King & Spalding

CRISIS PRACTICE

Coronavirus

FINANCIAL SERVICES

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Quick Cash – FCA and Pre-emption Group Announce a Series of Temporary Recommendations to Assist Companies in Raising Capital During COVID-19 Crisis / 'Cash Box' Placings

Yesterday, 8 April 2020, the Financial Conduct Authority (FCA) announced a series of measures in response to the coronavirus crisis designed to help issuers raise new capital while retaining an appropriate degree of investor protection.

The FCA announcement follows the temporary recommendation made by the Pre-emption Group, an industry group whose objective is to promote observation of investor pre-emption rights, on 1 April 2020 with specific reference to the COVID-19 crisis.

Together, the measures will facilitate issuers seeking to raise equity finance quickly in the difficult current economic climate.

In addition to exploitation of these regulatory dispensations and recommendations to fund raise more quickly, we expect to see issuers increasingly utilizing existing (but rarely used) 'cash box' structures to raise equity finance on an expedited and non-pre-emptive basis.

PRE-EMPTION GROUP TEMPORARY RECOMMENDATION TO SUPPORT NON-PRE-EMPTIVE ISSUANCES UP TO 20% OF SHARE CAPITAL

On 1 April 2020 the Pre-emption Group (PEG) issued a statement temporarily changing its recommendation on the percentage of share capital in respect of which shareholders should consider supporting non-pre-emptive share issuances, to 20% of the issuer's issued share capital.

Issuers are restricted in the amount of equity securities they can issue for cash otherwise than pro rata to their existing shareholders – generally non-pre-emptive offers are limited to approximately 5% of share capital. These pre-emption rights of existing shareholders can, in adverse economic conditions, inhibit the ability of an issuer to raise new equity finance and to do so quickly.

Pre-emption rights are a key protection afforded to shareholders under UK company law which protect shareholders against dilution of their investment by ensuring their ability to participate pro-rata in any equity issuance. These statutory pre-emption rights apply to UK incorporated companies listed on AIM or the Official List and to any other company with a premium (but not standard) listing on the Official List of the UK Listing Authority incorporated outside the UK.

Statutory pre-emption rights can be disapplied by special resolution of the shareholders at a general meeting. The high 75% approval threshold required to approve such disapplication reflects the importance of these rights to both majority and minority shareholders alike to protect their interests and defend inappropriate dilution. However, it also creates risk for the company that it will not get approval to raise the funds it may need on an urgent basis.

Prior to the temporary recommendation change, PEG's statement of principles specified that a company can disapply pre-emption rights in connection with an issue of shares for cash in respect of up to:

- 5% of existing issued ordinary share capital in any one year (which can be used for any purpose);
- an additional 5% of existing issued ordinary share capital in any one year (which must be used for an acquisition or specified capital investment; or
- 7.5% of existing issued ordinary share capital on a cumulative basis in any three-year rolling period.

Most issuers disapply the statutory pre-emption rights up to the PEG recommended thresholds on an annual basis to permit smaller fund raisings or to finance periodic acquisitions or investments on a non-pre-emptive basis. But if a proposed placing falls outside the limits approved, the company would otherwise need to go back to its shareholders to seek a specific disapplication for the placing. PEG's new temporary recommendation to increase the threshold recommendation for non-pre-emptive issuances to 20% of issued share capital will be a welcome move for the management of issuers needing to raise finance urgently in the coming months above and beyond the usual 5+5% thresholds.

The PEG statement sets out additional guidance which issuers seeking to make use of the revised recommendation should follow:

- shareholders should be fully informed of the circumstances of the fund raise;
- a representative sample of the company's major shareholders should be consulted;
- where possible, the issue should be made on a soft pre-emptive basis; and
- company management should be involved in the allocation process.

In addition to the usual disclosures required when leveraging the usual 5+5% limits, issuers issuing up to 20% of their capital would be expected to disclose information about the consultation undertaken prior to the issuance and the efforts made to respect pre-emptive rights.

FCA STATEMENT OF POLICY TO ASSIST ISSUERS RAISING FUNDS DURING COVID-19 CRISIS

In the 8 April announcement, the FCA has made the following recommendations and temporary regulatory modifications:

— Where a prospectus for a placing is required, issuers should consider using the simplified prospectus regime set out in the Prospectus Regulation (EU Regulation 2017/1129);

- Issuers may include coronavirus-related only modelling assumptions in working capital statements for inclusion in placing prospectus' and, for premium listed issuers, shareholder circulars; and
- Premium listed companies may apply to the FCA for dispensation from the requirement to hold a general meeting to approve certain Class 1 and Related Party transactions.

SIMPLIFIED PROSPECTUS REGIME

Is a Prospectus required?

Main Market issuers - provided the issue of new shares (together with other issues made over a 12-month period) is for less than 20% of the issuer's existing share capital, a prospectus is not required for an equity raise.

AIM issuers - because AIM is not a regulated market, the 20% restriction after which a prospectus must be published does not apply to AIM issuers.

Where a prospectus is required

For larger issuances for which a prospectus is required, the FCA has recommended that issuers utilize the simplified prospectus regime permitted under the Prospectus Regulation, which can be tailored for secondary issuances.

The simplified prospectus regime is available to any issuer that has been listed on a regulated market or SME Growth Market (which includes AIM) for at least eighteen months.

