount to market abuse. The Code does not have the effect of modifying or extending any disclosure obligations, including under the Listing Rules and the Takeover Code or which apply in relation to any prescribed market (that is, any securities, options, commodities or futures exchange).

The Code will be legally "made" when the principal provisions of the Act come into force, a date colloquially known as "N2". N2 is expected to be 1 December 2001. The publication of the Code coincides with similar initiatives in the United States and Europe. The United States Securities and Exchange Commission has adopted Regulation FD (Fair Disclosure) which came into effect in October 2000, while the European Commission has published a proposed directive on insider dealing and market manipulation (market abuse).

APPLICATION

The three tests in the Act which must be satisfied in order to establish that behaviour, whether by one person alone or by two or more persons jointly or in concert, amounts to market abuse, are as follows:

- the behaviour must occur in relation to a qualifying investment (that is, an exchange-traded investment) traded on a prescribed market which is located in the United Kingdom or which is accessible electronically in the United Kingdom
- the behaviour must satisfy one or more of the following conditions:
  - the behaviour is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected ("**Misuse of Information**")
  - the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question ("**False or Misleading Impressions**")
  - a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question ("**Market Distortion**")
- the behaviour must be likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in the position of the person in question.

MISUSE OF INFORMATION

Behaviour will amount to market abuse in that it will be a misuse of information where a person deals or arranges deals in any qualifying investment or relevant product where all four of the following circumstances are present:

- the dealing or arranging is based on information

- the information must be information which is not generally available
- the information must be likely to be regarded by a regular user as relevant when deciding the terms on which transactions in the investments of the kind in question should be effected
- the information must relate to matters which the regular user would reasonably expect to be disclosed to users of the particular prescribed market.

Dealing or arranging deals will not amount to a misuse of information:

- if it is required for other reasons
- if it is not based on information
- solely because it is based on trading information (other than relating to takeover bids and primary market activities)
- if it is engaged in to facilitate a takeover bid or other market operations.

Dealing or arranging deals in the context of facilitating a takeover bid includes:

- seeking from holders of securities irrevocable undertakings or expressions of support to accept an offer to acquire those securities (or not to accept such an offer)
- making arrangements in connection with an issue of securities where those securities are to be offered as consideration for the takeover offer or to be issued in order to fund the takeover offer, including making arrangements for the underwriting or placing of those securities
- making arrangements to offer cash as consideration for the takeover offer as an alternative to securities consideration.

A person should not be prevented from acquiring an equity or non-equity stake in a company with a view to pursuing a takeover bid or engaging in other forms of market operations simply because it knew that it would be making a bid, and the knowledge amounted to relevant information.

FALSE OR MISLEADING IMPRESSIONS

The following will amount to market abuse in that the behaviour gives rise, or is likely to give rise, to a false or misleading impression:

- engaging in artificial transactions
- disseminating false or misleading information
- disseminating information through an accepted channel without reasonable care
- engaging in a course of conduct to create a false or misleading impression.

The following will not give rise to a false or misleading impression:

- engaging in certain permitted transactions (for example, taking legitimate advantage of differences in the prices of investments or commodities as traded in different locations)
- required reporting or disclosure of transactions
- properly using Chinese walls.

MARKET DISTORTION

The following will amount to market abuse in that the behaviour gives rise to market distortion:

- engaging in price positioning (that is, entering into a transaction to position the price of a qualifying investment or product related to a qualifying investment at a distorted level)
- engaging in abusive squeezes (that is, exercising a significant influence over the supply of, or demand for, a qualifying investment or product related to a qualifying investment for the purposes of price positioning).

Behaviour which complies with the London Metal Exchange rules contained in "Market Aberrations: The Way Forward" published in October 1998, which govern the behaviour expected of long position holders, will not amount to market abuse in that the behaviour will not amount to distortion.

