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Shareholders' Rights & Shareholder Activism 2021

UK

Samantha Trevan, Kate Cooper, Zaid Fathoala and
Sorcha Horrocks-Burns
Freshfields Bruckhaus Deringer LLP

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Law and Practice

Contributed by:

Samantha Trevan, Kate Cooper, Zaid Fathoala and
Sorcha Horrocks-Burns

Freshfields Bruckhaus Deringer LLP see p.21



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1. SHAREHOLDERS' RIGHTS

1.1 Types of Company

General

There are four types of company which may be formed under the Companies Act 2006 (the CA06):

- a private company limited by shares;
- a private company limited by guarantee;
- a public company limited by shares; and
- an unlimited private company.

The majority of companies are formed as private companies limited by shares. Only UK companies registered as public companies are permitted to have their shares listed and admitted to trading in the UK.

There are no general nationality, residence or status qualification criteria for becoming a shareholder of a company. For example, a person who is bankrupt or under the age of 18 may be a member of a company, subject to any restriction in the company's articles of association and statutory restrictions under competition laws and in particular sectors. A person becomes a member of a company if shares are transferred to them or they agree to become a member, and their name is entered into the company's register of members.

Listed Companies

Shares of public companies admitted to the Official List of the Financial Conduct Authority, the conduct regulator for financial markets in the UK (FCA), and to trading on the London Stock Exchange (LSE) must be freely transferable and, therefore, such companies have less control over their shareholder base. However, these listed companies can place limited restrictions on the ownership of their shares in the company's articles of association if required to comply with

laws, eg, to prevent ownership by more than a specific percentage of foreign owners in certain circumstances; any such restrictions must be approved as an exception to the freely transferable requirement of the FCA's Listing Rules (the Listing Rules) (see **1.15 Shareholders' Rights to Grant Security over/Dispose of Shares**). Similar rules in respect of the transferability of shares also apply to companies listed on the LSE's alternative investment market (AIM).

1.2 Types or Classes of Shares

The main class of share issued by a company is an ordinary equity share. Share rights are set out in the company's articles of association and typically entitle shareholders to income, capital and voting rights, such as payment of dividends, payment on the winding-up of the company and participation in meetings of the company.

Companies may also issue preference shares which provide the holder with preferential rights regarding entitlement to dividends and/or on the winding-up of the company, but limited, or no, voting rights.

Shares can be redeemable or non-redeemable, convertible (into other classes of shares) or deferred (shares that do not provide rights to dividends, either for a set period of time or until specified conditions are satisfied).

Companies can also issue equity warrants conferring the holder with a contractual right (but not an obligation) to subscribe for securities of the issuer, usually for a stipulated period of time at a fixed price.

1.3 Primary Sources of Law and Regulation

The rights of shareholders arise under:

- the company's articles of association (articles);

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- statute and regulation (eg, the CA06), the Listing Rules and the Financial Conduct Authority (FCA)'s Disclosure Guidance and Transparency Rules (the DTRs), the EU Market Abuse Regulation (MAR) and the Panel on Takeovers and Mergers' Takeover Code (the Takeover Code));
- contract (eg, a shareholders' agreement); or
- common law (eg, a common-law derivative claim).

Shareholders may also have rights that are distinct from rights arising from their membership, eg, rights and obligations arising in relation to a directorship, under an employment contract or as a creditor of the company.

1.4 Main Shareholders' Rights

For an outline of the primary sources of law and regulation relevant to shareholders' rights, see **1.3 Primary Sources of Law and Regulation**. Shareholders' rights depend on the rights attaching to their shares set out in the company's articles, which typically cover a shareholder's rights as to income, capital and voting. Different classes of share can be created to enable shareholders to enjoy different rights. There is no limit on the number of different classes of share that a company can have.

Shareholder rights can be varied by amending the company's articles, although certain rights (eg, the right to call a general meeting) are governed by statute and cannot be varied. Any amendment to the company's articles must be filed with Companies House; copies of a company's articles are publicly available on the Companies House website. Class rights can also be created via a shareholders' agreement.

Where there is more than one class of shares, those rights can only be varied either in accordance with a provision in the articles for the variation of those rights or, where the articles are

silent, in accordance with the CA06 procedure, which requires the consent of not less than 75% of the members of that class. The variation procedure contained in a company's articles can replicate the statutory requirements or may set either a less demanding or more onerous procedure for the variation of class rights (although it cannot provide that no class consent is required). The variation of rights attached to one class of share may cause a variation of rights attached to another class of share; therefore, both classes must consent to implement the variation.

1.5 Shareholders' Agreements/Joint-Venture Agreements

Shareholders'/joint-venture agreements are enforceable in the UK and can be entered into between shareholders and with the company. Shareholders' agreements are more common in relation to private companies than public companies (where, for many reasons, shareholders generally wish to avoid any implication that they are acting in concert or are related/associated with one another).

Shareholders' agreements often contain arrangements that the shareholders prefer not to be made public (as it is the articles of a company that are publicly available rather than the shareholders' agreement). However, it may be preferable for certain arrangements to be reflected in the company's articles, as well as the shareholders' agreement, because the company's articles are binding upon anyone who acquires shares in the company. By contrast, a shareholders' agreement is only enforceable by the parties to the agreement, unless it is voluntarily adhered to by another party.

1.6 Rights Dependent upon Percentage of Shares

For the voting thresholds required to pass resolutions binding on the company, see **1.8 Shareholder Approval**. Separately, a shareholders'

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agreement or the company's articles may also contain certain reserved matters restricting the other shareholders/the company from implementing certain arrangements without the consent of a percentage of shares being voted in favour of it. For example, an investor shareholder holding a specified percentage of shares may be able to restrict the company from making a large disposal or acquisition without its consent (ie, a minority-protection right).

