Linklaters

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UK Corporate Update.

High Court considers parent company liability in a multi-national group

The High Court has indicated that general manifestations of a group identity should not be enough to fix a parent company with a duty of care for its foreign subsidiaries. This is consistent with previous authority.

A detailed note is available on the Linklaters Knowledge Portal here.

FRC calls for greater enforcement powers over directors and announces review of UK Corporate Governance Code

The Financial Reporting Council has announced plans for a "fundamental review" of the UK Corporate Governance Code. This will take into account the work done by the FRC on corporate culture and succession planning, as well as the issues raised in the Government's Green Paper on Corporate Governance and the BEIS select committee inquiry. It will also consider the balance between the Code's principles and provisions. However, there is no intention to amend what the FRC refers to as the strengths of the UK corporate governance framework such as the unitary board or the comply or explain approach.

To guide the review, the FRC will seek input from a wide range of stakeholders, including its recently established Stakeholder Advisory Panel. The Panel is drawn from a wide range of sectors including the Chartered Institute of Internal Auditors, Share Action, CIMA, Barclays, Co-operative UK, TUC, RPMI Railpen, Institute of Customer Services, Centre for Corporate Governance, London Business School, CIPD, IBE, ACAS, High Pay Centre, Resolution Foundation, City Values Forum, CBI, Joseph Rowntree Foundation, GHO Capital Partners.

In its response to the Government's Green Paper on Corporate Governance, the FRC will highlight the importance of helping boards take better account of stakeholder views, linking executive pay with performance, and extending the FRC's enforcement powers to ensure that disciplinary action can be taken against all directors where there have been financial reporting breaches.

The FRC will commence a consultation later in 2017 based on the outcome of the review and the Government's response to its Green Paper.

Further details can be found in the FRC's press release, here.

Corporate Governance Matrix 2017 published

Brexit, Theresa May's push for an economy that works for everyone and the unpredictable administration of Donald Trump make keeping track of regulatory developments concerning corporate governance more challenging than ever.

In this issue

High Court considers parent company liability in a multi-national group 1

FRC calls for greater enforcement powers over directors and announces review of UK Corporate Governance Code............ 1

Corporate Governance Matrix 2017 published 1

AGM Alert 2017 client guide published 2

ESMA publishes Q&A to clarify application of its guidelines on alternative performance measures..... 3

FCA confirms that list of reasons to delay disclosure is not exhaustive 3

FCA launches Listing Regime review 4

Our updated Matrix provides an index of corporate governance developments affecting listed companies. This aims to put into context UK, US and EU regulatory developments relating to directors, risk management, corporate social responsibility and other corporate governance matters.

New topics covered include:

> the increased focus in the UK on "stakeholder voice" and the responsibility of business to wider society, including the government's green paper on corporate governance reform;

> the plans by the FRC to review the UK Corporate Governance Code and its guidance on board effectiveness in 2017;

> new UK reporting requirements in the pipeline, including on pay by gender, supplier payment practices, tax strategy, diversity and anti-bribery policies; and

> the Trump administration's initial steps to roll back portions of the Dodd-Frank Act, including the resource extraction payments disclosure rule, the conflict minerals rule and the pay ratio disclosure rule.

The Matrix is available on the Linklaters Knowledge Portal here.

AGM Alert 2017 client guide published

We have published our AGM Alert 2017 guide for company secretaries and general counsel of UK premium-listed companies. This covers legal and regulatory changes, market practice and recent guidance on topical issues, including the government's Green Paper proposals for corporate governance reform.

Key points for 2017 are as follows.

AGM business

> The Pre-Emption Group now expects companies seeking an enhanced pre-emption disapplication authority to split the request into two resolutions.

> In selecting new officers, companies are asked to consider diversity of ethnic origin as well as gender. Updated investor guidelines suggest that there may be voting against director resolutions for corporate governance failures.

> Amendments to articles are not required, but companies should review any borrowing limits and may also want to consider updates which give greater flexibility.

Company reporting

> The Financial Reporting Council review of the viability statements published so far found that, while many are satisfactory, there is room for improvement.

> Companies need to consider how to report on the effect of Brexit on their business and those with an autumn year-end have started to do so.

> Outside the annual report, large organisations must now make a slavery and human trafficking statement. Companies should also consider whether to link this to the information in the annual report.

