CLIFFORD CHANCE

TOWARDS A NEW REGIME FOR SHARE CAPITAL INCREASES AND CONVERTIBLE BONDS FOR LISTED COMPANIES

Among the measures developed in different countries to help bear the economic consequences of the Covid-19 pandemic, many are designed to facilitate the financing mechanisms of companies, in light of the perception that many of them will face the need to raise capital in the coming months. The Spanish legislator has jumped on that bandwagon and the Draft Bill approved by Spain's Government on 14 July 2020 to implement Directive (EU) 2017/828 on long-term shareholder engagement (the "**Draft Bill**") includes, together with other changes such as the new figure of the 'loyalty shares', several measures to make the regime governing the issuance of shares and convertible bonds by listed companies more flexible.

The main aim of the Draft Bill is, as its Stated Purpose sets out, "to simplify and streamline the processes for listed companies and companies whose shares are traded on multilateral trading facilities to raise capital in the market".

SPECIFIC REGULATIONS FOR LISTED COMPANIES

Given the particular economic requirements that the listing of shares on a securities market entails for share capital increase and convertible bonds issue processes, the Spanish Companies Act (*Ley de Sociedades de Capital* ("**LSC**")) already includes a large number of specific regulations dealing with these matters for companies listed on regulated markets in Spain, which are the focus of this Draft Bill.

The Draft Bill in any case extends the application of these regulations in two ways: (i) to companies whose shares are traded on multilateral trading facilities, such as the Spanish Alternative Equity Market (MAB) in particular, and (ii) to share capital increases or Public Offerings for Subscription (POS) carried out prior to listing on any of these markets, when their purpose is precisely to achieve the necessary distribution of shares.

In relation to share capital increases and, in particular, those involving monetary contributions, the Draft Bill includes several changes.

Key issues

- The Draft Bill that implements the Directive on shareholder engagement modifies the regime governing the issuance of shares and convertible bonds by listed companies
- The deadline for exercising pre-emptive subscription rights is reduced
- In cases where the pre-emptive subscription rights are excluded, the requirement to obtain an independent expert's report on the issue price is generally eliminated
- The process for registering share capital increases and for creating new shares is streamlined
- However, some of the provisions of the Draft Bill are incongruent with European law

DEADLINE FOR EXERCISING PRE-EMPTIVE SUBSCRIPTION RIGHTS

- The Draft Bill reduces the deadline for exercising pre-emptive subscription rights ("**PSR**") to 10 days, as opposed to the current deadline of 15 days (under Art. 503 LSC) and the general deadline of one month that applies to companies on the whole (Art. 305.2 LSC);
- This shorter deadline is no doubt designed to reduce the economic and market exposure risk resulting from PSR exercise periods, which is one of the factors that, in practice, requires that this type of share capital increase be done with significant issue discounts;
- But despite its commendable aim, this provision of the Draft Bill is incongruent with European Community law, because Directive (EU) 2017/1132 relating to certain aspects of company law (codification) establishes "a period which shall not be less than 14 days" (Art. 72.3).

EXCLUSION OF THE PSR

- In relation to share capital increases without PSR, the Draft Bill generally eliminates the need for listed companies to obtain a report by an independent expert/auditor appointed by the Commercial Registry, giving an opinion on the reasonable value of the shares, the theoretical value of the suppressed PSR and the reasonableness of the data contained in the directors' report [Art. 308.2.a) LSC];
- Given that in listed companies the legislator assumes that the fair value corresponds to the market price (Art. 504.2 LSC), in truth, these reports tend to be of little, if no, value; in practice, they essentially serve only to determine if the amount of the discount that tends to apply to capital increases without pre-emptive subscription rights allows the issuance price to still be considered as fair; and this meagre function contrasts with the severe delay it creates in the duration of capital increases without PSR, in terms of the time allowed for the Commercial Registry to appoint an expert and for the latter to issue the report, which lessen companies' chances of rapidly and efficiently taking advantage of market opportunities or "windows";
- The Draft Bill instead quantifies the admissible issue discount, by assuming that a value that is less than 10% lower than the share price is considered a fair value or market value; only when the company intends to issue at below that value or when company directors justify that the market price is not representative of the fair value is the report of an independent expert required;
- This legal quantification of the admissible issue discount should lead to the simplification of share capital increases without PSR in most cases, when these target a small number of investors or when carried out by larger, more liquid companies; however, they may prove to be problematic for other companies attempting to carry out accelerated offerings of shares and the like, in which the discount amount is determined following a bookbuilding process and therefore according to the demand effectively obtained, with the possibility of the discount ultimately exceeding such 10%;

- With precisely these bookbuilding and similar processes in mind, the Draft Bill also establishes, for share capital increases without PSR approved by the General Shareholders' Meetings, that the Board of Directors can either directly determine the issue price or instead merely establish the process for determining the price "according to accepted market practices".