1.7 Access to Documents and Information

General

Shareholders are entitled to receive notice of meetings and the company's report and accounts. Other than as provided by contract, shareholders do not have an entitlement to information about the company beyond that required to be provided under statute or the company's articles. Copies of minutes of general meetings and shareholders' written resolutions (which can only be passed by private companies) must be made available for inspection by any shareholder.

Listed Companies

In addition, UK-listed companies are subject to greater disclosure and reporting obligations, eg, pursuant to the CA06, the MAR, the Listing Rules (or the AIM Rules) and the DTRs.

1.8 Shareholder Approval

General

Generally, a company is run by its board of directors, and they have full power and authority (under the articles) to make decisions. However, there is a limited number of matters which the law requires the shareholders to decide, not the board. The CA06 sets out the corporate actions requiring shareholder approval, which can be provided in a general meeting or, for private companies, by way of a written resolution.

Actions that require the passing of an ordinary resolution (approval of more than 50% of those attending and voting) include:

- removal of the company's auditor;
- approval of a limitation of liability between the company and its auditor;
- approval of a payment to a director for loss of office;
- approval of a political donation; and
- approval of a loan to a director or a substantial property transaction involving a director.

Actions that require the passing of a special resolution (approval of at least 75% of those attending and voting) include:

- amendment of the company's articles;
- approval of a share buy-back or reduction of capital;
- disapplication of pre-emption rights;
- re-registration of a private company as a public company (or vice versa); and
- change of the company's name.

A company's articles typically provide that the board of directors has the power to appoint additional directors. A director can also be appointed by the passing of an ordinary resolution of the shareholders, unless this power is expressly restricted by the company's articles. Under the CA06, a director can always be removed from office by the passing of an ordinary resolution of the shareholders – this is the ultimate sanction that shareholders have if they do not agree with the way the company is being run.

Directors of UK-listed companies have an additional layer of accountability, as they are subject to annual re-election by shareholders. See **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors** for further details.

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Listed Companies

The Listing Rules impose shareholder-approval requirements for certain corporate actions of the listed company, including, eg, approving:

- entering into a material transaction or reverse takeover;
- entering into a transaction, other than in the ordinary course of business, between the listed company and a related party (as defined in the Listing Rules);
- the delisting of the company or the transfer between listing categories in relation to the company;
- entering into certain employee share schemes and directors' long-term incentive schemes; and
- the purchase of 15% or more of any class of the company's own shares by the listed company.

What constitutes a material transaction is determined by reference to the "class tests" outlined in the Listing Rules which the company will need to run before completing the transaction. The requirement to obtain shareholder approval for a related-party transaction does not apply in certain circumstances (eg, to small transactions or those agreed before the counterparty became a related party).

Other actions may require shareholder approval under the Takeover Code, which will apply to a listed company during any period where it is the target of a takeover bid. These are designed, for example, to prevent a bona fide bid from being frustrated by the board of the target such that shareholders are denied the opportunity of deciding on its merits.

1.9 Calling Shareholders' Meetings

General

A shareholder/group of shareholders who hold at least 5% of the voting rights in the company may

request the directors to call a general meeting of the company (ie, a shareholders' meeting).

Under the CA06, the following notice periods are subject to the "clear days" rule (the day on which the notice is sent and the day of the meeting itself are not counted as part of the notice period) and prescribed deemed receipt periods, which companies must factor into their calculation of notice periods.

All shareholders are entitled to receive notice of a general meeting, which must set out the general nature of the business to be dealt with at the meeting. In practice, notices usually include the exact wording of the resolutions to be approved.

Private Companies

At least 14 days' notice is required to hold a general meeting of a private company; however, the company's articles may require a longer period. Shareholders holding at least 90% (or any higher percentage specified in the articles) of the shares in the company can consent to holding a meeting on shorter notice.

Public Companies

At least 21 days' notice is required before the holding of an annual general meeting of a public company. However, shareholders may pass a special resolution approving a shorter notice period of at least 14 days in relation to the holding of other general meetings; this resolution must be renewed at each subsequent annual general meeting of the public company (without this authority, the default notice period remains 21 days). The company's articles may also specify longer notice periods in relation to both annual general meetings and other general meetings.

Virtual Shareholder Meetings

The CA06 does not expressly prohibit a company from conducting a meeting electronically, and whether a general meeting may be held elec-

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tronically will generally be left to the company's articles. However, the effectiveness of a fully virtual meeting (as opposed to a "hybrid" meeting, where certain attendees are in the meeting place and others join remotely) has not yet been fully tested before the courts. As a result, some companies include provisions in their articles permitting a meeting to be convened at a specific place, with an ability for shareholders also to attend virtually, but do not go as far as allowing for entirely virtual meetings with no physical meeting location.

The Financial Reporting Council (FRC), the regulatory body responsible for setting the UK's Corporate Governance and Stewardship Codes, is now encouraging companies to consider amendments to their articles to permit greater flexibility and it is expected that more companies will adopt wording to allow hybrid (but not fully virtual) meetings in the next AGM season.

The Corporate Insolvency and Governance Act 2020 (CIGA) offered temporary flexibility for general meetings held between 26 March 2020 and 30 March 2021 in light of the COVID-19 pandemic. During this period, irrespective of the provisions in a company's articles, general meetings could be held, and votes cast, entirely virtually (eg, by telephone/online). However, at these meetings, members only have the right to vote (ie, no right to speak or ask questions). Companies must still comply with other aspects of the articles (and the CA06) regarding convening meetings and listed companies must also comply with FCA rules relating to meetings (eg, notices, circulars).

