Davis Polk

UK Corporate Finance Update

Our UK Corporate Finance Update looks at some of the key developments from the past 12 months 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 for 2020.

Key regulatory highlights for equity issuers in 2019 included the new EU prospectus regulation (the New Prospectus Regulation) coming into force fully and preparations to implement the Shareholder Rights Directive II (SRD II) into UK national law. In this update we explore the key changes introduced by the New Prospectus Regulation and give a comprehensive overview of the resulting regulatory framework, including delegated regulations and regulatory guidance, which now underpins the regime and in accordance with which market participants need to prepare prospectuses going forward. In connection with the implementation of SRD II, the Financial Conduct Authority introduced new related party transaction rules in the Disclosure, Guidance and Transparency Rules Sourcebook. We examine these new rules in detail and consider the interplay between this new regime and the existing related party transaction rules in Chapter 11 of the Listing Rules that also apply to premium listed companies.

In this update we also look at the key developments in corporate governance reform, including, in particular, the Financial Reporting Council's revised Stewardship Code. Against a backdrop of increased enforcement action by the Financial Reporting Council over the recent period, we consider the key findings and lessons to be learned from these cases and discuss ways issuers can improve their financial reporting. Executive remuneration continued to be a hot topic in 2019 and this update considers the new remuneration reporting regulations which came into force as part of implementing SRD II.

In terms of the UK takeover regime, key developments in 2019 included changes to Rule 29 of the Takeover Code on asset valuations and proposed changes to the Takeover Code in preparation for the United Kingdom's withdrawal from the European Union. In this update we also analyse the Takeover Panel's decisions published over the last year and, in particular, the Panel's considerations relating to the default auction process and circumstances for determining whether a person should be cold-shouldered.

Looking forwards, clearly the United Kingdom's withdrawal from the European Union on 31 January 2020 will dominate the legislative and regulatory landscape, particularly as the nature of the United Kingdom's relationship with the European Union post-Brexit becomes increasingly clear. This year will mark the official departure of the UK regulatory framework from that of the European Union and the beginning of its journey as a fully separate regime.

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Equity Capital Markets

New Prospectus Regulation Comes into Force Fully

The New Prospectus Regulation (Regulation (EU) No. 2017/1129), which has replaced the Prospectus Directive (Directive 2003/71/EC), was published in the Official Journal on 30 June 2017. It entered into force on 20 July 2017 and applied in full from 21 July 2019.

Summary of key changes

The New Prospectus Regulation seeks to harmonise requirements for the drafting, approval and distribution of a prospectus and reduce the burden on issuers as well as make prospectuses more user-friendly. The key changes introduced by the New Prospectus Regulation that are relevant for equity issuers include:

- New and modified exemptions from the requirement to publish a prospectus in respect of:
  - Fungible securities. A prospectus is not required for an issue of securities representing less than 20% of the same securities already admitted over a 12-month period without a prospectus. This exemption applied from 20 July 2017.
  - Convertible/exchangeable securities. A prospectus is not required for an issue of shares resulting from the conversion or exchange of other securities, provided such shares represent less than 20% of the same class of shares already admitted over a 12-month period. This exemption applied from 20 July 2017.
  - Small offers. The New Prospectus Regulation does not apply to offers of securities to the public with a total consideration in the European Union (EU) of less than €1 million (compared to €100,000 under the Prospectus Directive) calculated over a 12-month period. This exemption applied from 21 July 2018.
  - Higher threshold for voluntary exemptions. Member states have the option to exempt offers where the total consideration of each offer in the EU is less than €8 million (compared to €5 million under the Prospectus Directive) over a 12-month period. This exemption applied from 21 July 2018. Essentially, each member state can set its own figure between a range of €1 million and €8 million in respect of which a prospectus will not be required. On 2 December 2019, the European Securities Markets Authority (ESMA) published a document listing the various public offer thresholds that individual member states have chosen to adopt. The threshold adopted by the United Kingdom (UK) is €8 million.
  - Takeovers. There is no longer a requirement for the publication of an "equivalent" document in order for securities offered in connection with a takeover or a merger to be exempt from the requirement to publish a prospectus. However, an issuer must publish an "exempted document" that contains prescribed information describing the transaction and its impact on the issuer, which, based on ESMA's technical advice, is very similar to that required for a prospectus. An "exempted document" is not a prospectus (therefore it cannot be passported and the prospectus liability regime will not apply to it). It also does not require approval by a national competent authority (NCA).
  - Employee share schemes. Fewer offers of shares to EU employees will now need a prospectus as the employee exemption no longer differentiates between employer companies established in or outside the EU (as it did under the Prospectus Directive). Therefore, an "equivalence" decision relating to securities admitted to a third country market is no longer required.
- Summaries. Summaries must now be written in a mandatory Q&A format. Their length is limited to seven A4 pages in total and the number of risk factors included in the summary should not exceed 15.
- Risk factors. Risk factors must be specific to the issuer; generic, disclaimer-like risk factors should not be included. They must be presented in order of materiality and in categories (typically no more than 10).
- Profit estimates and forecasts. Profit estimates and forecasts in prospectuses no longer have to be accompanied by a public accountants' report.
- Incorporation by reference. Information that may be incorporated by reference into a prospectus has been extended to include documents previously or simultaneously published with the prospectus such as corporate governance statements and regulated information under the Transparency Directive (Directive 2013/50/EU) and the Market Abuse Regulation (Regulation (EU) No. 596/2014). The electronic format of a prospectus must contain hyperlinks to all such documents which must be available on a website with the prospectus.
- Publication. All prospectuses must now be published in electronic form and will be deemed to be "published" when made available on the website of the (i) issuer, (ii) financial intermediary placing or selling the securities or (iii) regulated market where admission to trading is being sought.
- Supplements. Where securities are purchased or subscribed through a financial intermediary, that financial intermediary now has an obligation to inform investors of the possibility that a supplementary prospectus may be published and a new requirement to contact investors on the day when such a supplementary prospectus is published.

- Universal registration document. The concept of "shelf registration" has been established with the introduction of a universal registration document (URD). URDs will set out all relevant information on the issuer and its business. After a URD has been approved by a NCA for two consecutive financial years, subsequent URDs can then be filed without prior approval. Following acceptance by a NCA of a URD, the approval time of prospectuses prepared by such issuer will be shortened from 10 to five working days. In certain circumstances, issuers will be able to fulfil some of their ongoing disclosure obligations under the Transparency Directive by integrating their annual and half-yearly financial reports into a URD.
- Reduced disclosure regime for secondary offerings. A new simplified disclosure regime replaced the regime under the Prospectus Directive. The new regime requires reduced information to be included in a prospectus for a secondary equity offering where the issuer has had securities admitted to trading on a regulated market or an SME growth market (which would include AIM) for at least 18 months. Unlike the regime under the Prospectus Directive, the secondary issue does not need to be made on a pre-emptive basis to benefit from this regime.
- Advertisements. The definition of "advertisement" has been broadened to cover any "communication" (as opposed to any "announcement" under the Prospectus Directive).

New regulatory framework of primary legislation, delegated regulations and guidance

The New Prospectus Regulation applies to all prospectuses approved on or after 21 July 2019. Prospectuses approved in accordance with the national laws transposing the Prospectus Directive before 21 July 2019 will continue to be governed by that national law until the end of their validity (i.e., 12 months after the New Prospectus Regulation fully came into force, 21 July 2020).

The table below sets out the legal framework which underpins the New Prospectus Regulation both at an EU and UK level. Market participants should ensure that all prospectuses are now prepared in accordance with these new regulations, guidance and rules.

Level 1 **Regulation**	• New Prospectus Regulation
Level 2 **Delegated Regulations**	• Delegated Regulation (EU) 2019/979 setting the regulatory standards on the key financial information to be included in a summary; publication and classification of prospectuses; advertisements and supplements • Delegated Regulation (EU) 2019/980 on the format, content, scrutiny and approval of the prospectus. The Annexes to this delegated regulation contain the detailed disclosure items that must be included in a prospectus for different types of issuer and issuances • Delegated Regulation on the minimum information contents of an exempt document relating to a takeover or merger (to be finalised and published in the Official Journal)
Level 3 **ESMA Guidance**	• Q&As on the New Prospectus Regulation • Q&As on the Prospectus Directive[1] • Guidelines on Risk Factors • Draft Guidelines on Disclosure Requirements • ESMA's update of the CESR Recommendations[1] • Technical Advice on Minimum Information Content for Prospectus Exemption • Guidelines on Alternative Performance Measures • List of national thresholds
Financial Conduct Authority Rules and Guidance	• FCA Prospectus Regulation Rules Sourcebook • FCA Knowledge Base

Brexit

Assuming the UK leaves the EU with a Withdrawal Agreement in place between the EU and the UK, the New Prospectus Regulation will continue to apply in the UK until the end of the transition period prescribed by the agreement. In such circumstances, it will still be possible to passport a UK-approved prospectus into an EU member state (or vice versa) until the end of the transition period. In a "no deal" scenario, the UK prospectus regime existing on the date of withdrawal, which will include the New Prospectus Regulation and the Prospectus Regulation Rules Sourcebook of the Financial Conduct Authority (the FCA), is expected to continue broadly unchanged. At present, there does not appear to be an intention to amend the prospectus regime immediately post-Brexit. However, in a "no deal" scenario, it will not be possible to passport a prospectus from the UK into an EU member state (or vice versa) from the date of withdrawal.

[1]These continue to apply to the extent they are compatible with the new regime.

Below is a summary of some of the new guidance from ESMA and key updates to the rules of the FCA and UK legislation that were introduced in 2019 following the New Prospectus Regulation coming into force fully on 21 July 2019 and replacing the Prospectus Directive.

ESMA Publishes Q&As on the New Prospectus Regulation

In 2019, ESMA published three versions of Q&As on the New Prospectus Regulation. These Q&As were published in a new document in order to separate them from the Q&As published in relation to the Prospectus Directive (which continue to apply to the extent compatible with the new regime). The purpose of these Q&As is to promote common supervisory approaches and practices in the application of prospectus supervision and help market participants by providing guidance as to how NCAs will interpret the New Prospectus Regulation.

On 27 March 2019, ESMA published the **first version** of its Q&As on the New Prospectus Regulation. These included ESMA's views on the following topics:

Grandfathering provisions

- Advertisements (Q&A 1.1). Advertisements do not fall within the scope of the grandfathering provisions in Article 46(3) of the New Prospectus Regulation. Therefore, for any advertisement published after 21 July 2019 (when the New Prospectus Regulation came into force fully), the rules in the New Prospectus Regulation will apply even if the advertisement relates to securities that are subject to a prospectus approved pursuant to the national laws implementing the Prospectus Directive.
- Registration documents (Q&A 1.2). A registration document approved or filed under the Prospectus Directive may not be used as a constituent part of a prospectus approved under the New Prospectus Regulation, although information from such registration document may be incorporated by reference so long as it complies with the relevant disclosure requirements in the New Prospectus Regulation.

  Registration documents approved or filed in accordance with the national laws implementing the Prospectus Directive may not be supplemented following entry into force of the New Prospectus Regulation. This is due to the fact that registration documents do not fall within the scope of the grandfathering provisions in Article 46(3) of the New Prospectus Regulation. However, if a registration document is incorporated by reference into a prospectus that is approved under the New Prospectus Regulation, the entire prospectus may be supplemented, including the information from the registration document.
- Passporting (Q&A 1.3). A prospectus approved under the national laws implementing the Prospectus Directive may be notified to a NCA in a host member state following entry into force of the New Prospectus Regulation. Such notification will need to be made in accordance with the national laws of the member state which approved the prospectus.
- Supplements (Q 1.4). Any prospectuses approved in accordance with the national laws of the issuer's home member state implementing the Prospectus Directive will need to be supplemented in accordance with those national laws following the entry into force of the New Prospectus Regulation.
- Final terms (Q 1.5). The final terms relating to a base prospectus approved under the national law of a member state implementing the Prospectus Directive must be filed pursuant to those national laws, and the content of the final terms and the specific summary attached to those final terms must comply with those laws.

Status of previous "Level 3" guidance

- "Level 3" guidance relating to the Prospectus Directive (Q&A 2.1). ESMA's Q&As relating to prospectuses and ESMA's update of the CESR Recommendations should be applied to prospectuses drawn up under the New Prospectus Regulation to the extent they are compatible with the New Prospectus Regulation.

Updating information in registration documents and URDs

- Registration documents (Q&A 3.1). The information in a registration document should be updated via a supplement pursuant to the New Prospectus Regulation if it is not a constituent part of a prospectus. The supplement must then be submitted for approval by the NCA that approved the registration document. Under the New Prospectus Regulation, the right to withdraw acceptances does not apply when a registration document is supplemented.
- URDs (before becoming part of a prospectus) (Q&A 3.2).
  - The information in a URD may only be updated via an amendment in the period before the URD forms a constituent part of a prospectus. The amendment must be filed with the NCA that approved the URD or where it was filed.
  - Where an issuer has filed a URD without prior approval and wants the URD (and any amendments) to form part of a prospectus, the entire documentation (including amendments) is subject to approval and must be approved before the prospectus can be passported.

  - Where a URD has already been approved, any amendments filed since the approval of the URD will need to be approved before the URD (and the amendments) can be used as a constituent part of the prospectus and must be approved before the prospectus can be passported.
  - Where a URD has been approved and passported but is not yet a constituent part of a prospectus, any amendments to the URD must be separately approved before a prospectus with the document as a constituent part can be approved by the NCA of another EU member state.
- Registration documents and URDs (after becoming part of a prospectus) (Q&A 3.3). After a registration document or URD has become a constituent part of a prospectus, the information in the registration document or URD must be updated via a supplement. The prospectuses of which the registration document or URD is a constituent part must also be supplemented. Both the supplement to the registration document or URD and the supplement to the prospectus should be published in a single document. Where the supplement updates several prospectuses, the supplement should clearly identify all prospectuses to which it relates. Investors have the right to withdraw acceptances under the New Prospectus Regulation when a prospectus of which a registration document or URD is a constituent part is supplemented.

On 12 July 2019, ESMA published the **second version** of its Q&As ahead of the New Prospectus Regulation coming fully into force. The three new Q&As introduced in this version related to:

- Grandfathering of offers (Q&A 1.6). An offer may continue after the end of the validity of a base prospectus approved under the national laws implementing the Prospectus Directive by using a base prospectus approved under the New Prospectus Regulation.
- Supplements and financial intermediaries (Q&As 8.3 and 8.4). Issuers that are financial intermediaries should also comply with the obligations addressed to financial intermediaries in Article 23(3) of the New Prospectus Regulation when distributing securities that they issue themselves.

ESMA noted that 22 Q&As that were originally published in relation to the Prospectus Directive had been carried over to the new Q&As document and updated for the New Prospectus Regulation and further noted 28 Q&As which would not be carried over.

On 4 December 2019, ESMA published the **third version** of its Q&As on the New Prospectus Regulation. This version included two new Q&As relating to:

- Inclusion of pro forma summaries in base prospectuses (Q&A 13.2). ESMA's view is that it is not possible to include a pro forma summary in a base prospectus. The intention of Article 8(8) of the New Prospectus Regulation was to clarify that it is not possible to include a summary in a base prospectus unless the final terms are included in the base prospectus or supplement and the issue-specific summary is annexed thereto.
- Application of prospectus disclosure annexes where securities do not fall neatly within a specific disclosure regime (Q&A 14.6). ESMA's view is that, generally, the annexes which apply to existing securities should be applied to the prospectus for comparable securities. However, issuers and NCAs should consider whether it is necessary to include additional information in the prospectus to satisfy the "necessary information test" in Articles 6(1) and 14(2) of the New Prospectus Regulation. ESMA advises that issuers should contact the NCA in their home member state when they are uncertain which annexes should be applied.

ESMA is continuing its review of existing Q&As published in relation to the Prospectus Directive. It is also developing new Q&As to address issues which have emerged since the introduction of the New Prospectus Regulation.

ESMA noted it will continue to publish existing Q&As relating to the Prospectus Directive until 21 July 2020 (the period in which prospectuses approved under the Prospectus Directive are still valid). After this period, those Q&As will no longer apply.

Sources: ESMA Q&As on the Prospectus Regulation – Version 1 (27 March 2019), Version 2 (12 July 2019) and Version 3 (4 December 2019) (ESMA/2019/ESMA31-62-1258).

ESMA Consults on Disclosure Guidelines

On 12 July 2019, ESMA launched a consultation and published draft guidelines on disclosure requirements under the New Prospectus Regulation (Draft Disclosure Guidelines).

The purpose of these guidelines is to ensure that market participants have a uniform understanding of the relevant disclosure requirements and to assist NCAs when they assess the completeness, comprehensibility and consistency of information in prospectuses drawn up under the New Prospectus Regulation. ESMA advises NCAs to incorporate the guidelines into their national legal or supervisory frameworks and ensure through their supervision that financial market participants comply with them.

The Draft Disclosure Guidelines cover topics including historical financial information, interim financial information, profit forecasts and estimates, working capital statements, capitalisation and indebtedness. ESMA has also introduced new guidelines and additional content.

The content of the Draft Disclosure Guidelines generally follows the content of the CESR Recommendations. The CESR Recommendations were originally adopted in 2005 by CESR (the predecessor to ESMA) and were last updated in 2013. Given the entry into force of the New Prospectus Regulation, ESMA is taking the opportunity to review and update the CESR Recommendations and convert some of the recommendations into guidelines, which would mean that they are subject to a "comply or explain" requirement.

The CESR Recommendations relating to selected financial information (paragraphs 20-26) have not been converted into guidelines because selected financial information is not required under the New Prospectus Regulation. Further, the CESR Recommendations relating to specialist issuers are not, for the present, being converted into guidelines, although ESMA noted that it is considering how to approach this topic and plans to address these recommendations in the future. ESMA has not rescinded the CESR Recommendations, so issuers and their advisers can continue to apply the recommendations relating to specialist issuers.

The consultation on the Draft Disclosure Guidelines closed on 4 October 2019. ESMA expects to publish a final report containing a summary of all consultation responses and a final version of the guidelines in the second quarter of 2020.

Source: ESMA consultation paper on draft guidelines on disclosure requirements under Prospectus Regulation (12 July 2019).

ESMA Publishes Risk Factor Guidelines

Under Article 16(4) of the New Prospectus Regulation, ESMA was mandated to develop guidelines to assist NCAs in their review of risk factor disclosure for compliance with the new provisions regarding risk factors set out in Article 16 (Risk Factor Guidelines).

ESMA published a consultation paper on 13 July 2018 seeking views on its draft Risk Factor Guidelines and then on 29 March 2019 published its final report. The final Risk Factor Guidelines were published by ESMA on 1 October 2019 and applied from 4 December 2019.

