

UKLA Publications

LIST!



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Introduction

This is a short supplement to the twelfth edition of List! which we published in February. A couple of issues have arisen where we felt it was important to inform the market immediately, rather than waiting until our next full edition.

One issue relates to our position on working capital statements in hostile bids, where we have tried to accommodate the practical difficulties these bids raise within the overall framework of the Prospectus Directive (PD). The other article outlines a proposed approach under Chapter 11 of the Listing Rules which deals with situations where a related party relationship exists through substantial shareholdings arising solely from fund management activities.

Guidance

We are limited in the way we can address technical matters by the requirements of the Financial Services and Markets Act 2000 (FSMA), which restricts the scope for issuing guidance without prior consultation. It is important to understand that the contents of this newsletter are not intended to be guidance as contemplated by FSMA, and the contents should neither be interpreted, nor relied upon, as guidance. You should refer to the Listing Rules, Prospectus Rules or Disclosure Rules for general guidance and where you need individual guidance, you may approach us. Technical explanations provided in this newsletter are illustrative only and are intended to indicate how the UKLA may expect certain issues to be addressed.

Working capital statements in limited access acquisitions

Recently, we encountered a number of difficulties in applying provisions of the PD in hostile takeovers because offerors that are also issuers have limited access to non-public information on offeree companies. One difficulty was the application of AIII, 3.1 which requires the issuer to make a statement regarding the sufficiency of working capital for the next 12 months from the date of a prospectus. This statement would take into account the impact of any material acquisition by the issuer.

CESR guidance

CESR's recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses no 809/2004 (CESR Guidance) states clearly that a working capital statement in a prospectus must be 'clean' or 'qualified' and the decision is 'binary'. In coming to a clean statement, paragraph 115 of CESR Guidance does not permit issuers to disclose in a prospectus any assumptions, sensitivities, risk factors or caveats to the statement. This is because adding such disclosures detracts from the value of the statement and, in effect, seeks to transfer risk to investors.

Problem in limited access acquisitions

In making a working capital statement, issuers are required to take into account a wide range of variables and sensitivities which may affect an issuer's working capital over the next 12-18 month period. This analysis also involves taking into account the impact of any material acquisitions.

In some hostile takeovers, offerors will be able to come to a clean working capital statement in compliance with paragraph 115 after following procedures normally used to support this confirmation, even though no access to non-public information on the offeree is given to offerors and their advisers. This will be possible because such an offeror will have comfortable financing headroom that can be used to support a clean statement even though they cannot fully assess the offeree's current and future working capital requirements.

However, in other hostile takeovers, undertaking the normal procedures to support a clean confirmation on the sufficiency of working capital is not generally possible due to the limited access to information on the offeree. It has been brought to our attention that in these cases, offerors cannot make a qualified statement confirming the offeror does not have sufficient working capital either. This is because an offeror will not know the underlying working capital position of the offeree, so this statement is potentially misleading.

Conclusion

Having considered this matter internally, we intend taking a purposive approach to the application of the PD in these circumstances, concluding that an offeror may either:

- a. include a clean or qualified working capital statement complying strictly with CESR Guidance; or
- b. state that the offeror is not able to undertake appropriate procedures to support a statement in respect of the sufficiency of its working capital, when taking into account the acquisition. The reason for this must be given i.e. the offeror does not have access to non-public information on the offeree allowing those procedures to be undertaken. Offerors would then be required to give a 12-month working capital statement on the offeror on an un-enlarged group basis. And it must be clear from this statement that the acquisition has not been taken into account.

We would also expect the prospectus to state that if the offeror is granted access by the offeree before the close of the offer and access is sufficient for the purpose of making an enlarged group statement, the offeror will produce a supplementary prospectus containing an updated enlarged group working capital statement. Listed offerors conducting a hostile class 1 acquisition will also need to be mindful of the additional disclosure requirements in LR13.4.3 and provide this information within 28 days of the offer going wholly unconditional.

If you have any comments or queries about this article please contact Lee Alam at: Lee.Alam@fsa.gov.uk

Related party transactions

The listing rules provide certain safeguards intended to prevent a related party from taking advantage of its position and also to address any perception that it may have done so. Under the rules, any transaction proposed between a listed company and a related party will normally require a circular and the prior approval of the company's shareholders in general meeting. The related party is not allowed to vote at the meeting.

Concerns have been expressed that, in one instance, the rules apply too widely. They have the effect, for example, that secured banking transactions between a company and its bank may be caught even though there is no suggestion of any kind of influence being exercised over the listed company. The problem arises where the Group the listed company wants a transaction with also undertakes fund management activities on behalf of third-party customers whose return is directly related to the performance of holdings in listed companies managed on their behalf, rather than the performance of the Group. As a result the Group may hold, in its own name, more than 10% of the listed company and consequently be classified as a related party.

Applying the Chapter 11 rules in these circumstances has caused listed companies to either restructure transactions or to exclude certain Groups from transactions to avoid having to comply with the full requirements of Chapter 11.

We accept that where the fund management activities of a Group attract an overriding fiduciary duty to such third-party customers to act in their best interests - and the shareholding could never be used to further the interests of the Group over the interests of the underlying third-party customers - then there can be no potential for influence as envisaged by Chapter 11.

We intend proposing changes to Chapter 11 to reflect the above in the listing rules update Consultation Paper which we expect to publish in September 2006. In this, we aim to address a number of issues which have emerged in the first year of operating the new Listing regime. In the meantime we will consider requests from listed companies for waivers from the requirements of Chapter 11 where the circumstances outlined in this article prevail.

We must emphasise that, as always, consideration of any waiver request will be on a case specific basis. However, the starting point must always be that, because of the nature of the holding, no potential for influence exists – rather than seeking to establish that while the potential for influence exists no actual influence has been, or will be, exercised.

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