Following the expiry of the CIGA provisions relating to conduct of meetings, uncertainty over the status of hybrid and virtual meeting prevailed (particularly where no specific power has been adopted in the articles). However, this should now be largely ameliorated, with England's

removal of legal restrictions on public gatherings.

1.10 Voting Requirements and Proposal of Resolutions

General

Ordinary resolutions at general meetings require the approval of more than 50% of those attending and voting in order to be passed. Special resolutions at general meetings require the approval of at least 75% of those attending and voting in order to be passed. It is common for the articles to provide that resolutions considered at these meetings be decided by a show of hands unless a poll is demanded. A vote on a show of hands means that each shareholder present has one vote, regardless of the number of ordinary shares they hold. In a poll vote, each shareholder has one vote for each share they hold. Unless amended by the company's articles, the quorum for a general meeting is two. If the company only has one shareholder, the quorum is one.

Shareholders cannot propose new resolutions or amend proposed resolutions at these general meetings. Shareholders who represent at least 5% of the total voting rights and who have the right to vote at a particular general meeting, or 100 shareholders who have a right to vote at a particular general meeting, and who hold shares that are paid up to an average of at least GBP100 per shareholder, can require the company to circulate a statement to the other shareholders in relation to a matter to be considered at a general meeting and, for public companies, can require the circulation of a resolution to be voted on in the company's annual general meeting.

Private Companies

Private companies may provide that resolutions be passed as written resolutions, rather than holding a physical meeting. The threshold for passing a written resolution is calculated by reference to the total voting rights of all share-

holders entitled to vote on the date the written resolution is circulated.

Public Companies

A shareholder can appoint a proxy to attend and vote at the general meetings of public companies; a proxy has the same voting rights as the shareholder who appointed them. If a shareholder appoints multiple proxies, they must be appointed in relation to different shares held by the shareholder.

Electronic Voting

Whether shareholders are permitted to cast their vote by electronic means will generally be a matter for the company's articles.

1.11 Shareholder Participation in Company Management

For details of corporate actions requiring shareholder approval, see **1.8 Shareholder Approval**.

General

It is the board of directors which manages the general affairs of the company. Shareholders are able to override the board of directors' general power of decision-making in the following circumstances:

- if the articles enable members to give instructions/directions requiring the directors to take or refrain from taking certain action or reserve certain matters to be decided by the shareholders (or a specified percentage of them), the board is obliged to act in accordance with the wishes of the members as a whole (unless requested to do an illegal act);
- if the board seeks shareholder approval either pre- or post-acting; or
- where the board of directors is unable or unwilling to act (eg, deadlock), shareholders have a residual management power under English common law.

Private Companies

Shareholders of private companies, particularly financial investors, may have a suite of reserved matters requiring shareholder approval contained in the articles of the company and/or a shareholders' agreement. These may include, eg, approval of the annual budget and business plan, or capital expenditure plans; this necessarily provides shareholders with a more direct management role in the company.

It is also common for institutional or private equity investors or joint-venture partners, via a shareholders' agreement, to require directors nominated by them to be included on the board and in the quorum for decision-making, and for certain board matters to be reserved for approval by a specified majority, including the votes of the investor or joint-venture partner directors.

Public Companies

Public companies have executive and non-executive directors on the board to assist with this management. Under the UK Corporate Governance Code, UK-listed companies are required to have a majority of independent non-executive directors on the board (excluding the chair), or otherwise to explain to shareholders why not, in its annual reporting. Shareholders have the power to appoint and remove members of the board of public companies however, they do not have the right to participate in the day-to-day management of the company.

A public company and a shareholder can agree to appoint a shareholder-nominated director to the board of directors of the public company. The public company and the shareholder will typically enter into a relationship agreement which governs, eg, which board committees the shareholder-nominated director can participate in and how the passing of confidential/price sensitive information between the shareholder-nominated director and the shareholder is regulated. Under

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the Listing Rules, premium-listed issuers with a controlling shareholder (a shareholder who holds 30% or more of the shares in the company) must enter into a relationship agreement with the controlling shareholder.

1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors

The company's articles typically contain provisions relating to the appointment and removal of directors. A director can be appointed by the passing of an ordinary resolution of the shareholders, unless this power is expressly restricted by the company's articles. Under the CA06, a director can be removed from office by the passing of an ordinary resolution of the shareholders. At least 28 clear days' notice must be provided prior to the holding of a general meeting at which shareholders intend to remove a director. A director subject to an ordinary resolution for his or her removal has the right to be heard at, and to make written representations to, the general meeting. Directors of UK-listed companies which comply with the UK Corporate Governance Code are subject to annual re-election.

The ultimate shareholder sanction is the power to appoint and remove members of the board, rather than a particular right to interfere with management. There is no set procedure for shareholders to challenge resolutions passed by the board of directors. However, shareholders can require the board of directors to call a general meeting to enable the shareholders to pass a resolution.

In certain circumstances, shareholders are able to bring derivative claims for and on behalf of a company in respect of a wrong done to the company (see **3.6 Derivative Actions**); these claims allow shareholders to enforce rights vested in the company in which they are a member, rather than allowing shareholders to seek enforcement of personal rights. As such, any remedies

granted will benefit the company directly. These derivative claims may be made by statute under Part 11 of the CA06 or under common law.

1.13 Shareholders' Right to Appoint/Remove Auditors

The auditors of a company can be appointed by either the board of directors or company's shareholders by way of ordinary resolution.

The company's auditor can be removed by the shareholders passing an ordinary resolution at a general meeting (the written resolution procedure cannot be used). The notice period for a general meeting including such a resolution must be at least 28 days. Large public companies must re-tender the position of auditor once an incumbent has completed ten years.