Below is a summary of ESMA's key guidance:

- Specificity. The disclosure regarding a risk factor must establish a clear and direct link between the risk and the issuer or the securities being offered and / or admitted to trading. Generic risk factors which only serve as disclaimers should not be included.
- Materiality. It is not expected that a description of every single risk that is specific to an issuer or the securities being offered and / or admitted to trading be included. Any such risk factor included in the prospectus must also be "material" for an investor to make an informed investment decision. Materiality is to be assessed based on the probability of a risk's occurrence and the expected magnitude of its negative impact. Article 16(1) of the New Prospectus Regulation provides that this assessment may (but is not required to) be disclosed by using a qualitative scale of low, medium or high.
- Definition of materiality. Article 16 of the New Prospectus Regulation does not define "materiality" in the context of risk factor disclosure, nor did ESMA include a definition in its Risk Factor Guidelines. Instead ESMA referred to paragraph 2.11 of the International Financial Reporting Standards (IFRS) Conceptual Framework to draw an analogous definition of "material information" being information that, if omitted or misstated in a prospectus, could negatively influence investment decisions made by investors based on such prospectus.
- Negative impact. Where available, ESMA encourages the inclusion of quantitative disclosure in order to demonstrate the potential negative impact of a risk factor. Where quantitative information is not available, qualitative information that demonstrates how and to what extent the issuer is or the securities are affected by such risk should be included.
- Mitigating language. Where mitigating language is included in risk factor disclosure, it can only be used to illustrate the risk factor's probability of occurrence and the expected magnitude of its negative impact. Such language should not be used as a general disclaimer which reduces the investor's perception of the materiality of the risk to which the issuer is exposed and leaves the remaining risk unclear.
- Corroboration. In order for a risk factor to be included in the prospectus, the information contained elsewhere in the prospectus should corroborate that the risk factor is indeed material and specific either to the issuer or the securities. For example, the disclosure in the business section of the prospectus should corroborate the risks described in the risk factors section as relating to the issuer's business.
- Categorisation. Article 16(1) of the New Prospectus Regulation requires that risk factors be presented in a limited number of categories depending on their nature. Risk factors should be categorised with the use of headings and spacing. ESMA proposes that any more than 10 categories would likely exceed the requirement in Article 16(1), although this should be assessed on a case-by-case basis depending on the nature of the risks and the issuer.

ESMA suggests the following categories:

- Relating to the issuer: risks relating to the issuer's financial situation; risks related to the issuer's business activities and industry; legal and regulatory risks; internal control risks and environmental, social and governance risks.
- Relating to the securities: risks related to the nature of the securities and risks relating to the offer to the public and / or admission of the securities to trading on a regulated market.

The most material risk factors should be described first in each category. Categories should only be further divided into sub-categories in cases where sub-categorisation can be justified on the basis of the particular type of prospectus.

- Concise disclosure. The disclosure of each risk factor must be presented in a concise form.

Although it is existing market practice in the UK to present risk factors broadly according to their materiality, issuers will understandably be wary of the potential for increased liability resulting from the order of risk factors having been formalised in Article 16. Careful consideration will need to be given by directors of issuers, together with their key business managers, in formulating the categories and order in which risk factors are presented.

Source: ESMA Guidelines on Risk Factors (1 October 2019).

ESMA Publishes Final Technical Advice on Minimum Content Requirements for Exempted Documents

The New Prospectus Regulation provides that issuers may offer or admit securities connected with a takeover, merger or division without publishing a prospectus, provided that a document is made available to investors describing the transaction and its impact on the issuer (an Exempted Document) and that the minimum content requirements of such document are to be set out in a delegated regulation. Consequently, on 28 February 2017 the European Commission requested that ESMA provide technical advice on the minimum information content for such documents.

On 13 July 2018, ESMA published a consultation paper on its draft technical advice on the minimum information requirements for Exempted Documents. The consultation closed on 5 October 2018 and on 29 March 2019 ESMA published its final report. In its report, ESMA noted that it received only five responses to the consultation and that none of these represented the interests and views of investors or provided specific evidence to address ESMA's concerns regarding investor protection. In particular, ESMA is concerned that these exemptions could lead to issuers using a takeover to effect a backdoor listing. As such, ESMA made limited changes to its draft technical advice and therefore the amount of information that must be included in an Exempted Document is very similar to that required for a prospectus.

Subject to its endorsement, ESMA's technical advice will form the basis for the delegated act to be adopted by the European Commission. There is no deadline prescribed by the New Prospectus Regulation pursuant to which any such delegated regulation must be adopted.

ESMA Publishes Final Report on Draft Regulatory Technical Standards Under the Prospectus RTS Regulation

On 4 December 2019, ESMA published its final report on the draft regulatory technical standards amending Delegated Regulation (EU) 2019/979 (the Prospectus RTS Regulation) containing regulatory technical standards under the New Prospectus Regulation.

The Prospectus RTS Regulation sets out key financial information content requirements for the summary of a prospectus, the data for classification of prospectuses and the practical arrangements to ensure that such data is machine readable, provisions concerning advertisements and situations where a supplement to a prospectus is required as well as the technical arrangements for the functioning of the notification portal to be established by ESMA. The draft regulatory technical standards in ESMA's final report propose minor amendments to the Prospectus RTS Regulation in respect of certain errors identified in the delegated regulation. ESMA will submit this report to the European Commission.

Source: ESMA final report on the draft RTS amending Delegated Regulation (EU) 2019/979 containing regulatory technical standards under the Prospectus Regulation.

AFME Updates Equity Selling Restrictions

On 26 July 2019, the Association for Financial Markets in Europe (AFME) published an updated version of its model equity selling restrictions, which have been revised to reflect the full entry into force of the New Prospectus Regulation.

The new version of the equity selling restriction for the European Economic Area (the EEA) is in substantially the same form as the model restriction published by AFME in April 2016, but has been updated to refer to the New Prospectus Regulation instead of the Prospective Directive, and to reflect the fact that the New Prospectus Regulation is directly applicable in member states without the need for implementing measures at the national level.

The updated model selling restrictions comprise:

- an EEA equity selling restriction (with separate versions for use in transaction contracts (e.g., underwriting agreements) and prospectuses); and
- a selling restriction addressing additional UK securities laws (for use in transaction contracts).

The model equity selling restriction wording for use following Brexit (with or without a deal) which AFME published on 26 March 2019 in readiness for the UK's initially anticipated exit date of 29 March 2019 continues to be available on its website which AFME has said it will update, if necessary, at the appropriate time.

Source: AFME website.

FCA Publishes New Prospectus Regulation Rules

On 15 July 2019, the FCA published the final Prospectus Regulation Rules Instrument 2019 (the Instrument), which provided for the revocation of the Prospectus Rules from the FCA's Handbook and its replacement with the Prospectus Regulation Rules Sourcebook (the Prospectus Regulation Rules). The Instrument came into force on 21 July 2019.

The key changes to the Prospectus Regulation Rules include updating references to the New Prospectus Regulation and other relevant EU legislation. Issuers and their advisers should update references to the new Prospectus Regulation Rules where required – for example, referencing the right exemptions when applying for admission to the Official List.

Source: Prospectus Regulation Rules Instrument 2019.

Key UK Legislative Updates Relating to the New Prospectus Regulation

The Financial Services and Markets Act 2000 (Prospectus) Regulations 2019 (the FSMA Regulations) came into force on 21 July 2019 to make amendments to the Financial Services and Markets Act 2000, in particular to Part VI (Official Listing), section 391 (publication of notices) and Schedule 11A (Transferable securities), in order to implement the provisions of the New Prospectus Regulation.

The FSMA Regulations also make consequential amendments to the following legislation:

- Financial Services Act 2012
- Data Protection Act 2018
- Financial Services and Markets Act 2000 (Financial Promotion) Order 2005
- Financial Services and Markets Act 2000 (Qualified EU Provisions) Order 2013

Source: Financial Services and Markets Act 2000 (Prospectus) Regulations 2019.

Shareholder Rights Directive II: New Related Party Transaction Rules

Background

Directive (EU) 2017/828 amending the Shareholder Rights Directive (2007/36/EC) (SRD II) is one of a series of initiatives launched by the European Commission to promote better shareholder engagement and improve transparency in the ownership of companies. It follows the European Commission's analysis of shortcomings in corporate governance, particularly with respect to short-termism and insufficient engagement by shareholders on key issues during the financial crisis.

SRD II requires asset owners and asset managers to make disclosures about their long-term investment strategies, their arrangements with each other and their engagement with the companies they invest in. The new rules seek to improve transparency by enhancing the flow of information across the institutional investment community, and by promoting common stewardship objectives between institutional investors and asset managers.

SRD II came into force on 9 June 2017 and member states of the EU were required to transpose the provisions into national law by 10 June 2019.

The FCA's new related party transaction rules

On 30 January 2019, the FCA published a consultation paper on changes to the FCA's Handbook to implement, amongst other things, the requirements of SRD II in respect of related party transactions. The consultation closed on 27 March 2019 and the FCA's new rules, which are located in the Disclosure Guidance and Transparency Rules (the DTRs), specifically DTR 1B.1 and DTR 7.3, came into force on 10 June 2019 and apply to financial years beginning on or after that date.

To whom do the new rules apply?

DTR 7.3 applies to UK-incorporated companies which have securities admitted to trading on a regulated market in the EEA (this includes those with a premium or standard listing of securities); it does not apply to companies traded on AIM. SRD II provides that companies with an EU-registered office and voting shares trading on an EU-regulated market must be subject to the material related party transaction rules of the jurisdiction where their registered office is located.

Non-EU incorporated issuers with securities trading on a regulated market in the EEA are not within the scope of SRD II. However, the FCA's Listing Rules extend some of the provisions of DTR 7.3 to certain non-EEA issuers listed on the London Stock Exchange's Main Market including:

- issuers incorporated overseas with premium or standard listed shares admitted to the Official List; and
- sovereign-controlled commercial companies incorporated overseas with premium listed global depositary receipts (GDRs) admitted to the Official List.

In each case, to the extent such issuer is not already required to comply with related party transaction rules imposed by another EEA state that correspond with DTR 7.3 (known as Rest-of-the-World issuers or RoW issuers). The Listing Rules do not extend the application of DTR 7.3 to non-UK incorporated open-ended investment companies and issuers of GDRs with a standard listing.

The FCA's extension of DTR 7.3 to RoW issuers is based on the principles that the UK listing requirements should apply to any issuer in a given listing category regardless of its country of incorporation and that all issuers within a particular listing category should generally be required to comply with the same requirements. The requirements, therefore, that apply to standard listed companies go beyond the minimum standards in SRD II for non-EEA incorporated companies.

Definition of "related party"

The definition of "related party" under DTR 7.3 follows the definition in SRD II, which is the same as that which applies to issuers who prepare their accounts under the International Financial Reporting Standards as adopted by the European Union (EU IFRS), specifically the definition in IAS 24. As a consequence, if the definition of "related party" changes in EU IFRS, then the scope of transactions subject to DTR 7.3 changes accordingly. RoW issuers who do not report in EU IFRS will be permitted to use the definition of "related party" set out in the equivalent accounting standards to which they are subject. The FCA's aim in this relaxation for RoW issuers was to avoid the need for such companies to have reporting systems that enable them to identify related parties under two different standards.

Crucially, the definition of "related party" under DTR 7.3 is wider than the definition in Chapter 11 of the FCA's Listing Rules (LR 11), which means there are a small number of instances in which the requirements under LR 11 would not cover the requirements under DTR 7.3. One example of this is that the IAS 24 definition of "related party" includes subsidiaries and subsidiary undertakings whereas the definition in LR 11 does not. Whilst there is a carve-out in DTR 7.3.5R(1) which disapplies approval and announcement requirements (discussed in more detail below) in relation to transactions with a wholly-owned or partly-owned subsidiary

undertaking so long as no other related party has an interest in it, where an issuer enters into a material related party transaction with a wholly-owned or partly-owned subsidiary undertaking in which another related party does have an interest, this transaction would be subject to the approval and announcement requirements under DTR 7.3, but would not be caught under LR 11.

In instances where DTR 7.3 applies but LR 11 does not, premium listed issuers will need to comply with DTR 7.3 independently and therefore need to re-examine their internal controls to ensure they are in a position to comply with, and identify transactions subject to, both regimes.

Transactions subject to the DTR 7.3 regime

Under DTR 7.3.3R, a "related party transaction" means:

- Transaction between an issuer and a related party. A transaction (other than in the ordinary course of business and on normal market terms) between an issuer (or its subsidiary undertaking) and a related party.
- Transaction benefiting a related party. Any other similar arrangement or transaction (other than in the ordinary course of business and on normal market terms) between an issuer (or its subsidiary undertaking) and any other person (i.e., the related party does not need to be a party to such transaction or arrangement), the purpose and effect of which is to benefit a related party.
- Financing arrangements. An arrangement (other than in the ordinary course of business and on normal market terms) pursuant to which an issuer (or its subsidiary undertaking) and a related party each invests in, or provides finance to, another undertaking or asset.

The variation or novation of an existing agreement between an issuer and a related party (whether or not the party was a related party at the time of the original agreement) will also be subject to the DTR 7.3 regime.

The definition of related party transaction under DTR 7.3.3R is nearly identical to the definition in LR 11.1.5R other than in respect of the exception for transactions which are "in the ordinary course of business and concluded on normal market terms". Issuers must therefore have in place procedures to establish whether a transaction is in the ordinary course and has not been concluded on normal market terms. The related party (and any person who is an associate, director or employee of the related party) must not take part in this assessment.

Material related party transactions under the DTR 7.3 regime

A "material" related party transaction will trigger certain approval and disclosure requirements if any of the class tests set out in Annex 1 to DTR 7 is 5% or more. The class tests relate to gross assets, profits, consideration and gross capital and are very similar (but not identical) to the class tests that apply for the purposes of Chapter 10 and 11 under the Listing Rules.

These additional requirements for "material" related party transactions include:

- Board approval. An issuer must obtain board approval for the transaction or arrangement before it is entered into. Any director who is (or an associate of whom is) the related party, or who is a director of the related party, must not take part in the board's consideration of the transaction or arrangement and must not vote on the relevant board resolution. This board approval requirement does not apply to RoW issuers.
- Announcement. An issuer must announce certain information via a regulatory information service announcement by no later than the time the terms of the transaction or arrangement are agreed.

Certain transactions are specifically excluded from the above approval and disclosure requirements, namely:

- Intragroup related party transactions. Transactions or arrangements between an issuer and its subsidiary undertaking provided that (i) the subsidiary undertaking is wholly-owned or (ii) no other related party of the issuer has an interest in the subsidiary undertaking.
- Directors' remuneration. Certain transactions or arrangements regarding remuneration of the issuer's directors where these have been disclosed and approved in accordance with the UK Companies Act 2006 (the Companies Act). Clearly, RoW issuers are not subject to UK domestic company law requirements and they will therefore need to consider separately whether they are required to comply with the disclosure requirements of DTR 7.3 in relation to directors' remuneration.
- Shareholder transactions. Transactions offered to all shareholders of the issuer on the same terms where equal treatment of all shareholders and protection of the interests of the issuer are ensured.

If after obtaining board approval or announcement of the transaction, but prior to completion, there is a material change to the terms of the transaction or arrangement, the issuer must comply again separately with the disclosure and (where applicable) approval requirements. The FCA has indicated it would generally consider, amongst other things, an increase of 10% or more in the consideration payable to be a material change to the terms of the transaction.

Aggregation under the DTR 7.3 regime

DTR 7.3 requires issuers to aggregate transactions or arrangements entered into with the same related party (and any of its associates) during any 12-month period. Where any percentage ratio is 5% or more for the aggregated transactions or arrangements, the issuer must comply with the approval and disclosure requirements of DTR 7.3 in respect of each aggregated transaction or arrangement.

This differs from the approach under LR 11, which requires issuers to only comply with the approval requirements (or, in the case of smaller related party transactions, the requirement to obtain a fair and reasonable confirmation) in respect of the transaction that results in the thresholds being crossed but not in respect of the other transactions included in the aggregation. Clearly, this will be a challenge for issuers to comply with the approval (which needs to have been obtained before the transaction or arrangement is entered into) and announcement (which needs to have been made no later than when the terms of the transaction or arrangement are agreed) requirements of DTR 7.3 in respect of previously completed transactions included in the aggregation. The hope is that the FCA will be pragmatic when considering such transactions.

RoW issuers

As discussed above, whilst SRD II does not apply to RoW issuers, the regime under DTR 7.3 has been extended by the Listing Rules to RoW issuers whose shares are admitted to a regulated market in the UK. Therefore, listed companies that are not EEA-incorporated that are not subject to a similar overseas regime will not be exempted from the requirements under DTR 7.3. However, they are subject to a modified regime in the following material respects:

- RoW issuers will be permitted to use a definition of "related party" from an IFRS-equivalent accounting standard that they use to prepare their annual accounts.
- RoW issuers are not required to obtain board approval of material related party transactions.
- RoW issuers will not benefit from the exemption relating to the Companies Act compliant directors' remuneration transactions as they are not subject to the Act. In practice for RoW issuers, remuneration paid to directors may be disclosable if the director is a related party (as defined under the accounting standard that they use to prepare their annual accounts) and the transaction is not in the ordinary course of business and on normal market terms. In this case, the RoW issuer must assess the materiality of the transaction and disclose it where the 5% threshold is met (including if it is met on aggregation).

Interplay between LR 11 and DTR 7.3 and next steps

- Premium listed issuers should continue to comply with the LR 11 regime in the usual way.
- Where a premium listed issuer has complied with the requirements of LR 11 for shareholder approval of a transaction, it will be treated as having satisfied the disclosure and approval requirements of DTR 7.3.
- Where a premium listed issuer has complied with the LR 11 requirements relating to smaller related party transactions, it will be treated as having satisfied the disclosure (but not the approval) requirements of DTR 7.3.
- EEA-incorporated issuers and certain RoW issuers with a standard listing of shares (not GDRs) that are not subject to LR 11 will have to comply with DTR 7.3.
- All issuers will need to consider what changes may be required to their internal systems and controls in order to comply with these requirements.

Issuers that are within the scope of the DTR 7.3 regime must comply with the requirements from the start of their first financial year beginning on or after 10 June 2019. The aggregation requirements apply to transactions entered into from the start of the first financial year on or after 10 June 2019.

Sources: FCA Consultation Paper: Consultation on proposals to improve shareholder engagement (CP19/7); FCA's Policy Statement: Improving shareholder engagement and increasing transparency around stewardship (PS19/13), FCA Handbook.

ESMA publishes updated guide to notifications of major shareholdings

On 31 July 2019, ESMA published an updated version of its Practical Guide to the national rules on notifications of major holdings under the Transparency Directive.

The Transparency Directive requires investors to notify issuers when they acquire or dispose of shares admitted to trading on regulated markets resulting in their total voting rights crossing certain set thresholds. As a minimum harmonisation directive, the Transparency Directive allows members of the EEA some discretion as to how they transpose the rules into national law. ESMA's Practical Guide has been prepared to assist shareholders in complying with the different requirements across the EEA on a country-by-country basis: it summarises the main rules and practices applicable across the EEA and presents key data including information on notification thresholds, the triggering event and the deadline for learning of the triggering event and for making a notification.

