Herbert Smith

A legal guide to investing in the UK

for Chinese investors

September 2007

Herbert Smith in association with
Gleiss Lutz and Stibbe

Introduction

Interest in investing in the United Kingdom is at record levels, particularly amongst investors from the People's Republic of China.

According to the UK Trade & Investment's annual inward investment report for 2006/07, a total of 1,431 investment firms came to the UK, either to set up here for the first time, or to expand existing business operations, marking a 17% increase on the previous year. A total of 223 companies – a 47% increase on 2005/06 – have chosen to set up their international or European headquarters in the UK. Projects from China almost doubled (from 27 to 52) on the previous year.

At the initial stages, the legal system in the UK, the way in which investment in companies is made, the restrictions on acquiring businesses in the UK, the rules on money laundering, in relation to financial services, employment law, tax law and many other areas can be difficult to understand.

We hope that you will find this Herbert Smith guide useful in explaining the key legal issues affecting your planned or existing investment in the UK. It aims to explain those legal areas to the Chinese investor and act as a glossary or step by step guide for the reader. It is very much an introduction to the subject and is not intended to be a comprehensive guide to all legal issues.

Of course, English law, like all legal systems, is subject to regular change. What you read here reflects the law at the date we published this guide. We intend to update the guide periodically, but please be careful to check with us before relying that the law as stated here is still in force.

We would welcome the opportunity to discuss any of these issues with you. Please feel free to get in touch with your usual Herbert Smith contact or one of the partners named overleaf.

Herbert Smith LLP

September 2007

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Defined terms

See Appendix “Common Abbreviations” at the end of this guide.

With thanks to the large team of partners, professional support lawyers and associates who have made this publication possible.

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The contents of this Guide are for general information only. They do not constitute legal advice and should not be relied upon as such. Specific advice should be sought about your specific circumstances.

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1. Introduction to the English legal system

The following is a brief overview of the English legal system which is historically derived from what is known as “the common law”.

The legal system (civil law, common law or a mixture of both)

Scotland, England and Wales, and Northern Ireland are largely separate jurisdictions for legal purposes. Scotland has a mixed common law and civil law system whereas England and Wales and Northern Ireland have a common law system.

Sources of English law

The rules governing civil and criminal law have evolved from three sources:

- **Legislation** – which includes statutes/Acts of Parliament. Legislation is approved by the Queen before it becomes law.
- **Common law** – made by judges. It has evolved over centuries from the judgment of cases appearing before the courts. These judgments set precedents against which future cases are judged. For example, murder is a common law offence, theft is an offence under the Theft Act (statute).
- **European Community law** (which is binding in all UK legal systems).

The interpretation of legislation made by Parliament is for the courts when they hear cases. When conflicts arise between common law and legislation, these are dealt with by the courts, with legislation taking priority over case law. Parliament is held to be sovereign. Where EC law conflicts with national law, the UK courts are required to apply the EC law or to interpret national law to fit in with EC law.

Judges may interfere with the decisions of the Executive, that is, with the decisions of Ministers, many regulators and official bodies that are empowered to make administrative decisions. This is typically on the basis that those administrative or government agencies have failed to exercise their discretion or decision-making power appropriately or reasonably or in accordance with their own protocols or operating principles. This is known as the principle of “judicial review”. Judges therefore maintain a great deal of influence on the balance of power in the English legal system.

The basic differences between civil law and common law

The English legal system is based on the common law. The legal systems of other European countries are based on Civil Codes – books defining what can and cannot be done.

The differences between practising in a civil or a common law system are huge, affecting not only the ways that laws are made but the way in which lawyers think and the make up of the personnel within the courts. For example in the common law system, English judges in a very real sense make the law on the job: they interpret and apply, usually relying closely on established precedent (the principles laid down in old cases), but in doing so they create the

law. On the other hand, within the civil law system, codes are typically constructed and commented upon by panels of legal "scientists" or academics, whose work is crafted to a great design, with detail flowing naturally from basic principles. The role of the judges in a codified system is then to apply and interpret the handiwork of the great codifiers.

One important difference that results is the principle of freedom of contract. While there are some legislative provisions and principles of case law restricting what parties can and cannot put into contracts, essentially English law allows parties to a contract to write their own terms and conditions. The agreement that results is a matter for their negotiation and reflects the individual circumstances of their transaction. This gives great flexibility to parties in writing and concluding commercial contracts when relying on English law. Legal principles developed by the English judges over centuries determine how certain phrases and clauses should be interpreted in English law, and draftsmen must be careful to take these into account when preparing contracts. But the essential point is that no party has to start from a fixed template or prescribed set of terms when seeking to conclude a commercial deal or transaction under English law.

The material in this guide relates only to the laws of England and Wales unless otherwise stated.

2. Foreign investment – restrictions

Most foreign investment into the UK is not regulated. However, authorisation is required for investment in sensitive areas, such as defence, and regulated areas, such as banking, media and financial services. These are covered in more detail in section 7.

Foreign investors should be aware of EC competition law rules and sector-specific policies. Some reference is made to these in section 10 below.

Exchange control or currency regulations

In the UK, there are no exchange control or currency regulations, affecting inward or outward investment, the repatriation of income or capital, the holding of currency accounts or the settlement of currency trading transactions. The only exception is in relation to money laundering (see section 18 below).

Grants or incentives available to foreign investors

Investment incentives are available at national, regional and local levels. A project may be eligible for assistance under more than one incentive scheme, in which case the assistance available under a particular scheme may be affected by other assistance available.

Eligibility for any grants or allowances described below should be checked with professional advisers or the relevant public body before plans based on such eligibility are implemented. Many programmes do not allow a project to start until it has been approved; assistance may be lost if the project starts before approval.

Foreign investors generally qualify for incentives, but some are only available to UK concerns.

The body responsible for administering a given incentive varies with the type of incentive and location of the project, but initial queries may usually be addressed to the nearest local office of the Department for Business Enterprise and Regulatory Reform (previously the Department of Trade and Industry) in England, the Scottish Office in Scotland, the Welsh Development Agency in Wales and the Northern Ireland Office in Northern Ireland.

Particular grant opportunities to be aware of are:

- **Financing for national and regional investments:** current government policy for the regions encourages investment in areas with industrial problems.
- **Regional selective assistance:** discretionary grants are available towards projects with fixed capital expenditure over £500,000 and which will create or safeguard employment in an assisted area. Grants are individually assessed against criteria. The amount depends on the need of the project, the number of jobs created or safeguarded or the impact the protect will have on the economy, including raising productivity, or improvements in the skills base. There are four priority (Tier One) assisted areas, namely parts of Wales, South Yorkshire, Cornwall and Merseyside. The scheme is designed mainly for manufacturing industry but is also available for certain service sector projects. Awards are subject to European ceilings although they are administered at a regional level.
- **European regional support for Objective One areas:** these are the same areas as mentioned above, together with Northern Ireland and the Highlands and Islands of

Scotland. Objective One provides an opportunity for those areas to enhance their economy. The provision of Objective One funding may be used to help companies wishing to develop or expand in the SME market (a market for small and medium enterprises), to help companies develop innovative ideas, for strategic infrastructure development and regeneration of rural development.

- **Local assistance:** this usually involves making land and buildings available or providing loans in inner-city areas for building and site work that improves the locality. Grants or loans are available for projects that create or preserve employment or stimulate the local economy. The UK has a number of new towns and development corporations. These enjoy wider powers than other local authorities.
- **Assistance for exceptional projects:** financial assistance is available for approved research and development projects likely to yield exceptional national benefits, if the costs involved are at least £500,000.
- **Department for Business Enterprise and Regulatory Reform Research and Technology initiative:** this encourages joint research projects, mainly by industry and higher education, including a range of advanced technology research projects requiring collaboration between at least three organisations, and a wider range of general industrial collaborative projects, often involving small or medium-sized companies. Broadly, grants and subsidies can be negotiated for up to 50% of eligible costs.
- **Science parks:** more than thirty science parks have been developed by universities and local authorities, usually in co-operation with industry and commerce, to encourage research and the development of high technology activities.
- **Small firms merit award for research and technology:** under an annual competition for this SMART Award, small and medium-sized enterprises (as identified by varied criteria) with fewer than 50 employees may receive up to £45,000 to assist with the costs of feasibility studies and grants of up to £60,000 to develop pre-production prototypes.
- **Support for products under research:** financial assistance is available under a programme called Support for Products Under Research (SPUR) to help small and medium-sized enterprises with under 500 employees develop new products involving significant technological advances. Grants of up to 30% of the eligible costs are available; the maximum grant is £150,000.
- **Free zones:** seven free zones currently operate within the UK: at Southampton, Sheerness, Hull & Humberside, Tilbury, and Liverpool docks and at Birmingham and Prestwick airports. In these free zones, goods can be subjected to a variety of operations before being either allowed into free circulation within the EU or re-exported outside the EU, without the payment of duty, VAT, or other charges. Because the free zones are regarded as outside the EU's customs territory, it may be possible, for example, to import goods that would otherwise be subject to antidumping duty for processing into finished products that are subject to normal duty rates. Goods may be stored in free zones for an unlimited period. Individual companies may be able to establish private free zones. With the approval of Customs & Excise, these companies may be able to import, store, and extensively process their own goods on their own premises, provided that security and record-keeping requirements are met.

- Customs Warehouses: in addition to the free zones, customs warehouses are available throughout the country. These warehouses provide much the same benefits as the free zones, except that in general goods may only be stored in them, with some repackaging or sorting. A company may, with the approval of Customs & Excise, operate a private customs warehouse to store its own goods.
- Employment and Training: numerous government programmes are designed to increase the opportunities for employment, work experience, or the acquisition of skills. The grants are available nationally throughout the country, regardless of location. Grant support may typically be in the range of £500+ per job.

Business vehicles

- **Partnership** – Partnerships are defined but they have no separate legal personality. A partnership is unable to contract in its own name and therefore it is individual partners who enter into contracts jointly. This means that if a partnership becomes insolvent, the creditors are entitled to satisfy debts owed to them by enforcement against the personal assets of each of the partners themselves; partners have unlimited personal liability.
- **Limited liability partnership (LLP)** – An LLP has the flexibility of a partnership with the added advantage of limited liability for its members. Legally, an LLP is a separate legal entity from its members and can contract in its own name. For tax purposes, it is treated as a partnership. It does though have to comply with company, rather than partnership, law.
- **Company** – A company is an artificial legal person with a separate legal identity from that of its owners/shareholders. The company may therefore enter into contracts in its own right. If the company becomes insolvent it will be wound up and any assets divided amongst the creditors but creditors are not able to access the assets of the shareholders. A company can have another company (or companies) as its shareholder(s) and therefore may fall to be treated as its shareholder company's subsidiary. There are different types of company, which are explored further in sections 3 and 4. The most common form of corporate vehicle established by foreign companies in the UK is a private limited liability company.
- **Joint venture** – A joint venture is a collaborative commercial arrangement between two or more parties to work towards a common business goal. It is not strictly a business vehicle as it can be structured in different ways – as a company, partnership or through a simple contractual arrangement.
- **Branch** – A branch is not a company but is an operation of an overseas company in the UK. It cannot contract in its own name but rather acts as agent for its overseas company. A branch must file certain details with the Registrar of Companies in England and Wales.

  A business may be located anywhere in the UK, provided that necessary building permits and planning consents are obtained (see section 22 below).

3. Regulations and procedures of English companies – basic company law

Please note that the UK is currently undergoing a complete overhaul of company law and the new Companies Act 2006 received Royal Assent on 8 November 2006. The provisions are coming into force on staggered implementation dates throughout 2007 and 2008. When it is fully in force, the Companies Act 2006 will completely replace the Companies Act 1985 (with a few very minor exceptions). This guide is up to date as at the date of publication but it should be noted that a large part of section 3 will change once the relevant provisions of the Companies Act 2006 Act are in force. A future revision will deal with this when appropriate.

The nature of a company

A company is a distinct legal entity, separate from its shareholders (or "members"), directors and employees, which can own property, enter into contracts, sue and be sued in its own name. However, it has no physical "corpus". It must operate through others, principally the shareholders as a body and the board of directors.

The legal framework

The rules governing the operation of a company incorporated in England and Wales are to be found in the following principal sources:

Companies Act 1985 (as amended by the Companies Act 1989) and Companies Act 2006

These are the principal Acts regulating English companies. The Companies Act 2006 is currently in the process of coming into force. In this guide, the term the "Companies Act" or "the Act" refers to the provisions of the Companies Act 1985 which are in force as at the date of this guide.

Insolvency Act 1986

This Act contains provisions relating to the insolvency and winding up of companies.

Common law

A large part of the law relating to English companies, including the law on shareholder rights and the management of a company (for example, the duties of directors), has no statutory basis but has been established by judges through case law (common law).

In addition, companies whose shares are traded on a stock exchange will need to comply with the Listing, Prospectus, Disclosure and Transparency Rules issued by the Financial Services Authority and the rules of the relevant exchange. These govern the requirements for admission to listing, the continuing obligations of listed companies and the contents of a prospectus on admission of securities to trading. All companies need to produce a prospectus when they offer their securities to the public. See section 4 for further details.

Types of companies

Five types of companies can be formed and registered in England and Wales:

Private companies limited by shares

This is the most common type of company. The phrase "limited by shares" means that the liability of the shareholders of the company in the event of the company going into liquidation and being unable to pay its debts is limited to the extent of payment of the nominal value of the shares issued to those members.

Public companies limited by shares

Only public companies are authorised to offer securities to the public – a private company cannot do so. See section 4 below for the main differences between public and private companies.

Private companies limited by guarantee and not having a share capital

These are not common – they are normally non-profit making organisations.

Private unlimited companies

These companies do not have any limit on the members' liability to contribute to the company's assets in the event of the company going into liquidation and being unable to pay its debts.

Societas Europaea (SE)/European Company

Since October 2004, it has been possible to form a new type of public limited liability company in England and Wales, the Societas Europaea, known as the SE (or European Company). The SE can be used by companies or groups with operations in more than one Member State of the EEA and will be registered in one of these Member States. SEs are governed by Council Regulation 2157/2001/EC and in Great Britain by the European Public Limited Liability Company Regulations (SI 2204/2326).

SEs are not companies formed under the Companies Act. However the Council Regulation does not provide a complete legal framework for the formation and operation of SEs but sets out a hierarchy of laws that govern SEs. Under this hierarchy of laws, certain provisions of law which govern public limited liability companies formed and registered in Great Britain may apply to SEs registered in Great Britain, where the matter is not addressed in the Council Regulation.

This section only considers the first four types of companies.

Registration formalities

Upon formation a company must submit to Companies House:

- a copy of its memorandum and articles of association; and
- specified forms detailing the registered office, directors and company secretary.

The Registrar provides a certificate of incorporation. Registration takes about five working days and costs GB£20 (about US$38). A company can be incorporated within one day for a fee of GB£50 (about US$95). There are separate charges for electronic registration.

Once the company has been incorporated and registered it is a distinct legal entity from its members. A person who purportedly contracts in the name of or as agent for a company before its incorporation, however, incurs personal liability unless there is an agreement to the contrary.

Constitutional documents

The documents which govern the constitution of the company are:

- the memorandum of association; and
- the articles of association.

Memorandum of association

Each company must have a memorandum of association. This document defines the basis on which it is incorporated and the extent of its powers and identifies the basic characteristics of the company's particular corporate personality. It states:

- the company's name;
- the situation of its registered office;
- the company's objects (ie, broadly, the trade or businesses which the company has been formed to carry on and the powers given to it for those purposes);
- that the liability of the members is limited; and
- the company's share capital.

A company has no powers other than those expressly given by statute or those expressly given by its memorandum of association and those incidental to the powers so given. A private company limited by shares or guarantee may be formed by one person only; accordingly it is permissible for one member to subscribe to the memorandum. Otherwise, the memorandum must be subscribed to by at least two people who agree to take at least one share each in the company.

Articles of association

Every company must have articles of association. The articles govern the internal affairs of the company and regulate (subject to the requirements of the Companies Act and general principles of common law) a great range of matters. These include the rights attached to the company's shares (including voting rights), the powers of the directors, the regulation of shareholders' and directors' meetings, the alteration of capital and the transfer of shares.

The articles of association constitute a contract between the company and its members, but may be altered by a "special resolution" (a 75% majority of shareholders voting on an issue).

By virtue of regulations made under the Companies Act, there is a standard form of articles generally known as "Table A", which may be adopted with or without variations. Private limited companies normally adopt Table A with some variations.

Rights attaching to shares

These are imposed by the:

- Companies Act;
- company's articles of association; and
- any shareholders' agreements.

Statutory books

The company must keep certain statutory books and records:

- Register of members: This contains the names and addresses of shareholders and the number of shares held by each shareholder in the company. On a transfer of shares the transferee does not become a member until their name is registered as a member in the register of members. Before their name can be entered in the register the transfer must be properly stamped (for stamp duty purposes). Stamp duty is not payable however on an issue by the company of new shares.
- Register of directors and secretaries: Details of other directorships held by the directors within the preceding five years must be given.
- Register of charges over the company's assets: The company must keep a register of all charges specifically affecting property of the company and all floating charges over the undertaking or any property of the company and enter a short description of the property charged, the amount of the charge and the names of the persons entitled to it.
- Particulars of almost all charges (including any floating charge) must be registered with the Registrar of Companies within 21 days of creation of the charge. If a charge is a fixed charge over the company's land, the charge must also be registered at the Land Registry or Land Charges Registry.
- Copies of the directors' service contracts if more than 12 months to run must be kept available for public inspection.
- Minutes of annual general meetings, extraordinary general meetings and minutes of board meetings.
- Accounting records.
- Copies of debentures.

The statutory books must generally be kept at the registered office, except that the register of members can be kept elsewhere provided notice of where it is kept is given to the Registrar of Companies.

Reporting requirements

A company must submit an annual return and annual accounts to Companies House and notify all changes to its particulars, such as the:

- registered office;
- directors; and
- constitutional documents.

All annual returns must be delivered to Companies House within 28 days of the made up date given on the relevant form. There is an annual document processing fee of GB£30 (about US$57) (or GB£15 (about US$29) if delivered electronically). It is a criminal offence not to deliver the company's annual return within 28 days of the made up date. There is no charge for filing the company's annual accounts, although there is an automatic civil penalty (in the form of a statutory fine) for late filing of accounts.

Management

Division of powers

Articles usually delegate to the directors the exercise of the powers of the company not required by the articles or the Companies Act to be exercised by the shareholders in general meeting. The articles may prescribe a maximum or minimum number of directors.

Management structure

Companies have a single tiered board with at least one director. Directors can be executive (with a service contract) or non-executive, with varying roles and duties. There are no restrictions on foreign directors.

Directors' liability

Directors are personally liable for, among other things:

- breach of their fiduciary duties and not acting with due skill and care, under common law;
- fraudulent or wrongful trading if the company becomes insolvent (Insolvency Act 1986);
- directors can be disqualified for up to 10 years (Company Directors Disqualification Act 1986).

Meetings

Acts of all shareholders in their capacity as members, whether or not decided on at meetings, are regarded as the acts of the company itself.

Annual General Meeting (AGM)

This must be held once in each calendar year and not more than 15 months after the previous one. Provided the first AGM is held within 18 months of incorporation, an AGM need not be held in the year of incorporation or the following year. Twenty one clear days notice of the AGM is required unless all who are entitled to attend and vote consent to short notice being given.

Extraordinary General Meeting (EGM)

Any meeting other than an AGM is an EGM. Unless a majority holding 95% of the nominal value of shares giving a right to attend and vote agree to shorter notice, 14 clear days' notice is required (or 21 clear days' notice if a special resolution is to be passed). Table A articles provide that 21 clear days' notice is required for a resolution appointing a director.

Resolutions

There are three types of resolution prescribed by the Act:

- **Ordinary resolution** – which requires the consent of more than 50% of those present and voting. Fourteen "clear days' notice" of a meeting at which an ordinary resolution will be proposed, which is exclusive of the day on which the notice is served and of the day of the meeting, is required, unless it is proposed at an AGM when 21 clear days' notice is required (unless consent to short notice is obtained (see above)).
- **Extraordinary resolution** – which requires the consent of not less than 75% of those present and voting eg, on a resolution for creditors' voluntary winding up. Fourteen clear

days' notice is required if it is proposed at an EGM and 21 clear days' notice if proposed at an AGM (unless consent to short notice is obtained).

