CLIENT UPDATE

FCA ANNOUNCES CHANGES TO THE PREMIUM LISTING RULES, WITH FOCUS ON COMPANIES WITH A CONTROLLING SHAREHOLDER

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OVERVIEW

The FCA has announced changes to the UK Listing Rules, focusing on premium listed companies with controlling shareholders, which will come into effect on 16 May 2014. The changes are based on the Consultation Paper published on 5 November 2013 (CP 13/15).

The November consultation contained a significant question on changing the rules on cancellation of a premium listing. Two options were considered: whether to add a new requirement for premium listed companies with a controlling shareholder to gain additional approval from the majority of independent shareholders before seeking to delist (option 1), or to retain the existing rules on cancellation (option 2). The FCA chose to only put option 1 to its board and that has been adopted in the new rules.

The FCA has re-introduced the concept of a "controlling shareholder" meaning a person who, together with its associates and parties "acting in concert" with it (as used in the context of the City Code on Takeovers and Mergers), owns 30% or more of the shares or voting rights in a premium listed company. The amendments will impose new requirements on premium listed companies with controlling shareholders regarding, inter alia, specified agreements with controlling shareholders and the election process for independent directors.

Once the new rules are in force, new applicants for a premium listing with controlling shareholders will be required to comply, in full, at admission. For companies which already have a premium listing, there are suitable "grace periods" for such companies to bring themselves into compliance.

INDEPENDENCE CRITERIA

The new rules enhance the current eligibility requirement that an applicant to the premium listing segment be carrying on an independent business as its main activity. They contain a non-exhaustive list of factors indicating that the applicant is not capable of carrying on an independent business, including where a majority of the revenue generated by the applicant's business is attributable to business conducted directly or indirectly with a controlling shareholder; where the applicant does not have strategic control over the commercialisation of its products, ability to earn revenue or the freedom to implement its business strategy; where the applicant cannot demonstrate that it has access to independent financing; or where the applicant has been required to provide security over its business in connection with the funding of a controlling shareholder. The new rules also introduce, as an additional factor determining lack of independence, the situation where the controlling shareholder appears to be able to influence the operations of the applicant outside its normal governance structures or through material shareholdings in one or more subsidiaries. Although deliberately broad in scope, the FCA has noted that this factor should not preclude the exercise of influence through normal governance structures such as representation on the board of directors.

In addition, the new rules change the existing eligibility requirement that an applicant (other than a mineral company or scientific research company) control the majority of its assets from *a requirement* to an additional factor which may indicate non-compliance with the overriding independent business requirement. For these purposes, an ability to exercise only negative control or to veto significant decisions affecting the management of the business would not be regarded as control.

AGREEMENTS WITH CONTROLLING SHAREHOLDERS

The new rules require that a company with a controlling shareholder must enter into an agreement that includes the following three undertakings:

- Transactions and relationships between the company and the controlling shareholder or its associates will be conducted at arm's length and on normal commercial terms;

- No controlling shareholder or any of its associates will take any action that would have the effect of preventing the company from complying with its obligations under the Listing Rules; and
- No controlling shareholder or any of its associates will propose or procure the proposal of a shareholder resolution which is intended or appears to be intended to circumvent the proper application of the Listing Rules.

Although, as a matter of existing practice, many premium listed companies with controlling shareholders have such relationship agreements in place, these agreements will still need to be reviewed (in the next six months) to ensure that they include these three mandatory undertakings.

The FCA has also incorporated further safeguards to encourage compliance with controlling shareholder agreements, including a requirement for the company to include in the annual report a statement as to whether the required agreement has been entered into with the controlling shareholder and the extent of compliance with the prescribed undertakings by both the controlling shareholder and the company, and including an explanation of any instances of non-compliance. If an independent director declines to support this statement, this must be disclosed and the FCA must be notified. In addition, the FCA may request information from the company to confirm or verify that the independence provisions contained in the agreement with a controlling shareholder are being or have been complied with.

In the event of a failure to conclude an agreement, non-compliance with the three prescribed undertakings or an independent director failing to support the compliance statement in the annual report, the FCA proposes that all transactions between the company and its controlling shareholder, including ordinary course of business and de minimis transactions, would be treated as if they were related party transactions and become subject to the prior approval of independent shareholders, until such time as the company's annual report includes a clean statement of compliance. These amendments increase the role and responsibilities of independent directors in monitoring compliance with the terms of agreements with controlling shareholders.