Sources: ESMA's Practical Guide – National rules on notifications of major holdings under the Transparency Directive (ESMA 31-67-535) (31 July 2019).

Launch of Shanghai-London Stock Connect

On 17 June 2019, the UK Government announced the launch of the Shanghai-London Stock Connect; a two-way arrangement between the Shanghai Stock Exchange (SSE) and the London Stock Exchange (LSE) pursuant to which:

- Eligible companies listed on the LSE will be able to issue Chinese Depository Receipts (CDRs) to Chinese investors and apply for them to be listed on the Main Board of the SSE. In the initial stages of the Stock Connect scheme, these companies may issue CDRs representing **existing shares only**.
- Eligible companies listed on the SSE will be able to issue GDRs to UK and international investors and apply for them to be listed on the LSE's Main Market. These companies may issue GDRs representing **both existing and newly issued shares.**

The Shanghai-London Stock Connect scheme will not require any direct trading infrastructure links. Instead, it will allow companies to dual-list on both the SSE and LSE and trade depositary receipts on the counter-party's stock market in accordance with the corresponding exchange's laws and regulations.

One benefit for eligible companies listed on the SSE will be that they are now able to (i) issue GDRs representing both existing and newly issued shares on the LSE and (ii) keep the capital raised abroad and use it directly for foreign investment. However, eligible companies listed on the LSE cannot use this scheme as a tool to raise new capital in China's domestic market; only existing (not newly) issued shares can be used as underlying shares to issue CDRs.

The Shanghai-London Stock Connect scheme is significant because it is the first time that:

- A foreign company will be able to list in mainland China.
- A company listed on the SSE can raise capital abroad through instruments fungible with its domestic shares.
- Chinese investors will be able to access international stocks from within China without being subject to domestic capital controls.
- International investors will be able to access China A-shares from outside Greater China and through international trading and settlement practices.

On the day of launch of the Shanghai-London Stock Connect scheme, Huatai Securities Co. Ltd., a company listed on both the SSE and the Hong Kong Stock Exchange, became the first company to list GDRs on the LSE through the scheme raising US$1.54 billion. On 1 October 2019, China Pacific Insurance became the second Chinese company to list GDRs on the LSE under the scheme.

The FCA and the China Securities Regulatory Commission have issued a joint announcement confirming their approval of the scheme and published a Memorandum of Understanding which provides the basis for the regulatory co-operation that underpins the scheme.

Currently, there are only five Chinese companies listed on the Main Market of the LSE. However, of the nearly 1,500 companies listed on the SSE, over 260 are potentially eligible to take part in the scheme and list on the LSE. With only two listings since launch, it remains to be seen how much this mechanism will be used, particularly by Chinese companies, to access a new pool of investors in London including in light of recent reports in the media that the mechanism has been suspended for political reasons.

Sources: UK Government press release: UK-China EFD sees launch of London-Shanghai Stock Connect (17 June 2019); LSE press release: Shanghai-London Stock Connect Welcomes its First Issuer: Huatai Securities (17 June 2019).

Of the nearly 1,500 companies listed on the SSE, over 260 are potentially eligible to take part in the scheme and list on the LSE.

Below is an account of key developments that took place over the course of 2019 relating to the Market Abuse Regulation (MAR).

ESMA Consultation Paper on MAR

ESMA published a consultation paper on MAR (the MAR Consultation Paper) on 3 October 2019. The MAR Consultation Paper considered and requested market participants' views on topics including:

- Definition of inside information. The MAR Consultation Paper considered whether the definition of inside information under MAR is sufficiently effective and whether the definition could be improved with respect to (i) commodity derivatives, (ii) front-running conduct (i.e., where a broker is aware of a forthcoming client order or transaction and uses that information to acquire or dispose of a financial instrument ahead of the relevant order or transaction) and (iii) pre-hedging activities.
- Delayed disclosure of inside information. The MAR Consultation Paper requested views on whether the conditions for the delay of disclosure are sufficiently clear to issuers for them to effectively rely on them in order to delay disclosure.
- Market soundings. The MAR Consultation Paper considered reformulating the market sounding safe harbour provisions in MAR to clarify that they are of an obligatory rather than optional nature. It also considered establishing administrative sanctions for failure to comply with the market sounding procedures prescribed under MAR and Delegated Regulation 2016/960, irrespective of any further sanctions which may apply to conduct constituting market abuse or unlawful disclosure of inside information. Moreover, the MAR Consultation Paper proposed limiting the definition of "market sounding" to exclude certain types of transactions and simplifying the procedures more generally.
- Insider lists. The MAR Consultation Paper considered possible changes to ensure that only insiders who actually access inside information are included on insider lists.
- Persons discharging managerial responsibility (PDMRs). The MAR Consultation Paper contemplated increasing the minimum reporting threshold for PDMRs on an EU-wide basis. It also invited views on whether the prohibition on PDMRs dealing during a 30 day close period before announcement of an interim financial or year-end report is working optimally and whether it should be extended to also include issuers and closely associated persons.

The consultation closed on 29 November 2019. ESMA intends to submit its final report to the European Commission by spring 2020.

Sources: ESMA Consultation Paper (ESMA70-156-1459): MAR Review Report.

ESMA Publishes New Q&As on MAR

On 29 March 2019, ESMA updated its Q&As regarding the implementation of MAR to include two new Q&As on collective investment undertakings (CIUs) and two on emissions allowances market participants (EAMPs). In relation to CIUs, ESMA provided its view on whether a CIU without legal personality is obliged to disclose inside information under Article 17 of MAR (Q&A 5.6), and if there any specific cases of inside information that may arise for CIUs admitted to trading or traded on a trading venue (Q&A 5.7). ESMA also considered whether EAMPs are obliged to disclose inside information on emission allowances where such information relates to installations of other undertakings of the EAMP's group (Q&A 11.3) and provided its views on the meaning of "parent" and "related undertakings" for the purposes of Article 17(2) of MAR (Q&A 11.2).

Source: ESMA Q&A on the Market Abuse Regulation – Version 14 (29 March 2019) (ESMA70-145-111).

ESMA's Annual Report on Accepted Market Practices

On 16 January 2019, ESMA published its annual report on the application of accepted market practices (AMPs) under MAR and on 13 December 2019 it published its second annual report. AMPs, which are established by NCAs and notified to ESMA, offer a defence against allegations of market manipulation. Dealings which are carried out under an established AMP will not constitute market manipulation.

The reports provide ESMA's views and recommendations to NCAs on the establishment and application of AMPs in the EU. ESMA noted that there are few AMPs established under MAR and AMPs remain a matter of interest for a small number of countries – at present the only type of AMP established pursuant to MAR concerns liquidity contracts. In its first report, ESMA encouraged any outstanding AMPs which were established under the old EU Market Abuse Directive to be withdrawn and replaced with AMPs established under MAR in order to ensure consistency with the MAR framework. In its most recent report, ESMA noted that one NCA is still applying an AMP established under the old EU Market Abuse Directive and reminded all members of the need to update their AMPs.

Source: ESMA reports to the Commission on the application of AMPs (16 January 2019 and 13 December 2019).

FCA Observations on MAR Compliance

On 13 February 2019, the FCA published a speech given by its Director of Market Oversight, Julia Hoggett, on improving compliance with MAR in the UK. Director Hoggett's speech noted the FCA's desire for a regime that proactively protects the market from suspicious behaviour occurring, rather than merely reactively detecting such behaviour after it has occurred. Director Hoggett highlighted the FCA's concerns regarding firms' systems (i) to identify market abuse risk, (ii) to ensure employees within institutions understand their responsibilities and (iii) to control inside information. She noted that the access controls and surveillance capabilities currently in place across investment banking and advisory platforms are not as evolved as they should be and encouraged proactive and frequent reviews of access permissions around inside information. She emphasised that controls must continue to evolve in the future alongside the evolution of markets and risk.

Source: Speech by Julia Hoggett, Director of Market Oversight at the FCA: Market abuse requires a dynamic response to a changing risk profile.

The FCA and the LSE published a number of regulatory updates through the course of 2019. In the summary that follows we have sought to highlight some of the key guidance from the period. We have omitted coverage of Brexit-related updates published in anticipation of the two proposed exit dates in 2019 given the nature of the UK's withdrawal from the EU has not yet been finalised.[2]

FCA's Primary Market Bulletins

The FCA published seven Primary Market Bulletins (Nos. 20 to 26) in 2019. These periodic newsletters provide general news and information to primary market participants, including an overview of changes made, or proposed to be made, to the FCA's Knowledge Base. The FCA's preparation for Brexit was a particular area of focus throughout 2019 (see Primary Market Bulletin Nos. 20, 21, 22 and 24, in particular), while the implementation of the New Prospectus Regulation was also a key topic (see Primary Market Bulletin Nos. 20, 23 24 and 26, in particular).

Highlights from Primary Market Bulletin No. 20

Use of the name "UK Listing Authority"

The FCA is gradually phasing out the name "UK Listing Authority" or "UKLA" to describe its activities as regulator of issuers of securities. Instead, it will refer to the FCA's "primary market" functions. Documents do not need to be revised specifically to remove these references. However, when templates and other documents are updated in the usual course, the terms "UKLA" and "UK Listing Authority" should be phased out.

Insufficient distributable reserves for paying dividends

Over the last few years, the FCA has noted a number of resolutions put to shareholders seeking to rectify instances where dividends have been paid contrary to UK company law. In such cases, interim accounts demonstrating sufficient distributable reserves have not been filed in a timely manner with Companies House. Upon identifying this oversight, issuers have tried to put the company, its shareholders, directors and former directors in the position they would otherwise have been in had the interim accounts been filed, including seeking shareholder approval to release any liabilities that may attach to the shareholders and any directors or former directors.

Given that significant shareholders, directors and, in some instances, former directors are classified as related parties under Chapter 11 of the FCA's Listing Rules, the FCA reminded premium listed companies that they must consider the application of such rules in this context and highlighted that issuers should ensure the relevant Companies House filings are made properly and promptly in the first instance so that consideration of Chapter 11 is not necessary.

Highlights from Primary Market Bulletin No. 23

Recent supervisory review of new regulatory requirements for firms managing securities offerings

In 2018, the FCA introduced new regulatory requirements for firms managing securities offerings designed to ensure that the UK's primary capital markets effectively serve issuers and investors, including MiFID II rules governing the provision of underwriting and placing services and domestic reforms on the availability of information in the UK initial public offering process.

The FCA undertook a review of how the industry is applying these new requirements. The FCA's review identified shortcomings by several firms in the adoption of the MiFID II requirements on informing and engaging with the issuer regarding risk management transactions and justifying allocation decisions. When managing a securities offering, the FCA's expectation is that firms should, at a minimum, explain to an issuer client whether, and in what circumstances, they will undertake risk management transactions and how those could impact an issuer client's interests. In addition, the FCA highlighted that firms should make judgements about whether the records they maintain can genuinely justify allocation decisions.

The FCA also reminded firms to carefully consider their obligations to manage conflicts of interest where research analysts play a role in providing internally-facing due diligence advisory services within the firm, prior to underwriting and placing mandates being awarded.

Highlights from Primary Market Bulletin No. 24

European single electronic format requirements

For accounting years beginning on or after 1 January 2020, issuers are required to prepare their annual financial report in a new electronic reporting format and in accordance with certain regulatory technical standards. The FCA is consulting on a new rule in the DTRs to implement these European single electronic format requirements under the Transparency Directive. See the discussions of FCA Quarterly Consultation Nos. 25 and 26 below for more information.

Updates following the New Prospectus Regulation coming into force

The FCA acknowledged that the materials in its Knowledge Base are still based on UK national law implementing the old Prospectus Directive. It is preparing to update such materials, but notes that in the meantime the current materials should be used to the extent that they are compatible with the New Prospectus Regulation. Refer to Primary Market Bulletin No. 26 and see the discussion on "Changes to the FCA Knowledge Base" below for details of the first stage of updates.

[2] For a discussion of the FCA's preparations for Brexit, see Davis Polk's Client Memorandum "Preparing for Brexit – The FCA Publishes Important Updates for Listed Companies" (15 October 2019).

Money laundering risks facing capital markets

In June 2019, the FCA published a thematic review (TR19/4) to understand the money laundering risks and vulnerabilities in the capital markets. The FCA noted that some participants were in the early stages of thinking about these risks and some needed to do more to assess the money laundering risks they face. The report also demonstrated a need for firms acting as nominated advisers, corporate advisers to firms on the NEX Exchange or sponsors for listings on the LSE's Main Market to better understand their obligations for customer due diligence, and for firms relying on professional advisers, who are also in a position to enable financial crime, to be aware of the risk factors.

Highlights from Primary Market Bulletin No. 25

Consultation on inside information best practices

The FCA consulted on a best practice note which is aimed at industry regulators, government departments and public bodies and provides up-to-date guidance on identifying, controlling and disclosing inside information.

The note recognises that some provisions of MAR apply to industry regulators, government departments and public bodies, and their staff, including the prohibitions on insider dealing and unlawful disclosure of inside information. The note clarifies how MAR applies to these bodies in practice, and provides suggestions on controlling inside information, managing the risk of handling inside information incorrectly and dealing with any leaks. Consultation on the note closed on 15 January 2020.

Sources: FCA Primary Market Bulletins No. 20 (7 February 2019), No. 23 (16 April 2019), No. 24 (3 October 2019), No. 25 (27 November 2019).

Changes to the FCA Knowledge Base

During 2019, five new technical notes and two new procedural notes were added to the FCA's Knowledge Base, sixteen existing technical notes and two existing procedural notes have been amended and one procedural note and three technical notes have been deleted, as set out in more detail below.

New technical and procedural notes

New technical and procedural notes have been added on the following topics:

- Quantified financial benefits statements
- Cash flow statement exemptions
- Schemes of arrangement
- Sponsors' duty regarding directors of listed companies
- Sponsors' obligations on established procedures
- Sponsors' obligations on no adverse impact
- Sponsor service enquiry line

Amended technical notes and procedural notes

Below is a summary of key practice points from the FCA's technical and procedural notes which were amended over the past year.

- Share buy-backs with mix-and-match facilities (FCA/TN/202.2). The FCA clarified that not all buy-back programmes fall within the exemption provided under Article 5 of MAR, so issuers should satisfy the criteria set out in MAR and in Delegated Regulation (EU) 2016/1052 to rely on the exemption when trading in their own shares.
- Compliance with the Listing Principles and Premium Listing Principles (FCA/TN/203.4). The FCA highlighted that it expects issuers to cooperate with their sponsor by providing all information the sponsor reasonably requests to carry out sponsor services in line with LR 8.
- Profit forecasts and estimates (FCA/TN/340.2). The FCA reminded market participants that the analysis of profit forecasts and estimates is fact-intensive and will ultimately be considered on a case-by-case basis.
- Periodic financial information and inside information (FCA/TN/506.2). The FCA clarified that to delay disclosing inside information in line with Article 17 of MAR, an issuer must be able to ensure the confidentiality of the information in question.
- Scope and application of vote holder and issuer notification rules (FCA/TN/541.2). The FCA clarified that, in the absence of a formal decision at the EU level, it continues to be of the view that GDR issuers are not within the scope of DTR 5 unless the relevant issuer's shares are admitted to trading on a regulated market.
- Exemptions from the requirement to prepare a prospectus (FCA/TN/602.2). The FCA noted that it received feedback requesting further guidance about applying this technical note to the inclusion of a "mix-and-match" in a scheme of arrangement context as a separate piece of guidance and is considering such request.
- Sponsors' obligations on financial position and prospects procedures (FCA/TN/708.3). The FCA clarified that the primary responsibility for establishing procedures, systems and controls rests with the directors of the applicant, and explained that a sponsor must maintain an appropriate level of oversight and challenge should a third-party adviser, such as a reporting accountant, be engaged to assess the appropriateness of the applicant's procedures, systems and controls.
- Primary market oversight and listing transactions – decision–making and individual guidance processes (FCA/PN/908.2). The FCA revised this note to reflect the organisational changes within the FCA and new procedures for individual guidance, appeals and complaints.

In addition, the FCA has made minor amendments to the following technical and procedural notes to reflect the New Prospectus Regulation coming into force which do not materially affect the substance of the guidance in the respective notes:

- Circulation and publication of unapproved documents
- Refinancing and reconstructions
- Open-ended investment companies
- Disclosure of 'lock-up' agreements
- Public offers
- Public offers - the six-day rule
- Collective investment undertaking prospectuses - portfolio disclosure
- Zero coupon notes
- Financial information on guarantors in debt prospectuses and requests for omission
- Eligibility process

Deleted technical notes and procedural notes

The FCA has deleted the following technical and procedural notes from its Knowledge Base:

- Incorporation by reference
- Risk factors
- Non-equity prospectuses aimed at retail investors
- UKLA standard comments

The FCA is also consulting on further proposed changes to the Knowledge Base as follows:

- Master-feeder structures (FCA/TN/409.1 – Amendment). The FCA is seeking to clarify that where there is only one fund acting as a "feeder" for a specific master fund, it would not consider this a genuine master-feeder structure for the purposes of LR 15.
- Class testing changes to an investment management agreement where there are unquantifiable benefits (FCA/TN/411.1 – New). The FCA often receives queries about changes to existing investment management agreements and how to classify them where the benefit of the transaction may be unclear and the class tests are difficult to apply. As this is not addressed in other guidance, the FCA is proposing to add a technical note describing its approach to classifying such changes.

The FCA's consultation closed on 14 November 2019.

Sources: FCA Primary Market Bulletins No. 20 (7 February 2019); No. 23 (16 April 2019); No. 24 (3 October 2019); No. 25 (27 November 2019); No. 26 (17 December 2019).

FCA's Market Watch

In 2019, the FCA published four "Market Watch" newsletters (Numbers 59 to 62), which provide information and updates from the FCA on market conduct and transaction reporting issues. The below provides a summary of the main issues addressed in the Market Watch editions published throughout the year. Market Watch Number 61 focused solely on the provision of information to help firms prepare for a possible no-deal Brexit on 31 October 2019, and therefore is not covered below.

Key highlights from Market Watch No. 59

Transaction reporting

The FCA has identified a range of data quality issues in transaction reporting, including firms reporting inaccurate details of the time, price and venue, misreporting buyer and seller identification codes, misusing the aggregate client account and making errors or omissions in instrument reference data.

The FCA highlighted the importance of market participants maintaining adequate procedures, systems and controls to meet their transaction reporting obligations, and promptly notifying the FCA of any errors or omissions identified in such reporting. In addition, the FCA noted that firms must conduct regular reconciliations of front office trading records with data samples provided by the FCA, and should not rely on data samples provided by the firm's approved reporting mechanism for transaction report reconciliations.

Telephone recording

The FCA has found that some firms have not properly ensured that telephone conversations are being recorded. In some recent instances, several months had passed before firms realised that a telephone conversation had not been correctly recorded. The FCA reminded firms of the importance of ensuring they have systems in place to record telephone conversations and are undertaking the appropriate checks to ensure that calls are consistently recorded.

