Legal Update

SLAUGHTER AND MAY
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CORPORATE EMIGRATION

1. Introduction

In October 2004, the Royal Dutch/Shell group announced that it planned to put a new Dutch tax resident but UK incorporated company, Royal Dutch Shell plc, above the existing Dutch and UK holding companies. The result was a happy combination of the two jurisdictions which, from a tax perspective, had the important benefit that companies on the Dutch side of the group were not brought within the scope of certain UK tax rules which apply where a multinational group has a UK parent company.

There followed in 2005 a restructuring of the Colt Telecom group which involved putting a company resident for tax purposes in Luxembourg above the existing UK parent and, in 2006, the establishment of the Experian group on the demerger of Great Universal Stores, headed by a company incorporated in Jersey but tax resident in Ireland. Then in Spring this year Shire and, very shortly afterwards, United Business Media announced that they would move offshore by inserting new holding companies with the same mix of characteristics.

This note seeks to explain why corporate emigration (or "redomiciliation") has taken off in this way, and exactly what is involved. It assumes throughout that the group will want to retain a primary listing in London (as is the case for all of the companies mentioned above save for Colt Telecom).

2. What has changed?

The growing interest in this radical move is a reaction to the Government’s attempts over the past few years to increase the effective rate of tax paid by UK corporate groups; that is, the percentage of a group’s accounting profit which is paid as corporation tax. The Government believes this should be at or not much below the headline rate of corporation tax, now 28%.

UK multinationals protest that groups domiciled in other jurisdictions will for one reason or another face materially lower effective rates of tax, even if the headline rate is similar (or indeed higher). They do not see why profits earned from their standard operations in low tax jurisdictions should be subject to a top-up tax in the UK. There may be a feeling, too, that the particular tax benefits available from locating IP rights or financing activities offshore could reasonably be seen as the UK equivalent of beneficial tax rules which reduce effective tax rates elsewhere. (The reason such techniques are advantageous is that, if they succeed, there will be a full tax deduction in the UK for the payer of the royalty, licence fee or interest but tax will be payable at a much lower rate (if at all) by the offshore recipient.)

Three strands in the Government’s drive to increase the corporate tax take are noteworthy.

First, new legislation has put an end to many forms of tax planning that were previously common, for example in the area of finance leasing; and there is a perception that HM Revenue & Customs ("HMRC") is pursuing more aggressively, through enquiry and litigation, tax planning that has already been implemented.
The second development focuses specifically on the taxation of so-called controlled foreign companies (“CFCs”). These are, broadly, subsidiaries located in low tax jurisdictions whose activities consist of something other than simple trading operations and which do not pass substantially all of their profits up to their UK parent; the CFC regime taxes the UK parent as though it had earned the profits itself. Every Finance Bill brings fresh legislation aimed at attempts to plan around these rules.

The third and most serious cause of dismay was the publication in June 2007, by the Treasury and HMRC, of a “discussion document” proposing radical changes to the taxation of foreign profits. It seemed good news at first: it was suggested that the UK might introduce a tax exemption for dividends from foreign subsidiaries, similar to the “participation exemption” that applies in many continental jurisdictions. Nor did it seem unreasonable that this was to be accompanied by tax-raising measures aimed at overall “revenue neutrality”.

However, it became clear from the detail of the discussion document that the likely result would in fact be a substantial increase in the corporate tax burden for many UK multinationals. There were to be (further) restrictions on the tax deductibility of interest; but then a fundamental shift away from deductibility had been mooted, so the actual proposal seemed by comparison an acceptable price to pay. The much more serious tightening of the screw was a suggestion that the CFC regime could be replaced by a completely new, and much more draconian, set of rules for “controlled companies”. The intended effect seemed to be that all “mobile” income – in particular, all returns from intra-group financing operations and licensing of IP – should be caught and, probably, taxed at the full UK rate.

This succession of actual or proposed legislative change points to another bugbear for UK groups: a lack of stability in the UK tax system, compounded by a perception that changes were being made without full thought as to their likely consequences.

The result of these concerns is that several major groups have, as noted above, decided to introduce a new holding company resident for tax purposes outside the UK, and very many more such groups appear to be giving the idea serious consideration. Safety in numbers is no doubt one factor: a few pioneers have shown that the idea is feasible, and it is no longer the startling proposition it would once have been.

Before moving on, it is worth noting a more positive legislative development that has some relevance to the viability of corporate emigration. This is the introduction in 2002 of the “substantial shareholdings exemption”, eliminating corporate CGT on the disposal of shares in a trading subsidiary where certain basic conditions are satisfied. This may, in particular, facilitate a tax-free restructuring of a group after it has emigrated.

HMRC were in fact aware at the time that one consequence of bringing in the exemption could be to assist groups to leave the UK and was naturally keen to discourage this. It therefore made what otherwise seemed an inexplicable change to the rules identifying UK companies which can be the subject of a “CFC apportionment”. This is explained below in the discussion of tax issues arising on implementing a redomiciliation.
3. Benefits and drawbacks

Three tax benefits should flow from redomiciliation, the first of course very much the most significant:

- It should be possible to establish operations that would otherwise be caught by the UK’s CFC regime – or move existing operations which are currently within its scope – so that they sit directly beneath the new parent company. They will then be beyond the reach of the regime. As has been mentioned, companies which provide debt finance or license IP rights to the rest of the group are obvious choices for the application of this technique.

- The group will have more scope to restructure its operations in the event of further adverse changes in UK tax legislation.

- As an incidental benefit for shareholders, there will be no UK stamp duty on the transfer of shares in a parent company incorporated outside the UK.

This is balanced by a trio of potential concerns. The first of these is again the most important by a wide margin and means that introducing a non-UK parent company is not a step to be taken lightly, even if the expected tax savings are substantial.

A company which is incorporated outside the UK can nevertheless be resident in the UK for tax purposes if its “central management and control” is exercised here. To avoid that it should take all strategic decisions outside the UK, which means in turn that holding even a single board meeting within the UK would be inadvisable. Any UK-based directors will therefore have to travel to the relevant jurisdiction for each meeting.

The extent to which it is necessary to go further and establish a substantial presence in the chosen jurisdiction will depend in part on the nature of the group’s business generally and the specific activities that are to be carried on by subsidiaries sitting immediately beneath the new parent company. The counsel of perfection would be to have more than half of the parent company’s directors themselves resident in the jurisdiction (or, at any rate not in the UK), and a significant head office function set up there at the outset. In practice, it may well take the emigrating group some years to achieve this and in the interim considerable care will be needed to ensure that decisions really are taken outside the UK and that the documentary record supports this.

The other UK tax issue to bear in mind will not have the same continuing significance, but may be a material consideration when assessing the balance of advantage. As has been noted, reducing the group’s UK tax bill is likely to involve moving certain operations from beneath the existing parent. It will not always be possible to do this without triggering a UK tax liability.

The third area of possible concern is that a company incorporated elsewhere will of course be subject to different company law. There is also the question of the continuing application of the City Code and jurisdiction for the Takeover Panel; and in relevant cases there could even be doubt over continuing eligibility FTSE inclusion.
This last set of issues is considered below under the heading “Corporate and market-focused considerations”.

4. **Choice of jurisdiction**

There will be a number of factors to weigh up when selecting a new base for the group. Some may conflict, hence the attractions of the split between jurisdiction of incorporation and jurisdiction of tax residence favoured by Experian, Shire and UBM.

