

Pre-Emption Group

Monitoring Report

May 2016



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Introduction

Pre-emption rights are an important element of investor rights in UK company law, providing them with protection against inappropriate dilution of their investments. Pre-emption gives existing shareholders in a company the right to subscribe for their pro rata share of any new shares in that company issued for cash. They may be disapplied only by a special resolution of shareholders at a general meeting of the company.

In addition to the statutory pre-emption provisions applying to UK incorporated companies, a company with a premium UK listing which is incorporated outside the UK is required 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.

The Pre-Emption Guidelines were originally published in 1987 to provide guidance on disapplying pre-emption rights. A review of the impact of pre-emption rights in 2004, carried out by Lord Paul Myners on behalf of the then Department of Trade and Industry, recommended that the guidelines be updated to reflect developments in the market. As a result, the Pre-Emption Group (PEG) issued a new Statement of Principles in May 2006 and a revised edition in July 2008.

As six years had passed since the Statement of Principles were last considered, the Financial Reporting Council (FRC), as Secretariat, decided to reform the PEG under the Chairmanship of Mr Robert Swannell. The PEG considered market changes, developments in best practice and whether consequential revisions to the Statement of Principles were appropriate, and a revised Statement of Principles was issued in March 2015.

The Statement of Principles aims to provide clarity on the factors to be taken into account when considering the case for disapplying pre-emption rights and making use of an agreed authority for a non-pre-emptive share issue and the circumstances in which flexibility might be appropriate.

When the revised Statement of Principles was published the PEG undertook to issue monitoring reports on its application. This report looks at the implementation of the Statement of Principles for meetings held between 12 March 2015 and 12 March 2016. It has been developed using information sourced from the Manifest Ltd database¹, public filings on company websites and other sources such as the London Stock Exchange.

The FRC would like to thank the members of the PEG for giving up their time to be involved in the work of the group.

¹ Manifest holds data on most but not all companies listed on the Main Market. In addition, the PEG has overlaid its own definitions and interpretations of the information provided.

The 2015 Revisions

In March 2015 the PEG published 'Disapplying Pre-Emption Rights: A Statement of Principles', providing guidance to companies and shareholders on the factors to take into account when considering whether to disapply pre-emption rights. The revisions clarified the scope of the Principles to take account of market changes and developments in best practice and encourage greater transparency.

Key amendments to the 2008 Statement of Principles included:

- Clarification of the scope of the Statement, making it clear that it applies to both UK and non-UK incorporated companies whose shares are admitted to the premium segment of the Official List of the UK Listing Authority.
- Clarification that the Statement applies 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, including, for example, "cashbox" transactions.
- Flexibility to undertake non-pre-emptive issuance of equity securities in connection with acquisitions and specified capital investments, consistent with existing market practice.
- Greater transparency on the discount at which equity securities are issued non-pre-emptively.

No changes were made to the key thresholds for general disapplication of pre-emption rights. The Statement of Principles provides that a company may seek authority by special resolution to issue non-pre-emptively for cash equity securities representing:

- no more than five per cent of issued ordinary share capital in any one year; and
- no more than an additional five per cent 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.

Monitoring of market practice

The PEG encouraged companies and investors to begin to use the revised Statement from the time of publication, but acknowledged the overlap with the beginning of the AGM season and that some flexibility may be required. Whilst the principles are not a rule book, the PEG expects all companies to engage with their investors on the basis of the principles.

FTSE 350

	Number	Passed	Defeated
Requests for authority to issue or allot			
General	TOTAL: 351 To approve a general authority to the directors to issue shares (330) Other Resolutions: <ul style="list-style-type: none"> - a general authority to the directors to issue Preference Shares (4) - a general authority to issue shares in relation to regulatory instruments (5) - a general authority to issue special converting shares (2) - a general authority to issue shares by way of a rights issue (1) - a general authority to the directors to issue shares in relation to the scrip dividend scheme (1) - approve a rights issue (1) - an extended general authority to the directors to issue shares (1) - extension of authority to allot ordinary shares to include repurchased shares (1) - authorise the directors to allot any repurchased shares (1) - authorise the directors to allot contingent convertible securities (1) - set the re-issue price range of treasury shares (1) - ratify the previous issuance of shares (1) - to set issue price at a discount (1) 	351	0
Specific	TOTAL: 13 Resolutions in connection with: <ul style="list-style-type: none"> - placings (5) - share consolidation (1) - acquisitions (5) - a merger (1) - issuance (1) 	13	0
Requests for disapplication			
General	TOTAL: 351 To disapply pre-emption rights on the issue of shares for cash (337)Other Resolutions: <ul style="list-style-type: none"> - to disapply in relation to an acquisition or specified capital investment (2) - to disapply on the issue of preference shares (3) - to disapply on the issue of contingent convertible securities (2) - to disapply on the issue of tier 1 securities (3) 	350	1