Key highlights from Market Watch No. 60

Insider lists and access to inside information

Following the conviction of a former compliance officer in the London branch of a major investment bank, and a review by the FCA of the systems and controls used by a sample of investment banks, legal advisers and other consultancies to manage access to inside information, the FCA highlighted that when investigating suspected insider dealing, it is crucial that the FCA can establish who had access to inside information at particular points in time. The FCA views an inability to respond to a regulatory request with accurate records of who had access to inside information as an indication of underlying weaknesses in systems, procedures and policies, and it expects firms to take reasonable steps to ensure that the risks of handling inside information are identified and appropriately mitigated.

Key highlights from Market Watch No. 62

Personal account dealing

As part of the FCA's assessment of the extent to which firms have incorporated recent changes in the market abuse regime into the way they do business, the FCA conducted a study on a sample of wholesale broking firms and their personal account dealing (PAD) activity (where employees of an authorised firm trade for themselves rather than for clients), policies, processes, systems and controls. The FCA noted that some firms have not established appropriate PAD rules and processes, and have not adequately identified or managed the PAD risks or conflicts of interest specific to their business model.

The FCA emphasised that firms need to assess how they manage conflicts of interest and the risk of market abuse, and ensure they have the appropriate policies and processes in place for managing PAD by employees. In addition, firms must consider how they can monitor PAD by employees. If any areas of concern are identified, the firm should revise their arrangements.

Sources: FCA Market Watch Nos. 59 (17 April 2019); 60 (1 August 2019); 62 (18 October 2019).

FCA Quarterly Consultations

The FCA consults typically once a quarter on miscellaneous amendments to the FCA Handbook. Three quarterly consultations were published in 2019. Some of the key highlights from those consultations are summarised below.

Key Highlights from Quarterly Consultation No. 24

On 7 June 2019, the FCA published Quarterly Consultation Paper No. 24. The consultation proposals largely focused on modifications to the General Provision (GEN) and fees and levy rate rules (FEES) in relation to Gibraltar-based firms and new notification procedures to changes to the FCA's MiFID supplementary forms. No significant changes were proposed in respect of the FCA's Listing Rules or DTRs. The consultation closed on 7 August 2019.

Key Highlights from Quarterly Consultation No. 25

On 6 September 2019, the FCA published Quarterly Consultation Paper No. 25. The consultation closed on 1 November 2019.

UK Corporate Governance Code

The FCA proposed making various amendments throughout the FCA Handbook to refer to the 2018 edition of the UK Corporate Governance Code.

European Single Electronic Format

The FCA proposed amending the DTRs to implement the European Single Electronic Format (ESEF), including inserting a new rule DTR 4.1.14R (Reporting format) to implement Article 4(7) of the amended Transparency Directive under which issuers would be required to prepare their annual financial reports in a single electronic reporting format in accordance with the European Single Electronic Format Regulatory Technical Standards (ESEF RTS) which came into force on 18 June 2019. This rule would apply to annual financial reports for financial years beginning on or after 1 January 2020.

Brexit

Further Brexit-related changes to the FCA Handbook, which would only come into effect if the UK leaves the EU without an implementation period, include amending DTR 7.3 (Related party transactions) so it only applies to UK-incorporated issuers with voting shares admitted to a UK regulated market from exit day amending DTR 7.3.2R (Definition of related party) so issuers must use the definition of related party in IFRS as adopted by the UK and amending the Listing Rules to remove the exemption for issuers required to comply with requirements imposed by another member state of the EEA corresponding to DTR 7.3.

Key Highlights from Quarterly Consultation No. 26

On 6 December 2019, the FCA published Quarterly Consultation Paper No. 26. The consultation closes on 6 February 2019.

Documents on display

The FCA proposes to amend LR 13, Annex I regarding documents on display that are required for a class 1 transaction to clarify that the sale and purchase agreement (or equivalent document) does not have to be made available online. Instead, a hard copy would need to be available for inspection and the issuer would need to state where it is located. The FCA notes that it did not intend to require the sale and purchase agreement to be available online when updating the rules last July in connection with the New Prospectus Regulation.

Disclosure of rights attached to securities

The FCA's proposals to amend the Listing Rules would require issuers with listed securities to keep publicly available in the National Storage Mechanism (NSM) either the securities' approved prospectus, a document with the securities' terms and conditions or a description of the securities' rights and how to exercise those rights. This information is to be available for the duration of the securities' admission to listing. Where it is already available on the NSM, the issuer would be exempt from the proposed rule.

European Single Electronic Format

In the event of a "no deal" Brexit, the FCA proposes to amend DTR 4.1.14R (Reporting format) proposed in Quarterly Consultation No. 24 to reflect the UK version of the ESEF RTS. The FCA also proposes amendments to onshore the ESEF RTS, which has direct effect in the UK from 1 January 2020.

The taxonomy used in the ESEF RTS is based on the IFRS taxonomy. On 16 December 2019, Commission Delegated Regulation (EU) 2019/2100 was published in the Official Journal to update the ESEF RTS to reflect the annual changes made to the IFRS taxonomy. This regulation entered into force on 5 January 2020 and will apply to annual financial reports containing financial statements for financial years beginning on or after 1 January 2020.

Sources: FCA Quarterly Consultation Paper Nos. 24 (CP19/19) (7 June 2019); 25 (CP19/27) (6 September 2019) and 26 (CP19/33) (6 December 2019).

FCA Handbook Notices

During 2019, the FCA published 11 Handbook Notices (Nos. 62 to 72) setting out details of the changes that the board of the FCA made to the FCA Handbook and other FCA materials throughout 2019.

LSE's AIM Updates

In 2019, the LSE published two "Inside AIM" articles, which provide guidance to the AIM community on technical matters regarding application of the AIM Rules for companies (the AIM Rules), and two AIM notices, setting out amendments made to the AIM Rulebooks. Below is a summary of the key updates from these publications, save that discussion of Brexit-related amendments to the AIM Rulebooks (as set out in AIM Notice 57) has not been included.

Key highlights from Inside AIM

AIM Designated Market Route

Smaller and medium-sized growth companies (SMEs) whose shares have been traded on certain markets for the previous 18 months may be eligible to use the AIM Designated Market route to admission, which streamlines the AIM admission process by dispensing with the requirement to produce an AIM admission document. The AIM Designated Market Route publication was updated in May 2019 to extend the categories of AIM Designated Markets to include EU regulated markets and SME growth markets.

Nominated Advisers

The LSE has provided answers to the following frequently asked questions relating to nominated advisers (nomads):

- Relevant Transactions. In relation to Rule 5 of the AIM Rules for Nomads, the LSE provided examples of alternative transactions that it may consider accepting as constituting a "Relevant Transaction" when exercising its discretion regarding a nomad's eligibility.
- Qualified Executive applications. The LSE provided information as to whether an individual who is a qualified executive (QE) in an existing firm will automatically transfer as a QE if that individual changes firm or joins a firm which is considering applying to become a nomad. The AIM Rules for Nomads were updated with effect from 1 November 2019 to reflect how the LSE applies the rules in respect of a nominated adviser's staffing and working arrangements for QEs.
- Ensuring coverage for nomad obligations. The LSE provided clarification as to its requirements regarding team working arrangements, such as part-time or other flexible working arrangements.
- Compliance. The LSE set out a list of suggested characteristics of a successful compliance function within a nominated adviser firm.
- Maintenance of knowledge and experience. The LSE noted that it believes it is more meaningful for a nomad to engage the experience and expertise within its team when conducting a review of its obligations to the LSE and its understanding of the AIM Rules, rather than commissioning an external review or training.

Key highlights from AIM Notices

Updates following the New Prospectus Regulation fully entering into force

References to the FCA Prospectus Rules included in the AIM Rulebooks (for example, in relation to the required contents of AIM admission documents) have been updated to align with the changes under the New Prospectus Regulation, with effect from 21 July 2019.

Sources: Inside AIM – AIM Designated Market Route (28 May 2019); Inside AIM – Staffing of Nominated Advisers (28 May 2019); AIM Notices 56 (20 June 2019); AIM Notice 57 (29 October 2019).

The FCA and LSE handed down several disciplinary notices during 2019, publicly censuring and fining companies and their directors and persons discharging managerial responsibilities (PDMR) for breaches of the FCA's Listing Principles, the DTRs and the AIM Rules.

Public Censure and Fine by the FCA for Breach of MAR

Breach for failing to comply with MAR's PDMR notification requirements

On 12 December 2019, the FCA issued a Final Notice against Kevin Gorman, a senior employee of the LSE-listed Braemar Shipping Services plc (Braemar), for failing to notify Braemar and the FCA of personal trades he made in his Braemar shares. Mr Gorman was fined £45,000, which was reduced from £64,300 due to his co-operation with the FCA. The decision is the first action brought by the FCA against an individual for failing to comply with the notification requirements under Article 19(1) of MAR for transactions by a PDMR.

Background

Article 19(1) of MAR requires a PDMR and persons closely associated with them to notify the issuer and the FCA of any transactions conducted on their own account in the issuer's shares, debt instruments, derivatives or other linked financial instruments promptly and, in any event, no later than three business days after the transactions if the total amount of transactions per calendar year has reached €5,000. Whether a person is a PDMR depends (in broad terms) on their status within the company, access to inside information and the power to take managerial decisions.

As Managing Director of Braemar's Logistics Division, Braemar considered Mr Gorman to be a PDMR and he was notified of this position on 22 July 2016. Mr Gorman was provided with Braemar's policies and memoranda on the responsibilities and obligations of a PDMR and he confirmed that he had read and understood these materials. However, between 31 August 2016 and 24 January 2017, he made three separate disposals of shares without providing Braemar or the FCA with the relevant notifications required under MAR. As a result, Braemar was not in a position to announce the necessary PDMR notifications to the market. He also failed to comply with Braemar's internal share dealing policy that required him to seek approval prior to dealing in the shares, so Braemar was not given the opportunity to approve or reject Mr Gorman's personal account dealing. The aggregate consideration for the three disposals was £71,235.28.

The FCA agreed with Braemar's assessment that Mr Gorman was a PDMR. In doing so, the FCA has provided useful insight into what it would expect an issuer to consider when compiling a list of PDMRs. The FCA noted two key points:

- Although Mr Gorman was not on Braemar's board, he was part of the executive committee, which comprised five members, including the CEO of Braemar and the individuals who directly reported to the CEO within the senior management group.
- Mr Gorman received group management accounts on a monthly basis and confidential information was discussed at the executive committee, which meant he had or was likely to have regular access to inside information.

Please refer to our client memorandum entitled "Who is a PDMR under MAR? The FCA provides some insight" dated 13 January 2020 for a more detailed discussion.

The lesson

In determining whether someone is considered a PDMR, it is clearly a relevant factor that such person sits on an executive committee, and an issuer should ensure that it considers whether members of any such committee are PDMRs. In making that assessment, it will be necessary to consider the committee's size and composition, the nature of the matters discussed and information shared at meetings, and the role played by that individual on the committee. However, that does not mean it is a prerequisite that an individual needs to sit on an executive committee to be a PDMR. The question remains one of the substance of the person's role and the information such person receives. If an individual who does not sit on an executive committee nevertheless makes material managerial decisions and has access to unpublished financial data and board packs, it may be necessary to designate such person a PDMR.

Source: FCA Final Notice (12 December 2019).

Public Censure and Fine for Breach of the FCA's Listing Principles and DTRs

Breaches for serious failings in procedures, systems and controls

On 3 June 2019, the FCA imposed a fine of £411,000 on Cathay International Holdings Limited (Cathay) for breach of the FCA's Listing Principles and DTRs. In addition, the FCA held Cathay's Chief Executive Officer and Finance Director accountable for their involvement in the breaches and imposed fines of £214,300 and £40,200 on the senior officers, respectively.

Background

Cathay is premium listed and operates through a number of subsidiaries. During 2015, between 70% and 80% of its revenue derived from its subsidiary Lansen Pharmaceutical Holdings Limited (Lansen).

Cathay's financial performance deteriorated over the course of 2015 and, as a result, Cathay announced on 29 December 2015 that it expected a material loss before tax for the 2015 financial year due to higher than expected operating expenses and a significant financial penalty imposed on a subsidiary of Lansen. This was markedly below market expectations and Cathay's share price suffered an 18.2% fall on the day of announcement.

In the FCA's view, there were serious failings in the procedures, systems and controls within the company, which meant that Cathay had not monitored the full impact of these issues on its expected financial performance for the 2015 financial year as compared to market expectations.

The FCA considered that Cathay:

- recklessly failed to take reasonable steps to establish adequate procedures, systems and controls to enable it to comply with its obligations. For example, there was a lack of clear and

documented procedure for considering financial results from group subsidiaries and for making ongoing comparisons of actual performance versus market expectations (breach of Listing Principle 1);

- recklessly failed to disclose to the market, as soon as possible, the material change in its actual and expected performance for the 2015 financial year, given that Cathay had become aware of the material deviation from market expectations of its after-tax loss on 6 December 2015 but did not release its trading update until 29 December 2015 (breach of DTR 2.2.1R and Premium Listing Principle 6); and
- failed to deal with the FCA in an open and co-operative manner, in that Cathay provided information to the FCA regarding forecasting procedures that was materially different to the actual procedures followed (breach of Listing Principle 2).

The lesson

The FCA's decision serves as a reminder to listed companies and their directors of the importance of establishing robust procedures, systems and controls to ensure that companies are able to meet their regulatory obligations, and of dealing with the FCA in an open and co-operative manner. The decision also serves as a reminder to directors that they may attract personal liability where there is a failure to comply with the FCA's rules.

Sources: FCA Decision Notice (3 June 2019); FCA Final Notice (25 July 2019).

Public Censures and Fines for Breaches of the LSE's AIM Rules

Breaches relating to inadequate corporate governance under the leadership of an overly dominant chair

On 30 May 2019, the LSE announced the public censure of Real Good Food plc (RGF) and a fine of £450,000 (discounted to £300,000 for early settlement) for breaches of AIM Rules 10, 13, 17, 19, 21 and 31.

Background

The LSE's public censure and fine followed findings of multiple and serious breaches of the AIM Rules and a pattern of unacceptable conduct by RGF's former board of directors during the period from 2014 to 2017. The LSE considered that RGF's conduct over this period reflected inadequate corporate governance under the leadership of the former chair and board, which facilitated a culture of poor decision-making with an overly dominant chair and directors who were allowed to go unchallenged.

This conduct included:

- disclosure of misleading or incomplete information in RGF's June 2017 trading update, which overstated the company's expected EBITDA for 2017 and 2018 based on information concerning the status of legal claims and of the company's expansion plan, which information the board either knew was incorrect or had concerns over its reliability. One month after the trading update, RGF released a further update containing materially reduced EBITDA expectations for 2017 and 2018 (breach of AIM Rule 10);
- disclosure failures with respect to multiple related party transactions between RGF and its former chair and certain other members of the former board (breach of AIM Rules 13 and 19);
- dealing by RGF's former chair in a closed period, and a delay in and falsification of the notification of that dealing (breach of AIM Rules 10, 17 and 21); and
- as a result of the above conduct, failures in (i) procedures and controls to comply with the AIM Rules, (ii) its approach to ensuring both collective and individual responsibility of its directors for compliance with the AIM Rules and (iii) providing information to, and seeking advice from, its nomad (breach of AIM Rule 31).

The lesson

It is incumbent on AIM quoted companies to ensure that appropriate corporate governance and financial controls are properly embedded in their culture and are effective in practice. In particular, robust procedures and controls, overseen by independent non-executive directors who can hold management to account, are essential to ensure corporate integrity, considered judgement and accountability.

Breaches relating to incomplete and misleading disclosures in an AIM admission document

Background

On 1 July 2019, the LSE announced the public censure of Telit Communications plc (Telit) and a fine of £350,000 (ultimately waived in the circumstances of the case) for breaches of AIM Rules 3 and 31.

The LSE's public censure and fine related to the disclosure of incomplete and misleading information regarding Telit's former chief executive officer (CEO) in Telit's admission document published in April 2005 and in subsequent disclosures to Telit's nominated advisers.

Telit's admission document failed to disclose, contrary to the disclosure requirements of AIM Rule 3, that the then CEO had previously varied his name and, moreover, had been indicted in the United States under his former name. This information only came to light in Telit's announcement of the CEO's resignation in August 2017 following an independent review.

In addition, Telit had failed to provide successive nomads with information relating to the former CEO. This conduct restricted the nomads' ability to carry out their responsibilities under the AIM Rules and the AIM Rules for Nominated Advisers, contrary to AIM Rule 31.

The LSE highlighted that the standing of an AIM company's directors is important information to be disclosed in an admission document, and is important information upon which a nomad is required to make judgement in respect of suitability under its responsibilities owed to the LSE. In deciding to waive the original fine, the LSE noted Telit's swift action when the matter came to light in August 2017 and the then current board's full co-operation in the investigation of the matters.

The lesson

Whilst the real difficulties in this case lay in the ability of Telit's board and advisers to uncover historical information relating to one of its directors, this decision serves as a reminder to boards that the responsibility for including accurate and complete information in an admission document and to the company's nomad is of paramount importance.

Sources: AIM Disciplinary Notices AD 21 (30 May 2019); AD 22 (1 July 2019).

Corporate Governance

FRC Publishes Revised Stewardship Code

On 24 October 2019, the Financial Reporting Council (the FRC) published a revised Stewardship Code following a consultation published by the FRC in January 2019. The UK Stewardship Code 2020 (the Stewardship Code) took effect on 1 January 2020 and replaces the UK Stewardship Code 2012 (the 2012 Code).

Background to the Stewardship Code and the need for change

The UK Stewardship Code was first introduced in 2010, and sets out how institutional investors should engage with the companies in which they hold investments. Its review forms part of a wider programme by the UK regulators who are examining more closely the role played by stewardship in corporate governance against the backdrop of the Kingman Review, changes to the UK Corporate Governance Code that was published in 2018 and amendments to the EU's Shareholder Rights Directive (SRD II).

It is intended to address the issues raised by Sir John Kingman's independent review, which claimed the 2012 Code was a driver of boilerplate reporting by large investors and, if that could not be changed, recommended that the 2012 Code be abolished.

SRD II, which aims to promote effective stewardship and long-term investment decision-making, covers some of the same ground as the revised Stewardship Code, although the FRC noted in its consultation paper that the revisions to the Stewardship Code are "more demanding" than the requirements of SRD II.

Application

The Stewardship Code comprises a set of 12 "apply and explain" Principles for asset managers and asset owners (e.g., pensions funds and insurance companies), and a separate six "apply and explain" Principles for services providers. Previously there were 10 "comply and explain" principles with supporting provisions, supported by guidance.

The Financial Conduct Authority requires UK-authorised asset managers to publish a statement of commitment to the Stewardship Code or to explain why it is not appropriate to their investment strategy (COBS 2.2.3R, Code of Business Sourcebook. However, the FRC does not formally require institutional investors to report on their compliance with the Stewardship Code, although it encourages them to do so.

