

## **UK implementation of the prospectus directive 2003/71/EC**

This paper contains the response of the Law Society's Standing Committee on Company Law to the consultation document "UK implementation of the Prospectus Directive 2003/71/EC" published by HM Treasury and the FSA in October 2004.

### **Q1. Do you agree that the Directive definition of a public offer benefits from this clarification?**

Yes.

### **Q2. Do you anticipate particular issues regarding the application of the definition of a public offer in other circumstances?**

We expect that there will be a number of issues. In some cases this is as a result of the decision simply to cut and paste the exemptions from Articles 3 and 4 of the Prospectus Directive into the draft Regulations and the draft Prospectus Rules. Because the definition of a public offer is so wide, the exemptions will be essential to making the regime operate properly and we find it surprising that no attempt has been made to clarify how a number of these exemptions would apply in the UK:

- (a) There has been an active debate in the UK as to whether the intention behind the Directive was to require a prospectus for public offers of securities which have already been admitted to trading. We can see good policy arguments on both sides. It would assist if the position could be clarified one way or another in the implementing legislation. We would point out that under the Prospectus Regulation the issuer of an exchangeable bond is not required to produce a registration document in relation to the underlying shares provided they are already admitted to trading. If the definition of offer to the public does catch securities which are already admitted to trading, this means that a holder of a stake in a traded company would have to produce share registration document information if he made a direct public offer of the shares but not if he issued a bond exchangeable into those shares. This appears to have no basis in logic. It is also unclear how a seller of already admitted securities who wishes to make a public offer of those securities would obtain the information necessary to publish a prospectus, which is presumably the rationale behind the approach taken by the Prospectus Regulation to exchangeable bonds.
- (b) The proposed new section 103(2) (which is not expressly limited to screen trading as paragraph 4.10 of the Consultation Document suggests) exempts communications in connection with trading on, inter alia, a regulated market. This could be read as exempting any secondary market offer, such as a block trade, where the transactions are settled through CREST. Is that the intention? If settlement through CREST would not be sufficient, would it be possible to bring transactions within the exemption by routing them through a broker so that they could be said to be "on-market"? In short, it would be helpful for issuers and offerors if the proposed new section 103(2) was clarified so that what is "on market" and what is "off market" were clearly delineated.
- (c) In most cases, one would expect the only persons participating in a block trade to be professionals anyway and so the Prospectus obligation ought not to apply but the exemption in the proposed new section 85(3)(a) applies only where the offer is

"addressed only to" qualified investors. How is this to be interpreted in the context of a block trade or accelerated bookbuild announced to the market as a whole but expressed to be available only to professionals? If "addressed to" means that the offer must be communicated only to people within the exempt categories, then block trades, which have been an important feature of the market in the last few years will be doomed. Importing the financial promotion vocabulary of "made to or directed at" would provide a solution.

- (d) The proposed new section 85 prohibits offers to the public unless a Prospectus has been published. The definition of public offer is so wide that it might catch a range of pre-prospectus communications about the offer. This might apply, for example to the current practice of making an announcement of intention to float ahead of an IPO. In practice a great deal of weight might have to be placed upon a judgment as to what would amount to sufficient information as to enable an investor to decide to buy or subscribe. It would assist if this test could be made more objective by reference to a reasonable investor. Even greater certainty could be achieved by clarifying that the communication has to have the legal characteristics of offer and acceptance (as per section 103(4) of the Financial Services and Markets Act). We believe there is a strong argument that this is implicit in the references to "offer" in the Directive definition.
- (e) Similarly, the definition could catch analysts research prepared in connection with an offer or even press articles; there is no requirement in the definition for the communication to come from the offeror or issuer, so the publication of either ahead of approval of a Prospectus could cause difficulties.
- (f) Unless clarified in the implementing legislation, there will be uncertainty as to whether the definition of securities (derived from Article 4 of the new Investment Services Directive) catches loan notes (in which case virtually all take over offer in the UK will require a prospectus equivalent document) and share options and employee share awards.
- (g) We assume that the FSA will publish disclosure items compliance with which will be deemed to be prospectus equivalent for the purposes of Articles 4.1(b) and (c) 4.2 (c) and (d); it would be thoroughly unsatisfactory for individual offerors or applicants to have to approach the FSA for clearance on a case by case basis.
- (h) The definition incorporates the concept of investors buying or subscribing for securities. *Governments Stock v Christopher* established that "purchase" or "subscribe", in the context of the Companies Act 1948, did not catch a securities exchange offer. If, as we assume to be the case, the intention is to override *Governments Stock v Christopher* it would be helpful if this could be made more explicit.
- (i) It would be helpful to clarify whether takeovers effected by way of scheme of arrangement will involve an offer to the public requiring a prospectus (current practice is that they do not under existing law). This will be very important for AIM companies, which cannot take advantage of PR1.2.2R(2).

