EXECUTING BLOCK TRADES
ISSUES IN PRACTICE

Nicholas Holmes of Ashurst LLP and Peter Castellon of Proskauer Rose LLP consider some of the issues that can arise when executing shareholder block trades.

A block trade is a secondary sale of a large quantity of existing shares. Block trades are typically carried out by institutional investors and are best suited to highly liquid and well-researched shares in public companies. They can provide a rapid and efficient solution for holders of substantial equity stakes wishing to monetise their positions through the equity capital markets. Unlike large public offerings, which require months of preparation, block trades are typically launched, executed and priced very quickly, sometimes within 24 hours. Since January 2000, offering sizes have varied between $2.3 million and $5.9 billion.

This article considers:

- The structures and timetables that can be adopted to execute block trades.
- The key issues that can arise before the launch of a block trade.
- How to document a block trade.
- Disclosure issues when executing a block trade.
- Issues that may arise after the block trade is announced.
- The impact of the MiFID II Directive (*2014/65/EU*) (MiFID II).

STRUCTURE

A block trade can be structured as:

- A bought deal, in which the investment bank acting as manager of the block trade buys the shares from the seller before the manager starts its formal marketing efforts. The manager generally resells the shares as soon as possible after they are acquired from the seller. To the extent that it is able to resell the shares at a higher price, the manager keeps the difference.
- A non-risk deal, also known as an accelerated equity offering (AEO), where the manager builds a book of demand for the seller before agreeing on a price based on that demand. Frequently, the manager receives a commission from the seller. In some cases, the manager may earn an agreed spread.
- A back-stopped deal, falling somewhere between a bought deal and an AEO, where the manager does not take the shares onto its own books before marketing (as with a bought deal), but does guarantee the seller a minimum price. If the manager is unable to find buyers for all of the shares at or above the back-stopped price, it buys the shares itself.

TIMETABLE

There are two general approaches to a block trade timetable. In the first, the seller appoints the manager in advance. This is most frequently used for AEOs but can be followed for bought deals and back-stopped deals. The manager and the seller will first agree on the block trade agreement, conduct due diligence, prepare announcements and take care of any formalities. They will then launch the block trade when they believe the time is right.

In the alternative approach, the manager is appointed in a competitive process immediately before the block trade is launched. In this case, the timetable is inevitably highly challenging (*see box "Indicative timetable for competitive process"*). The seller invites bids for a block of shares it wishes to sell. It does so by having one of its advisers (sometimes a law firm) call a pre-agreed list of investment banks, as potential managers, to alert them to the block trade.

Sometimes the investment banks will be asked to sign a confidentiality letter. The confidentiality letter (if used) usually arrives around 2:45 to 3:00 pm. It will not disclose the underlying securities but will require the interested parties to agree to be bound by an obligation of confidentiality in return for the disclosure of the details of the intended block trade transaction.

Confidentiality letters vary in scope but sometimes contain additional provisions intended to prevent unsuccessful bidders in receipt of information from selling short the relevant shares. These restrictions can sometimes be onerous, and it is important to ensure that a representative of the equities trading arm of a participating investment bank is comfortable with them before the confidentiality letter is signed by that bank. Confidentiality letters are not strictly needed, as banks have a duty of confidentiality in any event. (*For a form of confidentiality letter, see feature article, "Strictly confidential: new block trade confidentiality letter" www.practicallaw.com/3-500-2224.*)

The seller or its advisers will then circulate a package of documents, including an invitation to tender a bid, a draft timetable, a draft block trade agreement with schedules including an investor representation letter (if applicable) and, sometimes, forms of supporting legal opinions (*see "Documents" below*).

