Pre-Emption Group

DISAPPLYING PRE-EMPTION RIGHTS

A STATEMENT OF PRINCIPLES

2015

OVERARCHING PRINCIPLES

1 Pre-emption rights are a cornerstone of UK company law and provide shareholders with protection against inappropriate dilution of their investments. They are enshrined in law by the Second Company Law Directive and the Companies Act 2006, which provides that they may be disapplied by a special resolution of shareholders at a general meeting of the company.

2 In addition to the statutory pre-emption provisions applying to UK incorporated companies, a company with a premium listing on the Official List of the UK Listing Authority that is incorporated outside the UK is required by the UK Listing Rules to ensure that its constitution provides for rights of pre-emption for shareholders that are at least equivalent to those statutory rights that apply to UK incorporated companies.

3 Whilst not undermining the importance of pre-emption rights, a degree of flexibility is appropriate in circumstances where issuance of equity securities on a non-pre-emptive basis would be in the interests of companies and their owners.

4 The principles set out in this paper aim to provide clarity on the circumstances in which such flexibility might be appropriate and the factors to be taken into account:

- when companies propose, and when shareholders consider, a general disapplication of pre-emption rights (as defined in Part 2A);
- when companies consider making use of a general disapplication of pre-emption rights to issue equity securities non-pre-emptively; and
- when companies propose, and when shareholders consider, a specific disapplication of pre-emption rights (as defined in Part 3).

5 Companies, institutional investors and voting advisory services all have an important role to play in ensuring the effective and flexible application of this guidance.

- Companies should, where possible, signal an intention to undertake a non-pre-emptive issue at the earliest opportunity and to establish a dialogue with the company's shareholders. They should also keep shareholders informed of issues related to an application to disapply their pre-emption rights.
- Shareholders should, where possible, engage with companies to help them understand the specific factors that might inform their view on a proposed disapplication of pre-emption rights by the company. They should review the case made by a company on its merits and decide on each case individually using their usual investment criteria.

- Where a shareholder intends to abstain on or vote against a resolution to disapply pre-emption rights, Principle 6 of the UK Stewardship Code[1] makes it clear that it is best practice to explain to the company in advance the reasons for the decision.
- While companies should, where possible, consult their main shareholders in a timely manner, advisory services should be prepared to receive representations from companies. In such circumstances the advisory services should explain any recommendations made in light of the reasons provided. This should involve setting out the pros and cons of the proposal so that the ultimate decision maker can take an informed view.

6 The Pre-Emption Group will monitor the development of practice in relation to disapplying pre-emption rights and the issuance of equity securities pursuant to such disapplications. It expects that this Statement of Principles will inform the way in which all interested parties participate in this process. The Pre-Emption Group will not express a view on or otherwise intervene in specific cases.

7 These principles are supported by the National Association of Pension Funds and the Investment Association as representatives of owners and investment managers.

[1] The UK Stewardship Code; Financial Reporting Council; September 2012 available at: https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx

PART 1: APPLICATION OF THE PRINCIPLES

1 The principles set out here relate to issues of equity securities for cash other than on a pre-emptive basis (i.e. other than pro rata to existing shareholders) by all companies (wherever incorporated) with shares admitted to the Premium Listing segment of the Official List of the UK Listing Authority and to trading on the Main Market for listed securities of the London Stock Exchange. Companies with shares admitted to the Standard Listing segment of the Official List of the UK Listing Authority, to the High Growth segment of the Main Market of the London Stock Exchange, or to trading on AIM, are encouraged to adopt these principles.

2 The principles apply to all issues of equity securities that are undertaken to raise cash for the issuer or its subsidiaries, irrespective of the legal form of the transaction. For example, a "cashbox" transaction may be structured as an issuance of equity securities for non-cash consideration falling outside the scope of statutory pre-emption.[2] Nonetheless, such a transaction should be regarded, for the purposes of these principles, as being an issuance of equity securities for cash subject to the limits herein.

3 A "vendor placing" is to be distinguished from a "cashbox" transaction for the purposes of these principles.[3] A "vendor placing" is outside the scope of the principles set out in Parts 2A, 2B and 3, but shareholders will nonetheless expect a right of clawback in respect of any vendor placing that represents greater than 10% of ordinary share capital or that is undertaken at a discount[4] of greater than 5%.

