The City of London Law Society

The Law Society

Response to the Financial Conduct Authority Consultation Paper 13/15:

Feedback on CP 12/25: Enhancing the effectiveness of the Listing Regime and further consultation

February 2014

Introduction

This response has 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.

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.

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.

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 (LR) and the UK Listing Regime.

We set out below our responses to the questions set out in Annex 3 of Consultation Paper 13/15 regarding the further consultation on proposed changes to the LRs (the "**Consultation Paper**").

Annex 3 Questions

INDEPENDENT BUSINESS

Definition of a controlling shareholder

Q1. **Do you agree with our proposed definition of a 'controlling shareholder' as described in CP 13/15?**

We have some comments on the proposed drafting of the definition of a '*controlling shareholder*' and have identified a few issues which we suggest are addressed in the revised LRs or in supplemental guidance.

One or more 'controlling shareholders'

In chapter 4 of the Consultation Paper, the FCA states its reasons for amending its definition of a '*controlling shareholder*' as originally proposed in CP 12/25. In particular, the FCA proposes that a shareholder's '*associates*' are relevant to the assessment of whether a controlling shareholder exists. Consequently, the FCA proposes that all associates' shareholdings should be aggregated to assess whether the total holding of shareholders meets or exceeds the threshold of 30% of voting rights in the company.

The draft definition of a '*controlling shareholder*' in the Consultation Paper provides that a '*controlling shareholder*' is a person who exercises or controls on *their* own, or together with *their* associates or together with persons with whom *they* are acting in concert, 30% or more of the voting rights in the company. In paragraph 4.7 of the Consultation Paper, the FCA states that, under the proposed definition, it would regard each party whose shareholdings contributed towards the calculation to be considered a '*controlling shareholder in its own right*'. We assume that this means that, even though the

relationship agreement which is triggered by the existence of the controlling shareholder would need to capture the associate, the associate would not itself be required to be treated as a controlling shareholder independently if it with its associates and concert parties would not satisfy the test. A controlling shareholder will not necessarily itself be an associate of its associates (Appendix 1 paragraph (D)(2) and (3) look "downwards" only).

It would be helpful if the FCA would confirm our understanding of the position, as summarised above.

Who is an associate?

In addition to our comments above, we have a few additional comments in relation to the '*associate*' limb of the controlling shareholder definition.

We note that the definition of '*associate*' in Appendix 1 (D)(4) (and in the Glossary) includes individuals (or any of their associates) who would be able to exercise or control the exercise of 30% or more of the voting interest of the controlling shareholder or a company in (D)(1),(2) or (3) of the definition. It is not clear why companies in the same position are not caught.

We also believe that the drafting in Appendix 1(D)(4)(and in the Glossary) is too wide; in particular, we believe that the words "*or may be able to*" should be deleted, or replaced with the same formulation used elsewhere "or would, on the fulfilment of a condition or the occurrence of a contingency, be able to".

Furthermore, it is not clear how a company would investigate the associate relationships of its shareholders in order to enter into an agreement with the relevant parties (or comply with the continuing obligation in this respect) pursuant to LR 6.1.4BR and LR 9.2.2AR. For example, if shareholder A holds 20% of the voting rights in the listed company, and has a 32% holding in shareholder B, which in turn holds 16% in the listed company, shareholders A and B would together comprise a 'controlling shareholder' under the new LRs. However, whilst the listed company may be aware that its shares are being held by A and B, it may not be able to ascertain the relationship between A and B. We assume that the FCA does not expect issuers to devote material resource to investigating the relationships between shareholders. It would be helpful if the FCA could clarify what level of responsibility, if any, it places on issuers for unearthing controller shareholder groups where the existence of such a group is not apparent from the information supplied to the issuers. It is worth noting that the issuer cannot necessarily rely on information received pursuant to notices under section 793 of the Companies Act 2006, since a person is only deemed to be interested in shares in which a body corporate is interested if, inter alia, that person has the right to exercise or control the exercise of one third or more of the voting power at general meetings of the issuer (as opposed to 30% of the voting rights, which is the test under the controller shareholder definition).

