DIRECTORS' AND SHAREHOLDERS' PARTICIPATION IN CORPORATE ADMINISTRATION.

(Changes in the Framework for the Governance of Large Public Companies)

By

OSERHEIMEN AIGBERAODION OSUNBOR, LL.B. (First Class Hons), (U.N.N.),

Solicitor and Advocate of The Supreme Court of Nigeria. Winner of Dr. Elias' Prize for the best Student, Nigerian Bar Examination, 1976. Rhodes Scholar.

A Thesis submitted for the Degree of Ph.D. in Laws.

University of Warwick,
School of Law,

February, 1981.

CONTENTS

Page

LIST OF TABLES

CHART

TABLE OF CASES

ACKNOWLEDGEMENTS

I am greatly indebted to Professor Yash Ghai for his untiring supervision of my work and his ever readiness to give my drafts prompt attention despite his very tight schedules. His comments and advice have contributed in no small measure to the completion of this thesis. I am also very grateful to Professor Michael Chesterman who, as my supervisor until his departure for Australia, provided useful advice which have proved a very helpful basis from which this thesis has developed.

The Rhodes Trust deserve my greatest thanks not only for providing me with my scholarship but also for kindly holding it over when a call to National Service made it impossible for me to take it up immediately after its award. I am particularly grateful to Sir E.T.Williams and the staff of the Rhodes House, Oxford, for all their assistance.

I should also express my gratitude to Professor C.O.Okonkwo of the University of Nigeria, Faculty of Law, who, as my Lecturer in Company Law was very influential in my choice of this area for research, to Miss Jill Cottrell for all the assistance rendered, to my parents and Ussieh Julius for their love and encouragement and to all those who have contributed in one way or another to the successful completion of this thesis. My thanks also to Mrs. Joy Gardner for the speed and efficiency with which she has carried out the typing.

Whatever shortcomings may exist in this thesis are, however, entirely mine.

SUMMARY

This Thesis examines the nature of the framework for corporate governance with reference to the roles of the general meeting and the board of directors, and suggests that despite numerous reforms of Company Law and the changing nature of business enterprise in general, the framework for corporate administration has undergone little structural change. It discusses the extent of shareholders' involvement in the control of their companies and directors' participation in company management, and argues that the *de facto* roles of these two corporate organs is not quite to the same extent as is presupposed in legal theory, and that more effective participation may be achieved through certain changes in the existing framework for participation. To this end suggestions are made for increased shareholders' control through shareholders' committees and institutional shareholders acting individually or by collective action, sometimes as representatives of private shareholders. In respect of the board the thesis proposes a greater supervisory function for boards of directors which presupposes an increased use of non-executive directors (some of which would be special shareholders'nominees) under a unitary board structure.

This work has involved very little empirical research of its own but by drawing on empirical and theoretical materials (original and secondary) from economics, business, politics, sociology, etc., literature, a wider dimension is given to the discussion than would normally be the case in a "hard law" thesis. As the need for a modification in the framework for corporate governance becomes increasingly recognised and debated, it is hoped that lawyers, businessmen, legislators and all concerned would find this "law in context" approach to the twin-problems of improving shareholders' control and the board's supervisory functions more convincing.

PART I

THE FRAMEWORK FOR CORPORATE ADMINISTRATION

This work is not a thesis on legal history, but in order to put the subject matter under study in proper perspective it is necessary in this first part to set out the way in which the framework for corporate administration has evolved by drawing on historical (mostly economic history) sources . The historical account will of necessity be brief but some of the most important developments toward the emergence of the framework for business company organisation in the seventeenth century and the development of the governing regulations in the eighteenth century are treated in greater detail. The nature of these regulations as they continued to evolve through the 1844 Act to subsequent Companies Acts are examined. This will provide the basis for arguing that successive companies legislations have mainly sought to modify and modernise these regulations without introducing significant changes in the organisational structure handed down from the seventeenth century.

CHAPTER 1

THE EVOLUTION OF THE FRAMEWORK FOR CORPORATE ADMINISTRATION

1. Introduction

Problems in the organisation of business enterprises and, in particular, the separation of Ownership (the shareholders) from Management (the directors) 1/ in the modern corporate giants have generated much interest in their structures as well as the responsibilities and accountability of those who administer their affairs. One aspect of the organisation of business enterprise which has received relatively scant attention is the question of whether the existing structure or framework 2/ for the governance of the modern company is adequate for the attainment of the principle of shareholders' control over directors which underlies Company Law. 3/ An associated question is whether it can still be correctly claimed that the board of directors "manages" the large company of today. Studies in the last fifty or so years have given added momentum to the need to re-examine these problems and it is these that this thesis is concerned about. But in order to understand the nature of the present framework for corporate governance it will be useful to consider first, though briefly, the origin of the modern registered limited liability company and the development of its organisational structure.

1/ This thesis proceeds from the assumption of this separation but the writer is not oblivious of the deep controversy in this area. Further consideration of this question must in the meantime be reserved for Chapter 2.

2/ Although the word "framework" includes the rules, the main concern of this thesis is with the institutions or organs through which the company's governance is effected. These organs are considered at the end of this chapter.

3/ The Principle of Shareholders' Control is discussed in Chapter 2.

2. The Origin of the Company 1/

The legal origin of the modern business company is uncertain. However, there is a general consensus among legal and economic historians that it had its origin in one of three sources.

The first possible origin is the *Societas* and *Commenda* which were forms of commercial partnership developed in the middle ages. The *Societas*, in particular was extensively used by Italian financiers in England during the thirteenth and fourteenth centuries but their impact as commercial vehicles began to decline from about the mid-fourteenth century. 2/

Secondly, it is believed that the joint stock company derived from the idea of a corporation through the gild system. Gilds formed for religious, social as well as commercial purposes started to exist

---

1/ The historical survey which follows derives mostly from the following sources, in alphabetical order : John Carswell, The South Sea Bubble (London,1960); A.B.Du Bois, The English Business Company After The Bubble Act,1720-1800, (New York,1938); R.R.Formoy, The Historical Foundation of Modern Company Law, (London,1923); Sir William Holdsworth A History of English Law, (Second Edition), (London,1937); B.C.Hunt, The Development of the Business Corporation in England,1800-1867, (Harvard, 1936); J.B.Jeffreys, Trends in Business Organisation in in Great Britain Since 1856 (Unpublished Ph.D.Thesis University of London 1938); and W.R.Scott, The Contitution and Finance of English Scottish and Irish Joint Stock Companies to 1720, Vol.1. /The General Development of the Joint-Stock System to 1720/ (New York,1951). Henceforth these books will be cited only by the name of author and, where necessary, the volume.

2/ See Scott; Chapter 1. For an account of the development of business enterprise from partnership to limited liability in the nineteenth century, see Hunt, pp.49-55, and Holdsworth,Vol.8,pp.195-222.

from Anglo-Saxon times and soon certain corporate ideas such as the conception of "perpetual successimn" began to develop. It was, however, after the Norman Conquest in 1066 that the Gild Merchant, formed specifically for commercial purposes, and various other trade gilds began to appear. Many traces of the influence of these gilds were to be found in the trading companies of the sixteenth century and in the seventeenth century when the framework for the organisation of business companies became crystallised.

One important feature in the social gild, and presumably shared by the gild merchant, was the series of regulations as to the management of their businesses and the control of members at organised feasts, convivial meetings as well as other meetings. However, as the administration of gild merchants became more complex and had a greater variety of affairs to control it was inevitable that the organisation of its government had to be more detailed than those of social gilds. 1/ Their governing bodies often consisted of an "alderman" or "governor" and four associate members. The governor and his associates were responsible for what might be regarded as the business management of the gild in general. In addition there were other junior officers most of whom were charged with specific functions. With the increase in the commercial affairs of the gild merchant the new concern during the seventeenth century became the framing of by-laws for the regulation of businesses. This process of framing and recording by-laws was not to attain its maturity until the eighteenth century, by which time the framework for their governance had already been well established. 2/

1/ See Scott; p.7.

2/ The important role played by Companies' Counsel in the development of these rules and by-laws in the days of the Bubble Act are described by Du Bois in Chapter 4.

The third possible origin of the modern company is through the process of transplantation of a joint stock company constitution from the continent in view of the early dominance of foreign - mostly Italian and German - influence in the external trade of England. As far back as the fourteenth century some of these companies engaged in trade already had clearly determined systems of organisation such as an elected governor vested with executive powers and a general assembly of members who had periodic meetings and, of course, governing regulations for those meetings and other aspects of the company's operations. 1/

In view of the uncertainty about the exact origin of the joint stock company, it is hardly surprising that no precise account is available on the process of development of their organisational structures. An attempt will be made in the following section to trace this development.

3. <u>The Pattern of Internal Organisation in the Joint Stock Company and their development</u>.

One thing that is clear about the history of business organisation is that most early forms of business enterprises were conducted by the Partnership form in which all the partners had a direct incentive to be active in the running of the day-to-day affairs of the firm. Sleeping partners, if they existed in a firm could not afford to distance themselves too much from the affairs of the enterprise

1/ See Scott, pp. 8 - 14.

because of the Common Law practice of holding liable all the partners, whether "sleeping" or active, for the debts contracted by the partnership. This meant that in general firms were actively controlled by virtually everyone who had their investments sunk in it. Following the Industrial Revolution and the expansion and consolidation of methods of production the active participation of every partner became increasingly impossible in large partnerships. Furthermore, the need to increase the size and scale of production encouraged the advent of many wealthy investors putting their funds together to form joint stock enterprises. Under this new form the participant contributed his "stock" or fund with the understanding of receiving an equivalent proportion of the profits made in the business venture. If the venture failed he simply lost his contribution. He was not expected to participate in the management of the enterprise. He was not necessarily a partner. These two forms of business were carried on at the same period but the fundamental legal distinction between a large partnership and an incorporated joint stock company was not widely grasped until after 1720. 1/ It was not until 1844 that Parliament formally drew a distinction between the two. 2/

The best accounts of the pattern of internal organisation in the joint stock company of the seventeenth and eighteenth centuries can be found in the works of Scott and Du Bois respectively. 3/

1/ See Hunt, p.4.

2/ *Ibid.*,89.

3/ These books cover a wider scope than just the patterns of company organisations so that what follows are not in fact treated systematically by the authors but merely mentioned within the general trend they described. While it would certainly be very useful to ascertain the correlation between the development of these "features" and prevailing social, economic or commercial forces of these periods, direct evidence of these are scarce. But see J.B.Jeffreys and P.L.Payne, *British Entrepreneurship in the Nineteenth Century*,(1974). (henceforth,P.L.Payne), for the developments in the nineteenth century.

Up until 1620 and possibly beyond, writes Scott, no special arrangements had been made in companies charters as to such matters as the relation of the votes to the shares or stock and so, not surprisingly, companies' meetings witnessed serious dissentions and disorders as well as allegations of improper conduct by those put in charge of management of the companies. By 1630,however,some companies such as The East India Company had introduced rules like voting by ballot which helped to regulate and improve the conduct of general meetings as an essential element in their governing structure.

Between 1690-95, companies constitutions formulated by Charters or Deeds of Settlement adopted the established model of providing for the appointment of a governor, deputy governor and assistants - the number of the latter being as a rule 12 or a multiple of 12, subject to variations according to the individual needs of the companies. [1/] The use of management committees and the term "managers" were introduced during this period and for the first time the name of director displaced that of assistant, save in a few companies such as the Banks of England and Scotland which retained its use.

Companies' constitutions also provided for different shares qualifications for the office of directors, their assistants or committees.

The quorum for meetings of the governing bodies was frequently seven subject to the proviso that the governor or deputy-governor formed part of the quorum, but again this varied as between companies.

1/ Scott, p.339. No evidence is available to account for the choice of this figure of 12.

Other subjects such as members' voting rights, the division of capital into shares, methods of promotion, payment of calls and the relation of the governing body to the shareholders were often specified by companies' constitutions. [1/] These early companies and their patterns of internal organisation continued into the eighteenth century until 1720 when the development of the joint stock company was temporarily halted by the effect of the Bubble Act. [2/] But, already by this time, writes Du Bois: [3/]

> "... the organisation of the large-scale business unit in England had become a thing no longer amorphous, but clear-cut and stereotyped".

Du Bois' work contains a description of the typical structure of the business organisation which existed from the second quarter of the eighteenth century up to 1800. Typically, there was an assembly of shareholders, then referred to as proprietors, which was called the general court or sometimes, the general assembly or general meeting, and a court of directors or assistants, elected by the general court and presided over by the governor and the sub-governor. The general court corresponded to the legislative branch of the government of the Kingdom while the court of directors had the executive power. Day-to-day administration was carried out by committees of directors who were to be appointed by the directors themselves. The general courts were usually

---

1/ Ibid.,pp.339-344.

2/ 6 Geo.1, C.18.

3/ At 287.

summoned by the directors of their companies, but such matters as the minimum number of courts per year, the right to call meetings as well as the respective powers of the different organs were set out by Charters, Acts of Incorporation and Deeds of Settlements.

Companies' constitutional instruments set out the rights of members such as the right to vote and the number of votes per shares, and sometimes, a maximum number of votes per shareholder. Voting by proxy by the eighteenth century had already become a familiar feature in general courts and the rules and conditions for voting by proxy were set out in constitutional instruments. 1/

Even during this period the nature and conduct of the general courts or shareholders' meetings bear close resemblance to the early social gilds which had an air of convivial gathering or entertainment about them. For the leading companies of this period such as The East India and South Sea Companies the problem which conveners of meetings encountered was not so much whether there will be enough members in attendance but to reduce the gathering to a more manageable size by excluding those proprietors whose stock qualifications were below the minimum required for the privilege of voting. It is, however, also true that for less popular companies - and possibly, those who did not afford the same entertainments - "the general courts.... were no better attended than the typical stockholder's meeting of the twentieth century". 2/

1/ Cf. J.B.Jeffreys, who suggests that the proxy system had not been used to any extent in joint stock companies other than railway companies, before the late 1860s, p.398.

2/ See Du Bois, p.289. The attitude of the 20th century shareholder to participation in corporate governance is examined in a later chapter, but the points of similarity with the 17th and 18th century practices are interesting.

In some of these companies financial rewards were given as inducement for shareholders to attend and penalties for non-attendance at meetings were not unknown.

As a general rule, the general court of the eighteenth century company had the exclusive consideration of any policy matter or one involving important or fundamental change. 1/ On the other hand, the conduct of the day-to-day business was under the control of a general court to whom the name directors was generally given. Between these two organs the division of authority was effected with a considerable amount of flexibility in the companies' constitutions. For example, there was often to be seen in such instruments, a clause to the effect that the directors

> "were to order, direct, manage and transact all and every the affairs and thingsof or belonging to the said Company except such matters which ought to be ordered in and done by the General Court of the said Company". 2/

1/ These include the issuance of additional stock, the increase of outstanding bonds, extensive property acquisition or expansion through the acquisition of competitors and in some cases the power to make call on shares. See Du Bois, 291.

2/ See Du Bois at 292, citing a clause from the Charter of Chelsea Water Company,1723. (Patent Rolls, 9 Geo.1, Part 2 No.23). A similar clause in the proposed incorporation of the West New Jersey Society in 1738 declared:

> "The Court of Directors is to direct,order and manage the whole affairs ofthe Company and to have Power of making Rules, Orders, By-Laws and Constitutions for the ordering, regulating, and disposing of the Estates Affairs, Interest and Effects of the Company and for their good Government subject to the Order of the General Court".

Petition of February 9,1738/9, State Papers, Dom.,44/258.

Despite the existence of such clauses which apparently left the directors with unfettered powers the possibility of interference and domination by the general court is one which directors rarely forgot. Indeed, informed opinion at the time was that the courts of directors have no power to dispense with, control or vary the proceedings of the general court. 1/

On appointment a director was required by the relevant regulation to take an oath to carry out his office, and during this period a director's powers and responsibilities were regarded as those of a trustee - an analogy which was to continue to modern times. Directors have been held to the same fiduciary standards as trustees, although, as businessmen, to a lesser standard of care and skill, failure of which incurs liability for breach of duty. 2/

The office of a director imposed on him the duty of loyalty to the company by avoiding any position which would give rise to a conflict of interest between him and his company, or entering into a contract which is prohibited under the company's constitution. Other conduct likely to constitute a breach of duty included the misrepresentation of the company's affairs to the general meeting, the failure to secure the consent or authority of the general meeting, where this was mandatory under the company's constitution, and deliberately altering the recorded minutes of the general meetings.

1/ Du Bois cites the following rhetorical question by the registrar of the Amicable Corporation in 1791. "I wish to put one question to you, have the Court of Directors Power to dispense with, control or vary the proceedings of the General Court of the Society at Large? Pause a little upon this ... But I think I may without presumption anticipate that your Answer must be unanimously in the negative". See Chapter IV, footnote 82.

2/ The legal position of Directors is considered below.

Punishment against erring directors ranged from reprimand and fine to removal by a vote of the general meeting which was by far the most usual and far-reaching punishment. However, the sanctions which were evolved for the enforcement of directors' obligations really never proved effective as, according to Du Bois, the eighteenth century director "even by the twentieth century standard was adept in the art of using the mechanism of the company for his own best interests. Perhaps the technique has become more polished and complicated as the result of two hundred years of further experience, but the essentials were present in the eighteenth century". 1/

Although the directors were regarded as agents of the proprietors and despite the power of the general court to over-rule the court of directors the superiority of the general court did not go unchallenged. While the directors would recognise the theoretical power of the general court to over-rule their decisions the reluctance of directors to accept this form of control was expressed by the following statement of the sub-governor at the general court of the South Sea Company:

> "Upon this occasion we cannot avoid saying thus, that altho [sic] it is our general duty to follow your orders in doing which we shall ever be legally justified, we should nevertheless in a moral sense betray our trust by implicitly putting in execution orders that may really be, or which to our judgment upon mature deliberation may seem to be improper". 2/

1/ At.297

2/ Ibid, at 298-299.