DUAL VOTING FOR THE ELECTION OF INDEPENDENT DIRECTORS

The FCA has introduced a requirement for a dual voting procedure for the election and re-election of independent directors by companies with a controlling shareholder. This will require the separate approval of both a majority of all shareholders and a majority of independent shareholders. In the event that the two votes conflict, a further vote of all

shareholders will be required at least 90 days after the first vote (in order to allow time for dialogue among the company and the shareholders) and be decided on a simple majority basis. The rules do not specifically extend to the removal of independent directors. These voting procedures will have to be incorporated into the company's constitution. The grace period provisions allow companies until the next general meeting following the introduction of the new rules to make the necessary changes to their Articles of Association.

The FCA has also implemented a requirement for companies with controlling shareholders to include detailed disclosure on the proposed independent directors in the circular sent to shareholders in advance of the AGM. The circular will need to include details of any existing or previous relationship, transaction or arrangement the independent director has or had with the company, its directors or controlling shareholders, a description of why the company considers the independent director to be an effective director, how the company determined the director's independence and the process followed by the company for the selection of the independent director. Where a company already complies with the UK Corporate Governance Code, these proposals should not impose a significant additional burden as they are largely consistent with the responsibilities of the nomination committee of a premium listed company when selecting and recommending candidates for the board.

CANCELLATION OF LISTING

Currently, in order to cancel a premium listing or transfer to the standard listing segment, a premium listed company requires the prior approval of 75% of its shareholders. The new rules require that, in addition, for a company with a controlling shareholder, the de-listing must be approved by a simple majority of the independent shareholders.

Cancellation in Relation to Takeover Offers

The new rules also regulate situations where a controlling shareholder makes an offer for the minority. Where the offeror, or a controlling shareholder which is an offeror (together with its associates and concert parties), is interested in 50% or less of the voting rights before announcing a firm intention to make a takeover offer, the current regime would apply (meaning acquisition of issued share capital carrying 75% of the voting rights of the issuer is required). Where the offeror, or a controlling shareholder which is an offeror (together with its associates and concert parties), is interested in more than 50% of voting rights before announcing a firm intention to make a takeover offer, it would need to obtain acceptances or acquire shares from independent shareholders that represented a majority of the votes held by independent shareholders in addition to reaching the 75% acceptance

threshold. However, in this case, to address the position concerning the free float, the rules state that if the offeror has acquired, or agreed to acquire, more than 80% of the listed class of shares, then no further approval or acceptances by independent shareholders should be required to cancel the premium listing.

FREE FLOAT

The new rules confirm the criteria that the FCA will follow in deciding whether to modify the 25% minimum free float requirement upon admission to the premium list (which include the number and nature of public shareholders and whether the expected market value of the free float shares exceeds US$100 million). The new rules also clarify that shares subject to a lockup of more than 180 days are not eligible for inclusion in the free float with respect to both the standard and premium listing requirements.

Where the FCA has modified the 25% minimum free float requirement upon admission to the standard or premium list with respect to an applicant, the new rules specify that the FCA has the right to revoke any such modification in the event that the FCA considers that in practice the market for the securities of the premium or standard listed company is not operating properly.

OTHER CHANGES

Other changes to the Listing Rules include:

- a requirement that a premium listed company promptly notify the FCA of any instances of non-compliance with continuing obligations which are linked to the premium listing eligibility criteria;
- the introduction of two new Listing Principles for premium listed companies (that the voting power of each share within the same premium listed class should be equal and the voting rights of multiple classes of shares should not be disproportionate to the equity that they represent), as well as the extension of the application of two existing Listing Principles (in relation to adequacy of internal controls and dealing with the FCA in an open manner) to issuers with a standard listing;
- a requirement that a premium listed company's annual report present in readily identifiable form certain mandatory disclosures required under the Listing Rules;
- requirements in circumstances where a company has several classes of shares and not all classes are admitted to the premium listing segment to ensure that voting on

matters which are prescribed by the Listing Rules as applicable to the premium listing segment will be decided by a resolution of holders of the shares admitted to the premium listing segment; and

- a requirement to disclose smaller related party transactions (where each of the percentage ratios is less than 5%, but one or more of the percentage ratios exceeds 0.25%) immediately (rather than in the company's annual report, as at present) and include in the announcement, inter alia, the identity of the related party, the value of the consideration for the transaction or arrangement and a brief description of the transaction or arrangement.

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Please do not hesitate to contact us with any questions.

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