Equity Capital Markets Update
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OLSWANG

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Recent Legal Developments and News

This issue covers one of AIM's busiest quarters for some time. In the quarter running to 8 January 2014 there were 33 new admissions to AIM, which is more than double the number for the equivalent period in 2012, and a steady improvement on the 25 admissions in the quarter from July to September 2013. The money raised on these new admissions was more than double that of the previous quarter: £576.2m against £273.4m

In this issue we look at plans to give minority shareholders more protection where premium listed companies have a controlling shareholder, including the re-introduction of controlling shareholder or relationship agreements. We also look at changes to the UK merger control regime and further changes to the Transparency Directive which seek to improve disclosures of holdings in financial instruments and reduce some of the reporting burden on smaller companies. Finally, we take a look at changes to the law in Germany which should make it easier to take companies private.

Your feedback is always greatly appreciated and if you have any thoughts as to what you would like to see covered in the next edition of Olswang LLP's ECM Update please do get in touch with Andrew Stott (andrew.stott@olswang.com) or your usual contact.

Changes to the Listing Rules: protecting minority shareholders' rights in premium listed companies

Changes are expected to the Listing Rules regarding the rights of minority shareholders in premium listed companies that have a controlling shareholder. In response to concerns in the investment community over the interests of minority shareholders, the FCA began a review of the effectiveness of the Listing Regime in October 2012. Subsequently, near-final proposals for measures to protect minority shareholders rights in premium listed companies with a controlling shareholder were published in November 2013 (the full consultation paper can be accessed here). With implementation scheduled for mid-2014, such companies should understand how and when they will be affected.

Summary of key proposals

The proposed protections to minority shareholders include:

1. **Mandatory agreement between the company and controlling shareholder**

This agreement is aimed at ensuring independent operation of the company from the controlling shareholder through the inclusion of certain fundamental independence provisions (for example, an undertaking that transactions and relationships with the controlling shareholder (and/or any of its associates) will be conducted at arm's length and on normal commercial terms).

Premium listed companies will be given six months to bring themselves into compliance once the requirements come into force in mid-2014. A similar period is proposed for companies that acquire a controlling shareholder post-admission.

Additional measures will be activated, giving minority shareholders rights to vote on, and veto, all transactions between the controlling shareholder and company, if:

a) the company fails to implement the mandatory relationship agreement before this deadline;
b) the company fails to comply with such a relationship agreement that has been put in place; or
c) an independent director does not agree with certain statements made in the annual report as regards compliance with the mandatory relationship agreement.

The additional measures would remain in effect until the next annual report in which the board gives a clean statement of compliance for the entire preceding financial year and the independent directors do not dissent.

2. **Additional voting powers for minority shareholders when electing independent directors**

This proposal aims to ensure that minority shareholders have a greater say in appointing independent directors; an important source of control within the governance structure of a listed company.

Premium listed companies with a controlling shareholder will need to ensure that their constitutions provide for the election of independent directors by a dual voting structure. With this structure, independent directors are separately approved both by the shareholders as a whole and the minority shareholders as a separate class. If the necessary majorities are not achieved in the dual vote, the company would be required to wait at least a further 90 days before the vote could be passed by a simple majority of all shareholders.

Once implemented, companies will have until the next general meeting for which a notice has not yet been given to comply with these requirements.

3. Enhancing minority shareholder voting power in cancelling premium listing

The protections of the premium listing regime fall away after a listing is cancelled. This provision is aimed at ensuring that minority shareholders are given a proper say in any decision as to cancellation, as with cancellation significant rights of participation in the governance of the company are removed from shareholders.

It is proposed that for cancellation of a premium listed company's premium listing, the approval of a majority of votes of the independent shareholders would be required.

This is presented as an alternative by the FCA to the retention of the existing arrangements whereby any premium listed company wishing to delist must first obtain the prior approval of holders of 75 per cent of its shares in a general meeting. These two options are currently being presented for consultation.

Will the minority shareholder protections affect the level of free float?

The percentage of shares required to be in public hands (or free float) is currently 25 per cent. This is not proposed to change. Furthermore, the FCA is proceeding with their proposal to accept lower levels of free float in the standard segment where they are satisfied sufficient liquidity exists for the market to be able to operate properly.

