MACFARLANES

Corporate Law Update: 23 - 29 November 2024

28 November 2024

Shareholder had personal claim against company following improper allotment of shares

The Privy Council has held that a shareholder in a company had a personal claim against the company when its directors allotted shares to other shareholders other than for a proper purpose.

Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd [2024] UKPC 36 concerned a company with four shareholders which was incorporated in the Cayman Islands and listed on the Hong Kong Stock Exchange (HKSE).

In 2018, the company allotted and issued shares to some of its shareholders ostensibly for the purpose of bringing the company's free float back into compliance with HKSE rules.

However, one shareholder (Tianrui) alleged that the real purpose of the allotment was to dilute its shareholding to such a level that it no longer had sufficient voting rights to block special resolutions of the company.

Tianrui brought proceedings in the court seeking a declaration that the shares had not been allotted and issued for a proper purpose and that the allotment and issue was void.

The company counterargued that Tianrui had no right of claim, because the duty to allot shares only for a proper purpose was a fiduciary owed to the *company* by its directors, and not directly to Tianrui.

The Council held that Tianrui had a direct right of claim against the company.

Although a novel question of Cayman Islands law, there is already a body of authority in other common law jurisdictions (including in England and Wales and in Australia) that a shareholder has a direct claim against a company if the company's directors allot its shares other than for a proper purpose.

However, the legal basis for that claim has never been fully and definitively explored and set out.

In its judgment, the Privy Council explains that the basis for a shareholder's claim is, effectively, for breach of contract.

It is an implied term of a company's constitution (specifically, its articles of association) that the company's directors, acting as its agents, will exercise the company's power to allot shares only for a proper purpose. This sits alongside the separate fiduciary duty owed by the company's directors to exercise that power only for a proper purpose.

Read more about the Privy Council's decision that a shareholder had a direct claim against a company for an improper allotment of shares in our separate in-depth piece.

General partner was entitled to bring legal claim after limited partnership was dissolved

The Court of Appeal has held that the general partner of a limited partnership was entitled to pursue legal proceedings in the partnership's name after the partnership had been dissolved.

The court noted that the cause of action arose before the dissolution and pursuing it was necessary to wind up the partnership's affairs.

The court's judgment affirms the first-instance decision of the High Court.

You can read more about a general partner's ability to pursue legal proceedings after the dissolution of a limited partnership in our Private Funds Radar.

Pre-emption Group publishes annual monitoring report

The Pre-emption Group (PEG) has published its annual report, setting out its review of compliance with its Statement of Principles during the 2023/2024 reporting season.

The Statement of Principles sets out guidance on the UK's statutory pre-emption rights regime, under which companies wishing to raise finance by issuing new shares must first offer those shares to their existing shareholders. It is not legally binding, but listed companies are expected to comply with it.

In particular, the Principles set out limits within which companies can disapply statutory pre-emption rights. Those limits were expanded in 2022, following which the Principles have allowed an issuer to disapply pre-emption in respect of:

- up to 10% of its issued share capital for general purposes;
- up to a further 10% for the purpose of an acquisition or specified capital investment (ASCI); and
- in each case, up to an additional 2% (so, up to 4% in total) for a follow-on issue.

For the purposes of the report, PEG monitored the annual general meeting (AGM) of 99 FTSE 100 companies and 235 FTSE 350 companies (representing a total of 96.3% of the FTSE 350).

The report reveals that 67.1% of issuers sought authority to disapply pre-emption rights, an increase from 55.7% in 2022/2023. This perhaps demonstrates that issuers are becoming increasingly comfortable with the expanded headroom now permitted by the Principles.

Companies within the FTSE 100 were more conservative, with just over half seeking authority to disapply up to only 5% for general purposes and just under half disapplying up to the 10% limit. The split was 50:50 for the enhanced disapplication for an ASCI.

FTSE 250 companies, however, were more prepared to utilise the additional flexibility in the 2022 Principles. For general purposes, the ratio of those seeking the full 10%, as opposed to merely 5%, was just over 3:1. For an ASCI, the equivalent ratio was just over 2:1.