4 For the purposes of these principles:

- the sale of treasury shares for cash by a company should be regarded as equivalent to an issuance of new shares by that company; and
- shares held by a company in treasury should not be regarded as forming part of the issued share capital of that company.

5 Companies that do not comply with these principles are likely to find that their shareholders are less inclined to approve subsequent requests for a general disapplication. This applies to compliance with both the letter of these principles (for example, the percentage limits on dilution and discount) and their spirit (for example, the determination as to whether the use of proceeds of a non-pre-emptive issuance of equity securities falls within the meaning of "specified capital investment").

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[2] A "cash box" structure refers to a method of raising cash from the issue of equity securities for non-cash consideration through the acquisition of a special purpose vehicle whose principal asset is cash.

[3] A vendor placing is a marketing of equity securities that are allotted non-pre-emptively in consideration of the transfer to the issuer or its subsidiaries of a business or asset (other than a company whose principal asset is cash).

[4] Definition of discount in Appendix.

PART 2A: REQUESTING A GENERAL DISAPPLICATION OF PRE-EMPTION RIGHTS

1 A general disapplication of pre-emption rights is one sought by a company at an Annual General Meeting[5] other than for the purpose of an identified, proposed issuance of equity securities.

2 A request for a general disapplication is likely to be supported where it meets the criteria as to size and duration set out in paragraphs 3 and 4 of this Part 2A. While the fact that a request meets those criteria does not reduce the importance of effective dialogue and timely notification, such a request is less likely to need in-depth discussion and shareholders will be more inclined in principle to support it.

3 Size criteria - the company may seek authority by special resolution to issue non-pre-emptively for cash equity securities representing:

- no more than 5% of issued ordinary share capital in any one year, whether or not in connection with an acquisition or specified capital investment[6]; and
- no more than an additional 5% of issued ordinary share capital provided that, in the circular for the Annual General Meeting at which such additional authority is to be sought, the company confirms that it intends to use it only in connection with an acquisition or specified capital investment which is announced contemporaneously with the issue, or which has taken place in the preceding six-month period and is disclosed in the announcement of the issue.

4 Duration criteria - the disapplication of pre-emption rights should last no more than 15 months or until the next Annual General Meeting, whichever is the shorter period.

5 The above principles are intended to ease the granting of general disapplications at or below those levels, not to rule out approvals above them. Proposals for approvals above those levels should be considered by shareholders on a case-by-case basis and the considerations set out in Part 3 in the context of specific disapplications will be relevant. Shareholders will generally not support such a request without a sufficiently strong business case. Thus, a request for a general disapplication of pre-emption rights in excess of the size criteria set out in paragraph 3 above should be made only when the company is in a position to justify this approach by providing relevant information. Where this is not possible, a general meeting should instead be convened at the time an identified, proposed issuance is contemplated.

[5] Or at a general meeting other than an Annual General Meeting, where that general meeting is convened to consider a proposed transaction that will alter the company's share capital in a way that means it is appropriate to refresh the disapplication, provided that a general disapplication was granted by shareholders at the preceding Annual General Meeting.

[6] Definition in Appendix.

PART 2B: ISSUING EQUITY SECURITIES PURSUANT TO A GENERAL DISAPPLICATION

1 In any rolling three-year period, a company should not issue non-pre-emptively for cash equity securities that represent more than 7.5% of its issued ordinary share capital. This limit excludes:

- any equity securities issued pursuant to a specific disapplication of pre-emption rights; and
- any equity securities issued pursuant to a general disapplication of pre-emption rights in connection with an acquisition or specified capital investment as described in paragraph 3 of Part 2A.

2 Companies may also issue non-pre-emptively for cash equity securities in excess of the limit set out in paragraph 1 of this Part 2B[7] where:

- suitable consultation has been undertaken in advance and an explanation given; or
- the reason for possibly exceeding the 7.5% level was specifically highlighted at the time at which the last request for a general disapplication was made.

3 Instruments convertible into shares issued non-pre-emptively pursuant to a general disapplication of pre-emption rights will be counted within the limits set out in paragraph 1 of this part 2B, and should be counted at the point when the convertible instruments are issued, and not at the point at which ordinary shares are subsequently issued. Other than in the case of instruments, such as contingent convertible bonds, issued by financial institutions for regulatory capital purposes, the initial conversion price of such an instrument should not be lower than the market price of the underlying shares at pricing of the instrument.

