

UK Corporate Finance Update

Davis Polk

Our UK Corporate Finance Update looks at some of the key developments from the past six months or so in corporate finance law, regulation and practice that are relevant to London-listed companies and their advisers. We also highlight some of the key developments that are on the horizon.

One of the key regulatory changes of the past six months is the coming into force of reforms to the UK IPO process, particularly with respect to communications between a prospective issuer and unconnected analysts and the introduction of the requirement for prospective issuers to publish a registration document approved by the Financial Conduct Authority ahead of any prospectus. During the relatively small IPO window in the London market this past autumn, prospective issuers and their advisers came to grips with the new reforms and in this update we share some of our views regarding key trends that we have seen emerge.

In relation to the Takeover Code, whilst the Panel has published proposed changes to Rule 29 on asset valuations, the key developments covered in this update have been the Panel's consideration of the chain principle under Rule 9 and the use of an auction process to determine final offer prices, both in the context of the competing takeover offers from Comcast and Fox for Sky and Disney's proposed merger with Fox.

In this update we also look at corporate governance reform. The Financial Reporting Council's new, significantly restructured UK Corporate Governance Code will apply to reporting periods commencing on or after 1 January 2019. Consequential updates have been made to existing industry guidance (or are in the pipeline) and new guidance has been published to reflect changes introduced by the new code. However, corporate governance reform over the past six months has not been limited to just premium listed companies. Since October 2018, companies admitted to trading on AIM have been required to adopt a corporate governance code and include a corporate governance statement in their annual report and on their website. Moreover, publication of the Wates Principles in December 2018 has given large private companies the opportunity to adopt a corporate governance code tailored specifically for private companies as they prepare for new reporting requirements which have been introduced by the Companies (Miscellaneous Reporting) Regulations 2018. These regulations set out new reporting requirements for large, quoted and public UK-incorporated companies and will apply in respect of financial reporting periods commencing on or after 1 January 2019. They place a particular emphasis on stakeholder and employee engagement being factored into the determination of the strategy and the decision-making process of a company's board.

Looking forwards, the United Kingdom's proposed withdrawal from the European Union dominates the horizon with various legislative proposals and changes having been published over the past six months and with more in the pipeline to help us navigate the sea change which Brexit will bring to the UK's framework for corporate finance law, regulation and practice. This update summarises the key proposals that have been published.

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Equity Markets

The UK IPO Regime – The New Rules in Practice

In July 2018, the Financial Conduct Authority (the “FCA”) implemented changes to the initial public offering (“IPO”) regime that have had a fundamental impact on the process of conducting an IPO in the United Kingdom.

What are the new rules and how do they impact the IPO process?

The new rules are set out in Rules 11A and 12 of the FCA’s Conduct of Business Sourcebook and, broadly speaking, make the following changes to the UK IPO process:

Publication of a registration document

Prior to the implementation of the new regime, a prospective issuer’s prospectus (comprising a registration document, securities note and summary) was approved by the FCA and published only at the commencement of the offer period for the IPO. Where only institutional investors were participating in the IPO, such investors were required to make use of ‘connected’ research (i.e., reports prepared by analysts from syndicate banks) and, at the commencement of the offer period, a draft (or ‘pathfinder’) prospectus, before being provided with the approved prospectus at a very late stage in the IPO process.

In order to give investors more time to consider a prospective issuer’s disclosure, the new rules require the publication of a registration document approved by the FCA prior to the publication of any connected research. This means that the registration document, which includes a description of the prospective issuer’s business, financial results and strategy, as well as the risks associated with its business, is now available to investors approximately three weeks earlier in the IPO process.

The other sections of the prospectus, which contain details of the offer (set out in the securities note) and a summary, together with an updated registration document, are published later in the IPO process.

Involvement of unconnected analysts

Under the former regime, there was no requirement for issuers to engage with ‘unconnected’ analysts (i.e., research analysts not associated with the banks who make up the underwriting syndicate) during the IPO process. Research reports produced in connection with an IPO were therefore typically only published by analysts working for the same banks that were part of the underwriting syndicate.

In order to allow investors access to a wider range of views on an issuer, the new rules require that, if connected analysts are given access to the issuer, unconnected analysts should be afforded the same opportunities and receive the same information prior to any connected analyst publishing research on the prospective issuer during the IPO process.

An issuer has two options when engaging with analysts on an IPO process:

- all analysts can be invited to the same briefings and receive the same information; or
- within seven days of publication of the registration document, unconnected analysts can be provided with the same information that connected analysts have received already.

Where an issuer meets with all analysts at the same time, connected analysts are permitted to publish their reports one day after the registration document is published. If an issuer delays meeting with unconnected analysts until after publication of the registration document, connected analysts must wait seven days after the publication of the registration document to publish their reports in order to give unconnected analysts the opportunity to publish at or around the same time.

Enhanced conflicts rules

To enhance the standards for investment banks to manage conflicts of interest in the production and distribution of research, the new rules prohibit analysts who produce independent research from participating in pitches by banks for syndicate roles on an IPO.

The intention of the new rules is to remove any perception that an analyst’s report is tainted by the analyst’s association to an investment bank that is part of the underwriting syndicate. Excluding analysts from engaging with an issuer during the pitch process should ensure that analysts are not placed in a position where pressure is exerted on the analyst to be supportive of the issuer in return for a bank securing an underwriting role on the transaction.

“There was broad consensus among respondents to Consultation Paper 17/5 that we should proceed with a package of measures aimed at restoring the centrality of the prospectus in the IPO process, creating the necessary conditions for unconnected IPO research to be produced, and addressing the underlying conflicts of interest that can arise in the production and distribution of connected research.”

*Financial Conduct Authority press release
(26 October 2017)*

Which transactions are subject to the rules?

The new rules apply to IPOs of prospective issuers who seek admission of their shares to trading on the Main Market of the London Stock Exchange. They do not apply to IPOs on the Alternative Investment Market (“AIM”), although the FCA has indicated that it would encourage larger issuers on AIM to seek to comply with the new regime. No AIM IPO has, as of the end of December 2018, complied with the new rules.

Further, the rules do not apply to an application to listing with no issue or sale of shares (e.g., a demerger or technical listing), nor do they apply in circumstances where the prospective issuer does not engage with connected analysts. In such circumstances, a prospective issuer would not be required to publish a registration document in advance of a full prospectus.

How have issuers responded?

Since July 2018, there have been just under 10 announced UK Main Market IPOs that have engaged with the new regime. Whilst the sample size remains small, it is perhaps possible to identify how market practice is developing to account for the new rules.

Analyst meetings

The issuers in all of the announced IPOs have met with connected and unconnected analysts separately, leading to a seven day delay between the publication of the registration document and connected research. A key reason for this may be a concern that involving unconnected analysts earlier in the process would risk a leak and therefore the ability of the issuer to control the timing of the announcement of its IPO.

Price-range prospectuses

In line with its objective to ensure the centrality of the prospective issuer's own disclosure in the IPO process, the FCA intimated in its consultation paper (CP 17/5) that, under the new rules, it expected that prospective issuers would publish a ‘price-range’ prospectus.

A ‘price-range’ prospectus (which includes a range for the price and/or the number of shares to be offered in the IPO) is approved by the FCA prior to the public marketing of an IPO and is required where an IPO includes a retail offer. Where only institutional investors are invited to participate in an IPO, a prospective issuer is however not required by the new rules to have published an approved prospectus in order to market the transaction and therefore may, as was the case under the former rules, use an unapproved ‘pathfinder’ prospectus for such purposes.

Broadly speaking, issuers in the UK have historically eschewed the use of a price-range prospectus for an institutional-only offer, believing that using a pathfinder allows more flexibility to set the offer size and price, as it affords the prospective issuer more time to receive feedback from potential investors before doing so.

It is too soon to draw any conclusion as to whether there will be more ‘price-range’ prospectuses as a result of the new rules. As of the end of December 2018, no UK IPO under the new rules with an institutional-only offer has published a prospectus; however, the IPO announcements made by those issuers contemplating an institutional-only offer suggest an intention to make use of a ‘pathfinder’ prospectus, despite the FCA's stated preference for price-range prospectuses.

IPO announcements

Under the old regime, a prospective issuer's first public declaration of its intention to IPO was the ‘Intention to Float’ (“ITF”) announcement which was customarily published on the same date as connected research. This announcement typically contained a short summary of the company's business, directors and management team, its strengths and strategy and a summary of the key terms of the offer.

There was no specific regulatory requirement under the former rules to publish an ITF announcement. Whilst the new rules similarly do not make specific provision for the timing or content of an ITF announcement, the FCA intimated in CP 17/5 that the company would make its ITF announcement on the date of publication of connected research and not on the date of the registration document.

Notwithstanding this, all of the issuers that have publicly announced an IPO under the new rules have published an announcement on the date of publication of their registration document, which includes most of the information that was historically contained in the ITF announcement, although the details of the IPO itself (i.e., timing and size of the offer) have been more limited. Upon publication of connected research, issuers have updated the market with further offer details and any updates to the original announcement.

It remains to be seen if this approach will continue or whether issuers will seek to include all of this information in one announcement made on the date of the registration document or when connected analysts publish their research.

Whilst suggestions of how market practice will develop may be gleaned in the approach taken by the first issuers who have navigated the new IPO rules, it is clear that market participants are still familiarising themselves with the new regulatory regime and future IPOs may look to build on the lessons learnt since July 2018.

Sources: FCA Conduct of Business Sourcebook; FCA Consultation Paper 17/5 (March 2017).

The Process for Communicating with Unconnected Research Analysts Under the New IPO Regime

Who is an unconnected analyst?

The Association for Financial Markets in Europe (“**AFME**”) has defined an ‘unconnected analyst’ as an analyst not employed by one of the proposed members of the underwriting syndicate who produces research which is disseminated to one or more third parties that are external clients of the research analyst’s employer’s group. This has generally been interpreted to mean that financial journalists and buy-side analysts are not unconnected analysts.

Which unconnected analysts should be invited?

The new rules require that a ‘range’ of unconnected analysts have the opportunity to participate in the initial public offering (the “**IPO**”) process.

Where unconnected analysts are invited to join connected analysts prior to publication of a registration document (and when the IPO remains confidential), the issuer and its underwriting syndicate will therefore have to select a group of unconnected analysts to invite. To facilitate this process, the European Association of Independent Research Providers (“**Euro IRP**”) has compiled a list of analysts interested in writing research on prospective IPOs. AFME is adding to this list and it is envisaged that other representative firms will also contribute. Issuers would then contact all of the firms on the composite list to invite them to participate.

If analysts are involved in the process once the registration document is published, it is a straightforward process to ensure that unconnected analysts are invited to receive further information – an issuer will simply provide details in its announcement informing the market of the proposed publication of a registration document. Firms on the Euro IRP list should also be contacted directly.

All syndicate members have an obligation to record which unconnected analysts were contacted and selected in the IPO process. AFME has prepared a template file note for investment banks to use to satisfy this requirement.

How do you provide access for unconnected analysts?

The key point is that connected and unconnected analysts must receive the same information, but it does not need to be provided to them in the same manner.

The issuer can, for example, choose whether or not to have an analyst presentation for unconnected analysts or, alternatively, simply provide them with written materials (i.e. the presentation and a transcript of any additional Q&A at, or following, the session). Further, it would not always be necessary to conduct a site visit for unconnected analysts simply because the connected analysts were provided with this opportunity, only that the information shared on that site visit is passed to the unconnected analysts.

The practical difficulties of the new regime arise from having only seven days between involving unconnected analysts in the process and the publication date of connected research. As any additional information provided to unconnected analysts needs to be conveyed back to the connected analysts in time for them to potentially amend their reports, a prospective issuer needs to ensure that unconnected analyst questions are provided and answered within a very short period following publication of the registration document.

AFME has prepared helpful advice to investment banks on the steps they must take to ensure equality of information and recording the approach taken.

Source: AFME and Euro IRP Guidance on UK Initial Public Offerings – Process in Relation to Providing Issuer Access for Unconnected Analysts (20 August 2018).

Changes to the Prospectus Regime for ECM Transactions Under the New Prospectus Regulation

The New Prospectus Regulation⁽¹⁾, which will repeal the current Prospectus Directive⁽²⁾ and Prospectus Regulation⁽³⁾, was published in the Official Journal of the European Union on 30 June 2017, with the stated intention of making it easier and more cost-effective for companies to access the capital markets. The provisions in the New Prospectus Regulation concerning the format and content requirements of a prospectus will apply from 21 July 2019 and are supported by technical advice published by the European Securities and Markets Association (“ESMA”) in March and July 2018.

Issuers and their advisers will need to ensure that they comply with the new regime in respect of any equity prospectuses to be published on or after 21 July 2019.

Impact of Brexit – Whilst the changes discussed below will only come into force after the United Kingdom’s proposed withdrawal from the European Union, the current understanding is that the New Prospectus Regulation will be transposed in its entirety into UK law at the date of withdrawal and therefore will remain relevant in a UK context unless it is specifically repealed or amended. It is currently assumed that an issuer will be able to ‘passport’ into the European Union prospectuses approved in the United Kingdom during any transition period, but it is not clear at this stage what provisions will be put in place thereafter.

Format of the prospectus – ESMA’s technical advice prescribes that an equity prospectus should comprise the following parts in the following order: (a) table of contents, (b) summary, (c) risk factors and (d) other information items required to be included by the New Prospectus Regulation. The issuer is generally free to organise the sections within (d) as it wishes, which broadly follows the approach currently taken in the United Kingdom and existing guidance from the FCA.

New summary requirements – The form of the summary section in a prospectus has been amended so that there are now four sections (covering an introduction containing warnings, key information on the issuer, key information on the securities and key information on the offer of securities to the public and/or admission to trading) as opposed to the five sections under the old regime. Whilst the information contained in a summary will, for the most part, not change, the New Prospectus Regulation requires a Q&A format to be adopted and has also limited the length of the summary to seven pages (as opposed to the current limit of 15 pages and 7% of the prospectus).

Risk factors – The New Prospectus Regulation requires risk factors to be categorised by their nature and presented in order of their materiality, which is already the customary approach in the United Kingdom. ESMA has published some further draft guidelines on risk factors under the new regime, which stresses the need for them to:

- be concise and specific and have a clear and direct link with the issuer and/or its securities;
- be material, taking account of the probability of the risk’s occurrence and the expected magnitude of its negative impact;

- include, where available, quantitative information demonstrating the potential negative impact;
- include mitigating language only to illustrate the probability of occurrence of the risk and the expected magnitude of its negative impact (not to reduce the perception of the risk’s materiality);
- be corroborated by the disclosure elsewhere in the prospectus; and
- be disclosed by categories.

On 13 July 2018, ESMA published a consultation paper seeking views on its draft guidelines to assist national competent authorities in their review of the specificity and materiality of risk factors and of their presentation across categories in the prospectus. The consultation closed on 5 October 2018 and ESMA will publish its final report and guidelines by 31 March 2019.

Use of proceeds – ESMA has stated that under the New Prospectus Regulation issuers will be required to state a specific use of proceeds and, in many cases, a blanket phrase stating that the proceeds will be used “for general corporate purposes” will not be sufficient.

Profit forecasts and profit estimates – In ESMA’s view, the current requirement to include a reporting accountant’s report on profit forecasts and estimates by the issuer creates additional costs without providing clear value to investors. Consequently, ESMA has replaced this requirement with an obligation for the inclusion of a statement by the issuer that any profit forecast or estimate has been compiled on the basis set out in, and prepared on a basis that is comparable with the issuer’s annual financial statements and consistent with the issuer’s accounting policies. Whilst the abolition of the requirement to include an accountant’s report could save cost, underwriters may well seek the comfort of a private accountant’s report as a matter of their own due diligence.

Significant change statement – Currently, a prospectus must include a statement setting out any significant change to an issuer’s trading and financial positions since the date of the latest financial statements included in the document. The new rules delete references to ‘trading position’ (the meaning of which was considered unclear) and replaced it with the requirement to include an additional statement concerning any significant change to the issuer’s financial performance over the same period. This clarifies that an issuer’s disclosure concerning significant change should focus on any such change to the issuer’s balance sheet or income statement.

Dilution – Under the new regime, issuers will now have to include in a prospectus:

- a comparison of participation in share capital and voting rights for existing shareholders before and after a capital increase, on the assumption that they do not acquire new shares; and
- a comparison of the net asset value per share, as of the date of the latest balance sheet before the capital increase and the price per share in the offer.