	<ul style="list-style-type: none"> - to disapply pre-emption rights on the issue of shares under the Performance Share Plan & Incentive Award Deferral Plan (1) - to disapply on conditional capital (1) - to disapply on authorised capital (2) 		
Specific	<p>TOTAL: 9</p> <p>Resolutions in connection with:</p> <ul style="list-style-type: none"> - a merger (2) - placings (3) - share consolidation (2) - an acquisition (1) - issuance (1) 	9	0

FTSE 350 companies proposed 351 general authorities to issue or allot, all of which were approved. There were 13 specific authorities to issue or allot, covering placings, issuance, share consolidation, a merger and acquisition-related issuance. The wording of the specific resolutions was standard, with further disclosure of the nature of the requests included in related circulars and notes.

351 general resolutions to disapply were proposed. Only one of these resolutions was defeated, that of the general authority to disapply on the issue of shares for cash of up to five per cent of capital at SVG Capital. A poll was called on this special resolution, as opposed to the other resolutions, which all passed on a show of hands. The resolution received a 'for' vote of 69.74 per cent, an insufficient majority to pass the resolution. Whilst ten of the other resolutions at SVG's meeting received greater than 97 per cent support, those on the remuneration policy, remuneration vote, re-election of the Chairman and re-election of the CEO received significantly lower levels of support, between 60 and 70 per cent. The Group is aware of a number of cases of notable voting dissent. Disapplication resolutions are subject to the seventy five per cent special resolution threshold and in keeping with Provision E.2.2 of the UK Corporate Governance Code when, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result.

FTSE 350 companies proposed nine specific resolutions for disapplication. The specific requests, all of which were approved, covered placings, issuance, share consolidation, an acquisition and two share issuances in connection with a merger. The specific resolutions again took the same form as more general resolutions, but further information was provided in the relevant circulars.

Requests for different levels of disapplication for cash (by companies)			
	15per cent	10 per cent	5 per cent
FTSE 350	1	93	203

Of the requests for disapplication on general issuances for cash by companies², the vast majority were requests for disapplication of up to five per cent. Less than 35 per cent of the resolutions

² This does not include investment companies and trusts, which are covered below, and relates only to general issuances for cash, not those issuances for cash relating to regulatory or other purposes.

requested a disapplication of ten per cent or more, but one company requested disapplication of 15 per cent of its share capital.

For disapplications of ten per cent, most requested this in one resolution covering all of the disapplication, with the associated undertakings regarding an acquisition or specified capital investment referred to in the explanatory notes to the resolutions or the Chairman's statement. Four others, however, referred to the two portions of five per cent disapplication separately, but within the same resolution.

In contrast, Laird presented two resolutions, each for five per cent, with the second requesting the additional disapplication in connection with an acquisition or specified capital investment. The resolution was titled 'Disapplication of pre-emption rights for an acquisition or specified capital investment', but did not reference the Statement of Principles. However, the explanatory notes stated that the directors will have:

due regard to the Statement of Principles in relation to any exercise of this power and in particular they confirm that they intend to use this power only in connection with an acquisition or specified capital investment (within the meaning of the Statement of Principles from time to time) 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.

Other companies described the changes to the Statement of Principles in either the Chairman's statement or the explanatory notes to explain the context of their disapplication requests. For example, in the Chairman's statement at Rathbone Brothers, where two resolutions each covering five per cent were presented:

Each year at the AGM, shareholders are invited to grant the board a power to allot shares for cash (otherwise than in connection with a rights issue or similar pre-emptive issue) without first offering those shares to existing shareholders in proportion to their existing holdings. This power to disapply pre-emption rights has historically been limited to a maximum amount representing approximately 5% of the company's issued share capital in accordance with best practice guidelines on the disapplication of pre-emption rights issued by The Pre-Emption Group. A recent change to those guidelines has now introduced greater flexibility for companies to undertake non-pre-emptive issues for cash. Specifically, the guidelines have been relaxed to allow companies the opportunity to finance expansion opportunities as and when they arise. The board would like to have the flexibility that this change affords. Accordingly, in line with the revised guidelines, which have been endorsed by The Investment Association, the company is seeking, in addition to the customary disapplication power over 5% which is sought at Resolution 18, a disapplication power over a further 5% of the company's share capital provided that the additional power sought at Resolution 19 is only used in connection with acquisitions and specified capital investments.