Further transparency enhancement

It is proposed that other transparency requirements be enhanced for premium listed companies:

- companies announce smaller related party transactions as soon as possible rather than waiting for the next annual report; and
- a requirement is introduced that any disclosures required by the Listing Rules should either be in a single identifiable section in the annual report or that a cross-reference list to where the disclosures may be found is included.

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Changes to the UK merger control regime

A new competition regulator, the Competition and Markets Authority or "CMA", will start work on 1 April 2014. The CMA replaces the Office of Fair Trading and Competition Commission. On the same date changes to the UK merger control regime will take effect. Whilst much of the current regime remains unchanged, there are important reforms which will impact how businesses and their advisers plan a path through the regulatory scrutiny of mergers, acquisitions and joint ventures.

The current UK merger control regime

Certain key elements of the current regime will stay in place after 1 April:

- **Test for when the CMA can investigate:** a transaction may be reviewed if target has UK turnover of more than £70 million and/or acquirer and target have a combined share of supply within the UK of any type of goods or services of 25% or more;

- **Test for clearance:** the CMA will assess whether the transaction may result in a substantial lessening of competition within any UK market;

- **"Voluntary" regime:** the UK remains one of very few merger control regimes where there is no obligation to pre-notify or make completion conditional on merger clearance, though the CMA can investigate and prohibit completed transactions.

The UK will also retain a two phase process, with an initial investigation to determine if a case may raise issues, followed by longer and more intense scrutiny of potentially problematic transactions. The CMA will carry out both phases, unlike the current regime where the OFT reviews at Phase I, with an entirely new investigation by the Competition Commission at Phase II. It remains to be seen whether the CMA will be more inclined to find its Phase I decision to be justified than was the Competition Commission when it took over from the OFT (around half of cases referred by the OFT are cleared outright by the Competition Commission).

What's new in the new regime?

There are three areas where significant changes will take effect from 1 April:

- New powers to stop integration of merging businesses;

- New statutory time limits for investigations;

- A new regime for offering undertakings to secure clearance at Phase I.

New powers to stop integration of merging businesses

Both the OFT and Competition Commission have in in the past voiced concerns over alleged significant difficulties in enforcing remedies with respect to completed mergers because integration of the merged businesses hinders the re-creation of pre-merger competitive conditions.

Whilst there is limited evidence that this has been a problem in practice - and the regulators already had extensive powers to halt integration which they employed routinely – the new regime goes even further in stopping integration until the regulatory process has concluded.

First, the CMA has significantly enhanced powers:

- Rules now make clear that the CMA can order unwinding of integration that has taken place before CMA intervention. This could include reversing re-branding, requiring the replacement of departed staff (for example, recruitment of a new finance director for the acquired business to replace an executive who departed on completion), and separation of functions that have been integrated;

- The CMA can impose financial penalties for breach of non-integration undertakings of up to 5% of global turnover

Secondly, and of particular importance, the new regime extends these powers to anticipated mergers. If a transaction has not completed integration will normally be limited, but the CMA will nonetheless have powers, for example, to order parties to stop exchanges of information unless objectively necessary for due diligence and to cease joint negotiations with customers or suppliers. Most significantly, the CMA could order the parties not to complete a transaction, for example, if completion was likely to lead to an exodus by key staff. The CMA's use of these powers could be particularly disruptive.

New statutory time limits for investigations

Under the current regime there is already a procedure for notifying using a "merger notice" with fixed deadlines for a decision. However, the merger notice is rarely used, first because the OFT has always expressed its opposition to the procedure (making clear that "rushing" them by tying them to a time limit would be more likely to lead to an adverse decision), and secondly because the OFT usually finds technical means to "stop the clock".

For the vast majority of transactions therefore the only timetable is a non-binding OFT "administrative target" for decision of 40 working days from receipt of all required information.

Under the new regime, however, all investigations must by law be concluded within 40 working days of "Satisfactory Notification" or be deemed automatically cleared. The CMA has published a detailed standard form "Merger Notice" (32 questions covering 40 pages).

