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SPECIAL REPORT:

CORPORATE GOVERNANCE: BUILDING BETTER BOARDS

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BUILDING BETTER BOARDS

Boards of directors now face both growing scrutiny and a growing raft of issues with which to contend. This should come as little surprise, as corporate governance has been the subject of renewed attention, since the near-death experience of the financial markets in 2008 and 2009. This report on Corporate Governance in the UK focuses on 3 principal areas now facing boards and their advisors– Managing the Boards themselves; Managing the Risks that their companies face; and Managing the Growth opportunities amidst these prior two.

Managing Boards better has been the subject of wide-ranging discussion and has now reached new heights amidst continuing indication of shareholder conflict. Even absent these, scrutiny of board management has grown, spanning issues as varied as a new corporate governance code, the Walker Review, and gender equality in the boardroom. In tandem, agencies from the Financial Services Authority to the Financial Reporting Council are stepping up their involvement, adding teeth to the jaws of regulatory change. Better oversight and communication are expected.

Managing Risks faced by companies could cover a wide swath of issues in these risk-sensitive times. Emblematic of these are the UK Bribery Act and the U.S. Foreign Corrupt Practices Act. The former certainly tops the list of concerns in many UK boardrooms, as the new law requires companies to demonstrate adequate anti-bribery procedures if they are to avoid penalty under this strict liability offence. Together with its U.S. counterpart, these laws mark the different but related approaches taken by the world's legislators to address the dangers of turning a blind eye to moral and financial hazards.

Managing Growth is the board's other principal challenge, and M&A activity provides many with the answer. Growth is expected by shareholders and board, even whilst the prior 2 issues encourage an air of caution. Interestingly, shifts in global M&A markets are unfolding in parallel with the aforementioned moves toward a brave new regulatory world. This report looks at recent M&A trends around the globe, providing food for thought as to the sort of offers (and offerors) that UK boards may face.

In total, the following analyses provide a sweeping view of important changes and concerns touching the heart of corporate governance in the UK. All are provided courtesy of Thomson Reuters Accelus, focused on Governance, Risk and Compliance.

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SHAREHOLDER RELATIONS: WHEN CORPORATE GOVERNANCE WORLDS COLLIDE

As cross-border share ownership has grown, boards are now forced to consider new aspects of shareholder relations. Hammerson and Premier Foods have learned this the hard way, through recent experience. It may no longer be sufficient to solely consider local, UK standards of governance as foreign shareholders may expect foreign standards of corporate governance to apply.

Conflicting corporate governance standards cause strife for companies as the discrepancies between domestic and international norms clash over issues like political donations and short notice periods.

Few companies would argue that the highest standards of corporate governance are unimportant, but differences between international governance standards can present challenges for companies, as demonstrated by recent UK annual general meeting (AGM) disputes with interfering foreign investors.

Hammerson plc, the European property company, was among those that recently faced public humiliation at the hands of investors when a minority Canadian shareholder operating under North American assumptions chose to reject a resolution that would be considered standard practice in the UK.

Kicking out a proposal to reduce the notice period for extraordinary general meetings (EGMs), the case presents a perplexing conundrum for companies who will now have to decide whose corporate governance standards to apply.

GETTING SHORT WITH SHORT NOTICE

The increasing globalization of business means that investors in companies are no longer confined to the country in which a company is based. With ownership spanning multiple countries, the question of what is acceptable is taking on an international dimension and causing problems for companies when trying to agree corporate governance matters with shareholders from different legal jurisdictions.

Short on news coverage but not on significance was Hammerson's recent rejected AGM resolution to authorize the company to hold EGMs on 14 days' notice. Seemingly minor, the rejection reveals some of the significant challenges facing listed companies when trying to satisfy overseas shareholders and in particular those engaging U.S.-style proxy advisors.

No attempt at circumventing shareholder control, the short notice proposal was relatively standard in the UK and sought to take advantage of company law provisions that allow for EGMs to be held on 14 days' notice, subject to shareholder approval.

By way of background, changes to the law introduced by the Companies Act 2006 allow public and private companies in the UK to call EGMs on 14 days' notice, even where significant changes to a company's constitution by way of special resolution are proposed. Subsequent EU legislation, however, restricted this power for publicly traded companies to instances where such shorter notice periods had been approved by shareholders.

The restriction was introduced through the EU Shareholders' Rights Directive by virtue of the Companies (Shareholders' Rights) Regulations 2009 in the UK. The combination of UK and EU law means that now publicly listed companies such as Hammerson have to, and frequently do, work with shareholders to approve shorter notice periods.

A review of UKLA filed documents reveals that even well-known companies such as Balfour Beatty, the UK engineering company; Huntsworth, the international PR company; Tullow Oil; National Express Group; Rolls Royce Group and GlaxoSmithKline (GSK) have taken advantage of shorter notice periods in recent AGM resolutions.

Giving flexibility on urgent business and allowing companies to approve major deals such as significant acquisitions or a rights issue in a quick and efficient manner, approvals of 14 day notice periods have become a standard feature of this year's AGMs. Their standard appearance has been met with almost as much standard acceptance...until now. It seems that for a few Hammerson shareholders notice periods of less than 21 days will not be acceptable. So who are these troublesome shareholders and why do they object to what is standard practice in the UK?

Partly to blame may be the fact that, outside of the UK and its takeover code, shorter notice periods present a danger to investors by allowing companies to push through controversial M&A deals without proper shareholder scrutiny. This is a problem not faced by UK companies that are subject to the restrictions and timetable obligations of the UK's takeover code.

According to Hammerson's results of its AGM, it only narrowly missed out on passing the necessary resolution to approve a shorter notice period by just over three percent of the votes cast. An unusual course of events for a FTSE 100 company, Hammerson only managed to obtain 71.974 percent of votes cast in favour of the resolution rather than the required 75 percent.

Key to the explanation behind this extraordinary course of events is that the Ontario Teachers' Pension Plan Board is a significant shareholder in the company. That fact might be insignificant of itself, but then Ontario also happens to be a major shareholder of GlassLewis, the U.S.-based proxy advisor. Further, it is GlassLewis' policy to recommend to vote against resolutions which allow meetings to be held on short notice, the reasoning being that in the U.S. shorter notice periods can be used oppressively against shareholders, for example by rushing through unpopular M&A transactions.

It appears, therefore, that Ontario followed GlassLewis' U.S.-centric policy of voting against meetings held on short notice despite the fact that resolutions of this sort are commonly accepted due to the lack of risks they raise in the UK.

The difference in corporate governance is not without consequence for Hammerson. It now finds itself in a position where it has to operate a longer EGM notice period than many of its rivals. This longer notice period means that Hammerson may be slower to react than its competitors to significant acquisitions or to emergency rights issues, a fact that may hamper its market valuation.

Hammerson's AGM loss is not an isolated case either. Premier Foods may have felt the trying difference between corporate governance standards that can get lost in translation.

PLAYING POLITICS

Unlike the U.S., under company law provisions in the UK, shareholders must approve political donations or political expenditure by a company. It has become standard practice for shareholders to grant directors generic power to make political donations and expenditure up to a fixed amount on an annual basis at AGMs so as to avoid accidental infringement of company law restrictions.

Notwithstanding fears of big business playing politics, the reasoning behind the approval is that this authority allows companies to engage in activities that may fall within the wide definition of political expenditure but would be considered a legitimate business activity nonetheless. With the legislation covering a wide range of business activities, many conclude that it is better to allow a limited amount of political expenditure than curb normal business activities.

For example, many investors may feel uncomfortable with preventing business activities such as networking that could fall within the definition of political expenditure where attendees include public ministers or members of political parties. Rather than run the risk of inadvertently breaching these restrictions many public companies choose to seek shareholder authorization of a limited amount of political expenditure.

An analysis of recent AGM notices shows that Balfour Beatty, ITV, Ocado, National Express, and GlaxoSmithKline all sought shareholder authority this year to make political donations and expenditure with a range of limits between £25,000 and £100,000.

Despite the seemingly straight forward nature of the resolution to approve political donations, Premier Foods AGM results show that an abnormally high number of investors voted against the resolution. Despite passing most other resolutions with relative ease, a sizeable number of Premier Foods (16.67 percent of votes cast) voted unsuccessfully against the provision.

A probable cause behind shareholder backlash is that Premier Foods lists a number of large U.S. venture capital companies amongst its shareholders. Holding significant shares in the company are Warburg Pincus LLC, Franklin Resources Inc, and Paulson Europe LLP, investors with a strong U.S. corporate mentality.

