The City of London Law Society

4 College Hill
London EC4R 2RB
Tel: 020 7329 2173
Fax: 020 7329 2190
www.citysolicitors.org.uk

CP08/13 - DISCLOSURE OF LIQUIDITY SUPPORT
Response of the Company Law Committee of the City of London Law Society

The City of London Law Society (CLLS) represents over 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

Summary of our response

In relation to the specific proposal set out in the Consultation Paper:

- we agree that firms should be able to take advantage of the ability to delay disclosure of information concerning liquidity support, if the conditions in DTR 2.5.1R are met;

- we do not think the FSA has gone far enough in the proposed amendment to achieve this result. In particular the FSA should recognise that to achieve their objective it needs to be clear that it is permissible to delay disclosure of information regarding **both**:

  - the fact that liquidity support is (or may be) provided, and

  - the underlying circumstances that give rise to the need for that support

- we question whether the FSA is right to limit the guidance to information concerning liquidity support; we suggest that other forms of support (e.g. the FSA taking steps to promote a takeover by another firm) should equally benefit from the ability to delay disclosure

- we believe the FSA should provide formal guidance on when a delay in disclosure would be regarded as misleading the public.

In addition, however, we think the consultation raises an important point of principle for all issuers. The considerations that lead the FSA to conclude that firms should be able to delay disclosure of liquidity support apply to other issuers faced with a problem that may be capable of solution if there is no publicity and where public disclosure may prevent the implementation of a solution or irremediably damage the issuer. We think it important therefore that the FSA should take this opportunity to review and modify its guidance on the scope of the ability to delay disclosure more generally. In our view, the Market Abuse Directive (MAD) provides this flexibility and the FSA's restricted approach places an undue emphasis on the need for immediate disclosure in circumstances where that disclosure is damaging to issuers and their stakeholders, including long term shareholders, employees, customers and suppliers.

Response on the specific proposal

We agree with the proposal set out in the Consultation Paper that firms should be able to take advantage of the ability to delay disclosure of information concerning liquidity support. However, we believe that by limiting the scope of the amendment to information “concerning the provision of liquidity support” the FSA is significantly curtailing the usefulness of the proposed amendment in practice. The practical limitations we see are:

- there is no qualification of the guidance in DTR 2.5.4G(1), which would deny the issuer the ability to delay disclosure of the underlying reason behind its requirement for liquidity support;

- there are other regulatory actions the FSA may wish to take in order to preserve confidence in a firm (for example arranging a takeover by another firm that is adequately capitalised) which are not within the scope of the proposed amendment.

DTR 2.5.4G(1)

We do not believe that the position the FSA takes in DTR 2.5.4G(1) is required by MAD or the MAD implementing measures but it represents a policy position taken by the FSA to limit the scope of the ability to delay. The MAD implementing measure (Commission Directive 2003/124/EC) provides that an issuer “in grave and imminent danger” should be able (if the other conditions are met) to delay disclosure while it negotiates a solution that would avoid that danger crystallising. The guidance in DTR 2.5.4G(1) that this does not allow delay of disclosure of the fact that the issuer is in financial difficulty (which is inevitably the case if it is “in grave and imminent danger”) denies the ability to delay in exactly the circumstances contemplated.

Other regulatory actions

We do not understand why the FSA’s proposal is limited to information relating to liquidity support. The argument in favour of allowing delay in relation to liquidity support seems to us to apply equally to any other case where confidence in a firm may be preserved by actions promoted by the FSA where disclosure of the fact that the FSA is seeking action is likely to lead to the very consequences that the efforts are designed to avoid.

Guidance on when the delay in disclosure will mislead the public

It is a well known problem with the ability to delay disclosure that in order to delay disclosure the issuer must not thereby mislead the public but it is not possible to know when an omission to disclose is misleading without knowing when there is an obligation to disclose, which is where the question starts.

The FSA has provided an explanation of when a delay in disclosure would mislead, in paragraph 2.10 of the CP from which it appears that:

- failure to correct an impression resulting from recent market statements of the issuer; or
- where delaying disclosure would involve "an implicit endorsement of a specific misapprehension which is known to be generally held in the market",

may be regarded as misleading.

We agree with the first of these propositions and believe it would be helpful if the FSA set out that position as formal guidance, although we think the reference should be to a <u>specific</u> impression. This would make it clear that it is not regarded as misleading to leave general impressions (for example those that would arise because the issuer reported results as a going concern) uncorrected.

The second proposition is inconsistent with the FSA's guidance in DTR 2.7.3G that an issuer generally has no obligation to correct inaccurate rumours or speculation. If the "specific misapprehension" does not arise from a statement by the issuer (the first proposition) we do not believe it is appropriate to impose a duty on the issuer to correct the misapprehension.

