

# THE CITY OF LONDON LAW SOCIETY

## COMPANY LAW SUB-COMMITTEE

**Minutes of the 238th meeting held at 9.00am on Tuesday 27 January, 2009  
at Slaughter and May, One Bunhill Row, EC1Y 8YY**

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### **1. Apologies for absence and new secretary**

Apologies for absence were received from Richard Brown, Mark Curtis, Michael Hatchard and Vanessa Knapp. It was noted that alternates attending were: John Adebiyi (for Michael Hatchard), Tamsin Nicholds (for Richard Brown) and Simon Witty (for Vanessa Knapp).

The Chairman thanked Charmian Averty who had retired as Secretary to the Committee, and welcomed Emma Walton as the new Secretary.

### **2. Minutes of 237<sup>th</sup> meeting**

It was noted that the minutes of the 237<sup>th</sup> meeting would be sent round to Committee members shortly.

### **3. Matters arising**

#### **3.1 Companies Act 2006**

The items set out in section 3.1 of the Appendix of the agenda were noted.

#### **3.2 Short Selling**

The Committee noted that the FSA had (i) ended the ban on short selling in relation to shares in UK financial sector companies, (ii) extended the disclosure regime for significant net short positions in these companies until 30 June 2009, and (iii) was intending to publish a Consultation Paper on the long-term options for the short selling regime (given that the measures that the FSA had taken were on an emergency basis).

#### **3.3 Disclosure of Liquidity Support**

A Working Group of the Committee had submitted a response to the FSA's consultation (CP08/13 – Disclosure of Liquidity Support) which had stated that the Committee supported the proposal that firms be able to delay disclosure of information concerning liquidity support (if the conditions in DTR 2.5.1R were met), but that:

- in order to properly meet the objective, it should be permissible to delay disclosure of both (i) the fact that liquidity support was (or may be) provided, *and* (ii) the underlying circumstances that gave rise to the need for that support, because to delay disclosing (i), but not (ii) may in fact exacerbate the situation and undermine the solvency of the issuer;

- the FSA should provide guidance on when a delay would be regarded as misleading the public;
- other forms of support should also benefit from the ability to delay disclosure; and
- the considerations that had led the FSA to conclude that firms should be able to delay disclosure of liquidity support also applied to issuers faced with other problems that may be capable of solution if done in an environment free from publicity and where public disclosure may prevent the implementation of a solution or damage the issuer and so the FSA should consider modifying its guidance on the scope of the ability to delay disclosure more generally.

The Committee noted that, in the FSA Feedback on CP08/13, the FSA :

- stated its view that the trigger point for disclosure was the point at which liquidity has deteriorated to the extent that the issuer may be unable to continue trading unless it received liquidity support and at this point it may receive liquidity support and then be able to benefit from DTR2.5.5AR (meaning that no immediate disclosure was required);
- declined to provide formal guidance on the circumstances where a delay would not be misleading; and
- declined to consider wider changes to the disclosure regime and maintained the view that there should be a distinction between (i) an event that gives rise to inside information (that requires disclosure) and (ii) subsequent events that may be covered by an exemption.

However, the committee also noted the reference in paragraph 4.130 of the FSA Feedback that their “guidance does not mean that an issuer can never delay disclosing inside information about its financial position such as not to prejudice its legitimate interests”. This seemed to qualify DTR 2.5.4(1) but to what extent was not at all clear.

In paragraph 4.145, the FSA appeared to consider the trigger point for disclosure to be the point at which circumstances have deteriorated to the point that an issuer’s solvency is questionable (presumably on the basis that up to this point there is no inside information). This was helpful to issuers as it delayed the point at which the legitimate interests right to delay might become relevant, but unsatisfactory as it is unclear at what point the information becomes inside information. The Committee considered that a better approach would be to encourage directors to anticipate future problems and try to implement solutions (whether involving the provision of liquidity support or otherwise), but they should be able to do so in a confidential environment until they reached a point where they were in a proper position to inform that market as to what the scope of the problem was and what they were doing about it.

The Committee noted that it had already raised its concerns with the UKLA at the UKLA Liaison group meetings. The Committee thought that this was an important issue for

clients which it should keep pursuing and the Committee considered that it should raise the issue more publicly.

### **3.4 Rights issues and capital raisings**

Items 3.4 (A) – (E) of the agenda were noted.