There are, on the other hand, records of battles between the general court and the court of directors which were resolved in the former's favour in confirmation of their superior authority, but with the increasing use by directors of "extraordinary delegation" to committees - including secret commitees - and other evasion devices *de facto* power gravitated to the court of directors.

It was usual also for the agenda of a proposed general meeting to be considered in advance by the directors themselves before the general meeting is held. Indeed, it was not unusual for directors to meet in advance and agree resolutions which were later to be moved and almost certainly adopted at the general meeting. Thus, "[it] was only exceptionally that motions and proposals would be made independently of the directors". 1/

It was also common for directors to dominate the election of new directors by ensuring the appointment of their state of new appointees in replacement of retiring directors. Through this system of self-perpetuation directors were enabled to maintain control over the running of the company, and to preserve or even reinforce rules which restricted shareholders' intervention. It was, for example, common for companies to restrict the number of votes permitted to a proprietor at a general meeting and to prohibit attempts to evade this rule by the splitting of the member's shares amongst several proprietors or transfer to nominees.

1/ Du Bois, p.301.

Although companies' charters or regulations gave a prescribed number of proprietors the power to summon the general court, the proprietors were usually required to be holders of a substantial interest in the company's stocks so that only wealthy people could enjoy this power.

Each proprietor was entitled by charter to inspect his company's accounts. For some companies he enjoyed unrestricted access to his company's accounts but in others his right was restricted only to those accounts which were submitted to the general court.

Despite their existence, the rights of the eighteenth century proprietor to convene a general court and to inspect his company's books of accounts were so circumscribed that most members contented themselves with receiving dividends if and when declared and showed little or no enthusiasm for summoning or attending general courts or concerning themselves with accounts.

It is to be noted that the framework for corporate governance, with particular regard to the role of the general court and the court of directors, as described above evolved very slowly with the development of the joint stock company and is largely the same as exists today, though noting that this structure was formally incorporated into the 1862 Companies Act which is now generally regarded as establishing the present framework and the relations between the shareholders and directors. Although there has been an increasing number of companies' legislation since 1720 these have had little effect on the basic governing structure, the main emphasis having often been to *protect* investors and creditors from fraud perpetrated by promoters and directors, rather than increasing shareholders' *control* over directors and their companies. This pattern is borne out in the survey of companies legislation which follows in the next section.

4. Companies Legislations and their Effects on the Framework for Corporate Governance. 1/

(i) Pre - 1856 Legislation:

What may conveniently be regarded as the first legislation to regulate the joint stock company is the Bubble Companies Act,1720, 2/ which was passed in order to offset the then "prevailing orgy of company promotion and speculation"generated by the bogus "success" of the South Sea Company. 3/ This company chartered in 1711 had speculated in and manipulated its own securities which resulted in a great but fictitious rise in their market value. Companies which were quickly formed to cash in on the market "boom" soon crashed with amazing rapidity, generating large-scale scandals in their wake. These scandals led to the passing of the Bubble Act to restrict the formation of such "bubble" companies and the Act, ambiguous and unpopular as it was, did succeed to some extent in retarding the incorporation of joint stock companies and the development of company law for about a century.

1/ The purpose of this section is not to discuss the detailed provisions of these Acts or the circumstances which led to their enactment, but to show the concern of Parliament and the objectives of the Acts.

2/ This Act provided, inter alia, that anyone "who contrived dangerous and mischevious undertakings or projects under false pretense of the public good...." and all such "undertakings and attempts" to defraud the public were to be "effectually suppressed and restrained", as tending to "the common grievance, prejudice and inconvenience", and "to be punishable as public nuisance".

3/ For detailed account of the history of this company and the Bubble Act, see Carswell, supra, Scott, Chapters XVII-XXI; Holdsworth, Vol.8, 206-22, passim and Hunt, 6 et.seq.

It is remarkable that although the Bubble Act officially restricted the incorporation of companies, company law and enterprises continued to develop in spite of its draconian penalties, thanks largely to the ingenuity of eighteenth century companies counsel who advised businessmen to carry on business mostly through the trust device. As a result the Act did not completely halt the formation of companies, and this led to its repeal. 1/

After the repeal of the Bubble Act in 1825 the next Act was the Chartered Companies Act 1837 2/ which empowered the Crown to grant letters patent to a body of persons associated together for the purposes of trading. It soon became clear, however, that in spite of existing laws too many companies were being formed for fraudulent purposes and that better precautions against frauds perpetuated by company promoters were urgently needed. In 1841 a parliamentary committee was appointed "to inquire into the state of the laws respecting joint-stock companies, with a view to the greater security of the public". 3/ According to one commentator, the public during this period was "at the mercy of anyone who chose to publish an advertisement, call himself a company and receive money for assurances and annuities". 4/ When the Parliamentary Committee reported in 1844 it revealed that from 1837 to 1843, some fifteen of such companies had "commenced and ceased to exist". 5/ The Committee examined ten cases of company failures and

---

1/ See Du Bois, Chapter IV.

2/ 7 William IV and 1 Victoria C.73.

3/ Hunt, p.90.

4/ See, Ibid, citing the remarks of Francis, Annals of Life Insurance (1853), p.252.

5/ Report of the Select Committee on Joint Stock Companies VII (1844). Evidence Q.828.

its investigations revealed several flagrant abuses. 1/ In one of the companies it was found that the shareholders were unable to remove incompetent directors on discovering their mismanagement of the company because they had no power to inspect the books and papers of the company and to call a general meeting. This was in spite of the fact that an Act of Parliament had been obtained and a board of directors appointed to take over the running of the company. The committee reported that the "concoctors" of these bogus companies:

> "however fraudulent and however largely they had despoiled the public, are practically unamenable to any judicature, civil or criminal, for the reason that the parties affected could not discover of whom the company consisted; or if it was possible to discover the names of the parties responsible for the fraud, the victims were too poor or too ashamed to pursue the offenders, or were deterred by fear of losing the chance of recovering a portion of their loss. Moreover, legal proceedings were so cumbrous as to be almost impracticable". 2/

The Committee's report led to the passing of the Joint Stock Companies Registration and Regulation Act,1844, 3/ which was designed to check the frauds and encourage honest entrepreneurs and so protect the investing public against swindlers operating behind the facade of bogus companies. For the first time it became possible to obtain incorporation and registration of companies without a Royal Charter or Act of Parliament.

1/ See Formoy, pp.62-65.

2/ *Ibid.* p.64.

3/ 7& 8 Vict. CC 110. There were in fact two 1844 Acts, the other being 7, 8. Victoria C.111 which dealt with the winding up of insolvent companies.

Some other provisions introduced by the 1844 Act to protect investors and creditors include that requiring the publication of certain information regarding the company's organisation and its membership. The requirement for publicity was for the first time introduced by this Act, as an important protection for investors, thus implementing Mr.Gladstone's desire for adequate information for members. Indeed, the preamble to the Bill expressed this desire: "Whereas it is necessary that due publicity be given to the objects, nature and constitution of Companies, the names of their Members, their capital and liability".[1/] And as *The Times* also wrote: "Publicity is all that is necessary. Show up the roguery and it is harmless".[2/]

The information required included half yearly returns of members and their holdings; Directors were to cause "a full and fair balance sheet to be made up" and to approve it before delivery to auditors. The appointment of auditors "to receive and examine the accounts" was made prerequisite to provisional registration. Indeed, the parliamentary Committee in its report emphasised its belief in the value of publishing of accounts: "periodical accounts if honestly made and fairly audited, cannot fail to excite attention to the real state of (a) concern".[3/]

1/ See Parliamentary Debates (H.C.) LXXV (1844), 277-78.

2/ July 4 (1844), Cited by Hunt; 95.

3/ See Hunt, 97.

Some other provisions introduced by the 1844 Act to protect investors and creditors include that requiring the publication of certain information regarding the company's organisation and its membership. The requirement for publicity was for the first time introduced by this Act, as an important protection for investors, thus implementing Mr.Gladstone's desire for adequate information for members. Indeed, the preamble to the Bill expressed this desire: "Whereas it is necessary that due publicity be given to the objects, nature and constitution of Companies, the names of their Members, their capital and liability".[1/] And as *The Times* also wrote: "Publicity is all that is necessary. Show up the roguery and it is harmless".[2/]

The information required included half yearly returns of members and their holdings; Directors were to cause "a full and fair balance sheet to be made up" and to approve it before delivery to auditors. The appointment of auditors "to receive and examine the accounts" was made prerequisite to provisional registration. Indeed, the parliamentary Committee in its report emphasised its belief in the value of publishing of accounts: "periodical accounts if honestly made and fairly audited, cannot fail to excite attention to the real state of (a) concern".[3/]

1/ See Parliamentary Debates (H.C.) LXXV (1844), 277-78.
2/ July 4 (1844), Cited by Hunt; 95.
3/ See Hunt, 97.

The innovative provisions having been introduced by this Act subsequent legislations have merely "amplified, clarified and extended" the rules. However, the Act was soon found to have certain weaknesses.[1/] Existing standard forms for charters and deeds of association for the larger incorporated companies developed mostly in the eighteenth century continued to be used in framing the internal organisations and control of the Companies. Not surprisingly, the weakness of shareholders was further compounded, particularly in the large company which could not in all reality be "democratically controlled" and where the voting power of shareholders became insignificant.[2/] The realities of shareholders' position in the governance of their companies during this period is described in an illuminating passage by one Herbert Spencer cited by Professor B.C.Hunt:[3/]

> "As devised by Act of Parliament, the administrations of our public companies are almost purely democractic. The representative system is carried out in them with scarcely a check. Shareholders elect their Directors, Directors their Chairman; there is an annual retirement of a certain proportion of the Board, giving facilities for suspending them; and by this means, the whole ruling body may be changed in periods varying from three to five years. Yet, not only are the characteristic vices of our political state reproduced in each of these mercantile corporations - some even in intenser degree - but the very form of government, whilst remaining nominally democratic, is substantially so remodelled

---

1/ For example, there was requirement only for provisional registration and the Act had not yet accepted the principle of limited liability. For a critique of this Act see Formoy, 83 and Holdsworth, Vol.5, pp.49-54.

2/ See Hunt, 135.

3/ Ibid, Quoting from Edinburgh Review, Vol.C pp.420-21.

> "as to become a miniature of our national constitution. The direction, ceasing to fulfill its theory as a deliberative body whose members possess like powers, falls under the control of some one member of superior cunning, will or wealth, to whom the majority become so subordinate, that, the decision on every question depends on the course he takes. Proprietors, instead of constantly exercising their franchise, allow it to become on all ordinary occasions a dead letter, retiring directors are so habitually re-elected without opposition and have so great a power of insuring their own re-election when opposed, that the board becomes practically a close body; and it is only when the government grows extreme enough to produce a revolutionary agitation among the shareholders that any change can be effected".

Such observations failed to secure the attention of the legislature to devise a way that would improve shareholders' control over directors and the existing forms of internal regulations, and so forth, continued to be adopted until they were embodied in the 1856 Act, and later in the Table A model clauses addended to the 1862 Act. Before these two Acts, however, was the 1855 Act which, for the first time introduced the principle of limited liability in defiance of vigorous opposition from those who believed that limited liability would only encourage and protect reckless and fraudulent promoters. [1]

(ii) The 1856 Act [2]

The Joint Stock Companies Act, 1856 first introduced the modern manner in which the essential features of a company are constituted as well as some of the rights and responsibilities of directors and shareholders. It introduced companies constituted by memorandum and

---

1/ For a history of the hard-fought battle for the introduction of the limited liability company, see Formoy, 114; Hunt 72-144; Jeffreys, Chapter 1.

2/ Joint Stock Companies Act (19 &20Vict. C.47). This Act repealed the 1844 Act and the amending Acts of 1847 as well as the 1855 Act. See Holdsworth, Vol. 15, 55.

article of association - the main constitutional documents of a company. It set out in its schedule a form for the memorandum of association and the information to be contained in it. It provided for a minimum of seven members to form a company. The company was to be regulated by articles of association signed by the subscribers to the memorandum and if there were no such articles the regulations in Table B in the schedule was to apply, save to the extent to which it may have been modified by the company and were to be in the form set out in Table C. 1/ As soon as the certificate of incorporation was granted the company was entitled to commence business. 2/ The share register was to be open to inspection and copies of the memorandum and articles were to be forwarded to shareholders for a small fee.

In respect of the management and administration of the company, power was given to the company to alter its regulations by special resolutions which were to be registered. The right of shareholders to be involved in the operation of their company through the general meeting was recognised and so it was required to be held at least once a year. If the number of shareholders fell below the statutory minimum of seven, it automatically lost its privilege of limited liability with consequences as they still are today. 3/ Sections 48 to 52 gave power to one-fifth in the number and value of the shareholders to obtain inspection of

---

1/ Sections 5 - 10.

2/ Section 15.

3/ Every member who remains while the company carries on business for more than six months from the reduction and is cognisant of the fact that the membership is less than the required minimum is severally liable for the company's debts contracted during that period. See Section 31 1948 Act.

the affairs of the company by the Board of Trade or to the company in general meeting to appoint its own inspector. 1/ Apart from this one instance of inspection by the Board of Trade, the general policy of Parliament was one of non-interference in the relations between shareholders and directors in the management of their company. The oft-quoted Robert Lowe, the then President of the Board of Trade, explained during a Parliamentary debate the reason for this attitude:

> "to interfere with and abridge men's liberty, to undertake to do for them what they can do for themselves... is helping the fraudulent to mislead them.... The only way that the Legislature should interfere is by giving the greatest publicity to the affairs of such companies, that everyone may know on what grounds he is dealing".

And

> "Having given them a pattern the State leaves them to manage their own affairs and has no desire to force on these little republics any particular constitution". 2/

This liberty scarcely benefitted the small shareholders but allowed the directors to dominate them. But to Robert Lowe, this was *laissez-faire*. 3/

1/ The equivalent provision now is Section 164 of the 1948 Act which requires the Board to appoint an inspector on the application of 200 members holding not less than one-tenth of issued capital. Part III of the 1856 Act contained provisions relating to winding-up.

2/ Parliamentary Debates (H.C.). CXL (1856), 110-38, passim.

3/ J.B.Jeffreys' work attempts to account for the way the pattern of internal organisation during the second half of the last century was influenced by prevailing economic ideology and attitudes. See in particular, Chapter IX.

(iii) The 1862 Act and After.

With the foundation of modern Company Law having been laid by the 1856 Act it continued in operation until 1862 when the next major Companies Act was passed. 1/ It was with the passing of this Act that the joint stock company formally assumed the structure which has survived to the present day. It must be mentioned again that this Act did not create but only formally incorporated into Statute the pre-existing structure for corporate governance. Current terminology such as the board of directors, annual general meeting and auditors appeared with statutory force, replacing the older terminology. 2/ Shareholders and their rights became well defined. The conditions for granting limited liability were also spelt out. The model sets of articles contained in Table B of the 1856 Act was to appear for the first time in Table A of the First Schedule and it has remained there ever since.

The major significance of this Act was that it made company law very clear and provided a simple method of incorporation and an elastic framework for the constitution and management of companies. 3/

1/ The full title was "An Act for the incorporation, regulation, and winding-up of trading companies and other associations". 25, 26 Victoria C.89.

2/ See pp.7 - 9 supra. J.B. Jeffreys suggests that the substitution of the word "shareholder" for "proprietor" or "adventurer" was not just a matter of semantics but was designed to reflect the idea that investors in large companies did not in fact undertake in the "adventures" and were not "propertied" as such but only held shares in the companies. p. 39.

3/ See A.B. Levy, Private Corporations And Their Control. (1950), p.82. (To be cited henceforth as A.B. Levy).

Some of the most important provisions of this Act include that which maintained the principle that the liability of shareholders may be limited by the memorandum of association to the amount of the par value of their shares (S.7). By Section 12 any company limited by shares was empowered to alter its memorandum of association if authorised to do so by its original Regulations or by a special resolution in general meeting. The company could also by a special resolution increase its capital, by the issue of new shares or consolidate and divide its capital into shares of larger amounts than its existing shares or convert its paid-up shares into stock. Power was also conferred by Section 13 for a company to change its name by a special resolution but the approval of the Board of Trade was required in addition.

In respect of a Company limited by shares it was provided that if the Memorandum of association was not accompanied by the articles of association or in so far as the articles did not exclude or modify the Regulations contained in Table A contained in the First Schedule to the Act, that Table would so far as it was applicable be deemed to be the Regulations of the Company (S.15)

With regard to the membership of the company it was provided that the subscribers of the memorandum of association of any company under the Act shall be deemed to have agreed to become members of the company whose memorandum they have subscribed, and upon the registration of the company shall be entered as members on the Register of members. Membership could be extended to every other person who had agreed to become a member of a company under the Act and whose name was entered on the register of members (S.23).

It was made compulsory under the Act for every company to keep a register of its members. Amongst the information to be contained in the register were the names, addresses and occupations, if any, of members, a statement of the shares held by each member distinguishing each share by its number [1/] and the amount paid or agreed to be paid on each share by each member. Other particulars to be entered in the register included the date at which the name of any person was entered into the register as a member and the date at which such person ceased to be a member (S.25).