- **Special resolution** – which requires the consent of not less than 75% of those present and voting. Twenty one clear days' notice is required of the intention to propose a special resolution whatever the type of meeting (unless consent to short notice is obtained).

An ordinary resolution is the most common type of resolution. Most decisions of the company are made by ordinary resolution. A special resolution is required *(inter alia)* to alter the objects or articles, to change the name of the company, to reduce share capital, or if the company wishes to purchase its own shares. An extraordinary resolution is more rarely required, for instance, in the winding up of a company.

Calling a general meeting

It is for the directors to convene an AGM within the time period specified in the Companies Act. The directors may also convene an EGM whenever they think fit.

In addition, under the Companies Act, the members of the company may requisition a meeting by serving notice on the directors requiring them to do so. In order to be valid, a requisition must be executed by members holding at least one tenth of the paid up share capital of the company giving a right to vote at general meetings. The members of the company may also require the directors to circulate a notice of an additional resolution that they wish to be put to the members at an AGM. Such a requisition must be executed by members holding at least one twentieth of the total voting rights of all the members having the right to vote at that AGM or at least 100 members in number.

A general meeting is convened by way of a notice given by the company to all shareholders entitled to receive notice of general meeting (this is determined by the class rights of the shares in question set out in the articles of association). The notice must state the time and place for the meeting and specify the business which is to be conducted at the meeting.

Proceedings at general meetings

The quorum requirement for a general meeting is set by the company's articles of association. Generally, unless there are special class rights requiring a member of each class to be present to create a quorate meeting, the quorum requirement is simply two members present in person.

Under the Companies Act, any member entitled to attend and vote at a general meeting may appoint a proxy, who need not be a member, to attend in their place. The members must be informed of their right to appoint a proxy. As a matter of practice, when the notice of meeting is sent out by the company, a form of proxy will be made available to shareholders which will state that if a shareholder wishes to appoint a proxy, unless the shareholder specifies otherwise, the chairman of the meeting will deemed to be the proxy for the shareholder. In order to be valid, forms of proxy must be returned at least 48 hours before the relevant meeting.

Unless a poll is demanded, voting on resolutions at general meetings is by way of a show of hands. Usually, proxies may not vote on a show of hands. Unless the articles provide otherwise, on a show of hands each member present in person has one vote regardless of the number of shares they hold.

Under the Companies Act, a poll, that is a ballot vote, may be demanded by the chairman of the meeting, by not less than five members present in person or by proxy at the meeting or by a member or members, again present in person or by proxy, holding not less than one tenth of the total voting rights at the meeting. The articles of association may provide less restrictive and additional rights to demand a poll – they may not curtail these statutory rights to call a poll.

On a poll, each shareholder present, whether in person or by proxy, has (unless the articles provide otherwise) a number of votes equal to the number of shares held by them.

Class meetings

If a company's share capital is, or is to be, divided into separate classes of shares then it is possible that a separate meeting of the holders of the shares of one or more of those classes may be required in addition to a general meeting of all the shareholders.

Subject to any additional obligations to call class meetings which might be set out in the articles of association of the company, the company will be required to seek the approval of the members of a class of shares by way of a separate class meeting if the rights attaching to that class of shares are to be varied. It is only the strict legal rights of the shares that are relevant – other extraneous matters that could affect the value of the shares or the effectiveness of the rights attaching to the shares, will not generally constitute a variation of those rights. Articles of association will often provide that the creation of a new class of shares ranking in priority to the existing class will constitute a variation of the class rights of the existing class.

If a separate class meeting is required, the Companies Act provides that the quorum at the class meeting must be two persons holding, in person or by proxy, at least one third in nominal value of the issued shares of the class in question. However, at an adjourned meeting, this quorum is reduced to one person present in person or by proxy.

Relationship between the company and its shareholders

A shareholder's relationship with the company in which they hold shares is a contractual one. Under the Companies Act, the memorandum and articles bind the company and its members to the same extent as if they had been signed and sealed by each member. The memorandum and articles of association of the company therefore constitute a form of contract between the company and its shareholders and between the shareholders themselves. The shares held by the members give a right of participation in the company on the terms of the articles of association.

A shareholder does not have a proprietary interest in the underlying assets of the company. Shareholders are entitled in proportion to their respective shareholdings to a share of the distributed profits of the company and, on a winding up, to the surplus assets of the company after the company's creditors have been repaid in full. The shareholders are not regarded as part owners of the company – the company has its own separate legal personality.

Parent companies are not liable for the acts of their subsidiaries except in certain cases, such as fraud, where the corporate veil can be pierced. Each group company is treated as a separate entity.

The concept of the articles of association as a contract is subject to the limitation that it is possible for the articles to be amended at any time, or even completely replaced, with the

approval of a special resolution (that is a resolution passed by at least 75% of those shareholders present at the meeting) of the shareholders of the company.

It is the shareholder whose name is recorded on the register of members of the company who has rights vis-à-vis the company. No notice of any trust can be entered on the register and the beneficial owner of the shares, if he is not also the legal owner, therefore has no special status in relation to the company and only has rights against the legal holder. The definition of a "member" of a company is entirely concerned with the legal ownership of the shares, that is the person appearing on the register. The legal and beneficial ownership of shares is, however, frequently separated because it is often commercially convenient for shares to be registered in the name of a trustee or nominee but actually beneficially owned by a different person.

There are no restrictions on foreign shareholders, except in regulated industries, such as financial services (see section 7 below).

4. The differences between a private company and a public company

Please note that the UK is currently undergoing a complete overhaul of company law and the new Companies Act 2006 received Royal Assent on 8 November 2006. The provisions are coming into force on staggered implementation dates throughout 2007 and 2008. When it is fully in force, the Companies Act 2006 will completely replace the Companies Act 1985 (with a few very minor exceptions). This guide is up to date as at the date of publication but it should be noted that a large part of section 4 will change once the relevant provisions of the Companies Act 2006 are in force. A future revision of this guide will deal with this when appropriate.

The key difference between a public company and a private company is that only a public company may make an offering of its shares to the public. The Companies Act imposes certain additional restrictions on public companies for the protection of shareholders and creditors. The principal benefits of setting up a public company is the increased access to capital through public issues or securities. The principal additional obligations and restrictions faced by public companies are set out below.

Payment for share capital

There are a number of detailed rules in the Companies Act (sections 101 – 103 of the Act) concerning the payment for shares allotted by companies, most of which relate only to public companies:

- a public company may not allot shares unless at least 25% of the nominal value of the share and the whole of any premium has been paid up;
- a public company is prohibited from accepting an undertaking to do work or perform services as consideration for the allotment of shares;
- where a public company allots shares as fully or partly paid in exchange for a non-cash consideration, any undertaking which forms part of that consideration (eg, to transfer assets to the company) must be performed within five years of the allotment and an expert’s valuation and report on the consideration given will usually be required;
- the original subscribers to the memorandum of a public company must pay for their shares in cash; and
- a public company is prohibited from allotting shares for a consideration other than cash, unless an expert’s valuation is obtained.

Maintenance of capital

If at any time the net assets of a public company are reduced to 50% or less of its called up share capital, the directors must convene an extraordinary general meeting within 28 days of the date on which any one of them becomes aware of the fact. The purpose of the meeting is to consider what measures, if any, should be taken to deal with the situation – there is no obligation to undertake specific measures (section 142 of the Act).

Distribution of profits

A company can only pay dividends out of distributable (essentially realised) profits after netting off any earlier losses. A public company can only make a distribution if its net assets do not fall below the aggregate of its called up share capital and “undistributable reserves”. The availability of profits is determined by reference to the company’s latest statutory accounts (which may be drawn up under UK accounting standards or International Financial Reporting Standards as adopted by the European Union – IFRS). If these do not disclose sufficient profits, then special accounts may be drawn up (sections 263-272 of the Act).

Loans to directors

Where a group of companies includes a public company, the rules prohibiting loans to directors are extended in relation to each company in the group to transactions in the nature of or in substitution for loans.

Purchase of own shares

Both public and private companies may issue redeemable shares. They may also purchase their own shares in certain circumstances. However, only a private company can apply existing share capital in the purchase or redemption of its shares where it has insufficient profits available. Purchases by public companies must be made out of distributable profits or the proceeds of a fresh issue (section 143 of the Act).

A public company which is listed on the Official List or on AIM (the London Stock Exchange’s international market for smaller growing companies) may buy, hold and resell its own listed shares. Shares held by the company in this way are referred to as treasury shares.

Financial assistance for acquisition of shares

A public company cannot give financial assistance (including the giving of a guarantee or indemnity or the grant of any security over its assets) for the purchase of its own shares or the shares of their holding company or discharging a liability so incurred. In certain cases, private companies may provide financial assistance, subject to various safeguards for creditors and shareholders, by following the so-called “whitewash procedure” (section 151 of the Act).

Accounting requirements

Public companies cannot take advantage of the provisions contained in the Companies Act permitting “small” and “medium sized” companies to file short-form accounts with the Registrar of Companies. Public companies that have securities listed on an EU regulated market must produce their consolidated or group accounts under IFRS for periods beginning on or after 1 January 2005 (EC Regulation 1606/2002). However, they can choose whether to apply IFRS to their individual financial statements or remain on UK standards (although once the decision to apply IFRS is made, it is generally not possible to revert back to UK standards in subsequent financial years (see Companies Act 1985 section 226(4) and (5) and section 227(5) and (6)). Private companies and unlisted public companies can choose IFRS or UK standards in both or either of their individual and group accounts. AIM (which is an exchange regulated market but not an EU-regulated market) requires IFRS accounts for periods beginning on or after 1 January 2007.

Other matters

Other differences between a public and a private company include the requirement to have at least two directors rather than one, rules governing voting on directors' appointments, the ability of members of private companies to agree to written resolutions instead of having resolutions proposed at general meetings and the qualifications required by the company secretary.

Public listed companies

The Listing, Prospectus, Disclosure and Transparency Rules issued by the Financial Services Authority and the Admission and Disclosure Standards of the London Stock Exchange set out continuing obligations for companies whose securities are listed on the Official List and traded on the London Stock Exchange (and some of these requirements also apply to UK incorporated AIM listed companies). These continuing obligations largely relate to the circumstances in which public announcements are required to be made by the company (for example any major developments or a decision to pay a dividend), the contents of its annual accounts and half-year results, the form of any circulars sent to its shareholders, announcements relating to dealings by major shareholders in the company's securities, publicity regarding dealings by the directors, certain other senior managers and their connected persons in the company's securities and restrictions on those dealings, and transactions which require publicity or shareholder approval. In general terms, shareholder approval is required with respect to any transaction in which the value of the assets to be acquired or disposed of, or the consideration to be received or given, exceeds 25% of the assets of the company or if the transaction is one in which a director or a substantial shareholder, or any associated person, has an interest. See also section 4 below for the obligation on public listed companies to produce an approved prospectus.

Requirement to produce a prospectus

The Financial Services and Markets Act 2000, together with the Prospectus Rules issued by the Financial Services Authority, require all companies to produce a prospectus on an offer of transferable securities to the public in the UK. In addition, a prospectus is required on an admission of securities to trading on a regulated market in the UK, which includes the Official List. The prospectus must be approved by a regulatory authority, which for UK incorporated companies and certain companies incorporated outside of the EEA Member State will be the Financial Services Authority.

5. Acquisitions of private companies

One likely route to investment in the UK will be through direct acquisition of an existing company. The way in which a company is acquired in the UK depends upon whether the company is a public or private company. The usual process for acquiring a UK private company is described in this section. Section 6 explains how a takeover of a UK public company is governed.

Should the business of the company or its shares be acquired?

A key question to be asked by a prospective buyer at an early stage of the acquisition process is whether it is preferable to acquire the business of the private company or the shares. The difference is that, in the case of a share purchase, the ownership of the company as a separate legal entity is acquired, comprising all of its assets and liabilities. However, in the case of a business acquisition, the buyer selects which individual categories of assets and liabilities of the company it is interested in acquiring.

The main commercial advantage of a business sale is the ability to avoid inheriting the liabilities of the target business. Even though the buyer will be carrying on a business in succession to the seller under the same business name, any debts or other liabilities incurred by the seller before the acquisition of the business by the purchaser are not in general automatically transferred to the purchaser. On a share acquisition, the buyer can seek to protect itself by carrying out due diligence and obtaining warranties (see section on "Warranties and disclosure" below) but the difficulties of successfully recovering for loss or damage must never be underestimated.

The main commercial advantage to structuring an acquisition as a share purchase is that continuity of the business is preserved. Both before and after completion, the business is carried on by the same company and, as far as the world at large is concerned, no change has taken place. The heading on the company's notepaper will probably be the same except that different directors and/or a different registered office may be shown.

One point to consider is that a business acquisition may be much more complex than a share acquisition. In a business acquisition, the buyer must ensure that the ownership of each asset has been correctly transferred, whereas a share acquisition, reduced to the basics, requires only a share transfer form actually to transfer title.

There may be other specific advantages and disadvantages to a business or share acquisition, including tax structuring, which should also be considered in each case.

The acquisition process and documentation

Irrespective of whether the acquisition is a business or share purchase, there is a common pattern to the acquisition process.

Expressions of interest

In the early stages, when the prospective buyer and seller have agreed the key terms of the transaction, such as the price, they commonly enter into "heads of agreement". The main provisions of the heads of agreement are typically not legally binding but provide a checklist for the content of the final documentation and often set out an expected timetable for the

acquisition. Sometimes the heads also contain an exclusivity agreement, whereby the seller agrees that it will not negotiate and/or approach any other interested party for a specified period of time to give the buyer time to complete the acquisition. A confidentiality agreement is also either contained in the heads of agreement or entered into separately as a precursor to the buyer being given access to the target company's financial and commercial information for the purposes of due diligence. Both the exclusivity agreement and confidentiality agreement will be binding on the parties.

Due diligence

Due diligence is the term used to describe the process of a buyer investigating the affairs of the target company or business. Commonly, the buyer will employ its lawyers and accountants to review, respectively, the key contracts of the target for all aspects of its business (for example, with customers, suppliers, employees and property documentation) and the financial information. Also, personnel of the buyer may wish to review the documentation from a commercial perspective. The due diligence process can start before heads of agreement are entered into and often lasts up to the point that the final agreements are entered into. It runs alongside the seller's disclosure process which is described below.

Negotiation of the agreements

The main documentation for the acquisition of a business or company comprises a sale and purchase agreement which contains the key terms of the acquisition, including risk protection for the buyer in the form of warranties (see below) and restrictive covenants on the seller setting up competing businesses or poaching staff or suppliers and customers. There will usually be a disclosure letter from the seller to the buyer (see below) and a tax deed covering the allocation of liability for taxation of the target between the buyer and seller. There is also likely to be a range of ancillary documentation, such as resignations of the seller's nominated directors and auditors and board minutes covering a host of administrative details. All of these documents are negotiated between the parties and their advisers.

Exchange and completion

Once the parties have agreed on the terms of the sale and purchase agreement and other documentation, contracts for the acquisition are exchanged between the parties. At this point in time, the buyer and seller are legally bound to proceed with the transaction. Completion of the transaction, at which time the legal title to the shares or business assets is transferred, may occur simultaneously with exchange of contracts, or may occur in the future at a time agreed by the parties. A gap between exchange and completion is often chosen for practical reasons (for example, the buyer may need time to draw down funds from its banking facilities or may need to raise finance on the equity markets) or for regulatory reasons (for example, the acquisition requires competition clearances or listed shares are offered as consideration which need to be admitted to trading on a regulated stock exchange). In most cases, the reason for the gap between exchange and completion is also a condition to completion taking place. The sale and purchase agreement will also contain provisions regulating how the business of the target company is conducted whilst the parties are waiting for completion to occur.

Warranties and disclosure

A large section of the sale and purchase agreement is comprised of warranties. Warranties are contractual statements of fact on the condition of the company or business, covering all aspects of its affairs, including employees, relationships with customers and suppliers, property, intellectual property rights and litigation. Warranties are usually given by the seller, but can also be given by other parties such as directors.

The warranties have three principal purposes:

- they provide the buyer with contractual protection so that where a statement about the company is untrue, it can sue for breach of warranty and recover damages;
- they allocate risk between the parties so that the parties agree in the sale and purchase agreement on, for example, who takes the risk of the company's accounts not having been drawn up in accordance with generally accepted accounting principles (usually the seller) or who takes the risk on a debt owed to the company not being recovered in full (usually the buyer); and
- they help to flush out information – it is in the seller's interests to disclose any potential problems because the seller will not usually be liable to the buyer for damages for any matter that it fairly drew to the buyer's attention in the disclosure letter.

The role of the disclosure letter for the seller is therefore key in avoiding liability to the buyer. The form of the letter is usually by reference to the relevant warranties in the sale and purchase agreement, stating to what extent each warranty is made inaccurate by the information in the disclosure letter. Often, the underlying documentary evidence of the issues disclosed to the buyer is also referred to in the letter and copies provided to the buyer. The seller will usually dedicate plenty of resource to providing the relevant information to the buyer, which the buyer will want to review as part of its due diligence. Consequently, the due diligence and disclosure processes run alongside each other with the parties' lawyers working closely together until the final agreement is reached.

6. Takeovers of public companies

As mentioned in section 5 above, the processes for acquiring a private company and a public company in the UK are not the same.

The acquisition of a public company in the UK is governed by the Takeover Code and the Takeover Panel. An explanation of these and a comparison of private and public acquisitions is set out below.

The Takeover Code

Application of the Takeover Code

The rules of the City Code on Takeovers and Mergers (the "Takeover Code") apply to the acquisition or consolidation of control of:

- any public company incorporated in the UK, Channel Islands or Isle of Man which has its shares listed on the UK Official List or admitted to trading on any stock exchange in the Channel Islands or the Isle of Man; and
- any other public company (for example, a company whose shares are traded on AIM or are not traded at all) which is incorporated in the UK, Channel Islands or the Isle of Man and which has its place of central management and control in one of those jurisdictions.

It is the status of the target that determines whether or not the Takeover Code applies.

The Takeover Panel and sanctions for breach

The Takeover Code is drawn up and administered by the Takeover Panel (the "Panel"). The Panel has statutory powers to supervise and regulate takeover bids. It must be consulted whenever there is any doubt as to the application of the Takeover Code. The Panel has a range of sanctions available to it for breach of the Code which include private or public criticism, requiring compensation to be paid to target shareholders and requiring FSA (Financial Services Authority) authorised persons to refuse to deal with a person who disobeys a Panel ruling. The Panel also has power to require any person to provide information to it and it can apply to the courts to enforce any of its rulings.

General Principles and Code Rules

The Takeover Code contains six "General Principles" for the good conduct of takeover offers. These include equality of treatment for target shareholders; providing sufficient information to target shareholders; and the target board being required to act in the interests of the target as a whole. The Takeover Code also contains detailed rules in a number of areas including setting out restrictions on, and disclosure of, acquisitions of shares and interests in shares; when a compulsory offer has to be made; the timetable for an offer; the terms of the offer; and the contents and circulation requirements of the announcements and documentation produced by the bidder and the target. The spirit as well as the letter of the Takeover Code must be observed.

Many of the Takeover Code Rules also apply to those who are deemed to be "acting in concert" with either the bidder or the target, known as "concert parties".

Methods of effecting a takeover of a UK public company

There are two principal ways to effect a takeover of a UK public company. It can either be implemented by a contractual takeover offer by the bidder to acquire the shares of the target (a takeover offer) or by a court procedure known as a scheme of arrangement.

Takeover offer

A takeover effected by an offer involves an offer contract (the offer document) between the bidder and the shareholders of the target including the financial terms, conditions and other offer provisions. It must be a minimum condition of the offer that sufficient acceptances are received to give the bidder ownership of at least 50% of the target's voting shares. Normally also (but at the option of the bidder rather than as a Takeover Code requirement), it will be a condition of the offer that sufficient shareholders have accepted to allow the bidder to use the statutory power to force minority shareholders who have not accepted the offer to sell their shares.