Acting in concert

We ask the FCA to reconsider providing guidance on what is meant by '*acting in concert*' in the context of the controlling shareholder regime. In Chapter 4 of the Consultation Paper, the FCA notes that other industry guidance, for example, the Takeover Panel's guidance on persons who are presumed to be persons acting in concert with each other, should not be used when interpreting the Listing Rules. However, if the term is to be interpreted on a self-standing basis, there is a similar need for specific guidance on this concept to be included in the LRs, since otherwise market participants will not know what

is meant. In paragraph 4.3 of the Consultation Paper, the FCA notes that when assessing whether two parties are acting in concert, "*an issuer should consider whether two (or more) entities are acting together to control the exercise of 30% or more of the votes on all or substantially all matters at general meetings of the company*". It would be helpful if the FCA would incorporate this note into any further technical guidance on the term.

Additionally, we note that under LR 6.1.2AR(a), an investment manager or insurance company which holds, for example, 32% of a listed company will not normally be a controlling shareholder for the purpose of these rules. We assume that this is intended but please could the FCA confirm.

As a matter of drafting, we suggest that it would be clearer if the lead-in wording for LR 6.1.2AR(a) and (b) is "*For the purposes of calculating the voting rights exercised or controlled by a person, the following voting rights are to be disregarded*"…. In addition, we suggest that "*independently*" is omitted from LR 6.1.2AR(a). We do not understand what that qualifier means in relation to bare trustees and it is not necessary in relation to investment managers etc, as the requirement for independence is spelled out later in the clause.

In relation to LR 6.1.2AR(3), we further suggest that, as the conditions are supposed to apply to paragraph (b) (as is the case in the definition of substantial shareholder in LR 11.1.4AR), paragraphs (c) to (f) should instead be numbered (i) to (iv).

Additionally, please see our response to Q2 regarding the '*associate*' limb of the controlling shareholder definition and our general comments at the end of this response in relation to the mandatory agreements.

Definition of an associate

Q2. **Do you agree with our proposal to amend the definition of an 'associate' as described in CP 13/15?**

Please see our response to Q1 above in relation to the '*associate*' limb of the controlling shareholder definition.

In addition, we have some comments on the proposed drafting of the definition. Please could the FCA confirm what is meant by subparagraph (A)(4)(d)(ii) in Appendix 1, when it refers to an individual being able to hold or control '*at least 30% of the partnership*'. The ability to hold or control voting interests is dealt with in subparagraph (A)(4)(d)(i) but it is unclear what is referred to as being held or controlled in subparagraph (ii).

Furthermore, we note a typo in subparagraph D(3) of Appendix 1 which should refer to *"the type described in paragraph **C**(3)(a) or (b) of this definition".*

Finally, we think it would be helpful if the numbering in the paragraph in the associate definition in the Glossary was the same as the numbering shown in in Appendix 1.

Enhanced oversight measures in LR11

Q3. **Do you agree with our proposals relating to the circumstances for imposition of the enhanced oversight measures (LR 11.1.1AR) and the consequences of their imposition (LR 11.1.1CR), as discussed in CP 13/15?**

We see the logic of the FCA's new proposals to impose additional measures where the company or the controlling shareholder does not comply with the relevant provisions set

out in LR 11.1.1AR. We suggest, however, that the majority of independent shareholders should have the power to give a general authority to the board of the issuer to approve ordinary course transactions and small transactions with the relevant controlling shareholder, rather than requiring the company to go through the administrative cost of calling a general meeting to approve each transaction.

As described in our general comments at the end of this response, we think that it should be possible for a company to enter into a transaction or relationship that would otherwise be in breach of the undertaking in LR6.1.4DR(1) if it is authorised in advance by the company's independent shareholders in accordance with LR 11 (whether or not required by LR 11 to be so approved).

Where premium listed companies need to amend existing agreements, or enter into new agreements, with controlling shareholders solely to comply with the new independence principles set out in LR 6.1.4DR, please could the FCA confirm that the amendment of, or entry into, an agreement with the controlling shareholder, merely for the purpose of compliance with this requirement, will not be treated as a related party transaction requiring shareholder approval. Clearly, if an agreement contains other terms which may constitute a related party transaction, the agreement will be subject to the provisions of LR 11.

