

New dual process for appointing independent directors – amendments to articles of association

On 16 May 2014, the Listing Rules are changing to incorporate new provisions applicable to **premium listed companies** which have or gain a **controlling shareholder**. They are being introduced to address concerns about the position of minority shareholders and to give them a more effective voice, but without becoming dominant.

What are the key changes?

The changes include a re-instituted requirement for companies to put in place a legally binding relationship agreement with controlling shareholders. In this update, we focus instead on another of the new obligations - a mandatory dual process for shareholder voting on the election of independent directors. This will give the independent shareholders a separate voice from controlling shareholders on the appointment of independent directors and a chance to delay the final vote (although the final vote can be carried by a simple majority of all shareholders, as before).

What action do companies need to take?

Premium listed companies with a controlling shareholder will need to ensure their articles of association contain an appropriate mechanism to govern and facilitate the new dual shareholder voting process on the election of independent directors. The rules do not specify the exact wording to be incorporated into articles. In our experience so far, the drafting is straightforward and, helpfully, can be confined to one area of the articles.

- Companies seeking a premium listing (and which already have a controlling shareholder) should ensure their articles allow for the new dual election process from the outset.
- Existing premium listed companies (which already have a controlling shareholder) should make sure their articles allow for the dual process, and follow it in future elections or re-elections of independent directors. The rules afford companies time to amend their articles if necessary.
- What about existing premium listed companies which do *not* have a controlling shareholder but gain one in the future? They must, at that stage, amend their articles to allow for the dual process - again the rules give them time to achieve this.

The requirements in more detail

Who is a controlling shareholder?	Any person who exercises or controls, on their own or together with their concert parties, 30% or more of the votes able to be cast on all, or substantially all, matters at general meetings of the company.
Who are the independent shareholders?	Any person entitled to vote on the election of directors of the company that is not a controlling shareholder of the company.
Who is an independent director?	A director who the company has determined to be independent under the UK Corporate Governance Code.
What are the new rules on appointment of independent directors?	Where a premium listed company has a controlling shareholder, its articles of association must provide for the election and re-election of independent directors to be conducted in accordance with the "dual process" election provisions (rather than the approval of the election or re-election of directors simply by ordinary resolution).

What are the “dual process” election provisions?	An independent director will have to be approved by: <ul style="list-style-type: none"> • an ordinary resolution of the shareholders; and • a separate ordinary resolution of the independent shareholders.
What happens if either of the resolutions is not passed?	If either of the resolutions fails (or both do), but the company still wants to propose the person as an independent director, it will be allowed ¹ to put the matter to a further vote of all shareholders (including the controlling shareholder(s)). Any further vote must take place at least 90 days after the original vote, and within 120 days of the original vote. ² The 90-day delay provides a “cooling off” period and an opportunity for shareholders in opposing camps to engage with each other. Note that the timing is tied to when the vote takes place, not the meeting. Companies will need to ensure that any poll demanded is also held within the required timeframe.
What happens to a director who is not elected / re-elected by the first vote?	Guidance in the Listing Rules provides, as expected, that an existing director is allowed to continue in position until the outcome of the second vote.
What about the appointment of a new independent director to fill a casual vacancy?	In this case, the initial appointment is by the directors, rather than the shareholders. The FCA appears to have acknowledged that the requirement for two separate shareholder votes only becomes relevant if and when the director is proposed for re-election at a general meeting.
A company which has a premium listing already has a controlling shareholder. What should it do now?	Under transitional provisions, companies will have until the date of their next AGM to amend their articles to provide for the dual process. If notice of the AGM has already been given (or is given within three months of the pre-16 May event which resulted in the company having a controlling shareholder), this deadline is extended to the next following AGM.
What if a company with a premium listing gains a controlling shareholder in the future?	If the company did not previously have a controlling shareholder, it will have until the date of its next AGM to amend its articles to provide for the dual voting structure. If the company has already given notice of the meeting (or if notice is given within three months of the event which resulted in the company having a controlling shareholder), this deadline is extended to the next following AGM.

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¹ In fact the wording of LR9.2.2F says “if ... the company wishes to propose that person for election or re-election as an independent director, [it] must propose a further resolution...”. The language here generally seems elaborate; saying “the company may” would presumably amount to the same thing.

² The drafting of the time period can be made more concise in companies' articles. It is rather lengthy in the Listing Rules, because of the piecemeal evolution of the provision.