4 An issuance of equity securities may contain both a pre-emptive and non-pre-emptive element (a “combination issue”). The non-pre-emptive element of a combination issue should either fall within the criteria specified in this Part 2B or should be approved by a specific disapplication by special resolution. This includes a combination issue comprising a placing of equity securities with a partial clawback offer to existing shareholders, where only the firm element that is not subject to clawback need comply with these principles. Further, in the case of a combination issue where there is a substantial clawback element, provided that the firm element is priced at no greater discount than the element that is subject to clawback, that firm element need not comply with the 5% discount limit specified in paragraph 5 of this Part 2B.

5 When issuing equity securities non-pre-emptively, companies should aim to ensure that they are raising capital on the best possible terms in order to avoid unnecessary dilution of existing shareholders. This is particularly the case where the proposed issue is made in circumstances where the share price may reasonably be expected to rise as a result of the proposed equity issue, any related transaction or any other contemporaneous transaction or matter of which the directors are aware. Any discount[8] at which equity is issued for cash will be of concern, but companies should, other than in exceptional circumstances, seek to restrict the discount to a maximum of 5%, including expenses as set out in the Appendix to these guidelines. Companies will be expected to disclose any discount at which equity is

[7] But not exceeding the amount of the general disapplication granted in accordance with paragraph 3 of Part 2A of these guidelines.

[8] Definition of discount in Appendix.

issued in the announcement of the pricing of the relevant issue. Companies' attention is drawn to the guidance on calculation of discounts for these purposes in the Appendix to these guidelines.

6 In the case of an investment trust or similar listed closed ended fund company, if there would be no resulting value dilution, for example if an investment trust were to issue shares at a premium to the underlying net asset value per share,[9] this would not normally raise any concerns.

7 Companies should also have regard to any adverse impact on the share price of any earlier announcement, which may create the potential for a significant loss or transfer of value, in deciding whether to proceed with an issue in such circumstances.

8 Companies sometimes find it desirable to seek a "backstop" underwriting commitment prior to carrying out a bookbuilt equity issue, particularly in the context of acquisition financing. It may be impossible or uneconomic for a company to procure a backstop underwriting commitment at a discount of less than 5%. Provided that it is not expected at execution of the underwriting agreement that the underwriter will acquire equity securities pursuant to its commitment, an underwriting at a discount of greater than 5% will not typically be regarded as problematic from the perspective of these principles.

9 The next annual report published following a non-pre-emptive issue of equity securities pursuant to a general disapplication of pre-emption rights should include the following information:

- the actual level of discount achieved;
- the net proceeds raised;
- how those net proceeds were used; and
- the percentage increase in issued share capital due to non-pre-emptive issuance for cash over the three-year period preceding the issue.

[9] In relation to premium listed investment trusts, shareholders note the protection from dilution afforded by Listing Rule 15.4.11 in this regard.

PART 3: REQUESTING A SPECIFIC DISAPPLICATION OF PRE-EMPTION RIGHTS

1 A specific disapplication of pre-emption rights is one sought by a company for the purpose of an identified, proposed issuance of equity securities. It is neither possible nor desirable to define all the circumstances in which shareholders might be willing to agree to such a proposed disapplication of pre-emption rights. Such proposals should be considered by shareholders on a case-by-case basis.

2 It is particularly important that there is early and effective dialogue between the company and its shareholders, and that the company is able to communicate to shareholders the information they need in order to reach an informed decision. Set out below is a (non-exhaustive) list of some general considerations that, in the majority of cases, are likely to be critical to shareholders' voting decisions in response to a request for a specific disapplication of pre-emption rights.