Ordinary course transactions

Q4. **Do you agree with the proposed guidance in LR 11.1.1DG?**

Yes, subject to our comments in response to Q3.

Waiving the application of the enhanced oversight measures

Q5. **Do you agree with the guidance proposed in LR 11.1.1BG?**

Yes, however, we suggest that it would be clearer if the 'exemptions' as set out in LR 11.1.1BG and LR 11.1.1DG were combined in one provision to clarify that the FCA would consider modifying the enhanced oversight measures in respect of the concessions noted as available in LR 11.1.1 only in exceptional circumstances, whereas derogation from the measures in respect of ordinary course transactions would not be limited to exceptional circumstances.

Duration of enhanced oversight measures

Q6. **Do you agree that the enhanced oversight by minority shareholders should continue to apply until a clean statement has been made in an annual report and the report does not contain a statement that an independent director disagrees with the board assessment (LR 11.1.1ER)?**

Yes.

Transitional provisions

Q7. **Do you agree with our proposals for transitional provisions for existing premium listed companies with controlling shareholders, as well as for premium listed companies that in due course 'acquire' a controlling shareholder (proposed LR TR 11, section 1 and LR 9.2.2BR(1))?**

We agree that there should be a transitional period for existing premium listed companies with controlling shareholders and those that acquire controlling shareholders. We suggest that issuers should be exempt from the new regime for the full six months, and consequently LR 9.2.2BR(1) and (2) should be amended to clarify that there is no '*breach*' which needs to be '*rectified*' within the transitional period by such issuers, as such issuers would be exempt from the provisions during this period.

We believe that a six month period should be sufficient, provided that there is no need for the undertakings which are required to be entered into to receive shareholder approval under LR 11 (as referred to in our answer to Q3 above).

Furthermore, the six month period in LR 9.2.2BR(1) should start from time when the listed company acquires *knowledge* of the fact that a person has become a controlling shareholder.

Annual report disclosure

Q8. **Do you agree with our proposals to impose an obligation to make a statement as reflected in draft LR 9.8.4R(14) and the associated notification obligation in draft LR 9.2.25R?**

Yes, although we suggest that the statement is given by reference to the company's awareness. In particular, we note that the company's awareness is referenced in LR 11.1.1AR(2) and consequently, we suggest that the disclosure in the annual report should also be limited to the company's awareness.

Q9: **Do you agree with our proposals in draft LR 9.8.4AR requiring a statement to be included in an annual report where an independent director has declined to support the relevant statements of compliance made by the board and the associated notification obligation in draft LR 9.2.26R?**

Yes, but it may merit further consideration as to whether the enhanced oversight measures should be triggered by a majority of independent directors on the board declining to support the relevant statements of compliance, rather than by only one independent director. If the dissent of only one independent director is sufficient, we query whether the issuer should have a right of an appeal to the FCA.

Alternatively, we suggest that if only a minority of the independent directors considers that there is a breach, the matter should be put to the independent shareholders who would vote on whether the enhanced oversight measures should apply.

INDEPENDENT DIRECTORS

Circulars in relation to election of independent directors

Q10: **Do you agree with our proposal to require disclosure to be included in circulars relating to election of independent directors?**

Yes, subject to our response to Q12 and Q13.

Q11: **Do you agree that our proposals in this area should be limited to commercial companies with a controlling shareholder or should they be applied to all premium listed commercial companies or all premium listed companies (regardless of whether there is a controlling shareholder or not)?**

We agree that the FCA's proposals in this area should be limited to premium listed commercial companies with a controlling shareholder. The proposals have been designed to provide independent shareholders with increased power to engage in the affairs of the company where there is a controlling shareholder. Consequently, the requirement for a dual voting process to empower the company's independent shareholders is not necessary where there is no controlling shareholder.

