SQUIRE PATTON BOGGS

PRE-EMPTION GROUP MAKES IMPORTANT CHANGES TO PRE-EMPTION PRINCIPLES

On 12 March 2015 the Pre-emption Group published a revised version of its Statement of Principles for Disapplying Pre-emption Rights ("Pre-emption Principles"). This update is the first new version of the Pre-emption Principles since 2008 and it includes several important changes, including the following:

- **Disapplication for acquisition or specified capital investment:** While there have been no changes to the thresholds for the general disapplication of pre-emption rights, which remain at 5% annually and 7.5% in aggregate over a three year period, the new Pre-emption Principles now allow companies to seek authority to issue an additional 5% of issued capital in any year for use in connection with an acquisition or 'specified capital investment'. This change effectively allows companies to issue new shares of up to 10% each year on a non pre-emptive basis to finance acquisitions or capital investments.
- **Clarification on 'issues of equity securities for cash'; application to cash box and vendor placings:** The Pre-emption Group have noted that the Pre-emption Principles apply to all issues of equity securities that are undertaken to raise cash for the issuer or its subsidiaries, regardless of the legal form of the transaction. The principles specifically note that this includes cash box placings, which should be considered as being an issue of equity securities for cash, and therefore subject to the Pre-emption Principles. Vendor placings are however distinguished as outside the scope of the principles (see the box below for a description of cash box and vendor placings).
- **Application of Pre-emption Principles to non-UK companies:** The previous version of the Pre-emption Principles stated that they only applied to UK incorporated companies with a premium listing on the London Stock Exchange's Main Market. The new version confirms that the principles apply to all companies with a premium listing, including companies incorporated outside the UK. The principles also 'encourage' companies with a standard listing on the Main Market, an AIM listing or a listing on the High Growth segment of the Main Market to adopt the principles.
- **Greater transparency on discounts:** Where shares are issued non pre-emptively at a discount, the issuer will be expected to disclose the discount in the announcement of the issue. In addition, the issuer should disclose details of the issue, including the discount, in its next annual report.
- **Pre-emption Group's role:** The Pre-emption Group confirms in the new Pre-emption Principles that it will monitor the development of market practice with respect to disapplying pre-emption rights, but will not express a view on or otherwise intervene in specific cases.

Our View

This is undoubtedly an important update to the Pre-emption Principles. It formalises the views of the institutional shareholder bodies such as the Association of British Insurers ("ABI") and the National Association of Pension Funds ("NAPF") that cash box placings and similar arrangements should be subject to the same principles as to application (and disapplication) of pre-emption rights as share issues directly for cash. However, it also recognises and allows for the practical reality that where funds are needed for an acquisition or capital investment, having to wait while shareholder approval is obtained or a pre-emptive offer is undertaken can be commercially prejudicial to the underlying transaction. This new version of the Pre-emption Principles is clearly intended to find a balance between those two perspectives, by bringing cash box placings within the scope while also allowing more generally for listed companies to issue up to 10% on a non pre-emptive basis where the funds are to be used for an acquisition or investment.

Only time will tell whether there will be a significant practical impact from these changes. Cash box placings have been predominantly used to finance acquisitions and investments, and in most cases the amount was kept to less than 10% of issued share capital, so the confirmation that the Pre-emption Principles apply to cash box placings seems unlikely to change market practice. Similarly, the specific inclusion of non-UK incorporated premium listed companies should not result in any significant changes as companies with a premium listing have typically adhered to the Pre-emption Principles whether incorporated in the UK or elsewhere. Of more interest will be whether the 'encouragement' for companies with a Main Market standard listing, listing on the High Growth segment or AIM listing will result in those companies applying the Pre-emption Principles where they have not previously done so. For companies which are already listed, we expect that market practice will remain the same and that companies which are currently adhering to the principles will continue to do so, whereas others which have a valid reason for not doing so (such as dual-listed companies where the primary listing venue does not apply a pre-emption regime) will similarly continue with their usual practices when fund raising through new share issues. The most significant impact will likely be felt on new listed companies on those markets, which will now be under more pressure to comply with the Pre-emption Principles or explain to their investors why they do not.

Cash Box and Vendor Placings – a Quick Refresher

A **cash box placing** is a form of fundraising which uses a special purpose company (typically incorporated in Jersey for tax and practical reasons), the shares in which are transferred to the listed company in consideration for the issue of the new shares. As the shares are issued other than for cash, the exemption in section 565 of the Companies Act applies, such that the company is not required to make a pre-emptive offer of the new shares to its shareholders. Cash box placings have therefore traditionally been used to fund acquisitions as they offer the ability to raise money quickly and more cost-effectively. For a UK incorporated company, a cash box structure has the added advantage of providing merger relief so that the placing proceeds become distributable reserves.

While frequently used, cash box placings have previously been challenged by institutional shareholder bodies, and the ABI in particular, as a sham or unlawful transaction designed specifically to avoid pre-emption rights. Expert legal opinion is that the cash box structure provides a legitimate exemption from statutory pre-emption rights and is therefore legally valid. The ABI and NAPF have continued to object to cash box arrangements in principle on the basis that they infringe the Pre-emption Principles, although they have not usually objected where the share issue has been used to fund an acquisition and kept under 10% of issued share capital.

A **vendor placing** is an alternative means of raising capital to finance an acquisition. In this case the listed company buyer allots shares to the vendor of the company or assets being purchased as consideration, and the buyer's investment bank places those shares in the market so that the vendor receives cash. As the new shares are issued for non-cash consideration (that is, the shares or assets being purchased), the section 565 exemption applies and the new shares do not have to be offered pre-emptively to the company's shareholders. The disadvantage of a vendor placing compared to a cash box placing is that it requires the vendor to be involved, which may complicate and delay the placing. In addition, in certain instances an independent report on the value of the target company or assets may be required, which has further timing consequences.

For further information about anything in this document please contact your usual contact at Squire Patton Boggs or any of the lawyers listed below.

Adam Hastings
Partner
T +44 113 284 7487
E adam.hastings@squirepb.com

Matt Doughty
Partner
T +44 207 655 1044
E matthew.doughty@squirepb.com

Giles Distin
Partner
T +44 207 655 1046
E giles.distin@squirepb.com