**Tax regime**

The fundamental requirement is, naturally, a low rate and a generally benign system of corporate tax, while avoiding unfavourable tax consequences for shareholders. This crystallises into the following points:

- Any CFC regime should not be overly restrictive.
- Ideally, there should be some latitude in the application of “transfer pricing” principles to the intra-group provision of goods, services and debt finance.
- Many jurisdictions will exempt from tax standard dividends paid to the parent company by subsidiaries. This may be accompanied by an exemption from tax on their sale of shares.
- It is less common that dividends can be paid to shareholders free of withholding tax, as in the UK. But this problem can if necessary be mitigated through an income access arrangement, discussed below as part of the section on implementation.
- Finally, having escaped UK stamp duty the group would hope to find a jurisdiction which did not have its own equivalent tax on the transfer of shares.

Other things being equal, a jurisdiction within the EU (or EEA) is likely to be preferred because the company will then benefit from the non-discrimination principles set out in the EU Treaty, as applied with enthusiasm in the sphere of direct taxation by the ECJ. This is one reason why a tax haven such as Jersey may not be favoured, though a more important consideration is the fact that such a jurisdiction will not have a network of bilateral tax treaties affording protection from, for example, withholding tax on dividends (or interest) paid by subsidiaries.

**Corporate and market-focused considerations**

Unfamiliar company law may be a concern to investors and for this reason if no other it is obviously helpful if the rules in the new jurisdiction do not differ too greatly from those in the UK. There may also of course be differing rules to consider in areas such as employee consultation.
Shareholders are likely to favour the continued application of the City Code and continuing jurisdiction for the Takeover Panel. The place of incorporation (or, strictly, of the company’s registered office) will be a critical factor here. Broadly, the position is as follows:

• If the registered office is in the UK, Channel Islands or the Isle of Man, the Panel should retain full jurisdiction.

• Jurisdiction will be shared between the Panel and its equivalent in the relevant country if the registered office is in an EU (or EEA) Member State other than the UK; in the event of a takeover the Panel will then retain responsibility for regulating the consideration offered and the bid procedure employed (such as the making of announcements and the content of the offer document).

• The Panel will lose jurisdiction altogether if the company’s registered office is outside the EU/EEA. This is one drawback of Bermuda and Switzerland, two of the jurisdictions which may come in for consideration from a tax perspective.

FTSE inclusion will not generally be a major concern. FTSE clarified its approach in a Practice Note published in May 2007. As a general matter, a company incorporated outside the UK but in a “developed market country” will “be required to acknowledge publicly adherence to the principles of the UK Combined Code, Pre-emption Rights and the UK Takeover Code as far as practical” and should then be accepted for allocation to the UK by for index purposes.

Finally, there may of course be reasons peculiar to the existing spread of the group’s business or indeed the identity of members of senior management which favour one jurisdiction over another. In any event, good transport links with the UK are likely to be important, to facilitate attendance at board meetings by UK-based directors.

5. Implementation

Corporate mechanics

Assuming that redomiciliation will be achieved by inserting a new holding company at the top of the group, it is likely to be effected by a conventional “scheme of arrangement”. This will involve cancellation of the shares of the UK parent and a fresh issue to the new holding company, in consideration for which that company issues shares to the group’s shareholders. The scheme will require the approval of shareholders (75% in value and more than 50% in number of those who vote) and the sanction of the Court. No UK stamp duty will be payable.

The acquiring company will be treated as a new applicant for admission by the UKLA and it will have to issue a full prospectus.

There will naturally be a number of basic corporate law issues to check, such as any change of control provisions in commercial (or other) contracts.
**Tax issues**

Another way to do it

It should be noted that a group can emigrate without introducing a new holding company. The listed plc can aim to move tax residence itself by starting to hold board meetings outside the UK.

So long as the new jurisdiction has entered into a bilateral tax treaty with the UK which is (in this respect) in standard form, it should be possible to ensure that the plc is regarded as shifting its “place of effective management” to that jurisdiction. Plausible destinations within western Europe – Ireland, Luxembourg, The Netherlands and Switzerland – are all party to such treaties. If it is accepted that the company’s place of effective management is in such a country, that will override the principle that a company incorporated in the UK is tax resident here too.

The company will need a more substantive presence in the chosen jurisdiction from the outset if this course is taken. It will need to be able to show positively that it is effectively managed in that jurisdiction, which goes beyond the negative requirement that its central management and control is no longer in the UK. Indeed, there is some suggestion that the “place of effective management” test is intrinsically more demanding than central management and control, making a real business presence a necessary minimum. In the case of Royal Dutch Shell plc, the head office is in The Hague and a substantial proportion of senior management is located in The Netherlands.

The higher threshold for establishing tax residence is not however the main reason why direct emigration has not generally found favour with the pioneers in this area. Rather, the problem is a change to the CFC rules in 2002 which was mentioned at the end of the section of this note headed “What has changed?”.

As noted there, the change was introduced with the specific purpose of discouraging emigration. Subject to any possible challenge on the basis of UK domestic law, treaty obligations or EU principles, the effect of the change is that a company incorporated in the UK will for the purposes only of the CFC regime continue to be treated as tax resident in the UK even when it has moved its effective management to another relevant jurisdiction. In other words, it will still be potentially liable to a supplementary UK tax charge on the profits of subsidiaries in low tax jurisdictions.
An otherwise viable solution to this problem was rendered ineffective for future migrants by an amendment to the legislation in 2006. Other solutions have been mooted, but as yet no-one has wanted to put them to the test.

This method of emigration also requires consideration of a quite different tax issue. The migrating company will for UK tax purposes be deemed to dispose of any assets which it holds at the point when it ceases to be UK tax resident. There is however a good chance that such “exit charges” will be found to contravene EU principles of non-discrimination, so long as the emigrating company genuinely carries on business in the new EU (or EEA) jurisdiction. Pending resolution of that question, the company would have to rely on domestic tax reliefs such as the substantial shareholdings exemption (thereby using this to achieve exactly what HMRC was hoping to discourage, as has been noted).

**CGT rollover**

From a tax perspective, the main drawback of the new holding company method is that it involves shareholders disposing of their shares in the existing parent. This means it is open for HMRC to challenge the availability of CGT rollover for UK shareholders who hold more than 5% of the shares, on the grounds that the insertion of the new holding company is a tax-motivated transaction. An application for clearance will be made on behalf of any such shareholders in a standard scheme of arrangement, but it is possible that HMRC would refuse to grant clearance in the context of a redomiciliation.

**Income access**

It has already been mentioned that UK shareholders (and some others) may face a higher tax bill on receiving dividends from a non-UK company. For this reason, those groups which have already committed themselves to emigration have typically put in place income access arrangements designed to provide dividends from a UK subsidiary as an alternative to dividends from the new parent.

One of the disadvantageous features of non-UK dividends was in fact substantially removed this year. An individual taxpayer will now in most cases be entitled to the same tax credit as on receipt of a UK dividend, so that the effective rates of tax are zero or (if a higher rate taxpayer) 25% rather than 10% or 32.5%. The picture should improve further next year when some of the restrictions on this entitlement are to be removed.

However, there are still two ways in which a non-UK dividend may be less attractive. First, some categories of shareholder are in principle liable to UK tax but do not pay tax on certain kinds of receipt, including dividends from UK companies. Investment trusts and unit trusts/OEICs are notable examples.

The second potential drawback of a non-UK dividend is the fact that it may be subject to withholding tax in the relevant jurisdiction. This may be a particular concern for UK pension funds and some other types of shareholder who are generally exempt from UK tax: it will not
simply be a question of crediting the foreign withholding tax against a UK liability, so the tax will be an absolute cost.

