The Legal 500 & The In-House Lawyer

Comparative Legal Guide

United Kingdom: Corporate Governance

This country-specific Q&A provides an overview to tax laws and regulations that may occur in United Kingdom.

This Q&A is part of the global guide to Corporate Governance. For a full list of jurisdictional Q&As visit http://www.inhouselawyer.co.uk/practice-areas/corporate-governance/

Country Author: Jones Day

The Legal 500

Vica Irani, Partner

virani@jonesday.com

Giles Elliott, Partner

gpelliott@jonesday.com

Leon Ferera, Partner

lferera@jonesday.com

1. What is the typical organizational structure of a company and does the structure typically differ if the company is public or private?

The two most common forms of commercial company are private companies limited by shares and public limited companies. Companies offering their shares to the public are generally required to be public limited companies. The basic structure and functioning of all companies is similar and is governed by the Companies Act 2006 (although public companies are subject to stricter requirements in several respects, including in relation to maintenance of capital). Both public and private companies limited by shares have a share capital held by shareholders. While technically both can have multiple classes of shares, this is typically a feature of private companies.

Listed companies are subject to additional regulation pursuant to applicable securities laws and stock exchange regulations. In the UK, the level of regulation varies depending on whether the relevant company has a premium or standard listing on the Main Market, or is admitted to trading on AIM. Unless otherwise stated, the information in this Q&A applies to companies with a premium listing on the Main Market.

2. Who are the key corporate actors (e.g., the governing body, management, shareholders and other key constituencies) and what are their primary roles? How are responsibilities divided between the governing body and management?

The principal actors are the shareholders, the board of directors and management.
Their respective roles and responsibilities are generally governed by applicable law (principally the Companies Act 2006 and (where applicable the Listing Rule or AIM Rules) and the companies constitution. In offer situations, the UK Takeover Code will also apply. Listed companies will also need to comply with requirements stemming from the Shareholder Rights Directives (SRD I & II) which aim to strengthen the position of shareholders and encourage shareholder engagement, in particular for the long term.

Generally, the board may exercise all the powers of the company, with certain matters reserved to shareholders (for example, changes to the constitutional documents, share capital changes, share issuances etc).

Management are generally delegated the authority to manage the business on a day to day basis, under the overall supervision of the board, with material matters requiring board approval. The respective roles and responsibilities of board directors and management will typically be governed by their respective employment/engagement agreements, as well as internal corporate policies. Many listed issuers will implement a schedule of matters reserved to the board for approval, as well as bespoke delegations of authority for members of management.

Unlike in certain jurisdictions, such as the USA, there is no distinction between directors and officers: the directors of a company, and the company secretary are the company's officers. Senior management are not officers unless they are also directors (or the company secretary).

3. What are the sources of corporate governance requirements?

Premium listed companies are required to apply the UK Corporate Governance Code and FRC Guidance on Board Effectiveness (together the “UK Corporate Governance Code”) on a "comply or explain" basis – i.e., compliance is not mandatory but any deviations need to be explained (and may influence shareholder voting decisions). A revised version of the UK Corporate Governance Code came into force in respect of financial periods commencing on or after 1 January 2019. Other relevant regulation includes the Companies Act 2006 (which is the UK's main piece of company legislation), and, for listed companies, the Listing Rules, the Prospectus Rules, the Disclosure and Transparency Rules and the Market Abuse Regulation (MAR).

4. What is the purpose of a company?

In general terms, companies are typically formed for a number of purposes. They typically provide shareholders with limited liability in respect of the acts and omissions of the company and can provide a tax efficient structure for operating businesses. Incorporating a company is often viewed as an attractive means of aggregating capital to make investments. Companies provide a flexible framework within which the rights and obligations of various stakeholders can be defined to suit the particular circumstances. Finally, establishing a company (especially a public company) can provide legitimacy to a business and encourage stakeholder.

5. Is the typical governing body a single board or comprised of more than one board?

Companies generally have a single board (which is made of a balance of executive and non-executive directors) which would typically have power to delegate matters, for example, to individuals or committees.

