

Quarter in law

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Update on recent developments

Software infringement

The Court of Appeal has rejected a claim that rival games producers had infringed a company's copyright in its computer game based on pool (*Nova Products Ltd v Mazooma Games Ltd & Others (2007 EWCA Civ 219)*). The Court determined that the idea behind the game had been used and not the expression of the idea (which is protected by copyright). The Court also followed the High Court's decision in the case of *Navitaire Inc v Easyjet (2004)* (link to [Spring 2006](#) edition of newsletter) – it is not an infringement of copyright in software merely to emulate a program without copying the underlying code or any of the program's graphics.

Intellectual property infringement

The European Parliament (EP) has approved the proposed EU Directive on harmonising national law on criminal penalties for intellectual property rights offences (See [Winter 2003](#) and [Summer 2004](#) articles). However, the EP has also made some significant changes to the Directive, including removing patents entirely from scope and limiting its application with regard to trade marks. The Directive will now be sent to the European Council for further consideration.

The European Commission has published its vision for improving the European patent system. The communication is intended to allow the European Council to debate patent reforms and address the inadequacies of the current system. As it stands, Europe's patent system is far more expensive than its US and Japanese counterparts because it operates through a series of national patents. A new EU-wide system would dramatically reduce costs and make the patent system much more accessible.



The Companies Act 2006 – directors' duties

The Companies Act 2006 – directors' duties

On 8 November 2006 the Companies Act 2006 (the Act) received Royal Assent. Although the Act largely restates the Companies Act 1985 (the 1985 Act), it is the largest piece of legislation ever to be passed in the UK and as such there are a number of new provisions that companies need to prepare for prior to full implementation by October 2008.

One of the fundamental changes between the 1985 Act and the Act is the codification of directors' duties. In response to concerns about corporate social responsibility and events such as the Enron scandal, the Act codifies directors' duties for the first time, which has resulted in concern and significant debate as to directors' liabilities following the implementation of the new duties on 1 October 2007.

In this overview, we focus on the proposed changes to the duties directors and the potential impact that the codification will have on directors.

Directors' duties – will it make a difference?

Although the Act introduces many beneficial changes, the codification of directors' duties for both public and private companies is likely to impose greater burdens for companies, particularly given the increase in the scope of the derivative actions regime under the Act.

The actions taken by companies to prepare for and comply with the provisions of the Act relating to directors' duties will differ between companies.

However, all companies need to ensure that their directors (executive and non-executive) are fully aware of their new obligations and that clear policies are in place to deal with board decision making processes.

What's changed?

The Act puts directors' duties on a statutory footing for the first time and in doing so has expanded the current common law duties and created a clearly identifiable set of duties that directors must comply with. The codification of these duties has raised concerns that board meetings will become more cumbersome and that the information the board requires in order to make decisions will increase.

Companies will need to establish clear policies to document board decisions, and update the terms of reference for their boards, before the legislation comes into force. In addition, the individuals responsible for preparing board papers should also be aware of the changes to ensure that board papers are properly prepared to reflect the considerations that directors will need to have regard to in discharging their duties under the new Act.

Can common law principles be forgotten?

Although the codification of directors' duties puts these duties on a statutory footing, the common law relating to directors' duties cannot be disregarded as the Act specifically states that the codified duties will be interpreted by reference to the existing common law.



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The Companies Act 2006 — directors' duties cont'd

What are directors' duties under the Act?

The Act sets out seven general duties of a director and six factors that directors must have regard to when exercising their duty to promote the success of the company. These duties are the:

- 1 Duty to act within their powers;
- 2 Duty to promote the success of the company. A director must act in the way he considers will most likely promote the success of the company for the benefit of its members as a whole, and in doing so have regard to the following six factors:
 - a. the likely consequences of any decision in the long- term;
 - b. the interests of the company's employees;
 - c. the need to foster the company's business relationships with suppliers, customers and others;
 - d. the impact of the company's operations on the community and environment;
 - e. the desirability of the company maintaining a reputation for high standards; and
 - f. the need to act fairly between members of the company.
- 3 Duty to exercise independent judgment;
- 4 Duty to exercise reasonable care, skill and diligence;
- 5 Duty to avoid conflicts of interest;
- 6 Duty not to accept benefits from third parties; and
- 7 Duty to declare interest in a proposed transaction or arrangement.

