Financial Services Authority

FINAL NOTICE

To: **BDO LLP**

FSA Reference Number: **229378**

Of: 55 Baker Street, London W1U 7EU

Date: 26 May 2011

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives final notice about the publication of a public censure of BDO LLP.

1. ACTION

1.1. On 25 May 2011, the FSA gave BDO LLP ("BDO") a Decision Notice which notified BDO that pursuant to section 89 of the Financial Services and Markets Act 2000 ("the Act") and Listing Rule 8.7.19R, the FSA had decided to publish a statement censuring BDO LLP ("BDO") for contravening the following Principles for sponsors:

(1) Listing Rule 8.3.3R in relation to BDO's failure to act with due care and skill in relation to a sponsor service; and

(2) Listing Rule 8.3.5(1)R in relation to BDO's failure to deal with the FSA in an open and co-operative way.

1.2. The contraventions relate to BDO's conduct as sponsor on the proposed merger ("the Transaction") between Shore Capital Group PLC ("Shore Capital") and Puma Brandenburg Limited ("Puma") details of which were announced to the market on 11 June 2009 ("the Announcement").

1.3. BDO has confirmed that it will not be referring the matter to the Upper Tribunal (Tax and Chancery Chamber).

1.4. Accordingly, for the reasons set out below, the FSA publishes a statement in the form of this Notice censuring BDO for contravening Listing Rule 8.3.3R in relation to BDO's failure to act with due care and skill in relation to a sponsor service, and Listing Rule 8.3.5(1)R in relation to BDO's failure to deal with the FSA in an open and co-operative way.

2. SUMMARY REASONS FOR THE ACTION

Background

2.1. The FSA, when acting as the competent authority under Part VI of the Act, is referred to as the UK Listing Authority ("the UKLA"). The UKLA has responsibility for monitoring and enforcing compliance with the UKLA Listing Rules ("the Listing Rules").

2.2. When BDO was first approached to advise on the Transaction, around a month before the Announcement, there were already indications that the Transaction might constitute a reverse takeover because of the significant size of the target (later identified as Puma) relative to Shore Capital. (See section 3 below for details of the tests relevant to the classification of transactions, known as the 'class tests'). Before the announcement of a reverse takeover a suspension of the listed company's shares will often be appropriate, but if the UKLA is satisfied that there is sufficient information in the market about a proposed transaction it may agree with the listed company that a suspension is not required.

2.3. The Listing Rules and related guidance and commentary make it clear that sponsors should work closely with the UKLA. However, instead of liaising with the UKLA in advance of the Announcement of the Transaction to ascertain whether suspension of Shore Capital's shares was appropriate, BDO:

(1) agreed with Shore Capital from the outset that it would not contact the UKLA until after the Announcement; and

(2) in the run up to the Announcement, reworked the class tests several times in an attempt to classify the Transaction as a class 1 rather than a reverse takeover, despite recognising at the time that this was highly unlikely to succeed.

2.4. Given the complexities and circumstances of the Transaction, the FSA finds that BDO's conduct on the Transaction, including its reworking of the class tests and its specific agreement not to liaise with the UKLA until after the Announcement, did not satisfy the requirements for a sponsor to act with due care and skill and to deal with the FSA in an open and co-operative way.

3. RELEVANT STATUTORY PROVISIONS, GUIDANCE AND COMMENTARY

3.1. Pursuant to Part VI of the Act, the FSA issues the Listing Rules and is responsible for maintaining the Official List of securities in the UK. The FSA may issue Listing Rules pursuant to section 88 of the Act that impose requirements on a sponsor. Listing Rules 8.3.3R and 8.3.5R are issued under this provision and are two of the six Principles for sponsors.

3.2. The FSA may, pursuant to section 89 of the Act, publish a public statement to the effect that a sponsor has contravened a requirement imposed on him by the Listing Rules. There is no power under the Act to impose a financial penalty on a sponsor.

3.3. Listing Rule 8.7.19R states that if the FSA considers that a sponsor has breached any provision of the Listing Rules and considers it appropriate to impose a sanction it will publish a statement censuring the sponsor. LR 8.7.20G states that the Enforcement Guide ("EG") sets out the FSA's policy on when and how it will use its disciplinary powers, including in relation to a sponsor.

3.4. In deciding to take the action described above, the FSA has had regard to guidance published in the FSA Handbook, in particular in the Listing Rules, EG and the Decision Procedure and Penalties Manual ("DEPP"). The FSA has also had regard to the commentary it has issued on the Listing Rules in its List! publications[1].

