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Founders/controlling shareholders of companies considering an IPO on the London Stock Exchange

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Why do I need separate advice given my company will be engaging advisers for the IPO?

There are a number of areas where your interests as founder/controller and those of the company conflict. Once a company is listed, you will have to answer to the independent non-executive directors on the board and you will have to sign up to a relationship agreement pursuant to which you will have to agree to deal with the company on an arm's length basis. Another issue to bear in mind is that the board of the company may be less motivated than you to achieve the highest possible issue price for the shares on the IPO and, for that reason, we would often recommend that a financial adviser independent of the bookrunners is appointed.

You should also ensure that your personal position is protected, for instance, as regards any liability you may be asked to take on under the warranties in the underwriting agreement. There may also be non-core assets which you wish to extract from the group prior to IPO or businesses outside the group which the bookrunners insist should be part of the listed group. You will therefore need to negotiate the terms of any such pre-IPO reorganisation and you need independent legal representation to ensure that the reorganisation is implemented on terms favourable to you.

What level of confidence can I have in the bookrunners' views on valuation?

For larger IPOs, we would usually recommend that companies seeking a listing ('issuers') take advice from an independent investment bank who can look over the shoulders of the bookrunners and ensure that they are not leaving too much money on the table for investors. The perceived wisdom is that it is sensible to price an IPO so that the share price rises immediately following admission to the market because if a stock starts trading at below its issue price, it is much more difficult to subsequently regain investors' confidence in the stock. Typically an IPO would be priced around 5% below the expected market price at the end of the first day's trading. There is an inherent conflict, however, in banks keeping their key clients who are investing in the IPO happy (through an uplift in value in their investment following the IPO) as opposed to making sure the founders/controlling shareholders receive full value for their stock (which reduces the profits made by the investors).

What obligations will I have to take on as part of the IPO process?

Lock-in

You will be asked to enter into a lock-in arrangement pursuant to which you are not able to sell your shares for a period of time, normally a minimum of 6 months on a premium listing. You would usually want to negotiate in some carve outs to any such lock-in eg to allow you to transfer shares into a family trust or foundation or to family members.

Representations and warranties under the underwriting agreement

The bookrunners will require warranties from the founders/existing controlling shareholders that they believe that the prospectus contains all necessary information to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the company and the rights attaching to its shares. A raft of other warranties relating to the IPO process and the company's business would also customarily be included. If the founders/owners have stepped away from the day to day running of the business and/or they are not on the board, they would want to ensure that any warranties were qualified by their awareness and, in any event, their liability should be made subject to limitations both as regards the length of time in which warranty claims can be brought and their overall limit of liability.

Founders/owners who will be directors of the company will need to complete and sign detailed directors' questionnaires. These will include questions about source of wealth and compliance with money laundering, anti-bribery/foreign corrupt practices regulations. The accuracy of a director's response to their directors' questionnaire will need to be warranted in the underwriting agreement.

Statutory liability as a director of the company

If you are a director of the company, you will be required to take responsibility for the information in the prospectus and be a party to the underwriting agreement (in your capacity as a director) as the bookrunners will require the directors to give warranties, as they will with the founders/existing controlling shareholders.

Service agreement/letter of appointment/non-competition

Normally a new arm's length service agreement or letter of appointment would be put in place in anticipation of the IPO. You would want to ensure that you had the benefit of a separate contractual indemnity for directors' liabilities from the company and ensure that the company maintains cover for you under a directors' and officers' insurance policy. You would also want to review the provisions of any service agreement or letter of appointment. Typical issues to negotiate in a service agreement include termination provisions, the scope of your duties and your overall compensation package. You may also be asked to enter into a non-competition deed which would need to be carefully reviewed.

Stock-lending agreement

The bookrunner acting as stabilising manager, i.e. acting to support the price of the company's shares following admission, may request the founders/existing controlling shareholders to enter into a stock lending agreement in respect of a portion of their retained shares. A lead manager will typically over-allot shares, i.e. pre-sell more than 100% of the issue, leaving the lead manager with a net short position. The lead manager will then close out its short position by buying shares in the market but if the price rises above the issue price, it can borrow shares under the stock lending agreement instead to sell to investors and acquire further shares from the company under an option known as a Green Shoe Option. The terms of the stock lending agreement need to be reviewed, the counterparty risk considered and you would want to negotiate the payment to the issuer of a proportion (perhaps 50%) of the trading profits and commission earned by the stabilising manager from trading in the shares lent pursuant to the stock lending agreement.

What role can I and other members of my family have in the management of the company post IPO?

Companies with a premium listing are required to either comply with the UK Corporate Governance Code or explain why they do not comply. The bookrunners will generally be keen for there to be at least two non-executive directors in addition to the chairman of the board, for there to be a separate chairman and chief-executive and for the company to have a finance director who is experienced in acting as a finance director of listed companies. For larger companies, the bookrunners may want to see up to half the board, excluding the chairman, comprising independent non-executive directors and also for the Chairman to be independent on appointment.

Where you and your family and other persons acting with you or associated with you retain a 30% or greater stake in the company post IPO, a relationship agreement will need to be put in place which will require you to ensure that all arrangements between you and connected persons with the company are on an arm's length basis. You may, however, be able to persuade the bookrunners to explain away some non-compliance with the UK Corporate Governance Code if founders and other non-independent directors can justify their position on the board post IPO. Ultimately, the corporate governance position will depend on what the bookrunners consider will satisfy potential investors.

You may also want to consider putting in place a concert party agreement pursuant to which controlling shareholders give each other a right of first refusal on share transfers and potentially agree how to vote on certain issues. Any such agreement would need to take into account of the provisions of the UK Takeover Code given that transfers or acquisitions of shares by a concert party could trigger a requirement on the controlling shareholders to make a mandatory offer for the company.

Do I need to address the structure of my holding above the company in view of the potential liabilities identified above and for tax reasons?

It is important that you take steps in advance of the IPO to adopt the optimal structure for your holding, both commercially and from a tax point of view.

At the very least you will need to ensure that the jurisdiction chosen for the IPO vehicle does not jeopardise your personal tax position or, if that is not possible, ensure that it is held through an appropriate holding structure to shield you from any unwanted liabilities.

If you remain a significant shareholder in the company following the IPO, any restructuring that you engage in is likely to need to be disclosed to the market and may require a waiver from the Panel on Takeovers and Mergers. For this reason, it is advisable that any new holding structure is adopted before the listing.

In the UK, there are also a number of tax reliefs that are only available to private rather than listed companies, particularly for individuals looking to establish long term family holding structures, such as trusts or partnerships. Therefore it is advisable to ensure that all steps necessary to establish such structures are completed in advance of the IPO.

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