> Updated rules and recommendations require audit committees to consider the clarity of their reporting and say more about their work.

> Further disclosure requirements will mean information must be published about payment practices, gender pay gaps, tax strategy, further non-

financial reporting (on human rights, anti-bribery and diversity) and country-by-country reporting on tax.

Directors' remuneration

> This year sees a renewed interest in remuneration, with the government's Green Paper on corporate governance looking at executive pay reform as a key issue.

> Many companies will be putting a revised binding remuneration policy before the AGM this year and will need to take into account calls for greater pay restraint.

> Companies should also take note of the updated remuneration guidance issued by a number of investor groups. Topics to consider include: making pay ratios available, disclosing variable pay targets more promptly, reviewing the use of remuneration discretion and reducing pension entitlement disparities.

AGM Alert 2017 is available on the Linklaters Knowledge Portal here.

ESMA publishes Q&A to clarify application of its guidelines on alternative performance measures

The European Securities and Markets Authority has published some new Q&A to assist with the interpretation of its Guidelines on Alternative Performance Measures.

Alternative performance measures are a "financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework. APMs include measures such as EBITDA or sales per square metre. ESMA's APM Guidelines apply to regulated information or prospectuses (but not financial statements) published on or after 3 July 2016 and seek to improve the usefulness, transparency and comparability of APMs.

FCA confirms that list of reasons to delay disclosure is not exhaustive

The Financial Conduct Authority has now adopted in full the European Securities and Markets Authority's guidelines issued under the Market Abuse Regulation and made changes to its Disclosure Guidance in DTR 2 to bring it in line with ESMA's guidelines. The main change is the removal of a statement that delaying disclosure of inside information is only likely to be allowed where there is an ongoing negotiation that would be jeopardised by early disclosure, as this conflicts with ESMA's non-exhaustive list of situations when delay might be permissible.

Background

Under Article 17 MAR, an issuer must announce inside information as soon as possible unless it can satisfy three criteria: that immediate disclosure would prejudice the issuer's legitimate interests, that delay is not likely to mislead the public and that confidentiality will be preserved. ESMA issued guidelines under MAR which include a non-exhaustive list of situations where an issuer might delay to protect its legitimate interests, as well as guidance on misleading the public.

Conflict between ESMA guidelines and DTR 2.5.5G

The FCA's Disclosure Guidance contained a statement that, other than in relation to ongoing negotiations, there are unlikely to be other situations in

which delay might be possible to protect the issuer's legitimate interests. The FCA has now deleted this statement, following a consultation.

This change is welcome as it clarifies once and for all that the ESMA list of legitimate reasons for delay is indicative and non-exhaustive. It will allow issuers to delay in the other circumstances specified in the ESMA guidelines, and it potentially opens the door to delaying disclosure in circumstances not set out in the guidelines, as the list is non-exhaustive. However, the FCA has said that it and ESMA both interpret Article 17(4) MAR (ability to delay) narrowly.

The changes to DTR 2 took effect on 24 February 2017. Click here for the FCA's policy statement.

FCA launches Listing Regime review

The Financial Conduct Authority has launched a review of the UK listing regime. It has published a discussion paper on the effectiveness of the listing regime and a consultation paper on some more detailed changes to the Listing Rules regarding eligibility for premium listing and the application of the class tests.

Review of the UK Primary Markets landscape

The discussion paper forms part of the FCA's commitment to review the structure of the UK primary markets to ensure that they continue to meet the distinct needs of issuers and investors.

Standard listing

The FCA notes that the standard listing regime is seen as an unattractive option, because of a lack of clarity as to the purpose of the regime and the required standards for listing. The FCA is especially interested in whether it should continue to avoid treating UK and non-UK companies differently.

The FCA observes that traditional secondary listings by large overseas companies are declining in number and that, when a premium listing is not available, the favoured option for overseas issuers is a listing of Global Depositary Receipts. A listing of GDRs is typically targeted at sophisticated investors and inaccessible to the retail market.

The FCA asks whether there should be a distinct international segment for overseas issuers who wish to access the UK listing regime but for whom the existing UK listing requirements are not wholly appropriate. The FCA notes that for such segment to be successful, a package of investor protections, "appropriate to the segment's aims and capable of fostering investor confidence" would need to be developed. The FCA asks for feedback on what a package might contain.