Scheme of arrangement

A takeover effected by a scheme involves a court procedure for the approval of an arrangement proposed by the target company to its shareholders. The target will prepare and issue court documentation and a scheme circular to its shareholders. A majority in number representing 75% in value of target shareholders at the shareholder meeting must approve the scheme. The court must then approve the scheme and the takeover will be effected by a court order.

Schemes are often used for takeovers recommended by the target board. They have the advantage of ensuring 100% ownership of the target once approved and can usually save the stamp duty which is payable (at 0.5% of the consideration) on a transfer of shares under an offer. However, which of the two routes is chosen will depend on a variety of different circumstances.

A scheme is not the same as the "statutory merger" process which is used in other jurisdictions because the target is not removed as a corporate entity in the process. It remains in existence following the takeover, as a subsidiary of the bidder.

The pre-bid process

Recommended or hostile offer

Most bidders will wish to seek the recommendation of the target board to the offer. The offer is then "recommended" rather than "hostile". Target co-operation facilitates due diligence, and reduces the chance of target shareholder rejection of the offer. The two boards and their advisers would then negotiate the terms of the offer.

Requirement to make an announcement of a possible offer; put up or shut up deadlines

The parties will normally want to avoid making an announcement until the terms of the offer have been agreed. If there are any rumours in the market or an unusual movement in the target's share price, an announcement of the possible offer will be required by the Panel.

The first announcement of an offer or possible offer starts the "offer period" and any persons with interests in (including derivatives referenced to and put/call options over) 1% or more of the target's shares (and, on a securities exchange offer, the bidder's shares) must disclose any dealings in those interests to the market.

When an announcement of a possible offer is made, there is no fixed deadline in the Takeover Code by which a potential bidder must clarify his intentions. However, the target may ask the Panel to intervene by imposing a deadline (usually six to eight weeks) by which the potential bidder must either announce a firm intention to make an offer or make a "no intention to bid" statement (ie, it must "put up or shut up").

Due diligence

A bidder is usually unable to carry out the detailed due diligence exercise that it would carry out for a private company or business acquisition because a UK public company will be concerned about releasing confidential information (particularly because, if a rival bidder emerges, it will be obliged to provide the same information to that rival). On a hostile bid, the bidder has to rely solely on public information about the target to carry out its due diligence exercise.

Announcement of firm intention to make an offer – bidder's commitment to proceed with offer

The formal announcement of an intention to make an offer contains details of the principal terms of the offer and the conditions to which it will be subject. The Takeover Code requires that the bidder should only formally announce an offer when it has ensured that it will be able to satisfy the offer consideration eg, the financing must be fully committed. Once the bidder has formally announced an offer, it is bound to make the offer within 28 days by posting an offer or scheme document to the target shareholders. Once an offer is formally announced, the bidder is committed to proceed and the scope to withdraw based on the conditions to the offer is very limited and requires the consent of the Panel.

Employee consultation and information rights

Where the target has employees within the EU, consultation obligations may (but do not always) arise. The rules in this area can be difficult as obligations to consult employees can arise even before the takeover offer is public or the terms have been agreed. Rules vary from one EU jurisdiction to another and the position will depend on the specific facts.

Choice of consideration for the offer

All shareholders must be treated equally in relation to the consideration being offered. If any special deals are made with favourable conditions with any shareholders (eg, on a management buy-out where managers are to receive interests in the bidding vehicle), the Panel must consent and the arrangements must be approved by a vote of independent target shareholders.

Generally, the bidder is free to choose what type of consideration it offers. However, acquisitions of interests in target shares by the bidder will change this position. The effect of acquisitions on the level and type of offer consideration which must be made available is set out below. If there is a securities exchange offer, the offer documentation must contain additional information and a prospectus complying with the requirements of the EU Prospectus Directive may need to be issued.

The bidder will need to know how many options over unissued target shares are outstanding (whether for employees or third parties) and whether the target has issued any securities which

are convertible into voting shares. The bidder is required to make appropriate proposals to optionholders and holders of convertible securities in the target.

Obtaining control of the target

Takeovers effected by an offer

In order to obtain control of the target company, the bidder will need to receive acceptances in relation to shares which, when added to any shares that the bidder has already acquired, amount to more than 50% of the voting shares of the target company. Once the bidder has more than 50% of the voting shares of the target it will have the power to remove the directors of the board of the target.

Most bidders will be aiming to receive acceptances in respect of at least 90% of the voting share capital of the target not already owned by the bidder when it makes the offer because it will then be entitled to compulsorily acquire any outstanding shares from those minority shareholders who have not accepted the offer.

Takeovers effected by scheme of arrangement

The scheme must be approved at a meeting of the shareholders of the target by a majority in number representing 75% in value of those voting. Once the resolutions are passed, then court approval is sought for the scheme. Court approval is normally a formality. However, there is always a right for a target shareholder or creditor to raise technical or fairness objections to the scheme.

Irrevocable undertakings and letters of intent

The bidder will want to obtain irrevocable undertakings to accept the offer from some of the shareholders in the target before it announces the offer. There are restrictions on obtaining irrevocable undertakings over more than 30% of the voting share capital of the target unless the offer is recommended.

Defensive measures by the target

When deciding whether to recommend an offer the target directors must act in the best interests of the target at all times. The target board is also required under the Takeover Code to obtain independent advice from a financial adviser and to make the advice known to shareholders. If the target board wishes to resist the offer, it must publish a "defence document" outlining the reasons for its recommendation to shareholders to reject the offer.

The Takeover Code has specific provisions to prevent the target board from taking any action without shareholder consent which would be against the best interests of the target and which might reduce its value in an attempt to deter a prospective bidder.

It is possible to provide for a fee (known as a "break fee" or "inducement fee") to be payable by the target to the bidder if the bidder's offer fails. There are a number of legal issues around the giving of a break fee but it must generally be no more than 1% of the total value of the target at the offer price.

Restrictions on share acquisitions before and during a takeover

Significant shareholder levels

Level	Significance
1%	Disclosure to the market required of any dealings in target shares, or interests in target shares, during an offer period if the party dealing owns or will own, or has interests in, more than 1% of the shares.
3%	Any person whose interest in the voting rights of a UK company listed on the Official List, another EEA regulated market, AIM or PLUS markets reaches, exceeds or falls below 3% (or any percentage point over 3%) must notify the company, which must notify the market. (PLUS Markets Group plc is an independent provider of primary and secondary equity market services in London and trades over 1000 small and mid-cap companies.)
10%	If a bidder has acquired interests in more than 10% of the target's shares for cash within 12 months before an offer, it must offer a cash alternative to all shareholders at not less than the highest price paid. If it acquires interests in more than 10% of the target's shares in exchange for securities in the three months before an offer it must offer securities as consideration.
29.9%	No person (including parties acting in concert) may acquire shares or interests in shares, which would take his interests in the shares to 30% or more of the voting rights (except in certain limited circumstances). 29.9% is the maximum interest in target shares which a person may have without being obliged to make a mandatory cash offer (see below).

When a mandatory or Rule 9 offer is required

No person, or group of persons acting in concert can acquire an interest in shares of a UK public company carrying 30% or more of the voting rights without triggering an obligation to make a general offer to acquire the remainder of the shares, a "mandatory offer", or a "Rule 9 offer". A mandatory offer must only have a 50% acceptance condition and normally no other condition to the offer will be permitted. In addition, the mandatory offer must be in cash (or include a full cash alternative) at a value not less than the highest price paid by the bidder for any interest in shares during the offer period and 12 months prior to its commencement.

Effect of market purchases on ability to secure full control of target

Market purchases enable a bidder to build up a stake in the target but this does not always make it easier to obtain 100% control over the target. In particular, any share purchases prior to the despatch of the offer document are not allowed to be counted towards the 90% acceptance level required in order to compulsorily acquire the outstanding minority shares (see above). If a scheme of arrangement is being used then any shares purchased by the bidder, either before or after the offer document is posted, cannot be voted in favour of the scheme.

Contrast with the acquisition of a private company

A public takeover offer in the UK has a very different structure to a UK private acquisition. The table below highlights the key differences.

Private acquisition	Takeover offer or scheme
Bidder negotiates with target shareholders	Bidder negotiates with target board
Must be agreed	Can be recommended or hostile
Terms based on acquisition agreement	Terms based on offer document/scheme circular
Terms negotiated between parties	Price set by bidder (with target board if recommended). Other terms determined by Takeover Code
Financial adviser not required	Both bidder and target need a financial adviser
Extensive warranties from target shareholders	Generally no warranties
Extensive due diligence by bidder	Restricted due diligence by bidder
100% acquisition assured provided conditions are satisfied	Risk of not obtaining sufficient acceptances: – offer could lapse – could have outstanding minority if do not reach 90% acceptance level – scheme may not be approved by requisite majority of target shareholders
Usually completed within a 4/6 week timetable	Offer period could continue for up to three months after initial announcement of offer

7. Restrictions on acquiring regulated businesses

There are specific rules governing acquisitions of companies operating in regulated business areas, such as financial services, banking, media, broadcasting, telecoms, energy and utilities. Some of the regulatory obstacles that an investor might encounter in a number of these areas are set out below.

Financial Services Authority (FSA) authorised businesses (including banking, insurance, investment services)

Background

- Restrictions applying in the UK to the acquisition of interests in firms with FSA authorisation to carry on banking, insurance or investment services business reflect the requirements of relevant EC directives.
- The requirements can be found in:
  - Part XII of Financial Services and Markets Act 2000 ("FSMA") and relevant subordinate legislation; and
  - the FSA's Handbook of Rules and Guidance including, in particular, Chapter 11 of the Supervision manual ("SUP 11").
- FSMA change of control provisions impose a range of obligations upon persons who are either proposing to become controllers of UK authorised firms or are already controllers of UK authorised firms. The regulatory status of the proposed or actual controllers is not relevant and the requirements apply to authorised and unauthorised entities alike.

Requirement to notify/obtain approval

- Section 178 of FSMA requires a person to notify the FSA if they propose to take a step which would result in their doing any of the following:
  - acquiring control over a UK authorised person;
  - as an existing controller, acquiring an additional kind of control over a UK authorised person;
  - as an existing controller, increasing the control they have over a UK authorised person – FSMA establishes thresholds at 10%, 20%, 33% and 50% so any increased interest in shares or voting power (including interests held indirectly through parent undertakings) taking the controller through one of these thresholds will trigger the requirement.
- Notice must be in writing and include such information and be accompanied by any such documentation as the FSA may reasonably require (section 182 of FSMA).
- A person who intends to acquire control or increase its control over a UK authorised firm in any of the ways described above is required to obtain the FSA's approval before doing so.

- The application of the above requirements has been modified in respect of certain authorised firms, including insurance intermediaries and building societies.

Public procurement

The European Union procurement rules, as implemented through UK regulations, govern the way in which public bodies and certain regulated utility businesses place their contracts for supplies and services. The regulations apply, for example, to water companies, electricity distributors, railway and airport operators. These regulations do not apply to the acquisition of the regulated business itself, but will have an ongoing impact on the way in which such a business chooses its suppliers and contractors. They may, for example, limit the extent to which the regulated business can award contracts directly to its affiliates or parent company, without first advertising those contracts and calling for competition.

Telecoms, media and broadcasting

The provision of telecoms, internet and broadcasting networks and services (referred to as "electronic communications networks and services") and television and radio services are regulated in the UK by the Office of Communications (Ofcom).

Companies providing electronic communications networks and services do not require licences to provide their networks or services (unless they require radio frequency spectrum to provide wireless services). They are instead subject to a general authorisation scheme and, in certain circumstances, specific additional conditions (for example price controls imposed on operators with significant market power). The conditions do not, however, require regulatory approval to any change of control. Where a company has installed infrastructure, a change of control may need to be notified or approved in relation to any easements or wayleaves granted by governmental agencies over public land or in territorial waters.

Companies providing television or radio services require a licence from Ofcom. These licences will generally require companies to notify Ofcom in relation to a change of shareholding or control. There are also a number of general disqualifications on the holding of broadcast licences or of interests in licence holders. In addition, certain bodies are subject to qualified restrictions on their ability to acquire licences. Media ownership rules also provide for restrictions on the ownership of multiple radio licences and limits on cross-media ownership.

Finally, Ofcom has concurrent powers with the Office of Fair Trading ("OFT") to enforce the Competition Act 1998 and Articles 81 and 82 of the EC treaty in the communications sector. In the event of merger activity in the communications sector, the OFT will usually consult Ofcom before approving a merger or acquisition or refer it to the Competition Commission on competition grounds. Media mergers may additionally be referred to the Competition Commission at the discretion of the Secretary of State for public interest considerations.

Energy

Companies involved in the generation, supply, transmission or distribution of electricity, or the supply, shipping, distribution or transmission of gas onshore in Great Britain require a licence from the Office of Gas and Electricity Markets (Ofgem). Licences, particularly for companies carrying out monopoly activities, are likely to include conditions that are triggered by a change of control or corporate restructuring, such as a requirement for certain undertakings to be given by the licensed company's ultimate controller and the requirement to hold an investment

grade credit rating. Other conditions may impact on a proposed acquisition, such as restrictions on asset disposal and granting security, financial ring fencing obligations, and prohibitions on cross-subsidy.

Ofgem also has concurrent powers with the Office of Fair Trading ("OFT") to enforce the Competition Act 1998 and Articles 81 and 82 of the EC Treaty in the electricity and gas sector. In the event of merger activity, Ofgem is responsible for advising the OFT who may then approve a merger or acquisition or refer it to the Competition Commission. Although there is no current specific UK merger legislation relating to the electricity and gas sector (in contrast to the water sector), changes in ownership may require the modification of existing licence conditions or give rise to other issues within Ofgem's jurisdiction. As a result, Ofgem may issue a consultation on the impact a merger or acquisition may have on competition in the energy market before deciding on the advice it would offer the OFT. Ofgem may also advise the European Commission if a merger may impact the European energy market.

Different requirements apply to companies carrying out offshore oil and gas exploration or production activities, for which the regulator is the Department for Business Enterprise and Regulatory Reform, previously the Department of Trade and Industry ("DTI"). While DTI consent is not usually required for a change of control per se, certain structural changes could trigger a revocation, for example if the licensee ceases to have its central management and control in the UK.

Water

Companies that hold an appointment as a water or water and sewerage undertaker will be subject to detailed conditions within the terms of their appointment, which are regulated by the Water Services Regulation Authority (Ofwat). The terms of appointment will include conditions that may be relevant to an acquisition, such as conditions imposing price limits and requiring the maintenance of an investment grade credit rating and conditions concerning: restrictions on asset disposal and the granting of security; financial ring fencing obligations and corporate governance; prohibitions on cross-subsidy; and restrictions on intra-group transactions and on incurring cross default obligations. There is also likely to be a condition requiring the giving of parent company undertakings, and there may additionally be a "cash lock-up" provision.

Unlike the electricity and gas sectors, there is also a requirement, contained in the Water Industry Act 1991, for the OFT to make a mandatory reference to the Competition Commission in relation to mergers between water and/or water and sewerage companies (subject to a turnover threshold). The Competition Commission is required to determine whether the merger may be expected to prejudice the ability of Ofwat, in carrying out its functions, to make comparisons between the monopoly water/sewerage undertakers (eg, in relation to price control). However even if Ofwat's functions are inhibited by the proposed merger, the Commission may permit the merger to proceed if it considers that the benefits to customers are substantially more important than the prejudice concerned. Like Ofgem, Ofwat shares concurrent powers with the OFT to enforce the Competition Act 1998 and Articles 81 and 82 of the EC Treaty in the water sector.

8. Financial services regulation

The providers of financial services in the UK, whether based in the UK or abroad, are heavily regulated by a combination of UK and EC law, as we explain further below. There are also regulatory restrictions on the acquisition of regulated financial services providers in the banking, insurance and investment sectors.

Structure of regulatory environment

The Financial Services Authority

- The Financial Services and Markets Act 2000 ("FSMA") provides the framework for the UK regulatory regime. It provides for the establishment, objectives and ongoing functions of the Financial Services Authority ("FSA"), an independent, non-governmental body regulating the provision of financial services in the UK.
- The FSA's Handbook contains rules made by the FSA under powers given to it by FSMA, and guidance for authorised firms. It covers:
  - threshold conditions for authorisation and principles to be followed by authorised firms and approved persons;
  - prudential standards (including regulatory capital requirements);
  - conduct of business rules and controls;
  - rules governing the issue of financial promotions, training and competence rules;
  - listing, prospectus and disclosure rules; and
  - the FSA's supervision and enforcement powers.

The FSA also performs a number of other important functions:

- It is the UK Listing Authority, approving listing documents when securities are admitted to listing on the London Stock Exchange, and monitoring and enforcing compliance by listed companies with the continuing disclosure obligations in the Listing, Prospectus and Disclosure Rules.
- It is responsible for the recognition of UK investment exchanges and clearing houses, and recognition of overseas exchanges and clearing houses for the purposes of their conducting operations in the UK.
- It is responsible for applying certain standards derived from EU law, such as the Unfair Terms in Consumer Contracts Regulations 1999.
- It has extensive powers to investigate market abuse, whether or not conducted by FSA regulated persons, and impose unlimited civil fines and issue public reprimands, or bring criminal prosecutions for insider dealing or market manipulation.

Other relevant authorities

- The Bank of England is the UK's central bank, with responsibility for interest rate policies. It also manages the UK's foreign exchange and gold reserves.

- HM Treasury is the government department responsible for formulating and putting into effect the UK Government's financial and economic policy.
- The Takeover Panel draws up, administers, interprets and enforces the rules of the City Code on Takeovers and Mergers (the Takeover Code) which apply to the acquisition or consolidation of control of public companies incorporated in the UK.
- The London Stock Exchange and other Recognised Investment Exchanges make and enforce rules in relation to the conduct of business on their markets.

Authorisation and licensing

Authorisation regime

- The "general prohibition" within section 19 of FSMA prevents any person from carrying on a "regulated activity" in the UK unless authorised by the FSA or exempt.
- "Regulated activities" include accepting deposits, dealing in investments as principal/agent, arranging deals in/managing and advising on investments, and effecting contracts of insurance.
- "Investments" include deposits, shares, government securities, options, futures, and contracts for differences.
- Breach of the general prohibition is a criminal offence and agreements entered into as a result of carrying on the activities are voidable at the discretion of the courts.
- The FSA has the power to impose fines or issue public statements of misconducts in relation to approved persons that are found to have been guilty of misconduct.

Financial promotions

- Section 21 of FSMA states that a person must not "in the course of business communicate an invitation or inducement to engage in investment activity" unless:
  - they are the authorised person;
  - they are the unauthorised person and the content of the communication is approved for the purposes of the section by an authorised person; or
  - they are the unauthorised person but the financial promotion benefits from an exemption.
- A breach of section 21 of FSMA is a criminal offence and may render the relevant investment agreement unenforceable.
- Exemptions include where an approach is made to:
  - an investment professional (which would include any authorised firm);
  - a high net worth company;
  - a certified high net worth individual or self-certified sophisticated investor, if the promotion relates to an investment in an unlisted company or a fund which invests wholly or predominantly in unlisted companies; and
  - a sophisticated investor certified as experienced in relation to the investment or fund which the broker/dealer is promoting.

- There are further limited exemptions for overseas communicators, and exemptions for "generic promotions". The latter exemption covers all types of activity, but only exempts promotions which do not name any particular product or provider.

Collective investment schemes

- Under section 238 of FSMA the only collective investment schemes (also known as "mutual funds" or "funds") which may be promoted to the public by an authorised person are:
  - authorised funds constituted in the UK – either AUTs (unit trust schemes) or ICVCs (open-ended investment companies);
  - collective investment schemes constituted in other EEA states which are recognised by the FSA under section 236 of FSMA and which qualify under the EC's UCITS Directive (a set of European directives which aim to allow these schemes to operate);
  - schemes authorised in designated countries or territories recognised under section 270 of FSMA; or
  - individually recognised overseas schemes recognised under section 272 of FSMA.

Insider dealing and market abuse

Criminal

- Insider dealing is a criminal offence under section 52 of the Criminal Justice Act 1993. The maximum sentence on conviction is seven years' imprisonment.
- Market manipulation is a criminal offence under section 397 of FSMA. It covers the deliberate or reckless making of statements or forecasts which are false, misleading or deceptive; the dishonest concealment of material facts; and any conduct creating a false or misleading impression of the market in relevant investments.