There are several methods of providing shareholders in a non-UK company with UK dividends. The most popular of these involves the issue of one or more shares by a UK subsidiary to a special purpose vehicle which then holds the dividends it receives (or possibly the shares themselves) on trust for electing shareholders.

Post-emigration restructuring

The last major tax issue to bear in mind on an emigration has also been alluded to above. To obtain the desired tax efficiencies, it is likely that some companies or assets will have to be moved within the group once it is established in the new jurisdiction. In some cases this might involve a one-off tax cost.

6. Conclusion: trickle or flood?

The answer to this question depends very much on what the Government does in coming months, especially in relation to their proposals for the taxation of foreign profits. Were it to plough ahead regardless, it is likely that there would as a minimum be a significant surge in the number of UK groups emigrating.

It seems that the Government has appreciated this itself. No formal announcements have yet been made, but the next version of the discussion document is not now expected until the Autumn and most people believe that the “controlled companies” proposal will not be implemented before 2010; by that stage, there may of course have been a substantial shift in the political landscape. At any rate, it is clear that the aspects of the discussion document which have caused the most dismay amongst UK-based multinationals are being re-examined very carefully.

It may be that the Government is already facing a bigger problem. If redomiciliation is now seen as a feasible option, avoiding unpopular changes to the UK tax system may not be sufficient to stem the tide and it could instead be a question of making the current rules more attractive.

But there is some uncertainty for emigrating companies too. In particular, there have been no recent cases in which the Court has applied the test of central management and control to a substantial holding company as opposed to companies which have been established for a specific, limited, purpose. It may be that a modern concept of corporate tax residence is only now set to emerge.
COMPARATIVE ADVERTISING: WHAT’S OK AFTER O₂

The ECJ has ruled that O₂ cannot rely on its trade mark rights to prevent use by H3G of bubble imagery similar to O₂’s registered trade marks in comparative advertisement but held that there can be trade mark liability where there is confusion.

1. Summary

The European Court of Justice (ECJ) on 12 June 2008 handed down its judgment in the comparative advertising dispute between rival mobile phone companies, O₂ and Hutchison 3G (H3G). The dispute concerned H3G’s use of bubble imagery similar to bubble pictures registered by O₂ as trade marks in an advertisement comparing the prices of H3G’s mobile phone services with those of O₂.

O₂ brought proceedings in the English High Court for trade mark infringement against H3G which were dismissed at first instance. O₂ appealed to the Court of Appeal which sought clarification from the ECJ on whether H3G’s use of the bubble images could potentially amount to trade mark infringement. In particular, the Court asked the ECJ whether there could be infringement under Articles 5(1)(a) or (b) of the Trade Marks Directive 89/104 (TMD) where a sign which is similar or identical to a registered trade mark of a competitor is used in a comparative advertisement in such a way that it does not cause confusion or jeopardise the essential function of the trade mark as an indicator of origin.

The ECJ considered that the use in a comparative advertisement of a sign which is identical or similar to a mark of a competitor does constitute use within the meaning of Articles 5(1) and (2) of the TMD and may therefore be prevented under those provisions. However, when considering the relationship between the TMD and the Comparative Advertising Directive 84/450 as amended (CAD) the ECJ pointed out that Community legislature sought to promote comparative advertising and this required that trade mark rights were limited to a certain extent.

The ECJ held that Articles 5(1) and (2) TMD “must be interpreted to the effect that the proprietor of a registered mark is not entitled to prevent the use by a third party of a sign identical with or similar to his mark in a comparative advertisement which satisfies all the conditions laid down in Article 3(a)(1) CAD”. However, where there is a likelihood of confusion between the sign and the registered mark and of the goods or services – in other words, where there is confusion-type infringement under Article 5(1)(b) TMD – then the advertisement will not satisfy condition 3a(1)(d) of CAD which states that the comparison must not “create confusion in the market place between the advertiser and a competitor or between the advertiser’s trade marks ... and those of a competitor”. The ECJ stated that the test for confusion is the same under TMD and CAD.
2. The interaction between Comparative Advertising and Trade Mark Infringement

Relevant conditions in Article 3(a)(1) CAD are as follows:

“Comparative advertising shall, as far as the comparison is concerned, be permitted when the following conditions are met:

(a) it is not misleading according to Articles 2(2), 3 and 7(1);

...

(d) it does not create confusion in the market place between the advertiser and a competitor or between the advertiser's trade marks, trade names, other distinguishing marks, goods or services and those of a competitor;

(e) it does not discredit or denigrate the trade marks, trade names, other distinguishing marks, goods, services, activities, or circumstances of a competitor;

...

(g) it does not take unfair advantage of the reputation of a trade mark or other distinguishing marks of a competitor or of the designation of origin of competing products;

(h) it does not present goods or services as imitations or replicas or services bearing a protected trade mark or trade name.”

It appears the ECJ is saying that where a sign which is similar or identical to a competitor’s registered trade mark is used in a comparative advertisement, compliance with all the conditions of the CAD provides a complete defence to any allegation of trade mark infringement. If the use creates confusion, then a trade mark owner can take action under the TMD for infringement under Article 5(1)(b) – or, presumably, Article 5(1)(a) – or can take action under the CAD, or both. This is consistent with Recital 15 of the Directive 97/55 (which amended the CAD), which states that, to be immune from trade mark infringement, a comparative advertisement must have the intended target solely of distinguishing between the two competitors’ marks.

The ECJ did not consider Article 5(2) TMD in depth, confining much of its analysis to a discussion of Article 5(1)(b). Article 5(2) permits a trade mark owner to object to the use of a similar or identical mark in circumstances where that use takes unfair advantage of, or is detrimental to, the distinctive character or repute of the trade mark. The ECJ has stated that if an advertisement causes confusion within the meaning of Article 5(1)(b) TMD, then the advertisement cannot satisfy condition 3(1)(d) of CAD (so that CAD provides no defence to the infringement allegation). It did not explore whether the same analysis applies in the case of unfair advantage and detriment under Article 5(2) TMD. The ECJ’s reasoning suggests that it should. That is, if an infringement case can be made out under Article 5(2), then it follows that either condition
3a(1)(e) or condition 3a(1)(g) of CAD is not satisfied and so CAD provides no defence. However, this remains an inference to be drawn from the ECJ’s judgment. It is possible that the differences between the wording in Article 5(2) TMD and that of conditions 3a(1)(e) and (g) mean this is not the case and that it is possible to satisfy all the CAD conditions at the same time as taking unfair advantage of, or causing detriment to, the distinctive character or repute of a trade mark. If so, then the CAD would sometimes provide a genuine defence to Article 5(2) infringements. In our opinion, the better view is that the same analysis applies in relation to Article 5(2) and conditions 3a(1)(e) and (g) as applies in relation to Article 5(1)(b) and condition 3a(1)(d). It may be that further guidance will be forthcoming from the ECJ on this issue in the case of L’Oreal v Bellure.

What is clear, however, is that trade mark owners will be able to challenge the use of a similar/identical mark in a comparative advertisement where a likelihood of confusion is established between his goods and services and those of the advertiser. This offers more protection to trade mark owners than was offered by the Advocate General who, along with the Court of Appeal, took the view that the provisions of the CAD should exhaustively cover comparative advertising.

3. The result

Addressing the particular facts of this case (though strictly the facts are outside its remedies), the ECJ applied the four-part test for infringement under Article 5(1)(b): (i) the use must be in the course of business; (ii) it must be without the consent of the owner of the mark; (iii) it must be in respect of goods or services which are identical with, or similar to those for which the mark is registered; and (iv) it must affect or be liable to affect the essential function of the trade mark which is to guarantee to consumers the origin of the goods or services, by reason of a likelihood of confusion on the part of the public. The ECJ agreed with the Court of Appeal’s findings that H3G’s use of bubble images similar to O2’s bubble trade marks did not give rise to a likelihood of confusion and that the advertisement was not misleading and did not suggest that there was any form of commercial link between the parties.

