STRATEGIC INVESTMENTS IN LISTED COMPANIES AND SHAREHOLDER RELATIONSHIP AGREEMENTS

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In this article, we look at relationship agreements in the context of companies whose shares are admitted, or are seeking admission, to trading on one of the markets operated by the London Stock Exchange plc (the Main Market – Premium and Standard Listing – or AIM) or one of the markets operated by the Aquis Stock Exchange (the AQSE Main Market and the AQSE Growth Market) ("AQSE").

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WHAT IS A RELATIONSHIP AGREEMENT?

A relationship agreement is an agreement governing the relationship between a company and a significant shareholder. Similar considerations will apply to any strategic investment by a new investor and relationship considerations may be covered directly in the investment/subscription agreement or in a separate agreement.

The Listing Rules published by the UK's Financial Conduct Authority ("FCA") require a company with a premium listing on the Main Market ("Premium Listing") to put in place a relationship agreement with any significant shareholder that meets the definition of a "controlling shareholder" in the Glossary to the FCA Handbook. In essence, this defines a controlling shareholder as any person who, individually or together with its concert parties, exercises or controls 30% or more of the votes able to be cast on all or substantially all matters at the company's general meeting (with certain voting rights disregarded for the purposes of the calculation).

There is currently no other specific guidance as to when a shareholder's shareholding[1] in a company will be considered as significant for the purposes of determining whether a relationship agreement is required[2]. However, market practice is that a company will typically enter into a relationship agreement with a shareholder who holds 30% or more of its share capital. Depending on the circumstances, a relationship agreement may also be appropriate where a shareholder holds less than 30% of the company's share capital (e.g. between 10% and 30%). This is something a company will need to consider in conjunction with its solicitors and corporate finance advisers and the following considerations (among others) may be relevant when assessing whether a shareholder will be regarded as a significant shareholder:

- whether the shareholder's shareholding would enable it to block an ordinary or special resolution to be put before the company's shareholders (which will depend on the law of the company's home jurisdiction);
- in the case of an AIM company, whether the shareholder would be considered a "substantial shareholder" for the purposes of the AIM rules (i.e. a legal or beneficial holder of an interest of 10% or more in the AIM company's shares or voting rights);
- in the case of a company with a listing on the AQSE Growth Market, whether the shareholder would be considered a "controlling shareholder" for the purpose of the AQSE Growth Market Apex/Access Rulebooks (i.e. any person who exercises or controls on their own or together with any person with whom they are acting in concert, 30% or more of the votes able to be cast on all matters at general meetings of the company);
- the company's overall shareholder base and shares generally available for trading;
- whether the shareholder is acting in concert with any other party for the purposes of the UK Code on Takeovers and Mergers and, if so, the level of their combined interests in the company; and
- how involved the shareholder is in the company's business/how dependent the company is on that shareholder, e.g. for financing.

"Companies with a dominant shareholder must carefully consider putting in place arrangements to protect minority shareholders."

Paragraph 10, Section 4, The QCA Corporate Governance Code

ARE RELATIONSHIP AGREEMENTS MANDATORY?

Save as noted for companies with a Premium Listing, there is no specific requirement under English law for a company to enter into a relationship agreement with a significant shareholder. It is, however, market practice to do so and will generally be required by corporate finance advisers and investors. Moreover, the QCA Corporate Governance Code provides that "*companies with a dominant shareholder must carefully consider putting in place arrangements to protect minority shareholders. Accepted good practice may include putting in place contractual arrangements such as a relationship agreement*[3]*".*

In the case of an AIM Company, the company's nominated adviser for the purposes of the AIM rules ("Nomad") will need to satisfy itself that the AIM company is appropriate for admission to AIM[4] and, in assessing this, the Nomad will need to consider (amongst other things) whether any shareholder is able to exert control over the AIM company[5]. The Nomad will sometimes be made a party to the relationship agreement for the purposes, inter alia, of receiving undertakings (for itself and for the benefit of any subsequent Nomad) from the significant shareholder as regards its exercise of control and the operation of the AIM company's business (see further "Significant shareholder undertakings", below). Conversely, the Nomad may prefer to avoid potential conflicts that this could cause and be willing to rely on its Nomad appointment agreement.

A relationship agreement can help to evidence that a company has robust corporate governance policies and procedures in place and that it will be able to operate independently of its significant shareholder(s) for the benefit of its members as a whole.