James Palmer reported that at a recent conference on Rights Issues there had been support for the Rights Issue Review Group proposals in general and in particular for the reduction of the subscription period from 21 to 14 days, and the “short-form” prospectus for rights issues. However, regarding the proposed “short-form” prospectus, there had been some concern that issuers may wish to still do a long form prospectus so as to retain the flexibility to market the offer in other jurisdictions, and underwriters may still require full due diligence.

The Committee noted that the FSA was still examining the extent to which it might be able to take advantage of existing provisions in the Prospectus Directive to allow derogations from certain requirements in order to allow reduced disclosure although it was noted that in earlier discussions in the Rights Issue Review Group the conclusion reached was that a change to the Directive would be required.

The Committee were supportive of the recommendations of the Rights Issue Review Group and agreed that a shorter prospectus should be permitted for rights issues on the basis that the disclosure regime under the Listing Rules provides all the financial disclosures necessary in relation to the issuer (which, for a listed company, are available on their website) and the rights issue prospectus should just be about the offer (together with a trading update).

### **3.5 Shareholder Rights**

It was noted that a Working Party on Shareholder Rights had met and considered a paper written by an ad hoc group of City law firms in response to the consultation. The Chairman reported that the Working Group had been broadly supportive of the ad hoc group’s paper, but had also written a short paper to be submitted as the Committee’s response to the BERR consultation.

### **3.6 Takeovers Working Party meeting with the Takeover Panel**

James Palmer reported that he and other members of the Joint Takeovers Working Party had been to a meeting with the Takeover Panel to discuss the list of issues presented to the Committee at the previous meeting. He reported that generally it had been a productive meeting and that he would circulate a minute of the meeting once the Panel had given its approval.

### **3.7 Mergers and Acquisitions (public)**

Items 3.7 (A) – (B) of the agenda were noted.

### **3.8 Structure of the Listing Regime**

It was agreed that the Committee would form a Working Party to respond on the FSA's consultation paper on amendments to the Listing Rules CP08/21. [Since the meeting, Lucy Fergusson has agreed to lead this Working Party.]

## **4. Discussions**

### **4.1 Execution of agreements and deeds**

It was reported that the Law Society Company Law Committee had decided, in light of the comments in the recent case of *Mercury v HMRC*, to produce a "protocol" setting out advice on best practice as regards execution of documents (deeds as well as documents executed under hand) and the authority which lawyers should obtain from clients. It was agreed that the Committee would join the Working Party to look at this.

### **4.2 "Cash-box" structures**

The Committee noted that recently there had been several placings that had used a cash box structure where the proceeds were not to be immediately for acquisitions and that this had led to renewed debate on the appropriateness of such structures. There had also been recent negative comment in the press and from the ABI regarding the use of these structures to avoid shareholder statutory pre-emption rights.

The Committee discussed the fact that companies may use the structure for a variety of purposes such as (i) to create distributable reserves by taking advantage of merger relief under s131 Companies Act 1985, (ii) to avoid having to make an offer to overseas shareholders, as well as (iii) to make a non-pre-emptive placing in excess of 5% company's issued share capital.

The Committee debated the legality of using the cash-box structure in order to avoid making a pre-emptive offer to shareholders. While acknowledging that there were several legal challenges that could be advanced, the Committee discussed two in particular:

- (i) Breach of s89 (1) Companies Act 1985

It was noted that a number of firms had obtained opinions of counsel that had concluded that, on a strict interpretation of s89 (1) and the exemption in s89 (4), provided the cash-box company was a "real" company of sufficient substance, there would be no breach s89 (1). There was however, a view that it was necessary to construe s89 in the light of the implementing directive (Art. 29 of the Second Company Law Directive) and cases decided by the ECJ on that Article. This would suggest a broad interpretation of s89 that would catch any transaction by the company the effect of which was to raise cash through the use of schemes.

(ii) Breach of the fiduciary duties of the directors

Another argument was that to use an artificial structure designed to circumvent Companies Act pre-emption requirements could be viewed as a breach of directors' fiduciary duties. In such cases, the directors would have to prove that the structure was used for a "proper purpose", and while (i) the creation of distributable reserves or (ii) avoiding the expense of making an offer to overseas shareholders could be argued to be such a purpose, because they are other ways of creating distributable reserves and avoiding an offer to overseas shareholder, that would not involve circumventing shareholders pre-emption rights, the Committee queried whether any purpose, with perhaps the exception of quickly raising cash to avoid insolvency, would be regarded as a "proper purpose".