Unfortunately for Premier Foods, political donations have become a hot topic in the U.S. following a controversial 2010 Supreme Court decision that held that recognised political expenditures by corporate entities are protected under the First Amendment. The effect of the decision was that, unlike in the UK where donations are only permitted with shareholder authorization, U.S. companies are free to make unlimited political donations without the need to disclose these activities.

The concern raised from the Supreme Court decision has led to a spate of proposals in the U.S. 2011 proxy season intended to gain shareholder oversight on big businesses ties to politics. Among the typical proxy battles on pay and director nominations are now appearing a growing number of shareholder resolutions to monitor or review corporations' political spending. For more information on this year's U.S. proxy trends please see Business Law Currents Proxy 2011 Series.

With shareholder support growing for political expenditure restrictions in the U.S. it seems that North American fears of unlimited political donations may have spilled over into the UK, causing a significant number of Premier Foods' U.S.-based investors to vote against its political expenditure proposals.

CONCLUSION

Hammerson and Premier Foods present interesting examples of the clash of corporate governance cultures occurring between North America and the UK. With different voting practices across the Atlantic, some shareholders are bringing their domestic concerns to bear on unfamiliar jurisdictions. Sadly, it appears that some investors are employing voting practices that are inconsistent with the actual threats posed by traditional UK corporate governance practices and are instead focusing on areas that few UK shareholders have concerns with. One danger of this approach is that attention is being diverted away from areas of genuine concern and instead focused on matters of little significance.

For companies as unlucky as Hammerson, it may also mean that they operate at a disadvantage to their peers where they are forced to comply with the corporate governance norms of another country.

CORPORATE GOVERNANCE STANDARDS:
NEW GOVERNANCE CODE ATTACKS THE UK'S "FUNGUS"

The UK has had a new corporate governance code since mid-2010, covering changes from directors' terms to narrative reporting. A recap of the central elements of this reformed code is provided below.

A new corporate governance code in the UK has set out to attack the "fungus" of prior governance misdeeds as the Financial Reporting Council (FRC) seeks to create greater dialogue between directors and shareholders.

The UK Corporate Governance Code (formerly known as the "Combined Code"), which has been in effect since 29 June 2010, seeks to attack what that FRC calls "the fungus of 'boiler-plate' which is so often the preferred and easy option in sensitive areas but which is dead communication", as the FRC seeks to put right corporate governance failings identified in the wake of the 2008/2009 financial crisis.

New developments from previous versions of the code include reducing FTSE 350 company directors' minimum terms of office from three years to one year with the requirement that all directors be subject to annual re-election. Even boards of smaller companies are encouraged to consider their policy on director re-election. This provision (Principle B.7.1) has proved controversial among some critics, including the Institute of Directors and the CBI, who have accused the FRC of encouraging short-termism and undermining collective decision making.

Other new developments include the requirement for an external evaluation of the board of FTSE 350 companies (Principle B.6.2) at least once every three years. A statement is required as to whether the external facilitator has any other connection with the company.

Gender diversity is also encouraged under the new rules with "gender" explicitly stated as an objective component for determining board diversity under principle B2.

The code even includes a few changes to remuneration principles, requiring that shares issued under long-term incentive schemes do not vest in less than three years and that consideration should be given to claw back provisions that reclaim variable components in exceptional circumstances of misstatement or misconduct. Principle D1 also includes a supporting principle that requires that executive directors' remuneration is "stretching and designed to promote the long-term success of the company."

Other provisions of interest are Principle B.3.3 that provides that "the Board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company" and Principle C.1.2 which requires "an explanation from the directors of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company" to be included in the Annual Report.

GENDER EQUALITY: ADDING UP THE BOARDROOMS

Gender inequality in the boardroom continues to vex, as UK boards are being asked to re-style themselves with greater diversity. Recent developments don't (yet) portend well. Consider the analysis below.

With AGM season in full swing in the UK, attention is once again turning to corporate governance issues and in particular, board composition, as a recent report from Cranfield University reveals that only 12.5% of FTSE 100 directorships are held by women.

With an overhaul of discrimination law provided by the Equality Act 2010, the importance of gender diversity in boardrooms has never been more profound and the new act strives to achieve better gender equality in companies among other things.

Recent developments seem to suggest, however, that the UK government has stepped back from imposing the full force of the act and will not be imposing mandatory gender quotas or compulsory gender pay reporting - bad news for Cranfield University who produced a damning report on gender diversity in FTSE 100 companies recently.

FEMALE FTSE 100 REPORT

According to the Cranfield Female FTSE Index, 2010 saw "another year of barely perceptible change in the representation of women in leadership positions of UK PLC's top 100 companies." With only 13% of new appointments going to women, the overall number of female directors remained around 12%, representing a three year plateau. Incremental increases included three additional women on FTSE 100 boards taking the total to 116; one additional female executive director; four more companies with women on their boards; and two more companies with more than one woman on the board.

Burberry topped the list of Female FTSE 100 Rankings with 37.5% of board members being women, including the chief executive and the chief financial officer. Diageo was in close second being the only FTSE 100 company to have more than three female board members and Alliance Trust pinched bronze with three of nine board members women.

With the UK seemingly achieving little or no progress towards increasing the representation of women in British boardrooms, many have called upon the government to impose more stringent measures to generate greater gender equality.

EQUALITY ACT 2010

Spearheading the regulatory change for greater equality is the Equality Act 2010 ('the Act') which was passed into law on 8 April 2010. Voted into force in little under a month before the general election, the Equality Act has found itself in a kind of legal limbo as political momentum fades before all of its provisions come into force.

Replacing previous legislation such as the Race Relations Act 1976 and the Disability Discrimination Act 1995, the Act provides a basic framework of protection against direct and indirect discrimination, harassment and victimisation. More than restating and codifying previous equality laws, the Act goes further and even creates new equality laws.

Whilst most of the Act was brought into force in October 2010, certain new and more politically sensitive aspects still await activation as they continue to lumber in a legal no man's land.

POSITIVE DISCRIMINATION

Proving particularly controversial has been Section 159 of the Equality Act 2010 that gives "positive discrimination" powers to employers to prefer a person with a "protected characteristic" for recruitment or promotion over other candidates of equal qualification.

The Act lists nine "protected characteristics" that may justify positive action including: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation.

Having been recently approved, Section 159 will now come into force from April 2011 giving employers the option, when faced with two or more candidates of equal merit, to choose a candidate from a group that is under-represented in the workforce. The hope for listed companies is that they will use Section 159 to hire women onto FTSE 100 boards in advance of equally qualified male candidates.

GENDER PAY REPORTING

Less favoured is the gender pay reporting provision contained in Section 78 of the Equality Act 2010 which remains to be implemented. Section 78 gives the power to set regulations to require that employers publish information setting out the differences in pay of male and female employees.

Originally conceived of as a mandatory provision, the section applies to companies who have more than 250 employees and may prescribe descriptions of the employer, employee and may stipulate how to calculate the number of employees that an employer has. Under Section 78(4) regulations will be restricted so that they may not require an employer to publish information more than once every 12 months.

Lynne Featherstone, the Equalities minister, announced recently that the government would be stepping back from making gender pay reporting mandatory under Section 78 and instead would advocate a voluntary system of gender pay reporting. This voluntary system of gender pay reporting will be assessed annually by the government with the threat of imposing mandatory rules if things don't improve.

DISCRIMINATION IMMUNITY

Slightly confusing matters was the Equality and Human Rights Commission, an independent public body established under the Equality Act 2006, who announced on 20 January 2011 that it would offer limited immunity from investigation for pay discrepancies for those that chose to analyse and report publicly their gender pay gaps.

Hoping to encourage voluntary gender pay reporting the Commission's proposals give companies the option of reporting pay differences in the hope of achieving immunity from proceedings for discriminatory salary practices. The Commission's proposals give companies a menu of options for how to voluntarily report on pay by gender. These include:

1. A single figure difference between the median hourly earnings of men and women;

2. The difference between the average basic pay and total average earnings of men and women by grade and job type; and,

3. The difference between men's and women's average starting salaries.

Employers will have the option of including a narrative of the causes of their organisation's gender pay gap, which may be combined with one or more quantitative measures. Organisations with 250 to 500 employees are being encouraged to opt initially to publish information measured by at least one quantitative indicator with organisations of 500+ encouraged to report on initially two indicators, including a narrative, rising to all three over the next two years. The Commission is expected to provide additional guidance to companies on how to comply with gender pay disclosures in the near future.