The FCA is also interested in whether a new name for the standard listing segment might be helpful to attract prospective applicants.

Open-ended investment companies

Currently a super-equivalent premium listed regime applies to open-ended and closed-ended investment funds, effectively removing their access to the standard segment. The FCA asks whether premium listing obligations for open-ended investment companies should be removed (except for the requirement to be authorised/recognised). This would allow open-ended investment companies access to the standard segment.

Science and technology companies

The FCA is interested in whether the UK's primary equity markets are adequately supporting growth for science and technology companies. The

FCA seeks views on how to improve the provision of "scale-up" capital (which it defines as capital raised by companies starting with at least 20 employees and with an average growth in employees or turnover exceeding 20% per annum over three years) and notes that the resulting risk to investors also needs to be addressed. The FCA highlights that some stakeholders view early-stage companies as inappropriate for public markets.

The FCA also considers some of the changes that have taken place in the UK's secondary capital markets over the past ten years, including a perceived shift towards algorithmic trading strategies and the separation of primary from secondary markets. The FCA notes that some market commentators believe that secondary market activity is increasingly characterised by short-term trading rather than long-term investment considerations. The FCA is keen to explore some of the themes that have emerged in its previous discussions with stakeholders in this area, including whether alternative market structures might better support "patient capital" (investment based on long-term considerations). One question asked by the FCA is whether a primary market requires a continuous secondary market (noting the example of crowd-funding) and, if so, what features a secondary market needs to have.

Debt markets

The FCA also considers measures that might be taken to improve the effectiveness of the UK primary listed debt capital markets (for example, whether there is an opportunity for a new wholesale bond Multilateral Trading Facility and how the prospectus regime addresses retail participation in debt markets).

Enhancements to the Listing Regime

The associated consultation paper looks at a number of technical proposals aimed at ensuring that the Listing Rules continue to meet the needs of issuers and investors. Most proposals relate to the premium segment of the listing regime.

Eligibility for premium listing

Chapter 6 of the Listing Rules sets out the requirements an applicant has to meet to obtain a premium listing. The FCA is proposing changes to LR 6 to ensure that the drafting better reflects the intention of the rules and how they are applied in practice. The FCA is also proposing new technical notes to provide additional guidance.

The proposals include:

> clarifying the application of LR 6, including that a new top holding company which is inserted on top of an existing issuer to undertake a transaction will not necessarily be treated as an applicant for premium listing other than on a reverse takeover; and that LR 6 does not apply to further issues of shares of the class already listed unless this occurs in conjunction with a reverse takeover;

> requiring additional financial information on acquisitions during the three-year track record period to be audited;

> clarifying that the FCA will expect the three-year track record to cover revenues generated in the applicant's desired line of business. The FCA is also proposing a technical note with additional guidance on how to interpret the track record requirements;

> deleting the existing guidance in LR 6.1.13G to LR 6.1.15G on when the requirement for a track record/financial information may be waived (this is misleading, as the FCA does not normally waive the requirements);

- clarifying that that the requirement for a revenue earning track record does not apply to mineral companies. Where a mineral company has been in existence for less than three years, the FCA is proposing that the requirement for representative historical information should only apply to the period for which the mineral company publishes or files its historical financial information;
- splitting LR 6.1.4R (independence of an issuer's business) into three separate provisions (clarifying the need for independence and control of the business) as well as adding additional guidance supplemented by a new technical note; and
- deleting the guidance in LR 6.1.17G and LR 6.1.18G on when the sufficient working capital requirement may be waived, as the FCA has not waived this requirement in recent years and is unlikely to do so in the future.

Concessionary routes to premium listing

One of the requirements for premium listing is a three-year revenue earning track record. The FCA recognises that, in certain sectors, investors use non-financial statement metrics to assess the relevant company's prospects rather than a three-year track record. There are therefore specific rules ("concessionary routes") to listing for companies in those sectors, enabling relevant companies to gain a premium listing by complying with other conditions.

The existing concessionary routes to listing relate to mineral companies and scientific research based companies. In its consultation paper, the FCA proposes a new concessionary route to premium listing for certain property companies that cannot meet the track record requirements in LR 6. These are likely to be companies established within the previous three years which predominantly hold mature assets which generate rental revenue and companies that have been developing long-term projects for at least three years, but which may only be revenue generating at some point in the future.