Indicative timetable for competitive process

T-1	2.45-3 pm	• Confidentiality letter circulated
	3 pm	• Package of tender documents circulated to invited banks that have signed the confidentiality letter
	4.30 pm	• Deadline for invited banks to submit bids
	5 pm	• Notification to successful manager(s) • Conference call between seller and manager(s)
	5.15 pm	• Block trade agreement executed • Announcement and launch of transaction
	10 pm – 7 am	• Closing of books (potential to close earlier depending on how the deal is going)
T	7 am	• Pricing, pricing announcement and allocations
T+2		• Settlement and delivery

PRE-LAUNCH

Before a block trade is announced, the parties will need to address a number of issues.

Due diligence

The scope of the due diligence exercise for a block trade varies based on the circumstances of the transaction, the relationship between the manager and the issuer, and the relationship between the seller and the issuer; for example, if the manager is the issuer's corporate broker, it will already know the issuer well, so a shorter due diligence exercise might be needed. In any event, the scope of the due diligence exercise for a block trade is limited when compared to the scope for an initial public offering (IPO) or other offering by an issuer. The shares should already be listed and there will be significant amounts of publicly available information, including annual reports, other financial and corporate announcements and independent research reports. This is unlike an IPO or rights offering, where marketing efforts are focused on a prospectus and other marketing materials prepared especially for the offering and needed to disclose new or transformative information.

Timing

Managers will not usually wish to undertake a block trade in the shares of an issuer that will shortly report financial results. Block trades will usually take place at least four weeks before the relevant announcement, although this might be reduced by a few days or even a week in exceptional circumstances.

In any such case, the manager is likely to require a due diligence call with the issuer to assure itself that no material disclosures are imminent, that the issuer is up to date with its disclosure obligations and that trading is in line with market expectations, although care will be needed to avoid triggering the provisions of the Market Abuse Regulation (*596/2014/EU*) (MAR) and inside information concerns.

The safest time to conduct a block trade is shortly after the publication of the issuer's financial results: all material information concerning the issuer can then reasonably be presumed to be in the public domain. Separately, if the issuer is an EEA listed company and the seller is a person discharging management responsibilities (PDMR) within the issuer, or a body corporate in which a PDMR is a director or senior executive with power to make management decisions, then the trade cannot take place during a closed period (that is, the period of 30 calendar days before the announcement of an interim financial report or year-end report) (*Article 19, MAR*) (*see feature article "Market Abuse Regulation: ensuring compliance amidst uncertainty". www.practicallaw.com/6-629-5677.*)

Sounding out the market

A successful and profitable bid for a block trade requires a good knowledge of the market dynamics of the relevant stock and the sector in which its issuer operates. It also requires a good sense of the likely appetite of investors. Getting this wrong can lead to a failure to bid competitively for the block or, alternatively, to unsold stock on the bank's books and a risk of incurring a financial loss. For this reason, banks sometimes sound out the market by telephoning potential investors to assess their likely appetite before bidding for a block of shares at a particular price. A number of legal and regulatory constraints should, however, be borne in mind before undertaking any market soundings.

Insider dealing and market abuse. Inside information may arise at a number of different points in a block trade, and it is important to distinguish between them. These points include:

- When a manager contacts investors acting on its own behalf (that is, on its own initiative and without being under mandate from a seller) (scenario A).
- The sounding of investors, by a manager, to gauge their appetite for a trade when acting on behalf of a seller (scenario B).
- The actual offering of the securities to investors in order to effect the transaction (scenario C).

The fact that a particular prospective seller, or even an unnamed seller, is contemplating a substantial sale of specified securities is likely in itself to be inside information for the purposes of the criminal insider dealing regime under Part V of the Criminal Justice Act 1993 (1993 Act), and the market abuse legislation now contained in MAR (superseding the Market Abuse Directive (*2000/6/EC*) (MAD) and the provisions of the Financial Services and Markets Act 2000 (FSMA) that implemented MAD). However, this may not be the case in scenario A, where a firm is simply testing investor appetite for a block trade on its own initiative but has not been approached by the seller. In this respect, although MAR is a civil regime, EEA competent authorities have significant powers under MAR to fine, publicly censure, or withdraw or suspend the authorisation of, an investment firm or person where market abuse has been carried out (*Articles 30 and 31, MAR*).

