



Introduction

When preparing the notice for Annual General Meetings there are two resolutions in particular that often cause difficulties. These are the resolutions giving authority to directors to allot shares and the resolution to disapply pre-emption rights. These resolutions can be complex and difficult to understand. This briefing explains what the resolutions need to contain and why they are structured as they are. The briefing is relevant to UK listed public limited companies.

Allotment and issue of shares

Companies Act 2006

Under the Companies Act 2006 (s551) directors must be authorised either by ordinary resolution or by the articles of association to allot shares or grant rights to subscribe for shares or to convert any security into shares in the company. Most companies prefer to pass a resolution because any authorisation given in the articles becomes redundant after a maximum period of five years. The authority may be given for a specific purpose or may be given generally. Most listed companies will seek a general authority at their annual general meeting every year.

The resolution giving authority to allot shares must comply with the provisions of section 551. These are outlined below.

Amount

The resolution must state the maximum amount of shares that may be allotted under it.

Expiry

The authority must state the date on which it will expire, which must be not more than five years from the date the resolution is passed.

Renewal, revocation and variation

An existing authority may be renewed by ordinary resolution for a further five year period or may be revoked or varied at any time before it expires by ordinary resolution.

Listing Rules

For listed companies the circular (usually in the form of the notice of meeting) must include the following information in respect of section 551 resolutions:

- i) a statement of the maximum amount of shares or other securities which the directors will have authority to allot and the percentage which that amount represents of the total ordinary issued share capital (excluding treasury shares) as at the latest practicable date before publication of the notice;

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- ii) a statement of the number of treasury shares held by the company as at the date of the notice and the percentage which that amount represents of the total ordinary issued share capital (excluding treasury shares) as at the latest practicable date before publication of the notice;
- iii) a statement by the directors as to whether they have any present intention of exercising the authority and if so for what purpose; and
- iv) a statement as to when the authority will lapse.

Institutional investor guidelines

The Association of British Insurers issues guidelines for companies on the granting to directors powers to allot shares. Under these guidelines ABI members will regard as routine an authority to allot shares in an amount up to one-third of the existing share capital. In December 2008 the ABI revised its guidelines to allow for allotments of up to two-thirds of issued share capital provided that:

- the additional authority is only used for fully pre-emptive rights issues;
- both the general and additional authorities expire on the date of the next annual general meeting (if only a general authority is sought, an expiry date of up to five years is acceptable).

If the authority for an additional one-third is used, the ABI expects all directors to stand for re-election at the next annual general meeting. Many companies are taking advantage of the increased allotment authority so that they have greater flexibility to carry out a rights issue without requiring shareholder approval.

Both the National Association of Pension Funds (NAPF) and the Pensions Investment Research Consultants (PIRC) ask for authorities to allot shares to be renewed annually.

Allotments which do not need prior authority

Under section 549 (2) of the Companies Act 2006 the directors do not need authority to allot shares under an employees' share scheme or to grant rights to subscribe for or to convert a security into shares that has already been authorised.

Example resolution granting directors authority to allot shares

The resolution below is based on an example company with an ordinary issued share capital of 150,000,000 10 pence shares and 250,000 ordinary shares held in treasury. *[Note: so 149,750,000 shares subject to the allotment provisions]*

“To resolve that the directors be and are hereby authorised generally and unconditionally to exercise all the powers of the Company to allot relevant securities (as defined in section 551 of the Companies Act 2006):

- (A) up to a nominal amount of £[4,991,667] *[Note: i.e. one-third of 149,750,000]*

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(B) comprising equity securities (as defined in section 560(1) of the Companies Act 2006) up to a nominal amount of £[9,983,333] [Note: i.e. two-thirds of 149,750,000] (such amount to be reduced by any allotments made under paragraph (A) above) in connection with an offer by way of a rights issue:

- (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and
- (ii) to holders of other equity securities as required by the rights of those securities or as the directors otherwise consider necessary,

and so that the directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with any treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or laws of, any territory or any matter.

The authorities conferred on the directors to allot securities under paragraph (A) and (B) will expire on the date of the AGM of the Company to be held in [2012] or on [1 October 2012] whichever is sooner, unless previously revoked or varied by the Company, and such authority shall extend to the making before such expiry of an offer or an agreement that would or might require relevant securities to be allotted after such expiry and the directors may allot relevant securities in pursuance of that offer or agreement as if the authority conferred hereby had not expired.

