

COLLYER BRISTOW

CORPORATE KNOW-HOW

SHAREHOLDER RIGHTS: THE BASICS



WHAT DO YOU NEED TO KNOW?

SHAREHOLDER RIGHTS: THE BASICS

WHAT IS IT?

A common question for those looking to buy or sell shares in a company is what rights those shares grant to the holder. In England & Wales, the three main sources of shareholder rights in relation to a company are statute, the articles of association of the company and any shareholder agreement. Whether you are a minority shareholder concerned about what influence you can exert over a company's affairs, or a founding shareholder, considering the amount of equity you would be prepared to sell to investors without losing control – this guide is here to help you understand what shareholders can do and when.

STATUTORY RIGHTS

The best place to start is a short summary of the key rights granted to shareholders under statute and when they can be exercised, as set out in the table below. This table assumes that the company has a single class of shares – it is also possible to have different classes with each class having different rights, in particular different voting rights.

Shareholding	Rights
5%	Can: <ul style="list-style-type: none"> Require a shareholder resolution is circulated Require the directors call a general meeting of shareholders. Enforce directors' liabilities for unauthorised political donations or expenditure. Prevent the deemed re-appointment of an auditor.
10%	All the above and can also: <ul style="list-style-type: none"> Demand a poll vote on a resolution put forward at a general meeting. Require an audit of the company. Block consent to a short notice for a general meeting. Prevent squeeze out notices being serviced on a takeover.
15%	All the above and can object to variation of share class rights (and apply to court to cancel such variation).
>25%	All the above and: <ul style="list-style-type: none"> Can block special resolutions. Can block a compromise or arrangement with shareholders.
50%	All the above and can block ordinary resolutions (can pass them if over 50% is held).
75%	All the above and can pass special resolutions.

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As you can see, control over a company's operations can quickly change, particularly where multiple shareholders act in concert, aggregating their small individual holdings. The most significant thresholds are at 25%, 50% and 75% of available voting rights as these align with the thresholds to block or pass ordinary and special resolutions of the company, thereby giving substantial control over key decisions. By way of example, ordinary resolutions can remove/appoint directors or approve loans to directors, while special resolutions can be used to replace a company's articles of association.

The rights available at the lowest shareholding thresholds may seem fairly inconsequential at first glance. However, the right to require a general meeting to be called (5%), a shareholder resolution to be circulated (5%) or for the company to undergo an audit (10%) are all useful tools for exercising some level of oversight, especially where the shareholders do not have access to the day to day activities of the company which are managed at board level. Even in companies with a large number of minority shareholdings below 5%, shareholders can band together to overcome a majority shareholder. As an example, it would only take an aggregate shareholding of 25% plus one to block a special resolution from passing.

RIGHTS UNDER ARTICLES

A company's articles of association can be kept in a template form provided under statute or can be tailored to suit the requirements of the shareholders, provided that any changes do not contravene the law. Under the default articles of association, no shareholder rights over and above those granted under statute are provided for. In contrast, tailored articles of association can grant new rights to shareholders, such as access to information commonly only available to the board of directors (e.g. management accounts), setting a threshold where the majority shareholder(s) can "drag" the other shareholder(s) into a compulsory sale of the company's entire issued share capital or allowing minority shareholders to require a purchaser to buy their shares also.

On the other hand, the articles of association of a company can also remove or reduce certain rights. Share classes can be created that carry no voting rights at all or that carry voting rights but no right to dividends or capital distributions. Non-voting shares can exclude the holder from contributing towards decision making and limit their involvement in (and even awareness of) key constitutional matters. The ability to issue share classes with a variety of rights is a useful tool for pursuing different kinds of investment, where third parties may prioritise an enhanced dividend or capital distribution rights in return for less influence over decision making.

If there is no other provision within a company's articles of association, any variation to the rights of a certain class of shares must be passed by the holders of 75% of the nominal value of those shares – offering some protection against the imposition of less favourable rights in the future. Nevertheless, when looking to acquire shares with limited or no voting rights, incoming shareholders should exercise caution as, without the ability to vote on key matters, their rights can be eroded or the potential company value diminished, with limited options available to them to turn the business around.

RIGHTS UNDER SHAREHOLDERS' AGREEMENTS

A common provision in even basic shareholders' agreements is to set out certain decisions that require unanimous consent or that can be blocked by a right of veto held by a certain shareholder (or shareholders). If a minority shareholder has sufficient negotiating power to secure a veto or the agreement of unanimous consent matters, they can exercise control over a business without the usual percentage of voting rights to pass certain decisions. Often such rights will be negotiated by an investor who, although they are receiving a minority shareholding and are not taking an active role in running the business, still wishes to retain control of key decisions.

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Going further, a shareholders' agreement might set out situations where a shareholder is obliged to sell their shares at a determinable price, perhaps even nominal value in certain circumstances where they are at fault. Without going into too much detail here, there is a great deal of flexibility of rights that can be granted or restricted under shareholders' agreement, particularly when prepared in parallel with articles of association, which allows for choice as to which rights/restrictions are in the public view.

FINAL CONSIDERATIONS

Minority shareholdings offer plenty of opportunities to cause disruption if relations between management and shareholders are not carefully maintained. Good communication is therefore key to keeping operations running smoothly. While this guide sets out some of the shareholder rights investors and business owners may come across, it is important to take tailored advice on the specifics of the relevant company.

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Whether you are considering acquiring a business, selling a business or you are advising on such matters, our specialists in the Corporate team at Collyer Bristow would be happy to provide you with the support you need.



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