

Chapter 7

Corporate governance

The related party tests

Related party tests

This Annex sets out the following *related party tests*:

- (1) the gross assets test;
- (2) the profits test;
- (3) the consideration test; and
- (4) the gross capital test.

The gross assets test

- (1) The gross assets test is calculated by dividing the gross assets the subject of the transaction by the gross assets of the *issuer*.
- (2) The “gross assets” of the *issuer* means the total non-current assets, plus the total current assets, of the *issuer*.
- (3) For:
 - (a) an acquisition of an interest in an undertaking which will result in consolidation of the assets of that undertaking in the accounts of the *issuer*; or
 - (b) a disposal of an interest in an undertaking which will result in the assets of that undertaking no longer being consolidated in the accounts of the *issuer*,
 the “gross assets the subject of the transaction” means the value of 100% of that undertaking’s assets irrespective of what interest is acquired or disposed of.
- (4) For an acquisition or disposal of an interest in an undertaking which does not fall within paragraph (3), the “gross assets the subject of the transaction” means:
 - (a) for an acquisition, the consideration together with liabilities assumed (if any); and
 - (b) for a disposal, the assets attributed to that interest in the *issuer’s* accounts.
- (5) If there is an acquisition of assets other than an interest in an undertaking, the “assets the subject of the transaction” means the consideration or, if greater, the book value of those assets as they will be included in the *issuer’s* balance sheet.
- (6) If there is a disposal of assets other than an interest in an undertaking, the assets the subject of the transaction means the book value of the assets in the *issuer’s* balance sheet.

The *issuer* should consider, when calculating the assets the subject of the transaction, whether further amounts, such as contingent assets or arrangements referred to in ■ LR 10.2.4R (indemnities and similar arrangements), should be included to ensure that the size of the transaction is properly reflected in the calculation.

The profits test

- (1) The profits test is calculated by dividing the profits attributable to the assets the subject of the transaction by the profits of the *issuer*.

- (2) For the purposes of paragraph (1), “profits” means:
 - (a) profits after deducting all charges except taxation; and
 - (b) for an acquisition or disposal of an interest in an undertaking referred to in paragraph 2R(3)(a) or (b), 100% of the profits of the undertaking (irrespective of what interest is acquired or disposed of).
- (3) If the acquisition or disposal of the interest will not result in consolidation or deconsolidation of the target then the profits test is not applicable.

The amount of loss is relevant in calculating the impact of a proposed transaction under the profits test. An *issuer* should include the amount of the losses of the *issuer* or target, i.e. the *issuer* should disregard the negative when calculating the test.

The consideration test

- (1) The consideration test is calculated by taking the consideration for the transaction as a percentage of the aggregate market value of all the ordinary shares (excluding *treasury shares*) of the *issuer*.
- (2) For the purposes of paragraph (1):
 - (a) the consideration is the amount paid to the contracting party;
 - (b) if all or part of the consideration is in the form of *securities* to be traded on a market, the consideration attributable to those *securities* is the aggregate market value of those *securities*; and
 - (c) if deferred consideration is or may be payable or receivable by the *issuer* in the future, the consideration is the maximum total consideration payable or receivable under the agreement.
- (3) If the total consideration is not subject to any maximum (and the other *related party tests* indicate the transaction to be a transaction where all the *percentage ratios* are less than 5%) the transaction is to be treated as a *material related party transaction*.
- (4) For the purposes of sub-paragraph (2)(b), the figures used to determine consideration consisting of:
 - (a) *securities* of a class already *admitted to trading*, must be the aggregate market value of all those *securities* on the last *business day* before the announcement; and
 - (b) a new class of *securities* for which an application for *admission to trading* will be made, must be the expected aggregate market value of all those *securities*.
- (5) For the purposes of paragraph (1), the figure used to determine market capitalisation is the aggregate market value of all the ordinary *shares* (excluding *treasury shares*) of the *issuer* at the close of business on the last *business day* before the announcement.