3.5. Listing Rules 8.3.3R (due care and skill) and 8.3.5R (relations with the FSA) are two of the six Principles for sponsors. Listing Rule 8.3.3R states *"A sponsor must in relation to a sponsor service act with due care and skill"*. Listing Rule 8.3.5(1)R states: *"A sponsor must at all times (whether in relation to a sponsor service or otherwise): (1) deal with the FSA in an open and co-operative way"*.

3.6. The FSA expects sponsors to comply with all of the six Principles for sponsors, including those at Listing Rules 8.3.3R and 8.3.5R. The FSA has issued commentary on the application of the Listing Rules as is set out in more detail in the Appendix.

3.7. The FSA has made it clear that it expects to have an open, co-operative and constructive relationship with sponsors (LR 8.7.1G).

3.8. LR 8.3.2G states that a sponsor will be the main point of contact with the FSA for any matter referred to in Listing Rule 8.2. This includes a transaction which due to its size or nature could amount to a class 1 transaction or a reverse takeover in which case a listed company must obtain the guidance of a sponsor to assess the application of the Listing Rules (Listing Rule 8.2.2R).

Class tests

3.9. For the purposes of determining a listed company's obligations under the Listing Rules, a transaction is classified by assessing its size relative to that of the listed company proposing to make it. The comparison of size is made by using the percentage ratios resulting from applying the class test calculations to a transaction.

[1] All references in this Notice are to List! publications which were current at the time of the Transaction

Broadly speaking, the class tests seek to assess the size of a proposed transaction based on the consideration to be paid for the transaction compared with the market capitalisation of the listed company, the relative profits of the target compared with those of the listed company, the relative size of the gross assets of the target compared with those of the listed company and the relative funding structure of the target compared with that of the listed company.

3.10. The annex to chapter 10 of the Listing Rules provides details of how the class tests must be calculated for a proposed transaction. These details make it clear which figures need to be used for the calculation of the class tests and are provided to ensure that class tests are applied in a consistent manner.

3.11. If, following calculation of the class tests in accordance with the annex to chapter 10, it is believed that the class tests produce an "*anomalous result*" then "*the FSA may modify the relevant rule to substitute other relevant indicators of size…*": item 10G within annex 1 to Listing Rule 10. It is clear from the annex to Chapter 10 of the Listing Rules that there is no flexibility in the application of the class tests unless and until the FSA agrees to "*modify the relevant rule*".

3.12. Listing Rule 10.2.2R (4) defines a reverse takeover as a transaction consisting of an acquisition by a listed company of a business, an unlisted company[2] or assets where any percentage ratio is 100% or more or which would result in a fundamental change in the business or in a change in board or voting control of the listed company.

3.13. A reverse takeover is to be treated as a class 1 transaction if all of the 5 conditions set out in Listing Rule 10.2.3R are satisfied in relation to the transaction. The first condition is that none of the percentage ratios resulting from the calculations under each of the class tests exceeds 125%.

3.14. LR 10.6.3G makes it clear that a suspension is generally appropriate upon the announcement or leak of details relating to a reverse takeover, and that it is for the FSA to decide whether a suspension is required:

"*Before a listed company announces a reverse takeover which has been agreed or is in contemplation or where details of a reverse takeover have leaked, a listed company should consider whether a suspension is appropriate. Generally, when a reverse takeover is announced or leaked, because of its significant size there will be insufficient information in the market about the proposed transaction and the company will be unable to assess accurately its financial position and inform the market accordingly. So, suspension will often be appropriate (see LR 5.1.2 G (3) & (4)). <u>But, if the FSA is satisfied that there is sufficient information in the market about the proposed transaction it may agree with the company that a suspension is not required</u>.*" [emphasis added]

3.15. Specific commentary has been issued in relation to reverse takeovers. This makes it clear that, whilst there is no longer an automatic suspension of shares on the leak or announcement of details relating to a reverse takeover which has been agreed or is in contemplation, the UKLA would still ordinarily expect that suspension would be

[2] i.e. a company whose securities are not listed on the Official List of the FSA

required and would need to be persuaded that suspension would not be required on the particular facts. Further, the commentary makes it clear that it is a matter for the UKLA (not the sponsor) to decide whether a suspension is required.

3.16. Further details of the commentary issued on the Listing Rules are set out in the Appendix.

4. FACTS AND MATTERS RELIED ON

Background

4.1. BDO (formerly BDO Stoy Hayward LLP) is a firm providing accountancy and advisory services. BDO has been approved to provide sponsor services since 2001.