In practice, the key issue will be when a notification is deemed by the CMA to be satisfactory. Experience with the European Commission (and the OFT under the current regime) suggests that there will be a prolonged period of pre-notification discussions of the draft Merger Notice (even if the CMA merely indicates "at least 1 to 2 weeks"), and that the CMA may well seek to stop the clock by issuing detailed information requests (sometimes the merging parties themselves accede to this with a view to gaining extra time to address the regulator's concerns).

However, even if the new rules do not mean a guaranteed decision in 40 working days (itself a long time compared to most other regimes – the European Commission's process takes only 25 working days), it will be very interesting to see how the CMA responds to "time pressure".

New regime for offering undertakings to secure clearance at Phase I

Probably the most revolutionary change affects how parties can avoid a long and expensive Phase II investigation by offering undertakings at Phase I.

The current procedure is one of the most peculiar and, for merging parties, frustrating aspects of the UK merger control regime.

How it works is that the OFT sends the parties an Issues Paper which sets out hypothetical competition concerns. The parties have a very short period (usually around 2 days) to respond in a meeting and in writing. More importantly, within a similar period the parties are required to indicate what undertakings they would be prepared to offer to address these hypothetical concerns.

At no point in the process do the parties meet the OFT decision-maker and they do not know which (if any) of the hypothetical concerns will be upheld in the final decision. Parties will often therefore offer more by way undertakings than they hope will ultimately be required.

Whilst the OFT insists that any offer the parties make does not influence the final decision, it is difficult to avoid a suspicion that the OFT will be less diligent in thoroughly testing whether a hypothetical concern is justified if they know that the parties will in any event resolve the issue.

For example, if the OFT has hypothetical concerns in a merger between two supermarket groups that 20 stores raise significant problems, the only “safe” offer is to divest all 20; an offer of only 15 risks a Phase II investigation (and you do not normally get an opportunity to improve your offer). However, an offer to divest all 20 may lead the OFT to conclude, even if subconsciously, that it is not necessary to work too hard to defend its case against all 20 stores, as the parties are obviously “happy” to divest all of them in any event.

Under the new regime, it is still possible (and will often be useful) to discuss remedies pre-decision, but no offer need be made until the CMA issues its decision with a definitive finding on its concerns. At that point, the merging parties have 5 working days to offer undertakings to address those concerns.

So, in the supermarkets example, the Issues Paper may indicate hypothetical concerns with respect to 20 stores, but if the final decision upholds those concerns for only 15 stores, the parties know that an offer to divest 15 stores will definitely secure Phase I clearance.

This introduction of certainty and “real world” information can only be of benefit to merging parties, even if the period immediately post-decision is likely to be tense and busy. An interesting dimension will be market reaction during the critical 5 days, as the CMA’s decision will have been announced.

What difference will the new regime make?

The advent of the CMA and the new merger control regime is likely to bring advantages and disadvantages:

- **Advantages** are likely to be an improved quality of Phase I decisions, more efficient use of combined resources concentrated in one entity, and a more consistent policy approach between Phase I and Phase II (though the last could be a disadvantage if the approach is consistently wrong);

- **Disadvantages** include the uncertainty arising from a new regime and a new regulator, the likelihood of a cautious approach in the early days as the CMA finds its feet and, potentially the risk of so-called "confirmation bias" at Phase II, with the CMA thinking "we decided to refer it, so how can we now conclude that there's no problem?".

Overall, the changes are to be welcomed and should with time lead to an improvement of the UK merger control regime in both speed and transparency.

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Amendments to the Transparency Directive

The Transparency Directive aims to harmonise transparency requirements across the EU for companies trading on a regulated market. Amendments to the Transparency Directive were published in the Official Journal on 6 November 2013 and entered into force on 26 November 2013. Member states have two years to implement these amendments; however the UK government has indicated that it will introduce the changes as soon as possible.

Why were the amendments introduced?

The amendments aim to address two issues that have developed since the original Transparency Directive was introduced in 2004. Firstly the amendments aim to increase transparency of listed companies by capturing certain types of holdings of financial instruments that can be used to acquire an economic interest in listed companies without acquiring shares. Secondly the amendments seek to reduce the costs of compliance by reducing the administrative burden for small and medium sized businesses.

What changed?