It is possible to argue that if the identity of the issuer of particular securities is not disclosed, either expressly or by implication given the investment bank's or the market's existing knowledge, any information relating to a potential sale might not be inside information within the meaning of the 1993 Act or MAR. Therefore, it may be possible to disclose certain non-specific information regarding the issuer without falling within the MAR prohibitions. However, given the limited extent of information that can be disclosed before this information may be considered inside information under MAR, market participants may find the benefits of this approach limited and, in any event, this approach is unlikely to be available for scenario C involving the offering of securities, as the information given in respect of the offering will inevitably need to be precise and in scenario B it will still be a sounding under MAR (as set out below), even if there is no inside information.

Previously the FCA Handbook had two relevant safe harbours, known as the "legitimate business" and "dutiful execution of client order" safe harbours which related to the execution of the orders, rather than disclosure of inside information. However, under MAR, the concept of dutiful execution has been removed and the legitimate business safe harbor has been narrowed. Nevertheless, MAR sets out a legitimate behaviour safe harbour in Article 9(2)(a) that permits an entity in possession of inside information to trade where doing so is in the normal course of its function as either a market marker or a counterparty.

A further safe harbour exists where an entity that is in possession of inside information executes an order on behalf of a third party legitimately in the normal course of the exercise of that person's employment, profession or duties (*Article 9(2)(b), MAR*). These safe harbours under Article 9 of MAR continue to permit a market participant to carry out a transaction in the course of its legitimate business. For example, the acquisition of instruments by the manager who is conducting the block trade would be within the MAR safe harbour, where the manager is acting in accordance with its legitimate business as a counterparty (*Article 9(2)(a), MAR*). These safe harbours would not, however, apply to the disclosure of inside information itself and also would not permit the ultimate buyers, who may have been market sounded (*see below*), to deal.

If information disclosed by a potential seller to the investment bank is inside information (and it generally will be, as noted above), the dissemination of that information to third parties before any announcement of a transaction would prima facie constitute unlawful disclosure (*Article 10, MAR*). However, disclosure of inside information is lawful, according to Article 10 of MAR, where it is disclosed in accordance with the "normal exercise of an employment, a profession or duties". Taking this into account, inside information could potentially be disclosed in each of scenarios A, B and C above, and therefore market participants need to consider whether this disclosure is lawful.

In relation to scenario B, MAR provides a new safe harbour that can be relied on when carrying out this activity in the form of a market sounding regime, which may apply to communications under block trades in a similar way to other transactions (*Article 11, MAR*) (Article 11). In particular, recital 35 of MAR confirms that where a market sounding procedure is used, the disclosing market participant will be considered to be acting within the normal course of his employment, profession or duties. The requirements in relation to market soundings are set out at Article 11 and include, among other elements, ensuring that the recipient of the information agrees that he is prohibited from using that information or attempting to use that information to acquire or dispose for his own account (or third party) financial instruments relating to that information. A large number of the new requirements set out in MAR relate to the form and nature through which the market sounding is conducted and recorded. In order to deal with the MAR requirements for market soundings, many market participants have a market sounding script or checklist that is read out to a potential investor by the disclosing market participant before conducting the sounding.

In relation to scenario C, the firm would not be able to rely on Article 11 as it does not apply to effecting transactions; rather, it only applies to gauging interest in the proposed transaction. Instead the firm would have to ensure that any disclosure made as part of the dealing was made in the normal exercise of its profession or duties (*Article 10(1), MAR*). In addition, the position of the market participant who has received the market sounding has to be considered. If such a participant is in receipt of inside information (following the market sounding) it is generally accepted that in order to be cleansed of this information an announcement would need to be made before the participant can deal. Therefore, in relation to scenario C, an announcement will typically be made before the deal is effected.

