The City of London Law Society

The Law Society

Primary Market Bulletin 9: comments on the proposed amendments to certain technical notes

Law Society and City of London Law Society joint response

12 January 2015

Introduction

1. The comments set out in this paper have been prepared jointly by the Listing Rules Joint Working Party of the Company Law Committees of the Law Society of England and Wales and the City of London Law Society.

2. The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee.

3. The City of London Law Society ("**CLLS"**) represents approximately 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. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees.

4. The Listing Rules Joint Working Party is made up of senior and specialist corporate lawyers from both the Law Society and the CLLS who have a particular focus on the Listing Rules and the UK Listing Regime.

5. We set out below our comments on the proposed amendments to the three UKLA technical notes which were announced in the Financial Conduct Authority's Primary Market Bulletin No.9 (published on 27 November 2014).

Ratification circulars (UKLA/TN/204.2)

6. We note that the FCA proposes to amend its Technical Note on Ratification Circulars by inserting the following the paragraph at the end of the Technical Note:

   "*In assessing whether the potential benefit to directors is only an ancillary or unintended effect of the circular, we are of the opinion that it is very difficult to come to this conclusion where a specific resolution (or part of a resolution) is included in the circular that has the effect of expressly releasing the directors from liability.*"

7. We refer to the leading case in relation to unlawful distributions, *Bairstow and others v Queens Moat Houses plc [2001] All ER (D) 211*, which clarified that, in circumstances where a company makes an unlawful distribution, the company's ability to bring claims against its shareholders and its ability to bring claims against its directors are not mutually exclusive. Specifically, it made it clear that a company could pursue claims against its shareholders and its directors and potentially recover sums from both of them. The legal effect of this is that it is not possible to remove an actual or theoretical liability of the directors merely by removing the liability of shareholders.

8. Therefore, on the basis of the Queens Moat Houses case, where companies publish ratification circulars in respect of unlawful distributions, it is typical to include a specific shareholder resolution expressly waiving any claims that the company may have against its directors.

9. Practitioners have historically taken the view that this approach remained within the ambit of the current version of the Technical Note. This is on the basis that, in the case of a solvent, profitable company which has made an unlawful distribution, the primary purpose of the ratification circular is to ratify the unlawful distribution and that any potential benefit to directors in any separate waiver of claims is very remote. This is because, in such

circumstances, it is highly unlikely that a company would ever pursue a claim against the directors.

10. We understand that this amendment has been made to address the practice described above. The amendment to the Technical Note helpfully clarifies the current position adopted by the FCA in relation to ratification circulars.

11. However, it would be of great assistance if the FCA could provide guidance on how the Listing Rule class tests should be applied to such a waiver of claims against directors. In the majority of cases, it is probable that no asset is being given away to directors (as there is no likelihood of a claim ever being brought against directors). Indeed, most UK companies' accounting policies would prohibit the inclusion of such a theoretical claim as an asset or contingent asset in the company's balance sheet.

12. On this basis, we believe that it should be possible to continue to treat such a waiver as ancillary where the resolution does not deal solely with the waiver and the potential benefit to directors is remote.

13. If this is not accepted, then we would propose that such waivers should be treated as small Related Party Transactions under Listing Rule 11 Annex 1. We do not believe that shareholders would be prejudiced by such an approach, because, as the Technical Note states:

    "In many cases, it would appear that the law excludes affected directors from voting on the issue. Furthermore, the level of disclosure required by law is usually sufficient to allow a fully informed voting decision, and further LR requirements are not necessary."

    This position would not be altered by treating the waiver of claims as a small Related Party Transaction.

14. Finally, the amendment to the Technical Notes does not address how a "substantial shareholder" (as defined in the Listing Rules) should be treated in these circumstances. Practice has also developed where it is common for a waiver to be granted in respect of claims that a company may have against its shareholders for repayment of unlawful distributions. It would be most helpful for companies with "substantial shareholders" if the FCA would provide guidance as to how such substantial shareholders should be treated and in what circumstances the FCA would view such a waiver as a related party transaction. If the FCA is of the view that such a waiver should be treated as a related party transaction, then, we would respectfully suggest that the same approach should be taken as for directors, as suggested in paragraph 12 above.

Hostile takeovers (UKLA/TN/305.2)

Transactions by persons discharging managerial responsibilities and their connected persons (UKLA/TN/540.2)

We have no comments on the proposed changes to the above two technical notes.

Contact Details

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