Primary Market Bulletin No.30

Proposed Technical Note 606.1

Law Society and City of London Law Society joint response

29 September 2020

Introduction

1. The views set out in this paper have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (CLLS) and the Law Society of England and Wales (the Law Society).

2. The CLLS represents approximately 17,000 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, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

3. The Law Society is the professional body for solicitors in England and Wales, representing over 170,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

4. The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to takeovers.

Response

5. We refer to Primary Market Bulletin 30 (**PMB 30**) and the consultation on proposed new Technical Note 606.1 "*When a prospectus is required where securities are issued pursuant to Schemes of Arrangement*" (**Draft TN**).

6. We agree that the longstanding and common view among practitioners is that the issue of new securities pursuant to a scheme of arrangement does not constitute an offer to the public for the purposes of the Prospectus Regulation/FSMA.

7. As noted in the Draft TN, under s102B(1) FSMA there is an offer of transferable securities to the public if there is a communication by any person which presents sufficient information on the securities to be offered and the terms on which they are offered "*to enable an investor to decide to buy or subscribe for the securities in question*".

8. In our view, the reference to a decision to "*buy or subscribe for*" securities envisages that there is an underlying contractual offer of securities which is capable of acceptance by the investor. This is also supported by Article 23 of the Prospectus Regulation which refers (in the context of supplementary prospectuses) to investors that have already agreed to purchase or subscribe for securities having the right "*to withdraw their acceptances*". Again, this language presupposes that there is an underlying contractual offer which is capable of acceptance.

9. In the case of a scheme of arrangement, there is no such contractual offer. Shareholders are not being asked to decide to buy or subscribe for securities, rather they are being asked to vote in favour of the scheme. Assuming that the scheme is approved by the requisite majority and sanctioned by the Court, it will operate as a matter of law to bind all shareholders – including those who did not vote, or who voted against the scheme. No individual shareholder can decide to "buy or subscribe for" securities and no bilateral rights are created under the scheme. They are instead bound by the outcome of the collective vote and Court hearing. Any securities being issued as consideration will be issued pursuant to the scheme rather than under a contractual agreement between the shareholder and the bidder. This is consistent with Recital 22 of the Prospectus Regulation, as "there is no right to repudiate the allocation" and "allocation is automatic following a decision by a court" and the delivery of the scheme to Companies House.

10. This remains the case where the scheme involves a full or partial share alternative, mix and match or similar structure under which shareholders are offered the ability to choose between different forms of consideration. Although they are being invited to choose the form of consideration they wish to receive if the scheme becomes effective, there is no underlying contractual offer which is capable of acceptance and therefore (for the reasons outlined above) no offer to the public within the meaning of s102B FSMA.

11. Individual shareholders may wish to receive a particular form of consideration, only to find that the scheme is not approved by the requisite majority or sanctioned by the court, and so they receive nothing. Other shareholders may not make a choice, but find that the scheme becomes effective and so they nevertheless receive securities. As with other schemes, shareholders cannot individually decide to "buy or subscribe for" securities. The ability to make an election under the scheme affects the composition of the consideration that (subject to the scheme becoming effective) the electing shareholder will be entitled and bound to receive in exchange for his or her shares in the target. With a mix and match in particular, the proportionate elements of the consideration that an electing shareholder can receive will be subject to the equal and opposite elections of other shareholders and may have to be scaled back if insufficient opposing elections are made. This is simply achieved via a procedural mechanism under the scheme and does not involve any form of offer and acceptance. Accordingly, a scheme with a mix and match facility is unlike an offer of securities. Under an offer, the transaction with a shareholder only proceeds if that shareholder has agreed to buy or subscribe for the securities in question.

12. In our view the wording of Recital 22 of the Prospectus Regulation does not alter this analysis. There is no "element of individual choice" regarding whether securities are allocated or not, as this is determined by the outcome of the collective vote and Court hearing. Individual shareholders have "no right to repudiate the allocation" if the scheme becomes effective, and "allocation is automatic following a decision by a court" and the delivery of the scheme to Companies House. Recital 22 should not be read as implying that an element of choice somewhere in the process always results in there being an offer to the public – there must still be an underlying contractual offer.

13. In our view, the approach outlined in the Draft TN will result in reduced optionality for shareholders as, given the additional time and expense involved in producing a prospectus, bidders will be less inclined to offer a choice of consideration types if they cannot take advantage of an exemption in the Prospectus Regulation. More generally, given it is accepted that a prospectus is not required for a scheme involving all share consideration or a fixed cash and shares ratio (and that, in this context, shareholders are (pursuant to the Takeover Code and other applicable requirements) provided with sufficient information on the shares to decide whether to approve the scheme) it seems counterintuitive to require a prospectus to be produced simply because shareholders are offered the ability to choose the type of consideration they wish to receive if the scheme becomes effective.

14. The Draft TN also appears to be inconsistent with the FCA's Technical Note 601.2, which states that "*it is our policy not to provide formal binding guidance on whether a particular set of circumstances amounts to a public offer that requires a prospectus to be published*". As that Technical Note says, this requires legal advice based on full knowledge of the relevant facts and is ultimately a question for the courts to determine. Given the opposing views held by this Joint Working Party and, to our knowledge, held by various leading counsel, we do not think it appropriate for the FCA to be providing binding guidance on a legal issue of this type.

15. We have also seen, and support, the response to PMB 30 that is being submitted by Martin Moore QC and Andrew Thornton QC of Erskine Chambers.

FOR FURTHER INFORMATION PLEASE CONTACT:

Chris Pearson (chris.pearson@nortonrosefulbright.com)