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UK Corporate Update.

Pre-emption rights: revised Pre-Emption Group Statement of Principles

The Pre-Emption Group has published a revised Statement of Principles setting out the general attitude of UK institutional investors to disapplications of pre-emption rights and to issues of shares for cash on a non pre-emptive basis.

These Principles relate to disapplications of statutory pre-emption rights under Section 570 of the Companies Act 2006. Although the revisions will not require any changes to standard shareholder disapplication resolutions, companies may wish to change their resolutions to reflect the new 10% limit described below.

The key changes from the previous version of the Statement (published in 2008) are set out below.

Issuing equity securities for general corporate purposes

The principle that general disapplications of pre-emption rights should be limited to 5% of the issued ordinary share capital in any one-year period has been maintained, with a rolling 7.5% aggregate limit on non-pre-emptive issues for cash over a three-year period.

Specified capital investments

Companies are permitted under the guidelines to seek authority to undertake cash placings of up to 10% per annum to finance expansion opportunities. The AGM circular or explanatory notes to the resolution should commit to using the excess over the amount that can be used for general corporate purposes (see above) only in connection with an acquisition or specified capital investment.

Any such acquisition or specified capital investment must be announced at the time of the relevant share issue or be disclosed in the announcement and have taken place in the preceding six-month period.

The result of the new guidelines is that the maximum amount of shares that a company could issue non-pre-emptively for cash over a three-year period would be 30% (and not more than 10% in each year) of which a maximum of 7.5% could be for purposes other than a specified capital investment (for example, general working capital).

Issuing equity securities for non-cash consideration

The Statement has been amended to clarify that it applies to all issues of equity securities that are undertaken to raise cash for the issuer or its

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subsidiaries, regardless of the legal form. This means that "cashbox" placings, although falling outside the statutory pre-emption regime, will count toward the limits set out in the Statement.

Issues at a discount

The guidelines retain the principle that shares should not be issued for cash on a non-pre-emptive basis at a discount of more than 5% to the prevailing market price but clarify how this should be calculated and in particular that the company's expenses (including fees and commissions) in connection with the issue need to be included in the calculation.

Scope of the Statement

The new guidelines clarify that the Statement applies to both UK and non-UK incorporated companies with a premium listing on the London Stock Exchange. However, companies with a standard listing or which are listed on AIM or the High Growth Segment of the LSE are also encouraged to comply.

Status of the Statement

The principles are not hard and fast rules and Robert Swannell, Chairman of the Pre-Emption Group states in the Group's press release, "The revised Statement provides a framework for early and effective dialogue between a company and its shareholders. The Statement of Principles is just that – it's not a rule book". However, the principles do state that companies that do not comply with these principles are likely to find that their shareholders are less inclined to approve subsequent requests for a general disapplication of pre-emption rights.

Impact on the 2015 AGM season

The Pre-Emption Group encourages companies and investors to begin to use the revised Statement from now on, but acknowledges that as the 2015 AGM season is imminent some flexibility may be required. Some of our clients are currently considering whether to increase their disapplication resolutions in accordance with this authority.

Click here for the revised Statement of Principles. Click here for the press release.

European ruling casts doubt on Hannam interpretation of inside information

The Court of Justice of the European Union has issued a judgement which redefines what it means for information to be precise for the purposes of the definition of inside information. The Court found that it was not necessary to be able to determine the direction of possible price movement. This is in direct contrast to the findings of the Upper Tribunal in *Hannam* and further muddies the waters, making it even more challenging for market participants and issuers to determine whether they have inside information or not.

What happened?

The French financial markets authority requested a ruling from the CJEU on the interpretation of the definition of inside information in Article 1 of the Market Abuse Directive (which is enacted in the UK by Section 118C of the Financial Services and Markets Act 2000). The request arose in the context of an action concerning an investor who had economic exposure to an investment via a series of total return swaps and was intending to convert that into a significant shareholding. The question was whether that fact was inside information which should have been disclosed to the market.

Specific enough to enable a conclusion to be drawn as to possible effect on price

In order for information to be inside information it must be precise (see *Market Abuse reminder* below). In order for it be precise it must be specific enough to enable a conclusion to be drawn as to possible effect on price. The Upper Tribunal in *Hannam v the Financial Conduct Authority [2014] UKUT 0233 (TCC)* considered that the information must indicate the direction of movement in the price which would or might occur if the information were made public.