6. How are members of the governing body appointed and removed from service?

The appointment and removal of directors is governed by the Companies Act 2006 and the company's constitution, which typically provides for appointment and removal by the board of directors or shareholders. Directors of premium listed companies appointed by the board are typically required to have their appointment confirmed by shareholders at the next annual general meeting, and are subject to annual re-election by shareholders.

7. Who typically serves on the governing body and are there requirements that govern board composition or impose qualifications for directors regarding independence, diversity or succession?

The boards of premium listed companies generally comprise a mix of executive and non-executive directors. The UK Corporate Governance Code contains detailed recommendations on board composition, including that at least half the board, excluding the Chairperson, should comprise independent non-executive directors, and the Chairperson should be independent on appointment and that the board include an appropriate combination of executive and non-executive (especially independent nonexecutive) directors to avoid dominance by an individual or small group.

Independence is tested against a list of (non-exhaustive) criteria, including whether a director has been a group employee in the last five years, has had a material business relationship with the group in the last three years, has close family or other ties with any of the company's advisers, other directors or senior employees, holds cross directorships or otherwise has significant links with other directors, represents a significant shareholder or has served on the board for more than nine years.

Companies are required to identify independent non-executive directors in their annual reports. focus on boardroom diversity is also a key part of the UK corporate governanceregime. The Government regularly publishes reports on gender and ethnic diversity.

Listed companies are also required to disclose details of diversity policies annually.

The UK Corporate Governance Code recommends that boards establish a nomination committee to lead the process for appointments, ensure plans are in place for orderly succession for board and senior management positions and oversee the development of a diverse pipeline for succession. The Chairperson should not chair the nomination committee when it is dealing with the appointment of their successor.

8. What is the common approach to the leadership of the governing body?

The Chairperson leads the board and is responsible for its overall effectiveness in directing the company. The Chairperson should facilitate constructive board relations and the effective contribution of non-executive directors, and should ensure that the directors receive timely, accurate and clear information. The UK Corporate Governance Code recommends that the Chairperson be independent on appointment and that the role of Chairperson and Chief Executive not be combined.

In addition to the Chairperson, the board should also appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the Chairperson and serve as an intermediary for the other directors and shareholders.

9. What is the typical committee structure of the governing body?

The UK Corporate Governance Code requires premium listed companies to have three main board committees:

- the audit committee, which should comprise at least three (or two for smallercompanies) independent non-executive directors (not including the Chairperson), at least one of which should have recent and relevant financial experience;

- the nomination committee, which should comprise a majority of independent nonexecutive directors; and

- the remuneration committee. which should comprise at least three (or two forsmaller companies) independent non-executive directors. The Chairperson can only be a member if he or she was independent on appointment and cannot chair the committee.

Additional committees may be appropriate in the context of particular companies or industries (for example, a health & safety committee or an M&A committee).

10. How are members of the governing body compensated?

Boards generally set remuneration for their own members. For premium listed companies, pay is set by a remuneration committee made up of a minimum of two or three independent directors (depending on the size of the company). This committee should be responsible for setting pay for the chair, the executive directors and senior non-director level management. It should also review remuneration policies and the alignment of incentives and awards with culture and take these into account when setting pay levels.

The UK Corporate Governance Code sets out several general principles as well as more detailed provisions on how remuneration policies should be formulated and implemented.
Directors of premium listed companies must also prepare a remuneration policy at least once every three years. The policy is subject to a binding shareholder vote (on a simple majority). If the policy is not approved by shareholders, the company may:

- continue to operate according to the last policy to have been approved byshareholders;
- continue to operate according to the last remuneration policy to have beenapproved by shareholders and seek separate shareholder approval for any specific remuneration or loss of office payments which are not consistent with policy; or
- convene a general meeting and put forward the policy (which may be revised sincethe annual general meeting) for approval (this is the only possible option if the company has never had a remuneration policy approved at an annual general meeting).