We appreciate that maximum harmonisation imposes particular constraints upon the Treasury in implementing the Directive. However, we feel the responsible approach would be to

attempt to clarify the significant ambiguities and interpretational difficulties in the Directive when implementing it into national law. If it subsequently becomes apparent that national law is at odds with the Directive, it can be changed. In the mean time, however, providing this clarification will at least give issuers and offerors comfort that the UK government considers that they are operating within the law. The alternative, of simply incorporating the problematic elements of the Directive, places the risk on issuers and offerors, which is not where it should be, and is bound to undermine the efficient operation of the markets that the Government is trying to achieve.

**Q3. Do you consider the 2.5 million euros threshold to be an appropriate level at which the production and approval of a prospectus is required under UK law?**

Yes. We wonder whether the proposed section 85(3)(e) could not be deleted on this basis.

**Q4. What form of additional UK prospectus regime should apply below the 2.5 million euros threshold?**

None, reliance on the financial promotion regime and other existing law should be adequate.

**Q5. Do you agree with our approach to implementing the exemption where the offer of securities is addressed to fewer than 100 persons?**

On balance, yes. We are not aware of any difficulties having been caused by the existing paragraph 4(2) of schedule 11, but this (admittedly) limited element of "gold plating" is inconsistent with the harmonisation objective behind the Directive and may put the UK at a disadvantage, assuming other Member States do not follow suit. In addition, it is questionable whether it is open to the UK to introduce this element of "gold-plating" in the context of a maximum harmonisation directive.

**Q6. Do you agree with our proposed implementation approach for attaching responsibility to the prospectus?**

Yes, we agree with the approach set out in paragraph 4.22 but we note that schedule 3 of the proposed Regulations has the effect of revoking Regulation 10 of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001 without providing any replacement provision for identifying the persons responsible for Prospectuses. We assume that there will be new Regulations to achieve this; it is very important that an equivalent to the existing regulation 10(2) is contained in the new Regulations. This is to ensure persons making an offer in association with an issuer, eg employer shareholders in an IPO, are not fixed with responsibility.

**Q7. Do you agree that the UK should have a Qualified Investor regime?**

Yes.

**Q8. Do you agree that a prospectus should be made available on an issuer's website in addition to in printed form?**

Yes although we are concerned that some issuers (e.g. special purpose vehicle debt issuers, investment trusts and some very small issuers who are required to issue prospectuses for the purposes of making a public offer) may not have their own web site and that financial intermediaries may be unwilling to publish prospectuses on their web sites for fear of

potential liability issues (however unfounded). We think it very important that the FSA's proposal to publish a list of approved Prospectuses with hyperlinks on its website (Annex D.19) be followed through. Ultimately, we believe all Prospectuses should be available on the FSA's website. The EDGAR facility at the SEC quickly became an invaluable resource to investors and practitioners.

**Q9. Do you agree that a notice should be published stating how the prospectus has been made available and where it can be obtained by the public?**

Yes.

There are one or two areas where you have not invited specific response to your consultation but we would like to comment.