In relation to scenario A, where an entity is gauging investor interest on its own initiative (and therefore not within the market sounding regime) it must be careful that doing so does not result in the unlawful disclosure of inside information. The entity would not be able to rely on Article 11 as it is not acting on behalf of, or on the account of, the issuer or seller. However, an entity reaching out to investors on the public side should not be disclosing inside information (that is, the information being disclosed should be public in this context).

It is open to a regulated firm to disclose to a seller, as a customer or a potential customer, that the firm may contact selected investors to gauge their appetite for a particular transaction, or kind of transaction, and to obtain the seller's consent to that course of action where appropriate. The then-Financial Services Authority suggested in its 5 April 2004 decision notice concerning Morgan Grenfell & Co Limited that informing the customer of intended action is essential in circumstances where the customer's interests might be disadvantaged by that action. This disclosure might be made, in theory, at any time between the initial meeting with the seller or its advisers and the time at which the firm is mandated to act on its behalf. Until mandated or requested to by a seller, banks are not restricted from unilaterally seeking bayside feedback without falling into the market sounding regime.

FCA regulation. Managers will need to additionally take into account the FCA's Handbook provisions, where relevant. In particular, the first tier of the FCA's Handbook consists of the Principles for Businesses (Principles), which include that a firm must:

- Conduct its business with integrity (*Principle 1*).
- Conduct its business with due skill, care and diligence (*Principle 2*).
- Pay due regard to the interests of its customers and treat them fairly (*Principle 6*).
- Manage conflicts of interest fairly, both between itself and its customers and between a customer and another client (*Principle 8*).

The Principles are frequently the basis on which the FCA takes enforcement action, including in cases where market abuse or insider dealing legislation has not been infringed. A disclosure of trading information which damages a customer's interests may not constitute market abuse but may breach Principles 6 and 8.

Block trade agreement representations

The following representations from the selling shareholder are typically included in the block trade agreement:

- Corporate power and authority.
- No conflicts.
- Title to the securities.
- No stamp taxes.
- No manipulation.
- No inside information.
- Directed selling efforts. This should be included if the block trade is structured pursuant to Regulation S under the Securities Act (Regulation S). No further representation may be required if the transaction is structured solely pursuant to Regulation S.

If the block trade is structured pursuant to Section 4(a)(1) of the US Securities Act of 1933 (Securities Act), no US law-specific representations are needed.

The following additional representations are required if the block trade is structured pursuant to Rule 144A under the Securities Act (Rule 144A) or Section 4(1½):

- General solicitation. While there is an argument that the general solicitation representation is not required in the case of a block trade structured pursuant to Rule 144A, it is, nevertheless, always provided in Rule 144A block trade agreements. The representation is required in the case of a Section 4(1½) block trade.
- Investment company.
- Passive foreign investment company (PFIC).

The following additional representations should be included if the block trade is structured pursuant to Rule 144A.

- Fungibility.
- Ongoing information.

There is no need for a representation that covers integration. The concept of integration is not applicable in the case of a sale by a shareholder, whether or not the shareholder is an affiliate of the issuer.

Representations that cover foreign private issuer (FPI) status and substantial US market interest (SUSMI) are sometimes included. In circumstances where the FPI status and SUSMI status of the issuer are obvious, no representations are required. However, in block trades involving a competitive process, due to the limited time available to review the issuer's status, the representations are typically included.

US issues in block trades

There are a number of issues that need to be considered if shares are expected to be sold into the US.

Exemptions

The registration requirements of the US Securities Act of 1933 (Securities Act) apply worldwide, so any securities offering must be registered with the US Securities and Exchange Commission or structured pursuant to an exemption from the registration requirements. Possible exemptions include the following:

Section 4(a)(1). If the seller is not an affiliate of the issuer, it may be possible to structure the block trade under section 4(a)(1) of the Securities Act (Section 4(a)(1)), which allows the trade to be extended to both qualified institutional buyers (QIBs) and non-QIB investors in the US. Section 4(a)(1) is an exemption for secondary trades. The US securities lawyers involved should advise whether the seller is an affiliate of the issuer. There is a presumption of affiliation if the seller holds 10% or more of the issuer's voting securities or if it has representation on the issuer's board of directors; however, other factors may be taken into account. If the seller is not an affiliate of the issuer, this exemption is the easiest to use.