The general duties may overlap, depending on the issues before the board. However, the Act stipulates that a director should comply with every duty and cannot use one duty to justify breaching another.

The statutory factors are not simply a box-ticking exercise and directors are not absolved from liability simply by demonstrating they have considered the six factors when carrying out their duty to promote the success of the company. The Act requires directors to consider the statutory factors "amongst others" when deciding matters before them, and complying with one duty will not justify breaching another.

Does the codification of directors' duties impact on company directors' and officers' (D&O) insurance?

Companies should review their directors' and officers' insurance to check whether it covers a breach of the Act by the directors. There is concern that current policies will not cover a failure to consider the six factors set out above and companies need to address this issue now to ensure adequate policies are in place by the time the new duties are implemented on 1 October 2007.

Business review

The Act also expands the content that must be included in the business review of quoted companies.

The business review is intended to inform members of the company and to help them assess how the directors have performed their duty to promote the success of the company. As a minimum, the business review must contain a fair review of the company's business, a description of the principal risks and uncertainties facing the company and a balanced and comprehensive analysis of the performance and position of the company's business during the financial year.

There are more detailed requirements for the content of a business review of a quoted company. These matters include information about social, community and employment matters together with environmental matters, reflecting the considerations of corporate social responsibility that have influenced the drafting of the directors' duties set out above. In addition, quoted companies will need to disclose their "significant relationships".

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The Companies Act 2006 — directors' duties cont'd

What implications do the new duties have on the conduct of board meetings?

The biggest area of concern has been the six factors set out in the Act, “amongst others”, that directors need to consider when promoting the success of the company, and in particular whether board minutes should document that these factors were considered. The question remains as to what “amongst others” will include.

There is nothing in the Act requiring companies to create a paper trail of board decisions. However, directors will clearly want to ensure they are able to demonstrate they have discharged their duties under the Act. However, these concerns will need to be balanced against the administrative burden on the company in documenting each and every decision made by the board. It is highly unlikely that most companies will be able to fully document each decision that is made by its board.

To reduce the potential risk arising out of the codification of directors' duties, companies will need to ensure directors are fully aware of their new duties and that the company adopts a clear policy on board decision making procedures. In addition, companies should review the terms of reference for their directors to ensure that they reflect the new duties. Companies should also review the preparation of board papers to ensure these include the relevant information that will need to be considered by the board when discharging their new duties. In this regard, it is important that not only are the directors briefed on the new duties but also those members of staff that prepare the board papers.

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The Third Money Laundering Directive

In January 2007 HM Treasury published the Draft Money Laundering regulations 2007, implementing the Third Money Laundering Directive (2005/60/EC).

The public consultation period for the regulations expired on 2 April 2007. The regulations are expected to be finalised later this year, in time to give businesses an opportunity to update their procedures and systems prior to the Regulations' full implementation date of 15 December 2007.

Increase in businesses affected

The regulations will bring more businesses within the scope of anti-money laundering obligations, including dealers in high value goods (e.g. art dealers and auctioneers), trust companies and casinos. The following types of business will need to ensure they comply with anti-money laundering regulations:

- Credit and financial institutions regulated by the Financial Services Authority (FSA)
- Investment firms (as defined under the Markets in Financial Instruments Directive)
- Collective investment schemes marketing its units or shares
- Insurance intermediaries
- Consumer credit financial institutions
- Money service businesses
- Legal professionals
- External accountants, tax advisers and insolvency practitioners
- Trust and company service providers
- Estate agents
- High value dealers
- Casinos

Significant changes

The new regulations will introduce important changes to current anti-money laundering regulations, including raising the bar for checks on beneficiaries of companies and trusts, developing stricter rules in certain circumstances, including where the customer is a 'politically exposed person' (PEP – including their family members and close business associates), and widening the scope of money laundering to include activities related to raising funds for terrorism.