Notes: (1) Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC. (2) Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and amending Directive 2001/34/EC. (3) Commission Regulation (EC) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and the publication of such prospectuses and dissemination of advertisements.

In addition, where a pre-emptive and non-pre-emptive offer are run concurrently (e.g., a firm placing and open offer), the prospectus must include an indication of the dilution that existing shareholders will experience on the basis that they do take up their entitlement in addition to the situation where they do not.

Incorporation by reference – Under the current regime, an issuer may incorporate by reference in a prospectus only documents which have been approved or filed with a national competent authority. The New Prospectus Regulation expands this list to include certain other documents such as regulated information, management reports (as referred to in the Accounting Directive⁽¹⁾), corporate governance statements and the issuer's memorandum and articles of association.

Further streamlining measures – ESMA's technical advice has attempted to streamline prospectuses by removing the need for issuers to repeat information in different parts of the prospectus and include certain boilerplate disclosure. As such, the following changes are aimed at reducing the length of prospectuses:

- the disclosure requirements for the operating and financial review now mirror the requirements for a management report in the Accounting Directive in order to allow an issuer to more easily incorporate this information by reference;
- as the International Financial Reporting Standards as adopted by the European Union require tangible fixed assets to be included in an issuer's financial statements, the requirement to disclose these elsewhere in the prospectus has been deleted;
- disclosure in respect of the public takeover regime applicable to the issuer now needs only to stipulate the relevant national legislation applicable to the issuer and give an overview of the position of a shareholder in case of a takeover and what frustrating measures can be imposed against a bid;
- instead of including disclosure in relation to certain tax consequences of holding shares in an issuer, the tax disclosure in the prospectus now needs only to include disclosure of which tax regimes may apply and further information where the proposed investment attracts a tax regime specific to the type of investment;
- the description of an issuer's constitutional documents in the prospectus may now be limited to the issuer's principal objects and purposes and any change of control provisions; and
- the deletion of the requirement to include a section on selected financial information as this information will also be included elsewhere in the prospectus.

Additional requirements – The New Prospectus Regulation does require some additional items to be disclosed, many of which it is already customary to include in UK equity prospectuses. These include specific requirements to disclose:

- the company's strategy and objectives;
- the issuer's regulatory environment as a stand-alone disclosure item and not part of the operating and financial review;
- the issuer's website address (with a warning that it does not form part of the prospectus);

- the issuer's legal entity identification number; and
- further information around stabilisation activities that are required to be publicly announced under the Market Abuse Regulations.

Documents available – The New Prospectus Regulation allows that certain documents that must be available for inspection alongside a prospectus can be made available online and not in hard copy. ESMA has stipulated that where documents are made available electronically, their location should be relatively precise and should not simply refer to the home page of the issuer or a third-party website. Issuers will need to ensure that such web locations are kept up-to-date.

Publication requirements – The New Prospectus Regulation requires an electronic version of a prospectus to be fully downloadable, printable and searchable, and easy to access on a designated section of the issuer's website. The summary needs to be accessible in a standalone document in the same section of the website and there must be easier and more accessible links for investors to access any information incorporated by reference.

Under the New Prospectus Regulation, it will not be permissible to place the prospectus behind a web-blocker or otherwise require potential investors to register or pay a fee to view the prospectus. Following implementation of the New Prospectus Regulation, ESMA will publish an online and searchable database of all prospectuses which will be accessible to all investors.

Draft delegated regulation on format, content, scrutiny and approval of prospectuses

On 28 November 2018, the European Commission published a draft delegated regulation (the "**Delegated Regulation**") to supplement the New Prospectus Regulation. The Delegated Regulation will also apply from 21 July 2019. It includes provisions on the content and format requirements of a prospectus and EU growth prospectus (as published by smaller companies). Such contents may vary depending on different factors such as the type of issuer, security, issuance and whether there is an admission to trading. The Delegated Regulation sets out specific information requirements that should be combined depending on those factors and the type of prospectus. The Delegated Regulation also addresses how universal registration documents (URDs, which are used as base prospectuses by frequent issuers) should be scrutinised and approved.

Sources: ESMA Final Report – Technical Advice under the Prospectus Regulation (28 March 2018); ESMA Final Report – Draft Regulatory Technical Standards under the Prospectus Regulation (17 July 2018). Draft Commission Delegated Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Commission Regulation (EC) No 809/2004.

Final Draft Delegated Regulation on a Single Electronic Reporting Format

Directive 2013/50/EU amending the Transparency Directive⁽²⁾ requires that all annual financial reports be prepared in a single electronic reporting format from 1 January 2020.

Notes: (1) Directive 2013/34/EU of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and the related reports of certain types of undertakings. (2) Regulation No 596/2014 on market abuse, repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC and Directive 2014/57/EU on criminal sanctions for market abuse.

ESMA was mandated to develop regulatory technical standards specifying this electronic reporting format. ESMA published draft regulatory technical standards for consultation on 25 September 2015 and summarised the feedback received in a Feedback Statement published on 21 December 2016. Due to budgetary constraints, ESMA did not publish its final report on the draft regulatory technical standards until 18 December 2017.

The format proposed by ESMA makes use of the extensible Hypertext Markup Language which is non-proprietary, freely usable and can be opened without specialised software. In an effort to facilitate the accessibility, analysis and comparability of financial statements of issuers prepared in accordance with the International Financial Reporting Standards as adopted by the European Union, ESMA proposed introducing eXtensible Business Reporting Language (“XBRL”) mark-ups, which will make items disclosed in such statements machine-readable. This format will allow for the analysis of large amounts of financial information without extensive and burdensome manual processing, and will enable users to more easily compare numeric information in the financial statements across issuers. Moreover, the machine-readable XBRL information can be easily transferred to other formats such as SQL or Excel, thus avoiding onerous manual re-keying of information.

On 17 December 2018, the European Commission published the final draft text of its delegated regulation supplementing the Transparency Directive and adopting ESMA's regulatory technical standards. Issuers listed on regulated markets in the European Economic Area must prepare their annual financial reports in respect of financial years beginning on or after 1 January 2020 in the single electronic reporting format set out in the delegated regulation.

Source: Commission Delegated Regulation (EU) supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format (C(2018)8612 final).

The New Sovereign-Controlled Commercial Company Premium Listing Category

In July 2018, the FCA introduced a new category for its premium listing segment, which aims to make the UK capital markets more accessible to companies which are directly or indirectly controlled by a nation state.

The Official List is divided into the premium and standard listing segments. The requirements for a standard listing stem from the relevant EU directives and regulations that apply to regulated markets across the European Union. For admittance to the premium listing segment, an issuer is required to meet higher UK-specific standards that are intended to provide additional investor protection and promote shareholder confidence.

The new category of the premium listing segment is exclusively for sovereign-controlled commercial companies. According to the FCA, investors who choose to invest in sovereign-controlled commercial companies are accustomed to assessing sovereign risk. As such, some of the investor protections associated with a premium listing are waived for sovereign-controlled commercial companies with securities listed on the new category of the premium listing segment.

“These rules mean when a sovereign controlled company lists here, investors can benefit from the protections offered by a premium listing. This raises standards. This package recognises that the previous regime did not always work for these companies or their investors. These rules encourage more companies to adopt the UK's high governance standards.”

Andrew Bailey, FCA Chief Executive

What is a sovereign-controlled commercial company?

In order to qualify for the new category, a company must have a ‘sovereign controlling shareholder’, which is defined in the new rules as a shareholder:

- who is a sovereign or other head of state acting in his or her public capacity or a government or a department, agency or special purpose vehicle of that government; and
- who alone (and not with any concert party) exercises or controls 30% or more of the votes to be cast on all or substantially all matters at general meetings of that company.

The company must also be a commercial company and not an investment fund.

What securities can be admitted to the new category?

Equity shares and depositary receipts over equity shares can be listed on the new listing category.

This means that for the first time a listing of depositary receipts can be admitted to the premium listing segment. For some potential overseas issuers, this means that they now have access to the premium listing segment whereas previously this would not have been possible because their shares (or depositary interests in such shares) are not capable of being traded on the United Kingdom's electronic settlement system, CREST.

Depositary receipts may be an attractive option for sovereign-controlled commercial companies that do not wish to satisfy, or seek a derogation from, the 25% free float requirement for premium listed equity shares under the Listing Rules. The free float requirement is that all securities of the same class must be admitted to listing and 25% of that class (whether shares or depositary receipts) must be in public hands. As such, a sovereign-controlled commercial company will not be prohibited from listing a small percentage of its total underlying equity capital in the form of depositary receipts, as long as those depositary receipts satisfy the free float test by reference to the total number of depositary receipts.

What are the key differences between the new category and the commercial company premium listing category?

The Listing Rules require that a commercial company with a premium listing of its equity shares enters into a relationship agreement with a 'controlling shareholder' (broadly, a person who exercises or controls on its own, or together with any person with whom it is acting in concert, 30% or more of the votes able to be cast on all or substantially all matters at a general meeting of the company). A relationship agreement must contain certain prescribed provisions designed to ensure the issuer's independence and compliance with the UK listing regime. Under the new rules, this requirement will not apply to a sovereign controlling shareholder, but would apply to any other controlling shareholder of that issuer.

The premium listing regime also imposes certain controls on commercial companies entering into a transaction or arrangements with a 'related party' (which includes any shareholder of the issuer who is entitled to exercise, or to control the exercise of, 10% or more of the votes able to be cast on all or substantially all matters at a general meeting of the issuer). These controls include, in certain circumstances, seeking shareholder approval for the transaction or arrangements.

Whilst sovereign-controlled companies will not be required to seek shareholder approval for a transaction with a sovereign controlling shareholder under the related party rules, they will be required to publicly announce transactions over a certain size, notwithstanding whether the transaction or any aspect of it is inside information. Furthermore, the significant transaction regime will apply, and therefore where one of the ratios relating to the gross assets, profits, consideration or gross capital of the issuer and the subject of the transaction is 25% or more, the issuer will need to seek shareholder approval under the significant transaction regime.

What requirements apply to the new category?

Other than with respect to the controlling shareholder and related party regimes that have been amended for the new category, issuers with securities admitted to the new category are, broadly speaking, obliged to comply with all other eligibility and continuing obligations applicable to other commercial companies with shares admitted to the premium listing segment.

There have, however, been some necessary amendments to incorporate depositary receipts into the premium listing requirements. To preserve the spirit of these requirements, whilst appreciating that the listed depositary receipts may not represent the entire underlying share class, where shareholder consent is required under the Listing Rules for other commercial companies with a premium listing (for example, a significant transaction, implementation of a share buy-back or employee incentive scheme, the appointment of an independent director, or the offer of shares at a discount of more than 10% to market price) the sovereign-controlled commercial company will be required to convene a general meeting of shareholders of the class of shares represented by the depositary receipts and ensure that the holders of the depositary receipts are able to exercise their voting rights at such a meeting.

Does the new category allow for an issuer's securities to be included on the FTSE indices?

Currently, only companies with equity shares listed on the premium listing segment are eligible to be included in the FTSE UK Index Series. Without changes to the FTSE UK Index Series eligibility criteria, while equity shares admitted to the new listing category could be included, any listing of depositary receipts would be excluded. Sovereign-controlled commercial companies issuing equity shares would still have to meet the other criteria set out in the FTSE Ground Rules, including a free float requirement for issuers without UK nationality of greater than 50% which, given the nature of such issuers, may not be achievable.

What has been stakeholders' reaction to the new category?

Reaction to the new rules has been mixed, and it is worth noting that the only company eligible for the new category to list in London since July 2018 elected to list global depositary receipts on the standard listing segment of the Official List and not take up the option to make use of the new category.

The Investment Association, which represents UK investment managers, welcomed some of the amendments made in the final set of rules from those that were initially proposed, but remains of the view that sovereign-controlled commercial companies should not be admitted to the FTSE UK Index Series. The Institute of Directors, which represents UK business leaders, has expressed disappointment with the new rules, particularly the lack of a requirement for binding independent votes on independent directors which had been their recommendation.

Source: FCA press release - New premium listing category for sovereign-controlled companies (3 June 2018).

ESMA's Updated Q&A on the Market Abuse Regulation

On 1 October 2018, ESMA published an updated version of its Q&A on the Market Abuse Regulation⁽¹⁾ ("MAR"). ESMA added the following three new questions and answers relating to the delay in disclosure of inside information by a credit or financial institution to preserve financial stability under Article 17(5) of MAR.

New Question 5.3: *When issuers that are credit/financial institutions intend to delay disclosure of inside information under Article 17(5) of MAR, what are the elements they should consider in their assessment of the conditions therein contained?*

ESMA clarifies that where a credit/financial institution, as issuer, intends to resort to the financial stability delay, it should provide evidence to the Financial Conduct Authority (the "FCA") that the conditions under Article 17(5) are met. The issuer should consider the following conditions:

- **Risk to financial stability.** To resort to the delay under Article 17(5) of MAR, disclosure of inside information has to entail a risk of undermining the financial stability of both the issuer and the financial system. To entail such a risk, such information should pertain and be performed by an institution of relevance (e.g., in terms of impact and interconnection).

Note: (1) Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

- **Impact on public interest.** When assessing the public interest, the credit/financial institution should attempt to identify different entities or groups whose interest could be directly or indirectly affected by the decision to delay the disclosure of the inside information and whose interests may be considered as a public interest. During the assessment of the public interest, it is important to consider interests beyond the direct economic impacts and other non-financial interests of the public. Any assessment should consider the direct economic and other non-financial interests of the public; no single interest should be considered in isolation.
- **Confidentiality.** The issuer should provide the FCA with information on how confidentiality of the inside information can be ensured (both at the time of notification to the FCA and during any delay period). In connection with this, the issuer should consider the procedures and measures it has in place to ensure such confidentiality and draw up and maintain an insider list.

New Question 5.4: *Are credit/financial institutions required to notify the NCA of the expected duration of the delay under Article 17(5) of MAR?*

Yes. The issuer's assessment of the expected length of the delay and details of expected trigger events should be notified to the FCA if it intends to resort to the financial stability delay.

New Question 5.5: *Where the National Competent Authority does not consent to the delay of disclosure under Article 17(5) of MAR, can a credit/financial institution resort to Article 17(4) of MAR?*

Where the conditions under Article 17(5) are not met and the FCA does not consent to the delay, the credit/financial institution must disclose the inside information immediately as required by Article 17(6). It cannot resort to the delay of disclosure under Article 17(4).

Further update

On 12 November 2018, ESMA published a further updated version of its Q&A on MAR adding one new question and answer relating to the scope of trading restrictions for persons discharging managerial responsibilities (a "PDMR") during a closed period under Article 19(11) of MAR.

New Question 7.10: *Does the prohibition in Article 19(11) of MAR encompass transactions of the issuer relating to its own financial instruments even if it is the PDMRs taking the decision or bringing a previous decision into practice?*

In short, Article 19(11) of MAR prohibits PDMRs within an issuer, and not the issuer itself, from conducting any transactions on its own account or for the account of a third party, directly or indirectly, relating to the share or debt instruments of the issuer during a closed period of 30 calendar days before the announcement of financial information. ESMA clarifies that as the actions of the PDMR, in their capacity as a director or employee of the issuer, are not PDMR transactions for the account of a third party but transactions of the issuer itself, the prohibition of Article 19(11) is not applicable.

ESMA notes that issuers are subject to the prohibition on insider dealing under Article 14 of MAR and so where an issuer is in possession of inside information relating to its own financial instruments, it will not be able to trade on them unless it has established, implemented and maintained the internal arrangements and procedures set out in Article 9(1) of MAR. This may be relevant to remuneration committee meetings that take place during closed periods to take decisions on the level of vesting of incentive awards.

Source: ESMA Q&A on the Market Abuse Regulation (versions 12 and 13).

New FCA Primary Market Bulletin and Proposed Change to Technical Note on Inside Information

On 11 June 2018, the FCA published the 19th edition of its Primary Market Bulletin to consult on changes to its existing Technical Note (UKLA/TN/506.1) on how inside information should be identified and handled when an issuer is in the process of preparing a periodic financial report in light of the publication of ESMA's guidelines regarding the circumstances in which the disclosure of inside information may be delayed under Article 17(4) of MAR (the "ESMA Guidelines").

The proposed amendments to the Technical Note are extensive. The FCA uses the example of the preparation of a periodic financial report to illustrate its recommendations relating to the process for identifying and handling inside information. The note sets out the following guidelines for the assessment of such information:

- issuers should exercise judgment and should conduct the on-going assessment in good faith;
- issuers should record and be able to submit evidence of the assessment process to the FCA on request; and
- issuers should not take a blanket approach to the assessment of the status of the information they hold.