PENALTIES

The FSA will have the power either to impose a penalty, or to make a statement to the effect that a person has engaged in market abuse, if the FSA is satisfied that that person:

- has engaged in market abuse
- by taking or refraining from taking any action has required or encouraged another to engage in behaviour which, if engaged in by the person itself, would amount to market abuse.

The FSA's policy on penalties is set out in its Enforcement Manual and is to protect prescribed markets from any damage to their efficiency caused by market abuse without having an adverse impact on prescribed markets (for example, causing public uncertainty or affecting the timing or outcome of takeover bids). Part IX of the Act provides for hearings and appeals, which are in front of the Financial Services and Markets Tribunal in the first instance. Nothing in the Code makes lawful or permits any activity that contravenes the criminal law or applicable legal or regulatory requirements which apply to the same extent as before.

STATUTORY EXCEPTIONS AND DEFENCES

The Act provides statutory exceptions (or safe harbours) for behaviour that is described in the Code as not amounting to market abuse and for behaviour that conforms with an FSA rule. Behaviour will be regarded as conforming with an FSA rule only if it is required or expressly permitted by that rule. Aside from limited safe harbours, the regular user may not necessarily consider that complying with applicable requirements of the Takeover Code will be sufficient in and of itself to demonstrate that behaviour does not amount to market abuse.

The FSA cannot impose a penalty if there are reasonable grounds for it to be satisfied that a person:

- believed on reasonable grounds that its behaviour did not amount to market abuse
- had taken all reasonable precautions and exercised all due diligence to avoid engaging in market abuse.

NEXT STEPS

The FSA is now establishing procedures for giving guidance and finalising operating arrangements with the Recognised Investment Exchanges, the Takeover Panel and other relevant parties. The FSA also plans to publish a short summary of the market abuse regime and a decision tree setting out the key elements of the market abuse regime and the types of questions which persons should ask themselves when considering whether their behaviour might amount to market abuse.

COMMENTARY

The Code sets out a new market abuse regime which is in addition to the existing criminal regimes for insider dealing and market manipulation. The new regime is, however, considerably wider and will allow the FSA to impose fines or publicly censure individuals whose behaviour is damaging to the market but which does not constitute any of the existing criminal offences. In particular, the new regime does not require knowledge, intent or recklessness on the part of the alleged abusers in order for a market abuse offence to be committed. Listed companies will need to take particular care in preparing announcements or in disclosing information on an early or selective basis in order to ensure that their actions do not amount to market abuse.

Takeover directive hits the rocks

In the March 2001 edition of the Corporate Finance Newsletter, we reported that the debate on the European Takeover Directive (the "**Directive**") had been reopened in December 2000 by the European Parliament voting in favour of amending various parts of the agreed text of the Directive. Since then the Directive appeared to be on the brink of finally being adopted, before being scuppered at the very last minute by the European Parliament.

ALMOST THERE . . .

Success seemed close at hand when, in June 2001, an agreement was reached by the European Parliament's Conciliation Committee on a compromise text for the Directive. This compromise addressed the three most emotive issues raised in the Directive:

- **Defensive action:** Article 9 of the Directive proposed to impose an obligation on the management of a target company to consult shareholders before putting in place defensive measures against a hostile bid, so in effect prohibiting the use by companies of poison pills without prior shareholder approval. Under the compromise agreed, it was proposed that Member States be allowed an additional year to implement Article 9 (that is to say, by mid 2006).
- **Target employees:** In order to provide a far greater role in the takeover process for the employees of the target company, the compromise proposed that it would be necessary to notify the employees of the target company of the likely impact of the takeover bid on their employment, employment conditions and company locations at the same time as this information was notified to the public.
- **Mandatory bids:** In order to examine closely the position in relation to mandatory bids, the European Commission gave an undertaking, in the form of a declaration, to consider:
  - the principles to be used for defining the equitable price that must be offered in the case of a mandatory bid
  - the rights of the majority shareholder in a company to acquire the shares of minority shareholders
  - the equal treatment of shareholders in Member States.

