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Allotment of Shares and Pre-Emption Rights: New Guidance from the Association of British Insurers (“ABI”)

Companies across the London Stock Exchange’s markets raised a record £63 billion in new and further issues of equity during the course of 2008 - by many standards a good result in a difficult market. However, several secondary issues attracted specific criticism. In some cases this was because of the manner in which a pre-emptive rights issue to shareholders was carried out (for example, Bradford & Bingley’s rights issue in August 2008, which was first announced in May, was then repriced and restructured in June and then was restructured again shortly afterwards); in others it was because companies simply ignored shareholders’ pre-emption rights (such as Barclays, in its emergency fund-raising from Middle Eastern institutions in November 2008 and, more recently, Tullow Oil), on the basis that carrying out a pre-emptive rights issue would have taken too long and been too risky.

As a response to this, the ABI has recently issued new guidance in relation to the allotment of share capital and disapplication of pre-emption rights. This guidance implements the recommendations of the newly constituted Rights Issue Review Group and sets out the expectations of institutional investors in relation to the requirement on listed companies to obtain

shareholder authorisation for the allotment of shares. It is intended that the changes will make it easier for listed companies to raise new capital by way of a rights issue.

The ABI guidelines strictly apply only to companies listed on the Official List, although it is best practice for companies traded on AIM also to comply with them.

Background

The requirement for all English companies to obtain shareholder approval for the allotment of shares and disapplication of pre-emption rights on the allotment of shares is currently contained in the Companies Act 1985. While the legislation does not provide a cap upon the amount of shares to which the allotment or disapplication can apply, previous ABI guidance had recommended that the authority given to directors to issue new shares should be the lesser of:

- (a) the company’s authorised but unissued share capital; and
- (b) one-third of the company’s issued share capital.

While non-prescriptive, this guidance has generally been respected by companies seeking to renew this standard authority at their AGM. As a result, many companies

seeking to raise funds by way of a pre-emptive rights issue of shares in excess of those levels have been forced to obtain shareholder approval. This commonly means that it is necessary to call an EGM, for which a notice period of 14 days must be given, which in turn increases the company's costs and the period during which any discount offered to subscribers for the new shares is open to the risk of market fluctuation.

New Guidance

The Rights Issue Review Group recognised the need of many companies to raise additional capital quickly in the current market, as well as changes that have taken place in the nature of rights issues. In the past decade they have been carried out, on average, at almost double the discount to market price than in the previous decade, when the one-third restriction on directors' power to allot was introduced. Clearly, the greater

the discount, the more shares that a company will need to issue to raise an equivalent amount of funds. The ABI has updated its guidance in light of this.

The new guidance indicates that the ABI will regard as "routine" a request to allot a further one-third of the company's existing share capital - bringing the aggregate "routine" request to two-thirds - provided that such further authority to allot shall be valid only for one year and shall apply only to fully pre-emptive rights issues.

The ABI also expects that each of the company's directors who wish to remain in office will stand for re-election at the next AGM where this additional authority is utilised and:

- (a) the aggregate actual usage exceeds one-third of the nominal amount of the company's issued share capital; and

- (b) the proceeds (on a partly or fully pre-emptive rights issue) exceed one-third of the company's pre-issue market capitalisation.

The ABI will monitor the use by companies of the additional headroom and review its new guidance after three years.

Practical Implications

The increased headroom will make it easier for companies to raise money by way of a rights issue quickly and efficiently. However, to take advantage of this, companies will need to review the wording of their AGM resolutions. They will also need to consider, if they do choose to carry out a rights issue, whether the amount of money to be raised is such that the directors will be expected to stand for re-election at the subsequent AGM.