Civil

- The market abuse regime empowers the FSA to impose financial penalties in respect of insider trading and market manipulation.
- "Market abuse" is defined in section 118 of FSMA and covers insider dealing, improper disclosure, misuse of information, trading which gives a false or misleading impression as to the supply, demand or price of investments or which secures an abnormal or artificial price; placing orders which are fictitious or deceptive; disseminating information giving misleading impressions and engaging in conduct which a regular user of the market would view as distorting the market.
- Under section 119 of FSMA the FSA has issued a Code of Market Conduct giving guidance on how the definitions of market abuse should be applied and providing certain "safe harbours".
- The Market Abuse Directive has imposed new obligations on listed companies to control access to inside information on a "need to know" basis and to maintain lists of persons within their organisations who have "access to" inside information.
- Authorised firms must report suspicious transactions, which may amount to market abuse, to the FSA.

Changes of control of FSA authorised businesses under the Financial Services and Markets Act 2000 (FSMA)

See section 7 above.

9. Raising finance

Sources of finance for companies

The focus of this section is on debt finance provided for companies incorporated in England and Wales.

Loan facilities

A loan facility can provide a corporate borrower with financing which is both reliable and tailored to the particular purpose of the loan. For example, a company looking to ease its cash flow could obtain an overdraft facility which would provide it with instant access to variable sums of money, whilst a company aiming to fund a specific investment could enter into a term loan (the loan of a lump sum for a specific period of time). See below.

Debt capital markets instruments

This form of financing involves a company (the "issuer") issuing debt securities to investors in return for the loan of capital to the company. These debt securities usually provide that the issuer will repay the capital on a specified date (known as "maturity") and that interest will be paid on the capital until that date. Debt securities can be sold by the original investor, and the issuer will then pay interest (and eventually repay the capital) to the current owner of the debt security. See below.

The money invested in a company by its shareholders in return for a share in the business can be used to invest in the company's assets on a long-term basis as this money will only be returned to the shareholders in the event of a winding-up of the company.

Types of loan facility

The two key types of loan facility used by corporate borrowers are the term loan and the revolving credit facility. There are many other variances and some key ones are discussed in more detail below.

Although the emphasis in this section is on the borrower, the key terms of the loan agreement (for example, the representations and warranties) often apply also to the other companies in the borrower's group.

Term loans

A term loan provides a corporate borrower with a specified sum of capital over a specified period known as the "term". The term of a loan for general corporate purposes is not normally more than five years.

Term loans are usually committed facilities, which means that the loan agreement contains an obligation by the lender to advance monies to the borrower at the borrower's request (provided that the borrower has satisfied certain pre-agreed conditions known as "conditions precedent").

Under a standard term loan facility, there will be a short period at the beginning of the term during which the borrower can draw a lump sum up to a specified maximum amount. Alternatively, a term loan can allow drawings to be made in a series of advances when the

borrower needs the finance, which means that it borrows according to its specific requirements.

The loan agreement will either require repayment of the loan by instalments at specified intervals or in one sum at the end of the term.

The borrower will be required to pay interest on the loan. See below.

Revolving credit facilities

Under a revolving credit facility, the borrower is still provided with a capital sum which is made available over a specified period. However, the main difference between a term loan and a revolving credit facility is that under the latter the borrower can draw down and repay advances of the available capital throughout the life of the loan. Each advance is usually borrowed for a short period of one, three or six months, at the end of which it is repayable. But if the borrower is not in default an advance can be immediately re-drawn (a "rollover"). A "commitment fee" will be payable in respect of the revolving credit facility, which will be a percentage of the undrawn facility from time to time.

Bilateral and syndicated facilities

- **Bilateral facilities** – these facilities involve just two parties, the borrower and the lender. They are used for smaller loans and overdraft facilities.
- **Syndicated facilities** – For larger loans (for example, an acquisition funding), the finance is usually provided by a group of banks referred to as a "syndicate". The syndicate members will all be party to common documentation but they may contribute different amounts and will only be liable for their own obligations.

Secured and unsecured facilities

Lenders will normally take security over the assets of a borrower in order to increase the likelihood of recovery without unnecessary delay. The taking of security is also designed to avoid the need for litigation and in addition may ensure priority over other creditors of the borrower. See below.

The loan agreement

Covenants (including financial covenants)

Covenants are promises given by the borrower to the lender in the loan agreement. Their purpose is to give the lender some control over the borrower, its assets and activities, by either requiring positive action by the borrower or by prohibiting the borrower from doing something. Breach of a covenant will trigger an event of default.

Examples of non-financial covenants include "information" covenants (eg, to provide regular financial information), "positive" covenants (eg, to obtain and maintain insurance) and "negative" covenants (eg, a covenant which imposes restrictions on disposals).

Financial covenants are financial targets which a borrower undertakes to meet. Their purpose is to protect the lender's capital and interest and to impose financial discipline on borrowers.

The scope of the covenants will depend on the type of borrower and its business, the purpose of the loan and the level of risk.

Events of default

Events of default are circumstances which entitle the lender to terminate the loan early, cancel any commitment and demand repayment of all outstanding principal and interest. (This process is known as "acceleration" of the loan.)

Common events of default include late payment, breach of a covenant and insolvency events.

Interest

The interest on commercial loans payable by the borrower is usually floating, not fixed, rate. A floating rate of interest is normally the sum of the interbank funding rate (for example, in the London market this is known as a bank's London Interbank Offer Rate (LIBOR)), mandatory costs (which is the cost of complying with supervisory charges) and the bank's "margin" or profit.

Fees

The nature of the loan facility will determine the type and market conditions will impact on the level of fees payable by the borrower. Common examples include:

- **Front end fees** – payable in respect of the initial work involved in putting the loan together.
- **Commitment fees** – payable in respect of the undrawn uncancelled commitments (this is to cover a bank's regulatory capital requirements in respect of money which it is committed to lend but which has not yet been drawn).
- **Agent's fees** – payable to the bank which takes on the role of agent.
- **Cancellation fees** – payable in the event that the loan facility (or part of it) is never used (eg, in acquisition financing, where a company's bid for a target fails).

Security

Some common forms of English law security are:

- **Fixed charge** – A fixed charge gives a lender rights over the charged assets which prohibit the borrower from disposing of them without permission and allow the lender recourse to the assets should the borrower default under the loan. On a default, the lender may sell the asset or appoint a receiver to organise the sale.
- **Floating charge** – Floating charges are used where the relevant group of assets may fluctuate from time to time. A key difference between a fixed and a floating charge is that a floating charge allows a borrower to deal with the charged assets in the ordinary course of business. However, on the occurrence of specified events, the floating charge will effectively become a fixed charge – it "crystallises". Upon "crystallisation" the borrower is then unable to dispose of the assets subject to the charge unless it obtains the lender's prior consent.
- **Mortgage** – A mortgage transfers ownership of an asset to the lender. The lender has a right to sell the asset on default and an obligation to re-transfer title on repayment of the debt.
- **Assignment** – Assignment is the transfer of rights but not obligations. An assignment will transfer to the new party all the existing party's rights under the relevant agreement. A provision for reassignment on satisfaction of the debt will always be included in assignments by way of security. The type of assets which are usually secured by assignment are a borrower's rights against a third party ("choses in action") eg, debts, rights under contracts.

Guarantees

A guarantee is an undertaking by one party (the "guarantor") to answer for the obligations of another party, normally upon default by that other party. Guarantees are often given by the borrower's parent company or by another company in the same group. The guarantor may also be required to give security over its own assets to support its potential liability under the guarantee.

Financial assistance

As mentioned in section 4 above, a company and any of its subsidiaries are generally prohibited from directly or indirectly providing financial assistance to any person in order to purchase that company's shares. The definition of 'financial assistance' specifically includes financial assistance given by way of guarantee, security or indemnity.

Other entities seeking finance

Companies are not the only entities which could be seeking financing. Other types of borrower include governments, local authorities, partnerships, and sole traders.

Debt capital markets instruments

Raising capital through debt capital markets instruments is generally effected by the borrower (called the "issuer") issuing a debt security generally known as a bond or note. The terms bond and note are often used interchangeably as there is no difference in form or content between the two (we refer to the instruments as bonds herein) although, traditionally, bonds have a final maturity of seven or more years from the date of issue and floating rate instruments are notes. A bond is a certificate of debt under which the issuer promises to pay the principal of the amount borrowed to the lender (referred to as the bondholder) on the maturity date of the bonds. There are no rules as to when this maturity date will fall, typically it will be more than three years after the issue date of the bonds and may be as long as 10 or 20 years.

The main characteristics of a bond are:

- it is a debt obligation in the form of a transferable instrument with a medium or long-term maturity;
- it is sold by way of marketing to a large number of investors through a syndicate of financial organisations, or it is sold to a small group of specifically targeted investors;
- it is a marketable instrument (ie, it has an established secondary market);
- it may be listed on a recognised stock exchange;
- it will generally be unsecured;
- it may be credit rated by a rating agency to enhance marketability; and
- it will bear interest or be issued at a discounted price.

Types of bond issue

Fixed rate bonds

A fixed rate bond has a rate of interest which is fixed at the time of issue and will not change during the life of the bond. The interest is usually payable annually (or semi-annually in the case

of some "emerging markets" issuers) in arrear. The rate of interest will depend primarily on the market conditions prevailing at the time of issue, the credit rating of the issuer and the length of maturity of the bond.

Floating rate bonds

A bond with a floating interest rate is referred to as a "floating rate note". Floating rate notes pay interest which fluctuates in accordance with a variable benchmark rate plus a margin.

Variable rate bonds

These are bonds with a rate of interest which varies throughout their term, although unlike floating rate notes, the rate does not vary freely in accordance with an underlying benchmark.

Zero Coupon Bonds

Zero coupon bonds do not pay any interest, however, the amount which the investor pays for a zero coupon bond on its issue is less than its face value on redemption.

Equity linked bonds

Some bonds are linked to the equity (ie, the share capital) of the issuer and provide an investor with the opportunity to obtain some form of equity interest in the issuer or a related company.

The form of a bond

Bonds can be issued in one of two forms: bearer or registered.

- **Bearer bonds** – Bearer bonds are negotiable instruments whose title passes by delivery of debt securities. This means that passing the bond to another person transfers ownership; the bond itself is proof of ownership.
- **Registered bonds** – Unlike bearer bonds, registered bonds are not negotiable instruments and title passes by registration of the bondholder's name in a register. Registered bonds will be used where there are US bondholders to avoid US tax issues.

Both bearer and registered bonds will generally be held and traded through clearing systems. Their function is to provide safe custody for, collect payments on and facilitate the transfer of, securities. The principal clearing systems for bonds are Euroclear and Clearstream.

Key regulatory issues

The European Economic Area prescribes regulations which restrict the offering of bonds to the public. It is unlawful for securities to be offered to the public in the UK unless an approved prospectus has been made available to the public before the securities are so offered. There are certain exemptions to this requirement such as offers made to institutional investors. In the UK, supervision of compliance with this regime is handled by the Financial Services Authority (the FSA).

There are also US restrictions on the issues of securities which need to be considered even for companies with no connection with the US. Typically a bond is issued as a "Reg S" bond which cannot be sold into the US or to US beneficial owners or a "Rule 144A" bond which can only be sold to US qualified institutional buyers. US securities law advice is required in relation to any bond issue.

Bonds are often listed with a stock exchange listing to enhance their marketability and take advantage of the “quoted eurobond exemption” which allows an issuer in the UK not to deduct tax on interest at source. In order to gain a listing, the approval of the issue document is required from the relevant listing authority (in the UK, the United Kingdom Listing Authority operated by the FSA).

There is a self-regulatory organisation called the International Capital Markets Association (ICMA) which represents the investment banks and securities firms issuing, trading and dealing in international securities worldwide. They provide a self-regulatory code of industry driven rules and recommendations which regulate issuance of bonds with recommended timings and standard forms of agreements and conditions for bonds.

10. Competition and merger controls

On any acquisition or public company takeover, it is of vital importance that competition rules are considered. The following sets out the main anti-competitive rules and rules on merger controls in English law which are derived from EC law.

Anti-competitive agreements and practices

The key competition rules are set out in the Competition Act 1998.

The Chapter I prohibition is concerned with anti-competitive agreements and prohibits agreements between undertakings, decisions by associations or concerted practices which may affect trade within the UK and have as their object or effect the prevention, restriction or distortion of competition within the UK.

The Chapter I prohibition contains a non-exhaustive list of examples of anti-competitive agreements:

- fixing purchase or selling prices or other trading conditions;
- limiting or controlling production, markets, technical development or investment;
- sharing markets or sources of supply;
- applying dissimilar conditions to equivalent transactions with other parties, thereby placing them at a competitive disadvantage; and
- making contracts conditional on additional obligations that are not connected with the subject matter of the contract.

If an agreement is caught under the Chapter I prohibition, the prohibition may be inapplicable if it can be shown that the agreement contributes to improving production or distribution or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit. The exemption will only be available if any restrictions on competition are essential to achieve these objectives and as long as they do not allow competition to be substantially eliminated.

The Chapter II prohibition prohibits the abuse of a dominant market position which has or is capable of having an effect on trade within the UK. A dominant position in itself is not unlawful, it is the abuse of the dominant position that results in an infringement. The Chapter II prohibition sets out a non-exclusive list of conduct that may constitute abuse:

- Pricing abuses. Unfair pricing practices include:
  - excessively high pricing;
  - predatory pricing (designed to eliminate competitors);
  - discriminatory pricing (charging different prices to similarly placed customers); and
  - unfair fidelity or loyalty rebates or similar pricing schemes.
- Refusal to supply

- Tying (this occurs where a supplier agrees to supply particular products or services only if the purchaser agrees to buy other unrelated products or services from the supplier).

There is no possibility of exemption under the Chapter II prohibition.

Enforcement

The Chapter I and II prohibitions are enforced by the Office of Fair Trading (OFT) and concurrently by the sector regulators in relation to their respective areas. An agreement or practice in breach of the Competition Act is void and unenforceable. The OFT can impose fines of up to 10% of a company's worldwide turnover for the previous business year, where the prohibitions are infringed either intentionally or negligently.

Third parties who have suffered a loss as a result of a breach of these provisions can also bring civil damages claims, before the Competition Appeal Tribunal or before the High Court. The Enterprise Act 2002 introduced a number of new possibilities for legal redress for third parties who are harmed by infringements of competition law, in order to make it easier for third parties to bring damages claims.

Cartel offence

The Enterprise Act 2002 introduced a new criminal offence for those who dishonestly engage in cartels (price fixing, market sharing, limiting production or bid rigging). The cartel offence carries a maximum sentence of five years imprisonment and/or an unlimited fine.

EU duty / origin rules

The EU is a customs union, ie, a combination of the 27 customs territories of the Member States, including the UK. No customs duties are imposed on trade between EU Member States and a common customs and trade policy applies to trade between EU Member States and non-EU countries.

The precise level of customs duty imposed on imports from non-EU countries depends on the specific product and, in some cases, on the country of origin. Furthermore, imports from some countries may be subject to anti-dumping duties. For these reasons, it may be important to determine the country of origin of a product. However, this is increasingly difficult in today's reality of global production chains whereby different parts of one final product are manufactured in different countries and assembled in yet another. If more than one non-EU country is involved in the production of a product, the decisive factor for determining its origin will be in which country the product had undergone its last substantial and economically justified transformation, resulting in a new product.

The rules on customs duties and rules of origin are also important for companies considering investment in the UK (or elsewhere in the EU), in particular in the production sector. Investors will need to take into account the customs duties imposed on non-EU materials and parts used in the production process and the extent to which a final product assembled in the UK (from non-EU parts) can qualify for EU origin.

Merger controls

When a merger occurs

Under the Enterprise Act 2002, a "merger" occurs where two enterprises cease to be distinct. A merger will qualify for investigation only if:

- the value of the turnover in the UK of the enterprise being taken over exceeds £70 million (the "turnover test"); or
- as a result of the two enterprises ceasing to be distinct, there is an aggregation of shares of supply so that the merged entity will have a share of supply or purchases of at least one-quarter of a particular description of goods or services in the UK (the "share of supply" test).

Review by the OFT

The Enterprise Act imposes a duty on the Office of Fair Trading (OFT) to refer completed and anticipated mergers to the Competition Commission for further investigation if it believes that it is or may be the case that a relevant merger situation has been or will be created and the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets for goods or services in the UK.

The OFT may decide not to make a reference if it believes that the market concerned is not of sufficient importance to justify the making of a reference to the Competition Commission, or if there are customer benefits that outweigh any substantial lessening of competition.

The test for reference will be met if the OFT has a reasonably held belief that, on the basis of the evidence available to it, there is at least a significant prospect that a merger may be expected to lessen competition substantially. The Enterprise Act allows the OFT to accept binding undertakings from the merging parties as an alternative to making a reference to the Competition Commission.

Forms of approach to the OFT

Parties may take the risk under English law and not seek prior approval for a merger. The risk has become greater under the legislation introduced under the Enterprise Act which gives the OFT and the Competition Commission various powers to accept undertakings or impose orders preventing the further integration of merging businesses, where the merger is under consideration by the OFT, or the subject of an investigation by the Competition Commission. Where no notification is made, the OFT may decide to investigate at any time within four months of completion or of material facts coming to its attention (if this is later).

Investigation by the Competition Commission

Where a transaction is referred to the Competition Commission, the Competition Commission will have a maximum of 24 weeks to complete its investigation and make its decision on remedies. This may be extended by a maximum of eight weeks in very exceptional circumstances (where the parties have failed to provide or have been late in providing information). Detailed negotiations on remedies may, however, take place after this period.

The Competition Commission's duty is to investigate and report on whether a relevant merger situation has been or will be created and, if so, whether the creation of that situation has resulted or may be expected to result in a substantial lessening of competition within any market for goods or services in the UK.

If it does so conclude, the Competition Commission shall decide whether action should be taken for the purpose of remedying, mitigating or preventing the substantial lessening of competition and what that action should be. In some cases it might recommend that the merger should not take place. It can also recommend that assets, shares or interests in shares

already acquired should be disposed of, or that the merger should be allowed only subject to conditions. Final undertakings negotiated as a result of an adverse finding by the Competition Commission will be negotiated by and accepted by the Competition Commission. All undertakings and orders are published by the OFT in a Public Register of Undertakings and Orders, to ensure interested third parties are aware of the undertakings.

The Competition Commission is required to publish all merger reports in full (but there is an obligation to remove certain categories of material, such as confidential business information).

11. Employees

On acquiring or setting up a business or company in the UK, there will inevitably be employees and it is important to understand the employment law issues that apply in England and Wales.

Sources of employment law

Much English employment law comes from EU legislation, so one might expect the position to be similar throughout Europe. However, there are significant differences: English law emphasises the individual agreement between employer and employee with an overlay of statutory rights, whereas in many EU countries employment is regulated by industry sector collective agreements.

One key point to note is that English statutory employment rights will continue to apply even if the employment contract is expressed to be governed by a foreign law. Likewise, clauses requiring employees to refer disputes to arbitration will not be effective to prevent them bringing claims for breach of statutory rights.

Statutory claims must be brought in the Employment Tribunal; contractual claims can be brought in the Employment Tribunal (subject to certain limits) or in the civil courts. Tortious claims (eg, for personal injury) must be brought in the civil courts (see section 19).

The contract of employment

Where are the terms found?

- Employers must give employees a written statement of the main terms of their employment within two months of the job starting. If they fail to do so, the employee may apply to an Employment Tribunal for a declaration of terms (or, if they have an additional claim, for compensation of up to £1,240). In practice most employees will be given a fuller employment contract, setting out a whole range of terms covering remuneration, duties, termination provisions and so on.

- The courts will also imply certain terms into an employment contract, such as the requirement to give reasonable notice of termination (if there is no express term), the employee's duty of confidentiality, fidelity and good faith, and the duty on both employer and employee not to conduct themselves in a manner calculated and likely to destroy the relationship of trust and confidence between them.

- Employment terms may also derive from collective bargaining with a recognised trade union.

Terms applying post-termination

- Contracts will often contain express prohibitions on what an employee can do after leaving the employment. Without such provisions, employees are not prevented from competing or poaching customers or employees, only from using or disclosing trade secrets. UK courts will only enforce express restrictive covenants if they are reasonable and no wider than is necessary to protect a legitimate business interest.

