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Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

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FCA Listing Rule Changes Applicable to Premium Listed Companies

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Danny Tricot
London
+44.20.7519.7071
danny.tricot@skadden.com

James P. Healy
London
+44.20.7519.7042
james.healy@skadden.com

Nikolas K. Colbridge
London
+44.20.7519.7055
nikolas.colbridge@skadden.com

Hamed Afzal
London
+44.20.7519.7142
hamed.afzal@skadden.com

Adam M. Howard
London
+44.20.7519.7091
adam.howard@skadden.com

Richard Ho
London
+44.20.7519.7126
richard.ho@skadden.com

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40 Bank Street, Canary Wharf, London, England
Telephone: + 44.20.7519.7000
Four Times Square, New York, NY 10036
Telephone: +1.212.735.3000

WWW.SKADDEN.COM

Introduction

On 2 October 2012, the Financial Conduct Authority (FCA) published a wide-ranging consultation paper (CP12/25) on the effectiveness of the listing regime which proposed a number of changes to the Listing Rules, including in relation to controlling shareholders, corporate governance and free float requirements.

On 5 November 2013, the FCA published a further consultation paper (CP13/15) setting out a package of near-final rules based on the FCA's proposals in CP12/25 and further consultations on revised and new proposals resulting from feedback to CP12/25, which ended on 5 February 2014.

The package of final rules were presented to and approved by the FCA board on 1 May 2014 and the Listing Rules (Listing Regime Enhancements) Instrument 2014 (FCA 2014/33) was published on 2 May 2014. The instrument implements the new rules and comes into force on 16 May 2014. The FCA's policy and feedback statement on the new rules are also expected to be published on 16 May 2014.

1. Independence and Control

New Eligibility Requirement and Continuing Obligation

An applicant for and companies with a premium listing must carry on an independent business as its main activity at all times, subject to an exception for closed-ended and open-ended investment funds.

Guidance

The FCA has provided guidance setting out the factors that may be relevant in determining whether a premium listed company meets the independence requirement. The guidance lists factors that may indicate that an applicant is unable to carry on an independent business, including situations where:

- a majority of the revenue generated by its business is attributable to business conducted directly or indirectly with a controlling shareholder;
- it does not have strategic control over the commercialisation of its products or the freedom to implement its business strategy;
- it does not have access to independent financing other than from its controlling shareholder;
- its business consists principally of holdings of shares in entities that it does not control; or
- a controlling shareholder appears to be able to influence the operations of the premium listed company outside its normal governance structures or via material shareholdings in one or more significant subsidiary undertakings.

Mineral Companies

Mineral companies will be exempt from the guidance which provides that an applicant may not satisfy the requirement for an independent business if its business consists primarily of holdings of shares in entities that it does not control. This is due to the fact that mineral companies will be eligible for a premium listing if they have a reasonable spread of direct non-controlled interests.

2. Controlling Shareholders

Against the prevailing backdrop of recent concerns and market developments over the protection of minority shareholders (particularly where there is a controlling shareholder), the FCA is implementing various new initial and on-going requirements which aim to ensure that a premium listed company with a controlling shareholder is capable of acting independently of its controlling shareholder and its associates.

Definition of "Controlling Shareholder" and "Associate"

The FCA has set out a revised definition of "controlling shareholder", which retains the percentage holding test of 30%. The definition has however been amended so that a person's interests will be aggregated with those of their concert parties. Under the revised definition, a controlling shareholder would include any person who individually or together with any of its concert parties exercises or controls 30% or more of the votes able to be cast on all or substantially all matters at the company's general meeting (with certain voting rights being disregarded for the purposes of the calculation).

In addition, the FCA has also set out a new definition of "associate" to prevent controlling interests being split to avoid the relevant Listing Rules. An "associate", when used in the context of a controlling shareholder who is an individual, would cover:

- an individual's spouse, partner or child (the "individual's family");
- the trustees of any trust of which the individual or any of the individual's family is a beneficiary;
- any company in whose equity securities the individual or any member(s) of the individual's family are directly or indirectly interested to be able to exercise or control the exercise of 30% or more of the votes at a general meeting or to appoint a majority of directors of the premium listed company; or
- any partnership in which the individual or any member(s) of the individual's family are directly or indirectly interested so that they hold or control a voting interest at least or greater than 30% of the partnership.