The requirement to identify beneficiaries in trusts has triggered controversy, with businesses arguing that it will raise costs and may prove time consuming. In addition, certain industries that habitually employ complex ownership structures, such as private equity funds, may resist requirements to divulge their investors' details.

The regulations also provide for simplified due diligence procedures for certain low risk customers, such as most FSA authorised entities, local authorities and listed companies. In addition, simplified procedures also apply for low risk products, such as low premium life insurance, certain pension schemes and low value electronic money.

Industry guidance

To effectively guide businesses, the regulations will need to be supplemented by guidance issued by the EU Commission and industry bodies. While this guidance is being developed and refined, businesses may face some uncertainty in resolving key issues such as identifying beneficial ownership structures and effectively identifying PEPs.

Next steps

With the regulations due to be finalised this summer, and further guidance from industry bodies likely, businesses, particularly in the newly regulated sectors, must be alive to the challenges which lie ahead in ensuring effective compliance with their obligations.

To this end, businesses should be thinking about how they will implement the regulations' provisions in light of their business models, notably through the identification of particular areas of risk. Senior management time should be set aside to address implementation issues and ensure systems and procedures are updated prior to the 15 December 2007 implementation date.

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Recent Law Commission proposals for a radical reform of insurance contract law

For a number of years, insurance contract law in the UK has been criticised for being outdated and often unduly harsh on individual policyholders, making no distinction between consumers and businesses. As consumers and small businesses generally require enhanced protection because of their vulnerability, lower commercial awareness and experience, a failed insurance contract could have disastrous consequences to the life and financial position of such individuals or small businesses.

In January 2006, the Law Commission of England and Wales and the Scottish Law Commission (together, the LC) published a joint scoping paper. In addition, three issues papers have been produced by the LC. A summary of each is set out below. A fourth issue paper on post-contractual good faith is due to follow. The purpose of these papers is to develop thinking in readiness for a full consultation paper of these topics, due to begin shortly.

Issue paper 1

Paper 1 deals with misrepresentation and non-disclosure and suggests taking a different approach in relation to consumer policyholders and business policyholders. The duty to disclose would be abolished for consumers but retained for businesses; hence a two-tier approach would be adopted. Small businesses would be treated in the same way as consumers, although the definition of small business for this purpose is likely to arouse debate.

Issue paper 2

Paper 2 deals with warranties and proposes that in consumer insurance contracts, basis of contract clauses and similar clauses that have the effect of turning statements of fact into general warranties, should have no effect. For business contracts, basis of contract clauses would no longer turn statements into warranties. If any warranty of past or existing fact is to be permitted, each statement should be set out either in the policy or in some document incorporated by reference into the policy.