By Section 26 an Annual list of members was required to be compiled on the fourteenth day after the day on which the first or only general meeting for that year was held. This list and a summary of certain particulars about the membership were to be contained in a separate part of the register and be completed within seven days after the fourteenth day and a copy forwarded forthwith to the Registrar of Companies (S.26). Penalty on a company for failure to keep a proper register was a fine not exceeding five pounds for every day during which the default continued. Every director and manager of the Company who knowingly or wilfully authorized or permitted such default were to incur the like penalty (S.27).

1/ One important reason for this requirement was to provide the means of knowing the extent of directors' personal interests as a yardstick for measuring the risks in investing in a company because it was believed that the companies in which directors had heavy investments tended to be better managed and less susceptible to bankruptcies.

This Act maintained that only registered shareholders are deemed to be members of the Company by providing that "no notice of any Trust, expressed, implied, or Constructive shall be entered on the register" (S.30).

Companies were required to keep a register in respect of mortgages and other charges which register must be open to inspection by any creditor or member of the Company at all reasonable times. Every director or manager who knowingly and wilfully authorized or permitted the omission of such entry was punishable by a fine not exceeding £50 and a further penalty not exceeding £2 for every day during which such refusal continued. In addition to such penalties an order could be made by a Judge in special circumstances to compel an immediate inspection of the register (S.43). These stringent provisions were necessary in view of the widespread financing of companies by the issue of preferred shares and debentures with special securities which was prevalent at this period. However, the right to inspect was exercisable only by members and creditors and other members of the public were not covered by the section.

Certain companies (that is, banks and Insurance companies) were required to publish a statement in a form contained in the First Schedule copies of which were to be made available to members and creditors on payment of a sum not exceeding six pence (S.44). Companies without share capital were required to keep at their registered office a Register containing the names, addresses and occupation of their directors and managers and to send a copy of such register to the Registrar of Companies.

Any changes in such directors and managers were to be notified to the Registrar from time to time (S.45). If any Company required to keep such a register failed to keep one or notify the Registrar of any changes such delinquent company became liable to a fine not exceeding five pounds for every day for which the default continued and every director and manager of the company who knowingly and wilfully authorized or permitted the default incurred a like penalty (S.46).

The general objective of protecting the company's members was ensured in the Act by specific provisions for this purpose in Sections 49 - 61, which include some provisions that had been introduced by earlier Acts. 1/

One innovation introduced by this Act was the power given to the Court on the application of a liquidator, shareholder or creditor to investigate the conduct of any past or present director, manager, liquidator or officer of the Company. If it found that such person has misapplied or retained, or became liable to account for any monies of the company, the Court could compel him to repay the sum involved and for which he was accountable, together with interest at a rate determined by the court, or, to contribute such sum of money to the assets of the company by way of compensation in respect of the sum in question or for breach of trust, as the court deemed fit (S.165).

1/ For instance, the provisions for investigation by the Board of Trade which were first introduced in the 1856 Act.

The 1862 Act contained some other novel provisions in regard to companies limited by guarantee and unincorporated companies which we cannot go into here. It is to be regretted, however, that the legislature did not seize the opportunity in this Act to introduce provisions to strengthen control by members. Some of the most far-reaching provisions were, curiously enough, of restricted application only. 1/ The Act set out in the main to regulate relations between shareholders and those they appoint to look after their interests, but, as well as many other major Acts since then it failed to add anything substantial to the Company's organisational structure. 2/ It may well be that the existing structure served its purpose adequately and so there was no reason for any modification or "tinkering". 3/ As the Loreburn Committee 4/ said of the 1862 Act in 1906, it gave:

> "an immense stimulus to commercial enterprises. Under this system British trade has widely developed and the wealth of the community has been largely augmented... the number of persons interested as shareholders, debenture holders, stockholders, customers, creditors and employees are legion".

1/ For example, Section 44. See Supra.

2/ See J.B. Jeffreys, 394.

3/ See Hunt, 27 and P.L. Payne, 17.

4/ Cd. 3052 (1906).

Although British trade undoubtedly expanded in the post-1862 period this was not, one may say, because the system of organisation of companies operated so efficiently and effectively, but in spite of it. Shareholders were neither willing nor able to exercise control over directors and directors did not in general perform their duties honestly.

The general character of the 1862 Act may be explained by the fact that it was essentially designed to consolidate the earlier Acts of 1856, 1855 and, to some extent, 1844 and there was not much scope for entirely new formulations. Nevertheless, there were important areas where the Act should have at least effected some pressing reforms but did not.

A major weakness which quickly became apparent in company legislations was the inadequacy of rules as to accounts. Although the 1844 Act had made certain provisions for compulsory auditing this was abolished by the 1856 Act which made it a discretionary matter by placing the requirement in Table B of the Act. 1/

1/ Articles 69-73 dealt with accounts while articles 74-84 dealt with audits. By some curious irony it was the same Robert Lowe who in 1854 emphasised before the Royal Commission the necessity of full publicity as to accounts and auditing, who nevertheless as President of the Board of Trade introduced the Bill which dispensed with the compulsory appointment of auditors under the 1856 Act. See A.B. Levy, 76 and p. 22 *Supra*.

The 1862 Act adopted the same approach as the 1856 Act in respect of this question although here Table B of that Act became the new Table A. Having missed the opportunity in this Act to introduce new rules for Company accounts successive attempts to do this achieved very little success until several years afterwards. However, before proceeding further to discuss the difficulties brought about by this omission, a distinction has to be drawn between the two types of companies that operated, for the system of control between them differed.

The first type of companies were the so-called "home industrials" in which shares were not easily marketable or transferable. In most of them the shareholders were few and mostly wealthy and the control exercised by them over the directors was of a personal nature since every investor had good knowledge of those elected to the Board of Management. These men were persons who themselves had great financial and personal interests in the success of the Company.

The second type of Companies were those constituted by a thousand or more shareholders. Amongst these companies were to be found railways, docks, gas, water, telegraph and some shipping companies as well as Joint Stock Banks. Of these companies it was said, "the properietors throw up the reins and leave them in the hands of the directors". 1/

1/ Bankers Magazine (1860). Vol XX, p.411, cited by Jeffreys, at 408.

According to one commentator,"Theoretically speaking and in the eyes of the law shareholders are all powerful - this is a legal fiction; practically it is the reverse". 1/ And according to another, "the shareholders look mainly to the dividend paid and care little how it may have been earned". 2/

A leading company solicitor observed of shareholders in 1877:

> "So long as a company pays dividends and everything goes smoothly, one-twentieth of the shareholders only attend the meetings and you cannot get more of them to do so. Directly you get into difficulties the proportion increases; you get a fifth or a sixth; but by all the power in the world you could not generally get half". 3/

Several attempts were made to improve shareholders' control over the direction of large companies through such means as attendance at meetings. Voting by proxy was being encouraged and during the eighteen seventies most books dealing with details of company administration had a section on the use of proxies and often a fascimile form was incorporated for company directors to copy. There were suggestions that shorthand notes of the deliberations at general meetings should be sent to all the members and for a sort of "compulsory balance sheet" of the company's performances to be circulated by companies to their shareholders. These ideas never really took off.

1/ Herepath's Jounal, (1867), p.363, cited by Jeffreys, 409.

2/ The Economists (1887), p.107, cited by Jeffreys, Ibid.

3/ John Morris, Report of the Select Committee on the Companies Acts of 1862 and 1867, VIII (1877) Evidence Q.975.

The organisation of "Shareholders Protection Associations" were a favourite suggestion proffered by, among others, the "Shareholders Guardian". In 1864 it proposed the idea and a shareholder replied, expressing agreement that "the value and importance of your suggestion that shareholders should combine for mutual defence ... cannot be over-estimated". 1/ But after pushing and advertising the idea for six months, writes J.B. Jeffreys 2/ "the editor had to announce reluctantly thatone could not be formed owing to lack of consistent support from the investors. The scope of the association was too great, and the London shareholders were too much concerned with dividends and premiums".

Common suggestions for increasing shareholders'influence in the governance of their companies which were thought more practicable include one, for example, which called for more effective use of auditors: "Find honest auditors, pay them liberally, make them do their duty.... encourage them to sift boldly and to speak freely." 3/ This did not provequite effective because although the election of auditors by shareholders did increase after the 1862 Act their services to the shareholders were doubtful and it was difficult to find "an honest accountant's certificate honestly applied" to a document. 4/

1/ See Jeffreys, 401.

2/ Ibid

3/ See Ibid.

4/ See Jeffreys, 402, quoting from The Statist (1887) Vol.284.

Another suggestion was for shareholders to keep a more watchful eye on their directors. As one writer put it in 1863, "under the circumstances the statute itself (1862) will afford very little security to members of a company .... this will .... consist in their ascertaining that the Directors and Officers managing its affairs are honest and able men". 1/ Here again, there were many directors who could not in truth be regarded as honest or able, but only lent their names to be used by promoters in prospectuses in order to attract investors. These were the so-called "guinea-pig" directors for their rewards were payment in guineas. From being "agents" appointed by the members to protect their interests the function of directors in these companies became that of a "decoy", 2/ and, in some cases, "dummies". 3/

By the eighteen-nineties the attempts to improve shareholders' control and to reform the general meetings had begun to lose their steam, and the chief protagonists began to lose hope. By 1884 one popular advocate of shareholders' collective action came to accept the conclusion that "shareholders as a body are scarcely capable of effective action". 4/ It became generally agreed that shareholders' meetings were a farce due to proxies. "In effect the chief use of the proxy is to shield maladministration, to baulk enquiry, to thwart reform and its legitimate use is relatively so trifling that it would be better done away with altogether". And "no abuse is more common in the management of companies than the proxy one". 5/ The Legislature failed to come to the rescue

1/ Ibid

2/ Ibid, at 437.

3/ See Jeffreys at 424

4/ Ibid at 429

5/ Ibid

believing that all that was necessary was to ensure increased publicity of companies' accounts for the benefit of both shareholders and creditors.

It has been seen that the motivation behind the earlier Acts was to protect investors and creditors from fraudulent pomoters and reckless directors in the light of the crisis that had plagued many companies, especially banks, which went bankrupt. The slump in commercial activities in 1867 and widespread dissatisfaction with the effectiveness of the 1862 Act in serving its purpose gave rise to demands for reform which led to the passing of the 1867 Amendment Act. 1/

In order to protect the public against fraudulent promotions it was required by Section 38 of this Act that every prospectus of a company and every notice inviting the public to subscribe for shares in any company must specify the dates and names of the parties to any contract entered into by the company, or the promoters, or trustee, before the issue of the prospectus or notice. Any prospectus or notice which failed to specify the aforementioned information was prima facie regarded as fraudulent on the part of the promoters, directors and officers of the Company issuing it as regards persons acting on such prospectus in good faith and without notice. This provision proved less useful than might have been expected because, firstly, there was no obligation to disclose the contents of the contracts in question and merely to disclose the names of the parties to a contract without also disclosing what the contracts involved served very little practical purpose. Secondly, (and nevertheless) promoters and directors resorted to the evasive device of inserting

1/ 30 and 31 Vict., c. 131.

in the prospectus or form of subscription a clause by which the subscriber waived such disclosure. This more or less destroyed whatever protection might have been intended by this Amendment Act. 1/

No matter that such disclosure provisions proved an ineffective protection against fraud from promoters and directors the continued emphasis by the legislature for increased and improved publicity over a new structural system of control over directors was not in doubt. At the deliberations of the Select Committee on the Companies Act in 1867 a member explained the importance of publicity in a limited liability company in the following words:

> "A limited liability Company trades upon publicity. The whole essence of limited liability is publicity. They are compelled to publish their accounts and their reports, and to register their shareholders, and so on. That being so, the more effective the publicity is made, the more completely the intention of the Act is carried out". 2/

1/ Other important aspects of the Act involve the requirements that a reduction of capital was to depend not only on a special resolution in general meeting but also on an order of the Court. Creditors had a right to object to the reduction. See Sections 9-11.

2/ William Newmarch, Report of the Select Committee on the Companies Act, X (1867). Q. 1093. It is to be noted, however, that under the 1862 Act then in force the auditing of accounts was no longer compulsory and was not to be until its re-introduction in the 1900 Act.

The failure to achieve adequate publicity were to be corrected in future legislation.

Under the 1867 Act provision had been made for the reduction of capital by a special resolution in general meeting subject to confirmation by an order of the court and the creditors retained a right to object to such reduction. Doubts arose, however, whether the capital of a company could be reduced if it had been paid up. The 1877 Act [1/] was passed mainly to resolve this question. The Act provided that any Company may reduce its capital in so far as in consequence of losses or otherwise there is a discrepancy between the nominal capital and the value of the assets, or by making partial repayments of amounts paid up, or by reducing the shareholders' liability. The reduction was to be effected by special resolution subject to approval by the court.

The reform introduced by this Act was followed by a crisis which led to the insolvency of many companies, most especially banks, one of the most damaging of which was the insolvency of the City of

---

2/ 40 and 41 Vic., c. 76.

Glasgow Bank. [1/] Public opinion called for a reform of Company Law to prevent future failures of similar scale. Consequently, the 1879 Act[2/] was passed.

The 1879 Act was meant to apply to every joint stock company[3/] but in view of the fact that banks depositors were most in need of the

---

1/ The period 1874-79 was marked by a famous depression which resulted from a combination of several factors. These included the maintenance of higher purchasing power in Britain, with bad harvests at home, and relatively falling exports which, until 1877, created a growing net balance of imports; a greater fall in the price of Britain's capital-goods exports than her consumption-goods imports; an unfavourable American exchange rate; gold purchases from Paris and Berlin; and, internally, the crash of the City of Glasgow Bank which generated suspicions of the banking systems!

The celebrated crash of that Bank appears from the investigators' report to have resulted from its granting of credits amounting to about £6,000,000 to a small number of firms, disregarding the principle of distributing risks, and the deception of shareholders by over-stating the value of the Bank's gold reserves and reserve funds and making false entries in the balance-sheets. The Bank's directors, manager and secretary were later convicted for fraud. For a history of the depression 1874-79, see W.W. Rostow, British Economy of the Nineteenth Century. (1947) Chapter IX. For details about the City of Glasgow Bank's and other companies' failures see A.W. Kerr, History of Banking in Scotland. (1902), Chapter XXV. See also A.B. Levy, 116. For the discussion in this thesis of post-1877 legislation until the 1927 Act I am highly indebted to that author.

2/ 42 and 43 Vic. c. 76.

3/ This can be seen from its full title which reads: "An Act to amend the Law with respect to the Liability of Members of Banking and other Joint Stock Companies; and for other purposes".

protection it offered, it is not suprising that few companies other than banks availed themselves of its provisions. However, some of the provisions like those relating to audits were expressly restricted to banks alone.

For banks 1/ the Act introduced compulsory audits, thus re-introducing, albeit, to a limited extent the provisions for compulsory audits which first appeared in 1844. By Section 7 it was provided that at least once a year the accounts of every bank registered as a limited company must be examined by an auditor or auditors to be elected annually by the general meeting (S.7(1)). A director or officer of the company could not be eligible for appointment (S.7(2)) but an auditor quitting office could be re-elected (S.7(3)). If any casual vacancy occurred in the office of any auditor the surviving auditor or auditors could act but if there was no surviving auditor, the directors were to call an extra-ordinary general meeting for the purpose of filling the vacancy or vacancies (S.7(4)). Every auditor was expected to have delivered to him a list of all books kept by the company and was entitled to have access to the books and accounts of the company, any auditor could examine the directors or any other officer of the company. In the case of branches operating outside Europe the submission of copies and extracts from the books which have been transmitted to the company's head office in the United Kingdom sufficed (S.7(5)).

1/ Except the Bank of England.

Although there had been no compulsory requirements for the keeping of balance sheets since the 1856 Act Section 7(6) of the 1879 Act required the auditor or auditors of banks to make a report to the members on the accounts examined by him or them, and on every balance sheet laid before the company in general meeting. In every such report it shall be stated whether, in his or their opinion, the balance sheet referred to in the report is a full and fair balance sheet properly drawn up, so as to exhibit a true and correct view of the state of the company's affairs, as shown by the books of the company. Such report was required to be read before the company in general meeting.

By Section 8 every balance sheet submitted to the annual or other meeting of the members of every banking company registered after the passing of the Act as a limited company must be signed by the auditor or auditors, and by the secretary or manager (if any) and by the directors of the company or at least three of such directors.

The effect of the 1879 Act was to boost public confidence in the limited liability system which had fallen in the depression of the seventies: 1874-79. 1/ This revival was most marked in the Banking business, for by the end of 1883 fewer than ten banks maintained unlimited liability.

The decade 1881-90 witnessed stupendous growth for companies both in numbers and assets. For example in 1888 new registrations amounted

1/ See M. Gaskin, The Scottish Banks: A Modern Survey, (1965), p. 57.

to £353 millions, in 1889 to £241 millions and in 1890 to £238 millions. However, this growth was accompanied by an increase in the number of reckless promotions, some of which turned out to be mere bubbles. For example, in 1882 a company was formed to carry on business of any kind with a nominal capital of £12 millions in which only 20 one-pound shares were issued. Another with similarly extensive aims had a nominal capital of £10 millions.