Stewardship Report

Under the Stewardship Code, asset owners and asset managers, and the service providers (including proxy advisers and investment consultants) that support them, will be required to produce a single annual Stewardship Report explaining how they have applied the Stewardship Code in the previous 12 months. This report will need to be submitted to the FRC for approval in order for the provider to become a signatory to the Stewardship Code.

Signatories must report annually on their stewardship activity including their engagement with the assets they invest in, their voting records and how they have protected and enhanced the value of their investments for the benefit of their clients, and the outcomes these activities have had. The revised Stewardship Code states that reports should be fair, balanced and understandable, with examples of both successful and unsuccessful outcomes.

All Principles in the Stewardship Code are supported by reporting expectations which signpost the information that organisations should include in their Stewardship Report, and which underpin the assessment of reporting quality. Once approved, the Stewardship Report will become a public document and must be available on the signatory's website or in another publicly accessible form.

Key changes

The key content changes made in the revised Stewardship Code include:

- New definition of "stewardship". Stewardship is defined as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries, which leads to sustainable benefits for the economy, the environment and society.
- Focus of reporting. The focus of the revised Stewardship Code is on activities and outcomes, setting a much higher standard of reporting than under the 2012 Code.
- Extension of application to asset owners and service providers. In order to help align the stewardship approach across the whole investment community, the revised Stewardship Code extends its focus to asset owners and service providers, as well as the asset managers who were the main targets of the 2012 Code. The revised Stewardship Code includes an additional reporting expectation that asset owners and managers disclose the proportion of shares voted in the past year and why.
- Extension beyond UK listed equity. In light of the growth of investment in assets other than listed equity, the revised Stewardship Code requires signatories to explain how they have exercised stewardship across asset classes other than listed equity (e.g., fixed income, private equity and infrastructure) and in investments outside the United Kingdom (UK).
- Environmental, social and governance factors. The revised Stewardship Code makes explicit references to material environmental, social and governance (ESG) issues, and climate change factors, and signatories are expected to take them into account when making investment decisions and fulfilling their stewardship responsibilities. They will also be expected to show how their governance arrangements, resourcing and staff incentives demonstrate their commitment to stewardship.

- Purpose, values and culture. The revised Stewardship Code requires signatories to explain how an organisation's purpose, investment beliefs, values, strategy and culture enable them to practice stewardship. These concepts mirror those in the new UK Corporate Governance Code.

Next steps

The Stewardship Code took effect on 1 January 2020. To be included in the first list of signatories, organisations must submit a final Stewardship Report to the FRC by 31 March 2021. Existing signatories to the 2012 Code will need to submit a Stewardship Report which meets the FRC's reporting expectations under the new Stewardship Code in order to be listed as a signatory to the new code.

Whilst the revised Stewardship Code includes more ambitious provisions, it remains to be seen whether it will prove more effective than its predecessor given that the provisions remain voluntary and a large proportion of the UK stock market is held by overseas investors.

Sources: UK Stewardship Code 2020; FRC Press Release: Revised and strengthened UK Stewardship Code sets new world-leading benchmark (24 October 2019).

ICGN consultation on proposed revisions to Global Stewardship Principles

On 11 October 2019, the International Corporate Governance Network (ICGN) launched a consultation on proposed revisions to its Global Stewardship Principles (the Principles).

The ICGN was established in 1995 as an investor-led organisation whose mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies globally. The current Principles were published in 2016 and represent ICGN's view of the latest best practices in relation to investor stewardship obligations, policies and processes. They have served as a resource to support the development of stewardship codes around the world. The Principles focus on seven core principles which aim to provide an international framework for investors to implement their fiduciary obligations on behalf of clients and beneficiaries.

Key changes proposed in the consultation include:

- Greater emphasis on fiduciary duty, culture and values by institutional investors.
- More focus on systemic risks relevant to institutional investors.
- Capital allocation as a topic for engagement for both creditors and shareholders.
- Protecting voting rights against dual class share and other forms of differential ownerships.
- Greater focus on stewardship outcomes versus inputs in stewardship reporting.
- Use of ESG factors in investment decision-making and stewardship.

The consultation closed on 22 November 2019. ICGN intends to submit a revised draft of the Principles for member approval at the next ICGN annual general meeting on 9 June 2020.

Source: ICGN Member Consultation – Revisions to ICGN Global Stewardship Principles.

ICSA Consults on Independent Board Evaluation

On 29 May 2019, the Chartered Governance Institute (known as ICSA) published a consultation in relation to its review of the effectiveness of independent board evaluation in the UK listed sector. The consultation closed on 5 July 2019. The purpose of the review was to assess the quality of independent board evaluation in the UK listed sector and to identify ways in which it might be improved. The Review was carried out at the request of the UK Department of Business, Energy and Industrial Strategy (BEIS) following its consultation on Insolvency and Corporate Governance.

In particular, the consultation sought views on whether there is a need for:

- A code of practice for the providers of board evaluation services, and formal arrangements for implementing and monitoring such a code.
- Voluntary principles to be applied by listed companies when engaging external reviewers to undertake board evaluations.
- Guidance for listed companies on disclosure of the conduct and outcomes of their board evaluation, in accordance with the UK Corporate Governance Code.

After analysing the responses to the consultation and consulting fully with the Steering Group, ICSA will publish a report containing ICSA's recommendations and guidance. The report will be formally submitted to the BEIS, and it will be for the BEIS to consider whether, and how, to act on the recommendations.

Source: ICSA Consultation: Review of the effectiveness of independent board evaluation in the UK listed sector.

Institutional Shareholder Services (ISS), Glass Lewis and the Investment Association each published updated proxy voting guidelines for 2020. Companies preparing for their annual general meetings (AGMs) in 2020 will need to have regard to these updated guidelines. In particular, issuers should take note of the increased focus on matters related to gender diversity on boards, ESG matters and executive pay structures.

Smaller issuers should also take note that ISS and Glass Lewis will no longer apply certain exceptions that applied to issuers outside the FTSE 350 in previous years.

ISS 2020 Proxy Voting Guidelines

Proxy advisory firm ISS published its 2020 Proxy Voting Guidelines on 19 November 2019. Key changes to the guidelines include:

- Gender diversity on boards. ISS will now generally recommend a vote "against" the chair of a company's nomination committee (or other relevant directors on a case-by-case basis) when there are no female directors on the board. Mitigating factors may be the presence of a female director on the board at the preceding AGM and a firm public commitment to appoint at least one female director to the board within a year.
- Environmental, social and governance risks. Like financial performance, ISS expects that ESG matters will be reflected in remuneration outcomes, and if not, that boards provide adequate explanations for their omission. To this end, ISS considers it to be good market practice for the remuneration committee to disclose how it has accounted for relevant ESG matters when determining remuneration outcomes, including matters such as workplace fatalities and injuries, significant environmental incidents, large or serial fines or sanctions from regulatory bodies and / or significant adverse legal judgements or settlements.
- Chair tenure. ISS will not consider tenure in isolation but rather as one of several key indicators relevant to the re-election of board chairs.
- Board composition at smaller companies. ISS will no longer grant an exception to "smaller" issuers (members of the FTSE Fledgling index, companies quoted on AIM and other companies which are not widely-held) from the requirement that at least 50% of their board members, excluding the chair, should be independent directors. It also eliminates the exception that allowed board members of smaller issuers to sit on the audit committee.
- Pension contributions. New appointments to the executive board should receive a pension arrangement that is in line with the wider workforce. For existing directors, remuneration committees should seek to align pension arrangements with the workforce over time.
- Long-term incentive awards. Any outstanding long-term incentive awards should be pro-rated for time served as an executive (when a director transitions from an executive to a non-executive role).
- Bonus target disclosures. Bonus targets for directors should be disclosed immediately following the reporting year. An issuer seeking to disclose one or more years in arrears would be viewed sceptically, and a compelling explanation would be expected such a departure from market practice.

Glass Lewis 2020 Proxy Voting Guidelines

Independent governance services provider Glass Lewis published its 2020 Proxy Voting Guidelines on 4 November 2019. Key changes to the guidelines include:

- Gender diversity on boards. Glass Lewis will consider recommending voting against the election of any chair of the nomination committee of any FTSE 350 board that has neither met the 33% gender diversity target set out by the Hampton-Alexander Review nor disclosed any cogent explanation or plan to address the issue.
- Board skills. Board skills matrices are now included in the analysis of director election proposals at all companies listed in the FTSE 350 (previously the FTSE 100), excluding externally managed investment trusts. Glass Lewis may also recommend voting against the chair of the nomination committee if a board has not addressed major issues relating to board composition such as the mix of skills and experience of the non-executive element of the board.
- Audit committee meetings. Glass Lewis' guidelines now specifically provide that it will consider recommending against the election of the chair of the audit committee at any FTSE 350 company (excluding investment trusts) where the audit committee has, without explanation, failed to hold a minimum of three meetings during the year under review.
- Smaller premium listed companies. Exceptions for smaller issuers are no longer permitted and Glass Lewis will expect boards at premium listed companies outside the FTSE 350: (i) to be at least 50% independent (previously 33%) and (ii) to hold annual, rather than staggered, director elections. In 2020 (but not beyond), Glass Lewis may accept an explanation coupled with an intention to meet the board independence expectations, in lieu of compliance.
- Salaries and pensions. Executive salary increases and pension contribution levels will generally be expected to reflect those awarded to a company's wider workforce.
- Incentive plan limits. All incentive plans are expected to feature clear and transparent award limits, ideally expressed as a multiple of base salary per employee.

- Post-exit shareholding requirements. Post-employment shareholding requirements are now included among the best practice features generally expected of remuneration policies.
- Threshold vesting under long-term investment plans. Long-term incentive plans should generally not allow for more than 25% of an award to vest for threshold performance.
- Remuneration committee discretion. Remuneration committees are expected to consider exercising downward discretion where a company has suffered an exceptional negative event, even if formulaic targets have been met. For example, an annual bonus pay-out and / or the size of a long-term incentive grant may be expected to be reduced following a significant decline in share price.

Investment Association 2020 Principles of Remuneration

The Investment Association published its 2020 Principles of Remuneration (the Principles) on 1 November 2019, and wrote to the chairs of the remuneration committees of FTSE 350 companies highlighting the key areas of focus for the Investment Association's members for the upcoming AGM season.

With the majority of companies needing to seek fresh remuneration policy approvals at their 2020 AGM, the Investment Association is encouraging all listed companies to have simpler executive pay policies that clearly link pay to the company's long-term success, and is asking that companies focus on the following key areas in particular:

- Simplifying pay structures. Issuers should proactively consider whether alternative performance incentives may better align with an issuer's strategy, as long-term incentive plans may not work effectively for all companies.
- Level of executive remuneration and performance-related pay-outs. Issuers should show restraint in growing the overall size of pay packages. Executive pension contributions should be brought in line with the majority of the workforce as soon as possible.
- Strengthening policies for departing directors. Directors should now hold a proportion of their shares for at least two years once they have left the company to ensure the long-term value of the company is prioritised.
- Broadening *malus* and clawback provisions. *Malus* and clawback provisions should include triggers based on erroneous or misleading data, misconduct, misstatement of accounts, serious reputational damage and corporate failure (which procedures can be used to forfeit or recover executive bonuses).

The updated Principles relating to executive pension contributions follow guidance released by the Investment Association in September 2019, where the Investment Association said that its Institutional Voting Information Service would give companies a "red top" (the highest level of warning) if their existing directors are paid more than 25% of salary as a pension contribution, unless they have set out a credible action plan to bring their contributions in line with the broader workforce by the end of 2022.

Sources: ISS UK and Ireland Proxy Voting Guidelines Benchmark Policy Recommendations (19 November 2019); Glass Lewis 2020 Proxy Paper Guidelines (November 2019); Investment Association Principles of Remuneration (1 November 2019); Investment Association Press Release (27 September 2019).

SRD II and proxy adviser disclosure requirements

On 10 June 2019, the Proxy Advisors (Shareholders' Rights) Regulations 2019 (the Proxy Regulations) came into force in the UK. The Proxy Regulations implement, in part, SRD II with a view to encouraging long-term shareholder engagement.

The Proxy Regulations transpose Article 3j (*transparency of proxy advisers*) of SRD II, which requires proxy advisers to make certain disclosures about how they conduct their business.

Proxy advisers will be required to:

- disclose reference to a code of conduct which they apply, and report on the application of the code
- disclose information on their research capabilities and how they produce their advice and voting recommendations
- identify and disclose any conflicts of interest or business relationships that may influence the preparation of their research

The Proxy Regulations give the FCA responsibility for enforcing these requirements, and the power to sanction breaches through public censure and / or financial penalties.

On 26 June 2019, the FCA published a consultation on changes to the Decision Making and Penalties Manual (DEPP) and the Enforcement Guide (EG) relating to its new responsibilities over proxy advisers under the Proxy Regulations. The consultation closed on 26 July 2019 and the FCA published Policy Statement 19/28 on 25 November 2019 with its final changes to the DEPP and EG.

Source: Proxy Advisors (Shareholders' Rights) Regulations 2019; FCA Policy Statement PS19/28: Proxy Advisers (Shareholders' Rights) Regulations Implementation (DEPP and EG) – Feedback and final rules for CP19/21 (25 November 2019).

ESMA Enforcement Priorities for 2019 Annual Reports

In its annual public statement on European common enforcement priorities, ESMA set out the priorities that European enforcers should consider when examining the 2019 annual financial reports of listed companies. These priorities reflect the changes introduced in recent financial reporting standards and issues identified by NCAs through their enforcement activities in 2019.

Enforcement priorities for IFRS financial statements include:

- Specific issues related to the application of IFRS 16 (Leases), given the need to exercise judgement in its application, particularly with respect to the lease term and discount rate.
- The improvement of the quality, consistency and coherence of information provided under IFRS 9 (Financial Instruments) by credit institutions and IFRS 15 (Revenue from Contracts with Customers) by corporate issuers.
- The application of IAS 12 (Income Taxes) regarding deferred tax assets arising from the carry-forward of unused tax losses.

For non-financial information, priorities include disclosure of environmental and climate change-related matters, key performance indicators, the use of any national, EU or international disclosure frameworks and involvement in supply chains. ESMA also reminded issuers of the importance of providing adequate disclosures for any alternative performance measures modified or included as a result of new accounting standards.

In addition, ESMA highlighted the potential implications on financial reporting of the transition from one interest rate benchmark rate to another and the importance of timely disclosure of its consequences. ESMA further highlighted its expectation that issuers take all necessary steps to comply with the new European Single Reporting Format requirements that will begin to apply to 2020 annual financial statements.

Source: ESMA Public Statement – European common enforcement priorities for 2019 annual financial reports (22 October 2019).

Recent FRC Enforcement Action

FRC Annual Enforcement Review

The FRC published its first Annual Enforcement Review (the Enforcement Review) on 31 July 2019, in which it set out the enforcement action it had taken during 2018/2019, the sanctions it imposed (including the context and use of exclusions and other non-financial sanctions), and the issues identified in enforcement cases and actions taken to address them.

The FRC highlighted the following key findings:

- Significant increase in sanctions. Annual fines by the FRC have nearly trebled from £15.5 million in 2017/18 to £42.9 million in 2018/19 (before settlement discounts).
- Greater use and range of non-financial sanctions. The FRC's use of non-financial sanctions have risen from 11 in 2017/18 to 38 in 2018/19 and extend beyond reprimands (for firms and individuals) and exclusions from accountancy bodies, to also include undertakings by, and conditions imposed on, audit firms.
- Increase in investigations and concluded cases. The FRC opened 15 new investigations into auditors or accountants (compared to 14 and 11 in 2017/18 and 2016/17, respectively) and 13 cases were concluded (compared to nine in both 2017/18 and 2016/17) including two legacy cases.
- Settlement continues to be encouraged. The FRC encourages settlement through staged discounts for fines imposed and recognises exceptional cooperation, such as self-reporting and volunteering information that has not been specifically requested, as additional mitigating factors.
- Key issues resulting in investigations. The FRC flagged that some of the key issues arising in investigations related to a lack of integrity, objectivity and independence of auditors and the level of professional competence and due care exercised by auditors (including failure to obtain sufficient appropriate audit evidence and failure to act with professional scepticism).

With its transition into the Audit, Reporting and Governance Authority and proposed strengthening of the enforcement regime, the FRC's intention is that the Enforcement Review will provide a baseline for measuring future enforcement performance.

Outcome of Investigations

	Closed with no further action	Closed with findings of misconduct and sanctions		Total
		Settlement Agreement	Tribunal	
2016/17	1	7	1	**9**
2017/18	3	5	1	**9**
2018/19	1	8	4	**13**

FRC announces 2020/21 thematic reviews of corporate reports and audits

On 13 December 2019, the FRC announced that it will undertake four thematic reviews of various aspects of corporate reports and audits in 2020/21, including a review of IFRS 16 disclosures following its first year of implementation, cash flows and liquidity disclosures, a further review of IFRS 15 and the effects of the decision to leave the EU on companies' disclosures. The reviews will supplement the FRC's routine monitoring programme. In addition to these topics, the Corporate Reporting Review team will also contribute to a planned FRC-wide project focusing on climate change, by reviewing the relevant disclosures given in companies' annual reports. Issuers should be mindful of the FRC's increased focus on these topics when preparing their corporate and audit reports.

Source: FRC Press Release: FRC announces its thematic reviews of corporate reporting and audit areas of focus for 2020/21 (13 December 2019).

New FRC and ICAEW Guide for Audit Committees on Improving Financial Reporting

In May 2019, the FRC and the Institute of Chartered Accountants in England and Wales (ICAEW) published a new guide aimed at helping the boards and audit committees of smaller listed and AIM quoted companies improve the quality of their financial reporting.

Building on key themes that emerged from the FRC's 2015 discussion paper, "Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies", the guide acknowledges that audit committees of smaller quoted companies often face specific challenges, such as constraints on time and resources within finance departments. As such, the guide provides practical suggestions and questions for audit committees to reflect upon and ask those involved in the financial reporting process, in order to aid understanding around the importance of high-quality financial and non-financial reporting, build and nurture a culture of improvement, use external auditors wisely and ensure there is adequate time and resourcing available for financial reporting.

Source: Financial Reporting Council and Institute of Chartered Accountants in England and Wales (ICAEW) – Smaller listed and AIM quoted companies (13 May 2019).

New Remuneration Reporting Regulations

The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 (the Remuneration Reporting Regulations) came into force on 10 June 2019 and apply to financial years beginning on or after 10 June 2019. The Remuneration Reporting Regulations implement Articles 9a *(right to vote on a company's remuneration policy)* and 9b *(information to be provided in and right to vote on the remuneration report)* of SRD II. SRD II seeks to further encourage long-term shareholder engagement through granting shareholders a right to vote on remuneration policy and the remuneration report, as well as to improve the transparency of remuneration policies and the individual remuneration of directors.

The UK legal framework for approval of and voting on directors' remuneration is largely contained in the Companies Act 2006 (the Companies Act) and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) (the 2008 Regulations). Most of the directors' remuneration reporting requirements introduced by the SRD II already existed under English law.