- An alternative means of keeping departing employees out of the marketplace is the use of an express “garden leave” clause, enabling the employer to make an employee stay at home during their (paid) notice period.

Termination

UK employees have both statutory and contractual rights on termination.

Notice rights

Under statute, employees are entitled to a minimum period of notice prior to dismissal once they have worked at least a month, unless dismissed for gross misconduct. Minimum notice by the employer is one week (where the employee has worked less than two years), then one week per year of service up to a maximum of 12 weeks; notice by the employee is one month. However, employers and employees often agree longer notice periods and/or provide that the employer can pay an amount in lieu of notice. Payment in lieu provisions enable an employer to terminate immediately without breaching the contract (thereby retaining the benefit of any restrictive covenants), but do have tax disadvantages. Notice periods of between six and 12 months are commonplace for senior executives.

Failure to give notice (or exercise a contractual payment in lieu provision) entitles employees to claim damages for “wrongful dismissal” representing lost salary and benefits during what would have been the notice period, subject to the employee’s duty to mitigate their loss by seeking new employment.

Unfair dismissal

After one year of service an employee has the statutory right not to be unfairly dismissed. A failure to renew a fixed-term contract is treated as a dismissal. An employee can also resign and claim that they have been constructively dismissed where the employer has fundamentally breached the contract (eg, a breach of the implied duty of trust and confidence).

A dismissal will be fair if the principal reason for the dismissal and the procedure adopted in dismissing are both fair. There are six potentially fair reasons:

- lack of capability or qualifications;
- misconduct;
- redundancy;
- that the employment could not lawfully be continued;
- retirement; or
- some other substantial reason.

The most common award by a tribunal in cases of unfair dismissal is compensation, although occasionally an employer is ordered to re-employ the employee. Compensation includes a basic award of up to £9,300 depending on age and length of service and a compensatory award to reflect loss, currently capped at £60,600.

Redundancy

An employee dismissed for redundancy will be entitled to a statutory redundancy payment if he has two years’ service. Larger employers often provide enhanced redundancy packages

over and above the statutory amount. The statutory payment is broadly equal to the basic award (capped at £9,300) and is set off against that award if the redundancy dismissal is unfair. A fair redundancy procedure will involve using fair selection criteria and applying them fairly, looking for alternative jobs, and consulting with the employee. Where 20 or more redundancies are proposed, there are also obligations to consult collectively – see below.

Discrimination

Discrimination on the grounds of sex, pregnancy, marital status, race (including colour, nationality, national or ethnic origins), disability, gender reassignment, religion or religious or similar philosophical belief, sexual orientation and (since October 2006) age is unlawful in relation to recruitment, employment and certain post-employment conduct (eg, in giving references). The law prohibits direct discrimination, indirect discrimination (where a practice applied to all staff disadvantages a minority group), harassment and victimisation (treating someone less favourably because of their involvement in a tribunal claim) on these grounds. Employers can only justify direct discrimination which is on grounds of age (and this will be rare); objective justification is a potential defence to all forms of indirect discrimination.

There is no statutory limit to the size of compensation awards for discrimination claims. In addition to economic loss, tribunals will usually make an award for injury to feelings between £500 and £25,000 and can also award compensation for any personal injury caused. Aggravated damages can also be awarded to reflect unacceptable behaviour by the employer eg, in the way the employee is treated after having made a complaint.

It is also unlawful to treat part-time workers or employees on fixed-term contracts less favourably because of their part-time or fixed-term status, unless objectively justified.

Whistleblowing

It is unlawful to subject an employee to detriment or dismiss them for making a "protected disclosure", ie, a disclosure which, in the reasonable belief of the employee, tends to show, for example, the commission of a criminal offence or a failure to comply with a legal obligation, a miscarriage of justice or danger to the health and safety of any individual. The disclosure must be made in good faith and not because of a personal grudge. A whistleblowing dismissal is automatically unfair with no minimum service requirement and no cap on the compensation that can be awarded for loss of earnings.

Employee protection on business transfers.

"TUPE" is the UK version of EU rules protecting employees in the event of a transfer of a business or part of a business to another party. A revised version of TUPE came into force in April 2006. Mergers, outsourcings or insourcings of services, changes of contractor providing services, and intra-group transfers can all be covered, depending on the circumstances. It is not possible to contract out of TUPE. However, TUPE does not apply to simple transfers of some assets nor typically to share sales. TUPE applies to (i) a business or part situated in the UK prior to the transfer and (ii) an organised grouping of employees in Great Britain whose principal purpose is to carry out a service for a client (provided the service is not a single short-term task nor wholly or mainly for the supply of goods). It remains a moot point whether TUPE can apply even if the business or service-provision is transferred outside the EU.

Where TUPE applies, the protection includes:

- trade union or employee representatives must be informed and consulted in advance about the proposed transfer; if there are no appropriate representatives in place, elections must be held; the penalty for failure to inform and consult is up to 13 weeks' pay per employee and there may be joint and several liability for both transferor and transferee;
- the employment contracts of employees in the transferring business automatically pass to the transferee, save for certain pension rights; continuity of service is protected;
- the transferee inherits accrued rights and liabilities in relation to the transferring employees; the transferor is obliged to provide the transferee with specific information about employment liabilities at least two weeks before the transfer;
- any dismissal connected with the transfer will be automatically unfair (although employees still require one year's service to claim), unless the employer can show an "economic, technical or organisational reason entailing changes to the workforce" (this generally means that there must be a genuine redundancy situation); and
- changes to the transferring employees' terms and conditions will be unenforceable if made "in connection with the transfer", even if the employees agree to them; harmonising the newly-acquired workforce's terms with those of an existing workforce will usually be seen as transfer-connected and ineffective; there is greater flexibility to change terms where the transferor is insolvent.

These protections increase the importance of identifying possible TUPE transactions at an early stage, carrying out careful due diligence on human resource issues, and negotiating appropriate warranties and indemnities to reflect an acceptable allocation of risk.

Obligations to inform and consult

TUPE transfers are not the only occasion when UK employers are required to inform and consult their staff. An employer (of whatever size) who proposes to make redundant 20 or more employees at one establishment within a period of 90 days must inform and consult with trade union members or elected employee representatives, and must also notify the government. This period is increased to 90 days if 100 or more dismissals are proposed. Failure to inform and consult can lead to an award against the employer of up to 90 days' pay per employee. There are also obligations to consult employees in relation to health and safety matters. Some companies may also have European or domestic works councils, which they will be required to inform and consult about matters that could significantly affect employment. Finally there are obligations to inform and consult employee representatives about certain changes to pension entitlements, currently for employers of 100 or more employees in the UK. Again the threshold will reduce to 50 from April 2008.

Other statutory rights

UK employees enjoy a wide range of other statutory rights, including:

- employees may not work more than 48 hours a week (usually averaged over 17 weeks) unless they expressly agree to opt out of this or are senior employees "with autonomous decision making powers", records of hours worked must be kept; there are also minimum rest requirements;

- employees are entitled to statutory minimum paid holiday of four weeks; there are plans to increase the entitlement to 4.8 weeks from 1 October 2007 and to 5.6 weeks from 1 October 2008;
- family-friendly leave has recently been enhanced for women due to give birth or adopt on or after 1 April 2007; under this new regime:
  - all employees are entitled to 52 weeks' maternity leave; those with 26 weeks' service at the relevant time are entitled to statutory maternity pay (90% pay for the first 6 weeks followed by 33 weeks at a flat rate, currently £112.75 per week);
  - fathers with 26 weeks' service are entitled to two weeks' leave paid at the flat rate; there are plans to allow fathers to take additional paternity leave if the mother returns to work during the second six months of her entitlement, but this is unlikely to be introduced until April 2009;
  - adopters can take leave equivalent to maternity and paternity leave but are required to have 26 weeks' service at the relevant time;
- parents with one year's service are entitled to 13 weeks' unpaid parental leave to be taken before the child is five;
- all employees have a right to paid time off for ante-natal care and unpaid time off to cope with incidents involving dependants;
- parents of children aged under six or carers of adult family members with 26 weeks' service also have the right to request flexible work (eg, reduced hours);
- employees are entitled to statutory sick pay (currently £72.55 per week) during sick leave for up to 28 weeks during any three year period;
- employees have the right to be paid the national minimum wage, currently £5.52 per hour for those aged over 21;
- employers with five or more employees (who do not provide contributions to an occupational or group personal pension scheme) are required to designate a private pension scheme to which employees can contribute through payroll; the employer need not contribute to the scheme on the employee's behalf;
- employers have various health and safety obligations, including to carry out risk assessments;
- employees have rights to privacy and data protection; particular care needs to be taken when monitoring employees' e-mail or internet use or using CCTV, and it is advisable to put in place internal policies to inform employees what monitoring is carried out; there are also special rules about "transferring" employee data (which could include accessing data on a global HR intranet) to a country outside the EU.

Requirement for foreign employees to obtain work permits and/or residency permits.

British citizens, Swiss nationals and nationals of countries in the European Economic Area (EEA) do not require a work permit to work in the UK. Under the work permit scheme, it is easier for permits to be obtained in respect of senior employees, employees transferring within companies, and employees whose skills are in short supply.

Workers from some of the new EU member states must register with the Home Office Worker Registration Scheme as soon as they find work. Once they have been working legally in the UK for 12 months without a break they obtain full rights of free movement and will no longer need to register.

Non-EEA nationals usually require work permits. Further information can be found at http://www.workingintheuk.gov.

12. Tax

On acquiring a business or company or investing in the UK, specialist tax advice should be sought at an early stage. The following is intended to be an overview of the main relevant tax areas.

Tax residence for corporates

A company will generally be tax resident if it is either

- incorporated in the UK; or
- centrally managed and controlled in the UK.

Rates of tax

Corporation tax

UK companies must pay corporation tax on their worldwide profits. The main rate for 2007 to 2008 is 30%. This rate will be reduced to 28% with effect from 1 April 2008.

Value added tax (VAT)

VAT is charged on:

- goods and services supplied in the UK by businesses; and
- imported goods.

The standard rate is 17.5%. Some supplies are zero-rated (for example, books) and some are exempt (such as financial services). Unlike exemption, zero-rating allows VAT on related expenditure to be recovered.

Stamp duty or stamp duty reserve tax

This must be paid on transfers of shares and certain securities. The standard rate is 0.5%, although a higher rate of 1.5% applies where shares are transferred to depositories (such as American Depository Receipts) or into a clearance system.

Stamp duty land tax (SDLT)

SDLT is a tax on land transactions. Rates are:

- 1% of the net present value of the rental element of lease transactions; and
- up to 4% of consideration paid for the acquisition of land.

Business rates

Land owners must pay business rates in respect of non-domestic premises. Business rates are usually an allowable deduction when calculating profits for corporation tax.

Taxation of non-resident companies

Non-resident companies with a permanent establishment in the UK are liable for corporation tax on:

- income profits of that establishment; and
- gains from the disposal of assets situated in the UK, which are used in the trade of the establishment.

Non-resident companies that do not trade through a permanent establishment must pay income tax on rents from UK property.

Dividends/interest/royalties

- **Dividends paid to foreign corporate shareholders.** Withholding taxes do not apply to dividends paid to foreign corporate shareholders.
- **Dividends received from foreign companies.** A UK company must pay tax on dividends received from a foreign company. The dividend received is grossed up for overseas taxes but credit is given against that liability for withholding taxes and, provided that the UK company holds at least 10% of the voting power, underlying taxes that have already been paid.
- **Interest paid to foreign corporate shareholders.** A withholding tax of 20% applies to certain interest payments to foreign corporate shareholders unless a direction to pay gross or deduct a lower amount under a double tax treaty is obtained from HM Revenue & Customs.
- **Intellectual Property (IP) royalties paid to foreign corporate shareholders.** A withholding tax of 22% applies to patent royalties and annual payments to foreign corporate shareholders, subject to any direction to pay gross or deduct a lower amount under a double tax treaty.

Controlled foreign company rules

Under the controlled foreign company rules, profits of a foreign subsidiary can be imputed to a UK parent company if the foreign subsidiary is subject to a level of tax that is less than 75% of the tax that it would be subject to if it were UK tax resident.

Transfer pricing/thin capitalisation rules

Transfer pricing rules provide that transactions between UK companies and UK or foreign affiliates must be taxed on the arm's length value of the transaction. These rules apply where any of the following apply:

- the UK company has overall control of the foreign or UK affiliate;
- the UK company holds at least 40% of the affiliate's share capital and another entity also holds at least 40%; and
- a number of persons act together in relation to the financing arrangements of a business where collectively those persons would be capable of controlling the company if all their actual or potential rights and powers were aggregated.

In certain cases, the transfer pricing rules do not apply to small and medium-sized enterprises.

The UK used to have a separate set of rules for thinly capitalised companies which would restrict the deductibility of interest payments on loans from foreign affiliates. Since April 2004, these rules have been subsumed within the transfer pricing rules.

Imports and exports

This depends on whether goods are imported or exported within the EU or outside it.

Outside the EU

Exports of goods outside the EU are subject to VAT but are generally zero-rated. Imports from outside the EU are subject to VAT, which is payable by the importer at the same rate as if the goods were supplied within the UK. Customs duty and excise duty may also be payable on imports.

Within the EU

The supply of goods between VAT-registered traders is generally zero-rated (to qualify, the customer state code and VAT registration number must be put on the invoice). Where VAT is payable, the customer receiving supplies must pay VAT at his country's rate. VAT is charged in the normal way on sales to non-VAT registered customers.

Double tax treaty network

The UK has double tax treaties with about 100 countries, including the US, China and nearly all of Western Europe.

13. Intellectual property

When acquiring a business, intellectual property rights may be important assets of that business. All the intellectual property rights referred to here can be assigned, licensed in whole or in part or have charges taken over them.

The following is an outline of the main intellectual property rights that are capable of protection in the UK. It does not cover European Community wide rights which have effect in the UK but are Community wide rights valid over the whole Community at once, such as Community trade marks, Community registered designs and Community unregistered design.

Patents

Nature of the right

To be patentable, an invention must:

- be new;
- involve an inventive step;
- be capable of industrial application; and
- not be specifically excluded by statute.

The patent holder can:

- enjoy exclusive use of the invention within the UK;
- prevent the unlicensed manufacture, use, importation or sale of the patented invention;
- develop a business based on the invention; and
- license the patent to another party.

How it is protected

Applications for registration can be made via the UK Intellectual Property Office or via the European Patent Office (where a centralised prosecution system operates from which the patent is then translated into a bundle of national rights). The Patents Acts 1977 (as amended by the Patents Act 2004) governs patent protection in the UK.

How it is enforced

UK and European (UK) patents are generally enforced through the UK courts. The main remedies the courts can grant are:

- permanent or interim injunctions;
- delivery of the infringing articles to the right owner; and
- damages or an account of profits.

Criminal sanctions are also available.

Length of protection

Subject to certain exceptions, protection lasts for a maximum of 20 years provided that renewal fees are paid annually from the fifth year after filing.

Trade marks

Nature of the right

To be registered as a trade mark, a sign must:

- be capable of graphical representation; and
- distinguish the goods or services of one undertaking from another.

The trade mark holder can:

- enjoy the exclusive right to use the trade mark in the UK;
- prevent others from using a mark which is the same as (or similar to) their mark; and
- assign or license the use of the mark to other parties.

How it is protected

Applications for registration must be made to the UK Intellectual Property Office. Unregistered marks can also be protected through a common law action for passing off. Community Trade Marks can be applied for through the European Office for Harmonisation in the Internal Market (OHIM).

How it is enforced

The Trade Marks Act 1994 sets out methods of enforcement. The enforcement procedure and the main remedies available are similar to those for patents.

Length of protection

Protection lasts indefinitely, subject to renewal every 10 years.

Registered designs

Nature of the right

To qualify for registration, a design must:

- be new;
- have individual character, and
- relate to the appearance of all or part of a product resulting from certain features of that product or its ornamentation.

The holder of a UK registered design can:

- enjoy the exclusive right in the UK to make, import, export, use or stock any product to which the design has been applied or in which it is incorporated;
- let others use the design;
- prevent others from using the design; and

- assign or license the right to other parties.

How it is protected

Applications for registration must be made to the UK Intellectual Property Office. The Registered Designs Act 1949 (as amended) sets out the rules on protection. A Community design right (for which the qualifications are slightly different) can also be applied for through the OHIM.

How it is enforced

The enforcement procedure and the main remedies available are similar to those for patents.

Length of protection

Protection lasts for a maximum of 25 years subject to renewal fees every five years.

Unregistered designs

Nature of the right

The design must:

- relate to an aspect of shape or configuration of the whole or part of an article; and
- not be commonplace.

The holder of a UK unregistered design can:

- enjoy the exclusive right to reproduce the design for commercial purposes by making articles to that design or by making a design document recording the design for the purpose of enabling the articles to be made;
- prevent others from infringing his right; or
- assign or license the right to other parties.

How it is protected

A design is automatically protected provided that it is recorded in a tangible form such as a diagram. It is also possible to have automatic protection under Community unregistered design (for which the qualifications are slightly different).

How it is enforced

The enforcement procedure and the main remedies available are similar to those for patents.

Length of protection

Protection lasts for a maximum of 15 years from the end of the year in which the design was created.

Copyright

Nature of the right

Copyright subsists in the following original works:

- literary (including software);

- drama;
- music;
- sound recordings;
- films;
- broadcasts; and
- cable programmes.

The owner of the copyright in a work has the exclusive right to do the following acts in the UK:

- copy the work;
- issue copies of the work to the public;
- rent or lend the work to the public;
- perform, show or play the work in public;
- communicate the work to the public; and
- make an adaptation of the work or do any of the above in relation to an adaptation.

The right holder has also the right to:

- be identified as the author or director of the work;
- object to derogatory treatment of the work;
- not have work falsely attributed to them;
- prevent others from infringing any of their rights; and
- assign or license the rights to other parties.

How it is protected

Protection subsists automatically when the work is created. The rules on protection are set out in the Copyright, Designs and Patents Act 1988.

How it is enforced

The enforcement procedure and the main remedies available are the same as those for patents, except that additional damages are also available for flagrant copyright infringement.

Length of protection

The length of protection depends on the work:

- literary, dramatic, musical and artistic works: 70 years after the author's death;
- films: 70 years after the death of the last surviving director, author of the screenplay, or composer of any music specifically created for the film;
- sound recordings: 50 years from the year of publication;
- broadcasts: 50 years from the first broadcast; and
- published editions: 25 years from the first publication.

Confidential information

Nature of the right

The right is based on common law principles. The information must be:

- confidential in nature; and
- communicated in circumstances importing an obligation of confidence.

The right holder can take legal action against any party who is under a duty of confidence to the right holder with regards to the confidential information.

How it is protected

A court action for breach of confidence would be based on breach of contract or equity.

How it is enforced

The same applies as for patents, except only damages are available.

Length of protection

There is no fixed term, although the information must remain confidential for it to be protected.

14. Marketing agreements

Standard commercial contracts that investors in the UK will need to become familiar with include distribution, franchising and agency arrangements, the regulation of which is discussed here.

Distribution

There are no specific regulations relating to distribution agreements in the UK, and so these arrangements are regulated by generally applicable law. Two areas are worth noting:

Product liability

Suppliers should be aware of the extent of their product liability under the Consumer Protection Act 1987. Essentially, a supplier may be liable to the ultimate consumer for the products it supplies to a distributor, despite having no direct contractual relationship with that consumer (see section 17 below).

Competition law issues

Parties entering into distribution arrangements should also be aware of competition law issues set out in the Chapter I prohibition of the Competition Act 1998 and Article 81 EC Treaty (where there is an effect on trade between member states), which prohibit anti-competitive agreements. The following restrictions will bring a distribution arrangement within the scope of these prohibitions and should therefore not be included:

- a restriction on the buyer's ability to determine its sale price (this does not affect the possibility of the supplier imposing a maximum sale price or recommending a sale price, provided these do not amount to a fixed or minimum sale price);
- absolute territorial restraints or restraints on resale to customers; and
- certain types of non-compete obligations and exclusivity for a duration of more than five years.