CONCLUSION

Recent developments suggest that the full force of the Equality Act 2010 may never see the light of day despite its earlier high aspirations. As provisions such as compulsory gender pay reporting are dropped and positive action provisions only narrowly make it into law, it seems likely that quotas for the number of women on boards may also fail to be introduced. As the government steps back from earlier commitments, proponents will eagerly wait to see whether these watered down provisions will equate to greater equality.

REUTERS/ ALY SONG

WALKER REVIEW:

EFFECTIVE CORPORATE GOVERNANCE — SIGNIFICANT INFLUENCE CONTROLLED FUNCTIONS AND PS10/15

The Walker Review continues to have an impact on the corporate governance of UK companies, with the FSA and FRC implementing many of the report's recommendations. Consider the analysis below.

The Financial Services Authority has published policy statement 10/15 on effective corporate governance, implementing the final recommendations of the Walker Review and finalising changes to the significant influence controlled functions. PS10/15 also gives feedback on consultation paper 10/03 on effective corporate governance and sets out the final Handbook text in force from May 1, 2011. CP10/03 published in January 2010 set out the FSA's proposals to improve both the quality of governance within firms and the intensity of its supervisory regime. It also contained proposals to implement relevant recommendations from the final report of the Walker Review. In particular, CP10/03 put forward:

- A new framework of classification of controlled functions;
- Changes to the approved persons regime, including the scope and definition of certain, already existing controlled functions;
- Some guidance detailing the FSA's expectations of the role played by non-executive directors and a proposal to delete current guidance that discusses the limits of a NED's liability;
- Guidance on risk governance and the FSA's plans to support the implementation of recommendations in the Walker Review.
- Further detail on the FSA's approach to the approved person and significant influence function interview process that sets out, in detail, the way the fitness and propriety of SIF candidates will be assessed.

In PS10/15 the FSA has not just set out the new regulatory requirements for corporate governance and controlled functions but has also emphasised how its expectations have changed and developed. It has highlighted, in particular, the landmark speech that chief executive Hector Sants (who will head up the Prudential Regulatory Authority in the new supervisory architecture) made, in discussing the role that regulators have to play in judging culture and ethics in firms. Moving on from simply ensuring compliance with the Handbook, the FSA is seeking to police behaviour and ensure that firms have the right culture in place to facilitate the delivery of appropriate outcomes. Sants stated that regulators can influence this goal by:

- Ensuring firms hire managers who act with integrity by judging competency but also ensuring they understand the need to and are equipped to act with integrity and deliver the right culture;
- Ensuring firms have the right governance and behavioural framework to facilitate good judgement by their staff;
- Assessing the actions against society's wider expectations not just shareholder value.

All of which must be underpinned by strong enforcement action — backing up the now famous statement that Sants made that firms "should be afraid of the FSA". Overall, the FSA (and by inference its successor bodies) will in future seek to take judgements on both human behaviour and hard facts, informed by a fully integrated assessment of risks and the factors which drive them.

COMPLIANCE TIPS AND NEXT STEPS

The FSA, in line with numerous international bodies, is ramping up its approach to and expectations of corporate governance. Much of the spotlight will remain focused on the increased liability of NEDs under the new regime. Compliance officers should be at the forefront of ensuring that a compliance programme for all NEDs is implemented without delay, to include training and awareness on the new implications of the role, particularly the increased level of interaction with the FSA, an initial and then regular suitability assessment as well as clearly defined role, remit and reporting lines, all of which must be rigorously documented. there are a number of areas of work required to be in place from May 1, 2011: annex four of PS10/15 contains a table that maps the old control functions to the new, with Annex five setting out the transition arrangements and timetables.

All firms need to review their existing approved persons to ensure in the first instance that they are completely up-to-date and all supporting documentation, including training records and any annual certification of fitness and propriety, is complete. The mapping exercise to the new control function regime will need to include compliance, HR, senior managers, risk functions and internal audit, together with any parent company likely to be in scope. The corporate governance framework, within which the control functions operate, should, following the Walker Review, have been re-assessed; however, it may need to be revisited and the documentation updated to accommodate the new FSA requirements. There should be particular clarity around the independence of the internal audit function, the scope of the chief risk officer to challenge decisions as well as the increased role and remit of NEDs. In firms which use matrix management additional care will be needed to ensure that roles and reporting lines are defined particularly clearly and kept up-to-date. Senior managers and NEDs should be prepared to discuss their firm's preparation for the new regime and be able to explain how the corporate governance framework in place is tailored precisely to their firms business.

PS10/15 has extensive detail on the interview and assessment process that the FSA intends to use when assessing the suitability of individuals for significant influence control functions. Firms will need to consider how best to prepare potential candidates for this process and how best to take advantage of the FSA's offer to assist with certain due diligence, such as overseas regulators. In most firms it will be a combination of the compliance and HR functions that will be involved in setting the policies and procedures, although senior managers are likely to be important in the recruitment of other significant influence functions. Firms should consider whether or not to build Criminal Record Bureau checks, references and other due diligence in as a matter of course to all senior recruitment. Indeed, firms are on notice that if they do not show a level of care and rigour in selecting individuals for senior roles then the FSA may see that as a negative factor in its assessment of the culture of the firm.

One area where practices may have to change for firms is in the process regarding "dirty withdrawals" for approved persons. In the past many firms have shied away from citing any adverse reasons why an individual's registration is being withdrawn. Similarly, with regard to references, common practice has been that a firm would only confirm the time period during which an individual had been employed and to give no detail on performance, whether satisfactory or otherwise. In PS10/15 the FSA has made a particular point with regard to the disclosure of compromise agreements both to itself and to other firms. The requesting of references is not mandatory; however, the FSA has stated it does expect them to form part of a firm's due diligence. That said the FSA has sought to avoid prescription on the format and nature of the information that is expected to be provided in references. Where references are requested, the firm receiving the request must disclose all relevant information, including any compromise agreements.

Last but not least, the implementation of the new control function regime once again highlights the need for robust and consistent documentation to enable firms to evidence that their corporate governance arrangements are effective. It is an old chestnut but as far as regulators are concerned if a firm cannot evidence something then it did not happen. Firms need to ensure that they allocate the appropriate amount of time and money to records capture, management and retrieval to ensure that the investment in compliance is not wasted through lack of rigorous documentary evidence.

REUTERS/ ALY SONG

UK BRIBERY ACT:
THE LONG ARM OF THE LAW — HAS THE BRIBERY ACT LOBBY WORKED?

The extensive reach of the UK Bribery Act is the subject of some controversy– and equally controversial are certain possible exceptions from coverage of the Bribery Act, including those examined by the following analysis.

"THE GOVERNMENT WOULD NOT EXPECT, FOR EXAMPLE, THE MERE FACT THAT A COMPANY'S SECURITIES HAVE BEEN ADMITTED TO THE UK LISTING AUTHORITY'S OFFICIAL LIST AND THEREFORE ADMITTED TO TRADING ON THE LONDON STOCK EXCHANGE, IN ITSELF, TO QUALIFY THAT COMPANY AS CARRYING ON A BUSINESS OR PART OF A BUSINESS IN THE UK AND THEREFORE FALLING WITHIN THE DEFINITION OF A 'RELEVANT COMMERCIAL ORGANISATION' FOR THE PURPOSES OF SECTION 7. LIKEWISE, HAVING A UK SUBSIDIARY WILL NOT, IN ITSELF, MEAN THAT A PARENT COMPANY IS CARRYING ON A BUSINESS IN THE UK, SINCE A SUBSIDIARY MAY ACT INDEPENDENTLY OF ITS PARENT OR OTHER GROUP COMPANIES."

Ministry of Justice guidance.

THE LONDON LISTING CARVE OUT

A UK-based investors group, together with the International Corporate Governance Network, recently wrote a letter to the Financial Times expressing concern that the Bribery Act Guidance would exempt certain overseas issuers in the London market from the scope of the Act, and referred to what it termed the "mooted carve out" of overseas companies listed in the London market with no other business presence in the UK apart from raising capital. They challenged the notion that raising capital did not amount to carrying out business in the UK, arguing that such an interpretation could compromise the integrity of the London financial market and place UK companies at a disadvantage. Transparency International has gone further and argued that if a non-UK company listed on the London Stock Exchange were not automatically caught by the Bribery Act this would mean that it could use capital raised in the UK to pay bribes overseas, and that a UK-based company which lost a contract to such a company would have no obvious legal remedy. Other interested parties who had been concerned that, on the contrary, the inclusion of such companies within the scope of the Act would have a deleterious affect on London as a capital-raising market have clearly leaned on the Ministry of Justice to include the controversial carve-out in the revised guidance, however.