If the proposed amendments are approved, the revised Technical Note will offer some guidance on the identification and disclosure of inside information, particularly in the context of preparing periodic financial reports, and serve as a useful reminder that there may well be circumstances where delaying the disclosure of financial results until the scheduled release date of a periodic financial report could constitute a violation of MAR.

Comments on the FCA's proposals were requested by 23 July 2018.

Source: FCA Primary Market Bulletin No. 19 (11 June 2018).

FCA Review of Industry Implementation of MAR

On 17 December 2018, the FCA published the 58th issue of its newsletter *Market Watch* in which it outlined how market participants have been implementing and complying with MAR since its coming into effect on 3 July 2016.

In its review, the FCA also provided suggestions on how market participants can enhance their compliance with MAR in order to ensure that the market remains orderly and transparent and the United Kingdom remains an attractive place to do business.

Suspicious transaction and order reports

- Over 70% of the suspicious transaction and order reports the FCA receives are related to insider dealing in equities. The FCA reminded market participants that it expects firms to perform surveillance across all relevant asset classes.

Market soundings

- The FCA reported that during its review, it did not observe any impact on the ability of issuers to raise capital on UK markets following the introduction of the market soundings regime under MAR.
 - 76% of issuers who responded to the FCA's survey said that their appetite for initiating soundings had either remained constant or increased following MAR coming into force.
 - 87% of asset management firms said that their interest in receiving soundings had remained the same or increased over the same period.
- Investors have adopted different models for receiving market soundings, with some choosing to appoint 'gatekeepers' in compliance or front-office teams as a first point of contact who will then decide whether to accept a wall-crossing and how it will operate in practice.
- The FCA reiterated that investors should retain the flexibility to determine the internal organisation that best suits their business model but noted the benefits of a gatekeeper model in ensuring a consistent approach and minimising opportunities for information leakage.
- Market participants should be reminded that a declined wall-crossing could still convey inside information particularly where the sell-side making contact only initiates soundings for a small number of securities. Firms should consider whether a declined wall-crossing has actually had the effect of wall-crossing the investor and apply the relevant controls.

Record-keeping

- Fewer than half of the surveyed investors reported consistently using recorded lines to document soundings. Some firms indicated that they use written minutes agreed between the disclosing party and the sounding recipient as an alternative method.
- The FCA noted a mixed record among investors of documenting declined sounding approaches and encouraged firms to maintain a detailed record of these conversations, along with an explanation of why the sounding was declined, as good practice.

Post-market sounding cleansing

- Informing market sounding recipients when information disclosed during a sounding ceased to be inside information appears to be working well for most transactions, with 75% of investors disclosing that they were either satisfied or very satisfied with the disclosing market participants' procedures for cleansing.
- The FCA encouraged firms to consider whether their approaches to undertaking or receiving market soundings can easily adapt to changing market conditions, including a less favourable market for new issues or an uncertain trading environment.

Insider lists

- The FCA has observed varying quality in the insider lists it has received to date.
- Many issuers (63% from the FCA's survey) are choosing to use a permanent insider list to document those individuals who have access at all times to all inside information within the issuer. The FCA recognised that when used appropriately such lists can be a valuable tool to reducing administrative burden, but warned market participants that the number of employees captured on such lists should not be disproportionately large and the list should remain restricted to employees who have access at all times to all inside information. Those who do not have constant access, should be captured in a deal-specific or event-based insider list.
- Market participants should be in a position to submit completed insider lists within two days and a full chronology within five days of a request from the FCA.

Identifying inside information

- Of the issuers who responded to the FCA's survey, 93% reported using internal governing bodies, including disclosure committees, for assessing whether information constitutes inside information and determining the timing and content of any disclosure.
- 89% of issuers reported using external counsel, including legal counsel, financial advisors and corporate brokers to make this assessment.
- 93% of firms reported using additional lists, including confidential/project/prohibited dealing lists to record individuals who may have access to confidential information that has not been deemed inside information as an important tool to aid compliance and ease the transition where confidential information meets the threshold for inside information.

Source: FCA Market Watch No. 58 – Newsletter on market conduct and transaction reporting issues (December 2018).

New AIM Rules for Nominated Advisers

Further to its consultation in April 2018 (announced in AIM Notice 51), the London Stock Exchange (the “**LSE**”) published revised AIM Rules for Nominated Advisers (the “**Nomad Rules**”) which came into force on 30 July 2018. The main rule changes are outlined below:

- **Eligibility** – The LSE introduced additional eligibility criteria for Nomads to provide evidence to the LSE about their resources and ability to comply with the standards expected of them when performing their responsibilities (Rule 2). Guidance on the new eligibility criteria is contained in the Nomad application form (NA1).
- **Matters to notify to the LSE** – Rule 12 now contains a non-exhaustive list of matters relating to the operation, role or performance of a Nomad’s services which a Nomad must notify to the LSE.
- **LSE’s supervisory powers** – A new Rule 27 now specifies a range of supervisory actions which the LSE can take regarding a Nomad’s performance, including the imposition of restrictions or limitations on the services a Nomad can provide (e.g., where its experience and expertise are limited) and requiring a Nomad to take remedial action (e.g., the employment of additional staff, requiring remedial actions and/or restrictions in relation to “qualified executives” at a Nomad firm where issues of competency or training in relation to such persons arise).
- **Preventing a firm from acting as Nomad** – Additional examples of when the LSE may place a Nomad under a moratorium preventing it from acting as a Nomad have been added to Rule 31.
- **Jurisdiction** – The revised Nomad Rules clarify with respect to Nomads that were once, but are no longer, approved, the LSE has jurisdiction in relation to breaches or suspected breaches of the Nomad Rules or the AIM Rules for Companies committed whilst they were approved.

Sources: AIM Notice 51 (26 April 2018); AIM Notice 52 (4 July 2018); AIM Rules for Nominated Advisers (July 2018).

Recent Censures of AIM Companies

After not having issued a public censure of an AIM company since October 2017, the LSE announced two public censures and two separate private disciplinary actions for breach of the AIM Rules for Companies (the “**AIM Rules**”) in the second half of 2018.

Public Censure for Breach of AIM Rules 11 and 31

On 7 December 2018, the LSE announced the public censure of Bushveld Minerals Limited (“**Bushveld**”) and fined the company £700,000 (discounted to £490,000 for early settlement) for breaches of AIM Rules 11 and 31.

Background

Around March 2016, Bushveld was considering a potential transaction which, if completed, would constitute a reverse takeover under AIM Rule 14. The exclusivity agreement for the transaction required Bushveld to deposit US\$500,000 with its legal counsel, subject to an undertaking to release the funds to the proposed seller upon fulfilment of certain conditions. This exclusivity fee was a material sum in the context of Bushveld’s financial position and, before the undertaking was given, its Nomad explicitly advised that the binding obligation to pay the exclusivity fee that would be created by giving the undertaking would trigger a without delay disclosure obligation under AIM Rule 11. Having obtained advice from its legal counsel, Bushveld did not follow the Nomad’s advice in the hopes of delaying or avoiding the resulting suspension of its shares under AIM Rule 14 until there was more certainty around the transaction proceeding. Bushveld subsequently made the undertaking to pay the exclusivity fee on 7 April 2016 without informing the Nomad. The undertaking and exclusivity fee subsequently came to the knowledge of the Nomad in conversation with Bushveld regarding another matter, and its securities were suspended.

The lesson

Obtaining conflicting advice from external counsel does not justify or mitigate a breach of the AIM Rules.

Source: AIM Disciplinary Notice AD20 (7 December 2018).

Public Censure and Fine for Breach of AIM Rules 10, 11 and 31

In August 2018, the LSE announced the public censure of MBL Group plc (“**MBL**”) and fined the company £125,000 (discounted to £75,000 for early settlement) for breaching AIM Rules 10, 11 and 31.

Background

MBL announced its year-end results in August 2017, which did not give an indication of any material change to MBL's financial performance. However, subsequent management accounts meant that by 14 September 2017, MBL's board of directors was aware that the group was performing well below expectations. MBL failed to notify its Nomad or update the market on its change in financial position until 28 September 2017 and, in fact, issued an intervening financial performance update on 25 September 2017 that made no reference to the deterioration.

By failing to update the market for two weeks, MBL breached AIM Rule 11 which requires AIM companies to issue a notification, without delay, of any new developments that are not public knowledge and which would have a significant effect on the company's share price if made public. This requirement includes changes in financial condition.

By failing to include an appropriate update as to its financial condition in its 25 September announcement, MBL breached AIM Rule 10 which requires AIM companies to take reasonable care to ensure that information given to the market is not misleading, false or deceptive and does not omit important information.

MBL also breached AIM Rule 31 by failing to (a) have in place sufficient procedures, resources and controls to enable it to comply with the AIM Rules and (b) seek advice from its Nomad and take its advice into account.

The lesson

Challenging circumstances and competing demands on the board's and management's time during difficult financial circumstances is no excuse for non-compliance with the AIM Rules even if such non-compliance is not intentional.

Source: AIM Disciplinary Notice AD18 (13 August 2018).

Private Censure for Breach of AIM Rules

On 13 August 2018, the LSE announced it had privately censured and fined two AIM companies £75,000 each (discounted to £50,000 for early settlement) for breaches of AIM Rules 10 and 31, and 11 and 31, respectively.

AIM Rules 10 and 31

Background

The AIM company gave an update regarding the progress of its business via social media. Some of the information disclosed in this update was information which should have been notified via a Regulatory Information Service before it was disclosed through social media. The LSE concluded that the AIM company did not have an adequate

social media policy to monitor its social media output, including controls to check that information made public through social media was not released before it was notified in accordance with the AIM Rules. When the social media update was identified, the AIM company made a regulatory notification.

By failing to (a) notify information required to be disclosed by the AIM Rules via a Regulatory Information Service, the AIM company breached AIM Rule 10 and (b) have sufficient procedures, resources and controls in place to monitor its disclosures made through social media, the AIM company was in breach of AIM Rule 31.

The lesson

The fact that information released through other outlets may be, or may eventually become publically available, is not a substitute for making a regulatory notification via a Regulatory Information Service under the AIM Rules no later than it is disclosed elsewhere. This is to ensure equal, fair and timely disclosure of regulatory information to the market and that integrity in the market is maintained. Disclosure by social media alone will not meet an AIM company's disclosure requirements under the AIM Rules.

AIM Rules 11 and 31

Background

The breaches related to the AIM company's approach to providing information to its outgoing Nomad in circumstances where the relationship between the AIM company and its Nomad had become strained. The AIM company did not keep its existing Nomad informed as to its progress in appointing a successor Nomad despite frequent requests during the notice period. This prevented the incumbent adviser from being able to advise the AIM company on its disclosure obligations under the AIM Rules. As a consequence, the AIM company delayed notifying the market when the impending departure of its existing Nomad and its failure to appoint a replacement Nomad had become price sensitive and it could no longer withhold this information under the guidance to AIM Rule 11.

The lesson

Even where there is a deterioration in the relationship between an AIM company and its Nomad, it remains incumbent on the AIM company to meet reasonable requests for information from its Nomad and to seek its advice regarding compliance with the AIM Rules whenever appropriate and to take that advice into account. These requirements are no less important during the period in which a Nomad is serving its notice of termination.

Source: AIM Disciplinary Notice AD19 (13 August 2018).

Takeovers

Takeover Panel Seeks to Clarify Rules on Asset Valuations

Introduction

On 17 October 2018, the UK Takeover Panel (the “**Panel**”) published Public Consultation Paper 2018/1, which sets out several proposed amendments to Rule 29 of the City Code on Takeovers (the “**Takeover Code**”) relating to asset valuations.

Asset valuations have been required in at least three UK takeover situations in 2018 including the ongoing possible offer by a consortium comprising The Peel Group, The Olayan Group and Brookfield Property Group for Intu Properties (valuation of the offeree’s properties), CareTech’s offer for Cambian (valuation of the offeror’s and the offeree’s properties) and Stafford Capital Partner’s offer for Phaunos Timber (valuation of the offeree’s properties).

The purpose of the Panel’s proposed amendments is to provide a more logical framework for this rule and to reflect the Panel’s current practice. Responses to the consultation were requested by 7 December 2018.

Background to consultation

In general, Rule 29 of the Takeover Code provides that where a valuation of assets is given in connection with a takeover offer, it should be supported by the opinion of a named independent valuer. The rationale for this requirement is that shareholders of an offeree should have the benefit of an opinion on such valuation from an independent and competent valuer as such valuation is likely to be of importance to offeree shareholders’ decision whether or not to accept the offer. Rule 29 also sets out requirements in respect of the valuer’s qualifications, the basis of the valuation and the publication of such opinion.

Scope of Rule 29

In its consultation paper, the Panel has proposed that Rule 29 be amended to clarify that it applies to any asset valuations published by the offeree or by an offeror offering securities as consideration:

- during the offer period;
- in the 12 months prior to the start of the offer period; or
- more than 12 months prior to the start of the offer period, but only if attention is drawn to that valuation by the relevant party in the context of the offer.

The Panel has also proposed to clarify that Rule 29 would not apply to a valuation that the Panel considers immaterial to offeree shareholders in making a properly informed decision on the offer, and that the rule is not intended to apply to a valuation which is set out in a company’s financial statements, only as a result of accounting practice and which is not otherwise referred to by the relevant party in the arguments as to the merits or demerits of the offer. In addition, the Panel noted in its consultation paper that Rule 29 would not apply to asset valuations published by cash offerors in respect of their own assets.

Rule 29 would be amended to reflect the Panel’s current practice of principally applying the rule to valuations of real property, mineral, oil and gas reserves and unquoted investments, and to require the relevant party to consult the Panel if a valuation of other assets or liabilities has been or is proposed to be published (with the Panel given the discretion to apply Rule 29 to such valuation).

The Panel observed in its consultation that Rule 29 has been applied on occasion to valuations of other assets (e.g., brands, diamond gemstones and public-to-private infrastructure), and that it would not normally expect Rule 29 to apply to assets and liabilities such as the embedded value of life assurance contracts, pension fund surpluses or deficits and reserves of property and casualty insurers.

Further, the Panel has proposed that if a offeree or offeror offering securities as consideration publishes a net asset value or adjusted net asset value figure in circumstances where Rule 29 would apply if a valuation had been published in respect of the underlying assets, a valuation of such assets must be published in accordance with the requirements in Rule 29.

Requirements for valuers

The Panel has proposed that Rule 29 be amended to require valuers to:

- be independent;
- be appropriately qualified to give a valuation report on the relevant valuation (membership of a professional body will be an indicator of such qualification);
- satisfy any relevant legal or regulatory requirements; and
- have sufficient knowledge of each relevant market and the relevant skills and understanding to prepare the valuation report.

Specifically, the Panel commented that it would normally consider a valuer to be independent if neither the valuer nor any party to the offer has a substantial economic interest in the other and the valuer is independent under its professional standards.

Requirements for valuation reports

The consultation paper recommends that a Rule 29 valuation published during an offer period should be required to be in the form of a valuation report. If such valuation is published before the start of the offer period, Rule 29 would require such valuation to be confirmed in, or updated by, a valuation report, with such report included in the first announcement or document published during the offer period which refers to or draws attention to such historical valuation.

It also states that Rule 29 should set out detailed requirements relating to the contents of a valuation report (e.g., the basis of valuation and details of the valuation standards). The purpose of such proposed amendments would be to reflect the current market practice as regards the form and content of a valuation report.

The Panel has proposed to remove the requirement for a valuation to be current and to replace it with a requirement that:

- if the date at which the assets were valued is not the same as the date on which the relevant document or announcement containing the valuation report is published, that document or announcement must contain a statement by the directors of the offeree or offeror offering shares as consideration that the valuer has confirmed that an updated valuation would not be materially different; or
- if such statement cannot be made, an updated valuation must be published.

Finally, the consultation has recommended that if information contained in a Rule 29 valuation report could constitute a profit forecast under Rule 28, the Panel should be consulted in advance of its publication.

Impact of proposals

Given that the consultation paper largely seeks to codify current market practice and the approach of the Panel to asset valuations, if the Takeover Code is amended in line with the proposals, such amendments are unlikely to have a material impact on transactions.

Source: Takeover Panel Consultation Paper 2018/1 (17 October 2018).

Asset valuations have been required in at least three UK takeover situations in 2018, including the possible offers or firm offers for Intu Properties, Cambian and Phaunos Timber.