The Court of Appeal had also asked whether if a comparative advertisement is to comply with CAD, the use of a competitor’s mark must be indispensable and if so, the criteria by which this should be judged. The ECJ declined to answer the other questions posed by the Court of Appeal as these were only required to be answered if the answer to the first question was “yes”. However, the fact that the ECJ suggested that H3G’s use of the bubble imagery did not cause confusion and that the advertisement was not misleading, together with its answer to the first question, would imply that use of a competitor’s mark need not be indispensable in order for it to be compliant.

O2 Holdings Limited, O2 (UK) Limited v Hutchison 3G UK Limited (Case C-533/06) 12 June 2008
A NEW WEAPON AGAINST COPYCAT COMPANY NAMES

New legislative provisions that will strengthen the position of brand owners objecting to copycat company names will come into force on 1 October 2008.

Under the new legislation due to come into force on 1 October 2008 (following the Companies Act 2006 (“CA 2006”), there are important changes to the scheme for objecting to copycat company names:

I. the grounds for objection have been expanded

II. a new Company Names Adjudicator will enforce the provisions.

1. Basis for objection

It will be possible to object on one of four grounds, i.e. that a new company name is:

(i). the same or “too like” a name that appears or should have appeared on the index of company names when it was registered;

(ii). the same as a name already registered;

(iii). the same as one in which the objector has goodwill (which includes reputation of any description); or

(iv). sufficiently similar to a name with goodwill so that its use in the UK is likely to mislead by suggesting a connection between the objector and the company in question.

Grounds 1 and 2 reflect the existing law (and are to be re-enacted as CA 2006 ss66 and 67, respectively) and are enforced by the Secretary of State. However, as a high degree of similarity is required to satisfy the “too like” test, a mere difference of one or two words between a newly registered name and a name already registered is likely to be sufficient to preclude the Secretary of State from exercising his power to direct a change of name.

Grounds 3 and 4 (brought in by s69 (CA 2006) are enforced by way of an objection made to a company names adjudicator, a new office established under CA 2006.

On the basis of the approach of the Secretary of State under CA 1985, it is assumed that only very small differences will be ignored under the first limb of the test.

The second limb requires that the name be sufficiently similar that its use is likely to mislead by suggesting a connection between the company and the objector. It is noteworthy that protection is given to names with goodwill – it is irrelevant whether or not they are registered. The second limb however appears to be close to the passing off tests, which require confusion and which focus on goodwill owned by the objector rather than registration of the objector’s mark. This
gives protection which is similar in scope to that in the category of trade mark infringement, where confusion must be shown.

In considering whether a name is too close to one in which the objector has goodwill, it is expected that the adjudicator will seek guidance from the case law on passing off and, in particular, on cybersquatting. In the cybersquatting cases, a domain name registered for the purpose of benefiting from the goodwill associated with an existing established business has been held to be an instrument of fraud (see British Telecommunications plc v One in a Million Ltd [1999] ETMR 61 [1998] 4 All ER 476 CA CIT [T1998 Sep 33]). If these cases are used in the interpretation of CA 2006 s69, established businesses may be able to obtain significant protection for their business names against opportunistic registrations, potentially without the need for High Court proceedings.

There is, however, no equivalent to the infringement provisions which allow a trade mark owner to take action even in the absence of confusion (but where a link is established between the two names), where it has sufficient reputation and the use takes unfair advantage of, or is detrimental to, the trade mark. Presumably the intention is to broaden the provisions under the companies legislation while keeping them narrower than the full breadth of infringement and passing off. Further, if damages are sought in respect of use of a name it will be necessary to bring a trade mark infringement/passing off action.

2. Defeating objections

If the objector is able to show that the new company name is the same as a name with goodwill or sufficiently similar to mislead, the company must establish one of the following:

I. that the name was registered before the activities giving rise to the goodwill began or

II. that the company
   (i) is operating under the name or
   (ii) is planning to and has incurred significant start up costs or;
   (iii) was formerly operating under the name and is now dormant.

If one of these is established the objection can still succeed if the objector shows that the main purpose in registering the name was:

• to obtain money from or;

• block the objector registering the name.
The objection will also be dismissed if the company can show:

- the name was adopted in good faith or;
- the interests of the objector are not adversely affected to any significant effect.

This appears potentially to apply even if the applicant for the company name is using it to obtain money or block registrations (though in practice this is not likely to amount to good faith or have an insignificant effect).

3. Procedure

The proceedings are largely written (including all evidence) though there may be an oral hearing at the UK International Property Office. Costs may be awarded. The Company Names Adjudicator can if necessary determine a new name for the company (in contrast the Secretary of State can only direct a change).

The decision may be appealed to the High Court.

4. Comment

The opportunity to take action through the new company names adjudicator in relation to company names in which others hold rights is a welcome development. It is hoped that the system will be efficient and cost effective, eliminating the need for rights holders to bring High Court proceedings for passing off or trade mark infringement in reasonably clear cases (as opposed to being a parallel additional forum for disputes), in order to secure a change of company name. Ultimately it is to be hoped that it will also be a deterrent to opportunistic registrations. The success of the system will largely depend on the quality of the decisions and the adequacy of the resources assigned to the UK Intellectual Property Office to deal with these matters.
PENSIONS REGULATOR CHANGES: THE EMPEROR GETS HIS CLOTHES BACK

1. Background and summary

The Pensions Act 2004 introduced a number of new provisions in relation to defined benefit pension schemes, of which it was the Pensions Regulator’s power to issue “contribution notices” (CNs) which initially caused most concern. The recipient of a CN (which can include individual directors in their personal capacity) can be required to pay up all or part of the section 75 “buy-out” deficit in the relevant pension scheme. However, the requirement that the Pensions Regulator (TPR) show that one of the main purposes of an act (or deliberate omission) was to avoid, reduce or prevent the recovery of a section 75 “buy-out” debt before a CN could be issued, has meant that in operation the CN provisions have been of limited significance to bona fide commercial transactions.

On 14 April 2008 the Department for Work and Pensions (the DWP) announced an intention to change the law so that (among other things) this purpose test will no longer need to be met. TPR would in future also be able to issue a CN on a party to an act or series of acts, the effect of which is materially detrimental to a scheme’s ability to pay member’s current and future benefits. The change is billed as a response to the new “alternative to buy-out” business models (such as the Pension Corporation) that look to operate occupational pension schemes for profit; however, it potentially has a much wider impact on all kinds of transactions involving defined benefit pension schemes.

On 25 April 2008 TPR issued a statement confirming that it would only use its new powers retrospectively in certain specified circumstances. However, those circumstances were described in such generic terms that few commentators would consider it safe to rely on this statement to any significant degree.

It is intended that the change would apply to any acts which take place on or after 14 April 2008. This element of retrospectivity caused significant industry concern. As a result of that, TPR issued a statement on 25 April 2008 confirming that it would only use its new powers retrospectively in certain specified circumstances. However, those circumstances were described in such generic terms that few commentators would consider it safe to rely on this statement to any significant degree.