Franchising

There are no specific laws relating to franchising in the UK, and so the general law will apply. However, certain types of franchise which involve more than one tier of franchisees will be caught by the Trading Schemes Regulations 1997 and the Trading Schemes (Exclusions) Regulations 1997, both made under the Fair Trading Act 1973 (as amended by the Trading Schemes Act 1996). These regulations include/require:

- restrictions on the content of advertisements promoting trading schemes;
- the grant to new franchisees of a 14-day "cooling off" period prior to arrangements with franchisors becoming legally binding; and
- franchise agreements to include certain warnings.

Competition law issues

The competition law points mentioned above in relation to distribution arrangements will also apply to franchising arrangements.

European Code of Ethics for Franchising

There is also a European Code of Ethics for Franchising (the "ECEF") with which members of the British Franchise Association (and other bodies that are part of the European Franchise Federation) must comply. In the UK, membership of the British Franchise Association is voluntary; non-members are therefore not required to comply with the ECEF. In brief, the ECEF requires a franchisor (i) to have operated a pilot operation previously, (ii) to own all the brand names and trade marks associated with the franchise, and (iii) to provide initial and continuing training to franchisees.

Agency

Aside from generally applicable laws, the key specific regulations to be aware of when entering into agency agreements (in relation to goods) as part of business operations in Great Britain are the Commercial Agents (Council Directive) Regulations 1993 (the "Commercial Agents Regulations"). (Separate, but identical, regulations apply in Northern Ireland.)

Application

The Commercial Agents Regulations apply to arrangements involving a "self-employed intermediary" with "continuing authority to negotiate" the sale or purchase of goods on behalf of and in the name of a principal. (Note that there is a very wide interpretation of "negotiate", and the agent does not, for example, have to have authority to vary the price or other contract terms.) For the Commercial Agents Regulations to apply, the agent's activities must be undertaken in Great Britain, or the agency agreement must be governed by English law (if the activities are to be undertaken elsewhere in the EEA, and the corresponding regulations in that member state permit the parties to agree that the law of another member state can apply to the agency agreement).

The Commercial Agents Regulations will not apply if the parties have agreed that the agency agreement will be governed by the law of another EEA member state, but the corresponding regulations of that state will apply. The Commercial Agents Regulations may also apply even if the principal is outside the EEA and the parties have chosen the law of a non-EEA state. Activities undertaken outside the EEA are very unlikely to be caught by the Commercial Agents Regulations, even if the contract is governed by English law. The Commercial Agents Regulations do not apply in certain circumstances (eg, where the agent's activities are considered "secondary"), and so specific legal advice should be sought.

Effect

The Commercial Agents Regulations prescribe minimum terms which will apply to all agency agreements, in relation to notice periods, timing for payment of commission and agents' rights to information, for example. A key provision is the right of an agent to whom the Commercial Agents Regulations apply to compensation or an indemnity from the principal on expiry/termination of the agreement. If the agreement is silent, compensation rather than indemnity will apply. It is advisable to seek specific advice in this area, as different considerations apply to each of the compensation and indemnity amounts, and the level of an agent's entitlement in this regard.

Competition law issues

The Chapter I prohibition and Article 81 provisions referred to in the section on distribution above do not apply to agency agreements where one party (principal) appoints another (agent)

as a negotiator on behalf of the principal for the purchase or supply of goods or services. Whether or not an arrangement is a true agency arrangement for the purpose of competition law is a matter of substance, not form. A determining factor in assessing the agency arrangement is the level of financial or commercial risk assumed by the agent. An agency will fall outside these competition provisions if the agent bears no, or only insignificant, risks. The question of risk is determined on a case by case basis and with respect to the "economic reality" of the circumstances rather than any specific legal form.

15. E-commerce

Another regulated commercial activity in the UK that investors will need to be aware of is electronic commerce, whether it is via computer, mobile phone or other electronic device. Key regulatory issues are set out below.

Laws regulating e-commerce

- **Information provision** – suppliers must provide certain basic information to all users. Further information must be provided if the user is a consumer and is buying goods and services. The supply of financial services is regulated separately.
- **Contracting online** – in the UK contracts formed online are valid. Legislation also provides that electronic signatures are admissible as evidence of the authenticity of an electronic communication.
- **Consumer protection** – regardless of whether the supplier is located inside or outside the UK if it is selling to UK consumers it will need to comply with the mandatory UK consumer protection legislation. These laws will automatically insert into the contract warranties as to the quality of the goods and services and will also require that the contract terms satisfy a “fairness” test. They also reduce the supplier’s ability to limit or exclude liability. It is not possible to override the mandatory laws merely by including contract terms that specify that the laws (and courts) of the supplier’s home country will apply.
- **Cancellation rights** – consumers buying goods online or via any other distance sales method have a “cooling off” period in which they have the right to cancel even when there is no fault in the goods or services.
- **Marketing** – strict rules govern the sending of marketing material to customers via phone, fax or e-mail. The use of tracking software (eg, cookies) to monitor the customer’s online activity is also regulated.
- **Liability of intermediaries** – intermediaries (eg, ISPs (internet service providers) and hosting companies) are given statutory protection for the information they transmit, cache or host provided certain conditions are satisfied.
- **Broadcasting** – if the supplier is broadcasting (eg, streaming audio or video) it may also need to comply with aspects of the UK’s broadcasting regulatory regime.
- **Defamatory or obscene material** – the operator of a website can be held liable in the UK for any defamatory or obscene material on that website.

16. Privacy and data protection

The data protection rules that derive from the Data Protection Act 1998 and other legislation are an important part of everyday work in the UK. Further explanation is set out below.

Data protection and privacy laws

Privacy rights are governed by:

- the Human Rights Act 1998 (HRA), in particular the right to respect for private and family life (Article 8 of the European Convention on Human Rights, as enacted by the HRA);
- a developing common law of personal privacy (described as the tort of "misuse of private information" per Nicholls LJ in *Campbell v MGN Ltd*);
- The Data Protection Act 1998 (DPA);
- The Freedom of Information Act 2000 (FOIA); and
- The Privacy and Electronic Communications (EC Directive) Regulations 2003 (Privacy Regulations).

The DPA regulates the processing of personal data, which is data relating to living individuals who can be identified from the data. It requires that a data controller:

- notifies the Information Commissioner's Office describing the data it processes and the purposes of such processing (breach of the notification requirements is a criminal offence);
- complies with the eight Data Protection Principles set out in Schedule 1 of the DPA, which include (i) ensuring that data is up to date, accurate and secure, and that data is processed fairly and lawfully and (ii) observing restrictions on transferring personal data outside the European Economic Area.

In practice, every company or other organisation in the UK will be a data controller and therefore needs to notify and comply with the other requirements of the DPA.

There are additional conditions for processing "sensitive personal data" (such as data relating to race, political opinions and criminal records).

Within 40 days of a written request from a data subject, the data controller must identify, and provide a copy of, the data held, the purposes of processing the data and to whom the data may be disclosed. The data controller can charge up to GB£10 (about US$19) to deal with the request. Limited exemptions from the so-called "subject access right" apply. Data subjects also have the right, among other things, to:

- prevent processing for marketing purposes;
- have inaccurate data rectified or destroyed; and
- sue a data controller for compensation for damages caused by its breach of the DPA.

The Privacy Regulations govern the use of personal data in commercial communications by "electronic mail", which includes fax, telephone and e-mail. They also regulate the use of location data and govern the use of "cookies". A "cookie" is a small text file containing a

unique identifier (eg, a large number) assigned by a website. The cookie is deposited on the hard drive of the website visitor's computer when he accesses the site. At its simplest, a cookie enables a website to "recognise" a repeat visitor whatever the IP address.

The FOIA gives any person access to information held by public authorities (including personal data of individuals other than the applicant) and sets out the procedure to be followed.

17. Product liability

On acquiring any manufacturing business the law relating to product liability is key. There are three categories of liability in English law to which the manufacturer or seller of a product may be exposed. These are liability for breach of contract where liability is based upon the terms of any relevant contract of sale or supply; liability for breach of a general duty of care where liability is based upon fault; and liability pursuant to the Consumer Protection Act 1987 (the "1987 Act") which imposes a strict liability regime upon parties in the production and distribution chain.

Contract

A contract for sale or supply of a product may give rise to liability in a number of ways:

Express terms

The contract may include express terms (orally or in writing) that make promises as to some feature or characteristic of the product. The express terms may promise various remedies, for example the right to repair, replacement or refund. In addition, promises as to the products and/or the remedies available may appear in a guarantee or "extended warranty" contract between the buyer and the seller/supplier or manufacturer. These can exist alongside the main contract of sale/supply.

Implied terms

Terms are implied into contracts for the sale of products by statute. The Sale of Goods Act 1979 (as amended) and the Supply of Goods and Services Act 1982 (as amended) imply terms as to the description, quality and fitness for a particular purpose of products and arise in all contracts of sale/supply. The implied term that products will correspond with their description applies to all contracts of sale/supply regardless of the status of the parties involved whereas the implied terms that products are of satisfactory quality (ie, they meet the standard that a reasonable person would regard as satisfactory) and are fit for any purpose made known to the seller apply only to those who sell/supply in the course of business. The implied terms impose strict liability in that the buyer does not need to establish fault on the part of the seller, merely that the products were not as described, of satisfactory quality or fit for their purpose.

Pre-contractual statements

A statement made prior to the conclusion of the contract of sale/supply which relates to the characteristics, qualities or some other feature of the product can give rise to a number of legal consequences which may expose the maker of the statement to liability regarding the product. In the law of contract, such statements may be incorporated as a term of the main contract of sale/supply, or form the basis of a separate contract between the buyer and the seller/supplier or between the buyer and a third party which is collateral to the main contract of sale/supply.

Compensation may be available following any breach of contract as follows:

Damages

For any breach of contract, the buyer will be able to claim damages (intended to put the buyer in the position in which they would have been had the contract been properly performed). In

certain situations (where any of the implied terms described above have been breached, where the contract expressly provides or where a term has been breached which deprives the buyer of substantially the whole benefit of the contract), they will have the right to reject the goods and terminate the contract. With a contract of sale, the buyer may waive this right should he "accept" the goods. Acceptance in this sense occurs when the buyer intimates to the seller, either expressly or impliedly, that they have accepted the goods, or does any act inconsistent with the ownership of the seller.

Exclusion and limitation of liability

The rights and remedies provided by the contract-based regime are also affected by various rules on the exclusion and limitation of liability, the most important of which are contained in the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contracts Regulations 1999. UCTA creates a test of "reasonableness" which must be satisfied by any clause in a contract for sale or supply which purports to exclude or limit liability for breach of express terms. Liability cannot, under any circumstances, be excluded or limited in respect of a breach of an implied term where the buyer of the goods or services is a consumer.

Tort

The general principle

The liability of a product manufacturer under the English law of tort is fault-based. Indeed it was in the landmark decision of *Donoghue v Stevenson [1932] AC 562*, in which Mrs Donoghue discovered a decomposing snail in her bottle of ginger beer, that the House of Lords first articulated the general principle that a manufacturer of products which are sold in such a form as to show that they intend them to reach the ultimate consumer in the form in which they left them with no reasonable possibility of intermediate examination, and with the knowledge that the absence of reasonable care in the preparation of the products will result in an injury to the consumer or their property, owes a duty to the consumer to take reasonable care. That general principle underpins the basis of the modern English law of negligence.

Test for liability in the tort of negligence

As liability in negligence is based on fault, the injured party has the burden of proving:

- that the manufacturer owed them a duty of care;
- that the duty was breached (ie, that the manufacturer was at fault because their conduct fell below the required standard of care); and
- that the breach caused the damage suffered and that the damage was, or ought to have been, foreseeable at the time of the breach.

Duty of care

The principle established in *Donoghue* imposes a duty of care on manufacturers of defective products, which includes anyone directly involved in the manufacture of the product (held in subsequent cases to include assemblers, repairers and inspectors). The "neighbour principle" formulated in this case established that the manufacturer owed a duty of care to "those persons who are so closely and directly affected" by the manufacturer's acts that they "ought reasonably to have them in contemplation as being so affected" when carrying out their business.

Standard of care

The standard of care expected of a manufacturer is tested objectively. A manufacturer will be negligent if they have failed to act as a reasonable person (possessing the same skills) would have acted. If a particular danger could not reasonably have been anticipated then the manufacturer will not be at fault.

Compensation may be available following any breach of duty of care in tort as follows:

Damage

For any breach of duty of care in tort, the buyer will be able to claim damages (intended to put the buyer back in the position in which they would have been in before the tort was committed; ie, as if there has been no breach of the duty of care).

Actions in contract versus actions in tort

There are a number of advantages in the injured party pursuing a claim in contract. In contrast to a negligence claim, there is no need to establish a duty of care or a breach of this duty. In most cases there is strict liability. The buyer can recover loss caused by the product simply not being worth what it would have been had it conformed to the contract and the defences open to the manufacturer under the 1987 Act (discussed below) are not available in a claim in contract. However, in many cases the immediate supplier to the consumer may not have the wherewithal to pay a claim in which event the contractual claim will be of little value. Before the coming into force of the 1987 Act, the only alternative was to claim against someone further up the contractual chain, usually the manufacturer, alleging breach of a duty of care (ie, tort).

Consumer Protection Act 1987

Since 1987 the UK, in common with all EC Member States, has imposed a strict liability regime on certain parties in the manufacture and supply chain in respect of claims by consumers who have suffered damage caused by a defective product. The European Council Directive 85/374/EEC was implemented in the UK under Part 1 of the 1987 Act. The 1987 Act only applies to products supplied after 1 March 1988.

Strict liability regime

Section 2(1) of the 1987 Act imposes liability “where any damage is caused wholly or partly by a defect in a product”. This is strict liability in that the defect need not have resulted from another party’s negligence. However, there is still the requirement for the party suffering damage to prove a causal connection between the defect and the damage.

Test for liability

Liability under the 1987 Act only exists where something within the 1987 Act’s definition of a “product” contains a defect which causes damage. Section 1(2) defines “product” as “any goods or electricity used and... includes a product which is comprised in another product, whether by virtue of being a component part or raw material or otherwise”. “Goods” are given a wide definition under the 1987 Act.

Who is liable

The 1987 Act selects, on policy grounds, those links in the production and distribution chain that should be liable. By section 2(2) liability is imposed upon the producer (which includes, most simply, the manufacturer), importer into the European Community (EC) (which gives consumers the advantage of having a target defendant within the EC) and "own-branders" (which includes any entity which puts its name, trade mark or other distinguishing feature to a product and, as a result, holds itself out as being the producer). Liability is also imposed upon suppliers, although there exists a defence should the supplier reveal to the consumer the identity of the producer or importer.

Defect

There must be a defect in the product if there is to be liability under the 1987 Act. "Defect" is defined by section 3(1) as existing when "the safety of the product is not such as persons generally are entitled to expect" and the 1987 Act includes a list of circumstances to be taken into account in determining such expectations. These include the way in which the product has been marketed, any instructions for the use of the product, any warnings provided, to what use the product may reasonably be expected to be put and the time the product was supplied.

Defences

Section 4 of the 1987 Act lists six specific defences to the strict liability imposed by the 1987 Act. These defences exist where: the defect is attributable to compliance with any mandatory rules imposed within the EC; the person proceeded against did not at any time supply the product to another; the supply of the defective product was between two persons not engaged in a course of business; the defect did not exist in the product at the relevant time; the state of scientific and technological knowledge at the relevant time was not such that the producer of the product might have been expected to discover the defect; and the defect arose because of the way a component part was used in the final product. The burden (on the balance of probabilities) of establishing any of these defences rests upon the defendant.

1987 Act versus actions in tort of negligence

An action in negligence can still prove to be an important route for an injured party despite the advent of the 1987 Act. It may be in the injured party's interests to bring a negligence action in addition to an action under the 1987 Act, since the 1987 Act contains specific defences that are not available to the manufacturer in negligence.

18. Money laundering

In the last 10 years, the UK anti-money laundering regime has expanded to regulate systems and controls in various sectors with a view to deterring criminal activity. Its impact is wide and needs to be considered carefully.

The anti-money laundering regime

The UK's anti-money laundering regime is designed to assist the UK authorities to detect, disrupt and deter money laundering and the underlying criminal activity by requiring higher standards of due diligence across the regulated sector. It can be divided into three elements: the substantive law criminalising involvement in money laundering and imposing obligations to report; the administrative requirements which require firms to have procedures to forestall money laundering, and the regulatory requirements which impose additional obligations to have systems and controls to prevent money laundering.

Substantive law

Proceeds of Crime Act 2002 ("POCA")

- There are three principal money laundering offences under POCA which apply to anyone (whether in or outside the regulated sector) who may be involved in the laundering of any funds derived from any criminal conduct, no matter how minor:
  - concealing, disguising, converting or removing criminal property from the jurisdiction;
  - engaging in an arrangement which facilitates the acquisition, retention, use or control of criminal property; or
  - acquiring, using or possessing criminal property.
- To prevent the commission of an offence, a person is under a legal duty to report the suspected money laundering and seek consent from a constable for any affected transactions.
- In addition, businesses in the regulated sector are obliged to report where they know, suspect or have reasonable grounds to suspect that another is engaged in money laundering and that suspicion or knowledge is based on information which has come to them in the course of their regulated business. This obligation is wide and can require reports about third parties, clients, customers and any others involved in money laundering. It is a criminal offence to fail to report.
- A disclosure report can be made to a police officer, a customs officer or, where there is a Money Laundering Reporting Officer (MLRO), to the MLRO who will then decide whether to make a disclosure report to the Serious Organised Crime Agency ("SOCA") which is responsible for receiving and analysing suspicious activity reports and has wide investigative and compulsory powers.
- It is also an offence to tip off a suspected money launderer or prejudice an investigation.
- The penalties for committing an offence under POCA range from a maximum of between five and 14 years imprisonment and/or an unlimited fine.

Terrorism Act 2000

- Prohibits all forms of terrorist financing and fund raising as well as laundering the proceeds of terrorist activity.
- Those within the regulated sector must make a report if they know or suspect, or have reasonable grounds for knowing or suspecting, that an offence has been committed. However, persons outside of the regulated sector must also make a report as soon as is reasonably practicable if they come across information in the course of their trade, profession, business or employment, which causes that person to believe or know that another person is engaged in terrorist money laundering.
- The penalty for not making a disclosure is up to five years' imprisonment and/or an unlimited fine.

Other applicable legislation

- There are a number of statutory instruments which make it an offence to provide financial services to individuals on prescribed lists which are published by, *inter alia*, the Bank of England.

Regulatory requirements

Financial Services Authority ("FSA")

- For those it regulates, the FSA polices compliance with the Regulations and has the power to levy large fines for non-compliance.
- The FSA requires that a range of high level systems and controls be maintained by firms to prevent money laundering including:
  - arrangements to enable a firm to identify, assess, monitor and manage money laundering risk;
  - regular assessments of the adequacy of the systems and controls;
  - the appointment of an MLRO; and
  - the allocation of overall responsibility within the firm for the establishment and maintenance of effective anti-money laundering systems and controls to a director or senior manager.
- Other regulators are responsible for supervising other sectors' compliance with the Money Laundering Regulations 2003 and may impose additional regulatory obligations.

Administrative requirements

Money Laundering Regulations 2003 (the "Regulations")

- These require businesses which conduct "relevant financial business" to maintain systems and controls to detect and prevent money laundering including:
  - systems and training for employees involved in recognising and dealing with transactions that may involve money laundering;
  - customer identification procedures. These require documentary evidence to be obtained so that the business can satisfy itself of the identity of the proposed customer

(for example, passports for individuals and certificates of incorporation and other documents for corporates);

- record-keeping procedures (relating to all customer identification obtained and all transactions carried out); and
- internal reporting procedures (including the appointment of a nominated money laundering reporting officer ("MLRO")).

- "Relevant financial business" is defined widely and a non-exhaustive list includes almost every kind of banking and financial services business, external accountants, lawyers, auditors, casino operators, estate agents and dealers in high value goods. Such relevant business need not be the principal activity of the institution or firm.
- Contravention of the Regulations is an offence punishable on conviction up to a maximum of two years' imprisonment and/or a fine.