Analysis of the authority to allot shares resolution

The above resolution is a standard resolution that you would expect to see in the notice of annual general meeting (**AGM**) for a UK listed public limited company. Its constituent parts can be broken down as follows:

To resolve that the directors be and are hereby authorised generally and unconditionally to exercise all the powers of the Company to allot relevant securities (as defined in section 551 of the Companies Act 2006):

Under the Companies Act the resolution can be an ordinary resolution even if it amends the company's articles of association. A resolution under section 551 can be given for a specific allotment and can be conditional or unconditional (s551(2)). This authority is general and unconditional.

(A) *up to a nominal amount of £[4,991,667]*

The total nominal amount is usually specified rather than the total number of shares in order that the resolution does not need to be amended if the company consolidates or subdivides its shares. This amount will usually be up to one-third of the company's issued share capital in accordance with ABI guidelines.

(B) *comprising equity securities (as defined in section 560(1) of the Companies Act 2006) up to a nominal amount of £[9,983,333] (such amount to be reduced by any allotments made under paragraph (A) above) in connection with an offer by way of a rights issue:*

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- (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and*
- (ii) to holders of other equity securities as required by the rights of those securities or as the directors otherwise consider necessary,*

Part B is the second strand to the resolution allowing the directors to allot ordinary shares in connection with a rights issue up to an aggregate nominal amount of two-thirds of the issued ordinary share capital in accordance with ABI guidelines.

and so that the directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with any treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or laws of, any territory or any matter.

This part of the resolution gives authority to the directors to deal with practical issues that may arise from the allotment or take account of requirements relating to overseas shareholders due to local laws or regulations.

The authorities conferred on the directors to allot securities under paragraph (A) and (B) will expire on the date of the AGM of the Company to be held in 2012 or on 1 October 2012 whichever is sooner,

The Companies Act 2006 requires the resolution to state the date on which it will expire, which must be not more than five years from the date the resolution is passed. However, both NAPF and PIRC voting guidelines call for allotment resolutions to be renewed annually and this is generally market practice. Where the authority lasts until the next AGM it is usual to include a long-stop date as the company may stop holding AGMs if it is taken over or becomes private.

...unless previously revoked or varied by the Company, and such authority shall extend to the making before such expiry of an offer or an agreement that would or might require relevant securities to be allotted after such expiry and the directors may allot relevant securities in pursuance of that offer or agreement as if the authority conferred hereby had not expired.

Section 551(4) of the Companies Act 2006 allows the authorisation to be renewed, revoked or varied at any time by resolution of the company. Section 551(7) allows the directors to allot shares or grant rights to subscribe for or convert securities after the authorisation has expired if the shares are allotted or rights granted under an agreement made by the company before the authorisation expired. This section of the resolution confirms this position.

Explanatory notes to the resolution

Explanatory notes in the circular accompanying the resolution should include the information required by the Listing Rules as set out above. Confirmation is also often given that all of the directors will stand for re-election if the additional authority is used as required by the ABI.

Pre-emption rights

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Existing shareholders have a right of first refusal over the issue of new shares by the company. This allows them to keep the proportion of their shareholding in the company intact. These rights are known as pre-emption rights. Rules and regulations relating to pre-emption rights may be found in the Companies Act 2006, Listing Rules and articles of association. In addition, investor relation bodies publish guidelines relating to pre-emption practices setting out what they believe is acceptable practice. Companies may disapply pre-emption rights if they are given power in the articles of association or by special resolution. It is usual to see a special resolution disapplying pre-emption rights in the notice of annual general meeting of listed companies.

Pre-emption rights in the Companies Act 2006 are given over the allotment of 'equity securities'. Equity securities are defined as ordinary shares and rights to subscribe for or to convert securities into ordinary shares. Pre-emption rights also apply to the right to subscribe for or the sale of treasury shares.

Disapplication of pre-emption rights

Companies Act 2006

Under section 570 of the Companies Act 2006, if the directors are authorised to allot shares under section 551, they may be given power by the articles or special resolution to allot securities as if the pre-emption rights in section 561 did not apply. Section 573 of the Companies Act 2006 allows the company to disapply pre-emption rights in relation to the sale of treasury shares.