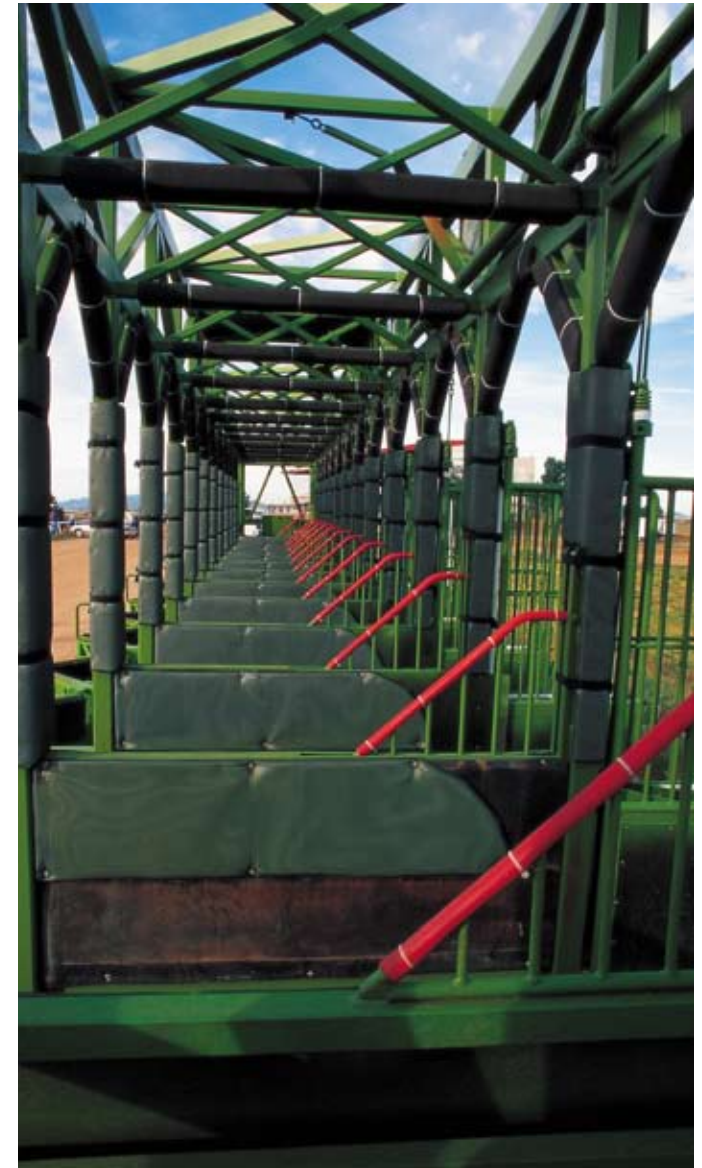
Issue paper 3

Paper 3 deals with intermediaries and pre-contract information in insurance contract law. Currently, where mistakes or fraud by an insurance intermediary leads to non-disclosure of information, or information being misrepresented to an insurer, the insurer will usually be entitled to avoid the contract of insurance. This does not apply if the insurer is deemed to be aware of the non-disclosures or misrepresentations.

Paper 3 proposes to treat the intermediary as the insurer's agent for the purposes of obtaining pre-contract information, unless the intermediary is genuinely searching the whole insurance market on the insured's behalf. In addition, the paper questions the extent to which small businesses should be treated as consumers in this regard.

The legislation emerging from the current proposals will signify a wholesale reform of English insurance law. The LC's consultation paper which is expected this summer, and the LC's substantive reports are likely to generate commentary from industry, consumer and business representation bodies.

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New client categorisation order – are you ready?

In October 2006 the Financial Services Authority (FSA) issued consultation paper CP06/19 seeking views on proposed changes to the Conduct of Business Rules (COB) including client classification. The current draft COB provisions reflect the client categorisation provisions of the Markets in Financial Instruments Directive (MiFID).

MiFID adopts three categories of client: retail, professional and eligible counterparty (ECP). The detailed COB obligations apply differently to each. The MiFID categories will replace the current classifications of private customer, intermediate customer and market counterparty.

Investment businesses need to be aware of and plan for the impact of the new regime. In particular:

- Firms will need to be aware of, and plan for, new client classification notification and form of agreement requirements under the new regime.
- Different boundaries between categories may result in clients falling into a different category than at present with a resulting change in level of protection.
- The introduction of quantitative thresholds for large undertakings as well as a quantitative tests for retail clients wishing to elect professional categorisation is likely to result in a greater number of clients being categorised as retail clients.
- The limited scope of the ECP classification may require some clients to be categorised as professional or retail clients for non-ECP business activities.

A professional client is one who “possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs.” Clients automatically assigned to this category (professionals) include entities which are required to be authorised or regulated to operate in the financial markets, large undertakings, and other institutional investors whose main activity is to invest in financial instruments. The application of COB obligations to professional clients will differ from the current application of COB to intermediate customers.