Increased transparency

Perhaps the most significant amendment to the Transparency Directive is the widening of what are considered to be financial instruments. Under the amendments the requirement to disclose major holdings in financial instruments has been broadened to include any financial instruments with similar economic effect to holding shares or entitlements to acquire shares. Transferable securities, options, futures, swaps, forward rate agreements, contracts for differences and any other contracts or agreements with similar economic effects which may be settled physically or in cash are all expressly included as constituting financial instruments for the purposes of the notification requirements. By broadening what is considered to be a financial instrument the amendments seek to eliminate “secret stake-building” in companies and to increase the transparency of listed companies.

Another change introduced is that for the purpose of calculating the thresholds that trigger the notification requirement, holdings of financial instruments need to be aggregated with holdings of shares.

Furthermore the amendments introduce provisions that aim to increase the accessibility of information required under the Transparency Directive by stipulating that a web portal must be made available by 2018 and by increasing the amount of time that half yearly financial reports must remain available to the public from 5 years to 10 years.

Reducing costs of compliance

In an attempt to reduce the administrative burden and costs of compliance with the Transparency Directive the changes prohibit member states from requiring quarterly financial reporting, subject to an exception. The exception applies where a quarterly financial report does not constitute a significant financial burden and the additional information required to publish a quarterly financial report is proportionate to what contributes to investment decisions by investors. The purpose of the amendment is to reduce the administrative burden and costs of compliance, with a particular emphasis on small and medium sized businesses. Nevertheless companies may still voluntarily publish a quarterly financial report.

Who will benefit?

It is hoped that the amendments to the Transparency Directive will benefit small and medium sized companies by reducing the administrative burden and associated costs of quarterly reporting. By increasing transparency through minimising the opportunity for "secret stake-building" it is hoped this will allow investors to be better informed about the ownership of listed companies and, in the European Commission's view, address "the misalignment of investor intentions with long-term interests of companies".

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German Federal High Court overrules decade old precedent and significantly eases taking companies private

In October 2013 a decision from the German Federal High Court overruled a precedent, which it had previously set in 2002, making it significantly easier to convert public companies into private companies.

Investor protection at two different levels

In Germany the requirements for publicly listed companies leaving the stock exchange are partially governed by statutory rules and regulations, but much of the development of requirements has come from case law.

Under the German Stock Exchange Act a company which intends to delist its shares must file an application with the stock exchange. Provided that delisting of the shares will not contradict the required protection for investors the stock exchange will accept the application. Details of the standards which must be fulfilled to achieve the required protection for investors are set by regulations enacted by each stock exchange. For example, the Frankfurt Stock Exchange, by far the most important stock exchange in Germany, requires trading in the shares to continue for at least six months after the publication of the announcement that the shares will be delisted, unless special protection is offered to the investors.

There has been a long history of debate as to whether corporate law should provide additional protection and set supplementary requirements for companies leaving the stock exchange. In a surprising and much debated precedent ("Macrotron") in 2002 the German Federal High Court had found that:

- the decision to delist the shares in a company from a regulated market at a stock exchange cannot be made by the management of the company alone, but requires a shareholders' vote at a shareholders' meeting; and
- either the company or its majority shareholder must make an offer to all of the outstanding shareholders to acquire their shares at an appropriate price.

Change in 2012

Irrespective of the praise and criticism the decision in Macrotron received it had set the standard. Pivotal to the decision in Macrotron was the High Court's argument that an element of any shareholder's right to property, as protected by the German constitution, was the right to freely dispose of its shares. This right would be significantly impaired by a delisting.

In a decision in 2012, the German Federal Constitutional Court ruled that this was stretching the protection required by the constitution too far. The constitution does protect the legal ability to sell shares, but not the de facto possibility of shareholders to dispose of their shares. However, this decision did not necessarily mean that the decision in Macrotron was irrelevant and it was largely believed that Mactron's principles should continue to apply, as there were other legal arguments to support the requirements for a shareholders' vote and an offer to the outstanding shareholders.

What is new now?