Takeover of Sky – The Chain Principle

Throughout 2018 in connection with Fox's offer for Sky and Disney's proposed merger with Fox, the Takeover Panel Executive (the "**Executive**") had to consider the application of the Takeover Code's infrequently applicable "chain principle" mandatory offer requirement.

In addition to determining if Disney should be required to bid for Sky, the Executive had to rule on the price at which a chain principle offer must be made – a decision that was referred to the Takeover Panel's Hearings Committee (the "**Hearings Committee**") and, subsequently, to the Takeover Appeal Board.

The ruling on price was significant due to the complexity of the situation, with Disney proposing a merger with Fox, Fox having made an offer for Sky and Comcast having made a competing offer for Sky. The ruling was therefore of interest to a number of people, including, in particular, some of Sky's larger shareholders given that Sky's share price had continued to trade in excess of the highest offer for Sky.

Overview of the "chain principle"

The mandatory offer

The Takeover Code is founded on six General Principles, the first of which states that "*all holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected*". The Takeover Code gives effect to this principle by requiring that a person who acquires a controlling interest (broadly, for Takeover Code purposes, 30% or more of the voting rights) in a company to which the Takeover Code applies, must make an offer to the other shareholders in that company to purchase their shares.

The price at which a mandatory offer has to be made (or if already announced, increased) must be at not less than the highest price paid by the offeror for any shares acquired during the 12 months prior to the announcement of the mandatory offer or, if the acquisition is made after such an announcement and at above the offer price, at not less than the highest price paid for the shares so acquired.

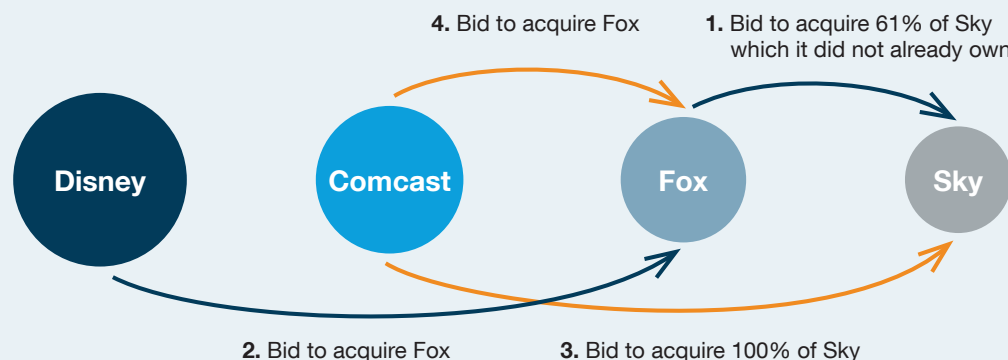
The rationale behind the mandatory offer rule is: (a) to secure equivalent treatment of offeree shareholders by ensuring that they are offered whatever price has been paid to obtain or consolidate control (which would usually be at a premium) of the offeree, and (b) to give offeree shareholders the opportunity to exit in light of the offeror's assumption or consolidation of control.

The chain principle mandatory offer

In order to prevent people circumventing the mandatory offer requirement through indirect acquisitions of control, the Takeover Code extends the mandatory offer obligation to situations where a first company (Company A) acquires over 50% of a second company (Company B, which need not be company to which the Takeover Code applies) and, as a result, acquires or consolidates indirect Takeover Code control of a third company to which the Takeover Code applies (Company C).

Although the Executive should be consulted in each case which may fall within the above fact pattern, the Executive will not normally require a mandatory offer to be made unless: (a) the interest in shares which Company B has in Company C is significant in relation to Company B, or (b) securing control of Company C might reasonably be considered to be a significant purpose of acquiring control of Company B.

The Takeover Code does not lay down the approach that should be followed to determine a chain principle offer price that Company A must offer to Company C shareholders.



Applying the “chain principle” to Disney

Key dates and events

Key dates and events that are relevant for the purposes of the “chain principle” include:

- **14 December 2017** – Disney announces that it has entered into a merger agreement to acquire Fox for approximately US\$28 per share. At the time of this announcement, Fox held a 39% interest in Sky (a company subject to the Takeover Code) and had announced a firm intention to offer for the remaining 61% at a price of £10.75 per Sky share.
- **12 April 2018** – The Executive announces that it has informed Disney, Fox and Sky that within 28 days of completion of its acquisition of Fox, Disney would, except in certain circumstances (including where Fox has successfully acquired Sky), be required to make a chain principle offer for Sky at a price of £10.75 per Sky share. The basis for the ruling was the Executive’s view that securing control of Sky might reasonably be considered to be a significant purpose of Disney acquiring control of Fox.
- **13 June 2018** – Comcast makes an all-cash proposal to acquire Fox at a price of US\$35 per Fox share.
- **20 June 2018** – In response to the superior proposal from Comcast for Fox, Disney announces an increase to its offer for Fox to approximately US\$38 per share with the option for Fox’s shareholders of electing for cash or stock subject to a 50/50 proration.
- **11 July 2018** – Fox announces an increase in its offer for Sky from £10.75 to £14.00 per Sky share.
- **13 July 2018** – The Executive announces that as a result of Disney’s price increase for Fox, Disney’s chain principle offer price for Sky would be increased to £14.00 per Sky share. This ruling was challenged by the Sky Independent Committee and several of Sky’s larger shareholders who asked for the Hearings Committee to review the decision.
- **3 August 2018** – The Hearings Committee confirms the Executive’s ruling and, following a further appeal, on 15 August 2018 the Takeover Appeal Board confirms the Hearings Committee’s confirmation of the Executive’s ruling.

Determining the price of Disney’s chain principle offer

As noted, the Takeover Code does not provide a mechanism for calculating a chain principle offer price. It was therefore open to the Executive to determine how best to do this, particularly given that there was no appropriate precedent to follow – none of the few prior cases had involved, among other things, Company B (namely Fox) having substantial assets other than its stake in Company C (namely Sky) and Company C being the subject of competing offers (including from Company B).

The first chain principle offer price of £10.75

To determine the chain principle price following Disney’s initial offer for Fox, the Executive approached Disney and Fox to see if they had attributed a value to Fox’s stake in Sky when negotiating the acquisition. In its answer, Fox stated that it had made clear that the price for the stake in Sky was £10.75 per Sky share, and Disney disclosed that it had included a price of £10.75 in an investor presentation. Although Disney claimed this value had only been included because it was an externally verifiable valuation of the asset for investors to use and that it actually valued the stake at below £9.00 per share, there was evidence available to the Executive that both parties had attributed a value of £10.75 per share to Fox’s 39% stake in Sky.

The Executive then examined the valuation materials prepared by and for Disney (including projections supporting fairness opinions) to see if they supported this price. In particular, the Executive looked at certain discounted cash flow (“DCF”) valuation ranges of Fox prepared by Disney’s advisers (which valued Fox without any synergies, with cost synergies only and then with both cost and revenue synergies, and which assumed Fox’s offer for Sky did not complete) showing what proportion of this value was represented by Fox’s 39% stake in Sky. The Executive considered a DCF analysis the most appropriate tool as it was better able to capture the evolving nature of an asset than a valuation based on a multiple of EBITDA.

In the DCF valuations shared with the Executive, because Disney took the view that no synergies could be gained from 39% ownership of a publicly listed company, bringing into account anticipated synergies added value to Fox’s other assets and increased the value of those assets relative to the value of its stake in Sky. Accordingly, the percentage contribution of Fox’s stake in Sky was highest on a no synergies basis and lowest on a basis that accounted for both cost and revenue synergies. Here, the Executive’s approach was to take a mid-point valuation to test the £10.75 per share data point against (the rationale being that the prospect of deriving synergies almost always has some impact on the acquisition price, and the DCF valuation which accounted for cost synergies could be used as a rough proxy for this). This mid-point projection indicated that the stake in Sky represented 18% of the DCF valuation of all Fox’s relevant assets which, when applied to the total consideration payable and then divided by the number of Fox’s shares in Sky, produced a price per share of £10.53.

As this figure from Disney’s advisers (and the figure Disney itself had produced which was even lower) did not exceed the price of £10.75 that had been publicly attributed by Disney to Fox’s stake in Sky, the Executive concluded that a first mandatory offer price of £10.75 was appropriate to offer to all Sky shareholders.

The second chain principle offer price of £14.00

To determine the second chain principle offer price following Disney's improved merger terms for Fox, the Panel adopted the same approach as before – i.e., to identify a data point which most effectively enumerated the price per share to be paid by Disney for Fox's stake in Sky and test this against the parties' internal valuation materials. This determination was set against new evidence that Disney was intent on acquiring 100% of Sky following the emergence of Comcast's competing offer for Sky and that the 39% stake could be viewed as a springboard for consolidating control.

In this instance, although Disney had not published an attributed revised value to Fox's stake in Sky in its investor presentation materials, shortly following the increase in its offer for Fox, it had authorised and supported an increase by Fox in Fox's offer for Sky to £14.00. It was this authorisation and support (which included agreeing to take on the increased debt which Fox would have to incur to make the higher offer) that the Executive considered to be "compelling evidence of an agreed attribution of value by Disney" for Fox's stake in Sky against which they could again test the valuation materials prepared by and for Disney.

As before, the Executive tested the £14.00 data point against the DCF projections of the relative value of the stake in Sky and the other assets of Fox. In light of these valuations (and having considered certain adjustments on the basis of representations made by Disney that expected synergies would flow from Fox's US assets and not Sky), the Executive concluded that a chain principle offer price of £14.00 per share was generous and certainly not too low.

Alternative arguments presented by stakeholders

The linear increase point

A linear approach to determining the second chain principle offer price (i.e., to increase the mandatory offer for Sky by the same proportion Disney had increased its offer for Fox) was promoted by Sky and a number of its shareholders. This approach was, however, ruled out by the Hearings Committee on the basis that, broadly, it was not possible to identify the perceived relative increase in the value of each of Fox's assets during the period in question and the value of Sky was unlikely to have increased precisely in line with Fox's other assets. Differences in the form of consideration offered under the first and second offers for Fox and movements in Disney's share price, as well as disagreements over what the correct starting point for any linear increase calculation should be, further complicated the calculation.

The true and fair value point

One Sky shareholder, Elliott Advisors (UK) Limited, challenged the Executive's approach to price on the grounds that it was too dependent on material prepared by parties who had a

strong interest in valuing so as to minimise the chain principle offer price. It was contended that only a determination of the true value of Fox's stake in Sky relative to the totality of Fox's relevant assets could provide fairness to other shareholders in Sky, and that such an assessment of value could only be made by an independent expert.

In rejecting this argument, the Hearings Committee noted that the chain principle offer price should give effect to the mandatory offer rules and related principles, which oblige the party in question to offer to other shareholders the highest price actually paid, not a price which represents the true or fair value of the company's shares at a given time. The object is to secure equivalent treatment (not a generalised concept of fair treatment) by ensuring that the price paid to obtain or consolidate control is offered to all offeree shareholders, who can then choose whether or not to accept it. An assessment of 'fair', 'true' or 'reasonable' value to Fox's stake in Sky was therefore an incorrect approach to determining the chain principle offer price.

Further, it was stressed that the Executive's scrutiny of Disney and Fox's materials was detailed and conducted with appropriate rigour. The Executive had not just accepted the parties' say-so on price and had proceeded to determine objectively against the available data what price was actually to be paid by Disney for Fox's stake in Sky.

Key takeaways

- The Executive will assess a chain principle price on a case-by-case basis. It will look to see if any price for Company C was agreed between Companies A and B in their negotiations or if there is any other evidence or data point indicating an agreement on price. It will then work backwards from this point and objectively examine the parties' valuation materials in order to test whether the price attributed by Companies C and B is reasonable in light of the overall value of Company B's assets (given the obvious limitation that any approach which allows parties to self-certify could be abused by ascribing artificially low values to Company C).
- The chain principle offer price should attempt to reflect the highest price actually paid by Company A for Company B's controlling interest in Company C, not some fair or true value of the stake in Company C assessed at any particular time. The objective is to ensure that whatever price was received by the shareholders of Company B for their shares in Company C will be offered by Company A to Company C's other shareholders.

Sources: *Takeover Appeal Board Decision 2018/4 (12 April 2018)*; *Takeover Panel Hearings Committee Determination 2018/14 (29 August 2018)*.

Takeover of Sky – Auctions Under the Takeover Code

On Saturday, 22 September 2018, the Panel supervised an auction process to determine final offer prices for Comcast and Fox in the battle to acquire Sky.

On conclusion of the auction, Fox and Comcast had made final offers of £15.67 and £17.28 per Sky share, respectively, with Comcast's superior offer valuing Sky at approximately £30.6 billion.

As the first competitive process to proceed to an auction since the introduction of the default auction procedure (the "**Default Procedure**") into Appendix 8 of the Takeover Code, the auction for Sky was watched closely by public M&A practitioners.

The Takeover Code rules

Rule 32.5 of the Takeover Code provides that "*if a competitive situation continues to exist in the later stages of the offer period, the Panel will normally require revised offers to be announced in accordance with an auction procedure*" the terms of which it will determine and announce.

To expand the different aspects of this rule:

- a "*competitive situation*" will "*continue to exist*" if neither offeror has declared its offer final such that, at the cut-off time for the commencement of the auction, either offer may be increased or otherwise revised;
- the "*later stages of the offer period*" will most likely be Day 46 of the reset offer timetable, being the forty-sixth day following publication of the second offer document ("**Day 46**"). The relevance of Day 46 stems from the Takeover Code rule prohibiting a revised offer document from being published in the 14 days ending on the last day the offer is able to go unconditional as to acceptances (Rule 32.1(c)) which, subject to any permitted extensions to the timetable, is the sixtieth day following publication of the last offeror's offer document ("**Day 60**") (Rule 31.6); and
- "*in accordance with an auction procedure*" means either pursuant to the Default Procedure or pursuant to a bespoke auction procedure the rules of which have been agreed to by the competing offerors and the offeree board.

To date, competing offerors have favoured agreeing bespoke rules (the exact details of which remain private), with the Default Procedure serving as a framework on which a bespoke alternative can be based or as a contingency where the parties are unable to agree an alternative.

The Default Procedure

The Default Procedure is an open auction (i.e., by public bids in the form of Regulatory Information Service announcements) between two competing offerors – where there are more than two, the Panel will modify the rules as appropriate. In summary:

- It commences where a competitive situation still exists at 5:00 p.m. on Day 46 and no alternative auction procedure has been agreed.
- It is spread over a maximum of five days, the first of which (Auction Day 1) is the business day immediately following Day 46. Auction Days 2 to 5 are the business days immediately following each previous Auction Day.
- Both bidders can bid on Auction Day 1, but if neither bids the auction ends.
- On Auction Days 2 to 4, each bidder may only announce a revised offer if the other bidder announced a revised offer on the previous Auction Day. Broadly, this means that both bidders can bid on each Auction Day, up until the point one bidder chooses not to bid, but the other does, following which the bidding will occur sequentially. If no revised offers are announced on a given day, the auction procedure ends on that day.
- On Auction Day 5 (if reached), either bidder may announce a revised offer, which may be conditional on the other bidder also submitting an offer on that day.
- Although formula bids calculated by reference to a competing bidder's revised offer are prohibited, there is no minimum increment limit on the amount that can be bid. If permitted to bid, a bidder may only make one revised offer per Auction Day.

There are also restrictions in the Default Procedure rules on competing offerors, the offeree and their concert parties making public statements, dealing in target securities or procuring irrevocable commitments during the auction procedure, which are designed to ensure the competitive situation is resolved in an orderly fashion.

The auction for Sky

In the offer for Sky, the interested parties (Comcast, Fox, Disney (as a concert party of Fox) and Sky) agreed an alternative auction procedure to the Default Procedure, in which bids would be submitted in private over a single day and with only three rounds of bidding. In summary:

- **Commencement of auction procedure** – If a competitive situation existed at 5:00 p.m. (London) on 21 September 2018 (being Day 45 of the offer period), the agreed auction rules would apply with the rounds of bidding taking place on 22 September 2018 (being Day 46).
- **Round 1** – Only the bidder with the lowest offer at the cut-off time or, if both offers were equal, the bidder which submitted the last offer, was permitted to bid.
- **Round 2** – Only the bidder which was not eligible to submit a revised offer in Round 1 was permitted to bid (and could do so even if no bid was made in Round 1 by the other bidder). The auction would end if no bid was made.
- **Round 3** – If reached, either or both bidders were permitted to submit a revised offer, which could be made conditional on the other bidder submitting a revised offer in the round.
- **Conclusion of the auction procedure** – As soon as practicable following completion of the auction the Panel would announce to the market the offer prices made by each bidder, following which each bidder would by no later than 7:00 a.m. on 24 September 2018 make a full Rule 2.7 announcement in respect of the last bid it made during the auction (or, if it did not revise its offer, confirm its pre-existing offer).