The Remuneration Reporting Regulations extend the current UK legal framework to bring unquoted traded companies within its scope, and also amended the Companies Act and the 2008 Regulations in the following key respects:

- Directors' remuneration policy. The date and details of the results of a shareholder resolution to approve the directors' remuneration policy must be made available on the company's website as soon as reasonably practicable and kept available for as long as that information is applicable.

  Any remuneration policies approved on or after 10 June 2019 must:

  - explain the decision-making process followed for its determination, review and implementation including measures to avoid or manage conflicts of interest and, where applicable, the role of the remuneration committee or other committees concerned where such information is not found elsewhere in the directors' remuneration report;
  - provide details on vesting periods and any deferral and holding periods in respect of share-based remuneration to directors;
  - indicate the duration of directors' service contracts or arrangements with directors; and
  - contain a description and explanation of all significant revisions to the remuneration policy.

  If a shareholder vote on a proposed remuneration policy is lost, the issuer must bring a new remuneration policy to a shareholder vote at the next accounts meeting or other general meeting.

- Directors' remuneration report. The report must include the split of fixed and variable remuneration awarded to each director, changes to the exercise price and date for the exercise of shares or share options by directors and a comparison of the annual change in directors' remuneration to that of the company's employees and of the company's performance over a five-year period. The report must be kept available for a period of 10 years (and may be longer if it does not contain personal data) from when it is first made available.
- Directors' remuneration payments. Remuneration or loss of office payments to directors that are not consistent with the approved directors' remuneration policy may only be made if an amendment to the policy authorising the company to make the payment has been approved by shareholders.

The Remuneration Reporting Regulations also implement a requirement of the original Shareholder Rights Directive that, solely for the purposes of future reporting of directors' remuneration in the UK, the remuneration of persons carrying out the function of Chief Executive Officer and, if such function exists, Deputy Chief Executive Officer (or whatever title is given to such function) must be reported even if they are not a director on the board. Previously, English law only required the remuneration of the directors on the board to be reported.

Updated guidance

On 14 June 2019, BEIS published an Explanatory Document to assist companies in understanding the new reporting requirements in the Remuneration Reporting Regulations.

Moreover, on 22 July 2019, the GC100 and Investor Group published an updated version of their Directors' Remuneration Reporting Guidance to reflect the Remuneration Reporting Regulations and other regulatory changes.

Next steps

The Remuneration Reporting Regulations came into force on 10 June 2019. Issuers preparing remuneration policies going forward must ensure they comply with the new regulations.

Sources: Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 (SI 2019/970); BEIS Q&A on Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 (14 June 2019); GC100 and Investor Group: Directors' Remuneration Reporting Guidance 2019 (22 July 2019).

> Most of the directors' remuneration reporting requirements introduced by the SRD II already existed under English law.

Gender Diversity on Boards and in Senior Leadership: An Update

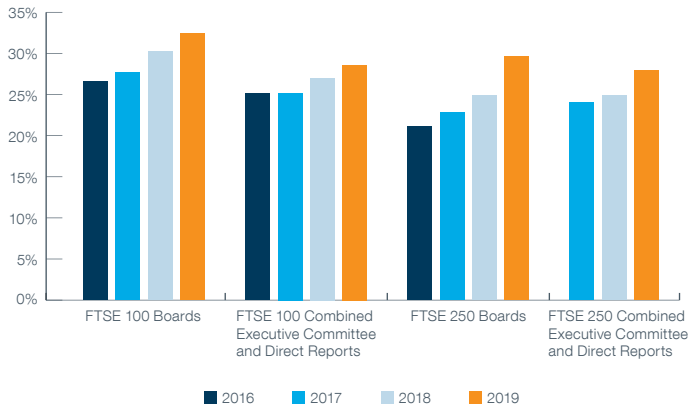
The Hampton-Alexander Review (the Review), which is an independent, business-led initiative supported by the UK Government, has set a target of 33% of all FTSE 350 board positions, executive committees and their direct reports to be filled by women by the end of 2020. In November 2019, the Review, in its fourth and penultimate annual report, highlighted that 2019 was the strongest year of progress for the representation of women on FTSE 350 boards, but noted that change is still needed for women to fill more senior leadership roles.

The Review found that women now hold 32.4% of FTSE 100 board roles and 29.6% of FTSE 250 board roles (up from 30.2% and 24.9%, respectively, in November 2018). If this progress continues, the FTSE 350 will be on track to meet the 33% board representation target by the end of 2020.

Progress has also been made to reduce the number of "One & Done" companies. Following investor pressure and campaigning by the Investment Association and the Review, the number of companies in the FTSE 350 that have only one woman on their board has reduced from 74 in 2018 to 39 in 2019. However, 28 of these companies have had only one woman for the second year running. In addition, there are still two all-male boards within the FTSE 350.

While there was improvement in the representation of women in senior leadership roles in the FTSE 350 in 2019, the Review noted that there are only 25 women in chair roles, 14 women in CEO roles and 74 women in executive director roles. The Review also noted that unless half of all the available senior leadership positions (below board level) are filled by women in the next year, the FTSE 350 will not achieve the target for women in leadership positions by the end of 2020.

Nomination committees of listed companies will need to continue to focus in accordance with their obligations under the UK Corporate Governance Code on ensuring there is a diverse pipeline for succession in order to achieve greater gender diversity at the board level and, in particular, at the senior leadership level and meet the Review targets before the end of 2020.



Sources: Hampton-Alexander Review – FTSE Women Leader Annual Report (13 November 2019); The Investment Association press release – Investors to target pension perks and poor diversity in 2019 AGM season (21 February 2019).

Modern Slavery Act: UK Government Publishes Response to Independent Review

Background

The Modern Slavery Act 2015 (the Modern Slavery Act) was introduced in 2015 to provide a legislative framework to tackle various forms of exploitation such as forced labour, human trafficking, debt-bondage, bonded labour and slavery and require businesses to prepare a statement setting out the steps they take to prevent modern slavery in their business and their global supply chains (the Modern Slavery Statement).

Unfortunately, reporting practices vary considerably across businesses and ultimately compliance with the Modern Slavery Act has been less effective than intended. To this end, analysis reveals:

- unsatisfactory compliance or complete non-compliance with the Modern Slavery Act, with complete non-compliance estimated to comprise 25% of in-scope organisations as of October 2019 (compared to 40% as at the time of the 2018 review); and
- significant disparity in the quality of reporting, ranging from minimal disclosure through to proactive discussion regarding procedures and practices in place, and acknowledging the risks identified within business operations.

Independent review of the Modern Slavery Act

An independent review of the Modern Slavery Act was launched by the Home Office in July 2018 to report on the operation and effectiveness of certain provisions of the Modern Slavery Act and to provide recommendations for improvements.

The First Interim Report was published in December 2018 and focused on the role of the Independent Anti-Slavery Commissioner.

On 22 January 2019, the Home Office published the Second Interim Report and focused largely on the legal application of the Modern Slavery Act and transparency in supply chains. It noted that the impact of the requirement for eligible companies to publish a Modern Slavery Statement has been limited to date, and that the reasons for poor quality statements and lack of compliance stem from the lack of enforcement and penalties, as well as lack of clarity over which companies are in scope. Moreover, the current legislation gives companies a large degree of flexibility to determine the contents, and therefore the quality, of their statements; a company can state that it has taken no steps to eradicate slavery from its supply chain and still be compliant with the legislation.

The Home Office made a number of recommendations in order to address these shortcomings. In light of the Home Office's recommendations, the UK Government published new guidance on 12 March 2019 to assist eligible organisations with preparing their annual Modern Slavery Statement.

On 22 May 2019, the independent review published its Final Report (the Final Report). It included the below definitive list of recommendations for reform to ensure better compliance and to improve the quality of Modern Slavery Statements:

- The UK Government should establish an internal list of companies falling within the scope of the requirement under the Modern Slavery Act to produce a Modern Slavery Statement. Non-inclusion in the list should not be an excuse for non-compliance.
- Companies should not be able to state that they have taken no steps to address modern slavery in their supply chains, as the legislation currently permits.
- The six areas of reporting currently recommended in the guidance published by the UK Government on 12 March 2019 should be made mandatory.
- Modern Slavery Statements should be dated and clearly state over which 12-month period they apply.
- The UK Government should set up a central repository to which companies are required to upload their Modern Slavery Statements and which should be easily accessible to the public, free of charge.
- The Independent Anti-Slavery Commissioner should monitor transparency.
- Sanctions for non-compliance should be strengthened.
- The UK Government should bring forward proposals for an enforcement body to enforce sanctions against non-compliant companies.
- The UK Government should extend the requirements to publish a Modern Slavery Statement to the public sector and strengthen its public procurement processes.
- The Companies Act should be amended to include a requirement for companies to refer to their Modern Slavery Statement in their annual reports, and the Modern Slavery Act should be amended to impose a similar duty on non-listed companies that meet the relevant size threshold but would not be captured by the reporting requirements under the Companies Act.
- Businesses should have a named, designated board member who is personally accountable for the production of the Modern Slavery Statement.
- Failure to fulfil Modern Slavery Act reporting requirements or to act when instances of slavery are found within an organisation should be an offence under the Company Directors Disqualification Act 1986.

UK Government response

In response to the independent review's Final Report on the Modern Slavery Act, the UK Government took the following actions on 9 July 2019:

- It published its response to the Final Report of the independent review of the Modern Slavery Act.
- It published a consultation on proposed measures to strengthen the transparency in supply chain provisions in the Modern Slavery Act. The consultation included proposals on the content of Modern Slavery Statements and how the UK Government can improve enforcement of non-compliance. The consultation closed on 17 September 2019.
- It announced the launch of a Policy and Evidence Centre for Modern Slavery and Human Rights which is to serve as a hub for sharing knowledge, advancing new studies and promoting collaboration with other countries.

On 17 October 2019, the UK Government published the 2019 UK Annual Report on Modern Slavery, which provides an overview of modern slavery in the UK and how the UK has responded to this threat over the past 12 months. The Annual Report provides examples of best practices in tackling modern slavery in supply chains, including training staff and new joiners on identifying and reporting modern slavery, developing technological interventions to eliminate high-risk practices and supporting survivors.

Next steps

We await the UK Government's final response following the consultation which closed on 17 September to understand what changes may be made in order to ensure the Modern Slavery Act is more effective going forward.

Sources: Home Office Guidance: "Publish an annual modern slavery statement" (12 March 2019); Independent Review of the Modern Slavery Act 2015: Final Report (22 May 2019); Policy Paper: Government response to the independent review of the Modern Slavery Act (9 July 2019); Home Office Consultation Paper: "Transparency in Supply Chains Consultation" (9 July 2019); 2019 UK Annual Report on Modern Slavery (17 October 2019).

Takeovers

Changes to the Takeover Code

Asset valuations

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 a target 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 their decision on whether to accept the offer. Rule 29 of the Takeover Code also sets out requirements in respect of the valuer's qualifications, the basis of the valuation and the publication of such opinion.

In Response Statement 2018/1, the Panel confirmed the adoption of the amendments proposed in Public Consultation Paper 2018/1 (with certain modifications), the purpose of which is to provide a more logical framework for Rule 29 of the Takeover Code and reflect the Panel's current practice. For further details regarding the consultation please see the article entitled "Takeover Panel seeks to clarify rules on asset valuations" in our UK Corporation Finance Update (Winter 2019).

Source: Takeover Panel Response Paper 2018/01 (6 March 2019).

United Kingdom's withdrawal from the European Union

In Response Statement 2018/2, the Panel confirmed that it intends to adopt the amendments proposed in Public Consultation Paper 2018/2. These amendments are set out in Instrument 2019/3.

The Takeovers (EU Exit 2019) Regulations

The Takeovers Directive (2004/25/EC) sets out measures for the coordination by member states of the European Economic Area of takeover bids. In the United Kingdom (the UK), Section 943(1) of the Companies Act 2006 (the Companies Act) requires the Panel to make rules giving effect to certain sections of the Takeovers Directive.

On 11 February 2019, the Takeovers (EU Exit) Regulations 2019 were made to address the fact that the Takeovers Directive would not be applied following the UK's withdrawal from the European Union (the EU) (subject to transitional arrangements). Specifically, under the regulations, a new Schedule 1C will be inserted into the Companies Act, which will:

- provide for the application of the principles set out in Article 3.1 of the Takeovers Directive to the UK following Brexit (with minor changes); and
- set out provisions equivalent to Articles 5, 6.1 to 6.3, 7 to 9 and 13 of the Takeovers Directive (but not Article 4.2 on shared jurisdiction).

Currently, the regulations are expected to come into force on 31 December 2020 at 23:00 (London time).

The Panel confirmed in Response Statement 2018/02 that it will amend the Takeover Code to reflect 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 and to make the general principles of the Takeover Code conform to the principles set out in the proposed Schedule 1C.

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 member state of the European Economic Area (EEA) and securities admitted to trading on a regulated market in another 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 target has its registered office would have jurisdiction over matters relating to company law and information to be provided to the target's employees.

In Response Statement 2018/2, the Panel confirmed that it will remove 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 UK and whose securities are admitted to trading on a regulated market in a remaining EEA member state (i.e., not in the UK) and which does not have its place of central management and control in the UK, the Channel Islands or the Isle of Man (the residency test); or
- a remaining EEA member state and whose securities are admitted to trading on a UK regulated market (but not on a regulated market in that EEA member state).

In general, the Takeover Code would apply only to offers for a company that has its registered office in the UK and either:

- its securities are admitted to trading on a UK regulated market or UK multilateral trading facility; or
- it satisfies the residency test (even if its securities are admitted to trading on a regulated market in a remaining EEA member state).

[3] 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).

In terms of shared jurisdiction offers which straddle the date on which the shared jurisdiction regime is removed from the Takeover Code, the Panel noted that, with regards to offers for a shared jurisdiction company to which the Takeover Code applies on a shared jurisdiction basis but to which the Takeover Code will no longer apply following the removal of the shared jurisdiction regime, it will stop regulating such offers from the date of such removal. The Takeover Code will apply in full from the date of removal of the shared jurisdiction regime which are expected to take place on 31 December 2020 at 23:00 (London time) (i.e., an offer for a company with a UK registered office which satisfies the residency test and whose securities are admitted to trading on a regulated market in an EEA member state, but not on a UK regulated market).

Cross-border mergers

The Takeover Code applies to cross-border mergers between UK companies and EEA member state companies undertaken under the Companies Act (Cross-border Mergers) Regulations 2007 (SI 2007/2974), which implemented the Directive on Cross-border Mergers of Limited Liability Companies (2005/56/EC).

On 19 February 2019, the Companies, Limited Liability Partnerships and Partnerships (Amendment etc.) (EU Exit) Regulations 2019 were made. The regulations are currently expected to come into force on 31 December 2020 at 23:00 (London time) and will revoke the Cross-border Mergers Regulations. The Panel has confirmed that it will withdraw its Practice Statement No. 18 (Cross-border Mergers), which explains the Takeover Code's application to cross-border mergers.

Source: Takeover Panel Response Paper 2018/02 (6 March 2019).

Panel Decisions

Default auction process

In 2018, the bidding war between Comcast and Fox for control of Sky proceeded to a Panel-supervised auction process. Comcast won the battle with a superior offer valuing Sky at approximately £30.6 billion. Auctions subject to the Takeover Code are rare and this was the first takeover to proceed to an auction since the introduction of the default auction rules into Appendix 8 of the Takeover Code on 1 January 2015. Notably, the interested parties agreed to an alternative set of rules rather than the default rules, in which bids would be submitted in private to the Panel over a single day and with only three rounds of bidding (for further details please see "Takeover of Sky - Auctions under the Takeover Code" in our UK Corporate Finance Update (Winter 2018)).

Since June 2019, Universities Superannuation Scheme and Macquarie have been engaged in a competitive takeover battle for KCOM Group plc (KCOM), a telecoms company. As was the case for the Sky takeover, it proceeded to an auction. However, the parties agreed to use the Panel's default auction rules as opposed to a separately agreed set of rules, making it the first time that the default auction rules have been used for a UK takeover.

KCOM takeover

On 24 April 2019, Humber Bidco Limited (Humber), a bidding vehicle for Universities Superannuation Scheme, announced a firm intention to make a recommended cash offer for KCOM at £0.97 per share to be implemented by way of a scheme of arrangement. The scheme document for Humber's bid was published on 9 May 2019.

On 3 June 2019, the KCOM board withdrew its recommendation for Humber's bid and MEIF 6 Fibre (MEIF), a bidding vehicle for Macquarie Infrastructure and Real Assets, announced a firm intention to make a recommended cash offer for KCOM at £1.08 per share to similarly be implemented by a scheme. The scheme document for MEIF's bid, published on 18 June 2019, stated that the shareholders' meetings for such bid would take place on 11 July 2019.

On 4 July 2019, the Panel published Panel Statement 2019/11, which stated that the default auction process set out in Appendix 8 of the Takeover Code would be applied for the purposes of Rule 32.5 thereof.

Application of Rule 32.5

Rule 32.5 of the Takeover Code states 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. Specifically, Panel Statement 2019/11 stated that:

- since neither Humber nor MEIF had declared that its offer was final, a competitive situation continued to exist for the purposes of this rule;
- as the parties had agreed no alternative auction process, the default auction procedure would be applied;
- assuming that a competitive situation continued to exist, the auction procedure would commence at 17:00 (London time) on 7 July 2019;
- neither bidder would be permitted to announce or make a revised offer for KCOM on or after 17:00 (London time) on 7 July 2019 save for a revised offer made in accordance with the auction procedure;
- following the end of the auction procedure, neither bidder would be permitted to revise its offer price for KCOM from that established by means of the auction procedure or to introduce any new alternative offer unless, under the Takeover Code, a person (other than Humber or MEIF (or their respective concert parties)) announces a firm intention to make an offer for KCOM; and
- KCOM and the bidders had agreed to the terms of the auction procedure and Panel Statement 2019/11.

One observation on the date of commencement of the auction procedure for competing offers implemented by way of contractual offers, Appendix 8 provides that the default auction process would normally take place on the business day immediately following Day 46 (being the 46th day following publication of the last bidder's offer document). This was the case for the Sky takeover. For the KCOM takeover, as both offers were by way of schemes, under Note 2 of Rule 32.5, the Panel would have had to have been consulted on the timetable. There is no date in a scheme which is directly equivalent to Day 46, as a scheme's timetable (which is agreed with the court) is not subject to the same timetabling requirements as a contractual offer.

Specifically, Panel Statement 2019/11 did not explain why the Panel chose 7 July 2019 as the relevant date (being four days prior to the date on which the KCOM shareholders' meetings relating to MEIF's bid were meant to be held (i.e., 11 July 2019) and 19 days after the scheme document relating to MEIF's bid was published (i.e., 18 June 2019)).

