

FINANCIAL SERVICES AND MARKETS ACT 2000

TWO YEAR REVIEW: CHANGES TO SECONDARY LEGISLATION

A response from the City of London Law Society Company Law Sub-Committee in relation to Chapter 6 (Sale of a Body Corporate)

1. GENERAL COMMENTS

- 1.1 We have confined our response to Chapter 6 (Sale of a Body Corporate). This is because Article 62 of the Financial Promotion Order (FPO) is one of the exemptions that is most often relied upon, but has caused much debate and difficulty in practice.
- 1.2 We agree with your policy statement in paragraph 6.3 that financial services regulation should not extend to activities carried on for commercial (as opposed to investment) purposes and that it is, therefore, appropriate to exempt activities in connection with the sale of a body corporate.
- 1.3 In line with this policy, Article 62 (in its current form) exempts **transactions** (rather than **individuals**) that fall within its scope – i.e. you look at the activity, rather than having to analyse the status of each of the individuals involved in the activity. We consider that this is an essential element of the exemption which should be preserved. Quite apart from policy considerations, there are important practical reasons for retaining this approach. It would be time consuming and expensive, in the context of a private company sale and purchase, to have to analyse the status of each individual to see whether they fitted within the relevant category (e.g. persons acting together) in order to decide whether or not the exemption applied. By their very nature, these types of transaction normally do not require or justify the involvement of an authorised financial adviser. It would be expensive and disproportionate to require such involvement in a commercial transaction, for no other reason than to approve a financial promotion which, on a technicality, falls outside the relevant FPO exemptions.
- 1.4 In our experience, the so-called "hard-edged" test is very seldom used in practice. Usually this is because there is more than one seller (or purchaser), one or more of whom fall outside the narrow definition of "group of connected individuals", and the very stringent conditions of Article 62(3)(c) are therefore not satisfied. Reliance is almost always placed upon the so-called "purposive test" in Article 62(2)(b)(ii).
- 1.5 The drafting of the proposed new Article 69 is complex and difficult to follow. Our strong preference is to have a single "purposive test", based solely upon the **transaction** meeting the criteria set out in your Option 2 (in paragraph 6.18). If, however, you decide to retain the "hard-edged" test, we suggest it is put into a separate exemption.
- 1.6 The reason we favour your Option 2 (in paragraph 6.18) is that it is the most flexible of the three options. Like you, we are not aware of any consumer detriment having arisen since N2 out of the width of the current exemption. We are, however, concerned that the financial promotion regime is more extensive in scope than in most other jurisdictions and the penalties and consequences of breach are serious. We therefore strongly support an exemption which is clear, easy to apply and proportionate.
- 1.7 In our view, the 50 person limit should relate to **legal** rather than **beneficial** ownership. This is consistent with the drafting of new Article 69 in the draft Statutory Instrument, but not with

the statement in paragraph 6.18. In this connection, it is worth noting that s.360 CA 1985 prohibits notice of any trust being entered on the register of members. If the company itself cannot look behind its register of members (other than in limited circumstances in the case of a public listed company), it would seem unreasonable that a third party should be required to do so.

- 1.8 It would be helpful to provide some guidance as to the meaning of "day to day control". Although "control" is defined in the Taxes Act and the Takeover Code, we are not aware of any similar definition of "day to day" control. The words "day to day" do not seem to us to be necessary or to add much. If, however, they are retained, then it would be helpful to clarify their meaning, for example by specifying a number of indicators of "day to day control", with a provision that if all or some are present the test will be met (along the lines of Articles 12 and 28 of the FPO).
- 1.9 The exemption should, in our view, extend to warrants and options to subscribe new shares.
- 1.10 If Article 62 is narrowed as you propose, this may cause difficulties in relation to a non UK takeover offer made in accordance with the requirements of the relevant non UK regulator, where there happen to be a few UK based shareholders of the target company. Some of the communications made to those shareholders in the course of such a non UK takeover may be financial promotions. If those communications do not contravene the rules of the relevant jurisdiction, it does not seem right that the presence of a few UK based shareholders should necessitate an additional layer of UK regulation. If the offer is made in France in accordance with French requirements, it could cause delay and unnecessary expense to require the relevant communications to be translated and approved before they can be made. It may be appropriate therefore to consider widening the scope of Article 67 of the FPO in order to exempt such communications.
- 1.11 In relation to telephone campaigns, we support the proposal to replicate the position under the old Common Unsolicited Calls Regulations, which exempted calls made under the supervision of an authorised person in connection with a takeover subject to the Takeover Code (i.e. Option 3). Option 1 seems to be at odds with the FSA guidance in AUTH App I 1.10.4G. We therefore favour Option 3 which mirrors the Takeover Code.

2. OUR RESPONSES TO YOUR QUESTIONS 24-31

Our response to your questions 24-31 are as follows:

Q24: Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the "may reasonably be regarded" test will apply only in relation to a party who is acquiring or disposing of the day to day control of that body corporate and hence not to advice given to a party whose object is not acquisition or disposal of day to day control?

No. As explained above, we consider that the exemption should continue to be based upon the **transaction**, rather than the parties involved in it. If a purchaser could only deal with a controlling shareholder, there is a risk that the minority shareholder(s) will be excluded or prejudiced by being left out of the negotiations.

Q25: Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the "may reasonably be regarded" test will apply only in relation to takeovers of small companies?

Yes.

Q26: Which option do you prefer as the definition of "small" company in respect of which the "may reasonably be regarded" test should apply? Do you have any other suggestions?

Option 2, for the reasons given above. Please see our general comments above for our other suggestions

Q27: Do you agree that the exemption for promotions in respect of takeovers should be subject to the same conditions as those which apply under the revised RAO?

Not necessarily. We consider that in both cases the transaction should be the key to the exclusion/exemption, but we accept that there may be an argument for taking a more restrictive approach with respect to authorisation. However we do not consider that this should then be automatically reflected in the FPO exemption. If it is decided that, for the purpose of the revised RAO, the jurisdiction of the Takeover Panel should continue to apply to certain unlisted companies, there is no reason why the same criteria should apply to the FPO exemption.

Q28: Do you agree that it is desirable to have some form of regulation or conditions on unauthorised persons who are carrying out telephone campaigns?

Yes.

Q29: Do you agree that broadly speaking we should regulate to the same extent as under previous legislation?

Yes.

Q30: Which of the three options above do you prefer and why?

Option 3 because it mirrors the Takeover Code provisions. We note your concern (in paragraph 6.36) that the Takeover Code should not form the boundary of criminal liability. Whilst we do not necessarily share this concern, there is no reason, in our view, why the requirements of Article 19.5 of the Takeover Code could not be incorporated into the FPO, if necessary.

Q31: Do you agree that under the proposed regulatory framework the provisions for the Financial Promotion Order providing exemptions for takeovers of relevant unlisted companies (i.e. Articles 63-66) are no longer necessary?

Yes.

28 May 2004