

CLIENT UPDATE

FSA CONSULTS ON CHANGES TO THE LISTING REGIME, FOCUSING ON COMPANIES WITH CONTROLLING SHAREHOLDERS

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On 2 October 2012, the Financial Services Authority (“FSA”) published a consultation paper on various aspects of the listing regime in the United Kingdom¹, with a particular attention to issues that they believe may be created with companies with controlling shareholders. The proposals, which, if adopted, could affect both new entrants to the premium listing segment as well as existing listed companies, include eligibility criteria with respect to the listed company's independence, relations with controlling shareholders, corporate governance and free float requirements. Many of the concerns raised by the consultation paper were initially raised by the FSA in a consultation paper in January 2012.

The FSA has also brought into force a number of changes to the Listing Rules in relation to reverse takeovers, the sponsor regime, externally managed companies, financial information requirements and significant transactions. These changes, which were summarised in our client update of 2 February 2012², were adopted in substantially the form set out in the FSA's January consultation paper and came into force on 2 October 2012 (subject to limited “grandfathering provisions”). The changes, together with the text of the relevant revised Listing Rules, are included in the FSA's consultation paper of 2 October 2012.

¹ <http://www.fsa.gov.uk/library/policy/cp/2012/12-25.shtml>.

² <http://www.debevoise.com/newseventspubs/publications>.

The proposals, on which the FSA is soliciting responses from listed companies and market participants, are summarised below.

INDEPENDENT BUSINESS AND CONTROLLING SHAREHOLDERS

The FSA is proposing to introduce further clarification to the current requirements that an applicant to the premium list must be carrying on an independent business. Under the proposals, factors which would indicate that the applicant is not capable of carrying on an independent business would include situations where the applicant lacks strategic control over the ability to earn revenue, where most of the applicant's revenue is attributable to transactions with a controlling shareholder, 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. In connection with these and other proposals made in the consultation paper, the FSA is proposing the re-introduction of the concept of a "controlling shareholder" – being a person, together with its associates and parties "acting in concert" (as used in the context of the City Code on Takeovers and Mergers), owning 30% or more of shareholding or voting rights in a premium listed company or a company applying for admission to the premium list.

RELATIONSHIP AGREEMENT WITH CONTROLLING SHAREHOLDER(S)

Under the proposals, if an applicant to the premium list has a "controlling shareholder", it would be required to enter into a relationship agreement with such shareholder. Although, to a large extent, this represents a return to the position under the pre-July 2005 Listing Rules and reflects current practice for most premium listed companies with one or more major shareholders, the new proposals are more prescriptive in terms of the contents of the relationship agreement, including a requirement that a controlling shareholder undertakes not to influence the day-to-day running of the applicant at an operational level. The FSA proposes that any material changes to the relationship agreement would require the approval of independent shareholders. It is also proposed that the listed company's annual report include a description of compliance with the terms of the relationship agreement.

Compliance with the relationship agreement would be a continuing obligation following admission applicable to all premium listed companies. To the extent that there are changes in shareholdings following admission which result in a new person becoming a "controlling shareholder", a premium listed company would be required to enter into a relationship agreement with that shareholder.

CONTROL OF BUSINESS

The proposals include guidance on how an applicant for premium listing may satisfy the eligibility criteria that it control its own business. Under these proposals, a new applicant would have to demonstrate that it controls the majority of its “business”, as opposed to the current eligibility requirement which requires control of the majority of its “assets”. The FSA is concerned that the applicant has “an unfettered ability to implement its business strategy”. The FSA suggests that, for these purposes, an ability to exercise only negative control or the ability to veto significant decisions made affecting the management of the business by other parties would not satisfy the new eligibility criteria. The FSA also proposes that an applicant may be ineligible if a significant part of its three-year track record prior to admission is represented by entities representing a “majority of the business” which were not controlled or under common control with the listed group. By contrast to the proposals summarised in paragraphs 1 and 2 above in relation to operation as an independent business and relationship agreements, which will apply to all applicants, the FSA is proposing to exclude mineral companies and scientific research companies from the eligibility criteria that an applicant control its own business.

INDEPENDENT DIRECTORS

Companies with a premium listing are currently subject to a “comply or explain” regime in respect of the Principles and Provisions of the UK Corporate Governance Code, including the Code Provision that at least half of the board of directors (excluding the Chairman) be “independent” (as defined in the Code). The FSA is proposing to introduce a more prescriptive approach by introducing a continuing obligation applicable to companies with a controlling shareholder, that either the board of directors comprise a majority of independent directors or an independent Chairman and the independent directors together form a majority of the board. If adopted as a continuing obligation, breach of this requirement would expose the company to sanctions, including ultimately suspension or cancellation of premium listing.

The proposals also include the introduction of a new dual voting procedure under which the election and re-election of independent directors would require the approval of both shareholders as a whole (i.e., with the controlling shareholder being permitted to vote) and, as an additional round of voting, independent shareholders. In the event that the two votes conflict, a further vote of all shareholders would be held within 90 days after the first vote and be decided on a simple majority basis. The proposals do not specifically extend to the removal of independent directors, although, under the proposed new minimum contents for relationship agreements summarised above, each controlling shareholder

would be required to undertake not to take any action that would have the effect of preventing the listed company from complying with its obligations under the Listing Rules.

This requirement in respect of board composition for premium listed companies which have a controlling shareholder would need to be met on admission and thereafter as a continuing obligation, although the proposals contemplate a grace period of six months in the event, for example, of a resignation of an independent director resulting in non-compliance. The proposals also contemplate providing a grace period for existing premium listed companies which have a controlling shareholder to make any necessary changes to their board to meet this requirement, although the length of such grace period is not specified.

FREE FLOAT

The FSA has reaffirmed that it considers the minimum free float requirements under the Listing Rules to be aimed at ensuring sufficient liquidity in a security rather than a mechanism for influencing corporate governance and providing minority shareholder protection. For companies seeking a premium listing, the FSA proposes to:

- introduce specific criteria that it would follow in deciding whether to modify the 25% free float requirement (including that an applicant requesting a free float modification must have more than 100 public shareholders and a free float market capitalisation in excess of US\$ 250 million), while confirming that any modification beneath 20% would be unlikely to be approved other than in exceptional circumstances; and
- exclude shares subject to a lock-up of 30 calendar days or more from the calculation of the free float.
- In addition, the FSA proposes to remove the requirement for a minimum absolute percentage free float within the standard listing segment, provided it is satisfied that there will be sufficient liquidity for the relevant security.

OTHER PROPOSALS

Other proposals set out in the consultation paper include:

Annual Reports: a requirement that the annual report of a premium listed company include a specific section which discloses compliance with continuing obligations under the Listing Rules, as well as more detailed information on smaller related party transactions entered into in the relevant reporting period.

Notification to the FSA of non-compliance: a premium listed company would be required to notify the FSA without delay of any instances of non-compliance with its continuing obligations set out in Listing Rule 9.2.

Listing Principles: the introduction of two new Listing Principles for premium listed companies (to the effect that the voting power of each share within the same premium listed class should be equal and the voting rights of multiple classes of share 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 FSA in an open manner) to issuers within the standard listing segment.

NEXT STEPS

The consultation period is open until 2 January 2013. The FSA has indicated that it expects to publish feedback on the consultation in the spring of 2013.

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Please do not hesitate to contact us with any questions.

9 October 2012