The simplified regime is ideal for secondary issuances where investors are already familiar with the business of the issuer, and its content should focus on the changes that have occurred since the publication of the issuer's previous annual report, as well as the reasons and circumstances behind the secondary raise. Being able to limit the scope of the prospectus and the information it contains will enable the placing prospectus to be prepared and issued much more quickly than would be the case for a long-form prospectus appropriate for an IPO.

Note that the Prospectus Regulation applies EU-wide. If, however, there is a non-EU element to the placing in a jurisdiction which has its own disclosure requirements, those must also be adhered to and could prevent application of the simplified regime under the Prospectus Regulation.

QUALIFIED WORKING CAPITAL STATEMENTS

The working capital statement is a key component to any prospectus. It assists investors' assessment of the ability of the issuer to trade and meet is operating expenses over the forward twelve months, even in a worst-case scenario.

Working capital statements are supported by detailed financial modelling undertaken by the company and its advisors. Under normal circumstances, the FCA would rarely support the inclusion of any working capital statement in a prospectus that is qualified or includes particular assumptions about the issuer's working capital position. This is to protect investors from bearing the risk and responsibility of assessing for themselves the adequacy of the issuer's working capital.

The FCA recognizes that the COVID-19 crisis presents a particular challenge to issuers and their advisers in modelling the company's reasonable worst-case scenario, making an unqualified working capital statement almost impossible to provide. In order to facilitate fund raising during the coronavirus crisis by companies that are otherwise financially sound, the FCA has temporarily revised its approach to working capital statements, as further detailed in a technical supplement:

- clear, concise and comprehensible coronavirus-related only modelling assumptions will be permitted in an otherwise unqualified working capital statement; and

- the prospectus must specify that the working capital statement has otherwise been prepared in accordance with the approach for the preparation for working capital statements set out in the Committee of European Securities Regulators' recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses, as adopted by the European Securities and Markets Authority, whose approach the FCA supports.

DISPENSATION FROM HOLDING CERTAIN GENERAL MEETINGS

The UK's coronavirus lockdown and the obligations to social-distance impose a particular challenge on issuers needing to hold a general meeting to approve a particular transaction or placing. The notice requirements for holding such meetings significantly extend transaction timetables and inhibit the issuer's ability to raise needed funds quickly.

To address this issue, the FCA has temporarily modified the Listing Rules for premium listed issuers in relation to the requirement for a general meeting to be held to approve certain Class 1 transactions and Related Party transactions.

Approval to avoid this requirement will be provided on a case-by-case basis and is subject to issuers obtaining written undertakings from eligible shareholders that they approve the proposed transaction and would vote to approve it, if a general meeting was held. Once the necessary approval threshold has been met, the issuer must inform the market. Circumventing the need to hold a physical meeting and adhere to the notice requirements for holding one could significantly reduce the period of time to secure necessary shareholder approval for a transaction to proceed.

Note that where issuers have provision to hold virtual general meetings, such process should continue to be utilized in order to obtain requisite shareholder approval for a transaction or placing.

CASH BOX PLACINGS – AVOIDING PRE-EMPTION RESTRICTIONS FOR FASTER FUNDRAISING

A cash box placing is an alternative to a conventional secondary rights issue or placing which enables a company to raise equity finance without incurring the cost and risk in seeking and obtaining shareholder approval to disapply pre-emption rights and (potentially) in the preparation of a prospectus.

Being able to avoid such costs, risk and delay, by using a cash box placing is of particular advantage to a company already in distress or in need of immediate funding to continue operating and avoid a solvency crisis in the face of the challenging trading and market conditions presented by COVID-19.

Under the UK companies act, statutory pre-emption rights do not apply to issues of ordinary shares for "non-cash" consideration. A cash box placing is not a cash issue as the issuer shares are issued in exchange for preference shares in a special purpose vehicle, usually incorporated in an offshore jurisdiction such as Jersey. A typical cash box structure is as follows:

- Issuer forms NewCo, in which it holds the majority of its ordinary shares (issued for nominal value). The issuer's investment bank/broker subscribes for the remainder (usually in excess of 10%);
- The placees pay over the cash subscription amount to the investment bank/broker, which, as principal, subscribes that cash amount for preference shares in NewCo;
- The issuer allots ordinary shares to the placees, in consideration for which the investment bank/broker transfers to it the NewCo ordinary shares held by it and the NewCo preference shares; and
- NewCo redeems its preference shares (now held by the Company) in cash for the amount of the placing proceeds.

Although a cash box placing is, on the face of it, a non-cash issue, the PEG statement of principles issued in 2015 specified that cash box placings should be treated the same as issuances for cash consideration for the purposes of its recommendations in respect of pre-emption rights and their disapplication. This means that the 5+5% threshold for non-pre-emptive issues applies equally to all placings, whether or not ostensibly made for “non-cash” consideration via a cash box. PEG’s objective was to protect investors from dilution where issuers sought to use a cash box placing to circumvent pre-emption. As a result, in the recent years prior to the COVID-19 crisis, few cash box placings have occurred.

We now expect to see an uptick in the use of cash box placings following PEG’s temporary recommendation enabling issuers to use cash box placings to rapidly raise equity finance through issuances of up to 20% of share capital via a cash box without the need to seek further shareholder approval or to issue a prospectus. This will be welcome news to company management, but careful consideration should still be afforded to the interests of shareholders and efforts made to respect pre-emption rights where it is possible to do so.