Companies listed on the premium and the standard segments are required to pass an ordinary resolution approving the directors' remuneration report for the relevant financial year. The vote is advisory but where the resolution is not passed or, even if it is passed but there is a significant vote against, companies have generated negative press comment. The Investment Association keep a public register of companies which have suffered significant shareholder rebellions.

11. Are fiduciary duties owed by members of the governing body and to whom are they owed?

Directors owe certain duties to their companies under, inter alia, the Companies Act 2006, including duties: (1) to act within powers; (2) to promote the success of the company; (3) to exercise independent judgment; (4) to exercise reasonable care, skill and diligence; (5) to avoid conflicts of interest (6) not to accept benefits from third parties; and (7) to declare an interest in a proposed transaction or arrangement. When exercising the duty to promote success of the company, directors should have regard to a range of stakeholders including, amongst others, employees, suppliers, customers, the community and the environment.
Larger public and private companies are required to report on how they have regard to such stakeholders from financial years commencing in 2019.

In addition, directors owe fiduciary and certain other duties as a matter of common law (for example, a duty of confidentiality) and duties under certain other specific legislation (such as health and safety and anti-bribery law) which are beyond the scope of this note.

Executive and non-executive directors are subject to the same duties and it is possible (though rare) for shareholders to bring so-called "derivative actions" against directors on behalf of a company for an alleged breach of duty.

12. Do members of the governing body have potential personal liability? If so, what are the key means for protecting against such potential liability?

Directors can be personally liable in a number of circumstances, including:

- breach of statutory or common law duties; wrongful trading, fraudulent trading and misfeasance under the Insolvency Act1986; market abuse under the EU Market Abuse Regulation.

In certain circumstances, directors may also be disqualified from holding office. As a general rule under the Companies Act 2006, a company may not exempt a director from, or indemnify him against, liability in connection with any negligence, default, breach of duty or breach of trust by him in relation to the company. However, there are exceptions, including one permitting companies to provide such an indemnity pursuant to a contract of insurance, although such insurance will usually not pay out if a director is found liable for criminal and certain other acts such as regulatory offences.

It is common for companies to purchase D&O insurance for board members and for articles of association to contain provisions expressly indemnifying directors in certain circumstances.

13. How are managers typically compensated?

Compensation for executives of listed companies tends to be a mix of base salary, cash bonus (part of which is typically deferred), and equity incentives. For premium listed companies, pay for executive directors, the chair and senior employees should be set by the remuneration committee. Where equity awards form part of remuneration, such awards should be designed to align the incentives of senior management with those of the long-term interests of the company.

14. How are members of management typically evaluated?

Structures for the evaluation of management will depend on the level of the manager and the size and complexity of the company. For employee managers (as opposed to executive directors), evaluations may form part of customary HR processes. For ownermanaged private companies, processes may be more ad-hoc. For listed companies, processes tend to be more formal and rigorous.

Premium listed companies should formally and rigorously evaluate the performance of the board, its committees, the chair and the individual directors. For FTSE 350 companies this should happen at least every three years. The chair should also consider obtaining the assistance of third party experts to assist in conducting such evaluations. The chair should act on the results of the evaluations by recognising strengths and addressing weaknesses. Evaluations should be summarised in the annual report.

In addition, led by the senior independent director, the non-executive directors should meet without the Chairperson present at least annually to appraise the Chairperson's performance, and on other occasions as necessary.

15. Do members of management typically serve on the governing body?

With limited exceptions, UK companies have a single board, which will usually contain a balance of executive and non-executive directors and, at a minimum, the Chief Executive Officer and Chief Financial Officer would typically serve on the board. Executive directors are involved in day-to-day management, whereas non-executive directors are not and play an oversight role.

16. What are the required corporate disclosures, and how are they communicated?

The level of corporate disclosures required depends on whether a company is listed. All UK companies must make certain basic information available to the public at Companies House, including details of the registered office, the directors, the company secretaries (if any), and persons with significant control and copies of the constitutional documents and annual accounts.

