

Listing Rule changes relating to controlling shareholders to take effect on 16 May 2014

The FCA has confirmed its intention to bring the Listing Rule changes relating to controlling shareholders, details of which are set out in its November 2013 consultation paper, CP 13/15, into force on 16 May 2014. The changes are intended to reinforce minority shareholder protection in a number of specific situations, in particular, where a premium listed company has a controlling shareholder. Companies affected by these changes will need to take action to ensure compliance with the new requirements.

These changes were not expected to be brought into force until later this year but a FCA press release, published on 17 April 2014, highlighted the FCA's intention to fast track implementation. The FCA has now published the Listing Rules (Listing Regime Enhancements) Instrument 2014, which sets out the text of the Listing Rule changes and the FCA intends to publish a policy statement on 16 May 2014, containing feedback on CP 13/15.

Key Listing Rule changes applicable to premium listed companies with a controlling shareholder

The principal Listing Rule changes that will affect companies with a premium listing are as follows:

- **Independent business test:** a company seeking a premium listing will need to demonstrate that it will be carrying on an independent business as its main activity ("**independent business requirement**")¹. New guidance is being introduced setting out factors that may indicate where an applicant for listing does not satisfy the independent business requirement, for example, where it does not have freedom to implement its business strategy². The current provision that a

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Amended LR 6.1.4R

²

New LR 6.1.4AG

company demonstrate that it controls the majority of its assets is to be deleted. Note that mineral companies and scientific research based companies applying for a premium listing will no longer be exempt from compliance with the independent business requirement. Existing premium listed companies will need to comply with the independent business requirement on an ongoing basis³.

- **Controlling shareholder agreement:** as part of the independent business requirement, a company seeking a premium listing must put in place a written and legally binding agreement with its controlling shareholder(s)⁴. Broadly, a controlling shareholder is any person who exercises or controls on their own or together with any persons with whom they are acting in concert, 30% or more of the votes of the company⁵.

The agreement must contain undertakings (the "independence provisions") that:

- transactions and arrangements between the controlling shareholder (and/or any of its associates) and the company will be conducted at arm's length and on normal commercial terms;
- neither the controlling shareholder nor any of its associates will take any action that would have the effect of preventing the company from complying with its obligations under the Listing Rules; and
- neither the controlling shareholder nor any of its associates will propose or procure the proposal of a shareholder resolution which is intended (or appears to be intended) to circumvent the proper application of the Listing Rules⁶.

Where a listed company has more than one controlling shareholder, it will not be necessary for the company to enter into a separate agreement with each controlling shareholder if, in light of the relationship between the relevant controlling shareholders, the company reasonably considers that one controlling shareholder can procure the compliance of the other controlling shareholders and their associates with the independence provisions in the agreement.

Existing premium listed companies will have until 16 November 2014 to ensure that a compliant controlling shareholder agreement is put in place or that current arrangements with a controlling shareholder are amended to comply with the new controlling shareholder provisions.

Where, after admission, a person acquires a controlling stake in a company, the company will have a period of not more than 6 months to put in place a controlling shareholder agreement⁷.

- **Requirement to notify FCA if controlling shareholder agreement provisions are not complied with⁸:** a new continuing obligation will require a premium listed company to notify the FCA without delay if it no longer complies with the independence provisions set out in the controlling shareholder agreement, or if it becomes aware that the controlling shareholder is not complying with the independence provisions in that agreement. Details of the enhanced oversight regime and the sanctions which will apply in the event of any such non-compliance are set out below.
- **Disclosure of controlling shareholder arrangements⁹:** the company's annual report will need to contain a statement by the board confirming that, where required, the company has entered into a controlling shareholder agreement. Where no such agreement has been entered into, the annual report will need to contain a statement that the FCA has been notified of the non-compliance, together with a brief description of the reasons for the company's failure to enter into such an agreement. The board will also need to confirm that the independence provisions in the agreement have been complied with or, if this is not the case, a description of the reasons for non-compliance and a statement that the FCA has been duly notified of it. Where any of the company's independent directors decline to support any of the relevant statements then this must be stated in the annual report¹⁰.