Individual disclosure requirements

Q12: **Do you agree with our proposal to include specific disclosure requirements as described above (LR 13.8.17R(i) and (ii))? Are there other requirements we should consider?**

We agree with the principle behind requiring enhanced disclosure relating to the election of proposed independent directors, but we would welcome some guidance in relation to the new requirements. In particular, it would be helpful if the FCA clarified what constitutes a '*relationship*' that an independent director has or has had with the listed company, its directors or its controlling shareholder which must be disclosed under the new LRs. There is also no time limit in respect of past relationships or agreements. The current provision is very broad and may capture various situations which are unlikely to prejudice the independence of the director (for example, where the director entered into a customer contract with the listed company ten years ago) and which would, if included in a circular, result in unnecessary clutter.

Furthermore, we assume that LR 13.8.17R is intended to apply to the election of new independent directors, rather than to the '*re-election'* of the independent directors at the annual general meeting, on the basis that LR 13.8.17R refers to the '*election*' of directors whereas LR 9.2.2DR sets out the process for the '*election or re-election*' of directors. It would make sense for the provision to apply to new directors only, rather than to repeat the same material for the annual re-election of a director, but it would be helpful if the FCA would confirm its position.

Transitional provisions (election of independent directors)

Q13: **Do you agree with our proposal for transitional provisions as set in draft sections 2 and 3 of LR TR11 and LR 9.2.2BR(2)?**

Please see our response to Q7 above. In relation to all the transitional provisions set out in sections 2 and 3 of LR TR11 and LR 9.2.2BR(2), issuers should be allowed a period from [x 2014] up to and including the next general meeting of the listed company held after [x 2014 plus six months]. This allows sufficient time for issuers to comply with the new LRs in the event that they are implemented with immediate effect following the publication of the FCA's feedback statement to CP 13/15. We note that there is no specific transitional period in relation to the disclosure requirements set out in LR 13.8.17 and consequently, we suggest that the same transitional period should also apply to this provision.

We have some additional comments in relation to LR 9.2.2CG which provides that an existing independent director who is being proposed for re-election may remain in office until any resolution '*required*' by LR 9.2.2ER has been voted on. First, LR 9.2.2ER provides that the listed company '***may*** *propose a further resolution to elect or re-elect the proposed independent director*'. Consequently, we suggest that '*required*' should be amended to '*permitted*' in LR 9.2.2CG, unless the change suggested in the following paragraph is adopted.

There is nothing in the proposed drafting that requires a director who is permitted to remain in office under LR 9.2.2CG to cease to be a director if the resolution permitted under LR 9.2.2ER is not passed within a specified time. We do not think that it can be intended that such a director should be allowed to remain in office indefinitely (until the next AGM). Accordingly we suggest that, where a director is allowed to remain on the board following a defeat of one of the resolutions, there should be an appropriate deadline for the second resolution to approve the election of the director and that, if the resolution is not passed, the relevant director should vacate his office. The second vote would be resolved by a simple majority.

As a matter of drafting, the reference to the words "*may provide for*" in LR 9.2.2C be replaced with "*may allow*", as, otherwise, this suggests that the company's constitution must provide that an independent director should remain in office. Furthermore, in LR 9.2.2DR, we suggest that the words "*by the shareholders*" be inserted after "*independent director*".

Shares in public hands

Specific criteria for modification of the free float requirement

Q14: **Do you support our proposal to delete LR 6.1.20G and replace it with LR 6.1.20AG as described above?**

Yes.

In relation to LR 6.1.19(4)(f), as currently drafted, *all* shares held by a person that has agreed to a lock up period of longer than 180 calendar days would be excluded from the free float calculation. We believe that it would be more appropriate for only the shares which are subject to the lock up to be excluded.

Additionally, in LR 6.1.20B, it would be more accurate to substitute the words "*may disregard*" with "*may agree not to aggregate*". We also suggest that the FCA should reconsider LR 6.1.20CG. In particular, we do not understand why the aggregate interest of the provider of the contract for difference is relevant to whether the holder of the financial instrument has an interest.