Investor representatives on the PEG noted a preference for companies to propose two separate resolutions, each requesting a five per cent authority to disapply pre-emption rights. The investor view is that resolutions requesting the second five per cent authority should refer specifically to use in connection with a specified capital acquisition or investment. To clarify best practice on the format of resolutions for authorities to disapply pre-emption rights the PEG has published template resolutions along with this report.

Investment companies and trusts accounted for 68 resolutions to issue shares or disapply pre-emption rights. Investment organisations covered by Chapter 15 of the UK Listing Rules often consider it appropriate to apply for approval of a ten per cent disapplication where they are trading at a premium to net asset value. These companies accounted for 41 disapplication resolutions, with 11 proposing a five per cent disapplication and 28 requesting ten per cent. Additionally, one organisation proposed, and had approved, a disapplication request covering 15 per cent of issued share capital and another proposed a disapplication of 12.1 per cent.

Six of the FTSE 350 resolutions concerning authority to issue or allot shares or disapply were addressed at Extraordinary General Meetings. Another 20 resolutions were considered at GMs, with the large majority addressed at AGMs. Most of the EGMs covered a series of resolutions, but at International Public Partnerships the allotment of ordinary shares without consideration of the pre-emption provisions within the company's articles was the only resolution proposed at the EGM, and passed with more than 98 per cent of the vote.

Guidance from the Association of British Insurers (ABI) used to provide that directors of those companies using their authority to allot an additional one-third of the company's share capital above the first third allotted should stand for re-election at the next AGM. This guidance was in place before amendments were made to the Corporate Governance Code in 2010. The Code now provides that all directors of FTSE 350 companies should be re-elected annually, on a comply or explain basis, and a recent survey found that 98.4 per cent of FTSE 350 directors stand for annual re-election, up from 69.5 per cent in 2011³. Most elections are no longer tied to the issuance of shares, however, some companies continue to refer to the ABI guidance, for example Inmarsat, which made the following disclosure in the explanatory notes for its resolution on the allotment of shares:

Where the aggregate actual usage of this authority exceeds the one-third threshold in the circumstances set out in the guidance issued by the Association of British Insurers ('ABI') concerning directors' powers to allot share capital in the context of a rights issue, all members of the Board of the Company will stand for re-election at the following AGM, as required by the ABI and to the extent not already doing so in accordance with the UK Corporate Governance Code.

³ Trust and integrity – loud and clear?; Grant Thornton; December 2015.

The greatest number of requests for issuance or to disapply pre-emption rights came from the Financial sector (247), Consumer services (141) and Industrials (130).

By Sector: Requests for Authority to issue/allot or disapply pre-emption rights (FTSE 350)	
Oil and Gas	26
Basic Materials	45
Industrials	130
Consumer Goods	54
Healthcare	33
Consumer services	141
Telecommunications	13
Utilities	14
Technology	21
Financials	247

In 2015, a number of companies carried out placings of just under ten per cent of their issued share capital. In some instances such placings appeared to be against the spirit of the Statement of Principles. Whilst planning for some offers may have been underway before the revised Statement of Principles was issued, and the PEG was not party to discussions with shareholders, it expects that such significant placings should have been the subject of extensive discussion with shareholders.

The most high profile placing was Glencore’s 9.99 per cent, £2.5 billion equity placing for cash in a non-pre-emptive accelerated bookbuild in September. Glencore said at its AGM in May that it would adhere to the Statement of Principles, however when the placing was undertaken Glencore stated it was “in the best interests of Glencore”. At the time, the IA and NAPF made a joint statement outlining that “whilst shareholders generally recognise that the company needed to strengthen its balance sheet, the use of the authority in this manner is a serious and unnecessary breach of the Principles. Most importantly, there is no evidence of any suitable consultation with existing shareholders. This sets a very damaging precedent for market practices”. The Investor Forum was asked to liaise with the company on behalf of investors. The PEG was not party to discussions between the company and shareholders, but was disappointed that some investors indicated there was insufficient consultation when the placing was of a significant amount and undertaken by a major company which had previously indicated it would adhere to the Statement of Principles.

We analysed the support for approved disapplications across the three indices. Companies of all sizes received significant support for their requests, as shown in the following table. More than 98 per cent support was achieved by 62 per cent, 70 per cent and 62 per cent of resolutions at FTSE350, FTSE Small Cap and FTSE Fledgling companies. FTSE Fledgling companies received slightly lower levels of support (78 per cent of resolutions receiving more than 95 per cent support as opposed to 81 per cent at FTSE350 companies) despite the smaller amount of capital subject to the disapplication.