The FCA notes that investors will typically value these companies by the value of the property assets that they own, rather than by their revenue generation. It is proposing replacing the requirement for a three-year track record with a requirement on the company to:

- demonstrate that it has three years of development represented by increases in the gross value of its assets, supported by a property valuation report; or
- publish a property valuation report that shows that 75% of the applicant's assets by value are revenue-generating at time when they made their application for listing.

The FCA is also proposing new technical notes to give guidance on the existing concessionary routes to listing for mineral companies and scientific research based companies.

Class tests and reverse takeovers

Profits test

In response to stakeholders' feedback, the FCA is proposing two changes to its approach to the profits test on class transactions for premium listed issuers:

- it will treat the profits test as anomalous and disregard it where the result is 25% or more and all other class tests are under 5%. This will result in the transaction being treated as unclassified. Premium listed issuers would not have to consult with the FCA about this but must still seek the

guidance of a sponsor under LR 8.2.2R. The consultation stresses the importance of a sponsor's judgement and highlights the fact that there may be some situations where the sponsor may not think it appropriate to regard the test result as anomalous. For example, this may be where an issuer is to acquire a loss-making entity and the relative size of the target's losses will have a significant effect on the issuer's medium term prospects; and

> in limited circumstances where the test result is 25% or more and is anomalous, the FCA will allow premium listed issuers to make certain adjustments to the profit figures they use to calculate the test. An issuer should apply any adjustments consistently to itself and the target to ensure a like-for-like comparison. The consultation proposes that the issuer can adjust profits in the following situations, as long as the items are genuine one-off costs:
  - costs incurred by the issuer or target in connection with its IPO; and
  - closure costs incurred either by the issuer or target, that are not part of an ongoing restructuring that will span more than one financial period.

In assessing whether the item is a genuine one-off cost, the consultation refers sponsors and issuers to the guidance in the Technical Note – Classification tests (UKLA/TN/302.1).

The FCA also proposes that the issuer or target may adjust the profit figure for historic financial costs where it has recently completed its IPO and undertaken a capital restructuring.

All these changes will only apply where the:

> transaction would otherwise be a class 1 transaction or reverse takeover; and

> the issuer has a premium listing. Standard listed issuers must still consult with the FCA before adjusting the class tests or disregarding any results.

At the same time as consulting on these changes the FCA is also seeking views on whether to change the figure used to calculate the profits test. Currently the profit before tax figure is used but the FCA is considering whether other measures may be preferable.

Figures used to classify assets and profits

The FCA proposes to move its guidance in Technical Note - Classification Tests (UKLA/TN/302.1) to the Listing Rules themselves. The guidance states that, in relation to both an issuer and target, class test numbers used to classify assets and profits must be adjusted to take account of transactions completed since the last year end, which are class 2 or larger.

Reverse takeovers

Currently the FCA has discretion to suspend the listing of any securities "if the smooth operation of the market is, or may be, temporarily jeopardised or it is necessary to protect investors". To date the FCA has considered that a suspension of listing may be necessary in a reverse takeover because the market will not have adequate information to operate smoothly. The FCA proposes to change its assumption that a suspension is usually needed on a reverse takeover, because sufficient information should be available to the market by virtue of the company's other disclosure obligations. The FCA proposes keeping its existing approach for shell companies.

The proposed change addresses FCA experience as well as stakeholder feedback that suspending a listing is a disproportionate action which harms

investors because it means they cannot trade in the securities of the acquiring party, potentially for a long period of time. Stakeholders have told the FCA that issuers want to avoid any possibility of suspension but are concerned that they may not be able to give the FCA the specific information it needs to decide not to suspend their listing. Feedback to the FCA also suggested that this has the practical effect of deterring some issuers from pursuing transactions altogether and that the current rule could be distorting companies' behaviour when they consider potential transactions.

Next steps

The FCA requests responses to both papers by 14 May 2017. Revised rules on the matters covered in the consultation paper will be published in the second half of 2017. If the FCA decides to proceed with any recommendations arising from the discussion paper, it will publish a consultation later in the year.

Click here for the FCA consultation paper CP17/04 on changes to the listing rules.

Click here for the FCA discussion paper DP 17/02 on the review of the effectiveness of the listing regime.

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