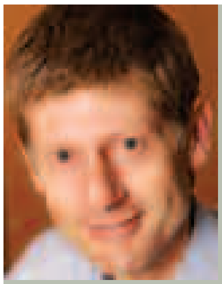
IN BRIEF

- The European Commission is proposing to incorporate the **1980 Rome Convention on the law applicable to contractual obligations (Rome I)** into EU law as a regulation. At present the UK has an opt-out from a key section of the convention to reduce the possibility of cross-border contracts being dealt with under the law of a party's home jurisdiction even when the agreement itself has specified another country's law or courts. The UK wishes to keep its opt-out and will continue to oppose allowing EU states to make contracts subject to their domestic law irrespective of the law specified in the contract.

- In its ruling on the **European Court of Justice judgment in *Marks & Spencer v Halsey (HMIT)*** the High Court has held that the rule of UK tax law that group relief cannot be claimed for the losses of a group company resident outside the UK is valid and enforceable. However, if it can be shown on the facts of an individual case that the losses have not been and cannot be used in another EU member state, the UK rule has to be disapplied to that particular case. The High Court rejected the 'wider' interpretation of the ECJ's judgment and endorsed the 'narrow' interpretation adopted by HM Revenue & Customs. The judgment also includes guidance on how the claimant should demonstrate that the losses of the non-resident subsidiary have not been and cannot be used in its resident state – in other words, that it has "exhausted the possibilities available".

- The expected **ECJ ruling on EU dividends**, covering areas such as exemption from UK tax and recovery of Advance Corporation Tax, has become clearer following a recent opinion from the Advocate-General in the Cadbury Schweppes case that aspects of the UK's corporation tax dividend regime are contrary to the EC treaty – namely, the exemption from corporation tax of dividends received from UK-resident companies while dividends received from companies resident in other member states are subject to corporation tax (albeit with credit for certain foreign taxes). The Advocate-General argued that establishing finance subsidiaries in Dublin's IFSC, which enjoys a 10% tax rate, did not constitute an abuse provided that the subsidiary conducted a genuine and actual business.

- The **UK Listing Authority** has published a factsheet giving straightforward guidance on procedures for submission and approval of prospectuses for issuers whose securities are not already admitted to the official list. See www.fsa.gov.uk/pubs/ukla/factsheet3.pdf.



INTRODUCTION

By Martin O'Donovan

ACT Technical Officer

The on-off saga of the Operating and Financial Review (OFR) is nearing a conclusion. It seems there will be a slightly extended Business Review instead of a mandatory OFR requirement. At the same time a very welcome concession sought by the ACT will be included in company law: to limit the liability of directors for statements in the Directors' Report (see story opposite). Given the repeated changes of heart, we might wonder for how long the rules will remain unchanged. It is therefore pleasing to know that in the law some things just do not change and that the Statute of Frauds 1677 remains applicable even in an electronic age (see In Brief, opposite page). Personally, I find it easy to lose a file I was working on a day earlier, so the miracle is that someone has held on to a copy of this law for over 300 years. ■

New pre-emption principles

Pre-emption rights – whereby a new issue of shares must be made pro rata to existing shareholders – is a cornerstone of UK company law. Creating shares via a rights issue ensures that shareholders do not have to suffer a dilution of their investment.

However, there may be occasions when it is helpful for companies to have additional flexibility, so they are allowed to take authority to disapply the pre-emption rules (section 95 of the Companies Act 1985). A revised set of guidelines, now called principles, has been announced, covering these circumstances when flexibility is being sought. The guidelines relate to UK companies which are primary-listed on the main market of the London Stock Exchange, although AIM-listed companies are also encouraged to apply them.

The ACT was instrumental in getting together with the Association of British Insurers and the National Association of Pension Funds to create the pre-emption group, which became a group of market participants who could advise on best practice in this area, and from this a set of guidelines were created in 1987. In essence, the 1987 guidelines recommended that shareholders would not normally object if a company was seeking shareholder consent to disapply the pre-emption rules if the volume of shares to be issued non pre-emptively was less than 5% a year and no more than 7.5% on a rolling three-year basis.

In February 2005 the Myners Report reviewed the operation of pre-emption rights and wholeheartedly supported their continuation. The report recommended that the then current guidelines should be replaced by new guidance with the emphasis on a case by case engagement between a company's directors and shareholders, and that a new pre-emption group should be formed with wider membership to take a more proactive approach to monitoring application of the guidelines.

The ACT is a member of the new pre-emption group and supports the new principles. The old guidelines were being interpreted in some quarters as implying that companies should never ask for consent to issue more than 5% non pre-emptively. The new formulation conveys the message that companies can ask for additional powers – and get them if they can give appropriate explanations and justification. Disapplications up to the same 5% and 7.5% limits are deemed routine and shareholders will be more inclined to support them.

In drafting the new principles, the treatment of treasury shares has now been built-in. Since December 2003 companies have been able to repurchase their own shares and hold them as treasury shares rather than cancel them. Resale of shares out of treasury is permitted in company law and within the principles it is recommended that such resales will count towards the 5% limit but not the 7.5% three-year limit.