Percentage support for disapplication by FTSE Index ⁴								
	50-60	60-70	70-75	75-80	80-85	85-90	90-95	95-100
FTSE 350	0	0	0	4	6	16	41	290 (223>98%)
FTSE Small Cap	0	0	0	8	2	14	28	217 (188>98%)
FTSE Fledgling	3	0	1	0	0	0	8	43 (34>98%)

FTSE Small Cap

	Number	Passed	Defeated
Requests for authority to issue or allot			
General	TOTAL: 260 To issue shares (255) Other Resolutions: - to issue B class shares (1) - to issue C class shares (2) - to issue at a price which represents a discount to NAV (1) - in connection with a rights issue (1)	260	0
Specific	TOTAL: 9 Resolutions in connection with: - placings (5) - consolidation (1) - acquisitions (1) - capitalisation (2)	9	0
Requests for disapplication			
General	TOTAL: 282 To disapply on the issue of shares for cash (277) Other resolutions: - to disapply in relation to an acquisition or specified capital investment (3) - to disapply on the issue of C shares for cash (2)	281	1
Specific	TOTAL: 15 Resolutions in connection with: - an acquisition (1) - placing (11) - restructure (2) - recapitalisation (1)	15	0

There were 260 general requests for issuance in the FTSE Small Cap, all of which passed. There were nine requests for specific issuance, covering placings, capitalisations, consolidation and an acquisition. Again the specific resolutions followed a general format, with more information provided in the related circulars.

In relation to disapplication, 282 general and 15 specific resolutions were presented and passed. The 15 specific requests for disapplication mostly related to placings, with 11 such resolutions. There were also two resolutions covering restructures and one each regarding a recapitalisation and an acquisition.

⁴ Note: Some companies do not provide detailed voting returns, so these statistics only reflect available records.

In the FTSE Small Cap only one resolution was defeated, a disapplication resolution put forward by Lakehouse. Resolution 15 requested a disapplication authority of five per cent. The resolution received 60 per cent of the vote, which is not enough for approval as a special resolution. Whilst a number of the resolutions received strong support, those relating to directors' remuneration, the authority to allot shares, the authority to purchase shares on the market and authority to make political donations received less than 70 per cent support.

The FTSE Small Cap approach to resolutions relating to issuance and disapplication also varied. Severfield and ITE Group, for example, proposed separate resolutions concerning the disapplication of the additional five per cent in connection with an acquisition or specified capital investment. The resolutions did not reference the Statement of Principles, but they were referred to in the explanatory notes.

In contrast, Acal's resolution concerning disapplication in connection with an acquisition or specified capital investment referenced the related limitations on its use. This resolution was put forward in addition the general authority to issue pre-emptively and allows the company:

to allot or grant rights to subscribe for or to convert any security into shares in the Company in connection with an acquisition by the Company or specified capital investment up to an aggregate nominal amount... For the purpose of this Resolution '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 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.

Tribal Group, however, proposed one resolution covering all of its request for disapplication, but referenced the authority relating to an acquisition or specified capital investment separately. It requested power to make an:

allotment (other than under (a) above and in addition to (b) above) of equity securities having a nominal value not exceeding in aggregate of £237,123.10 in connection with an acquisition or specified capital investment which is announced contemporaneously with the allotment, or which has taken place in the preceding six month period and is disclosed in the announcement of the allotment.

FTSE Fledgling

	Number	Passed	Defeated
Requests for authority to issue or allot			
General	TOTAL: 58 Authority to issue shares (56) Other Resolutions: - to set issue price (2)	55	3
Specific	TOTAL: 8 Resolutions in connection with: - placings (6)	8	0

	<ul style="list-style-type: none"> - to approve participation of particular investors (1) - to issue to a related party (1) 		
Requests for disapplication			
General	TOTAL: 64 To disapply on the issue of shares for cash (63) Other resolutions: <ul style="list-style-type: none"> - to disapply in relation to an acquisition or specified capital investment (1) 	59	5
Specific	TOTAL: 5 Resolutions in connection with: <ul style="list-style-type: none"> - placing (4) - share consolidation (1) 	5	0

FTSE Fledgling companies put forward 58 general resolutions for authority to issue or allot securities and eight requests for specific issuance. Six specific requests were in relation to placings, with the other two addressing approval of the involvement of particular investors and to approve specific issuance to a related party.

FTSE Fledgling companies proposed 64 general resolutions for the authority to disapply pre-emption rights. Five specific disapplication requests were made, covering placings and a share consolidation.