1.14 Disclosure of Shareholders' Interests in the Company Listed Companies

Under the DTRs, a shareholder of a company whose shares are admitted to trading on a UK-regulated market, such as the LSE, or other prescribed markets, must notify the company of the percentage of the voting rights it holds if the percentage of those voting rights reaches, exceeds or falls below 3%, or any whole percentage figure above 3% (subject to certain exemptions for fund managers, where the threshold is 5% in specific circumstances). Under the Takeover Code, which will apply when a company is in an offer period, this disclosure threshold drops to 1% in relation to dealings and positions in both the offeree and offeror company.

Non-listed Companies

Companies, other than those with voting shares admitted to trading on a regulated market situated in the UK or other prescribed markets, must identify persons (or relevant legal entities) who exercise significant control over the company; details of these persons/entities are publicly

disclosed in a PSC (people with significant control) register, which must be maintained by the company. A person will have significant control if they:

- hold, directly or indirectly more than 25% of the shares or voting rights of a company, or the right to appoint or remove a majority of directors in the company; or
- have the right to exercise, or actually do exercise significant influence or control over the company.

1.15 Shareholders' Rights to Grant Security over/Dispose of Shares

General

Shareholders are entitled to grant security interests over their shares. A charge or mortgage over shares created on or after 6 April 2013 by a company or limited liability partnership registered in England and Wales may be registered at Companies House. This registration requirement does not apply to individuals.

There are no general restrictions under English law preventing shareholders from disposing of their shareholdings. Disposals can be made to a third party, or in certain circumstances, the company may buy back or redeem the shares. Shares are generally considered freely transferable, unless a company's articles or a shareholders' agreement provide otherwise.

Public Companies

Any share pledges over shares in a publicly traded company must be disclosed to the market if granted by directors or senior managers.

Shares of listed companies must be freely transferable as a condition of eligibility for listing, unless the FCA otherwise agrees (which will be only in limited circumstances).

Private Companies

The transfer of shares in private companies can be restricted. For example, shareholders' agreements may provide that existing shareholders have a right of first refusal/offer over the sale of shares, or other pre-emption rights. Put-and-call options over shares can also be included to restrict their transferability. It may be preferable for any restrictions on the transfer of shares to be reflected in the company's articles as well as the shareholders' agreement, because the articles are binding upon anyone who acquires shares in the company. The articles of a private company may provide that the directors can refuse to register a transfer of shares in certain circumstances; however, certain protections are provided under both common law and the CA06.

1.16 Shareholders' Rights in the Event of Liquidation/Insolvency

In an insolvency situation, the duties of directors shift from acting to promote the success of the company for the benefit of its members as a whole to acting in the best interests of the company's creditors. Therefore, shareholders have fewer rights in an insolvency situation and cannot ratify directors' breaches of duty in such circumstances.

In a liquidation or administration, creditors must be paid in the following statutory order of priority:

- fixed charges;
- expenses of the insolvency process;
- preferential debts;
- floating charges; and
- unsecured creditors.

Only after the aforementioned creditors have been paid will the shareholders be entitled to any surplus assets of the company. Owners of preference shares may have a preferential right

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to the surplus assets ahead of other ordinary shareholders.

Under the Insolvency Act 1986 (IA86), shareholders can initiate a voluntary winding-up by passing a special resolution. Alternatively, shareholders can seek a court order that the company be wound up. The court may only make a winding-up order if one of the circumstances set out in the IA86 exists, eg:

- the company is unable to pay its debts;
- the company suspends business for a year or more; or
- the court is of the opinion that it is just and equitable that the company be wound up (see **3.2 Legal Remedies against the Company**).

The CIGA

The CIGA introduced the option for distressed companies to propose a restructuring plan with their shareholders or creditors, with cross-class cram-down, meaning that (subject to various safeguards) the court has the discretion to sanction a plan, even if one or more classes of shareholders or creditors vote against the plan. The voting threshold is 75% by value of each class present and voting (subject to cross-class cram-down).

The CIGA also introduced a 20-business day moratorium (subject to extension with consent of creditors/the court), during which shareholders may not (i) pass a special resolution to wind up the company (unless recommended by the directors), or (ii) present a winding-up petition.

The CIGA also included three temporary measures for COVID-19:

- suspension of liability for wrongful trading for certain companies from 1 March 2020 to 30 June 2021;

- restriction on the use of statutory demands as a basis for winding-up and certain limitations on the making of winding-up orders for the period from 27 April 2020 to 30 September 2021; and
- reinstating until June 2021 the government's power to regulate pre-packs to connected parties. This is now the subject of new permanent regulations to provide greater protection of creditors from abuse.

2. SHAREHOLDER ACTIVISM

2.1 Legal and Regulatory Provisions

Shareholder activism refers to shareholder engagement, demonstrations of disapproval and proactive, often public, measures taken by shareholders in order to elicit change in a company.

In the UK, the main sources of legal and regulatory provisions that govern and restrict shareholder activism are the CA06, the Listing Rules, the DTRs, the MAR and the Takeover Code. The UK Corporate Governance Code also requires companies actively to engage with shareholders.

The CA06 applies to all companies incorporated in the UK and provides shareholders with rights to interact with a company and each other, including a wide range of mechanisms which can be used against the board, eg, rights relating to requisitioning of, speaking at, and circulating statements ahead of, general meetings, voting, and the removal or appointment of directors (see **2.3 Shareholder Activist Strategies**).