Listing Rules

Pre-emption rights are also set out in the Listing Rules which specify that listed companies must offer equity securities for cash or sell treasury shares for cash to existing shareholders first in proportion to their existing shareholding unless shareholders have agreed otherwise. Where shareholder approval is sought to disapply pre-emption rights the circular sent to shareholders must contain a statement of the maximum amount of equity securities which the disapplication will cover and the percentage which the amount disappplied represents of the total issued ordinary share capital as at the latest practicable date before publication of the circular.

From April 2010 (and April 2011 for existing premium listed companies) the Listing Rules also require overseas companies with a premium listing to offer shareholders pre-emption rights unless they have received shareholder approval to disapply such rights.

Institutional investor guidelines

Various investor groups and intermediaries have established the Pre-emption Group which is supported by the Association of British Insurers. This group has issued a Statement of Principles relating to disapplication of pre-emption rights. The Statement of Principles requires routine disapplications to be limited to 5% of the ordinary share capital in any one year with a cumulative limit of 7.5% in any three year rolling period. The Pre-emption Group has acknowledged that there are inconsistencies in their position in that the 5% limit includes treasury shares issued for cash but the 7.5% rolling limit does not. The Statement of Principles also recommends that non-routine resolutions

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outside of the above criteria should be raised and discussed with the ABI and major institutional investors which will be considered on a case by case basis.

Allotments which are not subject to pre-emption rights

Under sections 564 to 566 of the Companies Act 2006, pre-emption rights do not apply to the allotment of:

- i) bonus shares;
- ii) an allotment of equity securities if these are to be, wholly or partly, paid for by non-cash consideration;
- iii) the allotment of shares under employees' share schemes.

Example resolution to disapply pre-emption rights

The resolution below is based on an example company with an ordinary issued share capital of 150,000,000 10 pence shares and 250,000 ordinary shares held in treasury. *[Note: so 149,750,000 shares subject to the disapplication provisions]*

“To resolve as a special resolution that, if Resolution [x] is passed, the directors be given power to allot equity securities (as defined in the Companies Act 2006) for cash under the authority given by that resolution (set out in this Notice of Meeting) as if section 561 of the Companies Act 2006 did not apply to any such allotment, provided that such power to be limited:

(A) to the allotment of equity securities for cash in connection with an offer of, or invitation to apply for, equity securities (but in the case of the authority granted under paragraph (B) of Resolution [x], by way of a rights issue only):

- (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and
- (ii) to holders of other equity securities as required by the rights of those securities or, as the directors otherwise consider necessary,

and so that the directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with any treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or laws of, any territory or any matter; and

(B) in the case of the authority granted under paragraph (A) of Resolution [x] and/or in the case of any sale of treasury shares for cash, to the allotment (otherwise than under paragraph (A) above) of equity securities up to a nominal amount of £[748,750] *[note: i.e. 5% of 149,750,000]*,

and shall expire at the conclusion of the AGM to be held in [2012] or on [1 October 2012], whichever is sooner (unless previously revoked or varied by the Company in general meeting), provided that the Company may before that date make offers, and enter into agreements, which would, or might,

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require equity securities to be allotted (and treasury shares to be sold) after the power ends and the directors may allot equity securities (and sell treasury shares) under any such offer or agreement as if the power had not ended.”

Analysis of resolution

The above resolution is a standard resolution that you would expect to see from a typical notice of annual general meeting of a UK listed public limited company. Its constituent parts can be broken down as follows:

To resolve as a special resolution that, if Resolution [x] is passed, the directors be given power to allot equity securities (as defined in the Companies Act 2006) for cash under the authority given by that resolution (set out in this Notice of Meeting) as if section 561 of the Companies Act 2006 did not apply to any such allotment, provided that such power to be limited:

Section 571(1) of the Companies Act 2006 allows disapplication of pre-emption rights by special resolution where the directors of the company have the power to allot shares. Therefore the disapplication resolution should come immediately after the resolution giving authority to the directors to allot shares and is conditional on this resolution being passed. The resolution refers to the allotment of equity securities as defined in the Companies Act 2006. The definition of the allotment of equity securities is given in section 560 (2) and includes:

- a) grant of a right to subscribe for, or to convert any securities into, ordinary shares, and
- b) the sale of treasury shares.