At this stage, we do not know how the legislation will be drafted (or whether the proposal will survive the parliamentary process). But given the potential retrospectivity, (notwithstanding TPR’s 25 April 2008 statement referred to above), it is important that all parties to a current transaction who are, or expect in future to be, “associated” or “connected” with a pension scheme employer should consider the transaction against this new test in relation to that pension scheme. Where it is possible that the transaction would have that effect, it may be that a clearance application is advisable; where it is concluded that it would not, then it may be prudent to retain evidence of the basis for that conclusion.

2. Analysis

• The Pensions Act 2004 strengthened the position of defined benefit pension schemes in three key ways:

  > it gave the Pensions Regulator (TPR) the power to serve a contribution notice (CN) on an employer, or any person (including an individual) connected or associated with an employer (for example, directors of the employer or its direct or indirect one-third
controllers) who has been party to an act or deliberate failure to act which had as one of its main purposes preventing the recovery of a section 75 “buy-out” debt from an employer to a pension scheme or (otherwise than in good faith) the avoidance or reduction of such a debt,

> it gave TPR the power to serve a financial support direction (FSD) on a party (but excluding an individual other than where an individual is an employer in relation to the scheme) which is associated or connected with an employer at a time when the employer is a service company or is “insufficiently resourced” (meaning, very broadly, that the employer’s net assets are insufficient to cover half its contingent section 75 “buy-out” obligation to the scheme at a time when one of the employer’s associates has net assets sufficient to make up the balance of that half), and

> it overrode employer trust deed vetos over their contribution rates to the scheme, providing for a new statutory funding regime, under which unless the trustees set employer contributions unilaterally, they are set by agreement between the employer and the trustees with TPR acting as tie-breaker if such agreement cannot be reached.

• TPR guidance has for some time suggested that commercial parties were at risk of a CN whenever they acted in a manner which was detrimental to the position of the pension scheme as a contingent creditor of the employer, regardless of the purposes of their actions. However, the legislation required a “purpose” to be identified, effectively protecting most normal commercial transactions. Furthermore, the requirement (which the DWP also proposes to remove) that avoidance or reduction of a section 75 “buy-out” debt be undertaken “otherwise than in good faith” before a CN could be issued in respect of it was important; the only case to have considered the requirement (in the High Court) found that directors would not be proceeding “otherwise than in good faith” if acting in a manner which they consider consistent with their duties to shareholders.

• So in practice it was the FSD and statutory funding requirements which most influenced behaviour.

• If, as the DWP proposes, the law is changed so that TPR no longer needs to prove intent to serve a CN, but can rather proceed on the basis that the effect of an act or course of conduct poses a “materially detrimental risk to members’ benefits”, that (together with the removal of the “good faith” safe harbour) will increase the importance of CNs. The DWP’s announcement expressly uses “the disposal of significant company assets” as an example of the sort of action which may not lead to a CN under the current law because of the purpose test but where it considers TPR may be able to issue a CN if the law is changed, as such a disposal “may seriously undermine the ability of the company to meet the pension promises it has made”.

• It is worth noting the following differences between CNs and FSDs/scheme funding demands:
> CNs can be served on individuals who are associated or connected with the relevant employer (for example, directors of the employing company who approve the relevant transaction),

> the “look back” period for a CN is up to six years (although this particular change would take effect only from 14 April 2008), meaning that a party which is no longer connected with a scheme (because, for example, it has sold the relevant subsidiaries) is potentially on risk for considerably longer than the 12 month period after association ends which applies to FSDs, and

> a party need not be associated or connected with the relevant employer at the time it participates in an act/course of conduct or deliberate failure to act in order to receive a CN in respect of it (as opposed to FSDs, which also pierce the corporate veil, but only if you are associated with an employer at a time when it is insufficiently resourced). So if a company transacts in a particular manner with an employing group, and then at a later stage seconds one of its employees (or permits one of its directors) to sit on the board of an employing company, it could conceivably, at some stage within six years of the initial transaction, be issued with a CN in relation to that transaction if that transaction had a detrimental effect on the financial position of the employing group’s pension scheme.

Comment: In this context, it may be of some comfort that the DWP have suggested that it may be appropriate to provide as a defence to the new CN power that the prospective recipient is “able to demonstrate that the likely consequences of their actions could not reasonably have been foreseen” (although note the burden of proof).

- The DWP has also proposed other changes: to provide that the resources of a whole group of companies can be considered when deciding whether there is an insufficiently resourced employer for FSD purposes, rather than TPR needing to identify a single associated or connected person who could make up the balance of the deficit; and also to confirm (with effect from 27 April 2004) that a CN can relate to a series of acts rather than just a single act (the greater retrospectivity proposed for this change is explained by the DWP as justified by the change being merely clarificatory rather than substantive).

3. Implications

It is not yet known what form (if any) the legislation implementing these proposals will take. But given the intention that it operate retrospectively to 14 April 2008, some caution may be needed. In particular, given that CNs were not considered a serious risk in a bona fide transactional context, it has become increasingly common for companies with defined benefit schemes to deal with the effect on the employer covenant of transactions or internal reorganisations solely through discussions with their pension scheme trustees, rather than spending additional time and resource seeking TPR “clearance”.
Until we have greater visibility on the precise wording of this legislation, that approach may require adjustment. All parties to a current transaction who are, or expect in future to be, “associated” or “connected” with a pension scheme employer should consider the transaction against the new “materially detrimental” test in relation to that pension scheme. Where it is possible that the transaction would have that effect, it may be that a clearance application is advisable. Where it is concluded that it would not, it may be prudent for evidence of the basis for that conclusion to be retained for the full six year “look back” period which applies to CNs.
CRUNCHING CREDIT — A MARKET UPDATE

1. The credit crunch

It is difficult to miss the fact that since the beginning of last summer the European acquisition finance market has been in the grip of a liquidity crunch, triggered by the US sub-prime mortgage crisis, which has seen, amongst other things, the leveraged lending market slow down considerably.

Although at this point, there are some tentative signs that the market is beginning to come back to life, the outlook remains uncertain and in the limited number of larger transactions that have reached the market, available leveraged lending terms are somewhat different from those that might have been achievable in early 2007. Some of the more borrower-friendly terms that appeared as the market boomed have simply disappeared. Others remain, but are being negotiated in more detail than might previously have been the case. In addition, deal volume is insufficient to talk of post-crunch market “standards”. The impact of the crunch on the key issues of leverage, pricing and deal structure is apparent and many underwriters are also insisting on wide market flex provisions and other yield protection mechanics. Furthermore, there is far more significant scrutiny of documents than was the case at the height of the market boom which means that the speed of negotiating financing documentation has been reduced significantly.

2. Pricing and financing structure

At the height of the market, typical senior debt pricing for European leveraged deals had fallen to around 200/237.5/275 basis points over LIBOR through the senior A/B/C tranches (from traditional levels of around 225/275/325). Currently, pricing is far less predictable, but is in general, markedly higher than pre-crunch levels, at around 275/325/375 or upwards. In addition, prior to the crunch the market had seen a trend away from amortising debt; this trend has now reversed although post-completion repayment holidays on Tranche A remain reasonably common.

European second lien or “Tranche D” had become an almost universal feature of European leveraged structures and typical pricing had fallen from around 500-550 basis points over LIBOR to around 400-475 in early 2007. Second lien debt, being a product intended to stretch leverage multiples, has largely fallen away post-crunch, allowing a strong return by specialist mezzanine lenders as true mezzanine takes the place of second lien.

According to some reports, warranted mezzanine is making a comeback although there is limited evidence of this to date at the upper end of the market. Mezzanine pricing has, however, also moved upwards. In early 2007, mezzanine pricing for UK based deals might typically have been around 800 basis points over LIBOR, whereas some recent mezzanine deals have been priced in excess of 1000 basis points.