The European Commission also proposed the setting up of a group of company law experts to assist it in identifying the priorities for a more detailed harmonisation of company law and the above three issues in particular.

The compromise text was submitted for definitive adoption by both the European Parliament and the European Union's Council of Ministers and it appeared that, after more than ten years of debate, the Directive was finally on the brink of being adopted.

BACK TO THE DRAWING BOARD

On 5 July 2001, to widespread surprise and dismay, the European Parliament failed to adopt the Directive, throwing it out after being split on the vote to pass it 273 to 273 with 22 abstentions. This has sent the exponents of a European wide takeover regime back to the drawing board.

The European Parliament's vote followed intense lobbying from opponents of the Directive, many of whom were German companies concerned about the threat of foreign takeover approaches. The Directive's opponents argued that it would not create the promised level playing field for European takeover bids. Their main objection continued to be the proposed provisions in relation to the use of poison pills (as mentioned above, Article 9 proposed to prohibit their use without the prior approval of shareholders - as is the case in the UK Takeover Code).

COMMENT

The European Parliament's rejection of the Directive arguably sends out negative signals in relation to its commitment to liberalise the European market. As it now stands, rather than putting into place a co-ordinated approach to regulate the consolidation of the European corporate market, European member state governments will be free to regulate their takeovers in accordance with domestic rules (so increasing the risk of certain member states adopting protectionist attitudes). However, the practical effects of this rejection of the Directive remain to be seen. Whilst the Directive had been the subject of years of wrangling and compromise, it has to a large degree been overtaken by events since, as European companies have sought to raise capital internationally, Anglo-Saxon practices have become increasingly common, including in relation to takeovers. The result of this has been the adoption by various Member States of their own takeover codes based heavily on existing Anglo-Saxon practices. Even where frustrating action is permitted, increasing globalisation of capital markets may tend to prevent such action being taken since many European companies have an increasingly international shareholder base which may find such action unacceptable.

Commission proposes single prospectus valid EU-wide

In June the European Commission presented a proposal for a directive that would introduce a new "single passport for issuers" so that once a prospectus had been approved by the home country authority of the issuer it would have to be accepted throughout the EU for public offers and/or admission to trading on regulated markets.

This represents an admission that the mutual recognition regime, which stems from the Listing Particulars Directive (implemented in the UK by Part IV of the Financial Services Act 1986) and the Public Offers Directive (implemented in the UK by the Public Offers of Securities Regulations 1995), has failed to achieve its purpose. Under the current regime, mutual recognition is granted only to prospectuses (for listing or public offer) that set out the information specified in the Listing Particulars Directive and are approved by the competent authorities. The host country authority is authorised to require additional information related to the domestic market (including translations into the host country language), and regulations and practices vary widely throughout the EU. As a result, EU capital markets remain fragmented and it has rarely proved possible to use prospectuses issued in one Member State to raise capital in others, a situation which has been described as "the antithesis of the logic of the single currency". The general consensus is that there is a need for modernisation and more flexibility in a system which is complex, inefficient and expensive. Furthermore, there is at present no European recognition system at all for securities falling outside the scope of the Listing Particulars Directive. The proposed directive envisages full coverage of equity and debt securities admitted to trading on regulated markets.

The directive follows the guidelines set out in the recently published Report of the Committee of Wise Men on the Regulation of European Securities Markets: it distinguishes between framework principles (dealt with in the directive itself) and non-essential technical implementing measures, such as clarification of definitions and exemptions and adaptation of disclosure standards. Such technical implementing measures would be prepared by a (yet to be established) Securities Committee in accordance with the relevant provisions of the directive.