19. Litigation

On acquiring a business or company in the UK, there may be continuing litigation involving that business or company which will need to be considered at the time of acquisition. Similarly during the course of running a business, litigation may occur from time to time and prove to be a costly and time-consuming matter.

Court system

The structure of the civil court system

Civil proceedings in England and Wales are conducted in the county courts or in the High Court.

There are over 200 county courts in England and Wales, each exercising its powers for a limited geographical area. If the value of a claim is below £15,000, the claim must be started in the county court. If the value of the claim exceeds £15,000 it can be started in the county court or in the High Court.

The High Court has three divisions:

- The Queen's Bench Division;
- The Chancery Division; and
- The Family Division.

The Queen's Bench Division deals with most claims in contract and in tort. The Chancery Division deals with cases involving land, mortgages, execution of trusts, administration of estates, bankruptcy, partnerships and deeds, as well as actions in contract and tort. There are also a number of specialist courts, including the Commercial Court.

The Court of Appeal (Civil Division) hears appeals from the county courts and the High Court. The House of Lords hears appeals from the Court of Appeal (and sometimes directly from the High Court). The House of Lords is to be replaced by a new Supreme Court for the UK which is likely to be operational from October 2009.

The Judicial Committee of the Privy Council is a final Court of Appeal for a number of Commonwealth countries.

Judges and juries

The role of the judge and, where applicable, the jury in civil proceedings

Civil cases are, generally, heard at first instance by a single judge. Exceptions include claims in respect of libel, slander, malicious prosecution or false imprisonment. In these cases, there is a right to trial by jury.

While the introduction of the Civil Procedure Rules (CPR) in 1999 has, to some extent, altered the role of the judge in civil proceedings – encouraging the court to take a more interventionist management role – the civil justice system remains adversarial and the judge's role during trial remains passive rather than inquisitorial.

Limitation issues – The time limits for bringing civil claims

Most limitation periods are laid down by the Limitation Act 1980. The basic rule for actions based on contract or tort is that the claimant has six years from the date of the cause of action to commence proceedings. In contract, time runs from the breach of contract. In tort, unless the tort is actionable without proof of damage, the cause of action accrues when damage occurs.

The limitation period for a claim under a deed (ie, a document under seal) is 12 years from breach.

Time does not run where any fact relevant to the claim has been deliberately concealed by the defendant until the concealment is discovered or with reasonable diligence could have been discovered.

There are plans to introduce new legislation relating to time limits for bringing claims in an attempt to streamline the rules by way of a single, core limitation regime.

The life of a case

Pre-action behaviour

Pre-action protocols outline the steps that parties should take to seek information from and to provide information to each other about a prospective legal claim. Their purpose is to encourage the exchange of early and full information about the prospective legal claim, to enable parties to avoid litigation by agreeing a settlement of the claim before the commencement of proceedings and to support the efficient management of proceedings where litigation cannot be avoided.

In addition, under the CPR, a party may apply to the court for disclosure of documents before proceedings have started from a party who is likely to be a party to proceedings.

An extra weapon in the claimant's armoury is the Norwich Pharmacal order. Such an order can be sought where the claimant has a cause of action but does not know the identity of the persons who should be named as defendants. The court may order a third party who has been involved in the wrongdoing, even if innocently, to disclose the identity of the defendant(s) or provide information to assist the claimant in bringing the claim.

Starting proceedings

Proceedings are commenced by the issue of a claim form which is lodged with the court and served on the other parties.

The claim form provides details of the amount that the claimant expects to recover, full details of the parties and details of the claim (which may be set out either in the claim form itself or in a separate document called the particulars of claim). A claim form must be verified by a statement of truth which is a statement that the party presenting the document believes that the facts stated in it are true. A fee is payable, based on the value of the claim.

Timetable

If the defendant wishes to dispute the claim, they must serve a defence. The timetable for service of a defence is capable of being extended by agreement between the parties or by application to the court. In most cases, the defendant has at least 28 days from service of the particulars of claim to serve their defence.

A case management conference (CMC) generally follows where the court makes directions as to the steps to be taken up to trial, including the exchange of evidence (documentary disclosure, witness statements and expert reports). The court will fix the trial date or the period in which the trial is to take place as soon as is practicable.

Cases can come to trial as quickly as six months from issue. Often, however, they will take between one and two years, and sometimes longer.

Case management (control of the case)

Under the CPR, case management has effectively shifted from the parties to the judge, who now enjoys considerable powers, including control over the issues on which evidence is permitted and the way in which evidence is to be put before the court. Nevertheless, there is some scope for the parties to vary by agreement the directions made by the court, provided that the variation does not affect any key dates (ie, the date of the pre-trial review or the trial itself).

Evidence

Disclosure of documents will usually be ordered by the court when making directions at the CMC.

Privilege

A document is subject to legal professional privilege (and does not need to be shown to the other parties) if it falls into one of two principal categories:

- **Legal advice privilege:** communications between client and lawyer for the purpose of giving legal advice. Lawyers include in-house and foreign lawyers, provided they are acting as lawyers and not employees/executives performing a business role.
- **Litigation privilege:** this applies to communications between client and lawyer or between either of them and a third party for the dominant purpose of giving or receiving advice in relation to litigation or collecting evidence for use in litigation. The litigation must be pending or in reasonable contemplation.

Witness evidence

At the CMC, the court will ordinarily also make directions for exchange of written statements of factual and expert witnesses on whose evidence the party wishes to rely. Under the CPR, parties are encouraged to use a single joint expert.

Evidence for pre-trial hearings is almost always provided in writing. However, factual and expert witnesses will generally be called to give oral evidence at trial.

Interim remedies

The court has wide powers to grant parties to an action various interim remedies (remedies available during the course of proceedings before the trial or final outcome) including interim injunctions, freezing injunctions, search orders, specific disclosure and payments into court.

Usually English courts will only make orders relating to property within the jurisdiction. However, in exceptional circumstances, the English court will make a worldwide freezing injunction. Also, English courts may grant interim relief (typically freezing injunctions) in aid of legal proceedings anywhere in the world.

Remedies

Common remedies awarded by the courts are damages (although the object is to compensate the claimant rather than punish the defendant which is usually done by costs penalties), declarations, injunctions (mandatory or prohibitory), specific performance (a form of mandatory injunction) or orders for the sale, mortgaging, exchange or partition of land. Interest may be payable on money judgments.

Enforcement

The following are the principal means of enforcement:

- execution by writ of fieri facias in the High Court or a warrant of execution in the county court, whereby the sheriff or bailiff has authority to seize and sell the debtor's property;
- third-party debt orders (or garnishee proceedings) which operate to stop funds reaching the debtor from a third party by redirecting them instead to the creditor;
- charging orders over land or securities; and
- if a company is unable to pay its debts, insolvency proceedings. Insolvency proceedings can include petitioning the court for the appointment of a liquidator, whose principal duty will be to realise the assets of the company and distribute them to those entitled. Alternatively, other insolvency procedures are available (such as administration), which may result in, but do not have as their primary objective, the liquidation of the company.

Costs

The court has discretion whether or not to order that costs are payable by one party to the other, the amount of the costs, and when they are to be paid. However, usually in litigation, the winning party will recover some or most of its costs from the losing party.

Fee arrangements

English law permits conditional fee agreements in relation to civil litigation matters whereby the client's solicitor receives lower payment or no payment if the case is lost, but normal or higher than normal payment if the client is successful. However, for conditional fee agreements to be enforceable, certain formalities must be followed. The success fee must represent an uplift of fees charged (rather than a percentage of the damages secured) and such uplift cannot exceed 100% of the normal rate. These arrangements are highly unusual in commercial cases.

In respect of civil litigation in England and Wales, a success fee that is directly attributable to the amount of damages recovered by a client remains unenforceable.

Third party funding remains rare. A third party may fund litigation in return for a share of the proceeds of the claim, if successful. If the claim fails, the third party may be liable for the successful defendant's legal costs.

Such arrangements are upheld provided that they are not contrary to public policy. The case law in this area is developing but still leaves scope for uncertainty.

Insurance is also available for litigation costs. There are two types:

- **"Before the event" (BTE) policies:** legal expenses insurance policies which are typically taken out with an annual premium. They are not usually relevant for major commercial litigation.
- **"After the event" (ATE) policies:** such policies typically cover a party's disbursements (eg, counsel and expert fees) and the risk of paying an opponent's legal fees if the insured is unsuccessful in the litigation. They may cover the insured's own legal expenses, although this is less common.

Appeals

An unsuccessful party may appeal from the county court to the High Court, from the High Court to the Court of Appeal, and from the Court of Appeal to the House of Lords.

Permission to appeal is generally required either from the lower court at the hearing at which the decision to be appealed was made or from the appeal court. For permission to be given, the appeal must have a real prospect of success or there must be some other compelling reason for the appeal to be heard. The appeal court will not allow an appeal unless it considers that the decision of the lower court was wrong or it was unjust because of a serious procedural or other irregularity in the proceedings.

Foreign judgments

The procedure for enforcing a foreign judgment in England depends on the arrangements which have been made with the foreign country in question. Where there are no arrangements in place (such as in relation to the United States and China), enforcement of judgments of the courts of these countries is covered by common law.

20. Arbitration

Arbitration is an increasingly important alternative to litigation in the English courts.

Arbitration – an explanation

UNCITRAL Model Law

The Arbitration Act 1996 reflects in many respects the provisions of the UNCITRAL Model Law.

There is no longer any major distinction between domestic and international arbitrations.

Arbitration agreements – formal requirements

Under the Arbitration Act 1996, consistent with the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), there must be an agreement in writing to submit present or future disputes (whether contractual or not) to arbitration. The term "agreement in writing" has a very wide meaning, for example the agreement can be found in an exchange of communications.

Courts in England will stay litigation proceedings in favour of arbitration if there is *prima facie* evidence of an arbitration agreement between the parties. Moreover, courts may grant an injunction to prevent parties from pursuing litigation proceedings in foreign courts in breach of an arbitration agreement (although whether this power is available regarding proceedings in the courts of European Union member states is currently being considered by the European Court of Justice – see *West Tankers Inc v RAS Riunione Adriatica di Sicurta SpA [2007] All ER (D) 249*).

Oral arbitration agreements are recognised by English law but fall outside the scope of the Arbitration Act 1996 and the New York Convention.

Choice of arbitrator

If there is no agreement as to the number of arbitrators, the tribunal shall consist of a sole arbitrator. In the absence of agreement, one party may serve a written request on the other to make a joint appointment.

A party may challenge an arbitrator if there are justifiable grounds as to their impartiality. If they do not have the necessary qualifications, is physically or mentally incapable or have failed to properly conduct the proceedings, a challenge can be made to court (provided it is not institutional arbitration) to have them removed. Pending the outcome of such an application, the tribunal can proceed with the arbitration and make an award.

Procedure

As party autonomy is the overriding objective of the law, it is up to the parties to select the rules of procedure that will govern the arbitration. However, if no express provision is made in the arbitration agreement, it is for the arbitrator to decide procedural and evidential matters. The tribunal is at all times bound by the mandatory provisions of due process and to act fairly and impartially between the parties.

Court intervention

The court's role is strictly supportive and there is minimal intervention by domestic courts in the arbitral process.

However, the court may provide assistance in certain procedural matters and has powers to order interim measures in certain circumstances. The majority of the court's powers can be excluded by the parties by agreement.

Interim relief

The parties may agree the powers the tribunal should have to grant interim orders. However, unless the parties have agreed otherwise, the tribunal has powers relating to security for costs and preservation of property and evidence. The tribunal can, for example, order freezing injunctions and interim mandatory injunctions.

If the parties have expressly agreed in writing, the tribunal has power to order provisional relief, eg, payment of money or disposal of property. Provisional relief is subject to the final decision of the tribunal on the case.

Award

Generally the tribunal may make its award at any time, unless otherwise agreed by the parties in writing. The tribunal must, however, produce its award promptly after the conclusion of the hearing.

As to the form of award, if this is not agreed between the parties, it should be in writing, signed by all the arbitrators, generally it should contain the reasons for the award (unless the parties agree otherwise) and it should state the seat of the arbitration and the date it is made.

Appeals

There are limited grounds for an appeal of an award to the court.

A party may challenge an award on the grounds of the tribunal's lack of jurisdiction or because of a serious irregularity in the proceedings that has caused substantial injustice to the aggrieved party. This test is quite onerous and an award will only be set aside in rare cases. Neither of these provisions may be excluded by agreement between the parties. These mandatory provisions are listed in Schedule 1 of the Arbitration Act 1996.

In limited circumstances, a party may also challenge an award on a point of law. Only appeals on English law are permitted. An appeal on a point of law requires the agreement of all the other parties to the proceedings or the leave of the court. Parties may exclude the right to appeal to the court on any question of law arising out of the award. An agreement that the arbitrator need not give reasons for his decision is treated as an agreement to exclude this right of appeal.

There is no right to appeal to the court on a question of fact.

Enforcement

The winning party to an award made in England may apply to the court for permission to enforce the award as if it were a court judgment.

Awards made in a contracting state to the New York Convention (such as an award made in China) will be recognised and enforced in England and Wales subject to the limited exceptions set out in the Arbitration Act 1996. Awards made in other countries may also be recognised and enforced in England and Wales.

Costs

Unless agreed to the contrary, the arbitrator can order one party to pay the costs of the arbitration. The general principle is that the loser pays the costs, which include the arbitrator's fee. However, this is at the discretion of the arbitrator who will take into account all the circumstances of the case, including the conduct of the parties during the arbitration. Any pre-agreement that one party should pay the costs of an arbitration is only valid if made after the dispute has arisen.

21. Alternative dispute resolution

Alternative dispute resolution is a term used to describe a range of processes outside of traditional litigation or arbitration which can be used to resolve disputes quickly, confidentially and economically. In recent years the courts have strongly encouraged the parties to litigation to attempt to resolve their disputes before reverting to the courts themselves.

The requirement to consider alternative dispute resolution (ADR)

English courts will not force a party to engage in ADR if it is unwilling to do so. However, under the Civil Procedure Rules the pre-action protocols which prescribe steps to be taken prior to the commencement of proceedings oblige prospective litigants to consider the use of ADR. Once proceedings are commenced, the court's duty of active case management includes encouraging the parties to use ADR if considered appropriate, and facilitating the use of ADR (sometimes through the use of court orders providing for a stay of proceedings while the parties attempt ADR). The courts may also penalise a party in costs if it has unreasonably refused to attempt ADR although the burden of proof is on the losing party (who will usually be required to pay the winning party's costs of the litigation) to demonstrate that the winning party was unreasonable in its refusal.

In arbitration, a tribunal would require nothing more than evidence that the parties had complied with any contractual agreement to negotiate or mediate before referring a dispute to arbitration. Multi-tiered clauses are common.

The types of ADR process commonly used

Mediation: This is by far the most common method and is a consensual and confidential process in which a neutral third party, who has no decision-making power, helps the parties to reach a negotiated agreement.

Early neutral evaluation: This is where a neutral third party gives a preliminary, non-binding assessment of facts, evidence or legal merits.

Expert determination: This is where a neutral third party, acting as an expert rather than judge or arbitrator, is appointed to decide the dispute with no right of appeal.

Adjudication: This is a statutory right to adjudication for disputes that arise during the course of a construction project. The adjudicator's decision is binding unless or until the dispute is finally determined through the courts or arbitration proceedings, or by agreement of the parties.

22. Acquiring and investing in property

There are three separate legal systems which operate in relation to property in the UK. The English legal system, the subject of this commentary, relates to property situate in England and Wales. Separate legal systems apply to property situate in Scotland and Northern Ireland.

Acquisition of UK property by foreign investors

There are no restrictions on foreign nationals acquiring property in the UK. Property can be purchased or rented/leased by individuals or companies for their own use or as an investment, subject only to tax rules referred to below and in section 12 above. There are a number of structures which can be used to invest in property such as property companies, partnerships and joint venture vehicles. Since 1 January 2007 real estate investment trusts (REITs) have been available.

Types of property interests and ownership

All land has been owned by the Crown since 1066 and all estates in land are held from the Crown. The Law of Property Act 1925 ("the LPA") established that only two forms of legal estate in land can exist namely:

- **A freehold estate.** Although the Crown technically owns all land a freehold is thought of as absolute ownership. A freehold estate is held in perpetuity and extends from the centre of the earth up to the sky (although in practice this is curtailed by planning and aviation law). An investor may prefer to own a freehold as this gives total control over the property and enables the grant of leases of the property to secure an income stream.
- **A leasehold estate.** This is an interest for a term of years absolute, that is, land held for a limited time. It will be an estate held by a tenant under a lease. This will be carved out of a freehold or superior leasehold estate. See below.

It is possible to divide the "legal" interest from the "beneficial" interest. The legal title holder is the paper owner who is registered at the Land Registry or who is the legal owner on the title deeds, and the beneficial owner is the person who is entitled to the economic interest in the property and enjoys the income.

The Commonhold and Leasehold Reform Act 2002 introduced a new form of freehold tenure known as commonhold. Under commonhold, each separate piece of real estate within a commonhold building is a unit and each owner a unit holder. The unit holders together form a commonhold association (a private company limited by a guarantor which owns the registered freehold estate and the commonhold land and manages the common parts).

Leases

A lease is a contract between a landlord and tenant which grants the tenant a leasehold estate. The term of the lease must be certain (ie, it must be either for a fixed term or be capable of being brought to an end by notice). It is also vital that the tenant is given exclusive possession of the premises in question, otherwise they will not obtain a leasehold estate but merely a personal licence. This is important not only in terms of whether third parties will be obliged to recognise the tenant's rights, but also because legislation confers certain, very significant benefits to tenants, but not to licensees. There are two main types of lease:

- **The ground lease:** this is a long lease (usually 99 years or more) granted in return for a capital sum paid, with a nominal rent payable throughout the rest of the term. A ground lease is more akin to a freehold, having a capital value and being capable of being used as security to raise funding.
- **The rack rent lease:** this is the standard commercial occupational lease. The tenant pays a full market rent, usually with no premium. The landlord will effectively transfer all liabilities to the tenant either directly (eg, by a repairing obligation in the lease) or indirectly (eg, by requiring the tenant to reimburse the landlord for the cost of insuring the building). This is known as a full insuring and repairing lease ("FRI lease"). Where a property is let to a number of different tenants the landlord will retain responsibility in relation to the structure and the common parts of the building. However, they will recharge all their costs to the tenant via a service charge. Rack rented leases are usually granted for terms of up to about 25 years, although 10 to 15 years and shorter terms are currently the norm. Short term leases are often called tenancies.

Security of tenure

The Landlord & Tenant Act 1954 gives a business tenant the right to renew his lease at the end of the term (the intention being to protect the goodwill that the tenant will have built up at the premises while they have been in occupation), and rights to compensation. At the expiry of the lease (subject to serving a requisite notice within strict time limits) the tenant has an automatic right to renew the lease on substantially the same terms as the original lease, subject to a review of the rent and the length of the term. The landlord can only object to the request for a new lease in limited circumstances such as if it requires occupation of the premises for its own use, or wishes to redevelop the property.

The parties can agree to exclude the tenant's right to a new lease which is known as contracting out and this is common. This is achieved by way of prescribed notices being served by each party on the other before the parties become contractually bound. If the lease is contracted out then the tenant must vacate the premises when the lease expires.

Registered land v unregistered land

Registered land

Most land in England and Wales is registered but some land is not. In 1990 the whole of England and Wales was made subject to compulsory registration and estates in land have to be registered for the first time on certain trigger events. All registered titles are recorded on a register maintained by the Land Registry. The register is open to the public and contains details of the type of estate (freehold or leasehold) and includes a brief description of the land by reference to a filed plan. The register also gives the name and address of the owner of the legal estate (who is referred to as the "registered proprietor"), and also details any restriction affecting the owner's ability to deal freely with the land. The charges section of the register includes details of all third party rights which have been registered against the estate or protected by a notice.

Certain information however will not be apparent from the register. Third party rights known as overriding interests will bind a purchaser of registered land regardless of whether they are noted on the register, or whether a purchaser has notice of them by other means. However, the information which is on the register is guaranteed and compensation is liable to be paid to anyone who suffers loss as a result of an error on the register.

The registered land system recognises four different classes of title, the most common and best of which is “title absolute”. The lesser forms of title general reflect some defect in the title which results in the Land Registry being unable to guarantee fully the owner’s title in relation to the relevant aspects/part of the land.