Alternative drafting

We suggest the following as an alternative to the proposed amendment:

DTR 2.5.4G (1) Except in the circumstances described in DTR 2.5.5A G, DTR 2.5.3 R (1) does not allow an issuer to delay public disclosure of the fact that it is in financial difficulty or of its worsening financial condition and is limited to the fact or substance of the negotiations to deal with such a situation. An issuer cannot delay disclosure of inside information on the basis that its position in subsequent negotiations to deal with the situation will be jeopardised by the disclosure of its financial condition.

DTR 2.5.5A G An *issuer* that is a *firm* may have legitimate interest to delay disclosing information concerning its financial position or any support it obtains or may obtain from a governmental authority or regulator (including the provision of liquidity support by the Bank of England or by another central bank), if a delay in disclosure would avoid a loss of confidence among customers and/or counterparties that would thereafter the solvency of the issuer.

Note: We have suggested that the new provision should be presented as guidance. We note that although the FSA's proposed new paragraph is presented as a rule it provides that "an issuer….may have a legitimate interest to delay….", which we think can only be considered to be guidance and not a rule.

The wider issue

The arguments used by the FSA to support the proposed amendment (paragraphs 2.6 and 2.7 of the Consultation Paper) are equally applicable to issuers that are not "firms" and that are seeking support from their bankers (e.g. a waiver of a breach of covenant), in circumstances where disclosure of the fact that the issuer is seeking support would cause loss of confidence in suppliers and/or customers, worsening the issuer's problems that led to the negotiations with its banks in the first place and jeopardising the issuer's ability to succeed in the negotiations.

This is the kind of situation envisaged by DTR 2.5.5G but, as noted above, the practical usefulness of this guidance is significantly reduced by the qualification in DTR 2.5.4G(1) and, in the same way that qualification needs to be modified in the case of liquidity support for the FSA's proposed amendment to provide any practical benefit, so it should be modified for other issuers.

We consider that the FSA's restriction of the ability to delay disclosure (in DTR 2.5.4G(1) and the guidance in DTR 2.5.5R that it is unlikely to apply except to matters under negotiation and "impending developments") is inconsistent with MAD and the implementing measure and we believe the FSA should consult on a broader amendment that would allow full scope for the "legitimate interests" of issuers to be protected from the potential harm that may be caused by premature disclosure.

Allowing issuers to protect their "legitimate interests" through a delay in disclosure would allow a proper balance between the interests of the participants in the capital markets in immediate disclosure (for practical purposes this usually means those who purchase securities) and the interests of other stakeholders in avoiding irreparable damage to the issuer. These other stakeholders include long term shareholders, employees, customers and suppliers. Clearly, any modification of the FSA's position should not provide an excuse for issuers to delay disclosure where there is no legitimate interest to protect but we do not see that as a significant risk (directors delaying disclosure for these reasons will no doubt be subject to close examination of the basis for their decisions and held to account if the delay was not protecting a legitimate interest). In particular, it should be clear from any new guidance that there can be no delay in the disclosure of information where there is nothing the issuer can do to mitigate the effect of an event that has occurred, whether or not information about that event is disclosed publicly.

Suggested drafting

We suggest that these objectives could be met if the FSA provided guidance in the following terms to replace the existing DTR 2.5.4G). We have suggest two possible approaches be considered. The first (Option 1), which is our preferred approach, it would apply in a range of circumstances, not only where solvency issues arise. An example where this may apply where there was no threat to solvency would be a case where a major customer gives notice to terminate a contract and while the issuer is negotiating the terms of a replacement contract its ability to negotiate satisfactory terms would be prejudiced by public disclosure of the termination.

The alternative (Option 2) deals only with the position of potential solvency.

Option 1

DTR 2.5.3 R(1) allows an *issuer* to delay public disclosure of an adverse development relating to the *issuer* or its business and of the fact or substance of any negotiations with a third party relating to that development where:

(a) the development is of special materiality to the *issuer*;

(b) the *issuer* is taking steps (including, but not limited to, negotiations with third parties) to minimise the adverse effect of the development on the issuer;

(c) there is a significant risk that public disclosure of the circumstances will make it materially less likely that the steps taken by the *issuer* will be successful; and

(d) there is a reasonable prospect that if disclosure is delayed the steps taken by the *issuer* will be successful.

Option 2

DTR 2.5.3 R(1) allows an *issuer* to delay public disclosure of the fact that it is in financial difficulty or of its worsening financial condition and of the fact or substance of the negotiations to deal with that situation where:

(a) the *issuer* is in grave and imminent danger of becoming insolvent;

(b) the *issuer* is taking steps (including, but not limited to, negotiations with banks or other creditors) to avoid insolvency;

(c) there is a significant risk that public disclosure of the circumstances will lead to a loss of confidence among customers and/or suppliers or other parties with whom the *issuer* has dealings and as a result the ability of the *issuer* to avoid insolvency would be jeopardised; and

(d) there is a reasonable prospect that if disclosure is delayed the steps taken by the *issuer* will be successful in avoiding its insolvency.

Please contact William Underhill (+44 (0)20 7090 3060, william.underhill@slaughterandmay.com) to discuss any of the points made in this response.

30 September 2008