The applicability of margin ratchets on the basis of reductions in leverage does not appear to have changed significantly post-crunch. It remains the case that the ratchet extends across A and B senior term facilities, any capital expenditure and acquisition facilities and the revolver.
In addition to the price increases noted above, maximum deal sizes have shrunk considerably, seemingly to somewhere around £1 billion. Leverage multiples have in general, fallen to around 5-6x EBITDA and typical equity contributions have risen significantly. For 2005-vintage deals, the typical equity contribution was somewhere around 25 per cent., dropping to around 20-22 per cent. in 2007. In 2008, typical equity contributions increased to somewhere between 30 per cent. and 50 per cent. of the overall capital structure and in some cases more. In addition, some transactions are being financed wholly from available resources and equity with the intention of refinancing in due course when the market settles.

3. **Market Flex, OIDs, LIBOR floors and Most Favoured Nation provisions**

2005 saw the first few acquisition financing transactions without market flex rights. By 2007, structural and pricing reverse flex had become the norm in the upper end of the market. Where market flex was included, “successful syndication” (that is, the point at which such rights fall away) was often agreed at around 15 per cent. of the underwriters’ final hold, pricing flex was typically capped at around 0.25 per cent., and arrangers were only entitled to invoke their flex rights once.

Since the crunch took hold, market flex rights have been the subject of increased focus in negotiations, with lenders seeking as much latitude to alter the pricing and structure of facilities as possible. In this environment, it is very difficult to identify any market trends. In very broad terms, caps on price increases are higher, limits on the number of times a flex right can be exercised are likely still to be agreed, but lenders may require more than one flex. “Successful syndication” or “minimum hold” levels are likely to be closer to 10 per cent. (or even lower). This is likely to be the case in particular for larger deals.

Arrangers are also increasingly seeking to negotiate Original Issue Discounts or “OIDs” to accelerate the syndication process. An OID allows the arrangers to sell the facility at a discount, subject to a cap. The amount of the discount is reflected in fees or the margin. Borrowers are usually able to finance the OID by an increase in the revolving facility amount.

Other yield protection measures that originated in the US and are now starting to appear in the European market include “LIBOR floors”, where a minimum yield is protected and “most favoured nation” agreements, which seek to protect investors by offering compensation if further participations in the same loans are sold at a discount to the price at which the investors invested during an agreed period.

4. **Financial covenants**

A full suite of financial covenants is once again the norm in the European leveraged debt market, usually comprising leverage, interest cover, cashflow cover and restrictions on capital expenditure. “Covenant-lite” or “covenant loose” terms are simply not available. In general terms, leverage and interest cover covenants applicable to senior debt appear to be set at levels close to those applicable pre-crunch, at around 20 per cent. to 25 per cent. headroom against the financial model, with mezzanine ratios around 10 per cent. looser.
Sponsors are still achieving equity cure rights (the right to cure breaches of the financial covenants by the injection of additional equity) but it is becoming less common for lenders to agree to the application of equity to increase EBITDA as well as cashflow. Instead, lenders are requiring equity cure amounts to be applied to prepayment. The exercise of such rights is now typically limited to once or twice a year and up to four times over the term of the facilities. Lenders may also seek to apply financial limits on the amount of a single equity cure.

“Mulligans”, or the right to disregard a breach of a financial covenant unless the breach subsists for two or more testing periods, were discussed often, but were very rare, even at the height of the market (and such provisions should not be confused with the more common “deemed cure” in relation to defaults under the financial covenants cured by the test date following the default). As a result, these have virtually disappeared in the current market.

Annual limits on capital expenditure are usually subject to “carry-forward” or “carry-back” rights, pursuant to which the agreed annual expenditure (or a proportion of it) may be used in preceding or subsequent years. Such rights are still a feature of post-crunch deals, although their scope is more limited. The right to carry-forward amounts of around 50 per cent. of the annual capital expenditure budgets for one to two years has been agreed in a number of deals. Carry-back rights are more difficult to achieve, but have not disappeared altogether (perhaps up to around 20 per cent. in appropriate cases). By way of contrast, in the first half of 2007, carry-forward and carry-back rights were achieved at levels of up to 100 per cent. (carry-forward) and 50 per cent. (carry-back).

5. Mandatory prepayments and excess cash sweep

The circumstances in which mandatory prepayment is required in leveraged transactions (on a change of control or flotation and out of insurance proceeds, disposal proceeds, acquisition proceeds and excess cashflow) have not changed post-crunch. The scope of agreed carve-outs and de minimis thresholds are likely to be the subject of increased negotiation and will vary according to the particular deal.

There have been changes to the scope of restrictions on the use of excess cashflow. In a pre-crunch 2007 deal, typical requirements might have been that around 50 per cent. of the borrower group’s excess cashflow should be applied to mandatory prepayment, subject to a downwards ratchet, usually dependent on leverage. Post-crunch, borrowers are under pressure to increase sweep percentages and, in addition, leverage levels at which the cash sweep ceases to apply are becoming lower, for example, at around 3.5 times EBITDA (as opposed to 4.5 times EBITDA prior to the downturn).

6. Voting rights

Lender decision making was another area where borrowers made significant inroads whilst the market remained buoyant. The number of lender decisions requiring unanimity was reduced in many deals. “Yank-the-bank” rights to remove non-consenting lenders became extremely
common and “snooze and lose” provisions, whereby lenders who fail to respond to requests for consent are disenfranchised, were almost invariably agreed.

Interestingly, most of these provisions appear to have survived the crunch. “Facility change” or “structural adjustment” language has been included in some 2008 deals – these amendments to the Finance Documents which are required to effect (commonly) a new tranche or facility, increased commitment, an extension to the agreed maturity or availability period, the redenomination of a commitment or loan into another currency, the extension of scheduled repayment dates or a reduction in the amount owing to a lender (including the margin or interest payments). These elements require only the consent of each lender participating in the additional tranche or facility or each lender whose commitments or amounts owing to whom are being amended (as applicable) plus “Majority Lenders”. Additionally, the release of security remains generally subject to super-majority rather than unanimous consent, around 85-90 per cent. Both “yank-the-bank” and “snooze and lose” provisions are also still commonly included. In general, however, this is an area where there is currently increased focus on the detail of such provisions.

7. Assignment and transfer provisions

In early 2007, borrowers were very often able to achieve significant levels of control over the identity of their initial syndicate and increasingly achieved consent rights in relation to transfers thereafter or at least the right to exclude specifically identified transferees or categories of transferees. Borrowers in some cases also sought information rights, if not control rights, in relation to “behind the scenes” changes to their investor base, for example as a result of sub-participation or derivatives structures. In the face of a liquidity crunch, this has changed and in most circumstances, lenders are seeking free transferability in the secondary market, save perhaps, for very specific restrictions, for example on transfers to competitors of the sponsor or borrower group.

8. Debt buybacks

Over the past few months many leveraged loans have been trading at a substantial discount in the secondary market. Some borrowers have taken advantage of the value in the secondary market by buying back their own debt.

Borrowers that have either undertaken a debt buyback or have announced to the market that they intend to do so include TDC, Lafarge Roofing, Fat Face (Bridgepoint Capital) and Citadel Broadcasting.

Aside from any adverse tax or regulatory consequences of a buyback (which will need to be examined in detail on a case by case basis), debt buybacks raise a number of legal and contractual issues:

• firstly, there is the question of whether the terms of the facility agreement and related documentation, and in particular the various undertakings contained in them, would allow for the use of amounts by the borrower for this purpose.
Customary undertakings restricting acquisitions or limiting the activities of the borrower to those of a holding company may prove problematic. In addition, it may be the case that certain activities are restricted after any default (and certainly any event of default) has occurred which is continuing. Furthermore, given that a cash sweep operates in leveraged facility agreements there is a question as to where the free cash to fund the buyback will be obtained from.