An "associate", when used in the context of a controlling shareholder which is a company, would cover:

- any company which is its subsidiary or parent undertaking or fellow subsidiary undertaking of the parent undertaking;
- any company whose directors are accustomed to act in accordance with the controlling shareholder's directions or instructions; or
- any company in the capital of which the controlling shareholder and any other company above taken together, would be able to exercise or control the exercise of 30% or more of the votes at a general meeting or to appoint a majority of directors of the premium listed company.

Relationship Agreement

The FCA has also implemented the requirement that a written and legally binding agreement be entered into between a premium listed company and a controlling shareholder so as to ensure the independence of the premium listed company. Where a premium listed company has more than one controlling shareholder, it would not be necessary to enter into separate agreements with each of the controlling shareholders if the premium listed company considers, in light of its understanding of the relationship between the controlling shareholders, that one controlling shareholder can procure the compliance of the others with the independence provisions.

The overall framework for relationship agreements will include the following:

- **Content:** The agreement must contain undertakings that:
  - transactions with the controlling shareholder (or its associates) are conducted at arm's length and on normal commercial terms;
  - neither the controlling shareholder nor its associates will take any action that will prevent the premium listed company from complying with its obligations under the Listing Rules; and
  - neither the controlling shareholder nor 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.
- **Duration**: The agreement must remain in place, and the independence provisions contained in it must be complied with, for so long as the premium listed company has a controlling shareholder.
- **Disclosure**: The premium listed company's annual report must include a statement by the board of directors that the company has entered into a relationship agreement, the company has complied with the mandatory independence provisions and, so far as the company is aware, the controlling shareholder and its associates have complied with the independence provisions. If this is not the case, there must be a statement confirming that the FCA has been notified of the non-compliance and a brief description of the reasons for the non-compliance to enable shareholders to evaluate the impact of the breach. The annual report must also include a statement if an independent director does not support the board of directors' statements.

A transitional period of six months will apply for existing premium listed companies with a controlling shareholder to comply with the requirement for a relationship agreement. The same period is proposed for companies that acquire a controlling shareholder following admission.

Sanctions for Breach of Relationship Agreement

The FCA has also implemented enhanced oversight measures which would require all transactions with the relevant controlling shareholder to be subject to prior independent shareholder approval in the event that the mandatory independence provisions in the relationship agreement are breached. These measures will be triggered in the following circumstances:

- where the premium listed company does not have a required relationship agreement in place;
- where the premium listed company breaches the independence provisions in the relationship agreement;

- where the premium listed company becomes aware that a controlling shareholder or any of its associates is breaching an independence provision in the relationship agreement; or
- where any independent director disagrees with the board's assessment of whether the obligations have been complied with.

The sanctions will remain in place until the publication of the next annual report in which the board makes a clean compliance statement without any disagreement from independent directors. During this period, none of the safe harbours in Listing Rule 11 (Related Party Transactions), including those for small transactions and ordinary course transactions, would apply in respect of transactions between the premium listed company and the controlling shareholder (effectively meaning that independent shareholders could veto any transaction between the company and the controlling shareholder, regardless of its size). This would however be subject to the FCA's ability to dispense with or modify the sanctions in exceptional circumstances where the company is for example in severe financial difficulty.

3. Independent Directors

The FCA is implementing the requirement for a dual voting structure to apply to the appointment of independent directors. This would require any such appointments to be approved both by the shareholders as a whole and also by the independent shareholders. In the event that the results of the votes conflict, a further vote of all shareholders may take place not less than 90 days nor more than 120 days later on a simple majority basis. The guidance to the new requirement clarifies that an existing independent director who is being proposed for re-election may remain in office until the second vote.

The dual voting structure must be provided for in the company's constitution. There is also a transitional period in place so that if the premium listed company did not previously have a controlling shareholder it will have until the date of its next annual general meeting to amend its constitution to implement the dual voting structure and to comply with such provisions.