Regulation S. Regulation S under the Securities Act (Regulation S) is an exemption for securities sold outside the US. There are three categories of restriction based on the volume of US trading in the shares. For shares of most European or Asian issuers, it will be sufficient to comply with this exemption if the shares are sold outside the US and there are no direct selling efforts in the US. It is usually possible to sell to a US institution as long as the buy order originates outside of the US. Only on rare occasions will it be necessary to exclude sales to US persons outside the US. In any event, Regulation S permits sales to US-based advisers acting for non-US accounts whether or not the adviser is acting with discretion. In addition, a non-US adviser acting with discretion for a US account is not a US person.

Rule 144A and Section 4(1½). If a block trade is extended into the US, it is likely that the US securities lawyers involved will recommend that sales in the US be limited to QIBs. This will permit the block trade to be structured pursuant to Rule 144A under the Securities Act (Rule 144A) or Section 4(1½) of the Securities Act (Section 4(1½)). In the case of both exemptions, there cannot be general solicitation in the US, and the issuer cannot be an investment company, as defined in the US Investment Company Act of 1940, as amended (investment company). Specific representations will be needed in the purchase agreement for a Rule 144A offering (*see box "Block trade agreement representations"*). If the seller is unable to give representations on fungibility or ongoing information, the offering can be structured under Section 4(1½). If the block trade is structured pursuant to Section 4(1½), it is customary to ask QIBs to provide an investor representation letter.

Investment company and PFIC

If the issuer is an investment company, it will be difficult to structure the block trade under Rule 144A or Section 4(1½) (*see above*). The US lawyers involved should advise whether the issuer is an investment company. If the issuer is a PFIC, there may be adverse tax consequences for US investors that buy its shares. The US lawyers involved should advise whether the issuer is a PFIC.

Volcker rule

The Volcker rule places restrictions in certain circumstances on investment banks engaging in proprietary trading in "covered funds" (*section 619, Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*). In general terms, a European or Asian company that is not an investment company will not be a covered fund. Accordingly, the investment company representation should be sufficient to confirm that the restrictions would not apply, and in most cases there is no need for any specific reference to the Volcker rule in the block trade agreement. If the issuer is an investment company, then the Volcker rule restrictions will need to be considered.

Section 4(a)(7)

Section 4(a)(7) of the Securities Act is an exemption from the registration requirements of the Securities Act for certain transactions extended to accredited investors in the US. This exemption is not practical for block trades in shares of non-US issuers.

Principles 6 and 8, and most of the FCA Conduct of Business (COB) Rules relating to designated investment business, concern business carried out with or for customers. For this purpose a customer includes pre-existing and potential customers of the bank but does not include a market counterparty. Market counterparties include governments, government agencies, central banks and monetary authorities, supranational organisations, state investment bodies, other regulated firms and certain other market professionals. In many cases, the manager is unlikely to classify the seller in a block trade as a professional client, so the Principles and COB Rules will be relevant to the relationship.

It follows that the Principles may be breached by actions carried out by the manager's employees before the manager has been mandated (as the Principles include potential customers) by a seller for a block trade, and irrespective of whether the seller is an existing customer of the manager. The Principles and COB Rules will clearly also apply after a mandate has been given.

Misuse of confidential information. Whether or not it signs a confidentiality agreement, the manager is bound by general principles of the law of confidence not to misuse or disclose any confidential information given to it in circumstances of confidence. If a potential seller provides information to the manager in relation to a proposed block trade (for example, its intention to enter into the trade, the nature of the trade it is contemplating or the identity of the securities to be traded), this information is likely to be held to be confidential information. On the other hand, information obtained by the manager from its own research or from speculation will not be confidential information.