The arguments for continuing to use some of Macrotron's principles have now been rejected by the Federal High Court. The decision in Macrotron was specifically overruled by the Federal High Court which found that the delisting of a company's shares neither requires a shareholders' vote nor an offer to the outstanding shareholders. Among other arguments, the Federal High Court rejected the idea of using the principles which apply in case of a merger. Statutory law provides that if a listed company is merged with and into a non-listed company with the non-listed company as the surviving entity, each shareholder that voted against the shareholders' resolution approving the merger must receive an offer to buy their shares. According to the Federal High Court, these principles do not need to be applied when delisting a company's shares without a merger occurring as the protection provided under the Stock Exchange Act is sufficient.

What does this mean for investors?

The decision affects different groups of investors in different ways:

- **Financial investors in German stocks:** Investors in German stocks have lost the prospect of receiving an offer to buy their shares before they lose the ability to sell their shares via the stock exchange. Nevertheless, the impact on investors should be limited, as the protection provided by the German Stock Exchange Act remains. The few empirical studies which exist indicate that the announcement that trading in the shares will end in six months has no immediate adverse effect on the stock price; therefore investors should always have sufficient opportunity to sell their shares at an appropriate price via the stock exchange before the delisting becomes effective. However, investors might want to check which stock exchange the shares they are buying are traded on, as not all stock exchanges provide for such a waiting period before trading is abandoned.

- **Investors targeting special situations:** Investors who seek to profit from the legal process in Germany in special situations have lost an opportunity to do so. In previous years investors such, as certain hedge funds, have increasingly bought into shares which were subject to a takeover offer or where structural decisions were expected which involve shareholders' resolutions and potential mandatory offers to the minority shareholders. Some of these investors appear to focus on filing claims challenging the validity of the shareholders' resolutions or the appropriateness of the offers made to the minority shareholders. Under the new Federal High Court decisions these investors will no longer be able to exploit the legal process in these special situations.

- **Strategic Buyers**: For investors who intend to take over German public companies the new decision is good news. Even after a successful takeover offer, it is by no means certain that the strategic buyer will be able to squeeze-out all minority shareholders of the target company, and sometimes the buyer might not even be interested in acquiring 100% of the outstanding shares. In such scenarios, it will be possible to take the company private without requiring a shareholders' vote (which could potentially be challenged in court) and, even more importantly, without being obliged to make an offer to the outstanding shareholders.