The premium listed company will also be subject to increased disclosure requirements where it will have to disclose in any election or re-election circular any existing or previous transactions or relationships between the proposed director and the controlling shareholder or its associates. The FCA has also provided that if the premium listed company did not previously have a controlling shareholder, the additional disclosure requirements will not apply to a circular which is despatched within three months from the date of the event which made the company have a controlling shareholder.

4. Free Float Requirements

The FCA has maintained the free float requirement for both premium and standard listings at 25%. It has however included new rules and guidance relating to the calculation of the free float and when it may modify the rules to accept a free float percentage lower than 25%, which include the following:

- **Locked-up shares**: In addition to the existing categories of shares that are excluded from the free float calculation for both premium and standard listings, shares subject to a lock-up period of over 180 calendar days will also be excluded.
- **Holdings of investment managers**: In relation to the exclusion of holdings of 5% or more of shares from the free float calculation for both premium and standard listings, the FCA has implemented new guidance that will disaggregate the holdings of individual investment managers in the same group and treat such holdings of individual investment managers separately, provided that investment decisions are made independently by the individual in control of

the individual fund and those decisions are unfettered by the group to which the investment manager belongs.

- **Modification of free float**: In relation to premium listings, the FCA may modify the free float requirement to accept a percentage lower than 25% if it considers that there will be sufficient liquidity for the market to operate properly with a lower percentage. When considering modifications to the free float requirement, the question of liquidity is key and the FCA will consider specific factors set out in the guidance to the new rules which include:
  - the number and nature of the public shareholders; and
  - whether the expected market value of the shares in public hands at admission exceeds £100 million.

The FCA has indicated that it will be very reluctant to allow very small free floats in the premium segment as a matter of policy. Derogations from the 25% free float requirement will only be granted in exceptional circumstances and the more that the free float falls below 25%, the weightier the evidence the FCA would expect to receive in order to be comfortable in granting a derogation.

In relation to standard listings, the FCA has indicated that the policy intention remains that the free float requirement should be effectively 'directive minimum' (i.e. reflecting the minimum standards required by EU directives instead of the super equivalent standards for the premium segment). The FCA is therefore able to provide a greater level of flexibility to cater for a wider range of issuers and securities and will focus on the liquidity of the shares in judging the appropriate free float level.

5. Cancellation of Listing

The FCA has implemented the rule that where a premium listed company wishes to cancel its listing or transfer its listing from the premium to standard segment, it must obtain prior approval at a general meeting from a majority of at least 75% of the votes attaching to the shares voted on the resolution. If the company has a controlling shareholder, it must also obtain prior approval from a majority of the votes attaching to the shares of independent shareholders.

In the case of the cancellation of a premium listing in relation to a takeover offer, where an offeror or a controlling shareholder who is an offeror is interested in more than 50% of the voting rights of the premium listed company before the announcement of its firm intention to make a takeover offer, such offeror will need to obtain acceptances or acquire shares from independent shareholders that represent a majority of the votes held by independent shareholders in addition to reaching the 75% acceptance threshold. 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 will be required to cancel the premium listing.

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While some of the new rules reintroduce into the Listing Rules previous concepts such as the concept of the "controlling shareholder" or codify existing best practices such as having a relationship agreement in place between a company and a controlling shareholder, premium listed companies will still need to perform certain internal actions to ensure compliance with the full suite of new rules.

Items on the immediate agenda for premium listed companies include: (i) reviewing existing relationship agreements or entering into new relationship agreements with controlling shareholders to ensure that the requirement for and prescribed content of such agreements under the new rules are complied with before 16 November 2014; (ii) monitoring any potential controlling stakes in order that a relationship agreement can be put in place with the relevant holder within six months; (iii)

establishing internal procedures to enable the board of directors to provide the various compliance statements in the company's annual report and reporting any non-compliance to the FCA; and (iv) amending the company's articles or other constitutional documents to reflect the dual voting structure for the appointment of independent directors at the company's next annual general meeting.

The new rules also widen the scope of responsibilities of independent directors in monitoring and ensuring compliance with the rules and the overarching framework of corporate governance best practices.