Each case will depend on its particular circumstances. For example, a seller that is known to have only one significant holding is more likely to be able to establish that the information it has given to the manager about its intention to undertake a block trade is confidential (even without having identified the security to be traded) than a seller that has many holdings and that has not revealed which security it intended to sell.

What constitutes misuse of confidential information will depend on the reason the manager received the information in each case. However, any use or disclosure of confidential information by the manager for its own or a third party's benefit without the seller's consent could constitute misuse of that information.

Once a confidentiality letter is signed the manager becomes bound by its terms. A breach of those terms is a breach of contract (*for background, see feature article "Drafting confidentiality agreements: the DNA of an NDA". www.practicallaw.com/9-536-5387.*)

Breach of agency duties. If the block trade is to be executed by the manager in an agency capacity, the manager will, following the mandate to act, owe the seller contractual and common law duties of agency; mainly, to act in the seller's best interests.

Basic provisions of an investor representation letter

We understand that no offering document or prospectus has been prepared.

We acknowledge that (a) we may not rely on any investigation that [US broker-dealer], any of its affiliates or any person acting on its on their behalf may have conducted, and none of such persons has made any representation to us, express or implied, with respect to the Securities or the Company, (b) we have conducted our own investigation with respect to the Securities and the Company, and (c) we have received all information that we believe is necessary or appropriate.

We confirm that we are a "qualified institutional buyer", as defined in Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), that is able to bear the economic risk of an investment in the Securities.

We understand that (a) the Securities are not being, and will not be, registered under the Securities Act, (b) the Securities are being offered and sold to us in a transaction that is exempt from the registration requirements of the Securities Act, and (c) the Securities are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act.

We agree (a) not to offer or sell the Securities, except [pursuant to an exemption from the registration requirements of the Securities Act] [outside the United States pursuant to Regulation S under the Securities Act] and (b) not to deposit the Securities in an unrestricted depositary receipt facility for so long as the Securities are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act.

(*The first alternative in the paragraph above is appropriate for most Section 4(1½) offerings. For certain Section 4(1½) offerings of securities listed on an exchange in the US, the lawyers providing the no registration opinion might require the use of the second alternative.*)

Even before it receives a mandate for the block trade, the manager may owe agency duties to the potential seller independent of the block trade, for example, as a result of a corporate advisory or corporate broking role.

DOCUMENTS

The main documents required for a block trade include the block trade agreement, law firm opinions and investor representation letters.

Block trade agreement

The block trade agreement will be short when compared to an underwriting agreement for an IPO or other offering by an issuer, even if the block trade is worth billions of pounds. The block trade agreement will contain representations from the seller, including as to valid title, no encumbrances, no inside information and compliance with securities laws (*see box "Block trade agreement representations"*). It will also contain pricing and settlement provisions. A block trade agreement will frequently also include an indemnity from the seller to the manager and a lock-up of the seller's remaining holdings in the issuer.

Some block trade agreements are structured so that the manager buys the shares from the seller and resells the shares to investors as principal, rather than as the seller's agent. In such a case, the manager and seller usually sign the block trade agreement only after the manager has found investors for the shares (that is, the book of demand is covered). For shares of a company incorporated in the UK, the manager will need to qualify for the intermediaries' exemption, which allows the manager to buy and resell the shares without incurring a stamp duty or stamp duty reserve tax liability (*sections 80A and 88A, Finance Act 1986*). Only the ultimate investors pay this duty or tax.

Other block trade agreements are structured so that the manager will act as the seller's agent.

Opinions

Law firms involved in a block trade will sometimes be asked to provide an opinion to the manager. This will generally cover the seller's corporate and other authority to sell the shares, its valid title to the shares and the validity and enforceability of the block trade agreement. In addition, if shares are expected to be sold into the US, US securities lawyers will more often than not be asked to provide a no registration opinion confirming that the transaction does not need to be registered with the US Securities and Exchange Commission (*see box "US issues in block trades"*). A no registration opinion from the seller's lawyers is especially helpful to banks bidding in a competitive process.