Nine FTSE 250 companies sought to disapply 20% for general corporate purposes. This is not compliant with the Statement of Principles. However, all nine companies' shareholder resolutions passed, with seven companies gaining more than 95% support. Moreover, many of the issuers were investment trusts, where the approach to non-pre-emptive capital-raising differs.

The report also provides statistics on the time periods set for utilising proceeds raised for an ASCI, the restriction of non-pre-emptive issues to 7.5% over a three-year period (which PEG no longer considers best practice) and voting results for disapplication resolutions.

PEG's review certainly shows that issuers are becoming more familiar with the expanded limits in the current Principles. This is encouraging, as lifting these thresholds was a key component in the overall strategy to open up the UK's equity capital markets. It will be interesting to see whether this upward trend continues into the 2024/2025 season.

Read the Pre-emption Group's report on compliance with its Statement of Principles (opens PDF)

Read the Pre-emption Group's Statement of Principles (2022) on Disapplying Pre-emption Rights (opens PDF)

FRC publishes annual review of corporate governance reporting

The Financial Reporting Council (FRC) has published its annual review of corporate governance reporting.

The review covers reporting by 100 listed companies that are required by the Financial Conduct Authority's Listing Rules to comply or explain against the UK Corporate Governance Code.

The review separately covers reporting on risk management and internal control by 130 companies across the FTSE 100, FTSE 250 and Small Caps.

The most recent edition of the Code (the 2024 version) applies (in the main) to financial years beginning on or after 1 January 2025. As a result, the FRC's review covers compliance with the previous edition of the Code (the 2018 version).

The FRC reports the following findings from its review.

- **Overall compliance.** Much fewer companies departed from the Code in 2023/2024 than in the previous year. The FRC attributes this to greater compliance with Provision 38 (2018), which requires executive pension contributions to be aligned with those for the workforce generally.
- **Specific provisions.** Alongside Provision 38 (2018), there was also an increase in compliance with Provision 19 (2018), which states that the chair should not be in place for more than nine years. However, the FRC also reports a decrease in compliance with several 2018 Code provisions, including Provision 9, which (among other things) requires the chair to be independent on appointment, and Provisions 11, 24 and 32, which relate to the composition of the board, audit committee and remuneration committee.
- **Stakeholder engagement.** Reporting on engagement with stakeholders was high, but the FRC comments that it is sometimes unclear how the board (as opposed to senior management or

employees) engages with different stakeholders. The review includes a case study with different metrics companies could use to measure engagement effectiveness.

- **Workforce engagement**. The review reveals that, for the purposes of Provision 5 (2018), most companies continue to designate a non-executive director with responsibility for workforce engagement. 20% of companies used a method of engagement not expressly suggested by the Code. Only 15% of companies utilised a workforce advisory panel, and no companies surveyed appointed a director from the workforce.
- **Risk management and internal control**. Provision 29 of the 2024 Code, which requires reporting on risk management and internal control, applies to financial years beginning on or after 1 January 2026. The FRC reports that there were no “early adopters” of Provision 29, although several companies had outlined their work preparing for it.
- **Audit standards**. The FRC published its Audit Committees and the External Audit Minimum Standard in May 2023. The Minimum Standard forms part of the 2024 Code but not the 2018 Code. Despite this, almost half of companies surveyed referred to the standard in their annual report, with 17 companies reporting that they already follow it wholly or in part.

Overall, the FRC notes that reporting quality remains strong, but there is still a need for more concise, outcomes-focused disclosure and enhanced reporting on risk management and internal controls.

Read the FRC’s 2024 review of corporate governance reporting (opens PDF)

Access the FRC’s UK Corporate Governance Code (2018 edition) (opens PDF)

Access the FRC’s UK Corporate Governance Code (2024 edition) (opens PDF)

Access the FRC’s Audit Minimum Standard (opens PDF)