Default auction rules

The default auction rules provide for an open auction (i.e., by public bids in the form of regulatory information service announcements to the market) between two competing bidders. In summary:

- The auction process is spread over a maximum of five days, the first of which (Auction Day 1) is the business day immediately following Day 46 (or its equivalent). 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 announce a revised offer only 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, but if one bidder chooses not to bid on a particular day and the other bidder does bid on that day, the bidding will occur sequentially from then on. 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.

KCOM auction process

Set out below is a summary of the offers made by the bidders during the KCOM auction process:

- On Auction Day 1 (8 July 2019), Humber announced an increased cash offer of £1.085 in cash for each KCOM share (which is higher than MEIF's £1.08 cash offer on 3 June 2019).
- On Auction Day 2 (9 July 2019), MEIF increased its cash offer to £1.095 per KCOM share.
- On Auction Day 3 (10 July 2019), Humber increased its cash offer to £1.10 per KCOM share.
- On Auction Day 4 (11 July 2019), MEIF increased its cash offer to £1.108 per KCOM share.
- On Auction Day 5 (12 July 2019), Humber increased its cash offer to £1.13 per KCOM share and MEIF increased its cash offer to £1.203 per KCOM share.

On 12 July 2019, the Panel announced the conclusion of the KCOM auction process and, unsurprisingly, the KCOM board recommended unanimously that KCOM shareholders vote in favour of the scheme in respect of MEIF's bid in light of it being a superior proposal. On 26 July 2019, the scheme was approved by the requisite majority of KCOM shareholders and on 30 July 2019, the English courts made an order approving the scheme.

Source: Takeover Panel Statement 2019/11 (4 July 2019).

Cold-shouldering

Section 11(b) of the Introduction to the Takeover Code states that if the Panel finds a breach of the Takeover Code, it may publish a Panel statement indicating that the offender is unlikely to comply with the Takeover Code. The consequence of such statement is that members of the Financial Conduct Authority (the FCA) and certain professional bodies would not, in accordance with their respective rules, be able to act for such person in a Code transaction i.e., that person would be "cold-shouldered". This sanction is the most serious disciplinary power available to the Panel and has rarely been used. A list of such instances is set out on the Panel's website.

On 11 October 2019, the Panel published Panel Statement 2019/16, which sets out the Takeover Hearings Committee's ruling on disciplinary proceedings brought against Mr David King (chairperson of Rangers International Football Club plc (Rangers)) for contravention of the Takeover Code. These Takeover Code contraventions stemmed from Mr King's obligation to procure a Rule 9 mandatory offer following the acquisition of Rangers shares by a concert party on and around 31 December 2014. In response to these contraventions, the Panel ruled that Mr King is someone who is not likely to comply with the Takeover Code and should therefore be cold-shouldered for four years.

Panel Statement 2019/16 provides helpful guidance on the factors that the Panel will take into consideration in determining whether a person should be cold-shouldered.

Facts

On 31 December 2014, Mr George Letham, Mr George Taylor and Mr Douglas Park (the Letham Group) acquired interests in shares in Rangers from Laxey Partners Limited. Following this acquisition, and taking into account shares already held by Mr Taylor, the shares held by the three men on 31 December 2014 amounted to approximately 19.7% of the issued shares in Rangers.

On the same day, Mr King instructed Cantor Fitzgerald to acquire Rangers shares from certain shareholders of Rangers. In accordance with these instructions, on 2 January 2015, New Oasis Asset Limited (owned ultimately by Glencoe Investments Trust, a trust established by Mr King for the benefit of himself and members of his family) completed its purchase of Rangers shares. Rangers shares held by Mr King on that date amounted to approximately 14.6% of the issued shares in Rangers.

Emails sent by Mr Letham to Mr King around 31 December 2014 revealed that the Letham Group and Mr King coordinated the above acquisitions. As these acquisitions produced an aggregate holding of around 34.3% of the issued shares in Rangers, this triggered an obligation on Mr King to make a Rule 9 mandatory offer for the remaining shares of Rangers.

Following an investigation by the Panel, as Mr King did not make such Rule 9 offer at the relevant time, the Panel directed Mr King in a number of rulings in 2016 to do so. Mr King, however, did not comply with these rulings. For the first time since the Companies Act put the Panel on a statutory footing, the Panel had

to commence court proceedings to seek a court order to compel him to comply with its rulings. The Panel also had to initiate contempt of court proceedings against Mr King, as he did not carry out the court order by the relevant deadline.

Eventually, on 29 March 2018, an affiliate of Mr King announced its intention to make a mandatory offer for all the shares of Rangers. On 25 January 2019, this affiliate published the relevant offer document. On 15 February 2019, the offer lapsed as the acceptances received fell short of the 50% acceptance condition.

Code contraventions

In Panel Statement 2019/16, the Panel ruled that Mr King had contravened the following Takeover Code provisions:

- Rule 9. Mr King did not comply with his obligation to make a Rule 9 offer until 25 January 2019 (over four years after he became subject to a Rule 9 obligation).
- Rule 24.8. Where a Takeover Code offer is for cash, the offer document must include a confirmation by an appropriate third party (e.g., financial adviser) that resources are available to the bidder sufficient to satisfy full acceptance of the offer. The Panel ruled that Mr King was in breach of this Rule, as there was no cash confirmation in the Rule 9 offer announcement or offer document.
- Section 9(a) of the Introduction to the Takeover Code. A person dealing with the Panel must take all reasonable care not to provide incorrect, incomplete or misleading information to the Panel. The Panel ruled that Mr King provided incorrect and misleading answers to the Panel during the course of its investigations of the circumstances in which he and the Letham Group (as a concert party) procured the purchase of Rangers shares. Specifically, Mr King denied that he had communicated with Mr Letham in terms of co-ordinating their purchases of Rangers shares at the end of 2014, but this was later shown to be untrue by email exchanges between them.
- Section 6(b) of the Introduction to the Takeover Code. Where a person or its advisers are in any doubt as to whether a proposed course of conduct is in accordance with the Takeover Code, that person or its advisers must consult the Panel in advance. The Panel ruled that Mr King should have consulted the Panel on the implications of his acquisition of Ranger shares at the beginning of 2015, particularly since Mr Letham reminded him in an email that he and the Letham Group would have to make a mandatory offer unless their aggregate holdings remained under 30% of Rangers' share capital. Similarly, the Panel ruled that Mr King should have consulted the Panel on the requirements and implications of Rule 24.8 of the Takeover Code.

Cold-shouldering

In considering the cold-shouldering sanction, the Panel noted that it had to determine whether Mr King's misconduct demonstrates a propensity to disregard the Takeover Code and, if so, to weigh that propensity against any undertaking from Mr King to comply in the future. Specifically, the Panel noted that he had such a propensity as he knew of the consequences of his actions under the Takeover Code and yet did not consult the Panel on the implications of his actions. Furthermore, he persistently ignored the Panel's rulings and the Panel had to obtain a court ruling (supported by contempt proceedings) to enforce his compliance.

Finally, the Panel noted that his Takeover Code contraventions, in particular his prolonged refusal to procure a Rule 9 offer and his conduct in dealing with the Panel during its concert party investigations, were offences of the utmost seriousness for which a statement of public censure would not be a sufficient sanction. Whilst Mr King had offered to undertake to comply with the Takeover Code in the future, the Panel did not think that this undertaking would outweigh his propensity to disregard the Takeover Code.

In considering what period the sanction should apply, the Panel considered a number of mitigating factors:

- Mr King had no previous Takeover Code contraventions.
- His investment in Rangers was not motivated by financial gain or commercial advantage. Instead, he had invested huge sums of money in Rangers solely for love of the club.
- It was not clearly established that his failure to procure a Rule 9 offer would have prevented shareholders who would otherwise have taken the opportunity to sell their Rangers shares from doing so. There was no clear evidence of significant detriment to Rangers shareholders.

Bearing the above mitigating factors in mind and balancing them against the seriousness of the Rule 9 contravention and Mr King's refusal to comply with the Panel's rulings until he was compelled by a court order to do so, the Panel ruled that Mr King should be cold-shouldered for a period of four years.

FCA statement on Panel "cold-shouldering" of Mr King

After Panel Statement 2019/16 was published, the FCA issued a statement to remind all regulated firms that, in accordance with MAR 4.3 (Support of the Takeover Panel's Functions), they should not act or continue to act for Mr King in connection with a Takeover Code transaction. In addition, the FCA stated that it expects regulated firms to inform all approved persons at their firms that they should not deal with these individuals on such transactions. The FCA added that a breach of MAR 4.3 may leave a firm and any individuals exposed to enforcement action by the FCA.

Source: Takeover Panel Statement 2019/16 (11 October 2019).

There have been a number of interesting English court decisions on schemes of arrangements over the past 12 months in a public takeover contect. The below discussions highlights some salient points from these decisions.

Matters Relating to a Significant Shareholder

In the matter of *Realm Therapeutics plc [2019] EWHC 2080 (Ch)*, the High Court had to consider whether it was right to convene a single scheme meeting for a scheme of arrangement for Essa Pharma Inc. (Essa) to acquire Realm Therapeutics plc (Realm) and to sanction such scheme in light of certain matters relating to a significant Realm shareholder.

Facts

On 16 May 2019, the Realm board of directors announced the proposed acquisition of Realm by Essa in exchange for consideration shares in Essa by way of a scheme of arrangement.

The scheme circular was published on 29 May 2019. On 28 May 2019, the courts gave permission for Realm to convene a single scheme meeting. This meeting was held on 24 June 2019, and a majority in number representing 75% in value of the Realm members present and voting at such meeting agreed to the scheme.

Bavaria Industries Group AG (Bavaria) (a Realm shareholder) then gave notice of its intention to object at the sanctions hearing for this scheme. Specifically, it contended that there should have been two class meetings for the following reasons:

- BVF's cross-shareholding in Essa. BVF Partners LP (BVF) held both shares in Realm and shares and warrants in Essa.
- BVF being a seller and buyer of Realm shares. Whilst BVF would sell its Realm shares under the scheme, on the day following this announcement, BVF acquired Realm shares from another shareholder, Abingworth BioEquities Master Fund Limited. BVF had also discussed a proposed acquisition of part of Bavaria's stake in Realm; however, this acquisition did not go ahead.
- Special treatment of BVF under the scheme. Under the implementation agreement for the scheme, BVF had the right to enforce a specific provision in this agreement.

Decision

The High Court rejected Bavaria's arguments.

- BVF's cross-shareholding in Essa. The High Court held that the fact that a class member has a cross holding in the purchaser is not a relevant issue for class composition.
- BVF being a seller and buyer of Realm's shares. The High Court held that BVF's acquisition of Abingworth's Realm shares after the transaction announcement did not "fracture the class". In particular, Essa and BVF were distinct from one another (neither was under the control of the other) and there was no evidence suggesting that they were concert parties.
- Special treatment of BVF under the scheme. On the facts, BVF's right under the implementation agreement was not a material difference, which puts BVF into a separate class. Specifically, the purpose of the relevant provision was to confer upon BVF (who under US securities regulations might be regarded as an affiliate by reason of the size of its shareholding) the same dealing rights that the other Realm shareholders would enjoy.

The High Court therefore held that the court was right to give permission for Realm to convene a single scheme meeting and therefore the scheme could be considered for sanction.

Specifically, in determining whether the scheme should be sanctioned, the High Court considered whether the "majority was acting bona fide and was not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent". It held that generally, when addressing issues faced by a class as a whole, a class member is entitled to vote in accordance with its economic interests relating to that issue. However, that class member cannot however vote in accordance with its economic interests in relation to a matter that is not shared by the class as a whole. For example, if BVF voted under the scheme in order to secure further finance for Essa bearing in mind its cross shareholdings, that would not have been using its vote in relation to the issue facing the class as a whole for the purpose for which it was conferred. Looking at the evidence, the court concluded that this was not the case and that BVF had voted in favour of the scheme as it shared the view (recommended by the Realm board) of the longer-term value presented by the transaction.

The High Court also noted that it was not well placed to determine whether the acquisition was a good deal for Realm's shareholders. On the facts, the Realm board and a 78.49% majority by value of Realm's shareholders had approved the transaction. Ultimately, the court's task at the sanction stage is not to ask whether this is the best scheme that could be devised. The question is whether the scheme as presented meets the "fairness" criteria.

Non-compliance with Court's Order on Convening of Court Meeting

In *Re RhythmOne plc [2019] EWHC 967*, the High Court had to consider whether to sanction the scheme of arrangement for Taptica International Ltd to acquire RhythmOne plc (RhythmOne), where RhythmOne had not been compliant with its directions order on convening the court meeting.

Facts

At a directions hearing, the court ordered that a notice convening a court meeting was to be sent by mail to each RhythmOne shareholder at their registered address. Those entitled to attend and vote at the meeting were to be determined by reference to the company's register of members. RhythmOne adopted 18:00 on 22 February 2019 as the applicable record time for such entitlement.

RhythmOne's registrar was Computershare and its uncertificated shares were settled through CREST. Computershare kept a mirror CREST register and a register of certificated shares for RhythmOne. Each day after 18:00, CREST would inform Computershare of changes to the CREST register for Computershare to maintain the mirror CREST register.

On 22 February 2019, Computershare sent a list of RhythmOne's shareholders which were named on the mirror CREST register and the non-CREST register to the printers for them to print and post the scheme circular. However, the list did not include five shareholders who had purchased RhythmOne shares during the trading day but whose purchases had not been notified by CREST to Computershare until after 18:00 on that day.

At the scheme meeting, 87% of shareholders present at the meeting (representing 97.7% of shareholders by value) voted in favour of the scheme.

Decision

In determining whether to sanction the scheme, the High Court had to consider whether there had been sufficient compliance with the court's order as to the convening of the court meeting and whether a valid scheme meeting had been held given that five shareholders had been left out.

The High Court did not think that there had been strict compliance with the court order for convening the meeting. However, it then noted that it had an inherent jurisdiction to give directions as to how to convene a meeting under section 896 of the Companies Act and had the power to waive non-compliance.

On the facts, the court was satisfied that such non-compliance had no serious impact. Specifically, the shares of the five shareholders represented only 0.01% of the issued share capital and, accordingly, their votes would not have altered the outcome of the meeting in mind that the scheme had been approved by 97.7% of shareholders present at the meeting. On that basis, the court decided to waive such non compliance.

The court also noted there was no blot on the scheme since RhythmOne's general meeting had produced valid resolutions enabling the full implementation of the scheme. In particular, the failure to send the notice to all shareholders had been accidental because Computershare had failed to await reconciliation of the CREST register and the mirror CREST register before sending the list to the printers.

Arrangements for Missing Shareholders

In the matter of *Vernalis plc [2018] EWHC 3898 (Ch)*, the High Court had to determine whether to sanction the scheme of arrangement for Ligand Holdings UK Ltd to acquire Vernalis plc (Vernalis), where there was a low turnout at the scheme meetings and a lack of arrangements for missing shareholders to claim their consideration.

Facts

On 2 October 2018, the scheme meeting for this acquisition was held. The turnout for this meeting was only 3.88% in number of Vernalis' shareholders although they represented 85.95% in value of Vernalis. In addition, the notice of the scheme meeting was returned to Vernalis undelivered in respect of 1,636 shareholders (although this only represented 0.016% of the total number of issued Vernalis shares).

Decision

The High Court held that the low turnout did not cause them to conclude that the scheme meeting had not been properly convened or held.

Specifically, the evidence provided by Vernalis indicated that the turnout, although low in number, was in excess of the numbers who attended recent general meetings. In addition, although the number of returned notices was significant, this could be explained, as there were a significant number of scheme shareholders holding very small numbers of shares who have not kept their addresses up-to-date. Vernalis had also advertised the scheme meeting in *The Times* newspaper, even though such advertisement is not required for such scheme, in order to reach more Vernalis shareholders.

In addition, even though the turnout was low, there was no evidence to suggest that the meeting was unrepresentative of Vernalis shareholders as a whole or that there was any unfairness to minority.

The High Court noted that the scheme did not contain any provisions dealing with payment by the purchaser of the scheme consideration not claimed by Vernalis' shareholders, and that such arrangements should have been made regardless of whether the amounts involved are small in monetary terms. Vernalis subsequently proposed to the courts that any unpaid consideration would be placed in the receiving agent's bank account and would be held for the sole purpose of paying those shareholders. The High Court held that on the basis that this arrangement would be a trust for the benefit of such shareholders, it was satisfied that this arrangement would adequately protect the interests of such missing shareholders.

Company and Case Law

Recent Statutory Developments

The key legislative changes to UK company law over the past 12 months largely focus on legislative preparations in anticipation of Brexit. Given the outcome of the general election in late 2019, returning a substantial majority for the government, a hard Brexit is not imminent and so the legislative preparations for such an outcome have not been covered in this update. The below therefore summarises the key non-Brexit related legislative changes in UK company law in 2019.

Cross-border Conversions, Mergers and Divisions

On 18 November 2019, the Council of the EU announced the adoption of a directive amending the Cross-Border Mergers Directive ((EU) 2017/1132) (the New Cross-Border Mergers Directive). The New Cross-Border Mergers Directive introduces comprehensive procedures for cross-border conversions and divisions and additional rules regarding a fast-track process for simple cross-border mergers.

The procedures allow national authorities to block a cross-border operation where it is used for abusive or fraudulent purposes to ensure that cross-border operations are implemented for genuine business reasons. Employees must be adequately informed and consulted regarding the impact of the transaction and creditor protections are enhanced by the ability to require companies to declare that there is no reason that a company cannot meet its liabilities. Shareholders opposing a cross-border operation have the right to exit the company.

Member states will have until 31 January 2023 to implement the New Cross-Border Mergers Directive. Given the intention that Brexit will be completed during 2020, it is unclear whether the New Cross-Border Mergers Directive will be implemented in the United Kingdom (the UK).

Source: Council of the European Union press release: EU makes it easier for companies to restructure within the single market (18 November 2019).

Review of the PSC Register

In October 2019, the UK Department for Business, Energy and Industrial Strategy (BEIS) published a post-implementation review of the Persons with Significant Control (PSC) register. The PSC register, which is a register of beneficial owners of UK companies, was introduced in April 2016 with the objective of enhancing the transparency of company beneficial ownership in the UK to increase confidence in the business environment, facilitate economic growth and aide investigations into corporate crime. The aim of the review was to evaluate the operation of the PSC register and determine whether the regulatory framework around the PSC register has met these intended objectives.

The report concluded that:

- The PSC regulations remain relevant with the PSC regime held out by other jurisdictions as a model to follow.
- There is near total compliance with the PSC regulations with data being used widely by stakeholders.
- Improving the accuracy and integrity of the data is a priority that can only be delivered through changes to the Companies Act 2006.
- It is too early to evaluate the wider economic effects of the PSC regulations and their contribution to the fight against criminal use of companies.

The UK Government does not currently intend to make changes to the PSC regulations. Another review is scheduled to be completed in 2024.

Source: BEIS: Post-Implementation Review of the People with Significant Control Register (30 October 2019).

Electronic Signatures

On 4 September 2019, the Law Commission published a report confirming that electronic signatures can be used to execute legal contracts under English law.