The Listing Rules apply to UK-listed companies and contain rules around how a UK-listed company should be governed. For companies with a premium listing, certain significant corporate transactions require shareholder approval; this

requirement could be used by an activist shareholder attempting to block a particular transaction, see **1.8 Shareholder Approval** for further details. However, certain provisions of the Listing Rules can be used to restrict activists. For example, under Rule 6.5.4, once a shareholder reaches a holding of 30% or more, they must enter into a “relationship agreement” with the company to govern interactions with the company. Although this can legitimise an investor’s demands, it may also limit the types of transactions into which an activist shareholder can enter with the company. In addition, once a shareholder holds 10% or more it will be deemed to be a related party for the purposes of the Listing Rules and more onerous requirements will apply.

The DTRs apply to listed companies and impose an obligation on investors to disclose their position within a company once they reach a certain level of share ownership (as part of any potential stake-building exercise) (see **1.14 Disclosure of Shareholders’ Interests in the Company** for further details). This may restrict an activist shareholder who would like to build up a stake within a company before making an approach to the board. There are certain exceptions available to regulated investment managers, allowing them to accumulate stakes of up to 5% in a UK issuer (instead of 3%) prior to the disclosure obligation biting (DTR5.1.5), which can be used by activists to enable them to stay under the radar for longer.

From 1 January 2021, the MAR, formerly an EU regulation directly applicable in the UK, has been “onshored” into English law via the EU (Withdrawal) Act 2018. It places certain restrictions on information which can be disclosed by a company or investors. Activist investors should be aware of the penalties for insider dealing, which is prohibited under the MAR and the Criminal Justice Act 1993, and other forms of market abuse which are prohibited by the MAR.

Insider dealing involves dealing in securities when in possession of inside information. Inside information is information which:

- relates to particular securities;
- is specific or precise;
- is not public; and
- if public, would likely have a significant effect on the price of the securities.

The Takeover Code may restrict activist investors by limiting the amount of shares they can purchase in a company as part of a stake-building exercise; under Rule 9 of the Takeover Code, if an investor reaches a 30% shareholding in a company, it will be required to place a mandatory bid for the rest of the shares it does not already own. This Rule is also triggered where a group of shareholders are taken to be acting “in concert with one another” (where their combined shareholding equates to over 30% of the shares of the company) and are seeking to take control of the company.

See **2.7 Company Response to Activist Shareholders** for details on a company’s ability to check its share register for potential activist stake-building.

2.2 Level of Shareholder Activism

Shareholder activism is not a new phenomenon in the UK. Prior to the COVID-19 pandemic, it had been steadily increasing in Europe, particularly in quoted companies in the UK, as a result of:

- changes in public perception towards activism/activists;
- greater shareholder engagement with companies;
- the UK’s statutory-based shareholder protections;

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- increased focus on encouragement of active share ownership (including through the FRC's Stewardship Code);
- US activist hedge-funds targeting UK-based companies and activist hedge funds outperforming other hedge funds; and
- changes to corporate governance requirements.

Following a drop in the level of shareholder activism in the UK in the first half of 2020, due to uncertainty around the impact of activism on target companies and fears of reputational backlash against activists, late 2020 and the first half of 2021 have seen a rebound in activity.

Among the notable campaigns, Elliott Investors highlighting of GlaxoSmithKline's financial under-performance, strategic misjudgment and leadership shortcomings garnered considerable attention. The next steps are awaited.

2.3 Shareholder Activist Strategies

The strategies employed by activist shareholders will depend on the objective of the investor. Activist shareholder activity can generally be split between event-driven activism (where a shareholder is seeking to influence the outcome of a particular company event, eg, an M&A transaction) and strategic activism (where a shareholder is seeking a change in the long-term strategy or governance of a company, eg, via the removal of board members). Forms of activist activity include:

- influencing the completion of or encouraging the company to undertake particular transactions, including seeking a takeover of the company;
- bidding to control the board in order to amend the company's strategy;
- amending board membership to improve corporate governance; and/or

- requesting that the company return cash to shareholders.

Activist Insight identified that, in the first half of 2020, 45% of the demands made by activists in Europe related to board representation/composition; M&A made up just over 11% of activists' demands.

Strategic activists tend to research markets and identify target companies before acquiring their shares, with the aim of making governance changes within the company, or they may be existing investors who have been dormant within a company but who become active and seek changes internally.

Event-driven activists are typically more opportunistic as their activity is based upon current events within the company. The agendas of event-driven activists are usually the short-term increase in value of their shareholding; they are not usually concerned with long-term development of the company.

In order of escalation, general activist strategies include:

- building up a stake within a company by purchasing shares in the market in order to gain greater voting influence;
- approaching the board privately for discussions as to the activist's concerns;
- asking difficult questions at general meetings;
- making public commentaries or writing public letters to the board;
- using a public relations campaign to put pressure on the board members;
- using shareholder rights within the company (eg, voting against resolutions);
- seeking that a director be removed from or appointed to the board, particularly via requisitioning a meeting of the company; and

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- commencing litigation or other legal remedies, including commencing a derivative action on behalf of the company for breach of directors' duties or an unfair prejudice claim.

The success of any of these strategies will depend upon the influence of the activist investor and the support it has from the other shareholders in the company; activist shareholders may request a copy of the company's share register in order to contact other shareholders and solicit support. However, with regard to institutional investors, registrars only have visibility over the top level of the chain and may not know who the larger underlying investors are, unless enquiries have been made by the company under s.793 of the CA06 (see **2.7 Company Response to Activist Shareholders**).