4.2. At the relevant time (May to June 2009) Shore Capital was a company whose shares were listed on the Official List of the FSA and admitted to trading on the Main Market of the London Stock Exchange. Puma was a property company whose shares were traded on AIM. The Announcement issued on 11 June 2009 in relation to the Transaction set out details of a recommended offer made for Puma by Marble Limited, a wholly-owned subsidiary of Shore Capital.

Chronology of events

4.3. On 11 May 2009, representatives of BDO met with Shore Capital to discuss the possibility of BDO acting as sponsor on a potential transaction, initial details already having been provided. The identity of the target was not revealed at that stage, but the general nature of the transaction was discussed, involving a merger between a subsidiary of Shore Capital and another company and it was apparent from documents created on 11 May 2009 that it was contemplated that the transaction might be a reverse takeover. Shore Capital expressed a preference for expediting the Transaction and for not involving the UKLA as far as this was possible in case this caused any delay. On 15 May 2009, the BDO team considered the Listing Rule implications regarding reverse takeovers including the possible suspension of Shore Capital's shares.

4.4. On 18 May 2009, BDO confirmed that they were prepared to act as sponsor and that they would proceed on the unusual basis that they would not contact the UKLA until after the Announcement. BDO informed Shore Capital that they would normally advise consulting at an early stage with the UKLA but that they understood this to be a convention rather than a requirement. BDO accordingly agreed to proceed on the basis of the preferences expressed by Shore Capital, and advised Shore Capital that this would be an acceptable way to proceed. BDO failed to identify or to advise Shore Capital that failing to involve the UKLA prior to the Announcement would be contrary to the Principles for sponsors set out at Listing Rule 8.3.3R and 8.3.5(1)R. At this stage, BDO still did not have full details of the Transaction or know the identity of the target and no work had been done on the class tests. There is no evidence that BDO reviewed this approach as they obtained further details of the Transaction. It was BDO's responsibility as sponsor to advise Shore Capital on the proper process for the Transaction.

4.5. BDO provided a draft of its letter of engagement on 22 May 2009. By this time, the identity of the proposed target was known (Puma). BDO had been aware since 11 May 2009 that the Transaction could be treated as a reverse takeover rather than a class 1 transaction such that a suspension of the issuer's shares would be necessary unless the UKLA could be convinced that there was sufficient information in the market on the proposed transaction. Two different fee structures were set out in BDO's draft letter of engagement, depending on whether the Transaction was treated as class 1 or reverse. BDO agreed in this letter to draft submissions to the UKLA so they could consult as soon as the Transaction was announced, but not before.

4.6. BDO carried out its initial calculation of the class tests on 1 June 2009. This suggested that the Transaction was a reverse takeover as three out of four of the test results exceeded 100%. Discussions took place within BDO and with Shore Capital on whether the Transaction should be treated as a class 1 acquisition or a reverse takeover, and the implications of each classification. It was agreed that BDO should prepare documents covering both a class 1 and a reverse transaction.

4.7. BDO's letter of engagement was signed on 2 June 2009, which formalised the arrangement that the UKLA would not be contacted until after the Announcement. Following this, BDO prepared drafts of three letters to the UKLA to be sent after the Announcement was issued. The first was a letter to the UKLA Listing Applications team which stated why BDO considered that the Shore Capital shares did not need to be suspended should the UKLA decide to treat the Transaction as a reverse (the "Suspension letter"). Secondly, BDO drafted a letter outlining details of the Transaction together with the class tests (the "Class test letter"). This proposed that the Transaction should be treated as a class 1 transaction for the purposes of the Listing Rules. BDO also prepared a draft eligibility letter (the "Eligibility letter"), to be submitted if the UKLA decided that the Transaction should be treated as a reverse takeover. BDO's preparation of the Eligibility letter indicated that it was aware that the Transaction might be classified as a reverse.

4.8. BDO carried out further work on the class test calculations and on 3 June 2009 a member of the team commented on the re-worked class tests: "*It really does look flakey*" i.e. that the transaction did not look like a class 1 transaction and that it was likely to be classified as a reverse. The re-worked tests involved adjustments to the class tests, which had the effect of reducing the results significantly and bringing three out of four of the results below 100%. However, even after the reworking, the tests still produced one result in excess of 100%, still suggesting that the Transaction was a reverse.

4.9. Following the Announcement of the Transaction at 12:30 on 11 June 2009, at 15:30 BDO sent the Class test letter and the Suspension letter to the UKLA and the Listing Applications team as proposed, which indicated their assessment that the Transaction should be treated as a class 1 transaction under Listing Rule 10.2.3R.