NOT CARRYING ON A BUSINESS?

Legal misgivings have already been expressed concerning the likelihood of the courts upholding the guidance approach. Eoin O'Shea, head of anti-corruption at Lawrence Graham LLP, noted that it was not immediately obvious that listing shares, dealing on the stock exchange or raising capital in London was not part of carrying on a part of one's business. A commentator in the DR Advisor Quarterly expressed a similar view before publication of the revised guidance to the effect that listing a depositary receipt on a UK stock exchange might amount to carrying on business in the UK. A depositary receipt is a negotiable financial instrument issued by a bank to represent a foreign company's publicly traded securities. The depositary receipt trades on a local stock exchange and the arrangement makes it easier for investors to buy shares in foreign companies because the shares of the company do not have to leave the home state. When the depositary bank is in the U.S. the instruments are known as American depositary receipts. European banks issue European depositary receipts, and other banks issue global depositary receipts.

SECURITIES AND THE SCOPE OF THE FCPA: THE BAE AND TECHNIP CASES

Clearly that would be the case under the Foreign Corrupt Practices Act in the U.S., where being the issuer of registered securities brings organisations within the scope of the law. ADRs traded off-exchange would not, however, fall within the definition of registered securities and would, therefore, not be covered.

The notorious BAE bribery case did not result in actual bribery charges, but in accounting and conspiracy charges. It has been suggested that the reason for this was that at the crucial time BAE Systems plc's ADRs were traded off-exchange and did not fall within the scope of the FCPA. In fact, BAE had filed for an exemption from registration under s12(g) of the Securities Exchange Act since at least 2002. By contrast, in the Technip bribery case the firm had ADRs listed on the NYSE from at least 2001 until 2007 and was an "issuer" for the purposes of the FCPA at the crucial time.

HONG KONG BECKONS?

Powerful pro-carve-out interests clearly include all those for whom the maintenance of London as a leading financial centre is paramount. A banker in Kazakhstan who had helped to arrange a large London equity fundraising was quoted in 2007 as having severe misgivings at the prospect of companies whose only connection to London was through capital raising or secondary securities markets trading, but whose actual business was located elsewhere, finding themselves caught within the jurisdiction of the Act. The banker anticipated that the Act would so severely affect the attractiveness of the London market that any valuation premium would not be enough to offset the additional red tape and potential risks; Hong Kong and other friendlier jurisdictions would surely beckon.

THE SERIOUS FRAUD OFFICE VIEW

Richard Alderman, head of the UK's Serious Fraud Office, has recently warned companies that they should not rely on over-technical interpretations of the Act and that he would use it to ensure that UK commercial enterprises were not disadvantaged by compliance with the law. Such views suggest that the SFO will not hold back on prosecuting foreign companies wherever they can. To reinforce this, Alderman has invited UK companies to tell him where foreign companies listed in the UK are breaching the legislation. He has also specifically referred to the fact that that he has been questioned about issues such as "whether a quotation on the London Stock Exchange is sufficient, whether subsidiaries in the UK are sufficient, whether the raising of loan finance is sufficient and whether supplying services over the internet is sufficient", making it clear that the SFO would adopt a determined stance towards the interpretation of the legislation with regarding whether or not a company was carrying on a business in the UK. Ultimately, of course, the matter will fall for decision in the courts if it is raised as an issue.

UNAWARE OF BRIBERY TAKING PLACE IN A THIRD COUNTRY

Alderman also pointed out that if a firm were found to be carrying on business in the UK because, for example, despite being based overseas it had a subsidiary in the UK, such a subsidiary could be caught by the legislation as a result of bribery which took place in a third country and was carried out by other subsidiaries of the corporate, bribery of which the UK subsidiary was entirely ignorant. The comments echo those made by Chris Walker, head of policy at the SFO, who has also been quoted in bullish mode addressing issues raised by a hypothetical situation. It involved a U.S. and a UK company which were both building a factory in a third country and were both approached by the local phone company with a take-it-or-leave-it proposition that if they wanted phone services to be provided, a (small) bribe was required. The UK company lost the contract as the U.S. company was able to take advantage of the facilitation payments defence in the FCPA, whereas the UK company was denied phone services for months. Walker noted that in such circumstances the SFO would look carefully to see if the U.S. company was carrying on business in the UK by, for example, having a subsidiary company based here and, if that were found to be the case, would not hesitate to prosecute that company for having made the facilitation payment.

CARRYING ON BUSINESS IN THE UK AND THE FINANCIAL SERVICES AND MARKETS ACT 2000

While there is no definition of carrying on a business in the Bribery Act, in the Financial Services and Markets Act 2000, in the context of carrying a regulated activity by way of business, PERG 2.3.3 provides that whether or not an activity is carried on by way of business is ultimately a question of judgement that takes account of several factors, none of which is likely to be conclusive. These factors include the degree of continuity, the existence of a commercial element, the scale of the activity and the proportion which the activity bears to other activities carried on by the same person.

PERIMETER GUIDANCE AND PERSONS BASED OUTSIDE THE UK

PERG 2.4.6G. provides that a person based outside the UK may also be carrying on activities in the UK even if he does not have a place of business maintained by him in the UK (for example, by means of the internet or other telecommunications system or by occasional visits). In that case, it will be relevant to consider whether what he is doing satisfies the business test as it applies in relation to the activities in question.

THE VIEW OF THE COURT OF APPEAL

This issue was discussed by the Court of Appeal in Financial Services Authority v Fradley & Woodward, a case which addressed the issue of whether certain betting-related activities constituted a collective investment scheme. Lady Justice Arden held that, in connection with a business, the running of which had substantially been moved to Ireland, it was sufficient if the activities in question, which had taken place in the UK, were a significant part of the business activity of running the collective investment scheme (if any) constituted by the betting services being offered. The court found that the communications with clients and prospective clients, and the maintenance of a bank account and an accommodation address, all of which took place in the UK, were all business activities and were of sufficient regularity and substance to constitute the carrying on of business there even after one of the parties concerned had moved his own office to Ireland in April 2003 and subsequently gave instructions by post or internet from there.

WILL THE LISTINGS CARVE-OUT REALLY WORK?

The London Stock Exchange has been actively marketing London to overseas companies as an ideal centre for raising equity capital. There are companies listed in the LSE which are not incorporated in the UK, but most of them do have significant operations there. Many listed mining groups have token holding company incorporation in London. Some commentators on the Act have suggested that it may be impossible at the moment to point to a single company which has a London listing and no presence, even through an agent company, in the UK. It is indeed difficult to imagine how a corporate could engage in a full-scale listing, such as a premium LSE listing, an AIM floatation or even secondary market trading, without carrying on some business-related activities in London. If the Ministry of Justice really wants to create such a loophole it would be well-advised to amend the legislation to make the position clear. This is unlikely to happen for various reasons which are economic, commercial and political rather than legal, and so the business community will have to wait for the judges to pronounce on this and other controversial scope-related aspects of the Act. Given the very different approach adopted in the US is possible that the tougher SFO line may find favour.

REUTERS/ ALY SONG

U.S. FOREIGN CORRUPT PRACTICES ACT: BRIBES, STINGS AND WHISTLEBLOWERS...THE 'SHOT SHOW' TRIAL BEGINS

The Foreign Corrupt Practices Act has stymied corporations for far longer than the UK Bribery Act. Even with that legacy, it now shows signs of presenting new obstacles, thanks to new techniques innovated amidst the colourfully dubbed "Shot Show" trial unfolding in Nevada during 2011.

The first of many trials following the "Shot Show" FBI/City of London Police arms trade bribery sting (named after the Shooting, Hunting, and Outdoor Trade Convention in Las Vegas at which 21 of the 22 defendants were arrested) began on May 12th in the U.S. District Court in the District of Columbia (Washington DC).with the swearing in of the jury. One of the defendants is a UK citizen - one of four UK defendants involved in a case which has been described by the U.S. Justice Department as the largest single investigation and prosecution of individuals in the history of the Foreign Corrupt Practices Act with the total number of defendants exceeding the number of individuals charged in 2009. It is also the first large-scale use of an undercover operation in the area of law enforcement and is unlikely to be the last. As Assistant Attorney General Lanny A. Breuer stated in the Department of Justice Press Release "From now on, would-be FCPA violators should stop and ponder whether the person they are trying to bribe might really be a federal agent."