DELEGATION OF FACULTY ON THE BOARD TO EXCLUDE PSR

- The Draft Bill limits to 25% of the share capital the possibility of delegating on the Board of Directors the faculty to increase the company's capital while excluding pre-emptive subscription rights, without affecting the general limit of 50% applied to the figure of the authorised capital [Art. 297.1.*b*) LSC];
- This reform should have a limited practical scope, considering the recommendation of the Good Governance Code of Listed Companies, so as to restrict the delegation to issue shares and convertible bonds without PSR to 20% of the company's capital (Recommendation 5), which some listed companies reduce even further so as to meet the criteria set by certain proxy advisors and institutional investors or to the practices and rules of good governance of other markets (such as the United Kingdom);

OTHER RULES REGARDING SHARE CAPITAL INCREASES

- As opposed to the general rule whereby share capital increases are invalid in the event of incomplete subscriptions unless the issue conditions expressly foresee this possibility (Art. 311.1 LSC), the Draft Bill inverts this rule for listed companies and declares that capital increases will be effective unless the resolution establishes to the contrary. But despite the little practical relevance of these rules due to their non-binding nature, the truth is that this rule contained in the Draft Bill also infringes Directive 2017/1132 relating to certain aspects of company law (codification), which requires that the issue conditions expressly establish the possibility of an incomplete subscription for the partial execution of the capital increase (Art. 71);
- The Draft Bill also establishes the general possibility of recording the resolution to carry out a share capital increase at the Commercial Registry prior to its execution; a provision that is already set out in the LSC (Art. 315.2). But unlike the regime in force, which makes the creation and delivery of the new shares – and therefore their listing – subject to recording the execution of the capital increase at the Registry, the Draft Bill permits shares to be delivered and transferred once the public deed of execution has been executed, with the obligation to send it for recording within the following five days. This is an attempt to streamline the process for creating and listing new shares, thereby reducing the subscribers' period of illiquidity (while at the same time lowering the risk taken by banks that usually pre-finance the capital increases, which will not have to wait to record the execution deed in order to transfer their shares to the investors).

CONVERTIBLE BONDS

Convertible bonds stand to become very important in the current economic situation, because of the possibility they offer to companies that consider their shares undervalued to issue them indirectly at a price higher than market price. And since their distinguishing feature lies in permitting an indirect and deferred issuance of shares, the legal regime governing convertible bonds for the most part reflects the same one applicable to share capital increases. In this regard, the Draft Bill also contains some specific regulations to deal with these bonds when they are issued by listed companies.

INDEPENDENT EXPERTS' REPORTS

- Just as is established for share capital increases, the Draft Bill eliminates the need to obtain a report by an independent expert appointed by the Commercial Registry in those cases – the vast majority – in which the convertible bond issue is done without pre-emptive subscription rights, in this case with no exceptions whatsoever. And it also eliminates the need for the independent expert's report on the conversion types and bases, currently required for all convertible bond issues, with or without PSR, which serve no purpose whatsoever and provide no protection for shareholders from the issuer and bond subscribers. The current content of both reports must correspond in that case to the directors' report, which continues to be required. The elimination of the independent expert's report should also help, as with share capital increases, to streamline the issue process of these securities.
- Also in line with the provisions on share capital increases, the Draft Bill limits the amount of the underlying shares to 25% of the convertible bonds in those cases in which the bonds are issued by the Board of Directors without the pre-emptive subscription rights, a limit that must be applied together with the delegation of faculties on the Board to issue shares with the same power to exclude PSR. In any event, in practice, issuances of convertible bonds generally do not exceed the 20% limit on capital, among other reasons so as to avoid having to present the corresponding prospectus for the subsequent listing of the shares.

CONTACTS

Javier García de Enterría
Partner

T +34 91 590 4102
E Javier.GarcíadeEnterría
@cliffordchance.com

Yolanda Azanza
Partner

T +34 91 590 7544
E Yolanda.Azanza
@cliffordchance.com

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Clifford Chance, Paseo de la Castellana 110, 28046 Madrid, Spain
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Paseo de la Castellana 110,
28046 Madrid, Spain

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