Application of certain provisions to the standard segment

Q15: **Do you agree that the provisions that are being introduced for the premium segment as discussed above should also be introduced for shares listed on the standard segment (LR 14) and GDRs (LR 18), including consequential amendments to 'group' definition?**

Yes.

CONTINUING OBLIGATIONS

Transitional provisions for voting on matters relevant to premium listing

Q16: **Do you agree with our proposal to allow existing premium listed companies 2 years to bring themselves into compliance with LR 9.2.22R?**

Yes.

Transitional provisions relating to annual report disclosure

Q17: **Do you agree with the transitional provisions as described in the Consultation Paper?**

Yes.

Miscellaneous amendments to LR 9.8.4R

Q18: **Do you agree with our proposal as explained in the Consultation Paper?**

Yes.

Smaller related party transactions

Q19: **Do you agree with our proposals for the treatment of smaller related party transactions as discussed in the Consultation Paper?**

Yes.

THE LISTING PRINCIPLES

Consequential changes to LR 7 and DEPP 6

Q20: **Do you agree that the consequential changes described above are appropriate?**

In relation to the assessment of whether the voting rights attaching to different classes of premium listed shares are proportionate for the purposes of Premium Listing Principle 4, it is unclear why LR 7.2.4G(2) requires the FCA to have regard to '*the extent of dispersion and relative liquidity of the classes*'. It would be helpful if the FCA would explain why this factor would be relevant for its assessment.

CANCELLATION OF LISTING

Q21: Do you agree with Option 1 or Option 2?

We will leave market participants to comment on which of the proposed options is preferable.

Q22: Have we set the 80% threshold in draft LR 5.2.11DR at the appropriate level?

This level seems appropriate in our view.

In LRs 5.2.10R(1) and 5.2.11AR(1), it is not clear why there is a reference to an offeror and a '*controlling shareholder who is an offeror*'. It would be helpful if the FCA could explain the reason for making this distinction in its proposed amendments to the LRs.

General comments

LR 6.1.4 - Agreements with controlling shareholders

We note that the FCA has finalised its policy position on certain of the LRs relating to the agreements which must be entered into with controlling shareholders, including LR 6.1.4DR which sets out the mandatory independence provisions to be included in the agreements. However, we have some additional comments which we ask the FCA to consider before it implements the final LRs.

Reasonable certainty

In LR 6.1.4CG, the new applicant or existing premium listed issuer is not required to enter into a relationship agreement with each controlling shareholder if a controlling shareholder can with '*reasonable certainty*' procure the compliance of another controlling shareholder with the terms of the relevant agreement. As a matter of drafting, it is not clear that the controlling shareholder who can fulfil the procuring requirement is the entity which enters into the relationship agreement with the issuer. Furthermore, the situation may arise where a controlling shareholder has a 32% interest in its associate, which in turn has a 2% interest in the relevant listed company. In this situation the controlling shareholder may not have the power to procure, the compliance of its associate with the terms of the relationship agreement but we query whether it makes sense to require such an associate to enter into a separate relationship agreement with the listed company. Would it not be appropriate for some de minimis exemption to be available, particularly as such an interest cannot on its own have any significant influence over the issuer. It may be best for the issuer to form a view as to who should be a party to the mandatory agreement, taking a purposive approach to the rules.

Furthermore, the independence provisions set out in LR 6.1.4DR relate to a controlling shareholder *and/or its associates*, but, as described above, a controlling shareholder may not be able to procure compliance by its associates. Another example of this is where a controlling shareholder has an associate which is its own shareholder. We assume that the intention is that, In this situation, the associate should enter into its own mandatory agreement as required by LR6.1.4CG, and consequently, the mandatory agreement of the 'first' controlling shareholder (and the independence undertakings contained in it) need not refer to that associate. It would be helpful if the FCA would confirm that this approach would be acceptable.