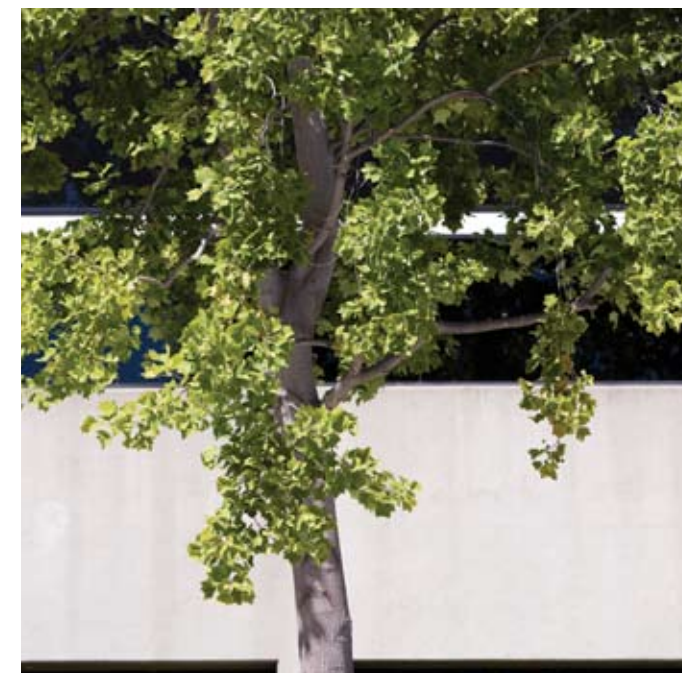
ECPs will be afforded the lowest level of protection. ECPs include investment firms, credit institutions, insurance companies, undertakings for collective investments in transferable securities (UCITS) and their management companies, pension funds and their management companies. Member States can also include other institutions within the ECP category. The ECP regime only applies to entities in respect of specified business activities, i.e. those executing orders on behalf of clients and/or dealing on their own account and/or receiving and transmitting orders.

A retail client is any client who is not a professional client. Retail clients are afforded the highest level of protection.

A client may elect to be treated as though they fall within a category other than their default category, thereby electing to benefit from a lesser or greater degree of investor protection.

To assist firms in the transition to MIFID, the FSA is proposing to implement certain grandfathering provisions. Firms will be able to automatically grandfather existing clients who map directly to the corresponding MIFID category without the need for review, re-paper or notification. For clients who do not map directly, transitional grandfathering and reviewed grandfathering will require firms to carry out varying levels of re-categorisation, review and notification.

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New WEEE regulations

The long-awaited Waste Electrical and Electronic Equipment Regulations 2006 (the WEEE Regulations) were published in December 2006 and came into force on 2 January 2007. They implement the EU Waste Electrical and Electronic Equipment Directive (2002/96/EC).

The WEEE Regulations impose obligations on producers and distributors of electrical and electronic equipment to ensure effective disposal, treatment and recycling of waste equipment (WEEE). It is related to the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Directive (2002/95/EC) (the RoHS Directive), which aims to reduce the environmental impact of electrical and electronic waste by prohibiting the use of certain restricted substances in equipment placed on the market after 1 July 2006. The RoHS Directive was implemented into UK law by the RoHS Regulations 2006, already in force.

Under the WEEE Directive, producers who put relevant equipment on the market are responsible for financing the collection, treatment, recovery and recycling of WEEE. Producers include manufacturers and importers of equipment and also resellers who have re-branded products of another manufacturer. Distributors (i.e. retailers) of equipment are required to operate a take-back facility, whereby consumers (and certain businesses) can return old equipment to a distributor when purchasing new equipment to replace it.

Different rules apply in relation to WEEE from private households (which includes consumer and certain business waste) and other types of WEEE (in general, business waste). A key difference is that some of the producer's responsibilities can be passed on to business users (by contractual agreement), whereas the responsibility for dealing with private household waste cannot be transferred to the user.

The WEEE Regulations will apply in relation to producers who put relevant equipment on the market on or after 1 July 2007, or in relation to business waste equipment which has already been put on the market. Producers are required to join a compliance scheme. All producers should have been registered with a compliance scheme by the 15 March 2007 and with the regulatory authorities (via their compliance schemes) by 31st March 2007.