KEY FEATURES

- **Notification system:** The introduction of a true "single passport for issuers" requires the replacement of the existing mutual recognition system by a simple notification system. Once the registration document and securities note for a public offer or for admission to trading has been approved by the issuer's home competent authority (see below), other regulated markets would be required to accept those documents and would be deprived of the possibility of asking for additional information to be included. Host Member States' competent authorities would be entitled only to ask for a translation of the summary of the prospectus, provided that the full prospectus is drafted in a language which is customary in the sphere of finance (normally English).
- **Enhanced disclosure standards:** The thinking behind the new directive is that adequate and equivalent disclosure standards should be in place in all European Member States when securities are offered to the public or traded on regulated markets. This implies the alignment of existing standards for public offers of securities and admission to trading as well as an overall alignment with standards set by IOSCO (the International Organisation for Securities

Commissions). This change acknowledges the fact that many hi-tech companies are traded on regulated markets outside the official listing segment. The directive would therefore apply to all securities which are offered to the public or are admitted to trading on a regulated market as defined in the Investment Services Directive, that is to say, there would be full coverage of equity and debt securities rather than only those admitted to the official list of stock exchanges. The wide definition of securities would be valid only for this directive and would not affect the various definitions of financial instruments used for other purposes such as taxation. It covers negotiable instruments only. Clear and common definitions are seen as a precondition to achieving harmonised disclosure standards. For example, the introduction of a definition of public offer is aimed at eliminating the disparity and treatment accorded to retail investors due to the fact that the same operation is considered as a private placement in some Member States (and therefore no prospectus needs to be published) but not in others.

- **Registration document system:** Under the proposals, a prospectus would be split into separate documents: the registration document, containing information about the issuer, and the securities note, containing information about the securities themselves. A summary of the information contained in these two documents would be provided in a summary note, which would also contain the risk warnings. Issuers whose securities are traded on regulated markets would have to update the registration document at least annually, as well as complying with ongoing disclosure requirements. Issuers whose securities are simply offered to the public without admission to trading on a regulated market may decide to publish the prospectus as a single document using the traditional format, and would therefore not have to comply with the annual update.

- **Fast track procedure:** The directive proposes a fast track procedure for new issues by companies whose securities have already been admitted for trading. In these circumstances only the information related to the securities being offered or admitted to trading would have to be given. The supervisory authority would be required to approve only the securities note and a summary and therefore the time for approval would be reduced. This system responds to an increase in demand from multinational issuers for frequent capital raising. In addition, incorporation by reference would be allowed, so that information to be disclosed in the prospectus could be incorporated by reference to a previously filed and approved document, saving time and cost for companies frequently raising capital.

- **Use of the internet:** To facilitate the circulation of prospectuses the use of electronic means such as the internet is encouraged. The proposed directive contains an obligation on issuers to ensure availability of the prospectus on the relevant competent authority's website.

- **Concentration of responsibilities in the home administrative competent authority:** The current regime simply requires Member States to notify the identity of the competent authorities. However, the introduction of a notification system requires mutual trust among competent authorities and similarities in performing regulatory and supervisory functions. The directive therefore clarifies that the home Member State administrative competent authority would be responsible for ensuring proper supervision to guarantee equivalent treatment of investors and ongoing disclosure of material information by the issuer (and sets out minimum powers they must have), leaving exchanges to compete solely on the basis of commercial efficiency without being fettered by public functions. This splitting of functions took place in the UK last year at the suggestion of the London Stock Exchange, following its decision to demutualise.

IMPLEMENTATION

The Commission would like the directive to be adopted in 2002, although the benefits will be available in practice only once it has been implemented into the legislation of all Member States. If the deadline for adoption is met, implementation should take place by the end of 2003. The Listing Particulars Directive and Public Offers Directive will be repealed at the same time as the directive enters into force.

COMMENT

It is hoped that implementation of the proposed directive will produce various benefits:

- easier and cheaper pan-European capital raising due to the "single passport" concept and the reduced time limit for approval of documentation on new issues (provided the registration document has already been filed)
- promotion of investor confidence due to harmonised disclosure standards and better access to information
- removal of disparities in the treatment of retail investors within the EU by standardising the definition of public offer.

