PCP 2012/3 - Response of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law

Introduction

The Law Society of England and Wales is the representative body for solicitors in England and Wales. The City of London Law Society represents the professional interests of solicitors in the City of London who represent 15 per cent. of the profession in England and Wales.

Below are the views of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law (the "Working Party") on the Panel Consultation Paper PCP 2012/3.

General comments

1. We agree with the arguments set out in the PCP in favour of removing the residency test as currently applied and agree with its removal. We are in favour of a regime which provides certainty in enabling shareholders and the market to determine whether the Code applies to a company without the need to consult the Panel in every case.

2. However, we do not agree with the proposal that the test should simply be deleted, with the consequence that many additional companies are brought within the regime with very little notice or time to prepare or contrary to the expectations of the shareholders.

3. We believe that the Code Committee should carefully consider a transitional period, or a grandfathering regime, as well as considering changing the proposed deletion of the residency test to allow for different approaches for different types of company within the Introduction to the Code.

4. With regard to a transitional period or grandfathering provisions for existing companies that the Code does not currently apply to, we believe that there are many cases where shareholders will have invested in full knowledge, and possibly in reliance on, the fact that the company is not subject to the Code. We suggest that at the very least the Code Committee should consider a transitional period of 12 months for such a significant change. In addition, the Code Committee should consider a regime whereby at the least companies incorporated prior to the date of the new Rules coming into effect and not subject to the Code prior to that date, should be able to pass a resolution at their next annual general meeting to opt out of the application of the Code.

5. We also wonder what the consequences will be for a company whose articles of association need to be amended to reflect the fact that the company will now fall within the jurisdiction of the Code, if either that company does not make the requisite changes or, where shareholder approval is required for such changes, if its shareholders do not approve the changes. For example, a company might have sought to incorporate into its articles certain provisions of the Code (with or without amendment, or some but not all provisions) and afforded its directors discretion as to how to apply those provisions. Such a company would therefore need to amend its articles of association (requiring time to convene a shareholder meeting and to obtain shareholder approval) in order to avoid a conflict between its articles of association and the Code. At the very least such companies should be afforded a significant transitional period in order to effect such changes.

6. To assist with certainty, the Code Committee could consider introducing a requirement that any company incorporated in the UK, Channel Islands or Isle of Man which is not admitted to trading on a regulated market wishing to opt out of the Code must pass a resolution at least once every five years to opt out, similar to other authorisation regimes imposed in the Companies Act 2006, allowing regular review by shareholders of the decision to opt out without creating too heavy a governance burden, although companies could elect for annual extension of the opt-out. Any opt-out resolution would be filed with the Registrar of Companies and the position of the company transparent as a result.

7. With regard to the drafting of the new regime, we believe that the Code Committee should consider different types of company differently and should retain the distinction between (i) companies admitted to trading on a regulated market in the UK; (ii) those admitted to trading on a prescribed market in the UK; and (iii) those not admitted to trading:

    a) For UK-incorporated public companies whose shares are traded on a non-regulated market in the UK, we agree that there is a risk that investors might mistakenly believe that they are afforded the protections of the Code when they are currently not. Subject to what we say above in relation to the need for a transitional period or grandfathering provisions for existing companies which are currently not subject to the Code, we agree that the residency test should be removed and that therefore the Code should apply to all UK-incorporated companies whose shares are traded on a prescribed market (i.e. currently AIM and PLUS) in the UK in the same way that the Code applies to UK-incorporated public companies whose shares are traded on a regulated market in the UK by virtue of the Takeovers Directive.