The WEEE Directive was due to be transposed into national law in all EU Member States by August 2004, with a trigger date for key producer responsibilities by August 2005. However, there have been many practical concerns around implementing some of the requirements and the UK regulations were therefore delayed. Difficult issues include the methods of imposing, and apportioning between producers, liability for collection and treatment of historic and future waste, the provision of guarantees and evidence for compliance, and the extent to which the additional costs of compliance can be shown to the ultimate users of products. These issues have been dealt with in different ways within the EU Member States.

Businesses are also facing concerns in identifying when and where their liabilities arise, particularly where they are operating across several EU Member States. These uncertainties relate to the interpretation of the phrase 'put on the market' and the fact that registration and information obligations arise at a different time and potentially in a different country to where products ultimately become waste. There is still uncertainty in this area which requires guidance beyond the text of the legislation and analysis of the variances between local requirements.

Businesses involved in the manufacture, distribution, importation and re-sale of electrical and electronic equipment, together with the operators of compliance schemes, are all affected by the new requirements. A range of legal issues need to be considered, including the structure and management of compliance schemes, regulatory compliance with the new obligations and re-negotiation of contracts to provide for the allocation of risk and pricing relating to WEEE obligations.

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The Takeover Panel and FSA consultations

The Takeover Panel adopts full statutory powers

The UK panel on takeovers and mergers (the Takeover Panel) is an independent body whose main function is to issue and administer the City code on takeovers and mergers (the Takeover Code). The Panel generally supervises and regulates takeovers and merger transactions by companies with their registered offices in the UK, the Channel Islands or the Isle of Man, whose securities are admitted to trading on a stock exchange in those jurisdictions. Its remit also extends to certain unlisted companies resident in the UK. Until this year, the Panel had limited enforcement powers because historically neither the Takeover Panel nor the Takeover Code had any statutory basis.

From May 2006, the Takeover Panel operated under interim provisions of the EC Directive on takeover bids (2004/25/EC) (the Takeover Directive). In May 2006 certain provisions of the Takeover Code, such as the substantial acquisitions rules, were abolished. Since 6 April 2007, the Takeover Panel amended the Takeover Code, adopting its full powers under the provisions of the Takeover Directive. The Takeover Panel now has statutory powers as a supervisory body in relation to takeover bids and other merger transactions, implemented as part of the Companies Act 2006. The Takeover Panel's statutory powers apply to all the entities it regulates and to all UK activities involving bids. The implementing provisions of the Companies Act 2006 require the Takeover Panel to give effect to certain provisions of the Takeover Directive, and give the Takeover Panel the power to give any direction that appears to the panel to be necessary to prevent an action in breach of the Takeover Code and to ensure compliance with its rules.

Whilst the Takeover Panel has stressed that its new statutory weight will make little practical difference to takeover activity by companies within its jurisdiction, the increase in the Takeover Panel's powers has been welcomed as another step in maintaining a well run system of takeover regulation in the UK. This is crucial in maintaining confidence in the financial markets throughout the EU as well as the UK.

FSA consults on permitted links rules for long-term insurance business

At the end of March 2007, the FSA issued consultation paper 07/07 setting out proposed changes to the permitted links rules. These FSA rules specify certain classes of assets on which the value of benefits under a life assurance or pension policy depend. Historically, the permitted asset classes have been based on authorised unit trusts, however the permitted links rules have not been updated and have become increasingly outdated and unworkable. The FSA's proposals to allow investments in collective investment schemes investing in real property will be particularly welcome to both property fund managers and institutions wanting to expose their investors to the property investment arena.

Under the current regime this area is problematic due to the requirement for interests in the underlying fund to be 'readily realisable' – a difficult definition for a property fund to satisfy due to the illiquid nature of the underlying investments. This restriction is out of date given the increase in appetite for property funds, as the permitted links rules currently allow for direct investment in land but not via a collective investment vehicle. The consultation paper is available at www.fsa.gov.uk and invites responses by 28 June 2007.