- **The strength of the business case.** In order to make a reasoned assessment shareholders need to receive a clear explanation of the purpose to which the capital raised will be put, the benefits to be gained and how the financing or proposed future financing fits in with the life-cycle and financial needs of the company.
- **The size and stage of development of the company and the sector within which it operates.** Different companies have different financing needs. For example, shareholders might be expected to be more sympathetic to a request from a small company with high growth potential than one from a larger, more established company.
- **The stewardship and governance of the company.** If the company has a track record of generating shareholder value, clear planning and good communications, this may give shareholders additional confidence in its judgement.
- **Financing options.** A wide variety of financing options are available to companies. Companies should explain why a non-pre-emptive issue of equity securities is the most appropriate means of raising capital, and why other financing methods have been rejected.
- **The level of dilution of value and control for existing shareholders.** Companies should aim to ensure that they are raising capital on the best possible terms in order to avoid unnecessary dilution of existing shareholders, particularly where the proposed issue is in the context of a possible rise in the share price. Any discount at which equity is issued for cash other than to existing shareholders will be a concern.
- **The proposed process following approval.** Companies should make clear the process they would follow if approval for a non-pre-emptive issue were to be granted, for example how dialogue with shareholders would be carried out in the period leading up to the announcement of an issue.
- **Contingency plans.** Companies should explain what contingency plans they have in place in case the request is not granted, and the implications of such a decision.

3 Companies should, where possible, signal the possibility of their intention to request a specific disapplication of pre-emption rights at the earliest opportunity. In some cases it may be appropriate for companies to consult a small number of major shareholders before making any announcement. Companies and shareholders should be mindful of the possible legal and regulatory issues in doing this.

CONTACT DETAILS

More details of the Pre-Emption Group and its activities can be found at:

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APPENDIX

DEFINITIONS

Acquisitions and Specified Capital Investments

The greater freedom to execute non-pre-emptive issues of equity securities in connection with an acquisition or specified capital investment pursuant to paragraph 3 of Part 2A is intended to allow companies the opportunity to finance expansion opportunities as and when they arise.

In the context of paragraph 3 of Part 2A, specified capital investment means one or more specific capital investment related uses for the proceeds of an issuance of equity securities, in respect of which sufficient information regarding the effect of the transaction on the listed company, the assets the subject of the transaction and (where appropriate) the profits attributable to them is made available to shareholders to enable them to reach an assessment of the potential return.

Items that are regarded as operating expenditure rather than capital expenditure will not typically be regarded as falling within the term "specified capital investment". In situations where there is doubt as to whether the use of proceeds of a particular issuance falls within the meaning of the term "specified capital investment", companies should, where possible, consult with their main shareholders in advance of agreeing to undertake the issuance.

While it is acknowledged that companies may occasionally raise equity finance in good faith for the purpose of a specific, identified acquisition or investment that subsequently fails to materialise for reasons outside the company's control, the issuance of equity securities representing in excess of 5% of issued share capital in any one year in order to build a "war chest", i.e. to fund unspecified or speculative opportunities, will be regarded as contrary to these principles.

Clawback

Clawback, as it is referred to in paragraph 4 of Part 2B, is the right of existing shareholders to subscribe for their pro rata share of an issue at the offer price. This differs from a full rights entitlement, since it is non-renounceable and therefore does not permit the shareholder to sell this entitlement to another investor.

Discounts

In general terms, the "discount" (paragraphs 5 to 9 of Part 2B and paragraph 2 of Part 3) is defined as the aggregate of:

(a) the amount by which the offering price differs from the market price, and

(b) expenses directly attributable to the making of the issue (including, without limitation, underwriting commissions, sub-underwriting fees, brokerage fees, corporate finance fees, performance or incentive fees, professional advisers' fees and roadshow and other marketing costs, in each case to the extent borne by the company).

Where any item of expense is unknown at the time of an issuance of equity securities, the company shall include a reasonable estimate of the relevant item for the purpose of calculating and disclosing discount. Where the amount of any performance or incentive fee is undetermined at the time of an issuance of equity securities, for the purpose of calculating and disclosing discount, the company should assume that the maximum amount will be paid.

The reference market price for the calculation of discount will depend on the manner in which an issue of equity securities is executed.

- In the case of an equity issue priced during London market hours, the middle market, on-screen, intra-day quotation at the time the company agrees the issue price is likely to be the most appropriate benchmark for measuring discount.
- In the case of an equity issue priced outside London market hours, the middle market quotation derived from the latest available daily official list of the London Stock Exchange (SEDOL) is likely to be the most appropriate benchmark for measuring discount.
- In the case of an equity issue priced outside London market hours by a company with shares or depositary receipts also admitted to trading on a market outside London, provided liquidity in that market is sufficient, it may be appropriate to use an on-screen, intra-day, middle market quotation from that market at the time the company agrees the issue price as a benchmark for measuring discount.

In each case, the reference market price and the time at which it was calculated should be stated in pricing announcements.