UNDERCOVER OPERATIONS AND UK LAW ENFORCEMENT

Law enforcement agencies in the UK, including the FSA also make use of contemporaneous modes of investigation including intrusive surveillance and the use of covert human intelligence sources particularly in the case of insider dealing investigations. When the Bribery Act comes into force there will be scope to focus more on corruption investigations. The FSA in particular has conducted joint operations with the Serious and Organised Crime Agency (SOCA) in this field. SOCA has the power, unlike the FSA to apply for the power to engage in wire tapping operations, although in the UK the result cannot be directly used as evidence in court - a position which contrasts with that in the U.S. as evidenced by the recent Galleon insider trading cases. This position may well change in the future.

THE WHISTLEBLOWER INFORMANT – A STRAW IN THE WIND FOR UK COMPANIES?

The investigation was greatly aided by FBI informant Richard Bistrong - a former arms salesman for Armor Holdings- who went undercover on behalf of the FBI after blowing the whistle on an earlier United Nations related arms trade corruption case with which he had been involved. He has now pleaded guilty in that case to charges of conspiracy to bribe officials to win contracts from the United Nations and other foreign entities, illegally exporting certain goods without authorization and falsifying books and records. The case concerned the use of bribery to secure contracts to supply United Nations Peacekeeping forces with helmets and body armour. Bistrong was sacked and Armor Holdings has been taken over by BAE systems.

THE SFO SELF REPORTING REGIME AND WHISTLE-BLOWING PROCEDURES

We may see increasing numbers of cases involving whistle blowing in the UK in the future. The self reporting regime is being actively encouraged by the Serious Fraud Office who are promoting the advantages of this system to firms. They point in particular to the various benefits that a corporate corporation can reap in terms of a possible civil rather than a criminal outcome through a negotiated settlement will not result in a mandatory ban in terms of EU procurement contracts. Furthermore in terms of the failure to prevent bribery offence firms are being urged to ensure that they have put in place whistle blowing facilities whereby individuals can report their suspicions of corrupt behaviour confidentially and, if they wish, anonymously. Such facilities should also be available in the case of companies with overseas operations to individuals in appropriate languages and time zones. The processes should encompass:

- The provision of a helpline;
- Escalation procedures;
- Procedures for the avoidance of conflicts of interest;
- Follow-up and investigation processes;
- The wide scope of the Bribery Act.

Under the Bribery Act companies can now be held liable for the corrupt acts of:

- Employees.
- Agents.
- Subsidiaries.
- Joint venture partners.
- Outsourcing contractors.

The Shot Show case involves defendants from several jurisdictions, as is often the case in major bribery investigations. The Bribery Act's extra territorial reach is even broader than that of the FCPA. For example, the offence of failure to prevent commercial bribery could apply to any corporate or partnership wherever it is registered, incorporated or conducts its main activities as long as it carries on a business, or part of a business, in the UK. It also applies to conduct that takes place outside of the UK. This means that, as long as it carries on some business in the UK, a foreign company can commit the failure to implement "adequate procedures" offence in relation to conduct in a foreign country that is not connected with any business undertaken in the UK.

STRUNG UP BY BISTRONG AND THE FBI

The defendants in the Shot Show case were brought together by Bistrong in the U.S. to participate in what purported to be another possible arms deal to supply equipment for the Presidential Guard of the President of Gabon, but which was in fact an FBI sting. The 22 individuals, including a Smith & Wesson Holding Co sales executive and a former U.S. Secret Service agent, were charged with trying to bribe the Gabon defence minister as part of a $15 million arms and equipment deal. Specifically they are accused of trying to bribe two undercover FBI agents who posed as representatives of the Gabon Ministry of Defence— to win the contracts to provide arms including guns, body armour and other related equipment.

AN INFLATED QUOTATION

The case against Patel is that he allegedly submitted an inflated sales quotation that included a 20% "commission" to a "sales agent" whom he believed to be representing the defence minister of Gabon and who would pay 10% to the defence minister in order to secure the contracts. The other 10% would be split between the undercover agent and Richard Bistrong.

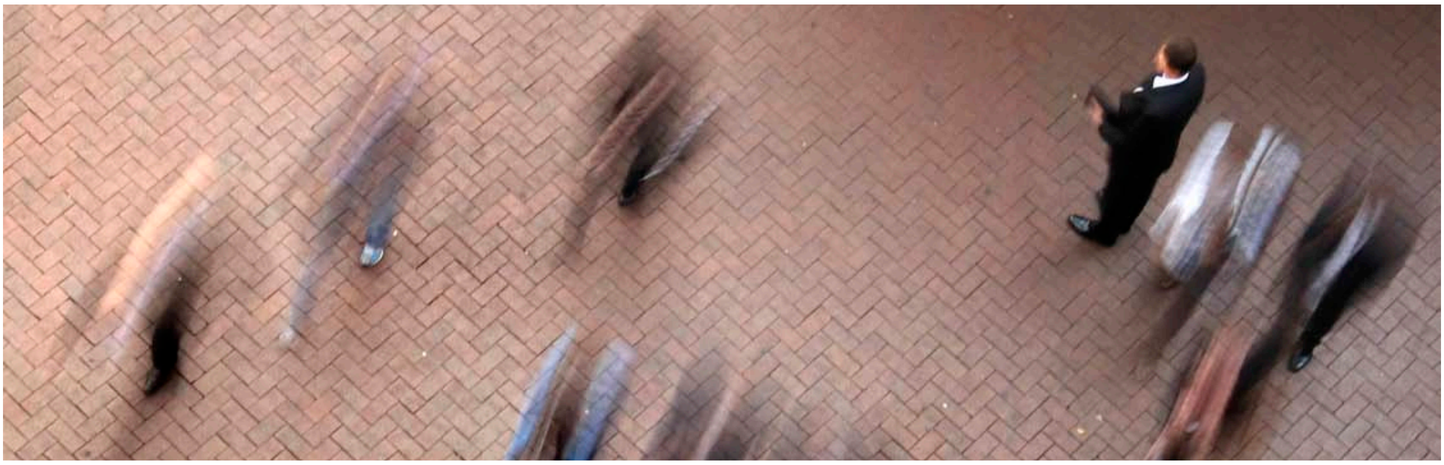
Corruption investigation heads up the law enforcement agenda

The City of London Police executed seven search warrants in connection with their own investigations into the conduct that led to the U.S. indictments. This case, therefore, continues the recent pattern of cooperation among governments in corruption cases.

Kevin Perkins, the FBI's Assistant Director of the Criminal Investigation Division is on the record that stating that investigating corruption at all levels is the number one priority of the FBI's Criminal Division - a policy which was clearly evidenced by the fact that 150 FBI agents were involved in the execution of the search warrants and the duration of the investigation (2 ½ years). City of London Police Detective Chief Superintendant Head remarked at the time of the arrest that combating overseas corruption was an important part of the UK's fight against economic crime.

NO DE MINIMIS

The actual amounts paid by each defendant that were allegedly intended to be passed on as bribes ranged from approximately $220 to $1,800 and were relatively small sums. This reinforces the fact that there is no de minimis or materiality threshold in the FCPA investigations and UK law enforcement agencies may well adopt a similar or even more stringent approach. All of the individuals are or were employed by small, private companies with the exception of one who is employed by Smith and Wesson Holding Corporation. Several companies were served with subpoenas on January 18, the day of the arrest of the individuals. It is unknown whether any action will be taken against any of the companies. Clearly if a company wishes to protect its valuable reputation from being compromised by the action of a rogue employee or agent then full compliance with the Bribery Act Guidelines is an absolute imperative.



REUTERS/ ALY SONG

GLOBAL M&A REVIEW: POISON PILLS, CHINESE TAKEAWAYS AND BURGERS FATTEN DEALS UP

Boards of directors face new opportunity for growth, fuelled by takeover activity. An overview of 2010 M&A activity provides a telling reminder of the heightened level of activity, across industry and geography. In some cases, multiple offerors have even begun to re-emerge. As a result, boards must carefully consider their next steps, both in the UK and beyond.