However, the proposed directive has been the subject of criticism from, amongst others, the London Stock Exchange. Criticisms include the following:

- The obligation for issuers to have a prospectus approved by their home Member State (that is, where they have their registered office) rather than by, for example, the Member State in which they intend to offer securities to the public, is too restrictive and ignores the fact that competent authorities vary in terms of resources and expertise, and that certain authorities have built up particular knowledge of complex financial instruments.
- Harmonisation of standards would impose the same basic standards on start-ups and large multinational companies, doing away with the regulatory differentiation between official listings and secondary markets. The need to file an annual registration document presents a significant additional burden on companies and takes no account of their capital raising intentions or the needs of their investor base.
- The new definition of public offer would involve significant changes to existing law and practice. For example, loan notes offered to target shareholders on a takeover offer would require publication of a document containing information equivalent to a prospectus.
- Factors not addressed in the directive may cause differences to persist between competent authorities, such as the fees they charge and continuing obligations they impose.

The LSE has made submissions to the UK government detailing its response to the proposals, but it is yet to be seen whether this will have an influence on the final form of the directive.

Corporate governance update

There has not been a new report on Corporate Governance since Turnbull (reporting in 1999) slotted in the final piece of the Combined Code jigsaw but Corporate Governance is a living thing and does not stand still. It is now virtually impossible to pay serious attention to Corporate Governance without acknowledging the importance for the Board to grasp a number of nettles firmly by their stems. This may come as a result of risk analysis following Turnbull, shareholder or public activism following exposure of business practices, an increasing recognition that creating long-term sustainable value is the business objective which (particularly when facing a potential downturn) should triumph over short-term profitability, or through acceptance of the notion of earning a "licence to operate". Some of these issues will also be relevant to the inclusion of a company in the new FTSE 4 GOOD Index Series.

This article reviews a number of disparate but connected issues which should be on the agenda of most Boards and behind which there are both business and legal drivers. Only the briefest mention is made of the scope of the various issues; Lovells can, however, help with more guidance on all of them.

INTERNAL CONTROL

Turnbull is for real. Listed company accounts that are drawn up for accounting periods ending on or after 23 December 2000 will have to describe how the company has complied with the requirement to have a sound system of internal control; this in turn will involve a thorough review at Board level of all material risk areas faced by the business.

INTERNATIONAL CORPORATE GOVERNANCE

Companies operating internationally, particularly those who are major investors in, or participants in joint ventures with, international public companies, should be fully aware of the international developments in Corporate Governance through the OECD Guidelines for Multinational Enterprises and Principles of Corporate Governance and World Bank initiatives and round tables to encourage good Corporate Governance. Recently these have focused on Eastern Europe and South America in particular, and Russia is in the process of preparing its own Corporate Govenance code to address many of the inherent flaws in its legal and corporate operating structure.

CORPORATE SOCIAL RESPONSIBILITY (CSR) AND SOCIALLY RESPONSIBLE INVESTMENT (SRI)

The UK Government has had a Minister for Corporate Responsibility for over two years and the new Secretary of State for Trade and Industry, Patricia Hewitt MP, has recently reaffirmed the Government's intention to promote corporate social responsibility "because it is good business" and not merely because it is a good thing. The Government are committed to the promotion of national and international standards capable of being enforced, making it clear that they will not put up with "bad" business, that is, business that does not recognise "human capital" - one of the main sources of wealth creation so that investment in people is seen as a vital function of business.

Pension fund trustees now have to disclose, in their Investment Principles, their approach to environmental and ethical considerations in the make-up of their investment portfolio. Representative investment bodies and fund

managers acting alone or together are producing investment guidelines almost monthly (see, for example, NAPF "Engaging for Success" - June 2001; Just Pensions - Socially Responsible Investment and International Development - May 2001).
Even the most reluctant Boards will find the pressure to add corporate social responsibility to their agenda and to engage in useful dialogue with investors almost irresistible. Guidance is needed on the variety of Codes and Standards which exist.