In the case of TDC, we understand that disposal proceeds were used to fund the buyback due to the fact that there was wide drafting in the agreement allowing disposal proceeds to be used “for any other purpose not restricted by [the] agreement” – however, given that there was a restriction on acquisitions, it may be either that the view was taken that the buyback was not caught by the specific terms of the acquisitions undertaking or fell within an exception (e.g. as to intra-group transactions, although arguably the acquisition is only intra-group once it has occurred).

- secondly, there is the question of the extent to which the documentation would permit the sale of participations to the borrower. The Loan Market Association (“LMA”) documentation permits the assignment or transfer of participations in a facility to:

  a “bank or financial institution or to a trust, fund or other entity which is regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets”.

Similar provisions appear in many other forms of loan documentation. The LMA language was not drafted with the possibility of buybacks in mind, but it is reasonably wide, and perhaps arguable that a borrower who regularly engages in intra-group lending, for example, might fall within the permitted category of transferees. It is relatively common in leveraged transactions for the borrower to act as a conduit for on-lending the proceeds of the facilities to the group, which perhaps may qualify it as “regularly engaged in…making…loans”.

- thirdly, even if there are no contractual restrictions and the transferee is an eligible transferee, there is a further, more difficult issue to consider if the transferee is the borrower.

The legal effect of a borrower becoming its own lender is unclear. In particular, there is doubt as to whether it is conceptually possible (since there is a general legal principle that a party cannot contract with itself but no specific caselaw on this situation). There is a risk, therefore, that the assignment or transfer could have the effect of extinguishing the transferred debt. This would give rise to an argument that the assignment or transfer should properly be characterised as a prepayment. The logic for this argument would be that the facility agreement provides a method for extinguishing the debt in the form of the prepayment provisions and this should be the only way in which the debt should be capable of being extinguished. If the acquisition of such debt was to be characterised as a prepayment, the conditions applicable to prepayment in the facility agreement would
apply and in particular, the consideration for the “transfer”, rather than being payable to the transferring lender, would instead be shared amongst the syndicate as agreed in the documentation.

If one considers the risk of re-characterisation as a prepayment to be material, then this means that effectively, the consent of the other members of the syndicate would be required in order to complete the buyback. In addition, it should be noted that consent could in any case be required by an agent that, due to the borrower being the transferee, refuses (whether within its rights or otherwise) to sign the documentation transferring the debt without such consent.

The approach to this re-characterisation risk by the borrowers that have reportedly carried out buybacks is interesting: TDC reportedly went ahead with its buyback without consent, while Citadel Broadcasting went back to its syndicate to seek consent for its buyback (although this was for a proposal allowing lenders to choose if they wished to receive prepayment of a proportion of the debt at a discount or not, thus allowing lenders to sell at a discount or hold as they wish).

The question of whether to seek consent is one also of the perception of the risk of the remaining lenders challenging the transfer. If the debt is extinguished the remaining lenders will be likely to have an upside as leverage/risk and pressure on the security package will lessen due to a reduction in the group’s overall debt burden.

9. Alternative structures

In order to overcome the above issues the following alternatives should be considered:

- **Transfer/assignment to a PE sponsor or another member of the Group:** The advantage of this route is that it would bypass the issues around the legal effect of the borrower lending to itself and thus bypass the question of re-characterisation as a prepayment. However, the entity acquiring the debt would still need to be capable of being a transferee under the terms of the facility agreement and a review would still be needed of any restrictions in the facility documentation to verify whether restrictions would apply. In addition, tax and other commercial consequences would be relevant and if the party acquiring the debt is a party to the intercreditor agreement then issues would arise. This is because intra-group and shareholder debt is usually deeply subordinated which may mean that a related party purchaser of leveraged debt loses the benefit of the security and other rights in relation to any debt purchased.

One issue with this route that will still be relevant to the lenders is the extent to which, once the debt has been acquired, the entity may be entitled to vote as a lender in the syndicate on proposed amendments, waivers and acceleration. There could, of course, be a mismatch between the interests of the entity that has acquired and those of the rest of the syndicate.
Sub-participation or some other “behind the scenes” method of sharing the loan: this type of structure could achieve the same economic effect as a transfer by novation. However, the structure would need, once again, to be considered carefully – a funded sub-participation would involve the borrower making payment to the seller which looks rather close to a prepayment. In addition, contractual limitations in the facility documentation would be relevant as the borrower or other group members may be restricted from entry into derivative transactions and/or making acquisitions. However, in conceptual terms a sub-participation (unless a funded sub-participation as this would have potential similarities to a pre-payment) or a derivative structure (such as a total return swap) should avoid the re-characterisation risk.

LMA’s position: The LMA has recently announced that it will be amending its primary documentation to address the buyback of debt by borrowers. The proposals have not yet been published, but the drafting is expected to include alternative options to cover the method by which the purchase of a debt by a borrower might be approved by the syndicate, the cash permitted to be used to effect the buyback and how voting rights will work if the borrower makes a partial buyback.
MISCELLANEOUS HEADLINES

1. Commercial

*Rome I and contractual obligations*

The EU Council has adopted the Rome I Regulation on the law applicable to contractual obligations. Rome I converts the Rome Convention on the Law Applicable to Contractual Obligations into a community regulation, whilst at the same time modernising the rules where appropriate. The Regulation will come into force on the twentieth day following publication in the Official Journal and its substantive provisions will come into force 18 months later.

In May 2006, the UK exercised its option to opt out of the negotiations on Rome I. However, on 2 April 2008 the Ministry of Justice issued a consultation paper addressing the issue of whether the UK should opt in to Rome I. In the consultation paper the Government expresses the view that the Rome I negotiations have resulted in an improved text and that the UK should now opt in. The consultation closed on 25 June 2008.

*Court of Appeal reverses decision on exception clause*

The Court of Appeal has overturned the High Court’s decision in *Regus (UK) Limited v Epcot Solutions Limited* [2008] EWCA Civ 361. The judge at first instance had held that the exception clause in Regus’s standard terms was unreasonable and unenforceable under Unfair Contract Terms Act 1977. The Court of Appeal held on appeal that the trial judge was wrong to say that the customer was left with no remedy for the breach of which it complained, namely defective air conditioning. The obvious and primary measure of loss for a breach of such a kind was the diminution in value of the services promised. Further, the exception clause did not purport to exclude liability for fraud or wilful, reckless or malicious damage. It was entirely reasonable for Regus to restrict damages for loss of profits and consequential losses. Finally, the limitation clause was separate from the exemption clause and the limit of 125 per cent of fees or £50,000 was reasonable.

2. Company

*Eighth Commencement Order – Companies Act 2006*

On 20 June 2008, the Department for Business Enterprise & Regulatory Reform (BERR) published a draft of The Companies Act 2006 (Commencement No. 8, Transitional Provisions and Savings) Order 2008 (Eighth Commencement Order), together with an accompanying consultation document. The Eighth Commencement Order will bring into effect on 1 October 2009 all of the provisions of the Companies Act 2006 that have not been commenced prior to that date. The commencement of the new provisions will have a significant impact on Companies House’s systems and the consultation document explains what the impact of the switchover to the new system will be on Companies House services in October 2009. Comments are invited by 5 September.
Seventh Commencement Order – Companies Act 2006


The Companies (Reduction of Share Capital) Order 2008 provides, in particular, that if an unlimited company reduces its share capital or a limited company reduces its share capital under the solvency statement procedure, the prohibition in section 645(1) of Companies Act 2006 (on distributing a reserve arising from a reduction of capital) does not apply and the reserve can be treated as a realised profit.