To prevent complicating the comparability between offers, each bidder was required to bid in cash only and, if Sky paid a dividend before the end of the offer period, to reduce its offer by an amount per share equal to the amount of the dividend per share. Further, on conclusion of the auction procedure, neither bidder was permitted to revise the price or nature of its offer unless a third party (excluding any concert party such as Disney) announced a firm intention to offer for Sky.

The Sky auction rules had broadly similar rules to those in the Default Procedure prohibiting formula bids and restricting public statements. The Sky auction rules also did not require minimum increment increases, provided the bid was higher than the last bid made by that party.

Sending a revised offer document post auction

As an auction will involve an offeror revising its offer, following its conclusion a revised offer document drawn up in accordance with the Takeover Code must be sent to target shareholders (Rule 32.1(a)).

The Panel has discretion to set the deadline by which any such document must be published (Rule 32.5), and will typically also extend Day 60 (Note 2 to Rule 31.6). This is necessary given the

obvious difficulty in finalising, printing and distributing a revised offer document on or prior to Day 46 (as required by Rule 32.1(c) of the Takeover Code) if the auction process only starts on or shortly prior to Day 46.

For the Sky auction, the agreed rules provided that each offeror that made a revised offer had to publish a revised offer document on or before 27 September 2018 (five days after the auction) and, regardless of when each offeror's document was published, the latest date on which either offer could become or be declared unconditional as to acceptances (Day 60) was set as fourteen days from 27 September 2018 (11 October 2018). Note, however, that in the auction rules for Shell's and PTT Exploration's offer for Cove Energy, each offeror was required to publish its revised offer document on or before the seventh day following the auction procedure and Day 60 was set as the fourteenth day after the latest date on which either offeror publishes its revised offer document.

It is possible that, if the target board consents, the lower bidder may be granted a dispensation by the Panel from the requirement to publish a revised offer document (Note 1 to Rule 32.5). To avoid the confusion of multiple offer documents and forms of acceptance being sent to shareholders, the target board's consent would typically be expected in this scenario (unless, for example, the deliverability of the higher offeror was less certain than that of the lower offeror).

If one of the offers is implemented by a scheme

The above discussion addresses the situation where both offers are being implemented by way of a contractual offer. If, however, one or more of the competing offers is being implemented by way of scheme, the Panel must be consulted on the applicable timetable (Note 2 to Rule 32.5). This is because a scheme's timetable (which is agreed with the court) is not subject to the same timetabling requirements as a contractual offer, and there are no dates in a scheme which are directly equivalent to Day 46 and Day 60 of a contractual offer.

Although the Takeover Panel should be consulted in all such occasions, in prior public statements the Panel has indicated how it may approach such situations. Accordingly, where a contractual offer is made in competition with an existing scheme, the Panel has commented that both offerors will normally be bound by the timetable set by the publication of the competing offeror's contractual offer document (i.e., the auction procedure will commence on Day 46 of the reset timetable), and, where a scheme is proposed in competition with an existing contractual offer, the Panel has said that the fourteenth day prior to the scheme shareholder meetings will normally be treated as the equivalent of the forty-sixth day following the posting of the competing offer document. The Panel has, however, also commented that it recognises that there may be situations where such an approach would be inappropriate – for example, if the scheme meetings are set at a date that is earlier than the first offeror's Day 60, it might be unfair to impose an auction procedure on a date which is earlier than Day 46 of the original offeror's timetable.

Source: Takeover Panel Statement 2018/15 (20 September 2018).

Corporate Governance

New UK Corporate Governance Code

On 16 July 2018, the Financial Reporting Council (“**FRC**”) published a new UK Corporate Governance Code (the “**Corporate Governance Code**”), which applies on a ‘comply or explain’ basis to all companies with a premium listing (regardless of their jurisdiction of incorporation) and can be adopted voluntarily by other companies. The new Corporate Governance Code has been significantly restructured. Set out below is a discussion of the key changes to the code.

“This new Code, in its new shorter and sharper form, and with its overarching theme of trust, is paramount in promoting transparency and integrity in business for society as a whole.”

Sir Win Bischoff, FRC Chairman

Timing

The new Corporate Governance Code applies to financial periods starting on or after 1 January 2019. This means that listed companies will start to report against the new code in 2020 covering action undertaken and information collected during the course of 2019, unless they choose to comply early. However, in its Feedback Statement, the FRC recommends that companies report against the provision regarding reporting on significant dissenting votes in relation to any shareholder votes taken after 1 January 2019. It also recommends that any new remuneration policies or changes to existing policies implemented in 2019 should be developed with reference to the new Corporate Governance Code and associated guidance. Premium listed companies seeking a premium listing during the course of 2019 should bear this in mind.

Overview of structural changes

The new Corporate Governance Code is half the length of the current code and focuses on the application of the Principles, with fewer supporting Provisions. It is divided into the following five sections:

- Board leadership and company purpose
- Division of responsibilities
- Composition, succession and evaluation
- Audit, risk and internal control
- Remuneration

In the case of a UK-incorporated listed company, LR 9.8.6(5)R requires that it include a statement in its annual report of how it has applied the Principles set out in the Corporate Governance Code in a manner that would enable shareholders to evaluate how the Principles have been applied. LR 9.8.6(6)R requires a statement as to whether the listed company has complied or explained its non-compliance with the Provisions of the Corporate Governance Code.

With the removal of the “Supporting Principles” and more Principles being added to the new Code, issuers will need to review their annual reports to ensure they contain all the necessary disclosures. In addition, issuers may wish to consider reorganising the corporate governance sections of their annual reports to reflect the structural changes which have been made to the new Code to enable shareholders to better evaluate the listed company’s compliance (or non-compliance) with the new Corporate Governance Code.

Key substantive changes

- **Culture and purpose** – Company culture is an important aspect of the new Corporate Governance Code. For those companies which have not yet clearly articulated and embedded throughout their business a set of values and culture, they will need to think about the steps they need to take in order to do this. In particular, listed companies will need to consider how they demonstrate that they have applied the principle that companies should have a role in contributing to the wider society (Principle A) and how their boards ensure that purpose, values and strategy are aligned with the company’s culture and how the directors act with integrity, lead by example and promote the desired culture (Principle B). They will also need to consider how they report on their compliance with Provision 2 which provides that the board should assess and monitor culture and disclose any corrective action that it has been necessary to take.
- **Stakeholder engagement** – Principle D states that the board should ensure effective engagement with, and participation from, the company’s shareholders and stakeholders. In doing so, the board should identify the company’s key stakeholders and understand their views. A description should be included in the company’s annual report of how the board’s decision-making has been influenced by stakeholder interests and the matters set out in Section 172(1) of the Companies Act 2006 (the “**Companies Act**”). The new Corporate Governance Code describes this as supporting the new statutory governance reporting requirements which are discussed in this publication. Listed companies will therefore need to assess who their key stakeholders are and why and engage with them to understand their views. A company’s method of engagement will need to be kept under review so that it remains effective.

- Shareholder engagement** – Provision 3 provides that the Chair of a listed company should seek regular engagement with the company's major shareholders and ensure that the board as a whole has a clear understanding of the views of shareholders. Where 20% or more of shareholder votes are cast against a board-recommended resolution, the company should explain when announcing the results what actions it intends to take in order to consult with dissenting shareholders and gain an understanding of the reasons for their vote (Provision 4). An interim update should be provided within six months following the vote with follow-up disclosures in the annual report and, if applicable, in the explanatory notes to resolutions at the next general meeting, on what impact the feedback has had on board decisions and any actions or resolutions now proposed. Details of significant votes against and related company updates are available on a public register maintained by the Investment Association.
- Workforce engagement** – The new Corporate Governance Code provides that a company should engage with its workforce by (a) appointing a director from its workforce; (b) implementing a formal workforce advisory panel or (c) appointing a designated non-executive director (or any combination of the three) (Provision 5). If none of these measures are implemented, the company should explain what alternatives it has put in place and why it believes they are more effective. The FRC's Guidance on Board Effectiveness includes examples of other workforce engagement activities that companies may wish to adopt (including consultative groups, social media updates, employee annual general meetings and surveys). Although the term 'workforce' is not defined in the Corporate Governance Code, the FRC's Guidance on Board Effectiveness explains that it includes everyone with a formal employment contract (including zero-hour) and other members of the workforce affected by board decisions (which can include agency workers and remote workers (regardless of their location)). Therefore, a listed company will need to choose who it regards as its 'workforce' and explain why and choose one of the three listed methods (or an alternative) for engaging with their workforce.
- Independence** – The FRC has not made any significant changes to the independence provisions in the current code. It remains the case that the Chair of a listed company must be independent on appointment (Provision 9). It also remains the case that at least half of the board, excluding the Chair, should comprise non-executive directors whom the board considers to be independent (Provision 11). However, the current exemption for smaller companies has been removed. Finally, it also remains the case that the board can consider a non-executive director independent notwithstanding certain factors listed in the code which are likely to impair his or her independence (Provision 12). However, the FRC did note in its Feedback Statement that it expects to see greater detail when companies report on the independence status of such directors so companies should re-examine their existing disclosure in this regard to ensure it is sufficiently detailed.
- Director over-boarding** – The new Corporate Governance Code provides that the board should consider prospective directors' time commitments prior to their appointment, and approve any significant new appointments of existing directors (Provision 15). Listed companies will need to disclose the reasons for permitting significant external appointments, even when approved by the board. Full time executive directors should not take on more than one non-executive directorship of a FTSE 100 company. Over-boarding is increasingly becoming an area of focus for investors, so listed companies may wish to evaluate existing director commitments to satisfy themselves that all board members have sufficient time to dedicate to their respective roles.
- Diversity and succession planning** – The new Corporate Governance Code places an emphasis on the need to refresh the composition of boards and adopt succession plans based on merit and objective criteria. In this context, the new code states that board appointments should promote diversity of gender, social backgrounds, ethnicity and cognitive and personal strengths (Principle J). Annual board evaluations should consider its composition, diversity and how effectively members work together to achieve these objectives.
- Expanded role of the nomination committee** – The new Corporate Governance Code provides that the nomination committee should lead the process for appointments, ensure plans are in place for the orderly succession to both board and senior management positions and oversee the development of a diverse pipeline for succession (Provision 17). Listed companies will need to consider how the committee can implement these obligations in practice and whether the terms of reference of the nomination committee should be updated in this regard. The annual report should describe the work of the nomination committee including how the company's diversity and inclusion policy has been implemented and progress on achieving the policy's objectives and the gender balance of those in senior management and their direct reports (Provision 23). These reporting requirements reinforce the requirements of DTR 7.2.8AR on diversity reporting in a company's corporate governance statement. On 27 July 2018, the FCA published Handbook Notice 57 which clarifies that the information required by DTR 7.2.8AR regarding a company's diversity policy must be included in the corporate governance statement in its Directors' Report and that the statement can be set out in a separate report published together with the annual report or, alternatively, in a document published on the company's website.

Update on Gender Diversity on Boards

The Hampton-Alexander Review, which is an independent, business-led initiative supported by the UK government, has set a target of 33.3% of board positions, executive committees and their director reports to be filled by women by 2020. In November 2018, the Hampton-Alexander review highlighted that the number of women on FTSE 100 boards has exceeded 30% for the first time, but within the FTSE 350 there are still five all-male boards and 75 companies that have only one woman on their board. Further, there are only 22 women in chair roles and 12 women (a drop from 15 in 2017) in CEO roles. The Hampton-Alexander Review noted that if each of these 75 companies added one woman to their board, this would take the FTSE 350 almost half way to achieving the 33% target.

The increasing focus on achieving greater gender diversity on boards will need to be considered by nomination committees of listed companies in having regard to their expanded role and obligations under the new Corporate Governance Code to ensure there is a diverse pipeline for succession to both board and senior management positions within listed companies.

Source: Hampton-Alexander Review – FTSE Women Leaders Annual Report (November 2018).

- **Chair's tenure** – The new Corporate Governance Code provides that a company's Chair should not remain in the post beyond nine years from the date of his or her first appointment to the board (Provision 19). In its Feedback Statement, the FRC explained that the nine-year tenure applies equally to a Chair who was previously a non-executive director on the board, and that his or her time serving as a non-executive director will accordingly reduce the time he or she can serve as Chair. This is subject to a limited extension, the duration of which has not been clarified in either the Corporate Governance Code or the FRC's Guidance on Board Effectiveness, to facilitate effective succession planning and the development of a diverse board, particularly in the instance where the Chair was an existing non-executive director on appointment. Therefore, listed companies with a Chair who is at, over or approaching a nine-year tenure will have to start succession planning or considering whether a limited extension could be applied (which will need to be explained).

- **Expanded role of the remuneration committee** – The remuneration committee has an expanded role of remuneration-setting responsibilities extended to include senior management and reviewing workforce remuneration and considering the alignment of executive remuneration with broader company culture and policy. The chair of the remuneration committee must have served on a remuneration committee for at least one year (Provision 32). A listed company's annual report should describe the work of the remuneration committee, including reasons why the remuneration is appropriate using internal and external measures (including pay ratios and pay gaps), what regard has been given to the factors set out in Provision 40 of the code in determining executive director remuneration policy and practices, what engagement with the workforce has taken place to explain how executive remuneration aligns with wider company pay policy and to what extent discretion has been applied to remuneration outcomes and the reasons why (Provision 41). Listed companies should consider whether to update the terms of reference of the remuneration committee to reflect the matters specified in Provision 41 and ensure members of the nomination committee are familiar with the committee's expanded role and provide additional training or support.
- **Remuneration** – The new Corporate Governance Code reiterates that remuneration schemes should promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests. It recommends that share awards granted for this purpose be released on a phased basis and be subject to a total vesting and holding period of five years or more, compared to three years under the current code (Provision 36).

New FRC Guidance on Board Effectiveness

Alongside the new Corporate Governance Code, the FRC also published its updated Guidance on Board Effectiveness which contains suggestions of good practice to support directors and their advisers in applying the provisions of the new Corporate Governance Code. The new Guidance on Board Effectiveness is significantly longer than the code itself (45 pages compared to the 15-page long new Corporate Governance Code). It is therefore important to read the Guidance on Board Effectiveness alongside the new Corporate Governance Code.

Next steps

- The FRC has stated that going forward it will be increasing its monitoring of governance practice and reporting, including more in-depth reviews of annual reports.
- The FCA is currently reviewing its handbook and considering what consequential amendments are needed as a result of the new Corporate Governance Code.

Sources: UK Corporate Governance Code (July 2018); FRC Guidance on Board Effectiveness (July 2018); FRC Feedback Statement (July 2018).

New Annual Reporting Requirements

The Companies (Miscellaneous Reporting) Regulations 2018 were published on 19 July 2018 and impose new reporting requirements with respect to the Strategic Report and the Directors' companies' annual report, as summarised in the table below. The regulations are the same as the draft regulations published on 11 June 2018. The new reporting requirements apply in respect of financial periods commencing on or after

1 January 2019 and will therefore begin to be reflected in annual reports published in 2020. The one exception in this regard is the requirement for companies to illustrate the impact of share price increases on executive pay outcomes, which will apply to any new remuneration policies introduced by companies on or after 1 January 2019. This timetable is intended to align with the new UK Corporate Governance Code coming into effect.