From poison pills, Chinese takeaways and hostile takeovers to booming Brazil, cautious Canadians and burger-eating private equity, Thomson Reuters Accelus breaks down global M&A in 2010 to make sense of last year's trends, developments, trials and tribulations, and what they may portend in 2011.

This review starts with a quick overview of key trends, but quickly gets down to detailed views of trends, geographies and sectors. For many, 2010 proved to be a decidedly mixed year. Whilst the U.S. and Europe remained sluggish in their economic recoveries, global M&A activity was boosted by increased emerging market demand and certain hot sectors, from commodities and energy to pharma and finance. Global M&A was up overall at 19% on the same period last year but the focus of mergers and acquisitions shifted to account for the new post-credit crunch reality.

First, the quick review: Rapidly-developing China, Brazil and India made notable gains on some more established markets. The latter suffered from less-available acquisition financing and rocky stock markets, as flash crashes and financial influenza gripped the Western World. Strategic acquisitions were in play and private equity picked up, though still taking a back seat to companies' expansion plans and global tie-ups.

Asia Pacific M&A was up 31% on this time last year at around $426 billion whilst the U.S. bounced up 11% at $773 billion. European M&A on the other hand remained plagued by Eurozone problems with a rather dismissal 5% increase on last year's own poor performance at $589 billion.

North America saw some bright spots. Canada's rich natural resources meant that it was well placed to benefit from the shift to gold and energy deals. Things looked positive in the U.S. for some. There was a resurgence of private equity and fund activity, on both sides of the deal. Private equity acquirers were part of the resurgence with Del Monte Foods and Burger King both being eaten up by private equity; at the same time, funds also acted as gadflies for companies like Dynegy.

Hostile takeovers, unsolicited bids, and takeover defences are also on the rise. U.S. and Canadian companies popped poison pills at a growing rate. At the same time, UK companies and the UK takeover panel were left wishing that they had such corporate pharmacology.

ASIA

In a showcase of outbound purchasing power, the People's Republic of China (PRC) has led M&A activity in the Asia Pacific region in 2010. While PRC companies have pursued targets in almost every sector imaginable, asset acquisitions and deals boosting branding have proved especially popular.

ASIAN ENERGY

China's state-owned oil behemoths have been particularly active this year, venturing into Latin America and even North America. American oil companies, which were previously wary of Chinese suitors, have dropped their guard somewhat post-financial crisis. Creeping in gently, some PRC oil companies have opted to purchase oil assets and minority stakes, as opposed to an outright more political takeover.

In October 2010, China's leading offshore oil producer, CNOOC dropped US$1.1 billion for a stake in a Texas oil and gas field owned by Chesapeake Energy. China's rising energy consumption has also led the company to explore new territory for acquisitions. This past summer, PetroChina teamed up with Royal Dutch Shell to acquire the entire share capital of Arrow Energy, an Australian energy company. Whilst earlier this month, the Sinopec Group announced that it would be relieving U.S. oil firm Occidental of its Argentinean assets, solidifying China's foray into Latin America. Previously, the China Development Bank agreed to extend a 10 year bilateral credit line worth US$10 billion to Brazilian state-owned oil giant Petrobras. As of December 2010, CNOOC, in conjunction with Sinopec are also rumored to be bidding for a US$7 billion asset acquisition from OGX SA, another Brazilian oil and gas entity.

ASIAN KNOW-HOW

In addition to engulfing assets, Chinese companies displayed a keen interest in targets rich in technical expertise and business strategy know-how. Most notable for this year was the acquisition of Volvo by Geely Automobile Holdings for US$1.8 billion, the largest auto acquisition made by an independent Chinese company. As a part of the acquisition, Ford also transferred some of its technical expertise and technology, further illustrating the ability of Chinese companies to buy whatever their business plans may lack.

Know-how driven acquisitions also flowed both ways. In the months following the Geely-Volvo deal, Fosun International announced that it had purchased a 7.1 percent stake in Club Mediterranee SA, the French operator of Club Med resorts. Club Med welcomed the transaction with open arms, expressing hope that its Chinese partner could help the company make China one of its top markets within five years. Wasting no time in putting Fosun's connections to good use, the resort operator recently opened Club Med Yabuli, the first Club Med branded resort in China.

AUSTRALASIA AND BEYOND

While many M&A success stories have come out of the Greater China region this year, 2010 has seen a small share of dark horses as well. Australia's BHP Billiton faces potential shareholder anger after a string of failed takeover attempts in recent years. Earlier this summer, BHP Billiton launched a hostile takeover bid for Canada's Potash Corp, which was called into question by the provincial government of Saskatchewan and, in a rare move, ultimately shot down by the Canadian federal government . The failed attempt further rubs salt in the Australian company's wounds, which are presumably still stinging from an unsuccessful attempt to purchase rival Australian minor Rio Tinto in the aftermath of the global financial crisis.

The second big loser this year was AIG's Taiwan unit, Nan Shan. AIG's first attempt to sell Nan Shan Life Insurance was blocked by Taiwanese regulators. Citing Taiwanese laws that limit investment from PRC investors, Taiwan's financial regulator expressed concern over a group of buyers with ties to mainland China. Just in time for the Christmas season, the Nan Shan deal was resurrected earlier this month when three buyers in Hong Kong submitted bids for the insurance unit. With AIA successfully listed in Hong Kong, perhaps buyers that are south of the border may put Taiwanese watchdogs at ease?

BRAZIL

An M&A hotbed, Brazil has garnered its share of interesting acquisitions with big deals in banking, energy and pharmaceuticals. While Petrobras and Vale generated most of the headlines, many other deals were humming beneath the surface with private equity playing its role in Brazilian investment.

Blackstone Group was among those going Brazilian with the acquisition of a 40% stake in Patria Investimentos, a São Paulo-based PE firm with $3.2 billion in assets under management. JPMorgan Chase likewise acquired a boutique investment bank in São Paulo. In December, BTG Pactual, called "the biggest independent securities firm in emerging markets" by Reuters, scored big with its $1.8 billion sale of an 18% stake "to a diverse group of heavyweight investors from Asia, the Middle East, Europe, North America and Latin America. The buyers," reported Reuters, "included sovereign wealth funds from China and Abu Dhabi as well as some of Europe's richest families."

One of the biggest Brazilian deals of the year involved a subsidiary of Spain's Repsol. The twist in this case is the acquirer: Sinopec, the Chinese oil company 76%-owned by the People's Republic of China. For its $7.1 billion investment, Sinopec acquired 40% of Repsol Brazil (please see Business Law Currents Repsol and the $7 Billion Silent Partner.)

In the pharma sector, both Pfizer and Watson Pharmaceuticals made substantial acquisitions in Brazil, in generic drug making and biotech, respectively. China Petrochemical, Sinopec's parent, also had a late-year hit with its $2.5 billion acquisition of Occidental Petroleum's Argentina assets giving a healthy glow to M&A markets (please see Business Law Currents Booming Brazil Bags M&A Billions).

CANADA

In Canada, 2010 was marked by the deal that wasn't. BHP Billiton's failed $40 billion bid to acquire Potash Corp of Saskatchewan was notable for being just the second deal blocked by the federal government under Canada's foreign investment rules since 1985, a period that has seen over 1,600 deals completed without incident. Following a year in which several major deals involving Chinese companies caught the attention of the Canadian public, foreign investors may be wondering whether the tides are turning against them.

The Billiton deal was also notable as one of several high-profile transactions in 2010 in which an issuer gulped down a poison pill in an effort to hold off pursuers. Lions Gate Entertainment had mixed results in its attempts to fend off corporate raider Carl Icahn, while Ivanhoe Mines appears to have backed off mining giant Rio Tinto, at least for a short while.

Even without the BHP/Potash deal, the first three quarters of 2010 were relatively healthy from an M&A perspective, certainly as compared to the doldrums of late 2008/early 2009. Gold companies were particularly active, with Goldcorp and Kinross both involved in billion dollar deals. In addition, the agribusiness sector saw deals by a number of players, and there was continued consolidation on the media front, with Shaw's acquisition of Canwest Global, the acquisition of CTV GlobeMedia by BCE and the merger of Sirius and XM keeping Canadian regulators on their toes.

EUROPE

According to Thomson Reuters' data, European M&A appeared up just 5% on last year at around $589 billion. M&A activity remained muted in the UK with public takeovers thin on the ground, despite a slightly more resurgent private acquisition sector.