Trading disclosures – Companies Act 2006

On 13 June 2008 BERR published on its website a series of Frequently Asked Questions on what trading information is required to be disclosed by companies. The Companies (Trading Disclosures) Regulations 2008 (SI 2008/495) (Regulations) come into force on 1 October 2008 and set out trading disclosures that must be made by a UK company, principally in respect of the places and manner in which it must disclose its registered name and other registration details. The Regulations also contain a number of exemptions from the general requirements.

Model articles – Companies Act 2006

On 7 April 2008 BERR published a response statement to its July 2007 consultation on a near final draft of the proposed model articles. The main issues identified in the BERR response statement are: (i) that it should also develop model articles for unlimited companies and specific types of companies limited by guarantee; (ii) the draft model articles now include an article specifically limiting the liability of members (a liability limitation will no longer be included in the company’s memorandum of association after 1 October 2009); and (iii) replacing the previous specific and detailed provisions on directors’ indemnities and insurance with a short permissive article.

Directors’ duties and unfair prejudice

In West Coast Capital (Lios) Limited [2008] CSOH 72 the Court of Session (in Scotland) considered a motion under section 994 of the Companies Act 2006 (unfair prejudice) in which the petitioner sought to prevent the board of an AIM listed company in which it was a substantial minority shareholder from proposing a resolution to increase the company’s authorised share capital, authorise the directors to allot shares and approve the terms of an open offer. The court
refused the motion, holding that, on the material before it, the petitioner had not established a prima facie case that the board was acting in an improper manner towards it or that the conduct of the company’s affairs was, or threatened to be, unfairly prejudicial to the petitioner’s interests. In reaching its conclusion the court considered sections 171 (Duty to act within powers) and 172 (Duty to promote the success of the company) of the Companies Act 2006, expressing the view that the sections appeared to do little more than set out the pre-existing law on the subject. The sections do not, however, seem to have been the subject of legal argument or detailed consideration by the court.

**Directors’ duties and financial assistance**

A company in liquidation was entitled to damages from two of its directors and from a firm of accountants in circumstances where the directors were shown to be in breach of their fiduciary duty to the company and where the firm had failed to adequately carry out an audit of the company’s financial status in accordance with the whitewash procedure under sections 155 and 156 of the Companies Act 1985. Robert Edward Caunce Cook and M&S Tarpaulins Ltd (In Liquidation) v Stephen Green, Tracey Donna Green and DTE Business Advisory Services Ltd (2008) EWHC (Ch) 2 May 2008.

*Financial Reporting Council – relevance of ‘true and fair’ concept confirmed*

In May 2008 the Financial Reporting Council (FRC) published an Opinion by Martin Moore QC that confirms the continued relevance of the ‘true and fair’ concept to the preparation and audit of financial statements following the enactment of the Companies Act 2006 and the introduction of international accounting standards.

3. Corporate Governance

*Financial Reporting Council – changes to the Combined Code*

The FRC announced that it will be updating the Combined Code to: (i) remove the restriction on an individual chairing more than one FTSE 100 company; (ii) allow the chairman of a listed company below the FTSE 350 to be a member of, but not chair, the audit committee provided he or she was considered independent on appointment; (iii) include in Schedule C to the Code the disclosure requirements under the new FSA Corporate Governance Rules, which implement EU requirements on audit committee and corporate governance standards; and (iv) reflect in the Preamble to the Code some of the findings of the FRC’s 2007 review of the impact and implementation of the Code. The revised Code was published at the end of June and will apply to accounting periods beginning on or after 29 June 2008. In practice, this means most companies will begin to apply them in 2009, and will report against them for the first time in 2010.

*NAPF and arbitration clauses in articles*

The National Association of Pension Funds (NAPF) has updated the November 2007 edition of its Corporate Governance Policy and Voting Guidelines with the addition of a new provision on
dispute resolution procedures in articles of association (provision D.1.6) (see www.napf.co.uk). The new provision states the “introduction or maintenance” of a provision in the company’s articles prescribing arbitration as the sole mode of settlement of all or a significant class of disputes between shareholders and any one or more of the Company, its directors, executive management or professional advisers “should be viewed in the first instance as a material reduction in shareholder rights”.

4. Financial Regulation

**FSA warning to file annual reports within 4 months**

On 6 June 2008, the FSA sent an update to all LIST! subscribers noting that DTR 4.1 of the Disclosure Rules and Transparency Rules (DTR) requires issuers with financial years ending after 20 January 2008 to publish their annual report and accounts within four months of their year end (compared to six months under the equivalent previous Listing Rule).

**Electronic communications**

On 30 May 2008 the FSA issued an update on electronic communications as discussed in List! Issue No 17. The article specifically covered the letters issuers send to their shareholders requesting permission to send future communications electronically. The original article indicated that issuers need to comply, where relevant, with LR 13.3.1, which requires a statement to be included asking shareholders to pass on the document to the new holder when the shares have been transferred (LR 13.3.1(6)). The FSA is aware that these letters are often personalised containing shareholder specific details and so it would not be appropriate for shareholders to directly pass on these letters. The FSA agrees that in these circumstances, because of the sensitive and confidential nature of some of the details in the letter, it may not be appropriate to include the disclosure required by LR 13.3.1(6).

**ICSA Guidance on Money Laundering Regulations**

On 4 April 2008, ICSA produced a guidance note to provide a quick reference guide as to what constitutes money laundering, which types of business are affected by the regulations, and where such businesses may look for information on how they should proceed. The guidance note is available at www.icsa.org.uk and the regulations came into force on 15 December 2007.

**Disclosure regime introduced for “significant” short positions**

On 13 June 2008, the FSA announced that it was introducing provisions in the Code of Market Conduct requiring the disclosure of significant short positions in stocks admitted to trading on prescribed markets in companies which are undertaking rights issues. These new requirements came into effect on 20 June 2008. A significant short position is defined as 0.25% of the issued shares achieved via short selling or by any instruments giving rise to an equivalent economic interest. The FSA considers that short selling is a legitimate technique which assists liquidity and is not in itself abusive, but it has taken this step as a result of the increased potential for market
abuse through short selling during rights issues. The FSA has also published a set of frequently asked questions and answers on the new provisions. This new disclosure regime will be kept under review.

The FSA has also announced that it will be conducting a review into how capital raising by listed companies can be made more orderly and efficient and the overall effectiveness of this new measure will be considered as part of the wider review.

**FSA imposes financial penalty on Woolworths Group plc**

The FSA has published its Final Notice setting out the reasons for its decision to impose a financial penalty of £350,000 on Woolworths Group plc for a breach of DTR 2.2.1 and Listing Principle 4. DTR 2.2.1 requires an issuer to announce as soon as possible any inside information concerning the issuer. Listing Principle 4 requires a listed company to communicate information to the market in such a way as to avoid the creation or continuation of a false market. The breach of the rules arose from Woolworth’s failure to announce a variation to a significant supply contract, the effect of which would be to reduce profits in the next financial year by over 10% of expected profits for that year. The points to note from the Final Notice are:

• The size of the penalty;

• A share price effect of less than 10% may be “significant”; the “reasonable investor” test assumes greater importance;

• No action taken against the directors.

For further analysis of the decision see our client publication “FSA imposes financial penalty on Woolworths Group plc” – June 2008. [www.slaughterandmay.com]
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