The *issuer* should consider whether further amounts should be included in the calculation of the consideration to ensure that the size of the transaction is properly reflected in the calculation. For example, if the purchaser agrees to discharge any liabilities, including the repayment of inter-company or third-party debt, whether actual or contingent, as part of the terms of the transaction.

The gross capital test

- (1) The gross capital test is calculated by dividing the gross capital of the company or business being acquired by the gross capital of the *issuer*.
- (2) The test in paragraph (1) is only to be applied for an acquisition of a *company* or business.
- (3) For the purposes of paragraph (1), the “gross capital of the *company* or business being acquired” means the aggregate of:

- (a) the consideration (as calculated under paragraph 6R);
 - (b) if a *company*, any of its *shares* and *debt securities* which are not being acquired;
 - (c) all other liabilities (other than current liabilities) including for this purpose minority interests and deferred taxation; and
 - (d) any excess of current liabilities over current assets.
- (4) For the purposes of paragraph (1), the “gross capital of the *issuer*” means the aggregate of:
- (a) the market value of its *shares* (excluding *treasury shares*) and the issue amount of the *debt security*;
 - (b) all other liabilities (other than current liabilities), including for this purpose minority interests and deferred taxation; and
 - (c) any excess of current liabilities over current assets.
- (5) For the purposes of paragraph (1):
- (a) figures used must be, for *shares* and *debt security* aggregated for the purposes of the gross capital percentage ratio, the aggregate market value of all those shares (or if not available before the announcement, their nominal value) and the issue amount of the *debt security*; and
 - (b) for *shares* and *debt security* aggregated for the purposes of paragraph (3)(b), any *treasury shares* held by the *company* are not to be taken into account.

Figures used to classify assets and profits

- (1) For the purposes of calculating the tests in this Annex, except as otherwise stated in paragraphs (2) to (7), the figures used to classify assets and profits must be the figures shown in the latest published audited consolidated accounts or, if an *issuer* has, or will have, published a preliminary statement of later annual results at the time the terms of a transaction are agreed, the figures shown in that preliminary statement.
- (2) If a balance sheet has been published in a subsequently published interim statement then gross assets and gross capital should be taken from the balance sheet published in the interim statement.
- (3) (a) The figures of the *issuer* must be adjusted to take account of transactions completed during the period to which the figures referred to in (1) or (2) relate, and subsequent completed transactions which the *issuer* would have been required to notify under ■ LR 10.4 or ■ LR 10.5 if the *issuer* had a *premium listing*, provided that for such subsequent completed transactions the figures for the transactions are reasonably available to the *issuer*.
- (b) The figures of the target company or business must be adjusted to take account of transactions completed during the period to which the figures referred to in (1) or (2) relate, and subsequent completed transactions which would have been a class 2 transaction or greater for the purposes of the *listing rules* when classified against the target as a whole, provided that for such subsequent completed transactions the figures for the transactions are reasonably available to the target.
- (4) Figures on which the auditors are unable to report without modification must be disregarded.
- (5) When applying the *percentage ratios* to an acquisition by a *company* whose assets consist wholly or predominantly of cash or short-dated *securities*, the cash and short-dated *securities* must be excluded in calculating its assets and market capitalisation.
- (6) The principles in this paragraph also apply (to the extent relevant) to calculating the assets and profits of the target company or business.

The *FCA* may modify paragraph 9R(4) in appropriate cases to permit figures to be taken into account.

Anomalous results

If a calculation under any of the *related party tests* produces an anomalous result, or if a calculation is inappropriate to the activities of the *issuer*, the *FCA* may modify the relevant *rule* to substitute other relevant indicators of size, including industry-specific tests.

Adjustments to figures

Where an *issuer* wishes to make adjustments to the figures used in calculating the *related party tests* pursuant to 11G they should discuss this with the *FCA* before the *related party tests* crystallise.

The profits test: anomalous results

Paragraph 14R applies to an *issuer* where the calculation under the profits test produces a *percentage ratio* of 5% or more and this result is anomalous.

An *issuer* may, where each of the other applicable *percentage ratios* are less than 5%, disregard the profits test for the purposes of classifying the transaction.