FSA consults on training and competence regime

The FSA has issued consultation paper 07/04 in relation to training and competence (TC). The proposals will have a significant impact on financial services firms who deal purely with wholesale customers, because the FSA's proposed TC rules will only apply to firms dealing with retail (private) customers and not wholesale firms. The existing TC rules will be replaced with a much shorter set of rules for retail firms. The FSA's examination requirements for individuals working only with wholesale clients will be removed. These changes are in line with the FSA's continued move towards principles based regulation. The senior management, systems and controls section of the FSA handbook will contain a new overarching obligation in relation to TC. Despite these changes, all FSA authorised firms will continue to be bound to ensure that all their staff are competent to carry out their role, both from a technical perspective and in relation to understanding the UK regulatory regime. Wholesale firms will therefore be able to develop their own TC requirements depending on the nature of their business, giving more flexibility. Certain wholesale firms may choose to retain the requirement for staff to pass examinations from their own risk-management perspective, particularly if the firm has both private and wholesale customers.

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Points based system for UK immigration reform to start in early 2008

Following two years of radical planning to reform the UK immigration system, the Government has announced that the implementation of the new points based system (PBS) will come into affect in under a year. UK companies employing foreign nationals should start ensuring systems are in place to comply with the new rules now.

The PBS is based on the Australian model and has been developed to provide a simpler, clearer and easier to enforce system, superseding the current confusing range of worker entry routes.

All companies employing non-EU nationals will be required to register as certified sponsors, allowing them to apply for visas on behalf of their prospective employees. The border and immigration agency (BIA) is currently visiting companies to explain the new procedures and will be arranging follow-up meetings to carry-out a compliance audit for companies wanting to become certified sponsors.

The new system uses objective criteria to determine whether an individual is suitable. Foreign individuals will need to complete an on-line application at their embassy and will need a UK sponsor to vouch for them and prove they comply with immigration rules. The system will be streamlined so it can be completed in one stage.

There are five tiers within the new system:

- highly skilled migrants;
- migrants with a job offer;
- low skilled migrants;
- students; and
- other temporary categories, such visiting workers and cultural exchange.

Points will be awarded to reflect aptitude, experience, age and the level of need in any given sector, allowing the UK to respond flexibly to changes in the labour market. There is also an English language requirement for qualification under tiers 1 or tier 2.

Tier	Type of worker	Implementation
Tier 1	Highly skilled migrants such as professional graduates and entrepreneurs. This will be similar to the current highly skilled migrant programme visa. Applicants with this visa can work for any UK employer	April 2008
Tier 2	Skilled workers with a job offer who do not qualify under tier 1	October 2008
Tier 3	Workers to fill low skilled shortage occupations	October 2008
Tier 4	Students applying to study in the UK	April 2009
Tier 5	Temporary workers such as visiting workers, youth mobility and cultural exchange and selective development schemes	October 2008

The BIA will require UK companies to anticipate the likely need of foreign labour for their business and companies should start monitoring and recording the number of non-EU nationals they employ. Employers should also ensure that data confirming permission for employees to work is up to date. Finally, employers should review and tighten their rules on issues such as post-termination restrictions and reimbursement of relocation expenses, as many highly skilled employees will no longer be tied to just one company.

For employers who have not previously applied for work permits a substantial amount of documentary evidence will be required in order to prove the need for foreign labour, to demonstrate that salaries are commensurate with UK market rates and that they qualify for sponsorship status.

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Dates for you calendar

June

- 01/06** Reintroduction of CoP10 clearance procedures in relation to substantial shareholding exemption (SSE)
- 22/06** Notification should be given of intention to disclose under HMRC's offshore disclosure facility by this date
- 28/06** Closing date for responses to FSA consultation on permitted links rules for long-term insurance business

July

- 01/07** Smoking ban to apply in England

October

- 01/10** Companies Act 2006 – implementation of Companies House related provision expected
- 01/10** Directors duties codified
- 19/10** Private Members Bill aimed at giving temporary agency workers improved rights is due to have its second reading

December

- 15/12** Third Money Laundering Directive implementation

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