Reporting requirements	Description of requirement	Applicable companies
Section 172 statement	<p>A statement must be included in a company's Strategic Report describing how directors have had regard to the factors set out in section 172(1)(a) to (f) of the Companies Act 2006 (the "Companies Act") when performing their duty to promote the success of the company for its members as a whole.</p> <p>The Department for Business, Energy & Industrial Strategy (the "BEIS") published a Q&A in November 2018 to help companies prepare for these new reporting requirements. Further guidance on section 172 statements is also set out in Section 8 of the Financial Reporting Council's (the "FRC") updated Guidance on the Strategic Report published in July 2018. Both the BEIS and the FRC note that companies will likely want to include some or all of the following in their section 172 statement:</p> <ul style="list-style-type: none"> the issuers, factors and stakeholders the directors consider relevant in complying with section 172(1)(a) to (f) and how they have formed that opinion; the main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and information on the effect of that regard on the company's decisions and strategies during the financial year. <p>This statement also has to be made available on a website. For quoted⁽¹⁾ and AIM-traded companies, this makes no practical difference because they are already required to make their annual report available on a website and the statement is a new component of this report. Unquoted companies, however, are not required to publish their annual report on a website and must make arrangements to ensure that the section 172 statement is available on a website (which can be the website of a parent company provided this is made clear). As the section 172 statement must be disclosed as a standalone statement, unquoted companies must ensure that disclosures made by cross-referencing to other parts of their annual report are included with the statement if published on a website without the rest of the annual report.</p>	<p>Large UK-incorporated companies which are required to produce a Strategic Report (i.e. to which any two of the following apply):</p> <ul style="list-style-type: none"> turnover of more than £36 million balance sheet total of more than £18 million more than 250 employees <p>The duty to promote the success of the company under section 172 of the Companies Act requires a director to have required (amongst other matters) to:</p> <ol style="list-style-type: none"> the likely consequences of any decision in the long term; the interests of the company's employees; the need to foster the company's business relationships with suppliers, customers and others; the impact of the company's operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct; and the need to act fairly as between members of the company.
Stakeholders engagement statement	<p>A statement must be included in a company's Directors' Report summarising how the board has given regard to the need to foster the company's business relationships with its suppliers, customers and other stakeholders, and the effect of that regard (including on the principal decisions taken by the board during the reporting period).</p>	Same as above.
Employee engagement statement	<p>A statement must be included in a company's Directors' Report summarising how a company has engaged with employees, how it has given regard to employee interests and the effect of that regard (including on the main decisions taken by the company over the reporting period).</p>	All UK-incorporated companies with over 250 UK employees (if the company is a parent company, this should be based on the number of employees in the group and not just the parent company itself).

Reporting requirements	Description of requirement	Applicable companies
Corporate governance statement	<p>A statement must be included in a company's Directors' Report (and also be made available on the company's website) explaining:</p> <ul style="list-style-type: none"> • which corporate governance code the company has adopted; • how the company applies such code; and • if the company departs from the code, how it does so and why. <p>If a corporate governance code has not been adopted, the statement must explain why and what other arrangements for corporate governance have been applied.</p> <p>Whilst the Government hopes that the Wates Principles will be widely adopted by large private companies, companies can choose the most appropriate code for them. For large private companies which choose to adopt the Wates Principles, it is envisaged that they should provide a short supporting statement for each principle explaining how it has been applied to achieve better outcomes.</p> <p>A UK-incorporated company may choose a foreign corporate governance code provided it ensures that an English language version of the code is available and easily accessible via a website free of charge. If an English language version is not readily available, the company should explain the code's provisions as part of the statement about its corporate governance arrangements.</p>	<p>Very large private and public un-listed companies with either:</p> <ul style="list-style-type: none"> • over 2,000 global employees; or • a global turnover of more than £200 million and a global balance sheet total of more than £2 billion. <p>Premium and standard listed companies which are already required under DTR 7.2 to report on their corporate governance arrangements are not within scope.</p> <p>Every company meeting the qualifying thresholds must comply with the new reporting requirement, including subsidiaries. This includes both subsidiaries of listed companies required to comply or explain against the UK Corporate Governance Code and subsidiaries of parent companies which prepare a consolidated group Directors' Report. A subsidiary of a premium listed parent company could, in principle, and if the circumstances warranted it, state that it did not apply a code because its parent applied the UK Corporate Governance Code which was applied throughout the group. This might shorten the statement, but the subsidiary would still need to explain how the Code applies to governance arrangements in the subsidiary and its directors.</p>
CEO pay ratio	<p>A ratio table must be included in a company's Directors' Remuneration Report setting out the ratio of the total remuneration received by the Chief Executive Officer to the 50th, 25th and 75th percentile full-time equivalent UK employee. Supporting information must also be published including reasons for changing the ratios from year to year and whether the median ratio is consistent with wider company policies on employee pay, reward and progression.</p>	<p>UK-incorporated quoted⁽¹⁾ companies with more than 250 UK employees.</p> <p>A UK-incorporated quoted company which is a subsidiary of a non-UK incorporated parent must still report its pay ratio although in this case the pay ratio reporting should relate to the pay and benefits of the Chief Executive Officer of the UK-incorporated quoted subsidiary, rather than to the pay and benefits of the Chief Executive Officer of the non-UK incorporated parent and cover only UK employee pay and benefits at the UK incorporated quoted subsidiary and any subsidiaries beneath it.</p>
Share price effect on executive remuneration	<p>The directors' remuneration policy included within the Directors' Remuneration Report should illustrate the effect of future share price increases on executive pay outcomes and how much of an executive director's remuneration is attributable to share price growth. In addition, a summary of any discretion that has been exercised in respect of executive remuneration outcomes reported that year must be included within the statement of the chair of the remuneration committee in the Directors' Remuneration Report.</p>	<p>UK-incorporated quoted⁽¹⁾ companies.</p>

Sources: Companies (Miscellaneous Reporting) Regulations 2018 (SI 2018/B60); Department for Business, Energy & Industrial Strategy Q&A on The Companies (Miscellaneous Reporting) Regulations 2018 (November 2018); FRC's Guidance on the Strategic Report (July 2018).

Note: (1) A quoted company under the Companies Act 2006 means a UK-incorporated company which is listed on the UK Official List, the New York Stock Exchange, NASDAQ or a recognised stock exchange in the European Economic Area. It does not include companies admitted to trading on AIM.

FRC's Annual Review of Corporate Governance and Reporting

In October 2018, the FRC published its annual review of corporate governance and reporting for the period 2017/2018 following a review of 220 reports and annual accounts. Outlined below is the FRC's assessment of key areas of corporate reporting which the FRC considers requires improvement and its assessment of compliance with the Corporate Governance Code.

Key areas requiring improvement

- **Financial statements** – The FRC noted that companies' reporting of significant judgments and estimates was a major area in need of improvement. In particular, the FRC highlighted poor disclosure of the sensitivity of assets and liabilities to assumptions and estimates on which they are based. An increase in the failure to correctly comply with certain areas of reporting, such as classification of cash flows, was also noted. According to the FRC, these deficiencies could have been avoided through a more robust pre-publication review process. The FRC reiterated the importance of effective procedures, especially in times of uncertainty (for example, regarding Brexit and changes to accounting standards).
- **Strategic Reports** – The FRC identified alternative performance measures ("APMs") as another key area for improvement stressing the importance that APMs be clearly presented and reconciled to International Financial Reporting Standard as required by the guidance set out by the ESMA Guidelines on APMs which represents the FRC's view of best practice for all companies.

Compliance with the Corporate Governance Code

For the first time the FRC has included information in its review on compliance and quality of reporting against the Corporate Governance Code, which is based on third-party research. The FRC reported that 95% of FTSE 350 companies reported compliance with all but one or two of the 54 Provisions of the current Corporate Governance Code, and full compliance rose to 72% from 66% in the previous year. However, the FRC highlighted the need for companies to fully explain any non-compliance with Provisions and suggested that this posed a positive opportunity for companies to communicate their alternative approaches. The review further noted that too few companies took the opportunity to provide more information about board evaluations, and that the standard of reporting on the relationships between director remuneration and employee pay was poor (which the FRC has sought to address in the revised Corporate Governance Code published in July 2018).

Risk reporting and viability statements

The requirement for a "viability statement" by directors on the company's long-term viability was introduced into the Corporate Governance Code in 2014, with the view to increase focus on risk management at board and senior management levels. The FRC notes that although some companies enhanced their disclosure this year, many are still not explaining the processes that they have undertaken to prepare their statement, including any stress and scenario testing they have carried out.

Source: FRC's Annual Review of Corporate Governance and Reporting 2017/2018 (October 2018).

New Corporate Governance Statements for AIM Companies

With effect from 28 September 2018, a company which is admitted to trading on AIM (regardless of its jurisdiction of incorporation) must include as part of its AIM Rule 26 disclosures on its website:

- details of a recognised corporate governance code that the board has decided to apply;
- details of how it complies with that code; and
- an explanation of its reasons for departing from the code, where it does so.

"As about two-thirds of all money raised on AIM is through secondary fund raisings rather than IPOs, it is ever important to create and maintain trust between the company and its investors."

QCA Corporate Governance Behaviour Review 2018/19

The information should be clearly presented and easily accessible from the 'AIM Rule 26' page of the company's website. AIM companies which currently state that they comply with the Corporate Governance Code or the Corporate Governance Code of the Quoted Companies Alliance (the "QCA") "so far as appropriate for a company of this size" or equivalent qualification, must now include a full explanation of any departures from such codes.

An AIM company may incorporate by reference its corporate governance statement (e.g., by referring readers to a specific section of the company's annual report). In such case, the website should make it clear where a copy of the relevant materials can be read or obtained (free of charge). An AIM company should review its corporate governance statement annually and note on its website when the statement was last reviewed.

The London Stock Exchange has not set out a prescribed list of corporate governance codes which AIM companies may adopt. In its Inside AIM publication on 26 July 2018, AIM Regulation referenced the FRC's Corporate Governance Code and the QCA's Corporate Governance Code, updated versions of which were published in July 2018 and April 2018, respectively, but it also noted that an AIM company should be free to choose a code that best suits its needs, taking into account its specific stage of development, industry and size. Where an AIM company has a dual listing in its home state, it can opt to report using an appropriate standard in its home jurisdiction, provided that the corporate governance statement is available on its website and reviewed annually in accordance with the requirements of AIM Rule 26.

These changes provide AIM quoted companies the opportunity to revisit their overall approach to corporate governance and consider going forward how to address any qualifications made in their compliance statements.

These changes provide AIM quoted companies with an opportunity to revisit their overall approach to governance.

On 3 December 2018, the QCA published a Corporate Governance Behaviour Review which analysed the annual reports and accounts and governance disclosures of a random selection of 50 AIM companies against the revised QCA Corporate Governance Code to identify patterns and to examine the impact of the change to AIM Rule 26. The review highlighted a marked improvement in the number of corporate governance disclosures, and their level of detail, since the change to AIM Rule 26. We expect that the extent and quality of corporate governance disclosures of AIM companies will continue to improve as AIM companies increasingly grow accustomed to the changes to AIM Rule 26 and as best practices develop.

Source: AIM Rules for Companies (March 2018); QCA Corporate Governance Behaviour Review 2018/2019 (December 2018).

The Wates Principles

On 10 December 2018, the Financial Reporting Council (the “**FRC**”) published the final Wates Corporate Governance Principles for Large Private Companies (the “**Wates Principles**”). The Wates Principles are designed to help companies of a significant size, that are not currently required to provide a corporate governance statement, to disclose their corporate governance arrangements in compliance with the Companies (Miscellaneous Reporting) Regulations 2018 which were published in June 2018 and apply to financial reporting periods commencing on or after 1 January 2019.

The Wates Principles are high level and are intended to offer sufficient flexibility for a diverse range of companies to explain the application and relevance of their governance arrangements, without being unduly prescriptive.

A company that adopts the Wates Principles should follow them using an ‘apply and explain’ approach in a way that is most appropriate for its particular organisation. Accordingly, boards should apply each Principle by considering them individually within the context of the company’s specific circumstances and provide a supporting statement that describes how their corporate governance policies and processes operate to achieve the desired outcome for each Principle. The Guidance to each Principle is provided to assist companies in explaining their approach to applying each Principle and does not need to be reported on in the same way as premium listed companies need to ‘comply or explain’ against the Provisions in the UK Corporate Governance Code.

The table on the next two pages outlines the six principles.

Principle	Summary of Guidance
Purpose and Leadership An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.	<p>Purpose – Effective boards ensure that the company operates with a clear sense of purpose and collective vision. To promote this, boards need to appreciate the importance of dialogue with the workforce and wider stakeholders around the company's stated purpose and be proactive in ensuring that it takes place. Effective boards are able to demonstrate how the sharing of this purpose has informed the decision-making process to achieve long-term sustainable success.</p> <p>Values – A company's purpose and values should inform expected behaviours and practices throughout the organisation. The values should be explained and integrated into the different functions and operations of the business. This may include internal assurance, employment practices, risk management and compliance functions.</p> <p>Culture – Culture can be defined as a combination of the values, attitudes and behaviours manifested by a company in its operations and relationships with its stakeholders. Effective ways of monitoring culture include (but are not limited to) employee surveys, engagement with trade unions, absenteeism rates, exit interviews and board feedback sessions.</p> <p>Strategy – An effective board is responsible for ensuring that its strategy is clearly articulated and implemented throughout the organisation, and that it supports appropriate behaviours and practices by taking the lead in the establishment of transparent policies and managing conflicts of interests.</p>
Board Composition Effective board composition requires an effective Chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.	<p>Chair – Consideration should be given to separating the roles of the Chair and Chief Executive Officer to ensure a balance of power and effective decision-making.</p> <p>Balance and diversity – An effective board should be able to demonstrate that there has been a considered effort to establish an appropriate balance of expertise, diversity and objectivity.</p> <p>Size and structure – Companies should consider the value of appointing independent non-executive directors to offer constructive challenge. Boards may wish to delegate some functions to committees which can consider specific issues such as risk or remuneration; however, this will be dependent on the structure, complexity and size of the company.</p> <p>Effectiveness – Companies should demonstrate a commitment to the ongoing professional development of their board members, and directors should embrace such opportunities and ensure that they have sufficient time to discharge their duties. Regular evaluation of the board can help individual directors to contribute effectively and highlight the strengths and weaknesses of the board as a whole. The Chair should act on the recommendations of such evaluations.</p>
Director Responsibilities The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should effect decision-making and independent challenges.	<p>Accountability – A company should set out policies and practices that govern the internal affairs of the company. These include matters relating to the authority, accountability, role and conduct of directors, and may include specific information relating to shareholders, such as shareholder agreements and protection of minority shareholders.</p> <p>Committees – A board may make use of committees to help with the consideration of matters such as financial reporting, risk, succession and remuneration. The terms of each committee should be set out including authorities delegated to it. A board retains responsibility for any final decisions.</p> <p>Integrity of information – A board should establish formal and robust internal processes to ensure the quality and integrity of information provided to it (such as financial reporting, key performance indicators, workforce data, environmental data, stakeholder engagement feedback and consumer data) is reliable, enabling directors to monitor and challenge the performance of the company, and make informed decisions.</p> <p>Board papers and supporting information should be:</p> <ul style="list-style-type: none"> • accurate, clear, comprehensive and up-to-date; • contain a summary of the contents of any paper; • inform the director of what is expected of them on each issue; and • be issued in good time.

Principle	Summary of Guidance
Opportunity and Risk A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value and establish oversight for the identification and mitigation of risk.	<p>Opportunity – Considering and assessing how a company creates and preserves value over the long-term requires boards to consider both tangible and intangible sources of value, and the stakeholders that contribute to it. A board should consider and assess processes for the identification of future opportunities for innovation and entrepreneurship (e.g., mechanisms for ensuring that new business opportunities of a certain value are considered and approved at board level).</p> <p>Risk – A board has responsibility for an organisation's overall approach to strategic decision-making and effective risk management (financial and non-financial), including reputational risk. This requires oversight of risk and how it is managed, and appropriate accountability to stakeholders. A description of principal risks is set out in the FRC's Guidance on the Strategic Report.</p> <p>Responsibilities – The board should agree an approach to reporting, including frequency of reporting and the points at which decisions are made and escalated. It should establish an internal control framework with clearly defined roles and responsibilities for those involved including:</p> <ul style="list-style-type: none"> • developing an appropriate risk management system to identify emerging and established risks facing the company and its stakeholders; • determining the company's 'risk appetite'; • agreeing how the principal risks should be managed or mitigated; • establishing clear internal and external communication channels on the identification of internal and external risk factors; and • implementing a monitoring and review process.
Remuneration A board should promote executive remuneration structures aligned to sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company.	<p>Setting remuneration – In setting director and senior manager remuneration consideration should be given to remuneration throughout the organisation to reinforce a sense of shared purpose.</p> <p>Policies – The board should establish clear policies on remuneration structures and practices which should enable effective accountability to shareholders. This should take account of the broader operating context, including the pay and conditions of the wider workforce and the company's response to matters such as any gender pay gap. Boards should consider commenting on how executive remuneration reflects general practice within the company's sector.</p> <p>Delegating remuneration decisions – The establishment of a committee is a way some boards may wish to delegate responsibility for designing remuneration policies and structures for directors and senior management. Such a committee might benefit from the contribution of an independent non-executive director.</p> <p>Subsidiary companies – Where a director's remuneration is controlled by a parent company, the subsidiary should explain this and cross-refer to information available elsewhere which explains the policy in relation to the subsidiary.</p>
Stakeholder Relationship and Engagement Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce and giving regard to the their views when taking decisions.	<p>External impacts – Boards of large private companies should consider how a company's activities may impact both current and future stakeholders, which, for example, could include impacts on the environment.</p> <p>Stakeholders – Stakeholders include the workforce, customers and suppliers, but also other material stakeholders specific to company circumstances or sectors, such as regulators, governments, pensioners, creditors and community groups. Boards should ensure that there are channels to receive appropriate feedback from discussions with stakeholders. When explaining impact on the community or environment, boards may want to refer to recognised international standards or frameworks that it follows.</p> <p>Workforce – Companies should develop a range of formal and informal channels that enable them to engage in meaningful two-way dialogue, enabling the workforce to share ideas and concerns with senior management. This might include:</p> <ul style="list-style-type: none"> • engagement with trade unions, focus or consultative groups; and • establishing clear procedures for raising concerns (e.g., whistleblowing policies) which are regularly reviewed to ensure they are effective.