4.10. The UKLA contacted BDO on 12 June 2009 to express concerns about BDO's approach to the Transaction and to explain that the adjustments to the class tests made by BDO, which had the effect of bringing three out of four of the results below 100%, had not been accepted and that the Transaction should be classified as a reverse. The

UKLA also pointed out that it is for the UKLA and not a sponsor to decide whether a suspension would be necessary or not, as set out in LR 10.6.3G.

4.11. Given the letters it had prepared prior to the Announcement, it is clear that BDO were aware of the implications of the Transaction being classified as a reverse and that there was a presumption that this would require a suspension of the shares of Shore Capital unless the UKLA agreed otherwise.

Events subsequent to the Transaction

4.12. The UKLA decided that a suspension of Shore Capital's shares was not required, on the basis that there was sufficient information in the market following the Announcement and on the basis of a further confirmation received from BDO subsequent to the Announcement. This does not justify or excuse the approach taken by BDO which risked jeopardising the smooth operation of the market given that the UKLA had not yet been able to assess whether there would be sufficient information in the market about the Transaction.

4.13. On 24 June 2009, BDO conceded that the Transaction should be classified as a reverse and submitted the Eligibility letter to the UKLA. On 4 August 2009 BDO notified the UKLA of Shore Capital's decision to de-list from the Official List and seek re-admission on AIM.

4.14. The partner leading the BDO team on the Transaction has since left BDO for unrelated reasons.

4.15. BDO has since implemented a number of changes to its processes and procedures. Having obtained external advice on its Corporate Finance Procedures, it has established a Corporate Finance Public Risk Committee, and all new transactions involving public companies must be reported to the committee for approval. The committee also decides at the outset of a new assignment involving a public company whether it requires the appointment of a second partner for reviewing purposes. Further training has been held within BDO, and the firm's Corporate Finance Policies and Guidance for sponsor and PLC advisory work have been revised.

4.16. BDO and the former partner who led the BDO team on the Transaction have co-operated with the FSA investigation. They have accepted that it was an error of judgment to approach the Transaction without liaising with the UKLA until after the Announcement and that it was a contravention of the Principles for sponsors.

5. ANALYSIS OF BREACHES

5.1. The FSA finds that BDO failed to comply with the Principles for sponsors set out at Listing Rule 8.3.3R and 8.3.5(1)R in relation to the Transaction for the following reasons:

(1) BDO failed to liaise with the UKLA in relation to the Transaction at any time prior to the Announcement. It decided at the outset to take this approach, which was formalised in its letter of engagement, and did not reconsider its appropriateness at any stage as further information emerged. Similarly, having advised Shore Capital at the outset that this approach was acceptable, it did not

revise its advice at any stage. The UKLA were therefore unable to reach a view prior to the Announcement on the classification of the Transaction or on the possible suspension of the shares of Shore Capital.

(2) BDO reworked the class tests several times. The results fluctuated considerably depending on the approach taken but at least one result exceeded 100% in each case. Before reworking, three of the results greatly exceeded 100%. These were clear indications that the Transaction was a reverse rather than a class 1 transaction (as BDO was aware, in view of its comment that the results were looking "*flakey*").

(3) The reworking of the class tests with substantially different results and the fact that BDO still maintained in the Class test letter to the UKLA that the Transaction should be treated as a class 1 indicate that BDO failed on this Transaction to provide the objective oversight required of a sponsor. The different test results should also have alerted BDO to the need to consult the UKLA at an early stage on the Transaction and in any event before the Announcement. BDO still maintained in the Class test letter to the UKLA that it should be treated as a class 1.

(4) By focusing on avoiding any delay and avoiding the suspension of the issuer's shares, BDO failed on this Transaction to provide the objective oversight required of a sponsor. As BDO accepts, it was an error of judgment and in breach of the Principles for sponsors to decide not to liaise with the UKLA until after the Announcement of the Transaction and to fail to review this approach at any stage.

6. ANALYSIS OF SANCTION

6.1. In deciding to issue a public censure to BDO, the FSA has taken into account the following aggravating factors:

(1) BDO placed too much focus on carrying out its client's expressed preferences and failed to provide the necessary objectivity as sponsor which should have led it to advise its client that it would not be consistent with the Principles for sponsors within the Listing Rules to avoid contacting the UKLA until after the Announcement;

(2) The circumstances of the Transaction were such that it was clear that there were issues that should be discussed with the UKLA before the Announcement, namely the class tests and the possible suspension;

(3) Having agreed at the outset not to contact the UKLA until after the Announcement, BDO failed to revisit and change this approach at any time as further information emerged; and

(4) The Listing Rules and commentary make it clear that sponsors are expected to work closely with the UKLA.