Listed companies are subject to additional disclosure requirements under the Listing Rules, the Disclosure and Transparency Rules and the Market Abuse Regulation. These include an obligation to announce "inside information" without delay (subject to a limited ability to delay disclosure in particular circumstances), disclosure of voting rights notifications it has received, information on signification or related party transactions, share issuances or buybacks and other material information.

In addition, depending on their size, companies may be subject to a variety of other disclosure obligations, including a strategic report, statement in relation to compliance with the Modern Slavery Act, gender pay gap reporting, and payment practices. Please also see the response to Question 28.

17. How do the governing body and the equity holders of the company communicate or otherwise engage with one another?

The annual general meeting is the most formal annual forum for the board to engage with shareholders. As part of their ongoing investor relations efforts, directors will often undertake 'roadshows' to meet investors in advance of significant events (such as results or transactions). The UK Corporate Governance Code recognises that the Chairperson has an important role in fostering constructive relations with major shareholders and in conveying their views to the board as a whole and recommends that, in addition to formal general meetings, the Chairperson should seek regular engagement with major shareholders in order to understand their views. Committee chairs should also seek engagement with shareholders on significant matters related to their areas of responsibility.

Boards are also encouraged to explore ways of obtaining the views of smaller shareholders. Accordingly, it is common for directors regularly to engage with shareholders on an informal basis through meetings, but they should ensure that any selective disclosure of inside information is avoided.
Many institutional investors also apply the UK Stewardship Code, which provides a framework through which such institutions engage constructively with investee companies and discuss any departures from recommended practice.

In addition, the EU has sought to foster shareholder engagement through two Shareholder Rights Directors. The first, which came into force in 2007, implemented rules in relation to transparency, proxy voting rights and electronic voting. The Second Shareholder Rights Directive is designed to encourage more long-term shareholder engagement, enhance transparency in the voting process and improve dialogue between companies and investors. It also seeks to make it easier for shareholders to exercise their rights and facilitate cross border voting. Many of the requirements of the directive have already implemented in the UK but it is anticipated it will be implemented in full by June 2019.

18. Are dual or multi-class capital structures permitted and how common are they?

All shares have the same basic rights and share capital structures are flexible. However, except in certain sectors (eg investment companies), it would be atypical for a premium listed company to have multiple classes of shares.

However, as a matter of company law, multiple classes of shares are permitted and there is no limit on the number of classes of shares that can be created. The rights of shares can be enhanced or restricted under a company's constitution.

Where shares are to be listed, the entire class of the shares must be listed and the shares must be freely transferable, fully paid up and not subject to any liens or other restrictions on transfer.

19. What percentage of public equity is held by institutional investors versus retail investors?

The latest data released by the Office of National Statistics estimates that the value of UK quoted companies listed on the London Stock Exchange at the end of 2016 was approximately £2.04 trillion, of which 53.9% was held by investors from outside of the UK, 33.8% was held by UK-based institutions (including, amongst others, unit trusts, insurers, pension funds, banks, and the public sector) and the balance of 12.3% was held by UK individuals. The data do not discriminate between individuals and institutions for non-UK persons but it is likely that the majority of these shares are held by institutional investors.

20. What matters are subject to approval by the shareholders and what are the typical quorum requirements and approval standards? How do shareholders approve matters (e.g., voted at a meeting, written consent)?

If a company has only one shareholder, the quorum for a shareholder's meeting is one. Otherwise, quorum requirements are regulated by the company's articles, with the default being two. Written resolutions must be signed by all shareholders and the procedure is available only to private companies. Shareholder resolutions may be proposed as ordinary resolutions (which require a simple majority to pass) or special resolutions (which require a supermajority of 75% to pass). In both cases, whether the approved threshold is met will be determined by reference to shareholders actually present and voting, in person or by proxy. Shareholder meetings may be conducted on a show of hands (where each shareholder gets one vote) or on a poll (where each shareholder has the number of votes equal to the number of shares he holds which carry the right to vote). Where a vote is conducted on a show of hands, a shareholders holding 10% of the voting rights may demand a poll. For listed companies, voting would be by way of a poll.
By default, a variety of matters are reserved to shareholders under the Companies Act 2006, including:

- changes to the company's name, legal form, share capital structure andconstitution;
- removal of directors and auditors;
- authorisations of directors' conflicts of interest;
- substantial property transactions with directors;
- compensation payments to directors;
- disapplication of statutory pre-emption rights (if applicable);
- authority to allot shares and to make market purchases of a company's own shares;
- declaration of final dividends.