    b) UK-incorporated public companies whose shares are not traded on a UK regulated market but are traded on a regulated market in another EU jurisdiction fall under the shared jurisdiction regime in accordance with the Takeovers Directive. However, under the proposed new regime, we believe that UK-incorporated public companies whose shares are not traded in the UK but are traded on a market outside the EU (or on a non-regulated market in an EU jurisdiction) will fall under the jurisdiction of Code (for example a UK incorporated public company traded in the US, Canada or Australia would become subject to the Code). We suggest that investors in such companies would be surprised to hear that they are subject to the Code and that this goes beyond the equivalent extra-territorial provisions of the shared jurisdiction regime of the Takeovers Directive. It will also generate scope for a clash in governance, with many such companies adopting a constitutional regime suited to the audience in which its securities are traded. Instead, we suggest that companies not traded on either a regulated or a prescribed market in the UK but which are traded on a non-regulated market elsewhere should not be subject automatically to the Code but free to opt in by shareholder resolution, allowing them to adopt constitutional and practice measures suited to the rules applicable to that market. At the least, such companies should be free to opt out by passing a shareholder resolution, although we believe this is an unsuitable alternative to a presumption that the Code does not apply unless there is an opt-in resolution.

    c) For UK-incorporated public companies whose shares are not traded on any market in any jurisdiction, we question whether it is right that the Code should apply to them at all. For those companies that are required to maintain public company status for reasons other than offering securities to the public, this would remove a significant regulatory burden, particularly for those with just a few shareholders and in many cases a governance regime suited to private ownership, including pre-emption structures, where a Code waiver is still

required every time a "Code" transaction is considered. We consider that it would be proportionate to remove such a burden.

d) For companies incorporated in the Channel Islands or the Isle of Man, in our view there might well have been careful consideration in maintaining residency outside of the UK in order to ensure that the company is not subject to the Code. Such companies should not be automatically opted into the regime. Such companies should be able to choose whether to be subject to the Code.

8. In all instances, we believe that there should be a disclosure regime so that companies incorporated in the UK, Channel Islands or the Isle of Man are required to disclose whether the Takeover Code applies to them and make it clear that in the event of any conflict between their articles of association and the Takeover Code provisions, the Takeover Code will prevail.

9. Conversely, we also believe that companies incorporated outside of the UK, Channel Islands or the Isle of Man but whose shares are admitted to a trading in the UK should have the ability to opt into the jurisdiction of the Code or parts of the Code (subject to shared jurisdiction rules). A company so opting in should be required to reflect this in its constitution so that members are bound by the Code requirements. We note that overseas bidders are currently regulated by the Panel and, as acknowledged in the PCP, the Code Committee concedes that the Panel has not encountered significant problems regulating their conduct.

Responses to the specific questions raised in the PCP

Q1. Do you agree that the residency test should be removed from the Code?

We refer to our general comments above.

Q2. Do you agree that the residency test should not be retained in relation to offers for certain categories of company?

We agree that the residency test should not be retained and agree with the extension of application of the Code to UK-incorporated companies admitted to trading on a market in the UK. However, we do not agree with the current proposal simply to delete it because of the consequent extension of the application of the Code to companies incorporated in the UK, Channel Islands or Isle of Man not admitted to trading on a market in the UK or EU which are not currently subject to the Code and which might be surprised to learn that they have become so. In addition it is unlikely that the majority of investors would expect to have the benefit of Code protection in these circumstances. We refer to our general comments above.

Q3. Do you have any comments on the proposed amendments to sections 3(a)(i) and (ii) of the Introduction to the Code?

We refer to our general comments above.

In addition, we believe that the new paragraph 3(a)(i)(A) to (D) to the Introduction to the Code should be amended to clarify that:

- the securities admitted or the prospectus filed must have been equity-related (i.e. not debt), for example by replacing reference to "securities" to "relevant securities"; and

- an equivalent document under the Prospectus Rules is also captured as well as a prospectus.

Q4. Do you have any comments on the proposed amendments to the ten year rule and the introduction of a new definition of "multilateral trading facility"?

We believe that the 10 year rule is too long. In the vast majority of cases, management will have changed within that time and we suspect that the new management will not be aware of, nor consider, whether the Code applies to the company. We believe that it should be reduced to a period as short as 3 years or, if the Code Committee is not persuaded by that, 5 years. Exception could be made if a significant percentage of the shares are dispersed.

As the Panel is introducing a generic definition for a multilateral trading facility, we suggest that the Code Committee review references to AIM and PLUS throughout the Code so that going forward there would be no need for new multilateral trading facilities to be added or obsolete references to be removed.

Q5. Do you have any comments on the proposed consequential amendments to the Code set out in Appendix B?

No.