(A) to the allotment of equity securities for cash in connection with an offer of, or invitation to apply for, equity securities (but in the case of the authority granted under paragraph (B) of Resolution [x], by way of a rights issue only):

- (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and*
- (ii) to holders of other equity securities as required by the rights of those securities or, as the directors otherwise consider necessary,*

..and so that the directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with any treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or laws of, any territory or any matter; and..

Paragraph A specifies that the disapplication applies to allotment of equity securities for cash as pre-emption rights do not apply to allotments if wholly or partly paid for by non-cash consideration.

This section of the resolution disapplies pre-emption rights under section 561 in connection with pre-emptive offers or rights issues. This is because there are advantages in doing so as, unlike the Listing Rules, the Companies Act 2006 does not provide that fractional entitlements can be ignored on a rights issues or open offer. In addition the Companies Act 2006 does not provide that overseas shareholders do not have to be offered equity securities on a rights issue or open offer if the directors consider it

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necessary to exclude them on account of the laws or regulations overseas. This section of the resolution therefore gives the necessary authority for the company to deal with both of these issues.

The authority is for a maximum nominal amount of [£4,991,667] representing, in this example c33% of the company's issued ordinary share capital as specified in part A of the authority to allot resolution. It also gives authority in relation to a rights issue only up to a further c33% of the company's issued ordinary share capital.

(B) in the case of the authority granted under paragraph (A) of Resolution [x] and/or in the case of any sale of treasury shares for cash, to the allotment (otherwise than under paragraph (A) above) of equity securities up to a nominal amount of £[748,750],

Part B of the resolution gives authority to allot shares non pre-emptively in any other case up to a maximum nominal amount of 5% of the company's issued share capital. This limit conforms to the Pre-emption Group's Statement of Principles.

and shall expire at the conclusion of the AGM to be held in 2012 or on 1 October 2012, whichever is sooner (unless previously revoked or varied by the Company in general meeting), provided that the Company may before that date make offers, and enter into agreements, which would, or might, require equity securities to be allotted (and treasury shares to be sold) after the power ends and the directors may allot equity securities (and sell treasury shares) under any such offer or agreement as if the power had not ended.

The Pre-emption Group's Statement of Principles require authorities to be granted for no more than 15 months or until the next annual general meeting – whichever is shorter. A UK plc must hold an annual general meeting within 6 months of the year end. This resolution assumes a December year end and therefore 1 October is the 15 month long stop date. Under section 571(3) of the Companies Act 2006 the authorisation may be revoked or renewed by special resolution of the company. Section 571(4) allows the directors to allot equity securities after the authorisation has expired if the resolution enabled the company to make an offer or agreement that would or might require equity securities to be allotted after it expired. This section confirms these rights.

Notes to the Resolution

The notes to the resolutions should contain a statement of the maximum amount of equity securities which the disapplication will cover and the percentage which the amount disappplied represents of the total issued ordinary share capital as at the latest practicable date before publication of the circular. It is also usual to confirm that the company intends to comply with the Pre-emption Group's 7.5% 3 year rolling limit.

Prism perspective

Companies will need to consider whether to ask shareholders for the further third allotment authority allowed under the ABI's revised position on allotment authority limits introduced to enable companies to instigate rights issues more quickly. The additional ABI requirement for all directors to stand for re-election if the extended authority is used may not now be an issue with the introduction of annual re-election for all directors under the UK Corporate Governance Code.

Allotment and Pre-emption Resolutions

Due to their nature the allotment and disapplication of pre-emption rights resolutions tend to be written formally and may be difficult for the small shareholder to understand. It is therefore essential that clear notes are provided in the notice of meeting accompanying the resolutions of the purpose and limits to which they apply.

Useful Sources

Companies Act 2006

FSA Listing Rules

Pre-Emption Group: Disapplying Pre-Emption Rights - A Statement of Principles

Prism Cosec

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About Us

Prism Cosec is a company secretarial and corporate governance practice. We are a team of highly experienced company secretarial professionals with a strong reputation for competency and an ethos for pro-activity.

Our principle emphases are in supporting companies with quoted securities whether on the Main Market or AIM, but we will also support private companies where complex company secretarial services are required. We have international experience and a strong record in working with companies from emerging markets.

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