HUMAN RIGHTS AND INTERNATIONAL LABOUR STANDARDS

Both nationally and internationally, companies are finding themselves operating in circumstances where human rights violations and poor labour standards are being scrutinised and in some cases exposed. South African employees of Cape who suffered mining related diseases have been given leave to sue the UK holding company in England. Corporate structures are not necessarily any "protection" against liability arising internationally. International standards and national and international legislation exists, regulating or guiding corporate behaviour in these areas. A Board led policy, based on an understanding of the relevant legal and regulation framework, including education, monitoring and auditing functions, may be essential for affected businesses.

CORRUPTION

There is growing support for and ratification of the OECD and Council of Europe Conventions aimed at combating corruption in international business. The Government has promised new UK legislation to bring our own laws up to date so that offences committed abroad will be punishable here. This trend of "home state rule" is developing around the world.

In certain sectors it is still often said that corrupt payments have to be made in order to do business. This will often be or will shortly become illegal.

Again, a Board led culture shift with appropriate programmes for training, monitoring and employee support, consistent with the legal framework wherever the business operates may be an essential way forward for affected businesses.

POLITICAL PARTIES, ELECTIONS AND REFERENDUM ACT 2000

In February 2001, a significant change took place in the ability of UK companies to support political organisations or spend money for political purposes. In most cases prior shareholder approval will be needed to enable such payments to be made with personal liability on directors to reimburse unauthorised payments.

This applies in varying degrees not only in relation to UK and EU political parties but also to political expenditure in the rest of the world.

DISCLOSURE OF PRICE SENSITIVE INFORMATION

A revised guide has been issued by the UK Listing Authority on the Dissemination of Price Sensitive Information. Although the guidance is essentially unchanged it is clear that the FSA intends there to be an increasing focus on the timely disclosure of price sensitive information (see, for example, Marconi).

The UKLA places the obligation squarely on the company both to determine what information (both internal and external) is likely to have a substantial effect on its price and to ensure that price sensitive information is given to the market as a whole, is sufficient and not inaccurate or misleading. Difficult judgments have to be made in relation to, for example, speculative rumours - particularly where the market is reacting to the rumour - and the guidance draws attention to the dangers of investor chatrooms and bulletin boards on the internet as a means of distributing information about issuers and spreading rumours.

Boards must have systems in place and appropriate personnel available who can deal with the market and the press and make informed decisions about announceable matters or developments.

FSA: CODE OF MARKET CONDUCT

A new detailed regime dealing with "market abuses" will come into force by the end of November. This opens up the possibility of civil fines being levied on companies and their officers who commit "market abuse". There is a clear determination to remedy the past situation where the rules and law have been virtually unenforceable or at least unenforced. The conduct and execution of many corporate transactions will need to be re-examined to ensure no transgressions of the new rules. The new regime is discussed in more detail elsewhere in this edition.

DIRECTORS' DEALINGS

Directors' dealings will now be subject to three regimes: the criminal regime applying to insider dealing; the Model Code incorporated as part of the Listing Rules; and, from December 2001, the Code of Market Conduct. Those responsible for monitoring, advising on and clearing directors' dealings will have to become familiar with the overlaps, carve-outs, safe-harbours and "no no's" arising from these sources.

COMPANY LAW REVIEW

The final Report of the Company Law Review Steering Group has just been published. Significant proposals affecting the Governance of companies are made including: a Statutory Statement of Directors' Duties; a recognition of the importance of assessing the long-term as well as the short-term consequences of management decisions and hence the impact on all relevant relationships on which the company depends; endorsement of a "comply or explain" approach to the Combined Code on Corporate Governance; better disclosure on directors' training, qualifications and other relevant information; and much more besides.