The Committee considered that the current state of affairs – that companies were being encouraged to adopt structures that gave rise to real legal concerns around shareholders' pre-emption rights - was very unsatisfactory, particularly for company directors.

The Committee agreed that an approach should be made to the ABI raising the issue and encouraging them to reconsider the current limit for non-preemptive issues (perhaps to 10% of an issuer's issued share capital), so that companies had the flexibility to quickly raise cash in a properly priced placing, without resorting to what some in the market consider a "legal trick" to do so.

It was noted that in many such placings the institutional shareholders would expect to participate on an effective pre-emptive basis so the problem was only for smaller shareholders. However, in many cases smaller shareholders may be less disadvantaged by a well priced placing than a failed rights issue.

#### **4.3 Disclosure by PDMR's of security over shares**

It was noted that the FSA had received a lot of questions regarding its view of the notification obligations of directors and other PDMRs who grant security over shares and that, on 9 January 2009, the FSA had released a clarificatory statement saying that it considered that the grant of security over shares is covered by the notification requirements in Chapter 3 of the Disclosure and Transparency Rules and that PDMRs should disclose any security already granted as soon as possible and by no later than 23 January (although the FSA does not intend to take enforcement action in respect of prior failures to notify). The FSA also noted that the grant of security is a "dealing" for the purposes of the Model Code and therefore directors or PDMRs of a company must obtain clearance before using their shareholding as collateral for a loan.

The Committee disagreed with the view of the FSA for the following reasons:

- the obligation was to notify "all transactions conducted on their own account in the shares of the issuer, or derivatives or any other financial instruments relating to those shares". Since the creation of security does not change the interest of the

director/PDMR in the shares, the Committee did not think pledging shares as security amounted to a "transaction"; and

- the reference to "transaction" comes from the Market Abuse Directive ("MAD") from which it was clear that the purpose of the notification obligations is to prevent market abuse (Recital 26 to MAD) and, from Recital 18 of Article 2 of MAD that for this purpose "market abuse" involves the acquisition or disposal of financial instruments (and not merely creating security over financial instruments).

It was noted that other regulators in other European jurisdictions do not regard the grant of security as a notifiable dealing.

The Committee thought the FSA may have reacted to the strong market reaction to the announcement that David Ross (of Carphone Warehouse plc) had pledged shares to secure personal loans, but it was not clear to the Committee that just because the market regarded the information as price sensitive, that that indicated that the market was entitled to the information. The real issue seemed to be that DTR5 does not (in most cases) require disclosure of the grant of security by substantial shareholders.

It was noted that the FSA acknowledged that its position differed from the approach in other member states and it would seek a common understanding of the Market Abuse Directive's requirements with the European Commission and CESR. The Committee would look for ways to be involved in those discussions.

#### **4.4 Disclosure of inside information**

The Committee agreed that the item in section 4.4 (A) would be discussed at the next meeting.

#### **4.5 Consideration of Pro-Forma Circular for inclusion on the CLLS website**

It was agreed that members would send any objections they had to the draft pro forma circular to the Chairman by the end of the week, and if there were none, it was agreed that it would be published on the CLLS CLC website.

### **5. Current problems and recent developments**

#### **5.1 Company law and legislation**

Item 5.1 of the Agenda was noted.

#### **5.2 Listing Rules, DTRs and Prospectus Rules**

Items 5.2 (A) - (C) of the agenda were noted.

#### **5.3 FSMA/FSA**

Items 5.3 (A) and (B) of the agenda were noted.

**5.4 Mergers and acquisitions (public)**

Items 5.4 (A) – (B) of the agenda were noted.

**5.5 Mergers and acquisitions (public)**

Item 5.5 of the agenda was noted.

**5.6 EU/overseas law and practice**

Items 5.6 (A) – (B) of the agenda were noted.

**5.7 Accounting**

Items 5.7 (A) – (C) of the agenda were noted.

**6. Cases not otherwise discussed**

The cases listed in section 6 of the Appendix were noted.

**7. Any other business**

It was noted that the time qualifying for CPD credit would be 2:00 hours.

**8. Close**

There being no further business the meeting closed.