

Sale of Body Corporate

Any change to the current regime should only be made after detailed analysis of how it might impact on minority shareholders in private companies and ensure it retains the facility for them to be informed of, and involved in transactions involving a change of control of a company. It is illogical on the one hand to try and make it easier for business angels to invest in private companies but on the other hand prejudice their ability to exit.

The proposed restriction of the “may reasonably be regarded” test may seriously prejudice minority shareholders in family run and other small companies. The alternative “hard edged” or “group of connected individuals” test is very narrow (the definition of close relative excludes, for example, grand-parents, nephews, nieces and cousins) so that a family company where some of the shareholders were only cousins or grandchildren of a director would not qualify, and nor would former directors and their relations. It is important that the exemptions are drafted widely enough to enable minority shareholders to be told of an offer and be given an opportunity to participate in the negotiation process before the sale of the majority interest is finalised and the minority either compulsorily bought out if the Articles of Association contain “drag along provisions” or left. The exceptions must also allow them to receive enough information to exercise any “tag along” rights they have under the Articles.

Under the proposed amendment to Article 70 RAO. Professional advisers acting for the minority shareholders who do not come within the definition of “S” or “T” will not be exempt from the regulated activities of dealing as agent, arranging a sale or giving investment advice to or for the minority. Whether a Part XX professional firm can advise the minority shareholder would then depend on whether the activity is (1) permitted under the (Professions) (Non-Exempt Activities) Order and the relevant firm’s DPB Rules and (2) is complementary to some other professional service supplied to that client (section 332(4) FSMA). For example, a professional firm will not be able to advise a minority shareholder to accept an offer if it involves taking shares or loan notes and the purchaser is a professional purchaser of securities, e.g. a private equity firm (article 6(2) of the (Professions) (Non-Exempt Activities) Order. It seems unrealistic to require the minority shareholders to bear the costs of involving an authorised firm with a permission to advise on unquoted investments (most IFAs only advise on collective investment schemes and insurance products), the fee in all but the case of the largest private companies would usually exceed the consideration for the shares sold.

Of perhaps greater concern is in respect of financial promotion. To be fair to the minority they should be told of the offer before a deal is concluded, and if the Articles of Association contain tag along provisions, it will be necessary to notify them of the offer to give them the opportunity to exercise their rights. The guidance by the FSA in 1.4.19G of Appendix 1 of the Authorisation Manual suggests that sending out a draft share purchase agreement after a deal has been agreed in principle may not be an invitation or inducement (as the recipient has already decided to sell). The inference is though that the initial approach will be. The guidance is equivocal on whether sending out an engrossment of an agreement asking the minority shareholder to sign without any prior notification will be (but if not an invitation to sell, what is it?). However, the importance for the minority is being told before a deal is final, so they are not simply presented with a fait accompli, or worst of all told that an offer cannot

be made to them because of the Financial Promotion prohibition. (In the case of “drag along” there is the argument that simply notifying them that their shares are going to be compulsorily acquired under the drag along provisions does not constitute a financial promotion as being neither an “invitation” nor an “inducement”).

Paragraph 6.22 of the Proposals suggests that it may be possible to contact minority shareholders in such a situation either via the directors of the company under Article 43 or through professional firms subject to the Part XX regime under Article 55 or 55A of the Financial Promotion Order. We would, however, point out that Article 43 does not permit the directors to inform shareholders of an offer if the consideration is not wholly for cash. Matters involving a loan stock (or share) alternative cannot be communicated under Article 43 because they would, to that extent, relate to an investment other than that issued by the company to be acquired. Nor would the offeror’s or the company’s own solicitors or accountants be able to communicate the offer under Articles 55 or 55A. Article 55 only permits real time (and not therefore written) communications by a professional firm to its own client. Article 55A only permits non-real time communications describing the Part XX services which a firm is able to offer its clients. The only professional firm that will be able to use Article 55 or 55A would be if a minority shareholder had already instructed a professional firm, that professional firm could then orally inform the client of the offer under Article 55.

Instead the parties and their professional advisers would have to rely on coming within the “one-off” exemptions in Articles 28 and 28A. Article 28 may allow a communication by the offeror or its professional advisers in writing (non-real time) to the minority shareholders, e.g. if they could be regarded as a group of recipients who would engage in the relevant investment activity (the sale of their interests) “jointly” (the FSA’s guidance is silent on the point (AUTH Ap1, 1.14.6G)). Use of the real-time exemption in Article 28A is more limited because of the need that the recipient understands the risks associated with engaging in the transaction. (This however is more likely to be a problem for the professional advisers to the small shareholder than the advisers to the offeror, who are unlikely to be making unsolicited real-time communications to minority shareholders).

To conclude, it would seem undesirable that minority shareholders, including family members who could not come within the definition of “S” or “T”, should be so excluded, and in the case of those that have tag along rights, potentially hindered from exercising their rights. Involving an authorised firm to approve the relevant communication will only rarely be realistic, because of the high fees charged by authorised firms for approval of financial promotions.

Accordingly, if any alteration to the present exemptions are to be made, those changes should still permit minority shareholders in private companies to (a) be informed of the offer and its terms before a change of control takes place and (b) be able to obtain advice from an unauthorised firm.

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