1. The proposed new section 86(6) appears to us to implement Article 8.1(a) of the Prospectus Directive incorrectly. The Directive appears to require both alternatives to be made available. If that is not correct, implementing only the alternative in Article 8.1(b) would be likely to make the use of price-range Prospectuses, which are an important feature of international equity offerings, impracticable. If only one of the alternatives is to be selected, the solution, which would be entirely consistent with current market practice, would be to opt for the alternative permitted by Article 8.1(a).
2. The proposed new section 87(1) provides that a supplemental prospectus is required if there is a significant change as at the final closing of the offer or, as the case may be, trading on a regulated market begins. It does not cater for the situation where there is both an offer to the public and an application for admission to trading. It is possible that the offer could close before trading commences or it is possible that it could close after trading commences. What is the point at which the obligation to provide a supplementary prospectus ceases in each of these cases?
3. As drafted, the proposed new section 87D(2)(c) could be read as requiring the competent authority itself to provide a translation of the summary to the host member state competent authority.
4. We think it would be unfortunate if the Regulations incorporated the definitions of home member state and host member state from Directive without clarification. The definitions in the Directive are difficult to apply for third country issuers in a number of respects. One is that multi-jurisdictional offerings usually commence in each jurisdiction simultaneously. If the offerings all commenced at the same time there can be no single jurisdiction in which the securities were intended to be offered for the first time. Where applications for trading are made in more than one member state, the vagaries of different application procedures (which will not be harmonised under the Prospectus Directive) may mean that different steps along the application process can be required at different stages in different member states for no great purpose. How, in these circumstances, can it be determined at which stage the first application to admission to trading has been made?
5. The cross-reference to Article 2.1 of the Directive in the definition of "home Member State" in the proposed section 103(1) would miss home Member States which had been selected by third country issuers under the transitional provisions in Article 30.1.

6. The proposed new section 85(2) incorrectly exempts transactions falling within section 85(3) from the prospectus requirement, not only in connection with an offer to the public, but also an admission to trading. It should be just the former (although section 85(3)(f) applies to both and would have to be dealt with separately).
7. The proposed paragraph 9(2) of schedule 11A could be improved by making it clear that the reference to "sub-paragraph (1)" is a reference to sub-paragraph (1) of paragraph 9, not paragraph 7. We would also suggest that paragraph 9 of schedule 11A could be moved to section 85(5). This would be more logical and would remove the possibility of an anomalous result on the application of new Listing Rule 4.1.1(1).
8. In order to avoid any suggestion that the proposed new section 85(6) would require "prospectuses" (in the wide sense of the word) produced by issuers which are exempt from the prospectus obligation under the Directive (e.g. an SME issuing securities with a value of €1m) to comply with the prospectus rules and the provisions of the Act, we think it would be helpful to make clear in the proposed new section 84(2)(b) that references here to a prospectus mean a prospectus submitted voluntarily to the FSA for approval under the Act. That is to say, it is only prospectuses voluntarily submitted under the Act to obtain the benefit of the passport which must comply with the Act; not a offering document which is exempt but, in accordance with normal market practice, is called a "prospectus"
9. It is not clear to us why the proposed new section 84(2) refers to the Directive. Surely the Directive will have been implemented by the Act and the prospectus rules? Including the reference to the directive seems to expose issuers and offerors to the risk of defective implementation by the Government.
10. The purpose of the proposed new section 87C(5) is unclear to us. What is gained by being able to treat issuers, offerors and applicants in this way?
11. The parentheses in proposed section 87(C)(2)(c) should extend to the end of that subsection: the competent authority has discretion to exempt an issuer from the transaction, not from the summary itself.
12. The proposed new section 90(12) would only have the effect of relieving liability under section 90; it would not apply to other forms of civil liability (e.g. common law liability for negligent misstatement) as required by the Directive. The relieving provision should also make it clear, as in the Directive, that it covers the translation. We suggest that, in addition to covering all forms of civil liability as required by the Directive, a clarificatory provision along the lines of the existing section 90(9) FSMA is desirable.
13. The reference in proposed section 103(2)(b)(iii) to section 118(3) FSMA should be a reference to section 130(A)(1) to take account of implementation of the Market Abuse Directive.
14. It is not clear to us why paragraph 3(iii) of the proposed new schedule 11A refers to "any international organisation" rather than "public international body" which is defined in the Prospectus Regulations.

15. In order to allow a prospectus approved in another Member State in connection with an offer to the public with no admission to trading to be circulated in the UK without breaching the financial promotion restriction paragraph 8(b) of schedule 3 should refer to prospectuses approved in accordance with the Directive. The same exemption should also apply to documents required or permitted to be produced by the Disclosure Rules.
16. Although some elements of the proposed Disclosure Rules cover similar ground, Article 21.4 of the Directive does not appear to have been implemented.
17. It is not clear to us why schedule 11 of the FSMA is proposed to be retained and why it is necessary to have a new schedule 11A.
18. We note that the Prospectus Rules referenced under "who is responsible for the prospectus" in Appendix A to the consultation document are incorrect.