Future issues of this Newsletter will look at some of the above in more detail and will touch on the growing list of systemic risk areas which have their place in the boardroom, including for example: directors' remuneration, the impact of the Freedom of Information Act 2000, whistle blowing policies to encourage compliance with the Public Interest and Disclosure Act 1998, corporate policies on e-commerce and e-mail/internet use and, of course, the implications of the Company Law Review and any Government statements on its implementation.

Stock Exchange news

LONDON STOCK EXCHANGE

Following its extraordinary general meeting on 19 July, at which members voted overwhelmingly to remove the 4.9% limit on shareholdings, shares in the London Stock Exchange ("**LSE**") were admitted to listing on 20 July. The LSE did not raise additional capital but the rationale for the listing is that it will give the LSE greater access to capital markets in the future which should provide it with the necessary strategic flexibility to play a leading role in the development of global capital markets. It remains to be seen whether the LSE will be given the chance to assume this role or whether the listing and removal of the 4.9% ceiling will leave it more vulnerable to take over, notwithstanding Don Cruickshank's pledge to retain independence. Rumours abound that a merger with LIFFE is on the cards.

To coincide with its listing the LSE has introduced a new electronic shareholding service designed to allow investors to hold shares in electronic form while retaining the benefits of legal ownership. The service, which is available not only for shares in the LSE itself but for listed securities generally, gives retail investors personal access to CREST through the LSE which acts as sponsor. Shares remain registered in the investor's own name with all the rights that this affords such as being able to attend shareholder meetings, vote on resolutions and receive communications such as the report and accounts direct from the listed company. However, the transactions can be settled electronically without any need to deliver share certificates and stock transfer forms. The investor remains free to deal with a choice of brokers.

On 23 July the UK Listing Authority introduced a number of changes to its listing rules. These include a new chapter setting out an explicit concessionaire approach for the listing of strategic investment companies and changes to the conditions for listing and disclosure requirements for scientific research based companies. A Lovells Client Note on the changes to the listing rules will be issued shortly.

NASDAQ EUROPE

Following the acquisition of a majority stake by Nasdaq, Easdaq has now been renamed Nasdaq Europe. Nasdaq required a 58% stake for approximately £44 million. In addition a number of financial institutions (including BNP Paribas, Credit Suisse First Boston, Goldman Sachs, Lehman Brothers and Schroder Salomon Smith Barney) have taken equity stakes in Nasdaq Europe amounting to an aggregate stake believed to be in the range of 8-12%.

June 2001 marked the successful opening of Nasdaq Europe's European Trading System ("**ETS**"), a new automated trading platform which allows European investors to purchase US stocks in their own time zones. Other features of ETS include executable market maker quotes, matched trade reporting and an electronic broker-to-broker negotiation facility. The introduction of ETS coincided with the introduction of a new Nasdaq Europe Rule Book to replace the old Easdaq rules.

EURONEXT

In July this year Euronext, the stock market trading platform created by the merger in September 2000 of the Amsterdam, Brussels and Paris stock exchanges, overcame difficult market conditions to complete an IPO, raising €400 million of new money as well as almost €300 million through the sale of existing shares. The offering valued Euronext at € 2.8 billion, below its original target and less than the €3.3 billion valuation of Deutshe Borse, its smaller German rival, when it floated in February.

Euronext is in the process of completing the integration of its three separate trading platforms, which are intended to be trading on the French NSC-EMM (Euronext Market Model) trading platform, clearing through Clearnet and settling on Euroclear in the second quarter of next year. Companies whose shares are listed in more than one market will then be able to trade on the same platform, a common rule book and common trading. The Paris and Brussels platforms have already completed a successful migration to NSC-EMM and Euronext Amsterdam is expected to complete its migration later in the year or early next year. Until then, companies which are listed in more than one market will continue to be traded in separate order books.

