



## *ABI guidance on allotment of shares and articles of association*

December 2009

The ABI has recently updated two documents it first published last year. These relate to:

- the allotment of share capital and the disapplication of pre-emption rights (published in December 2008 and updated in November 2009); and
- articles of association and other topical issues (published in December 2008 and revised in October 2009).

### **How does this affect me?**

The ABI guidelines apply to companies whose shares are listed on the Official List. AIM companies may also wish to apply some or all of the guidelines, depending on the nature of their shareholder base. When planning your next AGM, you will need to consider the revised ABI guidelines on allotment of shares and whether any changes are required to your articles of association to comply with the ABI guidelines on articles.

### **Allotment of shares and pre-emption rights**

The ABI guideline on headroom for allotment of shares was increased from one-third to two-thirds of a company's issued share capital, subject to certain safeguards. However, the additional one-third can only be used for rights issues. The revised ABI guidance is available [here](#).

### **Background**

The previous ABI guidance stated that the general authority of directors to allot new shares should be the lesser of: (i) the company's unissued ordinary share capital and (ii) one-third of the company's issued ordinary share capital. Although the one-third figure was always a suggested guideline rather than an absolute limit, in practice it was generally treated by companies as a ceiling above which their directors should not be routinely authorised to allot shares. The Rights Issue Review Group, which was set up in 2008 to review the rights issue process, highlighted in its report that most issuers undertaking large rights issues had had to call a general meeting to avoid exceeding the ABI allotment limit. This meant that the rights issue timetable was commonly extended by the notice period for a general meeting which, in turn, lengthened the period for which the offered discount price was open to potential market pressures. The Report recommended that the ABI review its guidelines and increase the headroom allotment for rights issues.

### **Changes**

The revised guidance no longer refers to "unissued" share capital, reflecting the fact that the Companies Act 2006 has removed the concept of authorised share capital. It now states that the figure should be an amount not exceeding one-third of the issued ordinary share capital.

As well as a resolution seeking authority to allot one-third of the existing issued ordinary share capital (see above), the ABI will also regard as "routine" (which indicates that institutional investors are likely to accept and approve this) an additional request from a company to authorise the **allotment of a further one-third** of the issued share capital provided that:

- such additional headroom shall be applied to **fully pre-emptive rights issues only**; and

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- the authorisation (for both the general authority up to one-third of the issued share capital and the additional authority for the further one-third) shall be valid for **one year only**.

There seems to be some flexibility in the limits to the extent that, if general authority is sought for less than one-third of the issued share capital, the amount of the additional authority for rights issues can be topped up with any remaining headroom, although it is not clear what benefit this would have since companies can already use part of their general authority for rights issues if they wish to do so.

The guidance states that all members of the board wishing to remain in office would have to stand for re-election at the company's next AGM in the event that:

- the number of shares actually issued pursuant to the aggregate authority exceeds one-third of the nominal amount of the company's issued share capital; and
- where the shares are issued wholly or partly by way of a fully pre-emptive rights issue, the proceeds exceed one-third (or such lesser relevant proportion) of the pre-issue market capitalisation.

We interpret this as meaning that if the directors use the additional authority, they will have to put themselves forward for re-election unless the money raised falls below the market capitalisation test. This would be the case where the rights issue is deeply discounted.

The ABI has stated that it will review the new guidelines after three years, and will in the meantime monitor the use by companies of the additional headroom.

### **Action to be taken**

If you wish to take advantage of the additional headroom, you will need to change the standard wording of your AGM resolutions to achieve this. The annex to the ABI paper includes model resolutions for both the allotment of shares and the disapplication of pre-emption rights, and we can provide you with further guidance on these. However, you should be aware that if you do choose to take advantage of the increased headroom, this could be interpreted by the market as a signal that you are planning to undertake a large rights issue. Our analysis shows that about half of Official List companies that have held AGMs since January 2009 have passed this additional resolution.

### **Articles of association and Companies Act issues**

The ABI note deals with a number of issues, mainly relating to articles of association, AGMs and other issues relating to the Companies Act 2006. The note is available [here](#).

### **Auditor liability limitation agreements**

The ABI supports the Institutional Shareholders Committee's statement on auditor liability limitation agreements ("LLAs"). Amongst the points noted in the ISC statement are: a preference that the limitation of liability in LLAs should be proportionate; a reminder that LLAs are permissive rather than mandatory, and a need to ensure that audit quality is preserved.

### **Borrowing powers**

All articles should include a limit of the level of borrowings of the company or group, which the ABI sees as an important shareholder protection. The ABI suggests that a broad figure for the borrowing limit in articles is twice capital and reserves, although it acknowledges that there may be wide variation depending on the nature and sector of the company. You may wish to check the current borrowing limits in your articles, and should, in any case, ensure that fixed limits to borrowing powers are kept under review.

### **Directors' fees**

The articles should contain a monetary cap on the amount of aggregate fees payable to non-executive directors.

### **Companies Act 2006 points**

**Electronic communications** – As you will be aware, companies can communicate with their shareholders by means of a website, in accordance with the provisions of the 2006 Act. The guidance reminds them to obtain shareholder approval, consult individually with shareholders and, if the regime is put in place, inform shareholders when information is available on the website

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**Directors' conflicts of interest** – The ABI recommends following best practice in line with the GC 100 paper on directors' conflicts of interest. We have a separate client note on directors' duties under the 2006 Act (which includes duties relating to conflicts of interest). The board of directors should report annually that there are procedures in place to deal with conflicts of interest and that they have operated effectively.

**Corporate representatives** – Since the amendments to the Companies Act 2006 in August 2009, the ABI no longer considers it necessary for companies to provide the "Designated Corporate Representative" option at meetings, except in those jurisdictions, such as Jersey, where the law has not been suitably clarified.

#### **Dispute resolution and exclusive jurisdiction**

The ABI is concerned about dispute resolution provisions being codified in companies' articles of association and advises that, where a company considers that such provisions may be appropriate, it should undertake careful consultation with shareholders.

#### **Compliance with notice requiring information about shares**

The ABI reminds companies that penalties for non-disclosure of an interest in accordance with section 793 of the 2006 Act (notice by a company requiring information about interests in its shares) should comply with Listing Rule 9.3.9, which prescribes what the sanctions may comprise and states, in particular, that sanctions may not take effect earlier than 14 days after service of the notice.

#### **Political donations**

Companies should state that it is their policy not to make political donations. Where a company seeks approval for political expenditure (which is not a political donation), the ABI recommends that such approval be renewed annually.

#### **Re-incorporating outside the UK**

Where a company is considering "re-incorporating" outside the UK (i.e. where a company is redomiciled through the use of an overseas parent company), it should consult its major shareholders. Investors will expect a clear rationale for the decision, as well as a commitment to continue to abide by UK corporate governance best practice standards.

If you would like further details on any of the points mentioned in this note please contact your usual contact at the firm.

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