Despite or perhaps because of this paucity, hostile takeovers featured large on the public M&A scene with the Yanks developing a particularly strong taste for the Brits. Cadbury, Raymarine and Chloride all went the way of British Imperial aspirations, bowing to the hegemony of their respective hostile bids as a strong dollar made sterling look cheap in the early part of the year. Even the supposedly patriotic success of Royal Bank of Scotland in wresting control of Liverpool Football Club from the hands of Tom Hicks and George Gillett ultimately benefited the States with New England Sports Ventures, the owners of the Boston Red Sox baseball team, becoming the ultimate successors.

With the Americans getting hostile, the UK takeover panel was pushed to consider whether UK corporate defences were really up to the task, concluding that British companies' takeover defences were about as secure as U.S. diplomatic channels.

With defences found wanting, the takeover panel announced new rules due to be implemented in the New Year that promise to address the balance between bidders and targets in UK M&A. Re-molding the M&A landscape to ban deal protection measures and requiring greater transparency from bidders over fees and financing arrangements, the rules represent a seismic shift in M&A rules to give greater autonomy to target companies (please see Business Law Currents Cross-Border M&A Watch: Radical UK Takeover Code Changes).

EUROPE: UK ENERGY

Despite Europe's lackluster overall M&A performance, energy M&A appeared to be buoyant, no doubt in no small part due to emerging market demand and BP's hemorrhaging of assets. Shell was among those horse-trading, swapping its Norwegian offshore assets for interests in Gabon and the North Sea with Hess Corporation, the U.S. oil company whilst UK SPACs (special purpose acquisition company) got in on the action.

Vallar, the UK SPAC run by Nat Rothschild, made a leap into the energy sector with a $3 billion acquisition of two Indonesian thermal coal suppliers, whilst BP's business sales created almost a subcategory of M&A activity in itself with sales to Apache, United Energy Group and Bridas Corporation to raise funds to cover its $20 billion Macondo oil well compensation fund.

Also worthy of mention was UK law firm Norton Rose who recognized that hot energy deals could also fuel fees, announcing strategic tie-ups with Canadian Ogilvy Renault and South African Deneys Reitz to follow its earlier merger Deacons Australia as it sought to focus around national resource deals.

EUROPE: HEALTHCARE

European pharmaceutical and biotech deals also showed signs of healthy activity with in-bound and out-bound activity. In-bound activity included GlaxoSmithKline's sale of its drug Wellbutrin XL together with its German assets to Aspen Pharmacare Holdings Limited, a South African generic pharmaceutical company, as well as Anavex Life Sciences and Uluru's acquisitions of Cyprus registered Genesis Biopharma Group and the UK's Crawford Healthcare respectively.

On the outbound side, Novozymes, a Danish biotech-based company, recently made a bid for U.S.-based EMD/Merck Corp BioScience for $275 million, to boost its presence in the fast-growing agricultural biotech sector, whilst Arseus, the Belgian medical equipment company announced its plan to buy Brazilian drug compounder DEG for around €25 million.

MIDDLE EAST

M&A in the Middle East region was down from its heady days as the shopping centre of the world with a spotty 2010. On the one hand, sovereign wealth funds (SWFs) have been active, acquiring stakes in some of the world's most high-profile companies. On the other, the Dubai's well-chronicled troubles have seen some of its marquee assets flowing the other way through the acquisition portal. New York real estate proved particularly nettlesome, as either through bankruptcy or handover, Dubai parted with signature properties in Manhattan. The W Hotel, Kickerbocker hotel and Barney's were all put on the block as Isthithmar, the Dubai government's investment arm, sold off assets to cover its liabilities (See Business Law Currents The City That Never Sleeps… In Hotels: Dubai's Diminishing New York Assets.)

At the other end of the portal, Qatar, the sporting-legend-in-the-making, scooped up London landmark Harrods, and is rumoured to be a potential white knight for Hochtief as the latter fends off a hostile bid. The tiny natural gas sparkplug spent $847 million to become the biggest shareholder in the Raffles Hotel chain, and the country's SWF also acquired a 5% stake in Banco Santander (Brasil) in 2010, rounding out a portfolio that also includes interests in Barclay's, Credit Suisse, Volkswagen and Indonesian telecom concern, PT Indosat.

While virtually every GCC country has a stake in one Indonesian telecom or another, MENA telecom has itself been a hotbed of activity with two controversial M&A plays. Egypt's Orascom made a messy exit from Algeria, which the Algerian government threatened to block over a…soccer game (see Business Law Currents Country Profile: Multinationals Still "Strangers" in Algeria), and the UAE's Etisalat remains in a highly-publicized (and costly) chess match as it tries to acquire control of Kuwait's Zain.

In the pharma space, Israel boasted of one of the year's biggest coups anywhere. Teva Pharmaceuticals, the world's largest generic drugmaker, saw its 18% market share expand even further with its $5 billion acquisition of Germany's Ratiopharm.

U.S.

U.S. M&A activity rebounded overall in 2010, but remained subdued in many ways. The years' largest deals were all strategic transactions, with buyers engulfing competitors or expanding into new markets. Some the U.S.'s largest strategic deals included CentryTel and Qwest's $22.6 billion merger, FirstEnergy and Allegheny Energy's $8.6 billion tie-up, and SAP and Sybase's $5.6 billion combination. Many of these deals were sparked by relatively low stock market valuations and the need to outgrow a sluggish economy.

The same macroeconomic factors that fueled strategic deals combined with a dearth of antitakeover protections to drive 2010 M&A. As hostile takeover activity burnt bright in the U.S., French pharmaceuticals giant Sanofi-Aventis continued to pursue an $18.5 billion hostile bid for Massachusetts-based biotech Genzyme. Similarly, Airgas is locked in a $5.5 billion hostile takeover and litigation battle with Air Products. The threat of a hostile takeover is very real in U.S. and this dynamic is undoubtedly weighing heavily on the minds of corporate board members.

A notable corollary to the increase in hostile bids is the efforts of activist investors to short circuit deals. The most notable example is Blackstone's thwarted designs on Dynegy. Investors led by Carl Icahn and Seneca were poised to vote against the deal even after Blackstone increased its $4.50 per share, $543 million offer to $5.00 per share. Dynegy recently struck a $6.00 per share $665 million deal with Mr. Icahn. Similarly, Charles River Labs could not find investor support for its proposed $1.6 billion merger with Wuxi PharmaTech. The deal was called off in the face of opposition from shareholders including: Relational Investors, JANA Partners and Neuberger Berman. Dynegy and Charles River's ill-fated deals are just a few of the deals that came under intense scrutiny from activist shareholders. This pressure will continue to shape M&A and deal terms in 2011.

Not every billion dollar deal in the U.S. market was a strategic acquisition, however. Financial buyers and private equity also played a prominent role in the U.S. M&A market in 2010. Some of the largest PE fueled deals of the year include: KKR's nearly $5.0 billion buyout of Del Monte Foods, 3G Capital Partners' $3.3 billion leveraged buyout of Burger King and Carlyle's $3.0 billion going private deal with CommScope. These deals are nowhere near the mammoth deals that PE firms struck during the last buyout boom, but the transactions do seem to be getting bigger. With credit attractively priced in today's market, 2011 could see the return of $10-$15 billion mega-buyouts in the U.S.


BANK
STREET

REUTERS/ ALY SONG

THE INDIAN M&A ONSLAUGHT: FROM KASHMIR TO CONGLOMERATE

Corporate boards must always be on watch for takeover bids. However, the stakes have risen, as entrants from India and other rapidly developing economies have reached new levels of intensity as acquirers. The following analysis takes a look at M&A activity originating with Indian companies extending their footprint to the UK.

Indian companies are snapping up marquee European assets once thought to be the reserve of sovereign wealth funds like never before. No slumdogs, these millionaire companies are combining football (soccer) with fowl (foul!) and property with pictures as they create some extraordinary globe spanning companies.

In a sign of the country's increasing market maturity, Indian companies are on a buying offensive and they are making some unusual acquisitions as they take up the mantel from the world's sovereign wealth funds. No longer content to strip out Western assets to be combined with Indian manpower, Indian companies are building an international presence with permanent moves into Europe. Through an unusual mix of portfolio investments, Indian conglomerates are making their presence known in in-bound European investment.

NOT CHICKEN…

Among those flying the roost is poultry company Venkateshwara Hatcheries (known as "Venky's") who recently demonstrated that it was not 'chicken' to make investments beyond its former expertise. Venky's recently bought Blackburn Rovers FC, the English soccer club, for £23 million or 17.17 pence per share as it makes the unlikely jump from fowl to football.