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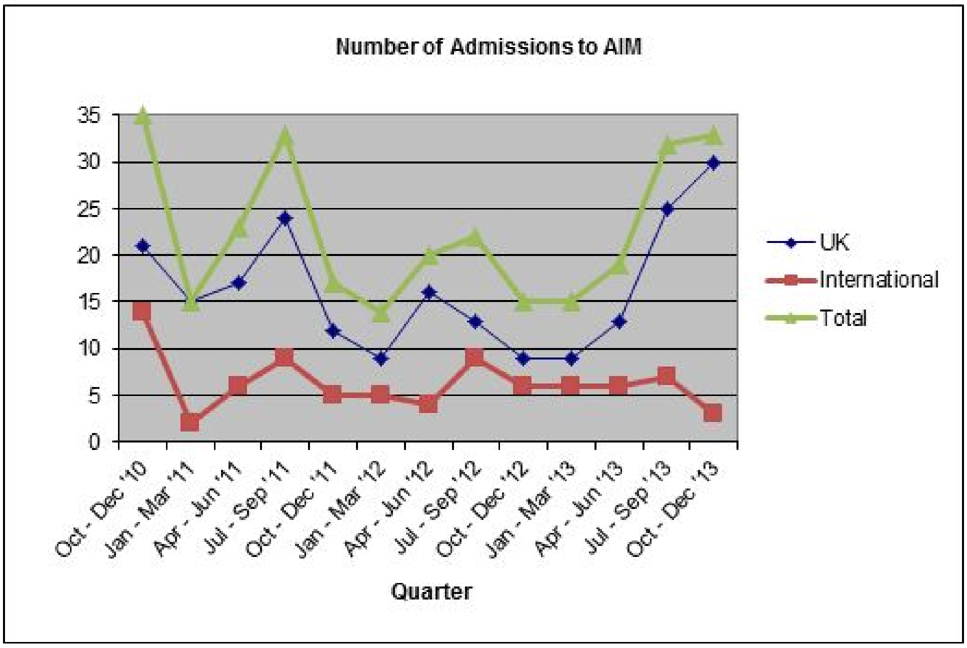
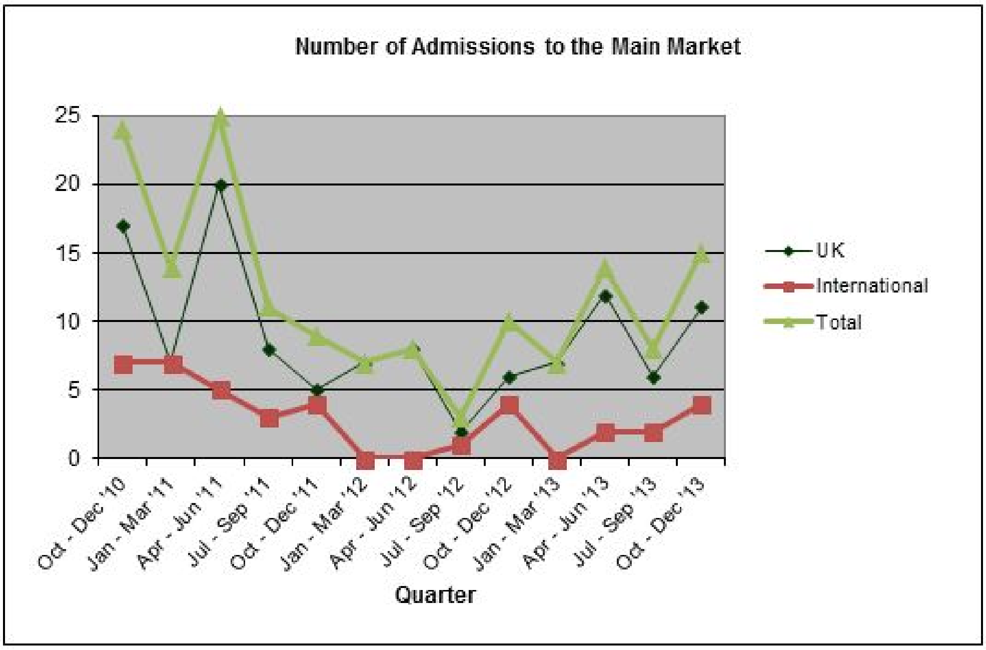
Market Overview

NUMBER OF ADMISSIONS TO AIM AND THE MAIN MARKET

The year 2013 ended with the highest total of admissions on AIM since the third quarter of 2011, thanks to a continued rise in UK admissions. The Main Market also saw an increase in admissions with the number of UK admissions nearly doubling in the last quarter and a small rise in international admissions.