The question referred to the CJEU by the French authorities in this instance was on that exact point: whether the requirement for information to be specific enough to enable a conclusion to be drawn as to possible effect on price must "be interpreted as meaning that only information in respect of which it may be determined, with a sufficient degree of probability, that, once it is made public, its potential effect on the prices of the financial instruments concerned will be in a particular direction may constitute inside information."

No need to determine direction of price movement

The Court found that it was not necessary to be able to determine the direction of price movement. It found that it is enough that the information be sufficiently exact or specific to constitute a basis on which to assess whether the set of circumstances or the event in question is likely to have a significant effect on the price of the financial instruments to which it relates. The only information excluded from the concept of 'inside information' by virtue of that provision is information that is vague or general, from which it is impossible to draw a conclusion as regards its possible effect on the prices of the financial instruments concerned.

Mr Lafonta argued that only information which indicates the direction of price movement would enable the holder to determine whether a particular financial instrument should be bought or sold and, as a result, gives the holder of that information an advantage over other market participants. The Court disagreed.

It found that the increased complexity of the financial markets makes it particularly difficult to assess the direction of a change in price. If information were to be regarded as precise only if it made it possible to anticipate the direction of a change in the prices of the instruments concerned, any uncertainty in that regard could be used as a reason for not making that information public. This would allow the holder of the information to profit from it to the detriment of the rest of the market.

The CJEU's ruling will have to be taken into account by the UK Financial Conduct Authority in its interpretation of inside information.

Comment

This finding potentially lowers the threshold for what can constitute inside information even further. It also introduces uncertainty into a question of interpretation that has been reasonably settled since the *Hannam* decision. This makes it difficult for issuers to determine when they have inside information such that they need to make an announcement and for investors to assess when the information they have prevents them from dealing.

See *Jean-Bernard Lafonta v Autorité des marchés financiers (Case C-628/13)*

Market Abuse reminder - what is inside information?

Inside information is defined in the Market Abuse Directive and in Section 118C FSMA as "information of a precise nature which

> is not generally available,

> relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and

> would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related instruments."

Section 118C(5) provides that "information is precise if it:

> indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and

> is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments."

Regulations banning takeovers by cancellation scheme now in force

Regulations have now come into force which ban takeovers being effected by a cancellation scheme of arrangement. This ban has been introduced in order to prevent cancellation schemes being used to avoid the payment of stamp duty on a takeover.

The regulations inserted a new section 641(2A) into the Companies Act 2006. This prohibits a company from reducing its share capital as part of a scheme of arrangement where the purpose of the scheme is to acquire all the shares (or all the shares in one or more classes) of the company (i.e. a takeover). Cancellation schemes of arrangement are still allowed for the insertion of a new topco in transactions such as demergers and redomiciles, subject to the satisfaction of certain conditions.

What about offers that have already been announced?

The regulations came into force on 4 March 2015 but they do include a transitional provision for transactions where an announcement of a firm intention to make an offer has been made, or the terms of the offer have been agreed (in the case of a company that is not subject to the Takeover Code), before that date. In these circumstances, the prohibition will not apply.

What does this mean for takeover structures?

It is worth noting that transfer schemes of arrangement are still available for takeovers. With the exception of the stamp duty saving, transfer schemes bring all of the advantages over contractual offers associated with cancellation schemes. These include:

> a lower approval threshold (75% of votes as opposed to 90% of shares);

> a shorter time to get to 100% ownership and avoidance of the slow and cumbersome squeeze-out procedure under Section 979 of the Companies Act 2006;

> increased certainty as to outcome and timing;

> avoidance of many, particularly US, overseas securities law implications; and

> the ability to extend the timetable to accommodate lengthy regulatory (often anti-trust) clearances.

So whilst contractual offers may still be the preferred structure for some takeovers, the scheme route remains open and scheme takeovers will continue to bring many advantages.

The Companies Act 2006 (Amendment of Part 17) Regulations 2015 (SI 2015/472) can be found here.

Minor changes to private company share buyback rules finalised

Amendments have been made to the rules for private company share buybacks that were introduced in April 2013.

The changes take effect on 6 April 2015 and will clarify, or in some cases adapt, the application of the rules in Part 18 of the Companies Act 2006 in light of some concerns that have been raised since the rules took effect.

They include changes relating to the calculation of the de minimis limit (where private companies make small repurchases out of capital without following strict creditor protection measures); the accounting treatment of shares repurchased under the de minimis exemption and the timing of the surrender of shares when a payment out of capital is made for a repurchase pursuant to an employees' share scheme.

The Companies Act 2006 (Amendment of Part 18) Regulations 2015 (SI 2015/532) are available here and an explanatory memorandum is available here.

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