The principles state that "Companies have a responsibility to signal an intention to seek a non-pre-emptive issue at the earliest opportunity and to establish a dialogue with the company's shareholders," although companies should remember any legal and regulatory issues in doing so, such as making investors insiders. "Shareholders have a responsibility to engage with companies to help them understand the specific factors that might inform their view on a non-pre-emptive issue by the company. They should review the case made by companies on its merits and decide on each case individually using the usual investment criteria." ■

Good news for treasurers on OFR liability law

It is now clear that a mandatory Operating and Financial Review (OFR) for listed companies will not be reintroduced. Instead, the narrative reporting in the Business Review will be slightly extended and made somewhat forward-looking for quoted companies. However, in response to strong views expressed by the ACT and other influential bodies, there will be, in certain circumstances, a form of statutory protection for directors against liability for untrue or misleading statements.

These developments and other helpful clarifications were unveiled in a series of amendments being introduced into the Company Law Reform Bill in committee in the House of Lords. However, this good news is tempered by a most unwelcome extension of liability for periodic financial statements made under the requirements of the Transparency Directive, which is in being implemented in the UK.

The corporate requirement to prepare a Business Review was introduced last year for periods starting after 1 April 2006 for all save small companies. The requirement arose from the EU Modernisation Directive.

The Business Review must contain a fair review of the business of the company and a description of the principal risks and uncertainties facing it (see *The Treasurer* Jan/Feb 2006, page 6). Under the new proposals for quoted companies the Business Review becomes forward-looking and must include:

- the main trends and factors likely to affect the future development, performance and position of the company's business; and
- information about environmental matters (including the impact of the company's business on the environment), the company's employees, and social and community issues, plus information about any policies of the company in relation to these matters and the effectiveness of its policies. If the review does not contain information on these matters, then it must state so.

Under the new arrangements, auditors will still be required to report on the consistency of the directors' report with the annual accounts, but will not be obliged to check for any other inconsistencies.

On directors' liability it is good that the common law principles in the Caparo case are maintained in the draft clauses so that the directors are liable to the company and not to anyone else.

Additionally, as a form of safe harbour, directors are liable to compensate the company for any untrue or misleading statement only if they knew it to be untrue or misleading, were reckless, or knew an omission to be a dishonest concealment of a material fact.

The ACT believes that this added protection is essential to encourage directors to make good-quality, open and forward-looking statements, rather than just producing bland boilerplate text capable of full legal verification.

The government is also proposing new powers relating to derivative claims (the shareholders claiming against the directors on behalf of the company), including a requirement for the courts to dismiss non-meritorious applications at an early stage.

Less welcome is the proposal that the issuer of securities is liable to pay compensation for omissions or untrue or misleading statements in any reports required under the Transparency Directive, which would include periodic financial reports like the half-year statement. This rule is similar to that applicable to prospectus information.

The government feels obliged by the Transparency Directive to introduce this rule, but is trying to limit its application by further clauses restricting the compensation to losses from acquiring the securities – in other words, it does not cover consequential losses. The issuer is only liable if its managers acted knowingly, recklessly or dishonestly, with the further caveat that the person suffering the loss was acting in reliance on the information in the report and at a time when it was reasonable to rely on it. Whether this extension of liability is really required by the Transparency Directive is still subject to differing legal opinions, but the government is trying to limit its effects.

In other areas of company law some widespread concerns have been addressed in the bill. The codification into law of directors' duties continues but amendments have been introduced to put beyond doubt that the need to have regard to certain factors (including the interest of the employees and corporate impact on the environment) is subject to the overriding duty to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. The phrase "so far as reasonably practicable" in the clause has been deleted in the light of concerns as to what it implied. ■

IN BRIEF

▸ The High Court has ruled, in the case of *Metha v J Pereira Fernandes SA,* that, for the purposes of an enforceable guarantee under section 4 of the **Statute of Frauds 1677,** an email may constitute a sufficient note or memorandum of an agreement. The 1677 Act requires any guarantee to be in writing or, if made orally, for there to be a memorandum of the agreement signed by the guarantor. However, the court held that the header automatically inserted at the top of an email did not constitute a signature since it was not inserted deliberately to give authenticity to the email. To count as a signature for the purposes of the Act, the sender's name or initials has to be included within the text of the email message itself.

▸ **The Pensions Regulator has published its medium-term strategy** to explain its overall approach and priorities for the next three years and provide more of the background to the individual issues that are likely to arise. It outlines its approach to the three main challenges: to strengthen the funding of defined benefit schemes, improve the governance of work-based pension schemes, and reduce the risks to members of work-based defined contribution pension schemes.

▸ The EC is proposing to postpone its decision of **equivalence between IFRS and US, Japanese and Canadian GAAP** until 1 January 2009. If the accounting bases are deemed equivalent, then the need to restate financial statements for Transparency or Prospectus Directive purposes would fall away.

▸ On 18 May the **Bank of England launched its new market operations framework** by which interest rate decisions are channelled into the market and through which banking system liquidity is managed.

▸ The **City Code on Takeovers and Mergers** is subject to several changes with effect from 20 May 2006. Notably, long positions in derivatives and options will count towards the 30% and 50% thresholds for the purposes of Rule 9.1 (requirement to make a general offer) and Rule 5.1 (restrictions on acquisitions of shares). The Takeover Panel is abolishing the rules on substantial acquisitions of shares (SARs). There will no longer be any restrictions of the speed of building up stakes up to the 30% level that has previously outlawed "dawn raids". Other changes to incorporate the requirements of the Takeover Directive are also being made.