Investment banks have varying requirements, and opinions are requested for some block trades, but not others. If an opinion is requested, consideration should be given to the timing of the opinion. In some cases, it could be preferable for the opinion to be delivered at pricing rather than closing.

Investor representation letters

US investors are sometimes asked to sign investor representation letters in order to participate in the block trade. If the transaction is structured pursuant to Section 4(1½) of the US Securities Act of 1933 (Securities Act), there are specific representations that the investor is asked to make. (*For an example of some of the basic provisions to be included in an investor representation letter in order to perfect an exemption from registration under the Securities Act, see box "Basic provisions of an investor representation letter"*).

DISCLOSURE

A manager bidding for a block of shares will need to know exactly what information about the trade or its purchase and subsequent resale will require public disclosure and when that information must be disclosed. This varies considerably depending on the statutory requirements in the jurisdiction in which the issuer is incorporated and the regulatory requirements in the jurisdiction in which its shares are listed. This must always be checked carefully in advance. The applicable rules for an issuer incorporated in England and Wales whose shares are admitted to trading on the London Stock Exchange are set out below.

Announcement

It would be usual for the seller to announce the launch of a block trade when books open (*see box "Indicative timetable for a competitive process"*). In the case of a bought deal the announcement would refer to a disposal. In the case of an AEO or back-stopped deal, the announcement would refer instead to an intention to dispose. In each case, the announcement would indicate the change in the seller's percentage holding in the issuer. It would not usually refer to the price at which the shares had been bought or back-stopped.

An announcement before the commencement of marketing is sometimes thought to be necessary to avoid any risk of committing market abuse through the making of "selective disclosure" to potential buyers of the shares. Under MAR, the new market sounding regime will generally be relied on in order to carry out marketing, pre-announcement (*see "Insider dealing and market abuse" above*).

Trade reporting

Under the Rules of the London Stock Exchange (LSE), the manager (assuming that it is a member firm) must submit a trade report of the dealing within prescribed deadlines. Where a transaction is effected outside of the trade reporting period (that is, between 7:15 am and 5:15 pm), the trade report must be submitted before 7:45 am on the next trading day.

The trade report will contain details of the transaction, including size and price. This would involve disclosing the price (where the manager was buying as principal) at a time when the manager may not yet have been able to offload its risk in full. It will have had some time on the evening of launch of the transaction to market to qualified institutional buyers in the US, but would only have had between one and two hours to access European demand on the morning of the pricing announcement. This might pose a commercial problem by revealing the price that the manager was committed to paying while the offering was still ongoing.

There are exemptions under the LSE Rules permitting the delayed publication of trade reports where a member firm elects to use block trading facilities (these will be further amended in relation to the MiFID II Directive (*see "MiFID II" below*)). Under a block trade facility, for example, publication would occur at the earlier of when it has been 90% offset and three business days after the relevant trade. The definition of a block trade for these purposes is made by reference to its size as a multiple of normal trading in the stock: for example, in the case of a SETSmm (the LSE's premier electronic trading service) security, the trade must be at least 75 times the normal market size.

DTR 5

If the block trade is of a block of shares in an issuer whose shares are admitted to trading on a regulated market and that issuer's home member state is the UK, the seller may need to notify the issuer under chapter 5 of the Disclosure Guidance and Transparency Rules (DTR 5) if it holds over a certain percentage of the issuer's voting rights and the block trade reduces its holding through a percentage threshold. The percentage thresholds that trigger this disclosure obligation are 3% and each one percent threshold above 3%, unless the issuer is a non-UK issuer in which case the percentage thresholds are 5%, 10%, 15%, 20%, 25%, 30%, 50 % and 75 %. A non-UK issuer is an issuer whose home member state is the UK other than a UK incorporated public company or a company incorporated in the UK or whose principal place of business is in the UK.