Preparing for AGMs in 2019

ISS 2019 Proxy Voting Guidelines

The proxy advisory firm Institutional Shareholder Services (“ISS”) published its 2019 Proxy Voting Guidelines on 6 December 2018, which apply to annual general meetings (“AGMs”) taking place on or after 1 February 2019. The key changes to the guidelines are outlined below:

- **Auditors** – Prior to recommending a shareholder vote in favour of the appointment of an external auditor, ISS will consider any concerns around the effectiveness of the auditor and whether the lead audit partner has been linked with any significant auditing controversies.
- **Equity issues** – A listed company’s compliance with the Preemption Group Principles as a whole, at any time, can form the basis of an ISS recommendation to vote against an equity issue. Previously, this was restricted only to compliance relating to a particular authorisation. A recommendation to vote against an equity issue may be applied to all share allotment authorities, not merely the disapplication of pre-emption rights.
- **Directors** – Where egregious actions related to a director’s service on another board raise substantial doubt surrounding that director’s ability to effectively oversee management and act in the best interests of the company, ISS will recommend against the election or re-election of that director.
- **Remuneration** – Voting will generally be in favour of annual bonuses of 50% of the maximum bonus potential, accompanied by a robust explanation. ISS will focus on long-term incentives, making clear that share awards should be subject to a vesting and holding period of at least five years (a requirement that reflects the changes to the new UK Corporate Governance Code published by the Financial Reporting Council in July 2018). So as to ensure active consideration by remuneration committees of award sizes on an annual basis, ISS states that when there has been a material decline in a listed company’s share price, remuneration committees should consider decreasing the size of long-term investment plan awards at the time of grant.
- **Environmental and social practices** – A new factor that ISS will consider when reviewing shareholder proposals is any significant controversies, fines, penalties or litigation related to the company’s environmental or social practices.

Glass Lewis 2019 Proxy Voting Guidelines

Independent governance services provider Glass Lewis published its 2019 guidelines on approach to proxy advice. The key changes to its guidelines are noted below:

- **Environmental and social risks** – Glass Lewis may consider recommending that shareholders vote against a board (or audit/risk committee) member who is responsible for mismanagement of environmental or social risks that threaten shareholder value.
- **Pay ratios** – The guidelines were updated to reflect the latest reporting requirements relating to pay ratios.
- **Board of directors** – Where 20% of shareholders vote against a board-recommended resolution, Glass Lewis may recommend that shareholders vote against a director’s re-election where the board of directors has failed to take adequate measures to address shareholders’ concerns (this is reflective of the changes made to the UK Corporate Governance Code).
- **Diversity** – The guidelines also affirm the expectation that FTSE 100 companies provide meaningful disclosure regarding the required skills and diversity of backgrounds of directors. Glass Lewis will consider companies’ disclosed gender pay gap data and composition of its executive pipeline in assessing board diversity.

Sources: ISS United Kingdom and Ireland Proxy Voting Guidelines Benchmark Policy Regulations (6 December 2018); Glass Lewis 2019 Proxy Paper (December 2018).

Company and Case Law

Statutory Developments

The key legislative changes to UK company law over the past six months relate to legislative preparations in anticipation of Brexit. Please see the section of this update entitled “Impact of Brexit” for a more detailed discussion.

Recent Case Law

Partial payment of a debt is not good consideration

It is established law that if a debtor pays part of an existing debt, this does not amount to consideration for a creditor's promise to accept a lesser sum in full consideration of that debt. The creditor must receive something additional to the part payment of the debt for the variation of the debt to be enforceable (*Re Selectmove Limited* [1995] 1 WLR 474). An offer to pay less than an amount due is ineffective in the absence of further consideration to the creditor.

This principle has recently been reaffirmed by the High Court in the case of *Simantob v Shavleyan* [2018] EWHC 2005 (QB), where it was held that for an oral variation to a settlement agreement to be effective, there needed to be consideration, including a benefit to the creditor beyond the debtor's promise to pay part of the pre-existing debt. On the facts, the High Court found that the creditor had been provided with an additional benefit because the debt in question was disputed on the basis that it was penal. The oral agreement by Mr. Shavleyan to give up a challenge to a daily payment clause in the original settlement agreement between the parties meant that there was compromise on both sides, and therefore the creditor's promise to accept a lesser sum in full consideration of the debt was enforceable.

Sources: *Re Selectmove Limited* [1995] 1 WLR 474; *Simantob v Shavleyan* [2018] EWHC 2005 (QB).

No special rule for interpreting shareholder agreements

It is a well-established principle of English company law that, since shares are private property and freely transferable, the right to transfer them can only be restricted or removed by clear words (*Greenhalgh v Mallard* [1943] 2 All ER 234). This principle was applied in the case of *Re Coroin Ltd* [2013] EWCA Civ 781 where the Court of Appeal interpreted a shareholders' agreement in accordance with the *Greenhalgh* principle.

The fact that the *Greenhalgh* principle was applied in the interpretation of a shareholders' agreement in one case does not mean that it will always apply in the context of the interpretation of a shareholders' agreement. In *United Co Rusal Plc v Crispian Investments Ltd* [2018] EWHC 2415 (Comm), a distinction was drawn between a shareholders' agreement and a company's articles of association. The articles of association are not only a contract between the shareholders, but they also form part of a company's constitution. A commercial agreement between shareholders, however, does not affect the intrinsic rights attached to the shares. It is a contractual agreement as to how such rights would or would not be exercised. Accordingly, the shareholder's agreement in *United Co Rusal* was interpreted in accordance with normal principles of contractual interpretation, rather than in accordance with the *Greenhalgh* principle.

The decision in *United Co Rusal* suggests that a shareholders' agreement will only be interpreted in accordance with the *Greenhalgh* principle in specific circumstances, such as those in *Re Coroin*, where the shareholders' agreement and the articles of association are synonymous. They may be synonymous, where, for example, the shareholders' agreement is made on the establishment of the company between the initial shareholders and the pre-emption provisions in the shareholders' agreement are the same as those in the articles of association.

Sources: *Greenhalgh v Mallard* [1943] 2 All ER 234; *Re Coroin Ltd* [2013] EWCA Civ 781; *United Co Rusal Plc v Crispian Investments Ltd* [2018] EWHC 2415 (Comm).

Moral hazard

The first case involving the Pensions Regulator's moral hazard powers under the Pensions Act 2004 (the “**Pensions Act**”) was recently decided by the Upper Tribunal in *Granada UK Rental & Retail Ltd v the Pensions Regulator* [2018] UKUT 164 (TCC), otherwise known as the *Box Clever* case.

In the *Box Clever* case, the Upper Tribunal considered whether the Pensions Regulator had jurisdiction to issue an FSD, or financial support direction, against a number of companies in the Granada group. FSDs require the recipient to put in place financial support for a pension scheme, where the sponsoring employer of the scheme is a service company or is insufficiently resourced.

Box Clever was a joint venture vehicle set up by Granada and the Thorn group in 1999-2000. It went into administrative receivership in 2003, whilst its occupational pension scheme grew to approximately £115 million. In 2009, the Pensions Regulator provided the Thorn group with a comfort letter asserting that it would not issue an FSD against it as administrative receivers had taken over *Box Clever*. However, at a later date the Pensions Regulator subsequently issued FSDs against a number of companies in the Granada group.

The recipients of the FSD in the Granada group claimed that they were not “connected with or an associate of” one of the pension scheme employers at the “relevant time” for the purposes of the Pensions Act. However, the Upper Tribunal found that they were connected with or an associate of the employer company at the “relevant time” despite the appointment of the administrative receivers, because they were entitled to control the exercise of one third or more of the voting power at a general meeting of the employer company. The appointment of administrative receivers did not change the beneficial ownership of the shares.

The case highlights that test as to whether a person is ‘connected with or an associate of the employer’ for the purposes of the Pensions Act is a wide test. Following this case, it is possible that the Pensions Regulator would be able to impose an FSD on a company even if the relevant company is placed in administration or liquidation.

Source: *Granada UK Rental & Retail Ltd v the Pensions Regulator* [2018] UKUT 164 (TCC).

Reminder of importance of company filing compliance

The importance of the timely filing of a company’s annual accounts has recently been discovered by David Beckham. His image rights company, Footwork Productions Limited, was required to file its annual accounts for the financial year ending 31 December 2017 with the Registrar of Companies by 30 September 2018, but had failed to do so as of 11 December 2018. The filing of annual accounts is a legal requirement for all private and public limited companies (with an exception for some small, medium-sized and dormant companies) under Part 15 Chapter 10 of the Companies Act 2006 (the “Companies Act”).

Pursuant to section 1000 of the Companies Act, if the Registrar of Companies has reasonable cause to believe that a company is not carrying on business or in operation (for example, by failing to file its accounts), it may send to the company a communication inquiring whether the company is carrying on business or in operation. If it does not receive a response within 14 days of sending the notice, it must send a second communication which refers to the first communication and states that if no answer is received within 14 days, a notice will be published in the Gazette with a view to striking the company’s name off the register.

Since the Registrar did not receive an answer within 14 days of the second communication, under its statutory powers, on 11 December 2018, it sent to the company and published in the Gazette a notice that 2 months from the date of the notice, Footwork Productions Limited would be struck off the register unless cause is shown to the contrary and, importantly, all property and rights vested in, or held in trust for, the company would be deemed to be bona vacantia and accordingly would belong to the crown.

Source: *Companies House filings*.

Guidance on jackpot damages

“Wrotham Park” damages, often referred to as “negotiating damages”, represent damages that would have hypothetically been agreed between the parties, acting at arm’s length and reasonably, as the price for releasing the defendant from its obligations to the claimant. They can be controversial because a claimant who would not otherwise have received significant damages because of evidential difficulties associated with establishing their loss may seek substantial negotiating damages from the defendant.

The Supreme Court considered Wrotham Park damages in the case of *Morris-Garner and another v One Step (Support) Ltd* [2018] UKSC 20. The Supreme Court rejected the argument that Wrotham Park damages ought to be awarded when the court considers them to be a “just” response because damages for breach of contract are not at the discretion of the court, but are awarded or refused on the basis of legal principle. The court considered that Wrotham Park damages can be awarded for breach of contract where the loss suffered is appropriately measured by reference to the economic value of the right which has been breached. This is most likely to arise where the breach of contract results in the loss of a valuable asset created or protected by the right which was infringed (e.g., a breach of an intellectual property or confidentiality agreement).

The decision should reduce the possibility for opportunistic claimants to pursue a “jackpot” damages award where they are unable to evidence that they have suffered loss.

Source: *Morris-Garner and another v One Step (Support) Ltd* [2018] UKSC.

“No Oral Modification” clauses

Contracts may generally be varied in writing or orally, but parties often seek to set out how contracts can be amended in the written terms of their contract. In particular, parties often include a clause which aims to exclude the possibility for oral variation to the terms of the agreement. The Supreme Court recently considered the effectiveness of such provisions in *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2018] UKSC 24.

The Supreme Court refused to allow the no oral modification clause in question to be ignored, and upheld its effectiveness. It was held that the law should give effect to contractual provisions requiring specified formalities to be observed when varying a contract. The court provided a number of reasons for upholding the no oral modification clause, including that they:

- prevent attempts to informally undermine written agreements;
- prevent disputes arising as to whether a variation is effective and to the terms of the variation; and
- provide formality in recording variations and make it easier for corporations to police internal rules restricting authority to agree them.

Source: *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2018] UKSC 24.

Execution formalities for a deed

English law has assumed a predominant position in international commercial transactions, but the recent case of *Katara Hospitality v Guez* [2018] EWHC 306 serves as a reminder of the dangers of failing to engage English lawyers in English law transactions.

The specific facts of the case turned on the validity of a power of attorney. Under English law, a power of attorney must be executed as a deed, meaning it must make clear on its face that it is intended to be a deed (the face value requirement) and it must be validly executed as a deed (the execution requirement). In *Katara*, the defendants executed powers of attorney in favour of one the other sellers in connection with a share purchase completion meeting in Qatar. The powers of attorney were drafted by the defendants' Californian lawyer, but did not use the word "deed" anywhere. In reliance on the powers of attorney, at the closing meeting the purported attorney entered into a guarantee deed on its behalf and on behalf of the other defendants, even though there had been no discussion with the defendants of the guarantee deed or its terms.

The court found that the powers of attorney did not take effect as deeds in law because they failed to make clear on their face that they were intended to be deeds, thereby failing the face value requirement. The court found no evidence that the defendants or their US lawyers were aware of the English law requirement that powers of attorney must be in the form of a deed, and therefore the court could not infer that the defendants intended the powers of attorney to take such form. Consequently, the powers of attorney were not deeds as a matter of English law, but appointments in writing. This allowed the court to take a more liberal approach in interpreting the document, which ultimately led to the finding that the guarantee was invalid.

Source: *Katara Hospitality v Guez* [2018] EWHC 306.

Impact of Brexit

Introduction

On 29 March 2017, the United Kingdom notified the European Council of its intention to withdraw from the European Union. Such withdrawal (“**Brexit**”) is currently expected to take place at 11:00 p.m. (UK time) on 29 March 2019.

On 14 November 2018, the UK Government and the European Commission published a draft agreement on the withdrawal of the United Kingdom from the European Union (the “**Withdrawal Agreement**”), together with a document entitled “Outline of the Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom”. With the ongoing political uncertainty in the United Kingdom, it is difficult to predict the future of the United Kingdom’s relationship with the European Union. If it proves impossible for UK parliamentary approval of the Withdrawal Agreement to be obtained prior to 29 March 2019, the prospect of a no-deal Brexit, a significant delay to Brexit or even a cancellation of Brexit is much more likely.

On 26 June 2018, the European Union (Withdrawal) Act 2018 (the “**Withdrawal Act**”) came into force. The purpose of the Withdrawal Act is to: (a) end the supremacy of EU law in the United Kingdom by repealing the European Communities Act 1972, (b) convert EU law (as it stands on exit day, 29 March 2019) into domestic law, and (c) grant the UK Secretary of State temporary powers to make secondary legislation to ensure the UK legal system can continue to function effectively outside the EU legal framework following Brexit.

Below is an overview of key legislative and regulatory preparations relating to corporate finance law and regulation undertaken by the UK Government and the FCA over the last six months in anticipation of Brexit.

FCA Consultation and Proposed Amendments to the FCA Handbook in Anticipation of Brexit

The FCA Handbook sets out rules, guidance and other provisions made by the FCA under powers given to it by the Financial Services and Markets Act 2000. On 10 October 2018, the FCA issued a consultation paper (CP 18/28) setting out its first set of proposed changes to the FCA Handbook and EU-derived binding technical standards in the event of a “no-deal” scenario whereby the United Kingdom exits the European Union on 29 March 2019 without a ratified Withdrawal Agreement in place.

Generally, the proposed amendments contemplate updating references to EU legislation, UK law which relates to or refers to the European Union, EU institutions and concepts and the European Economic Area. The paper also sets out the FCA’s proposed approach post-Brexit to EU Level 3 non-legislative material produced by European Supervisory Authorities, including guidelines and recommendations on the application of EU law, opinions and Q&As (“**Level 3 Material**”). Level 3 Material will not be incorporated into UK law but will continue to be relevant after the United Kingdom leaves the European Union. Market participants are advised to interpret Level 3 Material both “sensibly and purposively”.