In addition to the company law requirements, for premium listed companies shareholder approval is required for certain additional matters (for example, related party transactions and certain other significant transactions).

21. Are shareholder proposals permitted and what requirements must be met for shareholders to make a proposal?

company must send out a notice for a meeting within 21 days of a valid request fromshareholders holding 5% or more of the total voting rights. That meeting must be held within 28 days of the notice. The request must (inter alia) state the general nature of the business to be dealt with at the meeting, and may include the text of a resolution to be proposed.
In addition, shareholders holding 5% or more of the total voting rights (or at least 100 members each holding on average £100 of paid up capital) can require a resolution or matter to be put before the annual general meeting of a public company. This request must (inter alia) identify the resolution or matter and be received not later than 6 weeks before the relevant annual general meeting (or if later, the time the AGM notice is given). In addition, shareholders meeting this threshold can also require the company to circulate a statement to shareholders relating to matters proposed to be dealt with at a relevant shareholder meeting.

22. May shareholders call special meetings or act by written consent?

Written resolution procedures are available to private companies only. For further information on how a shareholder may call a meeting or require a written resolution to be circulated, see question 21.

23. Is shareholder activism common and what are the recent trends?

The UK has seen a rise in shareholder activism in recent years. Research suggests that approximately 60 UK companies are potential targets for activists, which increasingly target larger listed corporates. For example, during the summer of 2018, British Telecom came under pressure to spin out its Openreach internet infrastructure business and Elliott Advisers targeted Sky earlier in the same year.

Many institutional shareholders apply the UK Stewardship Code, a framework for active engagement with investee companies, and are increasingly showing discontent with boards at annual general meetings. One in five UK listed companies experienced a rebellion by more than 20% of shareholders on one or more annual general meeting resolutions in 2017 (most related to director compensation), a higher level than was generally expected. The discontent expressed at annual general meetings may suggest that the somewhat genteel culture of the UK stock market is changing and that accusations of shareholder apathy are less true than traditionally believed. In 2018, the Investment Association started to publicise the names of companies which experienced significant shareholder rebellions. A public register is now available online naming companies who had 20% of more of its shareholders vote against a resolution.

The register also gives details of which resolutions were the subject of such revolts.

Under the UK Corporate Governance Code, when 20% or more of the votes have been cast against the board recommendation for a resolution, the company should explain what actions it intends to take to consult shareholders in order to understand the reasons behind the result, and publish an update no later than six months after the shareholder meeting.

Whilst there has undoubtedly been a rise in activism in the UK, and greater publicity and transparency on this, the trend should be seen in context. Activism is not as pronounced as in many other jurisdictions and the process is often less adversarial and less likely to be the subject of litigation than in other large markets, notably the US.

24. What is the role of shareholders in electing the governing body?

Members of the board would typically be elected by the board, with the nomination committee taking the lead on appointments. In a listed company, appointments made by the board would typically need to be confirmed by shareholders at the next annual general meeting, and directors would be subject to re-election by shareholders on an annual basis.

25. Are shareholder meetings required to be held annually or otherwise, and what information needs to be presented?

Only public companies and private companies that are traded companies (essentially being companies whose shares, securities equivalent to shares (including depositary receipts), bonds or derivatives are traded on a capital market) are required to hold an annual general meeting. Annual general meetings typically deal with matters that must be dealt with each financial year, and often include, amongst other matters: approval of the annual report and accounts, approval of the remuneration report, approval of the directors' remuneration policy (at least once every three years), the appointment/re-appointment of directors, the appointment/re-appointment of auditors (and fixing their remuneration), authority to allot shares, disapplication of pre-emption rights, consent to general meetings being held on 14 days' notice, approval for buybacks, approval of political donations, adopting or amending an employee share scheme, a capitalisation or bonus issue of shares, and approval of a scrip dividend alternative or dividend reinvestment plan. Other company-specific approvals may also be sought at an annual general meeting.