Treatt plc put forward two resolutions covering disapplication. The first was for a five per cent disapplication for general corporate purposes and the second was for disapplication in connection with a specified capital investment. All of the 11 resolutions put forward at Treatt's AGM received more than 99 per cent support, with the resolution for the additional five per cent disapplication passing with 99.66 per cent of the vote. Three requests for issuance and five requests for authority to disapply were defeated. Resolutions were defeated at Aurora Investment Trust, Afren plc, New World Resources, JKX Oil and Gas and Duet Real Estate Finance and the types of issuance and approaches to disclosure are covered below.

Aurora Investment Trust's resolutions on issuance and disapplication were both defeated. The disclosure of the meeting results stated only that the voting failed to reach the 75 per cent required to pass the special resolutions. The resolutions each received approximately 32 per cent against. At Aurora's AGM one resolution received full support, a few received very significant support and a number received approximately 70 per cent support. The two resolutions on allotment and disapplication were amongst this group, but were defeated as they failed to reach the 75 per cent majority required.

Afren received fewer than 25 per cent of votes in favour of its resolutions to allot and disapply pre-emption rights. In its regulatory filing of the AGM results, Afren noted the votes against these resolutions, and another allowing market purchases, and undertook to "re-engage with its shareholders to get a better understanding of their concerns." The CEO, Alan Linn also stated that: "We would like to thank our shareholders for the continued dialogue about the future of Afren. With a new team in charge we will be well positioned to implement the new strategy." The resolutions concerning allotment and disapplication were the outliers at this meeting, however, the

resolution authorising the company to make market purchases was also lost, whilst all other resolutions received average support of around 80 per cent.

All of New World Resources' resolutions except those related to the allotment of shares and disapplication passed. The company disclosed in its AGM results that those resolutions were not supported by the majority shareholder, CERCL Mining BV. Both of those resolution received 36 per cent support, however, almost all other resolutions received strong support. All except one resolution received above 99 per cent of the vote, with the exception being the resolution authorising the company to issue its own shares, which received 90 per cent support.

Duet Real Estate's special resolution concerning the disapplication of pre-emption rights was defeated, as it did not achieve the necessary 75 per cent. The results disclosure outlined only that the relevant resolution had not passed. At this AGM the resolution on pre-emption rights was a significant outlier, with all other resolutions receiving full support or a maximum of 4000 votes against (on the reappointment of the auditor and the remuneration report and policy).

JKX Oil and Gas was requesting a five per cent disapplication at its AGM in June. Due to a legal dispute surrounding restriction notices, the results of two of the votes (remuneration report and ability to make market purchases) were unclear at the time of posting the results, so alternative voting outcomes were posted. However, the special resolution concerning the disapplication did not pass on either basis of counting, and ultimately, as the Supreme Court upheld the appeal, received a supporting vote of 31.33 per cent.

Conclusion and best practice

The research shows that generally the Statement of Principles was adhered to in 2015. This will be the first year in which the Statement of Principles has been in place for the entirety of the traditional AGM season. The Statement of Principles is clear that companies that do not comply with its spirit and letter are likely to find their shareholders less inclined to approve subsequent requests for disapplication.

The Statement of Principles provides a framework for early and effective dialogue between a company and its shareholders. Both companies and investors should engage effectively about issues of disapplication to ensure the system is effective. In order to be considered appropriate, consultation must be specific and unequivocal. In addition, such consultation must be with a broad range of shareholders.

After considering the results of the monitoring exercise and investor representatives' views on best practice, the Pre-Emption Group has decided to assist companies by publishing template resolutions. The template provides for companies to propose two resolutions, with the authority to disapply pre-emption rights in relation to the additional five per cent specifically referencing use in connection with an acquisition or specified capital investment as envisaged by the Statement of Principles. It also details the disclosures investors would expect to see when such an authority is sought.

When an additional five per cent disapplication authority is used, companies should disclose, in the relevant placing announcement, the circumstances that have led to its use and describe the consultation process undertaken. The Statement of Principles also provides that companies are expected, where they have undertaken a placing using the disapplication of pre-emption rights, to publish in the next annual report:

- 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.

In 2016, the PEG will be looking for continued improvement in disclosure of the intended and actual disapplication of pre-emption rights and for all companies to engage with their shareholders and adhere to the letter and spirit of the Statement of Principles.

Contacting the Pre-Emption Group

Any comments on this report, and any other correspondence, should be addressed to the Secretary of the Pre-Emption Group. Her contact details are:

secretary@pre-emptiongroup.org.uk

or write to:

Hannah Armitage
Secretary, Pre-Emption Group
Financial Reporting Council
8th Floor
125 London Wall
London EC2Y 5AS