In view of the concern generated by these reckless schemes it was thought that promoters and directors might be more careful if they had high personal stakes in the schemes. Thus in 1888 a new Companies Bill was presented which required that directors should have between them one-fifth of the total capital of the company. It was not enacted.

However, the 1890 Act [1/] succeeded in introducing liability for untrue statements in prospectuses. It was provided in Section 3 of the Act that directors and others who took part in the issue of prospectuses and notices inviting persons to take shares or debentures were liable to compensate persons who subscribed or purchased such shares or debentures on the faith of false statements. Liability was excluded, however, if, for example, the person concerned had reasonable ground to believe the statement true or if the statement was based on the opinion of an expert or official document which had been fairly represented. Where the name of a person had been improperly inserted as a director in the prospectus , that person was entitled to be indemnified by the person who authorised the issue of the statement (S.4).

1/ 53&54 Vic., c.64. "An Act to amend the Law relating to the Liability of Directors and others for Statements in Prospectuses and other Documents Soliciting application for Shares or Debentures".

Another Act passed in the same year [1] made it possible for a Company to alter its objects or form a constitution subject to confirmation by the court. Until the passing of this Act the law was that such an alteration could not be made unless on liquidation or reconstruction. [2] The new provisions can be seen therefore as an attempt to enhance the power of shareholders to determine whether to change the nature of the company's business and if so what new form of venture to go into. Some protection was afforded the minority by a provision whereby the court was empowered to adjourn the proceedings in order that an arrangement may be made to the satisfaction of the court for the purchase of the interests of dissentient members (S.1(4)).

The 1890s witnessed the cyclical pattern of recession and business boom which had characterised earlier decades. This decade began with a depression which peaked in 1893 but with the development of South African mining there came an improvement in economic conditions and a resurgence in company promotions which, not surprisingly, also gave rise to a new wave of reckless promotions. One interesting example cited by A.B. Levy [3] is that of the Ancient Goldfields of Africa which was registered with a capital of £10,000 divided into 9,600,000 shares of one farthing, but of which only a small fraction was ever issued. Public resentment against the abuses and excesses of promoters and company directors led to the setting

---

1/ 53 and 54 Vic., c. 62.

2/ The power of Companies freely to alter their memorandums of association under S.12 of the 1862 Act did not include the alteration of objects.

3/ At p. 120.

up of a Committee to amend the existing Companies Act. A Bill was tabled before the House of Lords Committee which would make the directors liable for false balance sheets and prospectuses but this met with strong opposition by the promoting interests who argued, firstly, that the director's role was not that of manager or accountant, but was merely to be consulted about the running of the company. Secondly, it was argued that if the Bill were passed the provisions will be so onerous that "honest" directors would decline the risk of directing a company and dishonest men with nothing to lose would take their places. 1/

Concurrent with the attempts to check the abuses of reckless promotion was the effort to improve the system of accountability of directors. In the 1890s the campaign for greater publicity also encountered stiff opposition especially from members and directors of "private" limited companies who did not wish to make public the state of their businesses. The attempt to introduce the balance sheet, for example, faced such a fierce and confused opposition that the Associated Chambers of Commerce at its Annual Conference in 1898, after years of preliminary discussions found themselves so completely divided on the subject that it was decided better to make no mention of the subject at all at the Conference. 2/ The usual compromise suggestion was that it should be left to the discretion of the company whether a balance sheet should be issued or not. However, the evidence available showed that many companies

---

1/ See J.B. Jeffreys, p. 431-432.

2/ See The Chamber of Commerce Journal, "Report of Annual Conference of Associated Chamber of Commerce", (1898) cited by J.B. Jeffreys, 433.

invited public subscription to preference shares and debentures amounting to several millions of pounds without issuing any balance sheets. In some other companies where the public had been invited to subscribe for ordinary shares the directors often convinced the shareholders into accepting non-disclosure with the argument that the publication of any information on the level of a company's profits was bound to encourage competition and labour disputes. For example, during the deliberations of the Company Law Select Committee in 1898, an amendment was proposed to "send a copy of the balance-sheet to the registrar within 30 days after the general meeting" but this was opposed. One B. Palmer in objection to the suggestion gave the following as his reasons:

> "I object altogether to it, I may remind your Lordships that when the Committee of the House of Commons in 1877 sat, Mr. John Morris, of the firm of Ashhurst & Co, a gentleman well known in connection with the formation of companies mentioned then that members of companies had been registered, but only on the assurance that it would not be necessary to disclose their private balance sheets; and there are undoubtedly an enormous number of companies who would object strongly to disclosing in a public office their private affairs; and even in the case of a public company it would sometimes be a very dangerous thing, because it is onething to put the balance sheet in the hands of the shareholders, supposing there are a couple of hundred of them (quite a public company in that sense), who are interested in their own business and keep it to themselves; but that it should get into everybody's hands that everybody is at liberty to go and search into the affairs of the Company and see what sort of business it is doing, in these days of competition would never do. I repeatedly have before me companies whose great difficulty is the excessive profit they are making and the danger of competition; and yet all these people are to be placed in the dangerous position of being obliged to let it all out. Again and again I have had companies that have been obliged to reconstruct in order to capitalise the great mass of profits latent in the business in order to meet the labour difficulties or otherwise". 1/

1/ Report of the Select Committee on the Companies Act, IX (1898) Q.681. See also the quotations by Guy Naylor in Guide To Shareholders' Rights. (1969), pp. 120-121.

The outcome of all these arguments about publicity were borne out in the next Companies Act which was passed in 1900. [1] The main provisions of this amending Act related to the creation of companies and the re-introduction of compulsory auditing for all registered companies, thus extending the provisions of the 1879 Act which related to banks only.

By Section 21 every company was required at each annual general meeting to appoint an auditor or auditors to hold office until the next AGM (S.21(1)). If this had not been done, the Board of Trade could on the application of any member of the company appoint an auditor of the company for the current year and fix his remuneration. A director was precluded from being appointed auditor of the company but the first auditors could be appointed by the directors before the first statutory meeting and directors were empowered to fill a casual vacancy in the office of an auditor. The remuneration of the auditors' was to be fixed by the company in general meeting or in the case of auditors appointed before the statutory meeting by the directors (S.22). Every auditor of a company was given a right of access at all times to the books and accounts and vouchers of the company, and was empowered to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors, and the auditors would sign a certificate at the foot of the balance sheet stating whether or not all their requirements as auditors have been complied with. The auditors were then to make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in

---

1/ 63 and 64 Vic., c. 48.

general meeting during their tenure of office; and it was to be stated in every such report whether, in their opinion, the balance sheet referred to in the report had been properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company. The report was required to be read before the company in general meeting (S.23).

Section 28 provided that if any person in any return, report, certificate, balance sheet or other document, required under the Act, wilfully made a statement false in any material particular, knowing it to be false, he would be guilty of a misdemeanor and be liable to imprisonment for a term not exceeding two years or to a fine in lieu of or in addition to imprisonment.

With regard to the provision relating to audits this Act is important for restoring the requirements of the 1844 Act which had been repealed in 1856. It is remarkable however that the previous Act had been criticised for not containing provisions as to the form and contents of the balance sheets and the fact that auditors had no directions to govern their work. It is regrettable that once again the legislature missed the opportunity to introduce these matters in the new Act.

Other important provisions of this Act include those which introduced more details as to the contents of prospectus. 1/ Non-compliance with the requirements rendered the director or person responsible for the

---

1/ Sections 9-11.

prospectus liable for any omissions, unless he could prove that he was not cognisant of the matter not disclosed or that the non-compliance arose from an honest mistake of fact on his part (S.10(7)). Clauses which waived the requirements for disclosure under the Act were rendered void.

It was made necessary under the Act to file every mortgage or charges with the registrar in order to be valid (S.14).

With regard to the management of the company it was provided by Section 13 that the directors of a company must on the requisition of the holders of not less than one-tenth of the issued capital of the company upon which all calls or other sums then due have been paid, forthwith proceed to convene an extraordinary general meeting of the company (S.13). This section was a major attempt to give the members more opportunity to intervene in the decision-making process by seizing the initiative from management in appropriate circumstances.

The directors were also required to convene a statutory meeting to consider among, other things, the total number of share allotted and the total amount of cash received by the company in respect of such shares (S.12).

The method of appointment and qualification of directors was provided for in Sections 2 and 3. These required, *inter alia* that the directors must declare their consent to act, which declaration must be filed with the Registrar. If under the company's memorandum and articles of association directors need to have a share qualification it must be stated that they have complied with this requirement, but the Act itself did not require any share qualification if none was required by the articles.

The beneficial effects of the Act can be seen from the increase once again of the number of new registrations although the nominal capital of these Companies was constantly diminishing. This was probably due to the fact that the new registrations comprised mainly of "one-man" companies [1/] engaged mainly in the retail business. The increase in the number of small companies was paralleled by an almost equal increase in the number of liquidations. The Legislature intervened in 1907 by enacting two Acts, the first [2/], to make it possible to register partnerships in which one or more partners limited their liability to a specified amount, and so making it unnecessary to form a limited liability company. The second Act [3/] was more important in that it regulated the private companies as a new type of business entity and introduced further amendments to the Companies Acts 1862 to 1900.

So far as it is relevant here, this Act introduced supplements to the rules relating to mortgages and other charges. The right to inspect the debenture register was granted to debenture holders (SS.10-18).

1/ That is, companies in which the former owner of the enterprise took up the whole capital.

2/ The Limited Partnership Act (1907), 7 Edw., VII c. 24.

3/ Companies (Amendment) Act (1907) 7 Edw., VII c. 50.

Section 23 of the 1900 Act was repealed by Section 19 which strengthened the position of auditors by giving them power to require information from the directors, and to state in their report whether they have received the information demanded, and whether in their opinion the balance sheet referred to in the report had been properly drawn up. Companies could appoint auditors other than the retiring ones in general meeting only if previous notice had been given to the general meeting.

The annual statement to be filed with the Registrar as required under Section 26 of the 1862 Act was required to be in the form of a balance sheet in so far as it related to the state of the company. But the balance sheet need not include a profit and loss account (S.21). In view of the fact that the profit and loss account has traditionally been more comprehensible than the balance sheet [1/] one wonders why the legislature should have thought it fit to exclude the profit and loss

---

1/ The function of the balance sheet is to show in monetary terms the capital, reserves and liabilities of a business as at the date at which it is prepared and the manner in which total money representing them have been distributed over the different types of assets. This is meant to serve as a statement of the assets and liabilities of the company at a specific point of time. The profit and loss account on the other hand shows as profit or loss the difference between the revenue for the period covered by the accounts and the expenditure chargeable in that period. This serves as an historical record of events in the period covered. See The Report of the Company Law Committee under the Chairmanship of Lord Jenkins (1962) Cmnd 1749, para. 333. These documents and the method of their preparation involve a lot of technicalities which make them difficult for the layman to understand. For details about the nature and purposes of each of these documents, See Gower's Principles of Modern Company Law, 4th Edition (1979), pp.507-515 and Pennington's Company Law, 4th Edition (1979), pp.616-627. For more specialised literature, see A.G. Touche, Accounting Requirements of the Companies Acts, (1967), and Robert Willott, Current Accounting Law and Practice, (1978).

account from the annual statement. A proviso to the section also excluded private companies from its application.

Other important provisions include the right of preference shareholders and debenture holders to receive and inspect the balance sheets of the company and the reports of the auditors and other reports as are possessed by ordinary shareholders. Again private companies were excluded from the application of the section (S.23).

General meetings were to be held at least once in every calendar year and not more than 15 months after the previous meeting (S.24). A poll may be demanded at a meeting at which a special resolution was submitted to be passed or confirmed, if demanded by at least three members entitled to vote or by five members if so specified by the articles.

The 1907 Act was in force for a brief period only, six months to be precise, until the passing of the 1908 Act [1/] to consolidate all the Companies Acts from 1862 to 1907. The 1908 Act was a comprehensive code of Company law and the pattern set by it was followed by the next Consolidation Acts of 1929 and 1948. However, the pre-existing structure for corporate governance remained substantially unchanged by it except that the system of publicity and accountability had become greatly refined. Thus, the earlier emphasis and focus in the 1860s and 1880s on proposals to strengthen shareholders' involvement in corporate governance, by for example, forming collective organisations and protection committees

---

1/ 8 Edw. VII, c. 69.

was replaced at the turn of the century by greater concern and emphasis on the issue of less "coloured" prospectuses and the publication of the balance sheets. Compared with those earlier Acts which contained virtually nothing on the above issues the 1908 Act can be said to have taken tremendous steps toward protecting investors and creditors. However, the contents of companies accounts were often inadequate as the requirements of the Acts were often disregarded by companies' directors. This, among other reasons, led to the passing of the 1929 Act.

Before proceeding to discuss the few major changes effected in companies organisational structure in the post-1929 period it is important to reiterate at this point, that the history of company legislation up to the end of the nineteenth century reveals a pre-eminent concern by the legislature over the protection and safeguarding of the interests of shareholders and creditors respectively 1/,"with an ever increasing degree of strictness," 2/ by introducing rules to regulate commercial enterprises. These rules, however, did not increase the control which shareholders exercised over the board of directors.

> "And although Table A contained admirable precepts for their guidance, directors seem to have been governed to a large extent in the selection of information to be made public, by a paternal notion that they knew best what shareholders ought to want. Protests of shareholders have in practice served only to confirm directors in their opinion of the unfitness of shareholders to make decisions which directors were always perfectly willing to make for them." 3/

1/ See Hunt, 139.

2/ See Holdsworth, Vol. 15, p. 60.

3/ Hunt, *ibid*.

The decade 1920-29 started with a boom which was quickly followed by a slump and a long depression. Once again public opinion was aroused as a result of the large number of fraudulent promotions and the evidence of mismanagement which were revealed. As economic recovery set in in 1925 a Committee was appointed under the Chairmanship of Mr. Wilfred Greene, K.C. (later Lord Greene) [1/] to propose reforms of Company law. This committee reported in 1926 proposing a substantial number of recommendations but it adopted a rather cautious approach and proposed little radical change to the existing organisational structure of companies. Only a part of these recommendations found their way into the 1928 Act. [2/] This Act was consolidated in the 1929 Act. [3/]

Amongst the most important provisions of this Act mention must be made of the steps taken to protect the rights of minorities from improper alteration of the memorandum. By Sections 4 and 5 of the Act a company could alter its memorandum by special resolution but subject to confirmation by the court. In exercising its discretion whether or not to confirm such alteration regard was to be had to the interest of dissentient shareholders or creditors. The Act introduced special procedure for the passing of extraordinary and special resolutions (S.117) and winding up. [4/]

1/ Cmd 2657 (1926).

2/ 184.19 Geo., V. c. 45

3/ 19 and 20 Geo. V. c.23.

4/ See Section 156 and Part V generally.

Detailed provisions as to accounts and audits were spelt out in sections 112 to 134. Section 122 provided that every company must keep proper books of account with respect to all sums of money received and expended by the company and the purpose of such receipts and expenditure, all sales and purchases of goods by the company and the assets and liabilities of the company. The books which must be kept at the company's registered office or any other place designated by the directors must at all times be open to inspection by the directors. Failure by any director to take all reasonable steps to secure compliance by the company with the above requirements or any wilful neglect by a director to secure compliance rendered him liable to punishment. The directors of every company were required to lay before the company in general meeting a profit and loss account at a date not later than eighteen months after the incorporation of the company or at least once every calendar year (S.123(1)). They were also required to cause to be made out in every calender year, and to be laid before the company in general meeting, a balance sheet as at the date to which the profit and loss account, or the income and expenditure account is made up. Every such balance sheet was to be accompanied by a report by the directors with respect to the state of the company's affairs, the amount, if any, which they recommend should be paid as dividend, and the amount if any, which they propose to carry to the reserve fund, general reserve or reserve account shown specifically on the present or a subsequent balance sheet (S.123(2)). Any wilful refusal to comply with the provisions rendered the defaulting director liable to up to six months imprisonment or a fine not exceeding two hundred pounds (S.123(3)).

Section 124 enumerated the matters which were to be contained in the balance sheets such as the company's authorised and issued capital, and its assets and liability. Also to be disclosed were the assets of a company consisting of shares owing from a subsidiary or subsidiary companies but these had to be set out separately in the balance sheet (S.125). Where also a holding company held shares in a subsidiary company a statement of this holding was required to be annexed to the balance sheet (S.126).

Other general information to be contained in a company's accounts included particulars as to loans made to and renumeration paid to directors for their services or other emoluments paid to or received by them or from the company or its subsidiary (S.128).

The balance sheet was required to be signed by two directors or sole director, if that was the case, on behalf of the board and the auditors' report must be attached to the balance sheet, which report must be read before the company in general meeting and be open to inspection by the members (S.129).

With the exception of private companies every person entitled to receive notice of general meetings of a company must be furnished with a copy of every balance sheet and other documents required to be annexed to it at least seven days before the general meeting at which it was to be laid (S.130(1)(a)). In addition every member and debenture holder whether or not they were entitled to be sent copies of the balance sheets must be furnished on demand and without charge with a copy of the last balance sheet of the company including every document required by law to be annexed to it, together with a copy of the auditors' report on the balance sheet. Failure to comply with the above requirements rendered the director, manager, secretary or other defaulting officer of the company liable to punishment (S.130(1)).

Section 132 provided for the appointment and remuneration of auditors and their right to attend general meetings. Section 133 set out those disqualified from appointment as auditor and these included not only directors and officers of the company, but partners of or in the employment of an officer of the company and any body corporate. The position of auditors was strengthened by section 134 which entitled them to attend any general meeting of the company at which any accounts which have been examined or reported on by them were to be laid and to make any statement or explanation they desired with respect to the accounts.