26. Do any organizations advise or counsel shareholders on whether to approve matters?

A number of industry groups provide guidance to institutional shareholders on whether to approve shareholder resolutions of public companies. These include the Association of British Insurers, the Investment Association, Pensions Investment Research Consultants and the Pensions and Lifetime Savings Association.

27. What role do other stakeholders, including debt holders, employees, suppliers and customers and the government, typically play in the corporate governance of a company?

Directors should have regard (amongst other matters) to the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the desirability of the company for maintaining a reputation for a high standard of business conduct and the need to act fairly between the shareholders of the company.

While these requirements ultimately remain subordinate to the overarching duty of directors to promote the success of the company for the benefit of its shareholders as a whole, the UK Corporate Governance Code requires the board to understand the views of the company’s other key stakeholders and to describe in their annual report how their interests and the matters referred to above have been considered in board discussions and decision-making.

In addition, as regards engagement with the workforce, the UK Corporate Governance Code recommends using one or a combination of (i) a director appointment from the workforce, (ii) a formal workforce advisory panel and (iii) a designated non-executive director (in the absence of these, the board should explain what alternative arrangements are in place and why these are considered effective). Employees should be able to raise concerns in confidence and, if they wish, anonymously, and these should be reviewed by the Board.

28. What consideration is given to environmental and social issues, including climate change, sustainability and product safety issues, and are there any legal disclosure obligations regarding the same?

Directors are to have regard to the interests of various stakeholders when taking decisions. For more information see question 27.

Companies which are not subject to the small companies regime are required to file a strategic report. This must contain a fair review of the company's business, and a description of the principal risks and uncertainties facing the company, which may include risks faced by climate change, sustainability and/or product safety issues. Depending on the size of the company, the nature of its business and whether it is quoted, the report is required to contain varying amounts of detail on these matters.

The contents of this report are changing in 2019.

The UK Corporate Governance Code also refers to companies' contributions to wider society although it contains no specific requirements on product standards, environmental or sustainability matters.

29. How are the interests of shareholders and other stakeholders factored into decisions of the governing body?

Directors are to have regard to the interests of various stakeholders when taking decisions. See questions 27.

30. Do public companies typically provide earnings guidance on either a quarterly or annual basis?

Practice around earnings guidance differs from issuer to issuer. Any information relating to performance relative to earnings guidance may be inside information and therefore disclosure should be considered in light of the relevant provisions of MAR. For further information on basic corporate disclosures, see question 16.

31. May public companies engage in share buybacks and under what circumstances?

In order for a public company to buy back shares, it must have the ability to do so under its constitution (which would typically be the case), and must seek authority from shareholders to do so (most listed companies seek authority on an annual basis at their annual general meeting subject to certain limits). Buybacks by public companies must be funded either through distributable profits or the proceeds of a fresh issue of shares for the purpose of financing the buyback.

Under the Listing Rules, buybacks must be made by way of tender offer if the price paid is 5% higher than average market value of the company's equity shares for the 5 business days prior to the day the purchase is made or if purchases are of 15% or more of any class of its equity shares. Buybacks may be on or off market, though typically listed companies purchase their own shares on market after announcing to the market that they intend to do so. Buyback programmes for listed companies are highly regulated and may be subject to the City Code on Takeovers and Mergers, the Listing Rules, the Disclosure and Transparency Rules and/or MAR.

32. **What do you believe will be the three most significant issues influencing corporate governance trends over the next two years?**

In addition to executive compensation, which continues to be a topical issue in the UK, we believe that corporate governance trends over the next two years will focus on (i) board and management diversity, (ii) corporate social responsibility and increased transparency and (iii) shareholder activism and engagement.