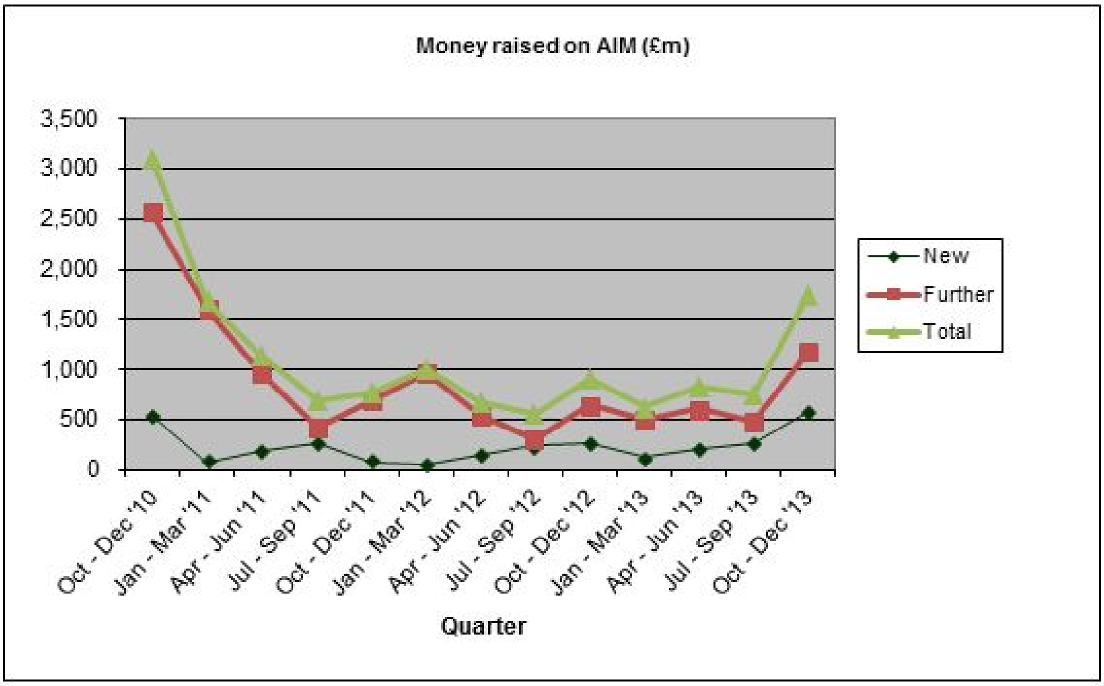


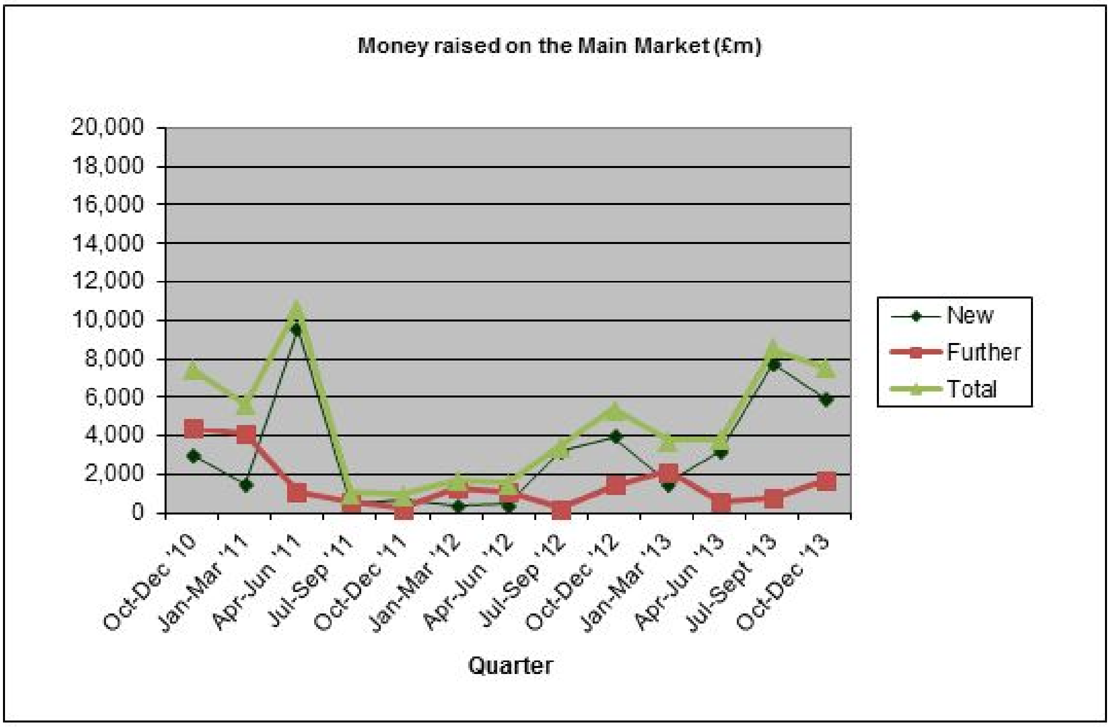


Source of data: London Stock Exchange

FUNDRAISING ACTIVITY ON AIM AND THE MAIN MARKET

Following a sharp increase in monies raised by further issues on AIM after the third quarter, the aggregate funds raised in the last quarter of 2013 on AIM was encouragingly at the highest point since the last quarter of 2010. On the Main Market, although the fourth quarter showed a decrease in funds raised by new issues, the monies from further issues more than doubled which resulted in only a slight fall in the aggregate funds raised since the third quarter and the highest total since Q2 2011.





Source of data: London Stock Exchange

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