The Board of Trade was also empowered to appoint inspectors and to investigate the affairs of a company (S.135).

In order to meet the practical need for reconstructions and amalgamations which were prevalent it was provided for the purpose of facilitating such arrangements that companies may by special resolution insert a clause in their articles giving power to sell the whole undertaking, or to amalgamate (S.154). Where such a scheme had been approved by the company appropriate arrangements could be made to acquire the shares of dissenting shareholders.

The "cautious" approach of the Greene Committee contrasts with the "radical" one of the Cohen Committee [1/] appointed on June 26 1943,

> "to consider and report what major amendments are desirable in the Companies Act 1929, and in particular to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest." [2/]

The Committee reported a number of defects in the 1929 Act. Regarding the availability of information to shareholders in companies accounts and reports, it was found that the legal requirements as to the contents of accounts to be presented to shareholders was too meagre. They referred specifically to the absence of "requirements as to the form of the profit and loss, or income and expenditure account", and the failure to make the auditors' report cover the profit and loss account", although, in their opinion conscientious auditors often examined this as well. [3/] The usefulness of accounts was expressed in their conviction that the profit and loss account is an important indication of the trend of profits and as such the best indication of the prosperity of a company. They criticised the practice of lumping a number of diverse items together which thereby obscured the real position about the assets and liabilities of the company and which made it difficult, if not impossible, for investors

---

1/ Cmd 6659 (1943)

2/ Page 7.

3/ See paras. 96-99 and 103.

to form a true view of the financial position and earnings of the company. Regarding the controversial question of the maintenance of undisclosed reserves [1/] by companies the Committee found that this practice often distorted the correct financial position of the company and made it difficult for investors and their advisers to have the information which will enable them to estimate the real value of the shares. The traditional defence that full disclosure encourages shareholders to press for excessive dividends [2/] was rejected in favour of "as much disclosure as practicable" which would serve to "create confidence in the financial management of industry and... dissipate any suggestion that hidden profits are being accumulated by industrial concerns to the detriment of consumers and those who work for industry". [3/] The Committee also recommended extensions to Section 134(3) of the 1928 Act so as to allow auditors to attend not only general meetings at which accounts examined or reported on by them are to be laid, but also to receive notices of and attend all general meetings of the company and to be entitled, if other auditors have been nominated, or if there is a proposal that they should not be reappointed, to put their views before the shareholders orally at the meetiing and in writing prior to the meeting. [4/] On the general question of shareholders' control it was found that the control theoretically exercised by shareholders over directors was "illusory". [5/]

1/ These are reserves created by using profits to write down more than is necessary assets of a company such as investments, land, plant and machinery by creating bad debts and other contingencies, by charging capital expenditure to revenue or by under-valuing stock in trade. The object of this is usually to enable the company to avoid violent fluctuations in its published profits or dividends and accumulated reserves may, for example, be used to swell the profits in a year when the company is doing badly. See Cmd 6659 para 101.

2/ See supra page 43.

3/ Para. 101.

4/ Para. 112

5/ Paras. 7(a) and 128.

The Committee submitted its report in June 1945 stating that:

> ".....while in making our recommendations we have borne in mind the importance of not placing unreasonable fetters upon business which is conducted in an efficient and honest manner, we have included a number of proposals to ensure that as much information as is reasonably required shall be made available both to the shareholders and creditors of the companies concerned and to the general public. We have also sought to find means of making it easier for shareholders to exercise a more effective general control over the management of their companies". 1/

Most of these recommendations were incorporated in the Companies Act 1947, consolidated in the Companies Act 1948 2/ (hereafter, the 1948 Act). The 1948 Act contains many significant sections which attempt to bolster the degree of control which shareholders have in their companies. But it is not necessary to set out here the major changes effected by this Act as these are referred to at the appropriate point in the thesis where they are discussed.

Although the 1948 Act still contains the main body of companies legislation, there have been at least four others after it. On December 10,1959, the President of the Board of Trade set up a committee under the chairmanship of Lord Jenkins:

1/ Para. 5.

2/ 11&12 Geo. VI. C.38 - 30 June, 1948.

"To review and report upon the provisions and working of the Companies Act,1948,.... to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable". 1/

The Committee reported in 1962 making a large number of far-reaching recommendations, not all of which have been fully implemented today. 2/ However, it was "the exhaustive labours of that Committee" 3/ that formed the starting point of the Bill which later became the 1967 Companies Act (henceforth, the 1967 Act). The main concern of the Bill was to implement the Jenkins Committee's recommendations for greater disclosure of information by limited liability companies but its scope was later widened to include rules for regulating insurance companies which had become expedient in the wake of scandals in the insurance business. The then President of the Board of Trade, Mr. Douglas Jay, during the presentation of the Bill on the Second Reading stated that he recognised the need for further legislation to implement more of Jenkins recommendations. The 1967 Act, he promised, was only intended as a first instalment of more comprehensive legislation, adding "I am hoping to legislate for wider reforms in the structure and philosophy of our Company Law. I think it is time ... to re-examine the whole theory and purpose of the limited joint stock company, the comparative rights and obligations of shareholders, directors,creditors, employees and the community as a whole". 4/ Any hopes for "the reform of the structure

1/ See Report of the Company Law Committee Cmnd1749 (1962), henceforth, the Jenkins Committee Report or Cmnd 1749, p.1.

2/ Several references will be made later to some of the recommendations of this Committee.

3/ Mr.Douglas Jay, President of the Board of Trade in Parliamentary Debates (H.C.), Vol.741. Col.358 (1967).

4/ Ibid, at col.359.

and philosophy" of Company Law promised by that Labour Administration were dashed with its defeat.

The Jenkins Committee in its review of the disclosure regulations had been mainly concerned with matters of details. Thus the amendments which were introduced by the 1967 Act deal with such details in respect of accounts as the contents of holding companies and groups accounts and such particulars as directors' emoluments, the waiver of rights to receipt of such emoluments, and so on. It would be useful at this point to consider the essentials of the current law on disclosure as introduced by the 1948 Act and as strengthened by the 1967 and 1976 Acts.

The current legal requirements for the preparation, audit and publication of the annual accounts of companies are to be found in Sections 147-163 of the 1948 Act and the various sections of the 1967 and 1976 Acts which will be referred to below. The general provisions as to the content and form of account is contained in Section 149 (1948). Sub-section (1) provides that every balance sheet of a company must give a true and fair view of the state of affairs of the company as at the end of its financial year and that similarly the profit and loss account must give a true and fair view of the profit or loss of the company for the financial year. Both documents are expected to comply with the requirements of the Eighth Schedule to the Act (S.149(2)) but the requirements of the Eighth Schedule shall be without prejudice either to the requirement for the accounts to give a "true and fair view" or to any other requirement of the Act (S.149(3)).

Section 156(1) of the Act requires the auditors' report to be attached to the balance sheet and profit and loss account, while section 157(1) requires that every balance sheet should have a directors' report attached to it giving a report of the state of the company's affairs, the amount recommended to be paid as dividend and the amount proposed to be carried to reserves.

The detailed legislative requirements as to the contents of company accounts under the 1948 Act particularly Schedule 8 were extensively revised by the 1967 Act. Sections 3-11 of that Act introduced a number of further matters to be included in company accounts and new requirements as to the auditors' report were laid down in Section 14.

Details of the contents of the directors' report were also enumerated in Sections 16-24 some of the most important of which were the requirement in Section 19 that the report must include certain particulars of contributions for political or charitable purposes and the right under Section 24 to receive copies of the directors' report in addition to the rights under Section 158 of the 1948 Act of members, debenture holders and persons entitled to receive notices of general meetings to receive copies of the balance sheet and auditors' report.

Section 26 required companies to keep at an appropriate place copies of directors' service contracts or memorandum thereof, which must be open to inspection by members of the company. Every director is required by Section 27 to notify the company of his interest in the shares or debentures of the company and subsequent transactions in connection with such shares such as a sale, assignment or other specified occurrence in relation to the shares or debentures. Any similar interest by the directors' wife or child in the shares and debentures of the company were also to be disclosed. These provisions were designed to prevent breach of directors' fiduciary duties by irregular dealings in their company's securities.

Provisions were also made for the disclosure by persons with substantial individual interests in the share capital of the ompany carrying unrestricted voting rights of the acquisition, changes in the amounts of and disposal of shares in the company. 1/ This was to ensure that the public would be able to find out at all times who had *de jure* control of the company and to minimise secret "warehousing" of a company's equities by a potential take-over bidder.

Important and rather novel provisions to secure greater publicity were afforded in Part III of this Act to empower the Board of Trade to inspect companies' books and papers. Section 109 empowers the Department of Trade (as the Board of Trade is now called) to require a Company to produce such books or papers as may be specified or to authorise any officer of the Department to require the production of the books or papers (S.109(1)). Production may also be demanded of any person in possession, or who appears to be in possession of the documents even though such a person has a lien on the documents but the production shall be without prejudice to the lien (S.109(2)). The Department or the officers

---

1/ Sections 33 and 34.

appointed by them are entitled to take copies or extracts from the books or papers produced to them. A penalty is imposed on any company or other person who fails to comply with a demand to produce the documents (S.109(4)).

A search warrant may be issued by a justice of the peace authorising any police constable to search any premises on reasonable suspicion that the books and papers are to be found there and to take possession of the documents which appear to be those in question and take steps to preserve and prevent interference with them (S.110).

Any information obtained under section 109 is confidential and is not to be published, unless publication or disclosure is necessary, for example, with a view to the institution of proceedings or otherwise for the purposes of any criminal proceedings under the Companies Acts, or for the purpose of complying with any requirement, or exercising any power conferred by the Companies Act with regard to reports made by inspectors appointed to investigate the affairs of a company (S.111).

The inquisitorial powers conferred under Part III of the 1967 Act is designed to afford further protection to investors by making needed information available to them but the Department of Trade has not often exercised its power thereunder readily or speedily enough. 1/ "If exercised speedily enough, they may prevent oppression [of minority

---

1/ See Tom Hadden, Company Law and Capitalism, (1977) pp.352-359; "Fraud in the City: Enforcing the rules", (1980) Co. Law 9, 12-13. See also Gower, 4th Ed., 671-681.

shareholders] from occurring". 1/

The philosophy of continuing improvement of accounts and auditing was continued in the 1976 Act, in fact, half of the Act dwelt on these matters, but again the provisions relate mainly to matters of details. As D.D. Prentice has said of this Act, 2/ it by no means constitutes a "fundamental restructuring of English Company Law" but contains "modest though important measures" as to accounts and audits. It is, as that writer puts, "a nuts and bolts statute" 3/. Some of the most significant provisions of the Act relate to the duty to prepare, lay and deliver accounts by reference to the company's accounting reference period, in otherwords, its financial year. It defines what the accounting reference period of a company shall be (S.2) and rules for the alteration of the accounting reference period (S.3).

Section 12 requires that every company must keep accounting records which must be sufficient to show and explain the company's transactions. It must disclose with reasonable accuracy, at any time, the financial position of the company at that time and enable the directors to ensure that any balance sheet prepared by them gives a true and fair view of the company's profit or loss. 4/ Accounting records kept in

---

1/ Gower, ibid., 679.

2/ "Companies Act 1976", (1977) 40 M.L.R. 314.

3/ Ibid., at 321.

4/ That is, it must comply with the requirements of Section 149, 1948 Act and Section 12(1)-(3) of the 1976 Act.

accordance with the section must in the case of public companies be preserved for at least six years from the date on which they are made. 1/

In relation to auditors a significant innovation was the right given to an auditor of a company who resigns his office under Section 16 to requisition an extraordinary general meeting of the company. The purpose of the meeting will be to receive and consider his explanation of the circumstances connected with his resignation as he may wish to place before the meeting. A copy of a statement in writing by the auditor not exceeding a reasonable length of the circumstances connected with his resignation may in appropriate circumstances be sent to every member of the company to whom notice of the meeting has been sent. 2/ But a court may dispense with the requirement to send out copies of the statement or to read it out at the meeting, if on the application of the company or of any other person who claims to be aggrieved, it is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter. 3/ The section is an important safeguard to auditors who adopt an uncompromising stand in an effort to protect investors from the abuses of management. It serves to ensure that the shareholders are given an opportunity to find out if the dismissal of the auditor is an attempt to prevent possible leakages of whatever improprieties the directors may wish to hide. 4/

1/ Section 12(9)(b)

2/ Section 17

3/ Section 17(4)

4/ This strengthens the rights of shareholders and debenture holders under S.158, 1948 Act to receive copies of balance sheets and auditors' reports and the system of appointment and remuneration of auditors under S.159 of that Act.

To the extent that the rules for disclosure and publicity were strengthened by the 1967 and 1976 Acts they may be regarded as having taken long strides to enhance shareholders' control 1/ but it is clear that they were effectively designed and accordingly have served to give members more of <u>protection</u> rather than <u>control</u>. It is submitted that it is one thing for legislation to protect the interest of investors by making it difficult for directors and managers to hide frauds and mismanagement from them and it is another for legislation to facilitate the performance of those functions which Company Law ascribes to them. This is not to say that legislation for the protection of investors is irrelevant for control. On the contrary the requirements for disclosure which have been described above have been very useful in the development of systems of internal and external control over directors. As Professor Gower puts it the protection of investors and the control by shareholders over management are both aspects of the same generic problem. 2/ The philosophy of disclosure has, according to the learned Professor, been a useful device for investor protection but this like civil and criminal sanctions for mis-statements or material omission provide only *ex post facto* sanction against management and are "far less effective than initial scrutiny of [for example] the prospectus to insure its accuracy and completeness". While in the U.S. the vital task of initial screening has been entrusted to the Securities and Exchange Commission (SEC): the author lamented the "extraordinarily lax" situation of English law. It is to be noted that with the strengthening

---

1/ See e.g. <u>The Corporate Report:</u> Accounting Standards Steering Committee (1975), 4.11.

2/ L.C.B. Gower, "Corporation Law in England and America", (1955-56)11 Bus. Lawyer 39, 47; "British and American Corporation Law", (1956) 69 Harv. L.R. 1369, 1381.

of such institutions as the Stock Exchange and their listing agreements with public companies and the City Panel on Take-Overs and Mergers the system of extra-legal control has become stronger than it was at the time of his address, with the one enforcing through its Quotation Department the provisions of the Listing agreement which govern the content and timing of disclosure by listed companies and the other enforcing the provisions of the City Code on Take-Overs and Mergers. 1/

The effectiveness of these bodies and the mechanism for their operation depends certainly on rather extensive disclosures. But while disclosure has been useful for the development of external control over directors this, as will be seen later, has proved less effective in enhancing shareholders' participation in corporate administration.

In their study of shareholder user of corporate report 2/ Professor T.A. Lee and Mr. D. P. Tweedie have found that the measure of

---

1/ This notwithstanding there are still many who advocate a sort of S.E.C. for British Companies to perform scrutiny functions identical to those performed by the S.E.C. in the U.S. See the recent report of the Committee to Review the Functioning of Financial Institutions (the Wilson Committee) Cmnd 7937 (1980) which called for the creation of an authority which will keep the regulatory parts of the present financial system under regular review. See e.g. para. 1119. As to the merits of these demands, see Tom Hadden (1977) pp.361-363. See also David Sugarman (1980) 1 Co. Law 302-303 and 304-305. But cf. D.D. Prentice, op.cit., (1977) 40 M.L.R. 314, 316.

2/ Lee and Tweedie, The Private Shareholder and The Corporate Report, (1977).

individual private shareholder's understanding of financial reports is in direct proportion to the accounting experience of the reader. Thus while financial disclosures in corporate reports are avidly read by such knowledgeable users as managers of investment institutions and professional analysts most private shareholders are unable to use or understand the existing form of financial report, that is, the profit and loss account and the balance sheet, and appear to be looking for less complex statements in the Chairman's report 1/ to provide them with relevant information. The greatest problem which confronts the "non-accountant" private shareholder in his understanding of the reports appear to be "the complexity of the reporting system and the terminology used in financial statements". 2/ Thus while complying with the accounting and disclosure requirements of the Companies Acts accountants quite unintentionally produce a financial reporting system which is capable of being used thoroughly and reasonably understood only by accountants or equivalent professionals. The result has been the creation of a considerable communication gap between companies and their private shareholders and to give an unfair advantage to other shareholders who are more knowledgeable in accounting.

The findings of these two writers as well as numerous other reports 3/ highlight the inadequacy of disclosure provisions and support our demand here for a re-examination of further and more effective systems

---

1/ The Chairman's report is not usually covered in the auditors' report.

2/ P. 131.

3/ A useful list of references to other reports on accounts is contained in The Private Shareholder and The Corporate Report. See also the Green Papers, The Future of Company Reports : A Consultative Document (1977) Cmnd 6888 and Company Accounting and Disclosure : A Consultative Document (1979) Cmnd 7654.

of control on corporate management in addition to publicity and disclosures in corporate reports. 1/ In order to bring about significant reform in the "structure" of Company Law this thesis advocates the introduction of some new structural system of control, not in substitution for but in addition to the disclosure requirements of the Companies Acts. So far the Companies Acts have dealt very little with this approach to the problem of shareholders' participation in corporate administration.

The only legislation 2/ which may be regarded as having affected this structure of corporate governance in some way, is the European Communities Act, 1972, particularly, Section 9 which was enacted in order

---

1/ Lee and Tweedie suggest that a solution to this inadequacy is to simplify the present system in order to make it more easily comprehensible to the unskilled user. See p. 132.