6.2. The FSA has also taken into account the following mitigating factors:

(1) BDO has introduced a number of changes since the Transaction which have improved its systems and controls for carrying out sponsor work;

(2) No evidence has been found of BDO taking a similar approach on other transactions; and

(3) BDO and the partner leading the BDO team on the Transaction have accepted that the approach taken was ill-advised and an error of judgment and that they will not take this approach again. They have co-operated with the FSA investigation.

Conclusions – Sanction

6.3. Pursuant to section 89 of the Act and Listing Rule 8.7.19R, the FSA publishes a statement in the form of this Notice to the effect that BDO has contravened requirements imposed on it by the Listing Rules.

7. DECISION MAKERS

7.1. The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers on behalf of the FSA.

8. IMPORTANT

8.1. This Final Notice is given to BDO in accordance with section 390 of the Act.

Publicity

8.2. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to BDO or prejudicial to the interests of consumers.

8.3. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

8.4. For more information concerning this matter generally, you should contact Clare Hitchcock at the FSA (direct line 020 7066 1490).

Matthew Nunan
Acting Head of Department
FSA Enforcement and Financial Crime Division

APPENDIX: RELEVANT COMMENTARY

1. The UKLA has issued commentary on the application of the Listing Rules in its List! publications. It has made it clear that the UKLA expects high standards from sponsors and a high degree of co-operation and engagement from sponsors and issuers. For example:

   (a) List! 2 (May 2003) states "*please contact our helpdesk…with any questions about class tests"*;

   (b) List! 7 (October 2004) refers to the introduction of the UKLA's dedicated sponsor supervision team that *"will be seeking a much closer relationship with sponsors than currently exists and will be requiring sponsors to focus on their responsibility for transactions and for unusual and complex issues"*; and

   (c) UKLA Factsheet Issue 2 (January 2006) states that where circumstances are complex then firms should submit queries to the UKLA helpdesk in writing. This includes reference to queries about class tests

2. Specific commentary has been issued in relation to reverse takeovers. This makes it clear that the changes made to the Listing Rules in 2005 did not alter the presumption that on the leak or announcement of details relating to a reverse takeover which has been agreed or is in contemplation the shares of the listed company would be suspended. List! 11 (September 2005) and List! 13 (September 2006) make it clear that while the automatic requirement for suspending listing had not been retained, the UKLA would still ordinarily expect that suspension would be required. They stated that "*there may be circumstances where advisers are able to demonstrate that a suspension is not required based on the particular facts*."

3. List! 11 stated that the UKLA would take the same approach as under the old rules, where the UKLA *"did not suspend where we were satisfied there was sufficient publicly available information on the target company to ensure a fully informed market was maintained. Under the new rules we will adopt the same approach, and will have regard to the following factors: whether the target company is listed or traded elsewhere; the quality of the information that is available; and whether the issuer is able to fill any information gap at the time of announcing the terms of the transaction. There will therefore be a presumption that a suspension will be required, but this presumption can be rebutted as described above"*. It is clear from this commentary and LR 10.6.3G that the UKLA would need to be persuaded that a suspension was not required and that this was not a decision which the issuer or its advisers could make themselves.

4. This position has been reinforced by further commentary in List! For example, List! 13 states that the UKLA "*would expect any advisors involved in a reverse transaction, where they do not believe it is appropriate to suspend, to contact the UKLA helpdesk in the first instance*". It reiterated that while the automatic requirement for suspending listing has not been retained in the new rules, "*this amendment was not intended to alter the approach taken towards suspensions. We*

would still ordinarily expect that suspension will be required. However, there may be circumstances where advisers are able to demonstrate that a suspension is not required based on the particular facts."

5. List! 18 (March 2008) highlights some of the frequently asked questions received via the UKLA helpdesk. Paragraph 3.8 specifically addresses reverse takeovers: "*In List! 11 we said that in order to avoid a suspension in relation to a contemplated reverse takeover, an issuer would need to satisfy us that there was sufficient publicly available information on the target. We also set out some of the factors that we might take into account in forming a view on this issue, such as whether the target is listed elsewhere, the quality of information available and whether the issuer is able to fill any information gap at the time of announcing*."

6. It is again clear from this commentary that the obligation is to satisfy the UKLA that a suspension is not necessary. List! 18 also contains a reminder to contact the UKLA as soon as possible where firms are performing reverse takeovers of targets listed on other exchanges.