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# Advisory

## Pre-Outsourcing Considerations for LSE-Listed Companies

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by Tim Wright and Caroline Grange

**A company listed on the London Stock Exchange must consider whether outsourcing transactions to which it intends to be a party require any announcement or shareholder approval as required by the rules governing the continuing obligations of listed companies. The United Kingdom's Listing Authority ("UKLA") has provided some useful guidance in assessing the applicability of such rules to outsourcing agreements.**

### The Listing Rules

Companies listed on the Official List of the UKLA are subject to the Listing Rules. The Listing Rules are published by the Financial Services Authority ("FSA"), the UK financial services regulator, and form part of the FSA Handbook. The FSA Handbook sets out the rules and guidance made under the Financial Services and Markets Act 2000. The Listing Rules lay down minimum requirements for the admission of securities (e.g., shares or warrants) to listing, the content, scrutiny and publication of listing particulars, and the continuing obligations of issuers after admission.

The regulatory objectives of the FSA in its capacity as the UKLA are to formulate and enforce rules that provide an appropriate level of protection for investors in listed securities, facilitate access to listed markets for a broad range of enterprises, and seek to maintain the integrity and competitiveness of UK markets for listed securities.

The Listing Rules contain ongoing requirements that must be adhered to by a company in order to maintain its listing. This advisory considers one element of the ongoing requirements, namely, the applicability of the Listing Rules to companies considering outsourcing agreements.

## Listing Rule 10

Listing Rule 10 applies to companies that have a primary listing of equity securities. Such companies need to consider Listing Rule 10 when entering into transactions. The rule outlines the steps a company must take in considering whether transactions it intends to enter into trigger any of the “class tests” and subsequently the scope of any announcement and shareholder approval requirements. The purpose of Rule 10 is to ensure that shareholders in listed companies are notified of certain transactions and have the opportunity to approve larger proposed transactions.

### What is a Transaction?

The Listing Rules’ definition of “transaction” is wide and covers all agreements (including amendments to agreements) entered into by the listed company, subject to specified exclusions. These exclusions are:

- a transaction of a revenue nature in the ordinary course of business,
- an issue of securities or transaction to raise finance that does not involve acquiring or disposing of any fixed asset of the listed company, and
- any transaction between the listed company and its wholly owned subsidiary undertaking(s).

In assessing whether a transaction is in the ordinary course of business, the UKLA looks at the size and incidence of similar transactions that the listed company has entered into.

If a transaction is not excluded, then the company must run a number of class tests (also known as the percentage ratio tests). The class tests are used to compare the size of the listed company with the size of the transaction in question. The results of the class tests are expressed as percentage ratios that are then used to categorise the transaction in accordance with Listing Rule 10.

The percentage ratio results will dictate the information required in any transaction notification to the market and whether shareholder approval will be required.

### Applicability to Outsourcing Agreements

Outsourcing refers to the delegation to a third party the responsibility for performing a significant business function.

On a strict interpretation of Listing Rule 10, outsourcing agreements would fall within the definition of a transaction unless such agreements or arrangements are “transactions of a revenue nature.” Unless it is possible to say that outsourcing transactions have become part of a listed company's business, it is unlikely that outsourcing transaction would be excluded.

In guidance recently received pertaining to a specific outsourcing transaction, the UKLA stated that for an outsourcing arrangement to qualify as a transaction of a revenue nature in the ordinary course of business, the outsourcing would have to be the normal business of the listed company. If the company cannot rely on this exemption, then the UKLA would review the proposed outsourcing arrangements to see if business revenue would effectively be leaving the company or group. If so, the transaction is likely to be subject to the class tests.

In considering whether an outsourcing arrangement is a transaction to which the class tests should be applied, the UKLA has suggested that a company should consider the following questions:

- **Are premises or fixed assets being transferred under the outsourcing?** If yes, then the transaction is one to which the class tests would apply.
- **Is business revenue being transferred over to the outsourcer as part of the arrangements whereby it provides outsourcing services?** If yes, there is a distinction between the circumstance where the outsourcer is only charging a fee for its services with the listed company retaining all revenue from the outsourced business and hence the only change would appear in the expense line in the listed company's profit and loss account, and the circumstance where the outsourcer is actually receiving all or some of the revenue of the outsourced business such that both the revenue and cost line of the listed company's accounts would change.

In the advice received from the UKLA, there appeared to be acceptance of the proposition that if the listed company is simply paying a fee to the outsourcer and there was no change to the revenue line in the listed company's accounts, then Listing Rule 10 would be unlikely to apply to the transaction. This would be the case regardless of whether the provision of the services was by existing employees of the outsourcer (with the listing company making its employees redundant), or if the listed company transferred some of its employees to the outsourcer to enable it to offer the services stipulated in the outsourcing agreement.

The UKLA has provided companies with useful questions to ask when considering whether a proposed outsourcing arrangement is a transaction to which the class test should be applied. Clearly not all outsourcing transactions will be subject to the class tests. The structure of a proposed agreement will be crucial in determining the applicability of the class test, particularly when it comes to considering the transfer of business revenue to the outsourcer.

Notwithstanding the foregoing, a listed company should consider each transaction on a case-by-case basis. A listed company should discuss any proposed arrangements with its sponsor and other professional advisers, and where necessary, seek guidance from the UKLA as to the applicability of the Listing Rules to specific circumstances.

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For further information, please contact:

**Tim Wright (bio)**

London

+44.20.7847.9505

tim.wright@pillsburylaw.com

**Caroline Grange (bio)**

London

+44.20.7847.9615

caroline.grange@pillsburylaw.com