There is no denying the fact that the existing system of publicity and disclosure are quite essential to financial analysts, investment managers and especially the press who exert a most effective extra-legal form of control over corporate management. These users are not constrained by those factors which inhibit the private shareholder users.

2/ The Companies Act 1976 dealt mainly with rules relating to accounts, accounting records and the appointment, removal, resignation of auditors. The legal position of Auditors is outside the main focus of this thesis.

to comply with the First Council Directive concerning publicity, pre-incorporation contracts and the capacity of companies and the authority of directors. 1/

Section 9(1) of the E.C.A. 1972, 2/ provides in favour of a person dealing with a company in good faith, that the directors' power to bind the company to a transaction decided upon by them shall be deemed to be free from any limitation under the memorandum or articles of association. The transaction so decided upon will bind the company even if the directors act:

(1) beyond the company's powers, or

(2) beyond the powers vested in them by the memorandum and articles of association.

1/ No. 68/151/EEC.

2/ For a very exhaustive examination of this section, see J. Segev, The Powers of the General Meeting and the Board of Directors in the Company Law of Britain and Israel. (Unpublished Ph.D. Thesis, London School of Economics) (1973). See also Gower's Principles of Modern Company Law (4th edition) 1979, pp. 178, 184-190.

In relation to the general meeting this section can be seen as greatly strengthening the position of the board of directors by validating acts which they had no powers to perform and so diminishing in fact, if not in law, the relevance of any division of powers which exists between them. 1/ It is to be noted, however, that the section only affects the relations between directors and outsiders dealing with them and has the effect of saving for such persons contracts which would otherwise have been declared *ultra vires*. 2/ The section does not alter in any material particular, the traditional relationship between the board and the general meeting including the rights of minority shareholders and the company.

The latest companies legislation is the Companies Act 1980 (1980 Act) which was designed primarily to implement the European Economic Community Second Directive 3/ on the reclassification of companies and the maintenance, increase and reduction of capital. The opportunity was seized, however, to introduce long awaited legislation on such matters as Insider Trading, the taking of loans by directors in their companies and conflict of interest cases. These new provisions became necessary to protect shareholders from fraud and mal-practices by company directors, of the sort which have been revealed in numerous Department of Trade Investigations.

1/ Such as the power to ratify acts which are <u>ultra vires</u> the directors.

2/ In other words, it mainly affects the law relating to <u>ultra vires</u> and the rule in <u>Royal British Bank v. Turquand</u> (1856) 6 E.4.B. 327, [illegible] which provides that an outsider dealing with a company is, not bound to ensure that the internal regulations of the Company Law have in fact been complied with as regards the exercise and delegation of authority. See Gower, 182-182

3/ No.77/91/EEC.

One of the provisions of the Act which is quite significant for the structure of corporate governance is Section 46 which provides:

(1) The matters to which the directors of a company are to have regard in the performance of their functions shall include the interests of the company's employees in general as well as the interests of its members.

(2) Accordingly, the duty imposed by subsection (1) above on the directors of a company is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.

The reason this section is regarded as significant is that for the first time in the history of Company Law, a positive duty has been imposed on directors to consider directly the interest by employees in their operation of the company. 1/ During the passage of the Bill

1/ This section widens the scope of the fiduciary duty of directors to act "bona fide" in what they consider - not what a court may consider - is in the interests of the company as a whole. Re: Smith and Fawcett Ltd [1942] Ch.304, 306 per Lord Greene M.R. The traditional legal position has been that when performing their function in the "interests of the company" directors are required to take account of the interests of the company's present and future members only: The Savoy Hotel Ltd and The Berkeley Hotel Co.Ltd. Department of Trade Report, (1954), per Mr.Milner Holland Q.C. (as he was then) and that they could not take into account the interests of the company's employees except in so far as to do so would be in the interests of the members of the company: Hutton v West Cork Railway Co. [1883] 23 Ch.D.654; Parke v. Daily News Ltd. [1962] Ch.927. The new section now makes it possible for directors within the context of their duties to consider directly the interests of the employees together with those of the members.

fears were raised by some sections of the public and in Parliament about the possibility of employees seeking to control the board's policies under the guise of attempting to enforce directors' compliance with the section. It required careful draftsmanship to ensure that this absurdity did not arise and the section as it now stands serves only as a shield to directors who are challenged for taking actions in the interests of the employees and not as a sword for employees to compel them to take specific actions in furtherance of their (employees) interests. 1/ It can be said, therefore, that the section does not affect the relations between shareholders and directors, except that it *de jure* gives the latter, wider latitude of discretion to do those things which it is commonly agreed they have often done, in fact.

At the international level there have been certain developments which are bound to have future consequences on the present framework for corporate governance. These developments derive from the EEC directives of which the most important for the purposes of this thesis are the Fourth Directive and the Draft Fifth Directive.

1/ See Victor Joffe, The Companies Act 1980 : A Practical Guide (1980), 12.102 - 12.104.

The Fourth Directive [1/] is concerned with the disclosure of financial information and the contents of accounts. Article 2(3) of the Directive provides that the annual accounts of a company shall give "a true and fair view of the company's assets, liabilities, financial position and profit or loss". Article 2(4) provides that information must be added in order to give a true and fair view if compliance with a provision of the Directive would not ensure this. In the exceptional case where compliance with the rules of the Directive would not give a true and fair view they must be departed from and a full explanation given in the notes to the accounts (Article 2(5)). Article 47 requires that the annual accounts of all companies together with the annual or directors' report and auditors' report must be published. Article 51 requires that the accounts of large companies must be audited.

Further legislation for the implementation of this Directive is to be expected but suffice it to say here that the requirements for the U.K. are hardly revolutionary and the main practical effect of the Directive here will be the provision of all information in a prescribed format and the provision of certain additional information. The existing over-riding requirement of existing law that the accounts must give "a

---

1/ 78/660/EEC, (1978). (This is now included in the 1981 Companies Bill).

true and fair view" of the company's financial position has been retained. 1/

The Draft Fifth Directive is concerned with the structure of companies. 2/ It applies to the large companies in member states with the exception of the United Kinddom and Ireland and requires that companies employing more than 500 employees should have two-tier boards either with one-third appointed by the workers, or with the workers and shareholders having a veto as under the Dutch system. Considerable resentment against the almost unqualified adoption of the German co-determination system led to its subsequent revision and

---

1/ For details on this Directive see the Green Paper Company Accounting and Disclosure : A Consultative Document. (1979) Cmnd 7654 (HMSO), p. 10. See also Ernst and Whinney, The Fourth Directive (1979), 315, for the effect of this Directive on UK and Irish Companies.

2/ C. 131/49 (1972). See the detailed provisions and the amendments thereto in (1979) 66 European Industrial Relations Rev. 23. For a discussion of the likely effects of the Implementation of this Directive on UK and Irish Companies, see Temple Lang, "The Fifth EEC Directive on Harmonization of Company Law", (1975) 12 C.M.L.R. 155 and 345.

The three other Draft Directives are the Draft Sixth Directive which relates to the issuing and contents of prospectuses and aims at the co-ordination of national requirements for the admission of securities to listing. The Draft Seventh Directive is concerned with the contents of group accounts and is a necessary extension of the proposals contained in the Fourth Directive. The Draft Eighth Directive deals with auditing and sets out who is entitled to audit the annual account and the minimum qualification of auditors.

The First and Second Directives were implemented in the European Communities Act 1972 and the Companies Act 1980 respectively while the Third Directive aims at the co-ordination of provisions regulating internal mergers within a member state, and is yet to be implemented.

amendment by the European Parliament. The final version will have to be adopted by the U.K. in future, and is bound to affect *inter alia* the existing rights of shareholders.

Some of the features of the draft Fifth Directive and its highly German bias are also to be seen in the Draft Statute on the European Company (1970). The concept of the European Company was first put forward by Professor Sanders in 1959, the idea being to have a new form of incorporation for two or more limited companies which decide to merge or form a joint holding or subsidiary company. 1/ Following the French and German pattern, the Statute proposes a division of the board of directors into two separate and independent corporate organs, the board of management and the supervisory board. Alongside these two organs the shareholders meeting continues to exist. According to Article 64(1) of the Proposed Statute the board of management is given wide authority to act for the corporation in all fields where authority is not expressly reserved by the Statute for some other organ. The board of management also has full authority to bind the corporation *vis-a-vis* third parties, unfettered by the limits of the corporation's object or the articles of association. 2/ The competence of the shareholders' meeting is limited to matters enumerated in Article 83. Besides the election of the supervisory board, only basic decisions are to be taken by the general meeting, such as modification of the articles of association, increase or reduction of capital or dissolution or transformation or merger of the corporation. The only

1/ See Gower, 88. For a history of The European Company see Prof. Peter Saunders, "The European Company", (1968) J.B.L.184.

2/ Art.67 of the Proposed Statute. The major powers of the respective organs in the governing structure of the European Company are discussed by Hans Claudius Ficker in "The Proposed Statute of a European Corporation", (1971) J.B.L. 167, 175-77.

active part the shareholders' meeting may take in the governance of their company, apart from electing the members of the supervisory board, is to nominate the auditors and to decide what should be done with the annual profits. The shareholders meeting is to be held only once a year, at which shareholders have the right to put questions on matters to be discussed in the agenda. 1/

So alien are most of the provisions of the Proposed Statute to the present governing structure in the U.K. that one commentator has described the concept of the European Company as "a stumbling block" to future development of the pattern of corporate governance in English Company Law. 2/ In particular, the existing machinery for shareholders' control will be so diminished at its introduction that one must heed the warning of Prof. Gower for more stringent requirements if mass "emigration" of companies electing for the "European form" is to be avoided. 3/

The question of workers' participation in corporate governance is a central theme underlying most of the legislative initiatives from Europe. Although it was omitted in the 1980 Companies Act, this is a question which is so important for the future structure of corporate governance in this country and has been much discussed in debates under the general name of Industrial Democracy. In 1975, the President of the

1/ See Ibid.

2/ J.C.Davies, "The European Company : a Stumbling Block" (1972),116. Sol.J.227.

3/ At 88. The existing machinery for corporate governance are considered, infra.

Board of Trade appointed a Committee of Inquiry to "advise on questions relating to representation (of employees) at board level in the private sector", "[h]aving regard to the interest of the national economy, employees, investors and consumers, to analyse the implications of such representation for the efficient management of companies and company law". 1/

The Committee reported in 1977 and proposed that large British companies adopt a new unitary board system constituted under the famous 2x + y formula. 2/ Their proposals have received little enthusiasm for their implementation so far although a future labour government under, say, Mr. Tony Benn might be more favourably disposed towards it, 3/ but this will not be for several years to come. It is safe to assume therefore, that the existing framework for corporate administration will remain unchanged for a long time yet - at least until such a time as there will be a change in the company law philosophy to accommodate an equal

---

1/ Cmnd 6707 p.V.

2/ The majority's central recommendation is that in order to provide a "new legitimacy for the exercise of the management function" and to ensure that employee representatives take equal responsibility for the board's decisions, the unitary board should be reconstituted so as to be composed of three elements,an equal number of employee and shareholders representatives and a third group of co-opted directors. This group should: (a) be co-opted with the agreement of a majority of each of the other two groups - the employees and shareholders representatives; (b) be an uneven number of three or more; and (c) form less than one third of the total board. Thus, called 2x + y formula, where x = the employee and shareholders representatives and y = the co-opted group of directors. When applied the minimum possible for the companies affected would be at least 11 directors. See Chapter 9 and para. 13.

3/ At the last Labour Party Annual Conference, Mr. Tony Benn declared that he would want to see a future labour government implement the proposals on Industrial Democracy, amongst other things.

role for both shareholders and employees in the governance of their company, for much of the U.K. company law rests on the principle of shareholder control. This principle will be examined in the next chapter. For the moment, however, it is necessary to examine next the legal nature of the different organs for corporate governance.

5. The Company's Organs

Since a company is an "artificial person" it cannot, like a natural person by itself organise and conduct its own affairs - functions which are referred to in this thesis as corporate governance or corporate administration. These functions are, however, performed on its behalf by natural persons acting as its organs. As Viscount Haldane L.C. described it in Lennard's Carrying Company Limited v. Asiatic Petroleum Company Limited: 1/

> "a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.That person may be under the direction of the shareholders in general meeting; that may be the board of directors itself, or it may be, and in some companies it is so, that that person has an authority to co-ordinate with the board of directors given to him under the articles of association, and is appointed by the genral meeting of the company, and can only be removed by the general meeting of the company." 2/

1/ [1915] A.C.705.

2/ At p.713.

(i) The Board of Directors and the General Meeting as Organs

The persons identified by Viscount Haldane as being responsible for the conduct of a company's business are the board of directors and the shareholders in general meetings, but the fact that his Lordship referred to them as "agents" rather than "organs" should not derogate from this position. The common tendency has been to regard the board of directors as agents who are subject to the control of the members acting as the company - a tendency which serves to obscure the true legal position of directors. In a recent case 1/ Walton J. in an attempt to distinguish between the general meeting and the board stated:

> "a director is an agent, who casts his votes to decide in what manner his principal shall act through the collective agency of the board of directors; a shareholder who casts his vote in general meeting is not casting it as an agent of the company in any shape or form. His acts, therefore, in voting as he pleases, cannot in any way be regarded as an act of the company". 2/

Notwithstanding the ambiguities of a director's position *vis-a-vis* the general meeting, it is now clear, as Professor Gower points out that,

> "Both [the board of directors] and the members in general meeting are primary organs of the company between whom the company's powers are divided....The old idea that the general meeting alone is the company's organ and the directors merely the company's agents or servants, at all times subservient to the general meeting, seems no longer to be the law as it is certainly not the fact". 3/

1/ Northern Counties Securities v. Jackson & Steeple Ltd. [1974] W.L.R. 1113.

2/ At 1144

3/ Gower 4th ed. at 152.

Indeed, the board of directors has often been referred to in the cases 1/ as one of the company's organs and its status as one cannot be seriously doubted. 2/

As corporate organs both the board and the general meeting have to function within the spheres of the respective powers allocated to them by the company's constitutional instruments. The system of allocation and the relations between these principal organs acting within the scope of their respective authorities will form the subject of a later chapter.

(ii) Other Organs

Although this work is concerned primarily with the board of directors acting as a body and the general meeting, this discussion will be incomplete without even a cursory reference to other organs of a company notably the Managing Director, the General Manager and the Company Secretary.

(a) The Managing Director:

Companies' articles especially where Table A 3/ is adopted as is often the case usually empower the directors to appoint one or more of their number to the office of managing director. For example, Article 109 of Table A provides:

1/ See e.g. Bolton v. Graham [1959] 1 Q.B. 159, per Denning L.J. (as he was then) at 172; Rudd v. Elder Dempster and Co.[1933] 1 K.B.566, per Scrutton L.J. at 576 and per Viscount Haldane in Lennards Case, supra.

2/ See G.O.Olawoyin ., The Status and Duties of Directors (Ife – Nigeria, 1977).

3/ That is Table A of the First Schedule to the 1948 Act (Regulations for Management of a company limited by Shares, not being a private company), hereafter Table A.

> "The directors may entrust to and confer upon a managing director any of the powers exercisable by them upon such terms and conditions and with such restrictions as they may think fit, and either collaterally with or *to the exclusion of their own powers* and may from time to time revoke, withdraw, alter or vary all or any of such powers".

The words in italics in that article are important for upon their construction depends whether or not the managing director is regarded as a company's organ. Professor Gower suggests that those words imply that the directors may abdicate in favour of the managing directors by completely divesting themselves of their own powers in the service agreement with the managing director without expressly reserving for themselves a right of supervision. "If this(suggestion)is correct" he says, "the directors are in effect authorised to substitute a managing director for themselves as one of the primary organs of the company. In such circumstances the powers of the company will be divided among three exclusive organs" [1/] - the general meeting, the board of directors and the managing director.

By the same token it is submitted that where a board of directors has abdicated in favour of a Committee, for example, an executive committee appointed under Article 102 such committee constitutes another organ of the company. [2/]

1/ Gower 4th ed. at 156.

2/ See in particular Article 105 which provides that acts done by any meeting of directors or committees or a member of either body shall be valid to the same extent. Committees are not discussed as separate organs in this thesis but further discussion on the use of the committee device will be undertaken in a later chapter.

(b) Manager:

Professor Gower points out that a Managing Director is something more than "a manager who happens also to be a director". 1/ Even a manager, he admits, is sometimes regarded as something more than a mere agent or servant. Indeed, in Fanton v. Denville 2/ the general manager of a company was regarded as an *alter ego* of the company, as Viscount Haldane regarded the board of directors and the general meeting in Lennard's case. According to Greer, L.J.:

> "It has, of course, to be remembered that in actions against companies a general manager of the business is deemed to be the alter ego of the company, and it would be responsible for his personal negligence". 3/

Thus, for some purposes, a manager may be regarded as one of the company's organs.

(c) The Company Secretary:

In a recent case 4/ it was pointed out that a secretary "is not concerned in the management of the company... (and) is not concerned in carrying on the business of the company". 5/ Although a secretary's duties in the company are essentially "ministerial and administrative" he forms such an important and integral part of corporate governance that he deserves some mention. A secretary is not, strictly speaking, an organ of the company, but dicta in a recent case 6/ indicate that for some purposes he would be regarded as one.

1/ At p.156.

2/ [1932] 2 K.B.309.