There are limited exceptions for issuers incorporated in certain other jurisdictions that are deemed to have substantially equivalent shareholding disclosure requirements. Currently, the FCA deems the US, Japan, Israel and Switzerland to be equivalent. The manager will also have a notifiable interest in a bought deal of this size. However, if the manager is acting as a market maker, the relevant percentage threshold for disclosure is 10% and, similarly, where the shares are held in the trading book, the percentage threshold is 5%. In assessing whether a notification is required, the net position at midnight on the day concerned should be considered, taking account of acquisitions and disposals executed during the day.

The notification to the issuer must be made as soon as possible and in any event within four trading days in the case of a non-UK issuer and two trading days in all other cases (DTR 5.8.3R). The issuer must publish the notification as soon as possible and in any event by the end of the trading day following receipt of the information, unless it is a non-UK issuer in which case it has three trading days to publish the notification (DTR 5.8.12R(1)). This disclosure is not usually problematic, however, as by the time it is published to the market, the manager is likely to have exited its position. Notifications must be made on form TR1 (*www.fca.org.uk/your-fca/documents/notifications-of-major-interests-in-shares-tr1-*).

POST-ANNOUNCEMENT

One selling issue that often arises is the manager's ability to disclose to potential buyers the status of its book of demand during the offering. This is a question it will frequently be asked and the answer has potential legal implications.

The simplest approach is to offer no comment. If that is not practicable, it is crucial to ensure that any statement made is not misleading, false or deceptive. If it is misleading and is made to induce the potential investor to participate in the offering, this could constitute a breach of the market manipulation prohibition in section 397 of FSMA, to which criminal liability could apply. Even if it is not intentionally misleading, the statement could constitute a negligent misstatement, a misrepresentation and a breach of contract.

If the status of the book of demand is to be disclosed, this should not be done selectively (that is, it should be sent by a Bloomberg to the newswires so that it is visible to the whole market) and the disclosure must be accurate, fair, clear and not misleading. Typical statements regarding the status of the book of demand include the following:

- "At the bottom end of the price range, the book is approximately half covered, based on indicated demand as of this morning."
- "The book is covered."
- "The offering is oversubscribed/multiple times oversubscribed."

MIFID II

MiFID II, which is due to apply from 3 January 2018, will introduce greater obligations for investment banks carrying out block trades, while also raising the following uncertainties:

- MiFID II will reintroduce a form of the old "concentration" rule whereby equities will have to be traded on a regulated market or other trading venue. This will modify Article 1(c) of the Association for Financial Markets in Europe (AFME) Model Block Trade Agreement, which permits the sale of a security outside a trading venue.
- The large-in-scale exemption for pre-trade transparency will still apply, although the thresholds for reaching the required size will increase. Similarly, the deferral period for post-trade transparency will still exist, but the time periods will generally be decreased (*see "Trade Reporting" above*). The reference price waiver or negotiated trade waiver, or both, to the extent that these were relied on, will be more problematic once MiFID II applies given that the trading volume through these waivers will be restricted by volume caps.
- The application of the best execution rule will depend on the structure of the block trade. In relation to bought or back-stopped deals it is likely that best execution requirements will be less relevant than in relation to an agency deal.
- Additional duties will be owed to professional clients and eligible counterparties in terms of investor protection rules, such as cost and charges, but the nature of a block trade should mean that these duties are more limited than, for example, an advisory or discretionary mandate. There are extended rules on conflicts of interest, but they will still be dealt with using similar procedures.
- A number of investment banks that provide agency deals may register as a trading venue, such as an organised trading facility, as they may be considered as providing "multilateral" services under MiFID II (*Article 1(7)*). However, there is currently uncertainty over this point pending European Securities and Markets Authority (ESMA) Level 3 guidance.

Nicholas Holmes is a partner at Ashurst LLP and Peter Castellon is a partner at Proskauer Rose LLP.

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