The CA06 provides a number of mechanisms for activists to use:

- the right to speak at general meetings provides an opportunity to pose challenging questions to the board;
- an activist shareholder with enough voting rights or support can block both special and ordinary resolutions (see **1.8 Shareholder Approval** for the voting thresholds required to pass resolutions binding the company);
- shareholders representing at least 5% of the paid-up voting share capital of the company can require the company to call a general meeting (see **1.9 Calling Shareholders' Meetings**);
- an activist shareholder/group of shareholders can require resolutions to be voted on at a general meeting they have requisitioned (further, shareholders of public companies can require resolutions to be considered at annual general meetings);
- an activist shareholder can require a company to circulate a statement, relating to a resolu-

- tion or matter to be considered in a general meeting, to the other shareholders;
- voting against a resolution relating to the re-election or new appointment of a director to the board or bidding to remove a director from the board via an ordinary resolution (see **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors**);
- bringing a claim for unfair prejudice, where the actions of the company are unfairly prejudicial to the interests of the shareholder (see **3.2 Legal Remedies against the Company**); and
- commencing a derivative action on behalf of the company for breach of directors' duties (see **3.6 Derivative Actions**).

The rights described in the fourth and fifth points above can be requested by a shareholder/group of shareholders which holds at least 5% of the total voting rights or at least 100 members who are entitled to vote on the resolution and each holding, on average, at least GBP100 of paid-up share capital.

Going forward, strategies for new campaigns could focus on addressing the impacts of COVID-19 by prioritising:

- take-privates of listed companies;
- carve-outs and initial public offering (IPO) spin-offs;
- credit investment pressure/loan-to-own restructuring; and
- board composition changes due to sub-par management during the pandemic.

Environmental, social and governance (ESG)-related demands have increasingly become part of the activist agenda as shareholders seek to hold companies accountable. This trend is expected to continue post-pandemic, as the wider social and environmental impact of doing business is subjected to increased scrutiny.

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Activists could also increasingly use ESG as a “tool” if other agitation tools are perceived negatively in the current environment.

Passive/long-term investors and funds are also feeling pressure to engage with ESG issues themselves; eg, BlackRock released its Engagement Priorities for 2020, outlining its roadmap for investment stewardship and furthering its commitment to making sustainability its standard for investing.

2.4 Targeted Industries/Sectors/Sizes of Companies

Generally, UK activists do not target particular industries or sectors. It is poor share performance, inefficient use of capital and corporate governance issues that are typical hallmarks of potential activist targets.

According to Activist Insight, the top three industry sectors subjected to the most activist demands in Europe in the 2020 were:

- the financial sector (with a 23% portion of activist demands);
- the industrials sector (with a 16% portion of activist demands); and
- the basic materials sector (with a 11% portion of activist demands).

European activists are increasingly looking to larger targets. Activist Insight identified that, in Europe for 2020, companies with large and mid-market capitalisations represented 46% of those against whom activist demands were made.

2.5 Most Active Shareholder Groups

Traditionally, institutional investors already embedded within companies undertook activist behaviours – but this has tended to be undertaken in private via dialogue with the board, rather than via public campaigns. This trend has continued, following the encouragement for more

active share ownership; eg, via the introduction of stakeholder guidance and codes of practice.

Despite the drive for further active share ownership by institutional investors, US hedge-fund activists have invested the most capital into activist campaigns in Europe. Notable US activists in the EU during 2020 included Third Point Partners (USD2.6 billion capital in four campaigns), Elliott Management (USD1.1 billion capital in six campaigns) and Sachem Head Capital Management (USD125.1 million capital in two campaigns). These US hedge-funds continue to be sophisticated players within the global activist market, with an increasing focus on the UK. Nevertheless, the line between passive, actively managed funds and activists is becoming increasingly blurred.

2.6 Proportion of Activist Demands Met in Full/Part

Activist Insight identified that, for UK-based companies in the first half of 2020, six of a total of 32 activist demands were partially or completely successful, compared to 47 of a total of 113 in 2019 (in each case, including ongoing disputes, unresolved and withdrawn demands).

2.7 Company Response to Activist Shareholders

Measures to minimise the risk of being targeted by an activist shareholder include:

- maintaining good levels of shareholder engagement (in line with the UK Corporate Governance Code) and continually communicating company strategy to shareholders;
- maintaining good levels of corporate governance and identifying any areas of vulnerability that activists may seek to challenge;
- monitoring the market for shareholder activist activity; and

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- maintaining relationships with analysts and media representatives in order to correct any misconceptions.

Companies should be aware of potential “warning signs” that they may be being targeted by an activist shareholder, eg, irregular trading in the company’s shares or new holdings in the company ahead of a general meeting and increasing levels of borrowing and lending activity in the company’s shares (activists often take positions in companies via derivatives).

Under s.793 of the CA06, a public company can issue a notice to any person it knows, or reasonably believes, has or recently had an interest in its shares, requiring the person to disclose information about that interest. There is no minimum threshold for any such disclosure and the relevant details must be kept on a register for six years, which is also open to inspection. It is good practice for companies to issue s.793 requests regularly, as a means of staying on top of changes to the register and alerting them to the potential presence of activists.

Boards may consider having a plan or strategy ready in place for when activist shareholders approach, eg, researching the activist and its past practices, considering how to engage with the activist (whilst complying with the company’s obligations under the MAR in relation to inside information), engaging the media and consulting advisers. A board might also consider what the reaction of the company should be to the investor and other external stakeholders (eg, designing a strategy for employees and the press).

The board should consider engaging with the activist in order to hear its demands (but not to commit to any future behaviour or actions); failure to do so may generate negative publicity. Following engagement with the activist, the board

may choose whether or not to amend its strategy to align with activist investor’s demands.

If the board is receptive to any of the activist’s demands, it may consider agreeing a settlement. This response has been used predominantly in the US, but it has been used by some UK-based companies to put an end to activist disputes (eg Rolls-Royce’s agreement with an activist investor, ValueAct, which included a board seat in return for support of management’s strategy and a cap on ValueAct’s shareholding).