Venky's, a fully integrated Indian poultry company, is the first Indian company to acquire a Premier League football team and demonstrates that Indian companies are not afraid to seek out established businesses even in diverse markets. Investing in a club that was established in 1875, Venky's described Blackburn Rovers as "one of the best run Clubs within the Premier League" and that it hoped to "add to the [Blackburn] family a huge Indian and Asian fan base."

The acquisition is only the latest in a string of acquisitions from Venky's, although it is its first to take flight from the world of poultry, as it expands into south-east Asia and Europe.

Last year, Venky's announced that it would be opening a state of the art poultry vaccine manufacturing facility in Switzerland. A deal it followed recently by announcing that it would be expanding into south-east Asia, with a 1.5 billion rupee poultry feed manufacturing facility and a Poultry Disease Diagnostic and Nutrition Laboratory in Vietnam.

BUYING BRITISH

Also thirsty for British acquisitions is Sahara India Pariwar, an Indian conglomerate with interests as diverse as newspapers, film, healthcare and cricket. Sahara announced at the end of last year that it had acquired the iconic Grosvenor House hotel in London from Royal Bank of Scotland for £470 million.

The Grosvenor House hotel, is located in the prestigious Park Lane in Mayfair, London, and is a landmark hotel housing one of Europe's largest and most famous banqueting spaces. With 420 rooms and 4,000 m^2 of meetings space the acquisition will see the hotel jointly managed by Sahara and JW Marriott.

Seeking to build on its experience in operating the Sahara Star, a 5-star hotel in Mumbai, the hotel is Sahara's first acquisition of a property in the UK, let alone an iconic luxury hotel. According to a press release, the "acquisition is part of the major expansion plans of the group. In addition to the acquisition of Grosvenor House, London will be the gateway for Sahara to introduce some of its new business ventures, internationally."

Since the deal, Sahara has also been linked with potential bids for Metro-Goldwyn-Mayer, the Hollywood studio, and Liverpool Football Club as it casts its eyes even wider to build its international presence.

Also manufacturing a European presence recently has been Ashok Minda Group, India's leading car component manufacturer, who acquired Schenk Plastic Solutions, a German specialist interior component supplier. Adding to its existing security, key and window manufacturing capabilities the acquisition gives Ashok a significant foothold in Europe as it expands into the interior parts business.

CONCLUSION

The changing nature of in-bound Indian M&A to the UK demonstrates the developing maturity of its markets and perhaps its relatively sound financial health to weaker European markets. No longer are Indian companies buying up European assets to be synthesized into Indian operations. Instead, companies from the world's largest democracy are buying up Western businesses to add to their portfolios. With acquisitions that stretch the remit of their buying companies' expertise, they are suitably Indian in nature: eclectic and ever entrepreneurial.

ACCOUNTING FOR GROWTH:
GLOBAL BUSINESS GAAPS GIVE IFRS FILERS AN EDGE

Different accounting standards reign internationally, with both GAAP and IFRS vying for pride of place. Though considered an esoteric issue by some, boards of directors may be forced to contend with these, where considering the reporting of their own results or those of their competitor, or where weighing in on a proposed acquisition. Consider the analysis below.

Global companies mean global competition but with GAAPs between accountancy standards, is everyone playing by the same rules? Recent disclosures shed new light on the differences between the U.S. Generally Accepted Accountancy Principles (U.S. GAAP) and the International Financial Reporting Standards (IFRS) as the U.S. moves towards IFRS adoption.

No esoteric argument, the use of IFRS or U.S. GAAP can have a very real effect on business, as seen recently in Barclay's acquisition of Egg's credit card assets and in IFRS-related disclosures from SEC filers.

BREAKING EGGS

Cracking open the GAAPs in accountancy standards was Barclays' recent acquisition of Egg's UK credit card assets from Citigroup for an undisclosed sum. With Barclays using IFRS and Citi using U.S. GAAP, the two companies pulled off a neat trick in which both were able to claim they were getting the better deal.

With Barclays going high and Citigroup low, Barclays was able to announce the acquisition of what appeared to be more assets than Citigroup was apparently selling. According to Barclays' press release it had agreed to acquire approximately 1.15 million credit cards with approximately £2.3 billion of gross receivables, yet according to Citigroup the same deal would only see it dispose of £1.8 billion of gross receivables on the same number of credit cards.

No typographical mistake, the variance lies in the different accounting policies used by the two banks and their ability to change the face value of the deal.

IFRS VS U.S. GAAP

This quirk results from revenue recognition models that vary between U.S. GAAP and IFRS, due partly to the way that U.S. GAAP and IFRS account for pricing contingencies. Under U.S. GAAP, revenue recognition is based on fixed or determinable pricing criteria, which results in contingent amounts generally not being recorded as revenue until the contingency is resolved.

IFRS, on the other hand, looks at the probability of economic benefits associated with the transaction flowing to the entity and the ability to reliably measure the revenue in question. This can result in differences in the timing of revenue recognition and potentially in revenue being recognised earlier under IFRS than U.S. GAAP. In the case of Barclays and Citigroup, Barclays' IFRS accounting standards allowed it to recognise revenue earlier than Citigroup could book the value, meaning that the deal was, at least in the short term, more valuable to Barclays than Citigroup.

Kinross Gold has also unearthed the benefits of IFRS reporting. The Canadian mining company announced that it would benefit from a decrease in future income taxes and opening deficit by approximately $98 million as a result of the conversion, with the timing differences under IFRS resulting in a further $33.4 million reduction in other tax liabilities.

Barrick Gold also found precious new figures in its recent 40-F which stated that "the conversion to IFRS will result in a decrease in operating costs, an increase in net assets and an increase in operating cash flow and capital expenditures compared to our equivalent results presented in accordance with US GAAP."

The distinction between IFRS and U.S. GAAP is not only a balance-sheet boosting exercise, however. Post-financial crisis, scrutiny has been growing on the accountancy methods used by the world's banks and their impotence in preventing the credit crunch. Debates are raging as to which accountancy standards might be the best to prevent further meltdowns.

MARK-TO -MARKET

"Fair value" or "mark-to-market" -- the method used to put a price on instruments such as derivatives held by many banks – has become a particularly hot topic, in part due to revelations of Lehman's Repo 105 shenanigans.

Mark-to-market requires the value of an asset or liability to be based on the current market price of the asset or liability, or for similar assets and liabilities, or based on another objectively assessed "fair" value. Fair value concepts have been part of U.S. GAAP since the 1990s and, for some, it is to blame for the extent of the financial crisis.

Mark-to-market valuations can prove problematic in distressed markets, where there may be no ready market to value assets. In extreme cases, such as the financial crisis, the value of an asset may drop to below the value of underlying cash flow. For example, the market for mortgage-backed securities (MBS) largely froze during the financial crisis, meaning that, in some cases, the value of MBSs fell to a level below the cash flow generated by their underlying mortgage assets.

The loss in value of these assets triggered fire sales of MBSs by many banks and in turn pushed down the value of these assets even further; creating a vicious circle that exacerbated the effects of the subprime mortgage crisis. This has led some to point out that mark-to-market relies on the efficacy of markets and may have actually made things worse during the financial crisis.

IFRS, its proponents argue, would have allowed U.S. banks to avoid fuelling this vicious circle by marketing some assets to historic costs rather than fair value.

CONCLUSION

Whilst the debate rages on the relative strengths and weaknesses of IFRS and U.S. GAAP in preventing a financial crisis, what is clear is that conversion to IFRS can give a balance sheet boost, with IFRS recognizing revenue earlier than U.S. GAAP.

This can mean that IFRS companies appear more profitable than their U.S. GAAP cousins. On the global platform this has led to discrepancies over the profitability of international banks, with many claiming that U.S. banks could have been worth as much as 30 percent more had they filed under IFRS rather than U.S. GAAP in 2008.

With a number of Canadian and European SEC filing companies using IFRS, the distinction between IFRS and U.S. GAAP can also have domestic implications. SEC-filing Barrick Gold, Dragon Wave, Kinross Gold and Thomson Reuters have all adopted IFRS, giving them a potential competitive advantage over U.S. GAAP filers. With much of the world, including Asia, Europe, Canada and parts of Africa having adopted IFRS, it may be the competitive disadvantage of not using IFRS that finally fills in the remaining U.S. GAAPs.

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