³ Amended LR 9.2.2A(1)
⁴ New LR 6.1.4B(1)
⁵ New 6.1.2AR
⁶ New 6.1.4DR

⁷ New LR 9.2.2CR(1)
⁸ New LR 9.2.24R
⁹ New LR 9.8.4R(14)
¹⁰ New LR 9.8.4AR

- **Enhanced oversight measures where company or controlling shareholder not in compliance with independence provisions:** where (i) a company is not in compliance with the independence provisions set out in the controlling shareholder agreement, (ii) the company becomes aware that the controlling shareholder is not complying with such provisions, or (iii) the independent director fails to support the statement in relation to such arrangements required to be included in the company's annual report (see above), then all transactions with the controlling shareholder will become subject to prior independent shareholder approval, regardless of the size of the transaction¹¹. In other words, the concessions in Listing Rule 11 regarding transactions in the ordinary course of business, small transactions and smaller related party transactions will be suspended.

The FCA does not have powers to impose direct sanctions on controlling shareholders for non-compliance with the Listing Rules. As such, in CP 13/15 it set out its proposals to introduce the enhanced oversight measures described above as a means by which to seek to secure compliance by a controlling shareholder with the independence provisions. The introduction of these measures will have serious implications for a company that has significant "ordinary course" dealings with their controlling shareholder in the event of non-compliance with the independence provisions. However, these provisions are unlikely to act as a deterrent to non-compliance by a controlling shareholder with no such ordinary course dealings. The FCA's ultimate sanction for non-compliance with the Listing Rules is to cancel a company's listing.

- **Appointment of independent directors:** a company with a premium listing will need to ensure that the election and re-election of any independent director is approved by both the shareholders of the company and the independent shareholders of the company (i.e. excluding the controlling shareholder)¹². If such approvals are not obtained then the company cannot propose a further resolution to elect or re-elect the proposed independent director until 90 days after the

date of the original vote. Any such further resolution must be voted on within 30 days from the end of that 90 day period but may be passed by a single vote of the shareholders of the company (i.e. including the controlling shareholder).

Both applicants for a premium listing and existing premium listed companies will need to ensure that their articles do not prevent the appointment of independent directors in this manner. Existing premium listed companies have from 16 May 2014 until the date of their next annual general meeting to comply with this requirement.

Where a company acquires a controlling shareholder after 16 May 2014, it will have until the date of its next annual general meeting to comply with the new provisions regarding the appointment of independent directors, save where notice of the company's annual general meeting has already been given or is given within a period of 3 months from the event that resulted in the company acquiring the controlling shareholder. In this instance, the company will have until its following annual general meeting to ensure compliance.

- **Minority protections on cancellation of listing:** as the protections afforded by a premium listing fall away on cancellation of listing, the FCA is giving minority shareholders additional voting power in relation to a proposed cancellation of a company's listing. If a premium listed company has a controlling shareholder and wishes to apply for a cancellation it will have to both:

- obtain the approval of a majority of at least 75% of the votes attaching to the shares of those voting on the resolution; and
- gain approval by a majority of the votes attaching to the shares of independent shareholders¹³.

Following a takeover, an equivalent requirement based on acceptances will apply, except that when a bidder has acquired or agreed to acquire more than 80% of the voting rights no further approval/acceptances by independent shareholders would be required to cancel the premium listing.

¹¹ New LR 11.1.1AR -ER
¹² New LR 9.2.2AR(2)(b)

¹³ Amended LR 5.2.5R(2)

Similar provisions will also apply where a premium listed company with a controlling shareholder is seeking to transfer from a premium listing (commercial company) to a standard listing¹⁴.