WHAT MIGHT A STANDARD RELATIONSHIP AGREEMENT COVER?

As well as usual boilerplate clauses, it would be common to see the following provisions in a relationship agreement:

- **Commencement and duration of the relationship agreement:** It would be usual to specify that the relationship agreement remains in effect whilst the significant shareholder continues to hold at least X% of the company's shares[6]. Unless the company is already listed when the relationship agreement is entered into, the relationship agreement will be conditional on listing having occurred and will usually terminate where the company's listing lapses;
- **Significant shareholder undertakings**: The significant shareholder will give various undertakings in favour of the company (and usually the relevant corporate finance adviser – in the case of an AIM company, the Nomad). These may include undertakings:

  – that the business of the company will be managed for the benefit of its members as a whole and independently of the significant shareholder;

  – that transactions/arrangements between the company and significant shareholder will be concluded on arm's length terms[7];

  – as to the composition of the board of directors of the company and its committees, in particular the number of independent directors sitting on the board/the committees;

  – as to the corporate governance code/standards to be adopted/applied by the company;

  – as to the quorum/voting arrangements at any board meeting to consider board reserved matters (see "Board reserved matters", below) – this will usually be a majority of independent directors; and

  – as to how the significant shareholder will exercise its voting rights in respect of the company's shares – e.g. it will not seek to influence the running of the company at an operational level, it will not seek to prevent the company from complying with its obligations under applicable law (e.g. for an AIM company, its obligations as regards related party transactions under AIM Rule 13 and for a company with a Premium Listing, its obligations under the FCA's Listing Rules[8]), it will not seek to cancel the company's listing and it will not vote at board and/or shareholder level on any matters in which it has a conflict of interest;

- **Nominated director/board observer**: Usually the company will grant the significant shareholder the right to appoint one or more (depending on its shareholding) directors to the board for so long as it holds at least X% of the company's shares. Where the significant shareholder's shareholding has fallen below the threshold at which it is entitled to nominate one or more directors to the board, the relationship agreement may provide for it to have the right to a board observer whilst it continues to hold at least Y% of the company's shares;
- **Interests in other businesses**: The relationship agreement will sometimes include non-compete/non-solicitation clauses in favour of the company, the scope of which will depend on the negotiating power of the parties;

> "A relationship agreement is generally personal to the parties and, as such, the parties will generally be precluded from assigning or otherwise transferring their rights under it."

- **Confidentiality:** It would be usual for the relationship agreement to include a clause precluding each party from disclosing confidential information relating to the other party, save in certain circumstances provided for in the relationship agreement. It would be usual to carve out disclosures required by applicable law, including disclosure required by the rules of the relevant exchange governing the listing, and (potentially) disclosure of information by a nominee director to its appointing shareholder (although this may be subject to restrictions to ensure that the shareholder is not automatically taken inside on price sensitive information). It should be noted that generally details of the relationship agreement will need to be included in any admission document or prospectus prepared in connection with the company's listing;
- **Board/shareholder reserved matters**: The relationship agreement will usually specify a number of matters, over and above those matters requiring board approval under applicable law, which require the approval of the directors (and usually a majority of independent directors). Reserved matters may include (without limitation):

  – any amendment to the relationship agreement and any other agreement in place between the significant shareholder and the company;

  – any decision regarding enforcement action against the significant shareholder;

  – any changes to the company's corporate governance policies or procedures, including any board committee changes;

  – any changes to the board; and

  – the appointment or removal of certain advisers;

- **Assignment**: A relationship agreement is generally personal to the parties and, as such, the parties will generally be precluded from assigning or otherwise transferring their rights under it. In the case of an AIM company, if the Nomad is a party it would, however, be normal for the undertakings given in its favour also to benefit (or for the agreement to be assignable to) any subsequent Nomad.

"Can the significant shareholder block ordinary and/or special resolutions? If so, would it be useful for the significant shareholder to undertake to vote in favour of certain matters to be considered by the company's shareholders on an annual basis?"

WHAT OTHER ISSUES SHOULD BE CONSIDERED?

Whilst the above sets out standard provisions usually seen in a relationship agreement, in our experience it is helpful to consider more broadly the issues that may arise during the day to day relationship between a company and its shareholders, and how these may affect the business of the company if not legislated for in advance.