Unregistered land

By contrast where land has remained in the same hands for years, there may not have been a dealing with the land which has triggered registration and the land may still be unregistered. In the absence of a register a landowner can only deduce title by demonstrating an unbroken chain of ownership by reference to the title deeds and documents relating to the property. In practice, for a landowner to prove good title the chain of deeds must go back at least 15 years without a break.

How is land transferred?

A typical sale and purchase transaction is a two-stage process involving an exchange of contracts between the buyer and the seller followed by completion of the legal transfer. A seller’s solicitor will issue a draft sale contract which will be negotiated and then exchanged with a deposit being paid. Prior to exchange of contracts the buyer will normally have carried out searches and enquiries relating to the property, and raised preliminary enquiries of the seller who will in turn have deduced the title to the property. Following exchange of contracts the transfer of the property is effected by completing the document which formally effects the conveyance of the land from the seller to the buyer, and by complying with registration requirements.

Tax implications of acquiring an interest in property

Value Added Tax (VAT)

Most property transactions are subject to Value Added Tax (VAT). See section 12 above.

Stamp Duty Land Tax (SDLT)

This is a mandatory tax payable by the buyer on the purchase price. See section 12 above.

SDLT is also payable on the grant of a lease. Again see section 12 above. There are a number of transactions that are relieved from SDLT, for example, transfers of land within group companies and the leaseback elements of a sale and leaseback.

23. China's Overseas Investment Rules

China encourages competitive domestic enterprises to invest in and run overseas enterprises. China also permits limited indirect overseas investment, such as overseas securities investment, though this chapter only addresses direct overseas investment.

Overview

Investments in the non-financial/insurance/securities sector are typically subject to approvals by two governmental authorities: the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM). Registration with, and approval of, the State Administration of Foreign Exchange (SAFE) are also required. Moreover, approval by the State Asset Supervision and Administration Commission (SASAC) may be required – in addition to the above approvals – if the overseas investment involves state-owned assets.

Without the required approvals and registration, overseas investments cannot proceed. Firstly, for projects subject to NDRC approval, no legally binding document may be signed before the NDRC gives its approval. Secondly, investments that are subject to MOFCOM approval cannot go ahead without MOFCOM's approval. Finally, foreign exchange cannot be remitted out of China until the overseas investment is registered with, and approved by, SAFE (although funds for certain initial expenses approved by NDRC and SAFE may be remitted out of China prior to the transaction being approved).

Overseas investments in the financial/insurance/securities sector are also subject to at least two governmental approvals: one by the relevant financial/insurance/securities regulator and the other by SAFE.

The required approvals can easily take months to obtain. Chinese overseas investors must plan well in advance to minimise the effect of these approvals on a proposed overseas acquisition.

The effect of the Chinese approval regime is to put Chinese overseas investors at a competitive disadvantage in comparison to buyers that are not subject to such approvals. Sellers may require a "China premium" to compensate them for the additional time required for approvals and the risk that a particular investment might not be approved.

Priority investments & preferential policies

UK investments in the following sectors are considered important, and may receive preferential treatment regarding foreign exchange, tax and customs:

- biopharmaceuticals;
- computer manufacturing;
- trade and distribution;
- storage;
- transportation;
- research and development;

- finance/insurance/securities; and
- legal consultancy.

Special loans at discount interest rates and other financial services provided by China Development Bank and China Export and Import Bank are also available to support the following key overseas investments:

- resource development projects needed to supplement domestic resources;
- production and infrastructure projects facilitating the export of domestic technologies, products, equipment and labour services;
- research and development centres utilizing international advanced technology or management experience or being equipped with international experts; and
- acquisitions or mergers that can improve the international competitiveness of Chinese investors or accelerate the exploration of international markets.

The above key overseas investments are also eligible to obtain special overseas investment insurance coverage (including political risks) and risk-consulting services provided by China Export & Credit Insurance Corporation.

Other investments may also be eligible for support with taxation, foreign exchange and customs, though such support shall be subject to satisfactory performance of the overseas investment during annual inspections by MOFCOM and SAFE.

On its official website, MOFCOM publicises overseas investment intentions of Chinese investors. MOFCOM also provides overseas investment services to Chinese investors, among other things, collecting information on a potential target country and assisting with Chinese investors' complaints regarding overseas investments.

Prohibited investments

An investment into the UK will be prohibited if it:

- impairs China's sovereignty, security or public interest;
- violates Chinese law or policies;
- is likely to cause China to violate any international treaty concluded by China;
- involves any technology or product that is prohibited from being exported out of China;
- violates UK law or customary practice; or
- assists in the commission of an international crime.

Structuring a deal

Chinese investors typically look overseas to increase their access to foreign technology, to leverage an established foreign brand, to limit their exposure to protectionist trade actions by foreign government or simply to take advantage of a good opportunity. Chinese investors in the resources sector have also been active for the purpose of securing a long-term supply of natural resources for consumption in China.

Some of the key points commonly arising in negotiations include:

- **Licensing of trademarks** – A Chinese investor will typically want to ensure post-acquisition access to the foreign brand. The foreign seller is likely to want to secure royalties.
- **Access to patents and other technology** – Technology arrangements can be complex with patents and other technologies being shared with other group companies of the seller.
- **Seller support during (a lengthy) transition period** – A Chinese investor with limited overseas investment experience is likely to need assistance to establish its control of the new business. The foreign seller, however, will be keen to limit its exposure.

A joint venture structure between the foreign seller and the Chinese investor has been used in a number of overseas investments to date.

Approvals for investments in the non-financial/insurance/securities sector

The NDRC approves project proposals relating to overseas investment in resources development and projects using large amounts of foreign exchange. MOFCOM, on the other hand, approves overseas equity acquisitions and company establishment, among which MOFCOM will focus on the approval of joint venture contracts and articles of association of the overseas companies established by Chinese investors. In many cases, both NDRC and MOFCOM approval will be required.

SAFE verifies the Chinese investor's source of foreign exchange, registers overseas investments and approves the remittance of foreign exchange.

Approval from the State Asset Supervision and Administration Commission (SASAC) may also be required if the Chinese overseas investment involves state-owned assets.

NDRC approval

Chinese investors must obtain NDRC approval to invest overseas either in its own name or through their overseas subsidiaries. NDRC approval is required before any legally binding document is signed by Chinese investors.

Investments that require NDRC approval include acquisitions of equity interests, operation and management rights and other related rights and interests of overseas companies.

The overseas investments made by Chinese investors in crude oil or mining resources of US$30 million or more must be verified and approved by the NDRC. If the amount is US$200 million or more, then State Council approval is needed.

Other overseas investments of US$10 million or more must be verified and approved by the NDRC. If the amount is US$50 million or more, then State Council approval is needed.

Investments below the US$30 million and US$10 million thresholds are subject to NDRC approval at the provincial level. The central government-controlled enterprises making investments below the US$30 million and US$10 million thresholds are only subject to filing requirements with the NDRC.

NDRC approval is also required for the remittance by a Chinese investor of certain initial expenses in foreign exchange. Such approval may be sought before the Chinese investor applies for approval of the overseas investment itself. The amount of the initial expenses, however, will be taken to form part of the total overseas investment.

If a Chinese investor intends to make its investment in an overseas company in the form of property in kind (including material objects, intellectual property, technology, shares or creditor's rights), the value of such investment must be decided in accordance with the appraised value or the fair value of such property. An asset appraisal report issued by a qualified asset valuation institution or other document issued by a third party confirming the value of such property must be submitted to the NDRC for review.

The NDRC will take the following matters into account when deciding whether or not to approve an application to invest overseas:

- compliance with PRC law and industrial policy, and principles of international law;
- national sovereignty, national security, and public interest;
- requirements of sustainable economic and social development, and the strategic resources required for China's national economic development;
- requirements of the State for industrial structure adjustment, promoting the export of competitive domestic technology, products, equipment and labour services and absorbing advanced foreign technology;
- China's administration of capital accounts and foreign debts; and
- investment strength of the investor.

The NDRC is required to respond within 20 working days from its acceptance of an application for approval. An extension of 10 working days is allowable. Additional time may also be taken if the NDRC decides to designate a consulting institution to assess the overseas investment.

The parties may request the NDRC to issue a confirmation letter within seven working days if an overseas competitive bidding process or overseas acquisition is involved. A written information report setting out the general information of such overseas competitive bidding process or overseas acquisition, however, must be submitted to the NDRC for the purpose of NDRC's confirmation letter. A formal application for NDRC approval of the overseas investment must be subsequently submitted; the NDRC's confirmation letter will form part of the required application documents.

For those overseas investments made by central government-controlled enterprises, the NDRC shall issue a filing record to the Chinese investors within seven working days of its receipt of the required documents. There is no time limit for State Council approvals.

The NDRC approval or filing record is required before any relevant binding document is signed. The NDRC approval or filing record will also be needed for foreign exchange and various other registrations.

MOFCOM approval

MOFCOM approval is required for the acquisition of overseas equity or management rights of an overseas company, and for the establishment of overseas companies (excluding overseas financial/insurance/securities companies). MOFCOM and SAFE also require a Chinese investor to submit a report as soon as the Chinese investor forms an intention to merge with or acquire an overseas entity and before the Chinese investor carries out the overseas investment approval formalities with MOFCOM.

MOFCOM's approval authority is delegated to its provincial-level branches for investments in certain countries (including the UK). However, if the Chinese investor is owned by China's central government, then MOFCOM remains the required approval authority.

The matters that MOFCOM will take into account in deciding whether to approve an application include:

- investment environment and safety of the target country;
- political and economic relationship of the target country with China;
- China's overseas investment policies;
- distribution of Chinese investments in the target country;
- obligations under international treaties; and
- protection provided by the target country for the lawful interests of foreign enterprises.

The Chinese investor is responsible for deciding upon the commercial and technical viability of an overseas investment.

The provincial-level branches of MOFCOM have 15 working days to decide whether or not to approve an application. If MOFCOM approval is required, the provincial-level branches of MOFCOM are required to respond within five working days and MOFCOM has 15 working days to make a decision on whether to approve an application. An approval certificate issued by MOFCOM or its provincial-level branch (as applicable) is required for subsequent foreign exchange and various other registrations.

MOFCOM, together with SAFE, conduct annual inspections of overseas companies established by Chinese investors (excluding financial/insurance/securities companies) from 1 April to 15 June each year. They also regulate various post-investment matters. Central government-controlled enterprises themselves, in coordination with SAFE, conduct annual inspections of their own overseas investments. The annual inspection reports must be submitted to MOFCOM and SAFE before 30 June each year. The annual inspection certificates are needed for various subsequent registrations and formalities.

Annual inspection results are categorized as Grade 1, Grade 2 and Grade 3. Only those overseas investments falling into Grade 1 category will be entitled to various preferential treatments for overseas investments in the following year. If any overseas investment falling into the Grade 3 category fails to improve its grading in the next year, the relevant Chinese investor may not conduct any new overseas investment for a period of one year.

SAFE approval

SAFE plays multiple roles in overseas investments:

- **Verifying the source of funds** – SAFE's role is to verify the source of foreign exchange funds of Chinese investors prior to an application for NDRC and MOFCOM approvals. Foreign exchange may be sourced from the Chinese investor's own savings, from the purchase of foreign exchange or from foreign exchange loans provided by China-incorporated banks. SAFE has 30 days in which to issue an opinion as to the source of foreign exchange. The source of investments in kind, funds for foreign aid projects and strategic investments approved by the State Council is not subject to SAFE verification.

- **Foreign exchange approval, registration and remittance** – SAFE registers overseas investment and approves the remittance of foreign exchange once an overseas investment has been approved by the NDRC and MOFCOM. Without SAFE approval, foreign exchange cannot be remitted abroad.
- **Overseas account opening** – SAFE approval is required if the Chinese investor needs to open an overseas account.
- **Post-investment supervision** – SAFE, together with MOFCOM or central government-controlled enterprises (as the case may be), conducts annual inspections of overseas companies established by Chinese investors from 1 April to 15 June each year and regulates various post-investment matters.

Initial expenses may be remitted out of China prior to the transaction being approved by the relevant Chinese authorities. Such initial expenses generally may not exceed 15% of the planned total investment (if the initial expenses exceed 15% of the planned total investment, special SAFE approval of such initial expenses will be required). The balance of the initial-expense funds must be repatriated to China if the transaction is not approved by the Chinese authorities within six months from the date of the remittance of such initial-expense funds.

Profits generated by overseas investments must be remitted back to China within six months of the end of the overseas company's financial year. The Chinese investor must also submit the financial statements of its overseas investment to SAFE within six months of the end of the overseas company's financial year. Income received from the transfer of any overseas investment must be repatriated to China within 30 days of completion of the transfer. In addition, the assets obtained by the Chinese investors upon the termination or liquidation of the overseas company must also be repatriated to China.

An overseas company established by a Chinese investor may raise funds in the target country. However, unless otherwise approved by SAFE, neither the Chinese investor nor any Chinese domestic bank or other Chinese domestic entity may provide foreign exchange guarantees for such overseas company in any form.

SASAC and Ministry of Finance approvals

Overseas investments using state-owned assets are subject to SASAC approval – in addition to NDRC and MOFCOM approvals and SAFE registration and approval. The requirement for SASAC approval arises out of the government's desire to prevent the stripping of state-owned assets.

- **Appraisal of in-kind property** – State-owned property in kind to be invested overseas must be appraised by a qualified appraisal institution and verified by SASAC (or its relevant provincial-level branch). The appraised value confirmed by SASAC will generally form the basis of the investment value.
- **Title registration** – Title registration with SASAC (or its relevant provincial-level branch) in respect of state-owned assets invested overseas is required both prior to and after the investment. The first registration must take place after the NDRC and MOFCOM approvals and before SAFE approval for remittance of investment funds. The second registration is required within 60 days of the incorporation of the overseas company established by the Chinese investors. In the event of any material change of the overseas company (eg, increase or decrease of the state-owned investment in the overseas company) or where

an overseas company sets up branches or obtains a controlling position in a project by way of re-investment, SASAC registration must be carried out within 60 days of the obtaining of the relevant Chinese government approvals or of the incorporation of such branch, as the case may be. Title registrations are reviewed by SASAC (or its relevant provincial-level branch) prior to 30 September each year. Title registrations are also required for registration with, and approval of foreign exchange remittance granted by, SAFE, and for the export of property for investments in kind.

Title registrations must also be filed with the Ministry of Finance (or its relevant branch). The following material events of overseas companies under the supervision of central or local government will then be subject to the approval by the Ministry of Finance (or its relevant branch) or the State Council (if applicable):

- overseas bond issuance, stock issuance, listing and other financing activities. The funds raised by the overseas companies through borrowings and bond issuance may not be repatriated to China;
- investments exceeding 50% of the net assets value of the overseas companies;
- any change in the share capital of the overseas companies;
- transfers of state-owned property or equity interests to foreign parties if this results in the loss of a controlling position;
- any division, merger, restructuring, sale, dissolution or bankruptcy application of the overseas companies; and
- other material events of the overseas companies.

The Ministry of Finance (or its relevant branch) or the State Council (if applicable) will decide whether to approve such material events within 10 working days from its receipt of the required documents. Filing with the Ministry of Finance (or its relevant branch) will suffice in the following events:

- the accumulated amount of reinvestment by the overseas company is less than 50% of its net asset value; or
- any "material event" has occurred to a subsidiary of the overseas company and not to the overseas company itself.

Approvals for investments in the financial/insurance/securities sector

Financial/insurance/securities institutions are required to obtain approval issued by the financial/insurance/securities regulatory authorities in China before making overseas investments in the financial/insurance/securities sector. For non-financial/insurance/securities institutions which propose to make overseas investments in the financial/insurance/securities sector, notwithstanding the approval of the Chinese financial/insurance/securities regulatory authorities, the approval issued by its industrial regulatory authority is also required.

The financial/insurance/securities regulatory authorities in China are: the China Banking Regulatory Commission (CBRC) for the financial sector; the China Insurance Regulatory Commission (CIRC) for the insurance sector; and the China Securities Regulatory Commission (CSRC) for the securities sector. Each of these authorities has a broad discretion as to which

Chinese investors and which overseas investments they will approve. The authorities are also responsible for supervising and regulating various aspects of an overseas investment in the financial/insurance/securities sector.

SAFE registration and SASAC approvals are also applicable to overseas investments in the financial/insurance/securities sector.

24. List of the relevant Chinese authorities for outbound investment

Name of organisation	Department	Website	Telephone
Ministry of Commerce of the People's Republic of China (MOFCOM)	Department of Foreign Economic Cooperation	www.mofcom.gov.cn	+86 10 6528 4671 (General line) +86 10 6519 7173
Beijing Municipal Bureau of Commerce	Foreign Economic Cooperation office	www.bjmbc.gov.cn	+86 10 6523 6688 (General line) +86 10 6525 1628
Shanghai Foreign Economic Relation & Trade Commission	Foreign Economic Cooperation Office	www.smert.gov.cn	+86 21 62752200 (General line)
Department of Foreign Trade and Economic Cooperation of Guangdong Province	Foreign Economic Cooperation Office	www.gddoftec.gov.cn	+86 20 3880 2165 (General line) +86 20 3880 2423
National Development and Reform Commission (NDRC) People's Republic of China	Department of Foreign Capital Utilisation	www.ndrc.gov.cn	+86 10 6850 1425
Beijing Municipal Commission of Development and Reform	Foreign Capital Utilisation Office	www.bjpc.gov.cn	+86 10 66415588 (General line) +86 10 6641 0833
Shanghai Municipal Development and Reform Commission	Foreign Capital Office	www.shdpc.gov.cn	+86 21 63212810 (General line) +86 21 6321 2810 ext. 2850
Shenzhen Municipal Development and Reform Bureau	Monetary and Financial Office	www.szpb.gov.cn	+86 755 8210 5842 (General line) +86 755 8210 8084

25. Appendix – Common abbreviations

ADR	Alternative Dispute Resolution
AGM	Annual General Meeting
ALL ER (D)	All England Law Reports (Digest)
AUT	Authorised Unit Trust
CBRC	China Banking Regulatory Commission
CIRC	China Insurance Regulatory Commission
CMC	Case Management Conference
CPR	Civil Procedure Rules
CSRC	China Securities Regulatory Commission
DPA	Data Protection Act 1998
DTI	Department of Trade and Industry (now the Department for Business Enterprise and Regulatory Reform)
EC	European Community
ECEF	European Code of Ethics for Franchising
EEA	European Economic Area
EGM	Extraordinary General Meeting
EU	European Union
FOIA	Freedom of Information Act 2000
FRI	Full Repairing and Insuring Lease
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
GB	Great Britain (England, Scotland and Wales)
HRA	Human Rights Act 1998
ICMA	International Capital Markets Association
ICVC	Investment Company with Variable Capital
IFRS	International Financial Reporting Standards
IP	Intellectual Property
ISP	Internet Service Provider
LIBOR	London Interbank Offer Rate
LLP	Limited Liability Partnership
LPA	Law of Property Act 1925
MLRO	Money Laundering Reporting Officer
MOFCOM	Ministry of Commerce (PRC)
NDRC	National Development and Reform Commission (PRC)
OFCOM	Office of Communications
OFGEM	Office of Gas and Electricity Markets
OFT	Office of Fair Trading
OFWAT	Water Services Regulation Authority

OHIM	European Office for Harmonisation in the Internal Market
POCA	Proceeds of Crime Act
PRC	People's Republic of China
REITs	Real Estate Investment Trusts
SAFE	State Administration of Foreign Exchange (PRC)
SASAC	State Asset Supervision and Administration Commission (PRC)
SDLT	Stamp Duty Land Tax
SE	Societas Europaea (European Company)
SMART	Small Firms Merit Award for Research and Technology
SME	Small and Medium Enterprises Market
SOCA	Serious Organised Crime Agency
SPUR	Support for Products Under Research
TUPE	Transfer of Undertakings (Protection of Employment) Regulations
UCIT	Undertaking for Collective Investment in Transferable Securities
UCTA	Unfair Contract Terms Act 1977
UK	United Kingdom (Great Britain and Northern Ireland)
US or USA	United States of America
VAT	Value Added Tax

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