The migration to NSC-EMM by the three markets is a major step in achieving integration of the European market, since it is the first time that regulated markets of different states are operated on a single platform with a single rulebook.

EXCHANGE-TRADED FUNDS ("ETFs")

In May the American Stock Exchange and Singapore Stock Exchange launched the trading of five Amex-listed exchange-traded funds ("**ETFs**") on the Singapore Exchange. This means that the same ETFs can be traded in both Singapore and the US with investors able to choose which exchange to use. The ETFs will be commonly settled in US dollars and will be cleared and settled through the coordinated efforts of the Depositary Trust Company and the Central Depositary (Pte) Limited, SGX's subsidiary responsible for securities clearing, settlement and depositary services.

Although there are now around a hundred ETF products trading on the American Stock Exchange and only five of these are traded on the Singapore Exchange, this development has been billed as a significant step towards the creation of a fully fungible, 24 hour global trading platform that will include Europe and potentially Latin America and Japan.

VIRT-X

In June Virt-x plc ("**Virt-x**") launched a pan-European platform for trading European blue chip equities on 25 June 2001. This will offer trading in the constituents of the Stoxx 50 and European Stoxx 50 indices, which contain the biggest companies across Europe. From 2 July 2001 onwards, it added the rest of the European blue chips, about 600 in all while the remaining stocks in the European blue chip indices were added on 9 July. Following the launch, Virt-x will support trading in 612 European blue chip equities, which represent approximately 80% of the European market capitalisation.

Virt-x also intends to offer cheaper settlement and clearing fees by creating competition between three settlement houses: the Swiss SIS, the pan-European Euroclear and the UK's Crest. Trades will not incur stamp duty.

International Corporate Finance

July 2001

GRANADA MEDIA

Acquisition of Border Television

Lovells acted for Granada Media

July 2001

LIVERPOOL VICTORIA

Acquisition of the Royal National Pension Fund for Nurses

Lovells acted for Liverpool Victoria

May 2001

SEQUENOM

Merger with Gemini Genomics

Lovells acted for Sequenom

May 2001

TiAUTOMOTIVE SYSTEMS

De-merger of TiAutomotive Systems from Smiths Group plc

Lovells acted for TiAutomotive Systems

May 2001

BHP BILLITON

Merger of BHP and Billiton

Lovells advised JP Morgan, financial advisor to Billiton

February 2001

EQUITABLE LIFE

Sale of Equitable Life's operating assets, sales force, non-profit and unit linked business to Halifax Group

Lovells acted for Equitable Life

February 2001

JOHN LEWIS

Acquisition of Buy.com Limited

Lovells acted for John Lewis

December 2000

EQUITABLE LIFE

Sale of Permanent Insurance Company Limited

Lovells acted for Equitable Life

November 2000

DEUTSCHE POST AG

Privatisation and flotation on the Frankfurt and other German stock exchanges

Lovells acted for the German Federal Government, the major shareholder

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October 2000

TEXACO

Merger with Chevron

Lovells acted for Texaco on various aspects

September 2000

OM GRUPPEN

Offer for the London Stock Exchange

Lovells acted for OM Gruppen

August 2000

BARCLAYS

Recommended offer for Woolwich plc

Lovells acted for Barclays

July 2000

GRANADA MEDIA (i)

Acquisition of the television assets of United News & Media

Lovells acted for Granada Media

July 2000

MICROSOFT

Acquisition by Microsoft of Media One's stake in Telewest Communications plc

Lovells acted for Microsoft

June 2000

EGG

International public offering and admission to trading on the London Stock Exchange

Lovells acted for the global co-ordinator, Goldman Sachs International

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June 2000

GRANADA MEDIA (i)

Global offering and admission to trading on the London Stock Exchange

Lovells acted for Granada Media

(i) Lovells was awarded "Corporate Team of the Year" by Legal Business and "M&A Team of the Year" by The Lawyer for its work on reorganising the Granada Group during 2000.