Other Listing Rule changes being implemented

Other changes are also being made to the Listing Rules with effect from 16 May 2014. In particular:

- **Changes to Listing Principles:** existing Listing Principles 2 and 6 are to be extended to apply to both premium and standard listed companies¹⁵. The remaining principles will continue to apply to premium listed companies, along with two new principles that will require that:
 - all equity shares in a class that have been admitted to premium listing must carry an equal number of votes on any shareholder vote; and
 - where a listed company has more than one class of equity shares admitted to premium listing, the aggregate voting rights of the shares in each class should be broadly proportionate to the relative interests of those classes in the equity of the listed company.
- **Modified free float requirements:** shares subject to a lock-up period of longer than 180 calendar days will be excluded from the free float calculation. The FCA is also introducing guidance on the factors it will take into account in determining whether to accept a free float of less than 25%. In particular, the FCA may take into account whether:
 - shares of the same class are held (although not listed) in non-EEA states;
 - the number and nature of the public shareholders; and
 - in relation to premium listing (commercial companies), whether the expected market value of

the shares in public hands at admission exceeds £100 million.

- **Changes to annual financial report:** a company will need to ensure that its annual report includes all the information required by LR 9.8.4R (information to be included in annual report and accounts) in a single identifiable section unless the report includes a cross reference table indicating where that information is set out¹⁶. This requirement applies to a company with a financial year commencing on or after 1 September 2014.

Action points for premium listed companies

Premium listed companies will need to examine any existing "relationship" agreement with any controlling shareholder to ensure that it satisfies the new Listing Rules requirements. Where this is not the case, the agreement will need to be amended or, where no such agreement exists, a new agreement put in place.

In our view, the entering into of an agreement with a controlling shareholder that contains only the mandatory independence provisions should not constitute a related party transaction, requiring the approval of the independent shareholders of the company in general meeting, on the basis that there is no transaction per se, nor is there an arrangement that would benefit a related party (i.e. the controlling shareholder). It is hoped that the FCA will affirm this view when it publishes its policy and feedback statement on CP 13/15 on 16 May 2014.

Companies should note however that if, in putting in place a new agreement or amending any existing arrangements, they intend to grant any rights or benefits to the controlling shareholder, then this may constitute a related party transaction. Any such arrangements would need to be assessed on a case by case basis.

With regard to timing, a compliant agreement needs to be put in place by not later than 16 November 2014. As mentioned above, enhanced oversight measures will apply in circumstances where the company is not able to ensure compliance with the independence provisions required to be set out in the controlling shareholder agreement and, in

¹⁴ New LR 5.4A.4R(3)

¹⁵ Principles 2 and 6 respectively require a listed company to (i) take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations; and (ii) deal with the FCA in an open and co-operative manner.

¹⁶ New LR 9.8.4CR

addition, the company will need to self-report any non-compliance to the FCA.

Companies will also need to review their articles of association to ensure that there is nothing in them that prevents the election of independent directors being conducted in the manner described above. Any necessary amendments to the articles should be put on the agenda as an item to be addressed at the company's next annual general meeting. In addition, companies will also need to ensure that next year's annual report contains the necessary controlling shareholder disclosures.

Please contact your usual Clifford Chance contact or any of the authors of this note for further guidance as to the actions that you may need to take in connection with these Listing Rule changes.

Useful materials

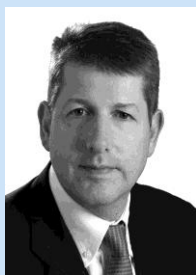
For further details on the background to these proposals, see our November 2013 briefing *FCA publishes feedback on CP12/25 and further consultation* which is available at:

http://www.cliffordchance.com/briefings/2013/11/fca_publicises_feedbackoncp1225andfurther.html

A copy of the Listing Rules (Listing Regime Enhancements) Instrument 2014, which sets out the text of the changes to the Listing Rules, is available at:

http://media.fshandbook.info/latestNews/FCA_2014_33.pdf

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