Some (but not all) of the more bespoke issues that it may be useful to consider when preparing a relationship agreement are set out below. The WFW team has a wealth of experience in preparing and negotiating relationship agreements and would be happy to assist with this:

- Who should be bound by the relationship agreement? Should it apply to group companies or other associates of the significant shareholder, and any parties with whom it is acting in concert?

- Does the significant shareholder require the company to give any other undertakings in its favour, in addition to any board/observer rights. The significant shareholder may seek to include express rights which allow it to participate in future offers/issues of shares, options, warrants or instruments convertible into shares. These rights often take the form of a right of first offer/refusal.
- Can the significant shareholder block ordinary and/or special resolutions (when taking into account usual shareholder voting practices)? If so, would it be useful for the significant shareholder to undertake to vote in favour of certain matters to be considered by the company's shareholders on an annual basis?
- What happens if the significant shareholder is no longer entitled to appoint a director/observer to the board? Can a procedure be agreed in advance which allows the company to remove the nominated director/observer in the event that the significant shareholder fails to do so? Can the company be protected from any claims that any such outgoing director/observer might bring against it following removal?
- Would it be appropriate to include a clause in the relationship agreement providing that any disposal of shares/other interests in the company by the significant shareholder will be done in a manner which maintains an orderly market and/or avoids the company being taken over without board recommendation?
- Would it be appropriate for the parties to agree in advance a more detailed dispute resolution procedure than may be provided for by standard boilerplate clauses, such that any disputes may be concluded with as little disruption to the company's business as possible?
- To what extent should the appointment agreements for the significant shareholder's appointee director(s) reflect/acknowledge the provisions of the relationship agreement?
- Might some of the relationship points be covered in the company's constitutional documents instead (subject to applicable listing rules)?

In considering the above questions, a careful balance has to be struck between the interests of the company (which will want to ensure independence and avoid undue influence from the significant shareholder) and those of the significant shareholder (which will want to ensure, among other things, that the relationship undertakings it gives do not undermine the value of its investment).

"A poorly drafted relationship agreement (or lack of relationship agreement at all) can cause major disruption to the day to day running of a company's business and its ability to raise finance when needed."

CONCLUSION

Save in respect of a company with a Premium Listing, it is not mandatory that a company enters into a relationship agreement with a significant shareholder, but its corporate finance advisers and investors are likely to expect that it does.

Relationship agreements help to demonstrate good corporate governance and, in our experience, a poorly drafted relationship agreement (or lack of relationship agreement at all) can cause major disruption to the day to day running of a company's business and its ability to raise finance when needed. With careful drafting, a relationship agreement can provide certainty as to how the relationship between the company and a significant shareholder should be conducted, without compliance being unduly onerous on either party.

Jenny Hodges was also involved in the writing of this article.

[1] In this note, for simplicity, we have referred to the significant shareholder's shareholding, but please note that these references should be read as references to any legal or beneficial holding or other interest in the shares or voting rights of the company.

[2] Note that the AIM Rules use the term "significant shareholder" to refer to any person with a holding of 3% or more in any class of AIM securities (excluding treasury shares) but that having a 3% shareholding in an AIM company would not, of itself, prompt an AIM company to require that shareholder to enter into a relationship agreement.

[3] See paragraph 10 (Shareholders) of section 4 (Roles and Responsibilities) of the QCA Corporate Governance Code.

[4] Rule 14 of the AIM Rules for Nominated Advisers.

[5] Schedule 3 to the AIM Rules for Nominated Advisers.

[6] A relationship agreement between a company with a Premium Listing and its controlling shareholder must remain in place for as long the relevant shareholder is a controlling shareholder.

[7] Listing Rule 6.5.4 R (1) requires that the relationship agreement between a company with a Premium Listing and its controlling shareholder must include an undertaking that transactions and arrangements with the controlling shareholder (and/or any of its associates) will be conducted at arm's length and on normal commercial terms.

[8] The Listing Rules require that the relationship agreement between a company with a Premium Listing and its controlling shareholder must include undertakings that (a) neither the controlling shareholder nor its associates will take any action that would prevent the company from complying with its obligations under the Listing Rules (Listing Rule 6.5.4 R (2) and (b) neither the controlling shareholder nor its associates will propose or procure the proposal of a shareholder resolution which is intended or appears to be intended to circumvent the proper application of the Listing Rules (Listing Rule 6.5.4 R (3)).

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