3. REMEDIES AVAILABLE TO SHAREHOLDERS

3.1 Separate Legal Personality of a Company

Subject to very limited (mostly statutory) exceptions, companies have their own legal personality distinct from their shareholders under English law. The principle was affirmed by the House of Lords over a century ago (*Saloman v Saloman* [1897] AC 22) and has since been widely endorsed.

Once incorporated, a company may own and deal in property, contract on its own behalf, and sue and be sued in its own name.

There are only very limited circumstances in which an English court will look past the principle of separate legal personality (or “pierce the corporate veil”) to hold shareholders legally responsible for a company’s conduct. Generally, English law permits this only to prevent abuse of the company’s legal personality, eg, in instances of fraud or deliberate breaches of trust (see *Petrol Resources Ltd v Prest* [2013] 2 AC 415).

Separate from any question of “piercing the corporate veil”, it is possible for a shareholder or parent company to be held liable for the activities

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of a subsidiary company in circumstances where the shareholder/parent has assumed a duty of care in respect of those activities, applying ordinary tortious principles (see *Lungowe v Vedanta Resources* [2019] 2 WLR 1051), or where there exists an agency relationship between the shareholder/parent and the company.

3.2 Legal Remedies against the Company

In addition to remedies that may generally be available in tort or contract, certain specific statutory remedies are available to shareholders against the company.

Under s.994 CA06, a shareholder may bring an action – known as an “unfair prejudice petition” – on the basis that the company’s affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of shareholders generally or of some of the shareholders (including at least the petitioner). In determining what constitutes “unfairness” and “prejudice” for these purposes, the court will apply an objective approach and have regard to whether there has been a departure from the terms on which the shareholders agreed to operate (as reflected in, eg, the company’s articles and any shareholders’ agreements). It is not necessary for the shareholder to demonstrate a loss in value in the shares, merely that the unfairly prejudicial conduct has affected it (in its capacity as a shareholder).

Most commonly, unfair-prejudice petitions are brought by minority shareholders, who are less able to influence the company’s affairs than majority shareholders. However, s.994 petitions may also be brought in appropriate circumstances by majority shareholders, eg, where they have been restricted by a shareholder agreement from exercising their normal voting rights.

If unfair prejudice is established, the court has a wide discretion in terms of remedies. In exercising that discretion, the court will have regard to the relief requested by the petitioner, but is not constrained by that request and can choose to order alternative relief (see *Ferdinand v Patel* [2016] EWHC 1524 (Ch)). Commonly (particularly where relationships between the shareholders have broken down) the court will order that the petitioner’s shares be purchased by the wrongdoing shareholder(s) or the company at fair market value.

Another statutory remedy available to shareholders (and to the company, its directors and its creditors), although it is less often used in practice, is a petition under s.122(1)(g) of the IA86 to wind up the company on the basis that it would be “just and equitable” to do so. Again, these petitions are most often brought by minority shareholders.

The courts have left open the list of grounds on which a winding-up petition may be brought (see *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360). These include serious concerns as to the governance of the company, where the company can no longer continue with its objectives and/or where there is an insoluble deadlock in management.

Even if the court is satisfied that it would be “just and equitable” to wind up the company, it is not required to do so where it considers that some other remedy is available to the petitioner (eg, an unfair-prejudice claim) and that the petitioner is acting unreasonably in seeking to have the company wound up rather than pursuing that other remedy (IA86, s.125(2)).

Finally, shareholders may also have statutory rights to bring claims under the Financial Services and Markets Act 2000 where they have suffered loss as a result of any untrue or mis-

leading statement or certain omissions in listing particulars or a prospectus (s.90), or any misleading statement or dishonest omission by the company in published information relating to its shares (s.90A). Recent examples of such claims include the RBS rights issue litigation and the proceedings brought by Tesco's shareholders in relation to Tesco's accounting issues.

3.3 Legal Remedies against the Company's Directors

As a general rule, a shareholder's remedy is against the company, rather than the directors directly. Directors' duties are owed not to the shareholders but to the company itself, meaning the company (rather than the shareholders) is generally the party able to bring a legal action against a director. An exception to this is where shareholders bring a derivative action on behalf of the company, as discussed in **3.6 Derivative Actions**.

If the directors of a company are parties to a shareholders' agreement, breach of this agreement by the directors may give rise to direct contractual remedies for shareholders, subject to the terms of that agreement.

In appropriate circumstances, shareholders may also bring tortious actions generally available under English law against directors, such as claims for fraudulent misrepresentation or conspiracy to defraud.

3.4 Legal Remedies against Other Shareholders

There are no statutory remedies available to shareholders specifically against other shareholders.

Shareholders may pursue contractual claims against other shareholders if the conduct complained of constitutes a breach of a shareholders' (or joint-venture) agreement in place between

them, subject to the terms of that agreement. The remedy for breach of an English law-governed shareholders' agreement is typically damages, but a court may also exercise its discretion to order equitable remedies such as injunctions or specific performance.

Shareholders may also bring tortious actions generally available under English law against fellow shareholders.

3.5 Legal Remedies against Auditors

Generally, an auditor does not accept or assume responsibility to anyone other than the company itself and the company's shareholders as a body (not to each shareholder individually) and does not accept responsibility for the investment decisions that an individual shareholder might make (*Caparo Industries plc v Dickman* [1990] 2 AC 605). As such, while the shareholders as a body may in principle be able to bring a claim in the tort of negligence against the company's auditor (subject to the application of the reflective-loss principle, discussed below), this remedy is not ordinarily available to an individual shareholder.