3/ At 329.

4/ Re. Maidstone Building Provisions Ltd. [1971] 1 W.L.R.1085.

5/ Per Pennycuick V.C. at p.1092.

6/ Panorama Developments (Guildford) Ltd. v. Fidelis Furnishing Fabrics Ltd. [1971] 2 Q.B.711,C.A.

Until 1971 a company's secretary has been generally considered a mere servant. Thus in Barnett, Hoares and Co. v. South London Tramways Co. 1/ it was stated by Lord Esher M.R. that a secretary:

> "is a mere servant; his position is that he is to do what he is told, and no person can assume that he has any authority to represent anything at all; nor can anyone assume that statements made by him are necessarily to be accepted as trustworthy without further inquiry, any more than in the case of a merchant it can be assumed that one who is only a clerk has authority to make representation to induce persons to enter into a contract". 2/

Even at the beginning of the present century that conception of a secretary's position in a company had not changed. In 1902 Lord Macnaghten in George Whitechurch Ltd. v. Cavanagh 3/ stated:

> "Now, the duties of a company's secretary are well understood. They are of a limited and somewhat humble character". 4/

In 1971 Lord Denning M.R., heralded a change in this conception in the case of Panorama Development (Guildford) v. Fidelis Funishing Fabrics Ltd. 5/ In that case B, secretary to the defendant company hired cars from the plaintiff company ostensibly for his company's business. The hiring agreements were always signed by B as Company Secretary but unknown to the plaintiffs B used the cars himself and

1/ (1887) 18 Q.B.D. 815.

2/ At p.817.

3/ [1902] A.C.117. See also Ruben v. Great Fingall Consolidated [1906] A.C.439.

4/ At 124.

5/ See *supra*.

not for the company's purpose. When the plaintiffs sued for the outstanding charges the defendants denied liability, arguing on the authority of Barnett's case that a secretary is a mere servant who has no authority to bind the company in a contract. Lord Denning rejected this argument in the defendants' appeal, saying:

> "But times have changed. A company secretary is a much more important person nowadays than he was in 1887. He is an officer of the company with extensive duties and responsibilites. This appears not only in the modern companies Acts, but also by the role which he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business .... He is certainly entitled to sign contracts connected with the administrative side of a company's affairs, such as employing staff, and ordering cars, and so forth. All such matters now come within the ostensible authority of a company's secretary". 1/

Salmon L.J. agreed with that decision adding that "there can be no doubt that the secretary is the chief administrative officer of the company", 2/ and has authority to bind the company.

While it has been sought to show that the general meeting, the board of directors, the managing directors, general manager and the secretary are organs of the company, albeit, to varying degrees, it is not intended to discuss the details of the operations of all of them. Rather, the focus of this work will be to examine the principle of shareholder control and the manner in which the board of directors directs the business of the company.

1/ At p.443.

2/ At p.444.

CHAPTER 2

THE PRINCIPLE OF SHAREHOLDERS' CONTROL

1. Introduction:

The principle that shareholders should have ultimate control over those they have appointed to run their companies is basic to English Company Law. The "logical theory" enacted by Company Law and companies constitutional instruments is, according to P.Sargant Florence, that shareholders who bear the risk in the enterprise should, by that fact, have top control - a theory he believes, "may almost be described as Capitalism's Golden Rule". 1/ And, according to D.H. Robertson, "where the risk lies there the control lies also". 2/ The manner and extent to which this control is exercised will be examined later, but first it is necessary to examine the reason behind this principle.

In his dissent note to the 1962 Jenkins Report, Professor Gower explained the reason why Company Law insists on shareholders' control. 3/

> "The business corporation is a device for enabling an expert body of directors to manage other people's property for them. Since these managers are looking after other people's money it is thought that they should not be totally free from any control or supervision and the obvious

---

1/ P.Sargant Florence, The Logic of British and American Industry (1970 edition), 211.

2/ D.H.Robertson, Control of Industry (1923) 89, cited by P.S.Florence in Ownership Control and Success of Large Companies (1961).60.

3/ Cmnd 1749 p.207.

> persons to exercise some control are the persons whose property is being managed. Hence the basic principle adopted by British Company Law (and, indeed, by the laws of most countries) is that ultimate control over the directors should be exercised by the shareholders. This control cannot be exercised in detail and from day-to-day, but shareholders retain the ultimate sanction in that it is they who "hire and fire" the directorate". 1/

That concise explanation strikes a similar note to the observations made by Mr.William Gladstone during the debates leading to the enactment of the 1844 Act. "The law is so dangerous", he said "and unjust towards a man of substance, by putting his whole property at the mercy of persons beyond his control...." 2/

It is apparent from those two observations that the right to have some control over one's property is the essential logic behind this principle. It is essential for capitalism - and is simple reason - that investors who supply the capital should have a say in the way the enterprise is to utilize the funds. The mere existence of this principle is reassuring for investors and helps to encourage and sustain the confidence of the public in investing in companies. Whether or not this control is actually exercised is of secondary importance. Its absence would, on the other hand, almost certainly diminish public confidence in investment.

1/ Ibid . See also L.C.B.Gower,"Corporation Law in England and America", (1955-56) 11 Bus.Lawyer,39, where the distinguished writer states the principal rights of shareholders as including those of making fundamental changes in the company's objects and the right to "hire and fire" the directorate - the latter being singled out as the "crux" of management-shareholder relationship in the largepublic company.

2/ Report of 1844. Evid.Q.2072, cited by Hunt,op.cit.98.

In a recent paper on the "Function of Ownership of public companies", [1] Lord Carr of Hadley in explaining this principle, added further dimension to it. As he put it:

> "Ownership is at the heart of the capitalist system. The success of a capitalist economy or of a mixed economy such as we have in Britain, depends to a significant extent on the ownership function being actively and effectively exercised. Where the ownership function withers away, so in due course will that part of the private enterprise capitalism system itself." [2]

What ownership function is is, of course, uncertain. There is, in general, no unanimity of views about the nature of responsibilities which share ownership thrusts upon the investor; this depends on the point of view from which you consider it and the responsibilities are not immutable. For the private shareholder, for example, the ownership function has changed from one of active involvement with and investigation of his company's affairs to one of increasing reliance on the opinions of stockbrokers and the Stock Exchange, with his interests mainly on the payment of dividends. To many private investors, therefore, it is not their business to involve themselves with their companies so long as dividends are paid. The only "function" the private investor can exercise is to dispose of his shares or to accept or reject a take-over offer.

1/ "The Function of Ownership and the Role of Institutional Shareholders". Booklet No.(4) in a series of papers entitled "Corporate Governance and Accoountability", published by the Institute of Chartered Secretaries and Administrators (London,1979). Lord Carr of Hadley is chairman of the Prudential Assurance Co.Ltd.

2/ Para.1.

To the institutional shareholders the primary responsibility of share-ownership is to make more profit for their own members and their activities and policies must be designed towards achieving this end.

To management the function of share ownership is the provision of essential capital and it is not within the province of shareholders to concern themselves with the way the business is managed, provided profits are made and dividends paid. To some management, therefore, the principle of shareholders' control is only a useful weapon to ward-off government interference in corporate governance, by asserting that it is for shareholders and not the government to make policy for the company.

While such divergence of opinion may exist, about the functions of ownership, Company Law does make clear the need for shareholders to exercise a number of important functions in the company and this leaves it in no doubt that they have ultimate control over the company through their power of appointment and dismissal of directors. 1/ However, these are only some of the *means* for control available to shareholders. The others will be considered later, but in the meantime it is necessary to examine the controversial question of the relationship of ownership and control which was briefly mentioned in the opening paragraph of this thesis.

1/ This has been referred to as the "control function of ownership". See R.A.Gordon, Business Leadership in the Large Corporation (1961 ed.) 44. See below for further discussion of the concept of control.

2. The Separation of Ownership from Management

A major controversy which has developed in relation to the governance of the large company during the past fifty or so years is the question of separation of ownership and control. 1/ Although the thesis about this separation has come to be closely identified with the leading book by Berle and Means, The Modern Corporation and Private Property, the phenomenon had long been described by Karl Marx in Book III of the Capital since the last century. According to Marx, the historical trend is that the twin functions of the contribution of funds and their utilization in the process of production which at the rise of capitalism were often performed by the same person, tend to become separated with the development of the capitalist mode of production. As he puts it:

> "Stock companies in general - developed with the credit system - have an increasing tendency to separate this work of management as a function from the ownership of capital be it self-owned or borrowed... The mere manager who has no title whatever to the capital, whether through borrowing it or otherwise, performs all the real functions pertaining to the functioning capitalist as such, only the functionary remains and the capitalist disappears as superfluous from the production process". 2/

1/ To Sociologists the concept of separation of ownership and control has two dimensions: (1) the separation of ownership and management-the functional differentiation, and (2) the dispersion of stock and the consequent split between small and big owners. See Michel De Vroey, "The Separation of Ownership and Control in Large Corporations",in Review of Radical Political Economics 7(2) Summer 1975. 1. The scope of this thesis doesnot permit a detailed discussion of the concept and the reason for referring to it as only to establish that the owners or a substantial number of owners of shares in large companies are divorced from the management of the companies.

2/ Capital, Book III, Chapter 23, pp.387-388.

This functional differentiation was facilitated by the emergence of the joint stock company and the relations of ownership and management therein.

R.Hilferding, in Das Finanz Kapital 1/ in 1910, emphasised another consequence of the emergence of the joint stock company - the dispersal of the stock. His contention was that the corporate system has brought about an actual concentration of power, paralleling the dispersion of share-ownership. Thus, the corporate system allows an increase of the power sphere of big capitalists who now control larger economic units with a reduced proportion of legal ownership. He writes:

> "With the extension of the shares system, the capitalist ownership is increasingly transformed into a restricted ownership, giving nominal rights to the capitalist without allowing possibility to exert any real influence on the production process... The ownership of a great number of capitalists is constantly being restricted and their unlimited disposition of the productive process is suppressed. But on the other hand, the circle of masters of production becomes more restricted. Capitalists form a society in the governing of which most of them have no voice. The effective disposition of the means of production is in the hands of people who have only partially contributed to it." 2/

1/ Cited by De Vroey, op.cit.3.

2/ At p.90. See also Ralf Dahrendorf, Class and Class Conflict in Industrial Society (1959), p.42.

Berle and Means' study in the early 1930's revealed this phenomenon in U.S. companies, although their interpretation of the consequences differ from that of Hilferding. 1/

While it is generally thought that "ownership" of a company goes hand in hand with "control", Berle and Means found from their empirical investigation that the latter is "something apart from ownership on the one hand and from management on the other". 2/ They regard control as lying "in the hands of the individual or group who have the actual power to select the board of directors (or its majority), either by mobilizing the legal right to choose them - "controlling" a majority of the votes directly or through some legal device - or by exerting pressure which influences their choice". 3/ To the authors the selection of directors is crucial to control since direction over the activities of a company is exercised through the board of directors, and so he who selects the board, for all practical purposes controls the company. 4/ *A fortiori* the individual or group which selects the board of directors has control, for all practical purposes, over the board of directors. This rule conforms with the theory and logic behind English Company Law.

1/ While Berle and Means saw the dispersion of stock as leading ultimately to a dispersion of power, Hilferding's contention was that the corporate system has brought about an actual concentration of power paralleling the dispersion of ownership. See De Vroey, 3.

2/ At p.66. Also according to Ralf Dahrendorf , ibid, "the roles of owners and manager, originally combined in the position of the capitalists, have been separated and distributed over two positions, those of stockholder and executive".

3/ Ibid.

4/ According to Knight in Risk, Uncertainty and Profit (1921) 297, "the crucial decision is the selection of men to make decisions".

The crux of Berle and Means' book may be divided into two broad principles:

1. That in the typical large U.S. company,[1/] control is divorced from ownership, in that the appointment of the board is not influenced by, subject to or identical with the ownership to any significant degree for "ownership is so widely distributed that no individual or small group has even a minority interest large enough to dominate the affairs of the company". [2/] As a result management is left in control of the company.

2. Just as managements without substantial shareholding controls the company so is "/t/he direction of industry (as a whole) by persons other than those who have ventured their wealth". [3/] Thus industry is characterised by "/o/wnership of wealth without appreciable control and control of wealth without appreciable ownership", [4/] and this it is believed leads to certain behaviourial tendencies for large companies' managements which are markedly different from those which exist in owner-controlled companies. There is no need to go into this question as it is not directly relevant to our main concern here, [5/] but further examination is necessary of the situation of shareholders' control in large companies.

1/ And presumably, the typical large U.K.Company too.

2/ At p.78.

3/ At p.66.

4/ At p.4.

5/ Useful references on this question are to be found in Theo Nichols, Ownership Control & Ideology,(1969),chapter IV.

According to Berle and Means, a stockholder in the typical large company has practically two options when it comes to the appointment of directors:

(a) To refrain from voting, since even if he did his vote would be insignificant in determing the choice of directors, or

(b) To sign a proxy transferring his voting power to the proxy committee selected by the management. These involve no *real* choice at all!.

> "In neither case will he be able to exercise any measure of control. Rather, control will tend to be in the hands of those who select the proxy committee by whom, in turn, the election of the directors for the ensuing period may be made. Since the proxy committee is appointed by the existing management, the latter can virtually dictate their own successors. Where ownership is sufficiently sub-divided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible". 1/

Both writers drew the inference that in the typical large company "control does not rest upon legal (ownership)". 2/ It is:

> "More often factual, depending upon strategic position secured through a measure of ownership, a share in management or an external circumstance important to the conduct of the enterprise. Such control is less clearly defined than the legal forms, is more precarious, and more subject to accident and change. It is, however, none the less actual. It may be maintained over a long period of years, and as a corporation becomes larger and its ownership more widespread, it tends towards a position of impregnability comparable to that of legal control, a position from which it can be dislodged only by a virtual resolution". 3/

1/ At p.82.

2/ At p.74.

3/ Pp.74-75.

Berle and Means have been criticised by many writers, 1/ for *inter alia* the interpretation which they drew from the facts before them, and the methodology of their analysis. As R.A.Gordon, writes "No systematic attempt was made to see what influence in each company was actually exerted by the minority group nor indeed *who* did exert influence". 2/

The fact that Berle and Means' investigation of share registers revealed a wide dispersal of ownership in the large company is not, in the opinion of C.S.Beed, 3/ enough to support the conclusion that "no individual or small group was in a position to dominate the company *through stock ownership*". 4/ "Whether an individual or small group, including institutional investors had a majority interest large enough to select a majority of directors if desired...could only be tested by referring to the experience of the companies concerned, not, as Berle and Means did, by attaching arbitrary theoretical significance to sizes of "minority interests"". 5/ To Beed, Berle and Means' finding of a wide dispersal of ownership in large companies under management control could mean either:

1. That no one individual or small group could gain sufficient votes for control or,

---

1/ See C.S.Beed, "The Separation of Ownership and Control", reprinted in M.Gilbert, ed., The Modern Industrial Enterprise (1972), 137. Robin Blackburn, "The New Capitalism" in Robin Blackburn, ed. Ideology in Social Science (1972), 164,175; W.G.Katz,"Responsibility and the Modern Corporation", (1960) J. of Law & Econs. Vol. 375; also Robert J. Larner Management Control and the Large Corporation (1970), Nichols, supra; and R.A.Gordon, supra.

2/ At p.166.

3/ Supra.

4/ At p.80. Original emphasis.

5/ At p.139.

2. that only a few percent of votes were required for control. [1/]

He suggests that rather than investigating the distribution of ownership in shares registers the more appropriate way to find out the *control* in a company is to study the voting pattern and the relationship which subsists between the shareholders and the board. [2/] "While (he agrees with Berle and Means) that the 'bulk of the owners have in fact almost no control over the enterprise', the power of the small proportion of 'large' owners (one to five percent) remains undemonstrated by (their) analysis, and in the absence of knowledge of relationships between directors and such large owners, the 'negligible proportion of the total ownership' held by directors themselves is irrelevant to the issue". [3/] He suggests that the voting power in the hands of small numbers of relatively large owners (one to five percent) is enough to determine control, as indeed, it is to secure the re-election of directors in Australian management-controlled companies, if this amounts to 15 percent of the total votes.

Precious little empirical research has been conducted in this country into the extent of separation of ownership from control, or for that matter, the relationship between both. The book by Professor P.Sargant Florence, Ownership Control and Success of Large Companies,1961. has provided useful reference to many writers. [4/] Professor Florence's

---

1/ Ibid

2/ Pp.139-140. See also Nichols, at p.21.

3/ At p.142.

4/ For example, to Nichols in Ownership Control and Ideology.

research was designed to find out the seat of control in the large companies. And one of his major findings was that large companies showed some degree of divorce of ownership from control. In other words, "The control of large companies is more divorced from ownership and their directors are not tied down to directing only where they own substantial capital". 1/. Also, apart from holding company-subsidiary relationships he found very few instances where one shareholder was able to control the company by virtue of owning more than 50% of the voting shares. Such cases were, in fact, diminishing in number.. 2/

Florence found an inverse relationship between the size of a company in terms of assets and the percentage of ordinary shares owned by the board. These were 2.9% for the smaller, 2.1% for the medium and 1.5% for the very large. Proportion of directors among the twenty largest shareholders was: 30% for the smaller, 21% for the medium and 16% for the very large companies. The proportion of companies with no directors holding no more than minimum qualification was, 47% for the smaller, 47% for the medium and 27% for the very large. 3/

While speculation is essentially unhelpful and is to be avoided in this area one can only surmise that the proportion of directors' share ownership and the proportion of directors amongst the highest groups of shareholders in large companies, must have diminished further with continued dispersal

1/ Florence, referring to his earlier 'pilot' study published in the Statical Journal, (1947) Part 1 p.14. See Ownership Control and Success, at p.87.