As a matter of law, the Law Commission concluded that:

- An electronic signature can be used to execute an agreement under hand and a deed provided that the person signing the document intends to authenticate it and formalities regarding execution are otherwise satisfied, which may take the form of legislative, contractual or private obligations.
- An electronic signature is admissible in evidence in legal proceedings.
- In applying the common law, the courts will adopt an objective approach in view of the applicable facts and circumstances to determine whether the means of executing a document demonstrates an authenticating intention. Accordingly, electronic equivalents of valid non-electronic signatures are likely to be accepted by a court including signing with an "X", using only initials, printing a name, applying a stamp of a signature or otherwise signing with a mark.
- The requirement that a deed be executed in the presence of a witness requires the physical presence of a witness and would not permit witnessing through electronic means such as a video link.

The Law Commission concluded that additional legislation in respect of the use of electronic signatures is not necessary.

The report also endorsed the best practice adopted by the legal profession in response to the decision in *R (Mercury Tax Group Ltd) v HM Commissioners of Revenue & Customs [2008] EWHC 2721 (Admin).*

Source: Law Commission report: Electronic execution of documents (4 September 2019).

Corporate Transparency and Economic Crime

On 5 May 2019, BEIS launched a consultation on corporate transparency and register reform, which closed on 5 August 2019. The consultation considers reforming the information that companies are required to disclose, increased checks on such information and measures to improve the exchange of information between Companies House and UK law enforcement bodies.

The consultation included the following proposals.

- Information about individuals who have a key role in companies should be verified. Directors, people on the PSC register and persons filing information would be caught by these requirements.
- Companies House should have greater power to query and corroborate information before it is entered on the register. It should be easier to remove inaccurate information from the register.

If the proposals are adopted in full, they would result in the most significant reform of the UK's company registration regime since a register was first introduced in 1844. All of the services provided by Companies House would be modernised and transformed.

On 12 July 2019, the UK Government published its Economic Crime Plan 2019 to 2022, setting out seven priority areas and actions to be addressed.

These areas and actions include:

- Increasing resilience to economic crime by enhancing the management of economic crime risk. There will be a review of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on Payer) Regulations 2017 and the Oversight of Professional Body Anti-Money Laundering and Counter Terrorist Financing Supervision Regulations 2017 and enhancing supervision by the Financial Reporting Council and HM Revenue & Customs.
- Enhancing systems for transparency of ownership of legal entities. Actions will include reforming Companies House and improving transparency of overseas ownership of UK property.

Sources: BEIS: Corporate Transparency and Register Reform – Consultation on options to enhance the role of Companies House and increase the transparency of UK corporate entities (5 May 2019); UK government: Economic Crime Plan 2019-22 (12 July 2019).

Corporate Crime: Bribery Act 2010

In its response on 13 May 2019 to the post-legislative scrutiny of the Bribery Act 2010 by the House of Lords Select Committee, the UK Government clarified its position on a number of important matters. Overall, the responses indicate a continuance rather than change to the current anti-corruption regime.

Primarily, the UK Government has declared no plans on legalising facilitation payments, and it therefore remains a form of bribery. UK exporting companies can expect increased, albeit still relatively limited, support on dealing with issues of corruption abroad with properly trained staff and officials. Whilst the Bribery Act has been confirmed to also apply to SMEs, the prime enforcement focus remains on large, cross-border transactions, particularly tenders in public procurement. The UK Government notably resisted providing further specific examples on either adequate procedures to prevent bribery or acceptable forms of corporate hospitality, and instead encouraged self-evaluation by businesses of their own internal processes, while engaging qualified legal and compliance professionals.

Source: Ministry of Justice: Government response to the House of Lords Select Committee on the Bribery Act 2010 (13 May 2019).

Confidentiality Provisions

In July 2019, the UK Government published its response to a consultation on measures to prevent the misuse of non-disclosure agreements and confidentiality clauses.

The response showed an attempt at balancing the potential utility of confidentiality clauses in employment contracts and settlement agreements with their potential misuse in connection with covering up sexual harassment, assault and discrimination in the workplace.

The UK Government's proposals include legislation to ensure someone cannot be prevented from making disclosures to the police, regulating healthcare professionals and legal advisers to require limitations of confidentiality clauses to be clearly set out and to ensure individuals receive advice about the nature and limitations of confidentiality clauses.

Whether the current UK Government will proceed with the proposals remains to be confirmed. If the proposed legislation is adopted, standard contractual confidentiality clauses will likely require redrafting to ensure there are suitable explanations of their limitations in accordance with the new legislation.

Source: BEIS: Confidentiality Clauses – Response to the Government consultation on proposals to prevent misuse in situations of workplace harassment or discrimination (21 July 2019).

Damages for Breach of Private M&A Accounting Warranties

Under English law, the measure of damages to breaches of warranty in a sale and purchase agreement of shares in private companies is the diminution in the value of the shares purchased.

No recovery on the basis of a hypothetical indemnity

The orthodoxy was affirmed by the High Court in the case of *Oversea-Chinese Banking Corporation Ltd v ING Bank N.V. [2019] EWHC 676 (Comm)*, where it was concluded that an indemnity measure of damages could not be recovered as a matter of law.

On the facts, the High Court considered that a warranty that relevant accounts gave a "true and fair view" of a company's state of affairs was a warranty of quality. In such circumstances, the appropriate measure of damages is the diminution in the value of the shares, comprising the difference between the true value of the shares and its value with the warranted quality. There was no basis for supporting a claim that, but for the breach of warranty, an indemnity would have been secured in respect of the true state of affairs and so damages should be measured by reference to a hypothetical indemnity.

Damages in respect of the full purchase price

The orthodoxy was also affirmed by the High Court in its decision in *116 Cardamon Ltd v MacAlister & Anor [2019] EWHC 1200 (Comm).*

In this instance, the parties to the transaction had agreed that the maximum aggregate liability the sellers could incur would be equal to the purchase price paid, subject to a £500,000 basket of claims that would not be recoverable.

In quantifying the diminution in the value of the shares resulting from a breach of warranty that the accounts gave a "true and fair view" of the state of affairs of the company, the High Court concluded, on the facts, that:

- the actual value of the shares was zero; and
- the warranted value of the shares exceeded the purchase price by more than the "basket" the parties had agreed would not be recoverable.

Accordingly, the aggregate damage suffered by the purchaser as a result of the breach of warranty exceeded the purchase price paid by more than the value of the basket and so the purchaser was awarded damages equal to the purchase price.

Key takeaways for companies engaged in private acquisitions or disposals

- Absent specific agreement to the contrary, the orthodox measure of damage for breach of warranty that should be expected to apply will comprise the difference between the actual value of the assets and the value as warranted.
- Contractual caps on liability for (non-fraudulent) breaches of warranty, if suitably drafted and consistent with customary practice, should be enforceable.
- Limitations on liability should be drafted with care and, if the seller may be found to have struck a bad bargain, tested against an outcome where a purchaser's loss exceeds the amount paid for the assets.
- The proper quantification of damage for breach of warranty will require a calculation of the value of the assets as warranted. Uncertainties may be mitigated if the parties specifically acknowledge in their sale and purchase agreement the basis on which the assets have been valued.

Sources: Oversea-Chinese Banking Corporation Ltd v ING Bank N.V. [2019] EWHC 676 (Comm); 116 Cardamon Ltd v MacAlister & Anor [2019] EWHC 1200 (Comm).

Rights to Information

In two cases, the High Court has recently considered the extent to which parties have rights to information in the context of purchase price adjustment provisions. The decisions underline that specificity as to a party's rights will be their best protection.

Preconditions to expert adjudication

In *O'Brien & Anor v TTT Moneycorp Ltd [2019] EWHC 1491 (Comm)*, the High Court considered a purchase price adjustment provision in a sale and purchase agreement relating to the sale of a company.

Purchase price adjustment provisions customarily set out a procedure to determine the actual value that is payable for a company or assets. In order to complete its assessment of actual value, a seller will require a purchaser to grant access to the financial information about the company or assets following completion of the sale. A failure by the parties to agree on the actual value will normally result in the appointment of an independent expert.

On the facts, the High Court concluded that the purchase price adjustment provision in question was intended to establish a unitary procedure with each step a necessary precondition to the next. Accordingly, before a reference to expert adjudication could be made, the purchaser was required to provide relevant financial information so that, in the absence of agreement, the seller could identify matters requiring expert adjudication.

The position under a sale and purchase agreement should be put beyond doubt if drafted so as to provide that failure to comply with any step in a purchase price adjustment provision is suspensory.

Information rights

In *Zedra Trust Company (Jersey) Ltd & Anor v The Hut Group Ltd [2019] EWHC 2191 (Comm)*, the High Court considered the extent of a seller's information rights in the context of a purchase price adjustment.

In connection with determining whether there had been an over-provision for tax liabilities for which the purchase price should be adjusted, auditors to the target company provided the purchaser with a complete report, supporting documentation and correspondence. In turn, however, the buyer provided the seller with merely an executive summary report obtained from the auditors. The seller sought an order that it also be provided with a copy of the report, supporting documentation and correspondence so that it could consider whether the conclusion reached by the auditor should be reviewed.

The High Court concluded that it was suitable to imply a term that the seller was entitled to a copy of the full report or else it would not be able to exercise its rights under the sale and purchase agreement meaningfully to inform the auditor of circumstances which may result in an amendment of the auditor's conclusion. However, considering that the implication of a term is on the basis that it is either necessary to give business efficacy to the contract or obvious, the High Court concluded that the supporting documentation and correspondence need not be shared.

Sources: O'Brien & Anor v TTT Moneycorp Ltd [2019] EWHC 1491 (Comm); Zedra Trust Company (Jersey) Ltd & Anor v The Hut Group Ltd [2019] EWHC 2191 (Comm).

Restrictive Covenants

In *Tillman v Egon Zehnder Ltd [2019] UKSC 32*, in the context of an employment agreement, the Supreme Court considered the meaning of being directly or indirectly engaged, concerned or "interested in" any business in the context of an employment agreement.

The Supreme Court concluded that the restrictive covenant was an unenforceable restraint of trade because "interested in" captured any shareholding in another company. However, the Supreme Court was comfortable severing the reference to "interested in" to protect the employer's legitimate interest in restricting a former employee's ability to compete.

The decision may be relevant to restrictive covenants in sale and purchase agreements because a restrictive covenant on the same terms would be expected to be interpreted as having the same meaning. The risk of having to rely on severance in such circumstances may be mitigated by including an exception for *de minimis* holdings in other companies. However, the Court of Appeal decision in *Ronbar Enterprises Ltd v Green [1954] 1 WLR 815* remains relevant to the sale of companies and assets. With respect to the meaning of being "interested in" any business, the Court of Appeal remarked that "the court takes a far stricter and less favourable view of covenants in restraint of trade entered into between master and servant than it does of similar covenants between vendor and purchaser".

Sources: Tillman v Egon Zehnder Ltd [2019] UKSC 32; Ronbar Enterprises Ltd v Green [1954] 1 WLR 815.

Notice Provisions

In *Stobart Group Ltd & Anor v Stobart & Anor [2019] EWCA Civ 1376*, the Court of Appeal considered whether a letter from the buyer to the seller satisfied the requirements of a notice provision relating to "Tax Claims".

The relevant notice provision contemplated that liability for a Tax Claim would not arise unless, before the seventh anniversary of completion, written notice was provided stating in reasonable detail the nature of the Tax Claim and, if practicable, the amount claimed.

The Court of Appeal concluded that the letter failed to satisfy the notice provision requirements because it did not refer to a Tax Claim, did not refer to the relevant provision of the agreement, made reference only to a potential claim and provided an estimate of damage, not an amount claimed. Accordingly, the claim for recovery of the relevant amount failed for non-compliance with the notice provision of the sale and purchase agreement.

In sending a notification pursuant to a notice provision, parties must consider how a reasonable recipient would understand it and ensure that appropriate cross-references are made and requirements in the relevant notice provision are specifically addressed.

Source: Stobart Group Ltd & Anor v Stobart & Anor (Rev 1) [2019] EWCA Civ 1376.

Fiduciary Duty to Shareholders

In *Vald. Nielsen Holding A/S Newwatch Ltd v Baldorino [2019] EWHC 1926 (Comm)*, the High Court concluded that directors participating in a management buy-out had not breached any fiduciary duty owed to shareholders.

Under English law, the general position is that directors do not owe fiduciary duties to a company's shareholders simply by virtue of the office that they hold. However, a special relationship or unusual circumstances can give rise to a fiduciary duty between directors and shareholders. Such special relationships usually arise in respect of small closely held companies where there is a familial or personal relationship between the parties.

On the facts, the High Court did not identify a special relationship or unusual circumstances. It was insufficient that in the context of a management buy-out the shareholders may depend on directors for unformation about the company or the directors may have greater knowledge regarding the state of affairs of the company.

Accordingly, parties to a management buy-out should assume that absent an unusually close relationship between directors and shareholders that goes beyond a normal director / shareholder relationship, directors will not owe fiduciary duties to shareholders.

Source: Vald. Nielsen Holding A/S Newwatch Ltd v Baldorino [2019] EWHC 1926 (Comm).

Parent Company Liability for an Overseas Subsidiary

In *Vedanta Resources PLC & Anor v Lungowe & Ors [2019] UKSC 20*, the Supreme Court considered whether the English courts had jurisdiction in respect of a claim brought against an English incorporated parent company in respect of pollution caused by its Zambian subsidiary.

In order for jurisdiction to be established, it had to be shown that there is a real issue to be tried on the basis that there was a good arguable case that the parent company owed a duty of care.

In considering whether there was a good arguable case that Vedanta Resources PLC owed a duty of care to those persons impacted by pollution, the Supreme Court considered that the publication of group-wide policies and guidelines could be sufficient to assert its responsibility for the maintenance of proper standards of environmental control over the activities of its subsidiaries.

While the position in any particular case will be fact-specific, the Supreme Court decision may increase the prospect of English courts finding that an English-incorporated parent company owes a duty of care in respect of the activities of an overseas subsidiary. The risk of such a conclusion may be mitigated by ensuring that substantive decisions are taken by a subsidiary's board and that a parent company does not implement policies or assume control of activities on behalf of a subsidiary.

Source: Vedanta Resources PLC & Anor v Lungowe & Ors [2019] UKSC 20.

Shareholder Class Actions

During November 2019, the High Court dismissed a shareholder class action brought by shareholders against Lloyds TSB Group plc (Lloyds) and several former directors *(Sharp v Blank [2019] EWHC 3078 (Ch))*.

The shareholder class action related to the takeover by Lloyd's of HBOS plc in 2008. It was claimed that:

- in making their recommendation to Lloyds shareholders to vote in favour of the transaction, the directors had been negligent; and
- the shareholder circular distributed to Lloyds shareholders contained insufficient information regarding the risks associated with the transaction.

The High Court dismissed both claims and also affirmed the principle of reflective loss, whereby individual shareholders are not entitled to seek to recover on their own account a loss suffered by a company. Accordingly, even if the claims had been established, the High Court would not have awarded damages to the shareholders on the basis of an absence of any loss suffered by the Lloyds shareholders.

In reaching its decision, the High Court provided guidance on establishing whether a recommendation was negligent and whether disclosure was insufficient.
With respect to a board recommendation, the High Court considered that directors would be negligent if the recommendation fell outside the spectrum of views that reasonably competent directors could have taken, and not merely that others could have adopted a different view. In making such an assessment, the High Court warned against subsequent events being regarded as evidence of a misjudgement at the time a recommendation was made. The High Court also considered that the failure to take professional advice would almost certainly constitute negligence by a board of directors.

With respect to establishing whether the duty to disclose sufficient information is satisfied, the High Court considered that, when viewed objectively, a shareholder circular should present a fair, candid and reasonable account of the circumstances to assist shareholders in their decision-making. However, every piece of information relied on by directors in making their own decision to recommend how shareholders should vote need not be disclosed.

By contrast, in establishing whether the duty not to negligently misstate information has been breached, the High Court must consider the process adopted and the advice received to determine whether the judgment of directors was exercised negligently as to the relative materiality of information to be disclosed.

Source: Sharp v Blank [2019] EWHC 3078 (Ch).

Davis Polk in London

Davis Polk has practiced in London for almost 50 years. We focus on providing advice across a range of equity and debt capital markets, private and public M&A, finance and restructuring transactions.

The team is versatile and our lawyers are encouraged to be conversant in both UK and US law to effectively handle complex international and cross-border transactions. Our corporate and finance lawyers are supported by first-rate tax, financial regulatory and antitrust lawyers and have extensive experience of advising on all aspects of UK corporate and securities law, including the Listing Rules, the AIM Rules and the Takeover Code.

We provide sophisticated, practical advice and continually seek innovative solutions to our clients' most challenging business and legal needs. Our lawyers are consistently recognised as individual leaders in their fields and our teams have won numerous awards for the transactions that they have advised on.

Over the last 18 months, the transactional experience of our London-based team has included advising:

- Financial advisers to **Apollo** on its £3.3 billion takeover offer for RPC
- Financial advisers, sponsor and bookrunner to **Bovis Homes** on its £1.075 billion Class 1 acquisition of Galliford Try's housing businesses and related £152.2 million placing
- Underwriters on $3.5 billion notes offering by **British American Tobacco**
- **Charles Taylor** on its £17.6 million placing in connection with the acquisition of Inworx
- **Charles Taylor** on the £285 million recommended cash takeover by Lovell Minnick
- **Comcast** on its £30.6 billion competitive takeover of Sky
- **Comcast** and Sky on consent solicitations relating to 13 series of outstanding Sky debt securities listed on the LSE
- **ContourGlobal** on its £306 million Class 1 acquisition of Acciona Termosolar
- **EQT** on its $1.4 billion IPO and Nasdaq Stockholm listing
- **Ferguson** on its $750 million senior notes offering
- Demerger from A.P. Moller-Maersk and $3.6 billion Nasdaq Copenhagen listing of **Maersk Drilling**
- **Mereo BioPharma** on its combination with Nasdaq-listed OncoMed Pharmaceuticals
- Financial adviser and sponsor to **Mondi** on the simplification of its dual listed corporate structure
- **Nuvei** on its $889 million recommended cash takeover of SafeCharge
- Joint bookrunners to **Ocado** on its £143 million placing
- **Ocado** in connection with its successful solicitation of consents from holders of its notes offering in connection with the formation of a 50/50 joint venture between Ocado and Marks and Spencer
- **Temenos** on its £1.4 billion takeover offer for Fidessa
- **Temenos** on its £12 million acquisition of Logical Glue and $559 million acquisition of Kony
- Financial adviser to **The Rank Group** on its recommended offer to acquire Stride Gaming
- Financial adviser and sponsor to **Vedanta Resources** on the Class 1 acquisition of Electrosteel and on a subsequent related party transaction involving the entry into revenue sharing contracts with the Government of India for the exploration of oil and gas
- **Whitney Wolfe Herd**, Bumble's founder, on the acquisition by Blackstone of a majority stake in MagicLab

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