Depending on the contractual arrangements in place (eg, if an auditor is engaged by a parent company rather than directly by the company to be audited), a shareholder may also have contractual remedies against an auditor, subject to the terms of the agreement in place and, in particular, any limits placed on the auditor's liability. More often, however, the relevant engagement will be between the company itself and the auditor, such that the company will be the proper claimant where there is a breach of contract by the auditor.

It should be noted, however, that shareholders' actions against third parties may be restricted by reason of the reflective-loss principle, which provides that shareholders cannot (in their capacity as shareholders) recover damages for a fall in

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the value of their shareholding or loss of dividend, where those losses were merely the result of damage suffered by (and actionable by) the company. The UK Supreme Court has recently confirmed that the scope of this principle will be limited to these circumstances, and that shareholder actions brought for other types of loss will not be barred by the reflective-loss principle (see *Sevilleja v Marex Financial Ltd* [2020] UKSC 31).

3.6 Derivative Actions

The general rule is that the company itself is the “proper claimant” to bring any legal claim for a wrong done to the company, and the court will not intervene with the internal management of a company if it is acting within its powers (see *Foss v Harbottle* 67 ER 189). As such, the directors, exercising the powers of the company, are usually the parties to determine whether to bring an action.

However, under Part 11 of the CA06, a shareholder (including a minority shareholder) may bring a derivative action on behalf of the company in respect of an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company (CA06, s.260(3)). The cause of action may be against the director or a third party (where it has been involved with the director’s breach), or both. There is no requirement for the shareholder to show that the company has suffered actual loss or that any benefit was derived by the wrongdoer from any breaches.

Once a Part 11 claim has been commenced, as a safeguard against frivolous or vexatious claims, the court will make a preliminary assessment as to whether the shareholder has made out its case sufficiently in order to allow the claim to continue. The court has wide discretionary powers in this regard. If the court deems that the action has merit, it will continue to a full hearing.

As a Part 11 claim derives from rights belonging to the company, not the shareholder, the benefits of the claim (eg, any damages awarded) accrue to the company, not to the shareholders directly (although usually the shareholders will benefit indirectly).

3.7 Strategic Factors in Shareholder Litigation

There are many different factors to be weighed by a shareholder considering litigation aside from the legal merits, including:

- the desired outcome;
- the potential cost of litigation;
- the impact on its relationship with other shareholders and the board; and
- the short- and long-term impact of litigation on the company.

A key consideration will be precisely what the shareholder wants to achieve, whether this is compensation in the form of damages, to bring about a change in governance, to halt a specific action or to receive an apology from the board or another shareholder. Not all available remedies will be appropriate in all circumstances; eg, a shareholder that wishes to continue to be part of a company (as opposed to seeking simply to retrieve capital) is unlikely to seek the winding-up of the company. Similarly, if the shareholder has been, or intends to be, actively involved in the running of the company, it may also place weight on the damage that litigation might cause to its relationships with other stakeholders or to the effective running of the company.

In certain circumstances, a shareholder may want to use legal action or the threat of legal action as a negotiating tool with the directors or with other shareholders, potentially in conjunction with other strategies discussed in **2.3 Shareholder Activist Strategies**. In many cas-

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Freshfields Bruckhaus Deringer LLP*

es, a negotiated settlement can produce a better outcome for all parties involved.

The factors to be considered (and the weight put upon them) will be highly fact-sensitive, and careful consideration of these factors with legal advisers is recommended before any action is taken.

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tors and listed companies on ongoing governance issues, so appreciate the pressures that both sides face. The firm is well versed in giving boardrooms and senior managers around the world advice on shareholder activism, engagement and litigation, including in the USA, Europe, the Middle East and Asia. In addition, with social and environmental concerns coming to the fore, the firm is helping senior leaders pivot to business models that are not only sustainable but also anticipate where shareholder pressure might arise.

AUTHORS



Samantha Trevan is a partner in the commercial disputes group in London. She has a wide-ranging practice, based on managing disputes in many business sectors and involving

different jurisdictions. Sam has particular experience in advising large international corporations on their high-value, complex, commercial litigation, including M&A-related and other shareholder disputes, commercial fraud claims, professional negligence claims and contractual disputes. She has worked in both London and the Cayman Islands.



Kate Cooper is a partner in the global transactions group. Based in London and acting for a range of corporate clients, Kate's areas of practice include complex public and private

mergers and acquisitions, defence and activism advice, as well as other general corporate governance and listed company matters. Kate also has particular expertise dealing with the consumer and healthcare industries, and in the technology, media and telecoms space.

*Contributed by: Samantha Trevan, Kate Cooper, Zaid Fathoala and Sorcha Horrocks-Burns,
Freshfields Bruckhaus Deringer LLP*



Zaid Fathoala is an associate in the commercial disputes group in London, with a broad practice spanning various business sectors and jurisdictions. Zaid primarily advises large

corporates on high-value commercial litigation and arbitration, including post-M&A disputes, contractual disputes, professional negligence claims and fraud claims. He also acts on contentious insolvency matters and has spent six months at Freshfields' Paris office, working primarily on commercial and investment treaty arbitrations.



Sorcha Horrocks-Burns is a corporate associate in the global transactions group in London. She has also spent six months at the firm's Hong Kong office during her time at Freshfields.

Sorcha advises clients across a range of sectors on mergers and acquisitions, joint ventures and corporate restructurings, as well as general corporate advisory and listed company matters.

Freshfields Bruckhaus Deringer LLP

65 Fleet Street
London
EC4Y 1HT

Tel: +44 (0) 20 7936 4000
Fax: +44 (0) 20 7832 7001
Web: www.freshfields.com



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