The FCA intends to give feedback on the paper in early 2019 and publish final versions of the materials shortly before March 2019. If the UK Parliament approves the terms of the Withdrawal Agreement, and there is an implementation period, the proposed amendments will not come into effect on 29 March 2019.

On 23 November 2018, the FCA published a second consultation paper (CP 18/36) with further proposed amendments to the FCA’s Handbook and EU-derived binding technical standards in the event the United Kingdom leaves the European Union without an implementation period in place. The FCA is also consulting on its proposed approach to non-Handbook guidance and to forms which appear in the FCA Handbook. The consultation closes on 21 December 2018 and the FCA expects to provide feedback and publish its final amendments early in 2019.

Sources: FCA Consultation Paper 18/28 (10 October 2018); FCA Consultation Paper 18/36 (23 November 2018).

UK Takeover Code and Brexit

Introduction

The Takeovers Directive⁽¹⁾ lays down measures for the co-ordination of Member States of the European Economic Area (“**EEA Member States**”) in relation to takeover bids. Specifically, section 943(1) of the Companies Act 2006 (the “**Companies Act**”) requires the Panel to make rules giving effect to Article 3.1 (*General principles*), Article 4.2 (*Shared jurisdiction*), Article 5 (*Protection of minority shareholders, the mandatory bid and the equitable price*), Articles 6.1 to 6.3 (*Information concerning bids*), Article 7 (*Time allowed for acceptance*), Article 8 (*Disclosure*), Article 9 (*Obligations of the board of the offeree company*) and Article 13 (*Other rules applicable to the conduct of bids*) of the Takeovers Directive. On 5 November 2018, a revised version of the draft Takeovers (Amendment) (EU Exit) Regulations 2019 (the “**2019 Draft Takeovers Regulations**”) were published (superceding the draft published on 29 October 2018) which will amend Part 28 of the Companies Act to enable the UK takeover regime to operate outside the EU takeover regime.

On 5 November 2018, the Panel published Public Consultation Paper 2018/2 (“**PCP 2018/2**”) which sets out a number of proposed amendments to the City Code on Takeovers (the “**Takeover Code**”) relating to Brexit; in particular, the removal of the shared jurisdiction regime which is derived from the Takeovers Directive. The Consultation closed on 17 December 2018.

Draft Takeovers (Amendment) (EU Exit) Regulations 2019

The 2019 Draft Takeovers Regulations will amend the Companies Act to remove the Takeovers Directive as the legal basis for the Panel’s rule-making powers and insert a new Schedule 1C which will replicate certain requirements of the Takeovers Directive. The Panel has observed in PCP 2018/02 that the provisions of the new Schedule 1C are, in substance, the same as the relevant Articles of the Takeovers Directive (other than Article 4.2). Specifically:

- the General Principles of the Takeover Code are currently the same as those in Article 3.1(a) to (f) of the Takeovers Directive. The proposed Schedule 1C will make clear that these principles will continue to apply in the United Kingdom following Brexit (with some minor drafting and formatting changes); and
- provisions equivalent to Articles 5, 6.1 to 6.3, 7 to 9 and 13 of the Takeovers Directive will be set out in Schedule 1C (but not Article 4.2 on shared jurisdiction).

Shared jurisdiction

Article 4.2 of the Takeovers Directive provides for a shared jurisdiction regime which applies to offers for a company with its registered office in one EEA Member State and securities admitted to trading on a regulated market in another EEA Member State. In general, the supervisory authority of the EEA Member State in which such regulated market is located would have jurisdiction over matters relating to the takeover offer itself. The supervisory authority of the EEA Member State in which the offeree has its registered office would have jurisdiction over matters relating to company law and information to be provided to the offeree’s employees.

In PCP 2018/02, the Panel proposes removing the shared jurisdiction regime such that the Takeover Code would no longer apply to a takeover bid for:

- a company which has its registered office in the United Kingdom and whose securities are admitted to trading on a regulated market in an EEA Member State and which does not have its place of central management and control in the United Kingdom (the ‘UK residency’ test) – the Takeover Code would still apply (in full) to an offer for such company if that company satisfies this test; or
- a company which has its registered office in an EEA Member State and whose securities are admitted to trading on a regulated market in the United Kingdom.

In short, the Takeover Code would only apply to offers for:

- companies which have their registered offices in the United Kingdom, the Channel Islands or the Isle of Man if any of their securities are admitted to trading on a regulated market or multilateral trading facility in the United Kingdom or on any stock exchange in the Channel Islands or the Isle of Man; or
- companies which have their registered offices in the United Kingdom, the Channel Islands or the Isle of Man and satisfy the “residency” test.

The Panel understands that there are currently 11 companies with UK registered offices and securities admitted to trading on a (non-UK) EEA Member State regulated market (in particular, in Belgium, Germany, Norway, France and Denmark). Under the Panel’s proposals, these companies would only be subject to the Takeover Code if they are resident in the United Kingdom, the Channel Islands or the Isle of Man. If that is the case, the Panel acknowledges that these companies would also be subject to the rules of the supervisory authority in the EEA Member State where the relevant regulated market is located – they would be subject to the dual jurisdiction of the Panel and such supervisory authority. In such situation, the Panel noted that it should be consulted so that guidance can be given on how any conflicts between the relevant rules may be resolved.

Note: (1) Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids.

The Panel also understands that there are 25 companies with registered offices in an EEA Member State other than the United Kingdom (in particular, Cyprus, Luxembourg, the Netherlands and the Republic of Ireland) and securities admitted to trading on a regulated market in the United Kingdom, which have chosen to be subject to the Panel's jurisdiction. The Panel has discussed the consequences of the shared jurisdiction regime ceasing to apply to such companies with the relevant supervisory authorities in these jurisdictions. The authorities in Cyprus, Luxembourg and the Netherlands have confirmed that they would not take jurisdiction over such companies. In other words, these relevant companies would not be subject to the Takeover Code or the takeover rules in these EEA Member States. In contrast, the Irish Takeover Panel has confirmed that it would take full jurisdiction over a company with a registered office in the Republic of Ireland.

In terms of shared jurisdiction offers which straddle the date on which the shared jurisdiction regime is removed from the Takeover Code, the Panel's position is that with regard to offers for a shared jurisdiction company:

- to which the Takeover Code initially applies on a shared jurisdiction basis but to which the Takeover Code will no longer apply following the removal of the shared jurisdiction regime, the Panel will stop regulating such offers from the date of such removal; and
- to which the Takeover Code will apply in full from the date of removal of the shared jurisdiction regime, i.e., an offer for a company with a registered office in the United Kingdom, is resident in the United Kingdom and whose securities are admitted to trading on a regulated market in an EEA Member State (but not on a regulated market in the United Kingdom), the Panel will regulate such offers in full from the date of such removal.

Cross-border mergers

The Takeover Code currently applies to cross-border mergers between a UK company and an EEA Member State company undertaken under The Companies Act (Cross-Border Mergers) Regulations 2007 (SI 2007/2974) which implemented the "**Cross-Border Regulations**". The Takeover Code's application to cross-border mergers is explained in the Panel's Practice Statement No 18 (Cross-Border Mergers).

On 31 October 2018, the draft Companies, Limited Liability Partnerships and Partnerships (Amendment etc.) (EU Exit) Regulations 2018 were published. These regulations will revoke the Cross-Border Regulations when they come into effect. In relation to such revocation, the Panel has proposed the withdrawal of Practice Statement No 18.

Societas Europaea

Since 8 October 2004, it has been possible to set up a European public limited liability company (Societas Europaea "**SE**") in the United Kingdom. The Takeover Code currently provide, that it would apply to an offer for a Societas Europaea which has its registered office in the United Kingdom if its securities are traded on a regulated market or multilateral trading facility in the United Kingdom or any stock exchange in the Channel Islands or the Isle of Man or if it satisfies the 'UK residency' test.

On 1 November 2018, the European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2018 were published. These regulations provided for the conversion of any UK-registered Societas Europaea into a UK Societas which will be a new UK corporate form. The Panel proposes amending the Introduction to the Takeover Code to replace all references to 'Societas Europaea' with 'UK Societas' with such legal entities treated in the same way as a company following Brexit.

Tidy-up amendments

The Panel is also proposing to make certain minor and technical amendments to the Takeover Code to reflect the fact that the Takeovers Directive would no longer apply to the United Kingdom but would, in substance, be replicated in Schedule 1C of the Companies Act. A number of these proposed amendments is set out below:

- the removal of the reference to the Panel being designated as the supervisory authority to carry out certain regulatory functions in relation to takeovers pursuant to the Takeovers Directive;
- making a number of amendments to the Takeover Code to conform the General Principles of the Takeover Code to the principles set out in the proposed Schedule 1C;
- amending references to the 'EEA' in Rule 30.4 (which requires documents, announcements and information to be made available to shareholders and employees in the EEA) to refer only to the United Kingdom, the Channel Islands and the Isle of Man; and
- replacing the terms 'regulated market' and 'multilateral trading facility' (which are currently defined in the Takeover Code by reference to MiFID II Directive⁽¹⁾) with the terms 'UK regulated market' and 'UK multilateral trading facility' with new definitions given to these terms.

Implementation

If there is an implementation period, the Panel has proposed that the amendments set out in PCP 2018/02 will come into effect following the end of the transition period. However, if the Withdrawal Agreement is not approved by the UK Parliament and the United Kingdom therefore withdraws from the European Union in a "no deal" scenario, the Panel has proposed that these amendments will come into effect at 11:00 p.m. on 29 March 2019.

Sources: Takeover Panel Consultation Paper 2018/2 (5 November 2018); Draft Takeovers (Amendment) (EU Exit) Regulations 2019; European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2018.

Note: (1) Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014.

Draft Company Law Legislation in Anticipation of Brexit

As noted above, the United Kingdom is expected to exit the EU at 11:00 p.m. UK time on 29 March 2019 (“**exit day**”). The UK Government has developed plans for all eventualities, including a “no deal” scenario in which there would be no withdrawal

agreement in place between the UK and EU implementing a transition period and later date of exit. In the event of a “no deal” Brexit, without an agreement establishing the terms of withdrawal, statutory instruments have been drafted to ensure a functioning statute book from exit day. The table summarises these draft regulations in relation to UK company law.

Regulation	Description	Key legislation amended or impacted*
Draft Accounts and Reports (Amendment) (EU Exit) Regulations 2018	Published on 31 October 2018, these draft regulations remove certain exemptions relating to the obligation to prepare individual financial accounts that are currently available to companies with EU parents and subsidiaries including restricting to UK companies with UK parents the exemption from preparing accounts for dormant companies and from filing accounting information. The regulations also address a number of other issues arising from the UK’s exit from the European Union, such as substituting references to the Accounting Directive ⁽¹⁾ with references to domestic legislation. Generally, changes made by the draft regulations which relate to financial accounts will apply to financial years beginning on or after exit day.	<ul style="list-style-type: none"> • Companies Act 2006, Part 15 • Partnerships (Accounts) Regulations 2008 • Reports on Payments to Governments Regulations 2014 • Overseas Companies Regulations 2009 • Supervision of Accounts and Reports (Prescribed Body) and Companies (Defective Accounts and Directors’ Reports) (Authorised Person) Order 2012 • Companies (Receipt of Accounts and Reports) Regulations 2013
Draft Takeovers (Amendment) (EU Exit) Regulations 2019	Published on 5 November 2018, these draft regulations make the necessary changes to the Companies Act 2006 to cause the framework of the Takeovers Directive ⁽²⁾ not to apply to UK takeovers following exit day. See the article entitled “UK Takeover Code and Brexit” above for a more detailed discussion.	<ul style="list-style-type: none"> • Companies Act, Parts 16 and 42, and Schedules 10, 11, 11A and 12 • Statutory Auditors and Third Country Auditors Regulations 2016
Draft Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2018	Published on 6 November 2018, these draft regulations relate to the framework for regulatory oversight and recognition of statutory auditors and third country auditors in the United Kingdom. Legislation implementing the Audit Directive ⁽³⁾ is amended and powers held by the European Commission are granted to the UK’s Secretary of State to determine equivalence of third country audit regimes and to the Financial Reporting Council to adopt International Standards on Auditing in addition to their existing standard setting powers. Under the regulations, equivalence and adequacy status is applied to any third countries that were granted equivalence and adequacy status by the European Commission before exit day.	<ul style="list-style-type: none"> • Companies Act 2006, Parts 8 and 23 • Overseas Companies Regulations 2009 • Companies (Cross Border Mergers) Regulations 2007 (revoked)

Notes: (1) Directive 2013/34/EU of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and the related reports of certain types of undertakings. (2) Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids. (3) Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

Regulation	Description	Key legislation amended or impacted*
Draft Companies, Limited Liability Partnerships and Partnerships (Amendment etc.) (EU Exit) Regulations 2018	<p>Published on 6 November 2018, these draft regulations amend the framework of company legislation, including the Companies Act 2006 and pre-existing related regulations, in order to reflect the UK no longer comprising part of the European Economic Area (the “EEA”) common company law framework. The amendments include:</p> <ul style="list-style-type: none"> • creating a distinction between a “UK regulated market” and an “EU regulated market” so that the regulatory framework can be amended in certain respects, such as prohibiting intermediaries admitted to an EU regulated market from availing themselves of the exemption from the prohibition against holding shares in their holding company; • applying the filing requirements for corporate directors of UK companies equally to all overseas companies whether or not incorporated in the EEA; • EEA companies becoming subject to filing and disclosure requirements of overseas companies generally, including the display of business information on business letters, order forms and websites; and • the cross-border merger regime available pursuant to the Companies (Cross-Border Mergers) Regulations 2007 being repealed. 	<ul style="list-style-type: none"> • Companies Act 2006, Parts 8 and 23 • Overseas Companies Regulations 2009 • Companies (Cross Border Mergers) Regulations 2007 (revoked)
European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2018	<p>Published on 6 December 2018, these regulations provide that from exit day it will no longer be possible to form an SE in the United Kingdom and that any SEs still registered in the United Kingdom on exit day will convert automatically into ‘United Kingdom Societates’.</p> <p>It is envisaged that United Kingdom Societates will be a temporary status with entities converting to public limited companies in due course.</p>	<ul style="list-style-type: none"> • European Public Limited-Liability Company Regulations 2004 • European Public Limited-Liability Company (Employee Involvement) (Great Britain) Regulations 2009
European Economic Interest Grouping (Amendment) (EU Exit) Regulations 2018	<p>Published on 6 December 2018, these regulations provide that any European Economic Interest Grouping (“EEIG”) company registered in the United Kingdom immediately before exit day will convert automatically into ‘UK Economic Interest Grouping’ (“UKEIG”) companies.</p> <p>Registrations of new UKEIGs will not be possible and UKEIG status is anticipated as being temporary until appropriate restructuring is completed.</p>	<ul style="list-style-type: none"> • European Economic Interest Grouping Regulations 1989 • Registrar of Companies (Fees) European Economic Interest Grouping and European Public Limited Liability Company Regulations 2012 • Council Regulation (EEC) No. 2137/85
Draft Official Listing of Securities, Prospectus and Transparency (Amendment) (EU Exit) Regulations 2019	<p>Published on 12 December 2018, these regulations are intended to address deficiencies in the prospectus, transparency and listing regimes that arise from the United Kingdom leaving the European Union. They form part of the planning for a no-deal scenario and will not take effect if the United Kingdom enters an implementation period. The draft regulations appear to be consistent with the proposals set out in the explanatory information published by Her Majesty’s Treasury on 21 November 2018.</p>	<ul style="list-style-type: none"> • EU Prospectus Directive (Directive 2003/71/EC) • EU Transparency Directive (Directive 2013/50/EU)

* To ensure consistency across the UK statute book, the above-mentioned regulations make wide-ranging amendments to existing UK legislation – the table above only lists the key provisions and regulations which have been substantively amended.

Davis Polk in London

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- **Mereo BioPharma** on its proposed combination with NASDAQ-listed OncoMed Pharmaceuticals
- Joint bookrunners to **Ocado Group** on its £143 million placing
- **Temenos** on its £1.4 billion takeover offer for Fidessa
- **Charles Taylor** on its £17.6 million placing in connection with the acquisition of Inworx
- **Heineken** on its €1.025 billion acquisition of Brasil Kirin from Kirin Holdings Company
- **Natura** on its €1 billion acquisition of The Body Shop from L'Oréal

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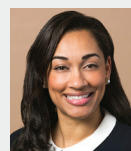
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