Additionally, it is not clear what is meant by '*reasonable certainty*' and it would be helpful if the FCA could clarify this either in the rule or in supplemental guidance. Does this mean that the controlling shareholder must have the legal power to procure compliance or is something less stringent than this acceptable? One approach would be to require a controlling shareholder to '*take all reasonable steps*' to procure the compliance by another controlling shareholder with the agreement, which is the same requirement required by LR 11.1.7(4)(b) of related parties to ensure that their associates do not vote on the relevant resolution. If this approach is not considered to be stringent enough, an alternative approach would be to allow a controlling shareholder not to be party to the relationship agreement, provided that it is covered by an unqualified undertaking by another controlling shareholder to procure its compliance with the independence provisions and the issuer reasonably believes that the controlling shareholder should be able to procure compliance.

Additionally, in LR 6.1.4D(2) and (3), the references to "*no controlling shareholder*" should be to "*the controlling shareholder*". The reference to "*no controlling shareholder*" suggests that each controlling shareholder must undertake to control other controlling shareholders – there could potentially be two entirely unconnected controlling shareholders of the same issuer.

Furthermore, we suggest that the references to "a controlling shareholder" in LR6.1.4A(1) and (3) should be to "*one or more controlling shareholders*" rather than to "*a controlling shareholder*".

Mandatory independence provisions

Whilst we agree with the principle of requiring mandatory independence provisions to be included in the agreement, it would be helpful if the FCA would provide some guidance on what situations are intended to be caught by the provisions. For example, it would be helpful if the FCA would provide guidance on:

- what types of actions by a controlling shareholder would have the effect of preventing compliance with the LRs;

- what types of resolution would circumvent the proper application of the LRs, particularly since draft LR 6.1.4DR(3) has a considerably wide scope by proposing to catch resolutions which are '*intended or appear to be intended*' to circumvent the proper application of the LRs; and

- how these undertakings interact with the proposed continuing obligation for premium-listed companies to be carrying on an 'independent' business.

In relation to the undertaking in LR 6.1.4DR(3), whilst we acknowledge that the new regime is designed to afford suitable protections to independent shareholders, controlling shareholders should not be penalised for exercising their shareholder rights fairly. For example, a controlling shareholder may propose a resolution for the company to pay a dividend. However, this may be regarded as a situation which interferes with the company's '*freedom to implement its business strategy*', which is also an indication that the company is not carrying on an independent business, pursuant to the guidance in LR 6.1.4AG(2)(c). Similarly, would any pressure to adopt or desist from any particular acquisition strategy breach the independence business obligation? Furthermore, we assume that the provisions are not intended to prevent a controlling shareholder from accepting a takeover offer, or making an offer for the minority's shares.

Consequently, it would be helpful if the FCA would provide guidance to reassure the market that it does not intend to restrict controlling shareholders' rights to engage fairly in company matters but is targeting behaviour which will be unfairly detrimental to the minority shareholders.

The undertakings to be given in LR 6.1.4DR(1) in relation to transactions and relationships with the controlling shareholder are wider in scope than the restriction in LR 11 in relation to transactions or arrangements with a substantial shareholder. There are no exemptions for small transactions and also "relationships" could include arrangements which are solely for the benefit of the company – in contrast, an "arrangement" does not fall within LR 11 unless it is for the benefit of the related party. Whereas in LR 11 there is a definition of a related party transaction (in LR 11.1.5), there is no equivalent for LR 6.1.4DR(1). Is the FCA intending to provide any guidance on the scope of LR 6.1.4DR(1) instead? Alternatively, would there be any ability for companies to seek consent on an individual basis from the FCA for a transaction or relationship that could otherwise be in breach of the undertaking, for example because it is solely for the benefit of the listed company? There is also no independent shareholder approval mechanism in relation to LR 6.1.4D(R)(1), in contrast to LR11. We think that the FCA should consider whether an exemption should be provided, which could, for example, be included as part of the enhanced oversight measures provisions in LR 11, from what would otherwise be a breach of the undertaking in LR 6.1.4D(R)(1), if the transaction or relationship is approved in advance by the independent shareholders according to the procedures set out in LR 11 (irrespective of whether such approval would be required or not under LR 11 in any event). We would go further and suggest that independent shareholders should be able to approve categories of transaction that would be allowed without further approval (for example, all ordinary course trading transactions).

If you have any queries or would like to discuss any aspect of this response, please contact Richard Ufland.

February 2014