2/ Ibid.109

3/ At p.191.

of share ownership since Florence's investigation, even though there must be a definite increase in the *nominal value* of their current holdings. Indeed, Theo Nichols, in Ownership Control and Ideology, has come to this conclusion after re-working Florence's data.

While many company directors now have huge financial stakes in companies' shares (a few companies like Lonrho Ltd. and House of Frazer Ltd. may easily be recalled) [1/] it is generally accepted that this remains a very negligible proportion of the total votes and in most cases is often less than 1%. However, a higher proportion than this is necessary to secure control through votes, and the minimum proportion which has been suggested is about 10 percent.[2/] The statistical basis for exercising control with so small a proportion of votes is illustrated by Professor L.S.Penrose. [3/]

> "In a committee of three people one member will obtain the decision of his choice - that is to say, he will be on the winning side in 75% of the votings, if the other two members vote in a random manner. In a committee of five, the chance that one member will obtain the decision he wishes will be 11/16.....
>
> If a committee or electorate consists of two sections, a "resolute" bloc and an 'indifferent' random voting group, a small 'resolute' group of people who always vote together can exercise a surprisingly powerful control over

---

1/ For example, as at 30.9.79, out of the total issued share capital of Lonrho Ltd. (210,970,942), the chief executive, Mr.'Tiny' Rowland had interests in 26,276,845 fully paid shares. In the House of Frazer, the chairman Sir Hugh Frazer, as Trustee, had interests in 3,576,291 ordinary shares out of 27,383,000 (as of Jan.1980)

2/ Gordon, op.cit. p.39, suggests a minimum of 3% and Beed, 15%

3/ "The Elementary Statistics of Majority Voting", (1946), 109, Journal of Royal Statistical Society, 53-54; see also P.S.Florence "The Statistical Analysis of Joint Stock Company Control", (1947) J. Royal Statistical Society, 2, 4.

> the whole committee. Thus, three resolute votes can control a committee of twenty-three to the same extent that one vote can control a committee of three. Furthermore, a block of twenty-three could control, again to the same extent an electorate of over 1,000.... These blocs have about a 75% chance of carrying the decision in their respective electorates, but, by increasing the size of the resolute bloc, any specified degree of control can be obtained. Blocs three times as great as those mentioned would carry the decisions they desired in nearly 96% of the situations encountered".

From the above calculation, in a company with 1,000 voting shares a resolute bloc with 20 x 3 votes (6.0%) could with 96% probability carry the decisions they desire - including the appointment of the board. 1/

Given appropriate circumstances, therefore, any shareholder whether or not he is a director, if "resolute" enough, and can gather a reasonable amount of votes can control the company. However, as Professor Florence notes, "The proportion of *votes* directors hold is of less importance since, once they are directors, they exercise control more by the very fact that they are directors and less by ownership of votes". 2/

The fact that control is in the large company separate from ownership must not obscure the primary concern in Company Law that the diverse shareholders who provide the funds must be assisted to the means of safeguarding their investments. The means for shareholders' control will therefore be examined.

1/ See P.S.Florence, Ownership, Control and Success, 46.

2/ Ibid., 92.

3. The Means for Shareholders' Control

While, so far, control has been considered solely in terms of the ability to influence the policies of the company through the appointment of directors, this is not an exhaustive definition. Indeed, Berle and Means, whose definitions we have adopted, themselves observed that control may be exercised "not through the selection of directors, but through dictation to the management, as where a bank determines the policy of a corporation seriously indebted to it". 1/ As Berle later points out in New Directions in the New World "No accurate definition of control has ever been made (and) it is impossible to describe the process". 2/

The issue of shareholders' control has never been that they should become involved in active day-to-day management of the company and if that was the case it would defeat the objective of appointing directors. Thus, apart from the appointment of directors, shareholders control is often for the most part, passive, which in the words of R.A.Gordon, consists of "the ability to take effective action if at any time it thinks its interests are adversely affected". 3/ A chief concern for the members, therefore, is to ensure that the goals and policies pursued by the board and the company's management do not constitute a threat to or

1/ At 66.

2/ (1940) 82.

3/ At 157.

conflict with the interests of the company. Berle and Means first drew a contrast between the interests of shareholders - the maximisation of profits and freely marketable shares, and the interests of corporate management - and wondered that if the prime motivating factors in the control of companies is *personal* gain then there might be a temptation for the directors to use their position to maximise *their* own interests. While this tendency cannot be demonstrated scientifically, 1/ and while many directors are themselves shareholders "it does not", as Nichols observes, "necessarily follow that they will regard themselves as shareholders rather than managers or administrators". 2/ This, therefore, reinforces the need for shareholders to oversee the activities of directors.

(i) The Techniques and Resources for Control:

Although it had been observed in Chapter 1 that the overriding intention behind most of the Companies Acts has been the protection of shareholders and creditors this must not be understood to mean that the provisions of these Acts have been of no relevence whatsoever, for shareholders' control. Indeed, some of those provisions as briefly mentioned above and as will be further illustrated below, form part of the techniques and resources for control available to shareholders, and to this extent rules for the protection of shareholders and rules for control by shareholders cannot be put into completely water-tight compartments. The relationship between both is best illustrated by the disclosure provisions in the Companies Acts.

1/ See Robin Marris, The Economic Theory of Managerial Capitalism (1964) and Oliver E. Williamson, The Economics of Discretionary Behaviour : Managerial Objectives in a Theory of the Firm (1964).

2/ At 79.

At Common Law there was no positive duty for disclosure [1/] but it was inevitable, in view of the complexity of the business of the joint Stock company that the keeping of proper books of accounts and reports should be considered a *sine qua non* to good and efficient management. Indeed, Eldon L.C. had stated in White v Lincoln [2/] long before it was considered a subject for legislation in the 1844 Act that any person standing in the relation of a "general agent", and "manager" "is bound to keep regular accounts of his transactions on behalf of his employers". [3/] Thus it has often been held that directors as agents of a company are under duty to keep accounts of their receipts and payment dealings and transactions on the company's behalf. [4/] When the 1844 Act came to be passed its originators "aware of the difficulties and dangers of corporate enterprise, were convinced that the best protection for the public was the fullest possible publicity, extending to the auditing of balance sheets, while the best protection for creditors was the maintenance of the principle of the full liability of shareholders" [5/] The ideas of disclosure and publicity have, therefore, been recognised as vital to enable shareholders to find out when their interest are being adversely affected or to prevent this occurring in the first place. Successive companies legislations since 1844 (with a few exceptions [6/]) have "relied upon and extended the original legislative idea as an essential

---

1/ See O. Akanki, "The Legal and Practical Significance of Disclosure and Publicity of Company Information", (1976) Vol. 13 Nigerian Bar Journal, 13.

2/ (1803) 8 Ves. 363; 32 E.R. 395.

3/ 32 E.R. 395, 397.

4/ See A.B. Levy, 728.

5/ Ibid. 71-72.

6/ See supra pages 29 and 45.

weapon for effective control and efficient management of companies whose membership became more and more fluid and widely dispersed". [1]

The requirements of the Companies Acts, it was pointed out in Chapter 1, obliges the company and directors to lay before the annual general meeting copies of the annual accounts, which consist of the balance sheet and profit and loss account and group accounts in the case of a holding company, and the directors' report, and to maintain an accounting record. [2] Every member is entitled to inspect the auditors report on the above matters, which must be made to the general meeting. Also usually presented to the members these days is the increasingly more informative Chairman's report [3] which, however, is not usually covered by the auditors' report. Also every year the annual return must be filed with the Registrar and is to be open to inspection by members on payment of a fee. [4]

Apart from those matters required by law to be contained in the accounts companies may by their articles specify additional matters for disclosure and where Table A is adopted for example, such matter as the amount of dividends to be declared must be disclosed to the general meeting. [5]

1/ Akanki p. 14.
2/ See pp.59-64 supra.
3/ See Cmnd 1749. para. 115.
4/ See Sections 124-126 1948 Act.
5/ See article 52 Table A.

weapon for effective control and efficient management of companies whose membership became more and more fluid and widely dispersed". [1]

The requirements of the Companies Acts, it was pointed out in Chapter 1, obliges the company and directors to lay before the annual general meeting copies of the annual accounts, which consist of the balance sheet and profit and loss account and group accounts in the case of a holding company, and the directors' report, and to maintain an accounting record. [2] Every member is entitled to inspect the auditors report on the above matters, which must be made to the general meeting. Also usually presented to the members these days is the increasingly more informative Chairman's report [3] which, however, is not usually covered by the auditors' report. Also every year the annual return must be filed with the Registrar and is to be open to inspection by members on payment of a fee. [4]

Apart from those matters required by law to be contained in the accounts companies may by their articles specify additional matters for disclosure and where Table A is adopted for example, such matter as the amount of dividends to be declared must be disclosed to the general meeting. [5]

1/ Akanki p. 14.

2/ See pp.59-64 supra.

3/ See Cmnd 1749. para. 115.

4/ See Sections 124-126 1948 Act.

5/ See article 52 Table A.

The importance of disclosure becomes very apparent when it is realised that decisions and votes on such matters as the shareholders' approval of the dividends recommended by the directors would usually be determined by what is disclosed to them in the accounts and reports. In addition:

> "availability of financial information assists shareholders in determining whether they should sell their holding, accept take-over bid or amalgamation as a protection against abuse or inefficient management. It is for this purpose that copies of financial statements of the company have to be forwarded to members including debenture holders twenty-one days in advance of the general meeting" ...
>
> "Indeed disclosure in accordance with the requirements of the law...may have the effect of preventing blanket ratification of acts and business proposals of bad management by shareholders who have thus become well informed" 1/

It is generally accepted by many writers that disclosure and publicity is a means of forewarning shareholders of possible danger and that "forewarned is forearmed". Although this principle is sound in logic its relevence to investors has, for a number of constraints been less than adequate, unless it is supported by more effective weapons such as a Department of Trade investigation. 2/ The problem of difficulty of communication in accounts and reports have been mentioned in Chapter one. The other problem which is more "structural" in nature will be examined in

---

1/ Akanki, p. 14. No doubt, disclosure in accounts serves also as a protection to directors by, for example, affording them information about the company's financial position so that they may avoid such irregularities as the payment of dividends out of capital and helping them to plan ahead. Other beneficiaries from disclosures include creditors, employees and liquidators. See Pennington p. 616.

2/ See Gower 4th ed. p. 497.

later chapters and in the meantime, we will continue with our discussion of techniques for shareholders' control.

(ii) The Right to Dismiss Directors:

Until 1947, many company directors held office for life and could not be removed while some could only be removed by special resolution. The 1947 Act, and later, Section 184(1) of the 1948 Act empowered the general meeting to dismiss directors by ordinary resolution. The only limitation to this power now is that if it is exercised in breach of an existing agreement between the company and the director, the company will be liable to pay damages for wrongful dismissal. 1/

1/ Southern Foundries v. Shirlaw [1940] A.C. 701.

The power of dismissal under Section 184(1) has until the past decade been regarded as absolute but the two cases of Bushell v.Faith.[1] and Re.Westbourne Galleries Ltd.,[2] have revealed two ways in which the application of the section can be defeated:

(a) The Loaded Vote:

In Bushell v. Faith, the House of Lords was faced with the question of deciding the validity of a provision in a company's article (Art.9) which had been inserted with the express purpose of circumventing Section 184(1). The company had an issued share capital of £300 divided equally between the plaintiff, the defendant and B, her sister into 100 shares each. By Article 9 in respect of any resolution for the removal of a director from office any shares held by that director would carry the right to three votes per share. At a meeting of the company, a resolution for the removal of the defendant from the board was voted in favour by the plaintiff and her sister and against by the defendant with the result that there were 200 votes for and 300 against the resolution. The House of Lords found that Article 9 was valid and enforceable, despite Section 184(1). It was perfectly legitimate, they said, for members to incorporate by contract in the Articles such a provision to defeat the effects of Section 184(1).

1/ [1970] A.C.1099.

2/ [1971] 1 W.L.R.1378 (C.A.). [1973] A.C.360.

(b) The "Just and Equitable" Doctrine:

In Ebrahimi v. Westbourne Galleries Ltd. the plaintiff and N carried on business in partnership. Subsequently, a company was formed which acquired the business of the partnership. The other shareholders were N and his son G who were also directors. A dispute arose between the appellant and the other two and the company passed an ordinary resolution under Section 184(1) for the removal of the appellant as director. The appellant petitioned the Court for, *inter alia*, a winding-up order on the "just and equitable ground" under Section 222(f). Plowman J, at first instance, granted a wind-up order, stating:

> "while no doubt the petitioner was lawfully removed, in the sense that he ceased in law to be a director, it does not follow that in removing him the respondents did not do him a wrong. In my judgment, they did do him a wrong, in the sense that it was an abuse of power and a breach of good faith which partners owe to each other to exclude one of them from all participation in the business upon which they have embarked on the basis that all should participate in its management. The justification put forward for removing him was that he was perpetually complaining, but the faults were not all on one side and, in my judgment, this is not sufficient justification. For these reasons, in my judgment, the petitioner, therefore, has made out a case for a winding-up order". 1/

1/ [1971] 1. W.L.R.1378,1389.

Plowman J. was reversed by the Court of Appeal but the House of Lords restored his decision.

The ways in which the full rigours of Section 184(1) can be evaded by the circumstances illustrated by those two cases have come under criticism from many sources, for they "contravene the spirit, if not the letter of Section 184", [1] although, one commentator [2] has justified them as a check to possible abuse by shareholders of their power of dismissal. At any rate, it is to be noted that those two cases involved private companies and the circumstances surrounding them are those peculiar to small, private, quasi-partnership types of companies. They should not, therefore, hinder the important use which shareholders in large companies can make of Section 184. In particular, a clause similar to that in Bushell v. Faith is prohibited under the Listing Agreements of the Stock Exchange rules. [3] A public company which had such a clause would not, therefore, be listed.

1/ See the Editorial Note. "House of Lords Sanctions Evasion of Companies Acts" (1970) J.B.L.1; D.D.Prentice "Removal of Directors from Office", (1969), M.L.R.693; Gower 4th edition, 149.

2/ Bernard J. Cartoon, "The Removal of Company Directors" (1980) J.B.L.17, 23. See also A.B. Afterman, Company Directors and Controllers.(1970).20

3/ See Admission to Listing. Schedule VII, Part A. D.4.

(iii) The Right of Access to Books and Records.

Beside the control exercised through the appointment and dismissal of directors, Company Law further enhances the power of shareholders through other subtle means, as dismissal, which is the ultimate punishment, is rather too drastic and cannot be employed on a continuing basis. The most important of these other means of control is shareholders' right of access to the company's books and records as well as interim and annual reports.

By an extension of the partnership analogy at Common Law a shareholder had the right to inspect the corporate books and records for legitimate purposes but a company could not be compelled to open its books and records to a shareholder on mere suspicion that the company were being mismanaged. In other words, the law would not allow him to go on a "fishing expedition" in the hope of discovering suspected acts of mismanagement or fraud. 1/ However, while the above is still law in some U.S. jurisdictions, 2/ in the U.K. the Common Law rights of shareholders to inspect corporate books and records is now, as A.B. Levy puts it, "practically extinct". 3/ Thus in Butt v Kelson 4/ Romer J., held that beneficiaries (who were entitled to be treated as though they were registered shareholders and having the same rights as shareholders in relation to directors) were not entitled to compel the directors to produce certain documents of the company which they wished to inspect.

1/ See Lattin on Corporations. 344 (1971 edition)

2/ Except to the extent to which such right is curtailed. See Lattin, ibid; 345-352 and Gower, 505.

3/ A.B. Levy, p. 778.

4/ [1952] Ch. 197.

It is important to draw a distinction between shareholders' right to inspect the register and index of members and minutes of the general meeting on the one hand and their right to inspect minutes of directors' meetings and accounting records on the other hand for their rights in either case differ .

In accordance with Common Law Section 113 of the 1948 Act gives members the right to inspect the register and index of names which must be made available without charge for inspection for at least two hours each day except where the register remains closed to inspection under the provisions of the Act. Section 146 provides for the inspection of minute books which are required to be kept in accordance with the provisions of Section 145. The books containing the minutes of proceedings of the general meeting of a company, must, during business hours be open to the inspection of members without charge.

This is made subject to such reasonable restrictions as the company may impose by its articles or in general meeting, but at least two hours each day must be allowed for inspection. Any member is entitled to be furnished within seven days after he has made a request in that regard to the company with the necessary minutes at a charge not exceeding sixpence for every hundred words. 1/

1/ Section 146(2). This charge needs to be reviewed if it is to remain in the books at all, for it is no longer a fair assessment of the true costs involved.

The above provision reinforces the decision in R. v. The Mariquita.[1/] In that case a company registered under the 1856 Act had the following clause in its articles of association:

> "the books wherein the proceedings of the company are recorded shall be kept at the principal offices of the company, and shall be open to the inspection of the shareholders every day of the year..." "(except on Sundays and holidays)".

The deed provided that separate books should be kept of the minutes of the proceedings at the general meetings of the shareholders, and of the minutes of the proceedings of the directors. On an application for an order of mandamus to compel the company to grant to a shareholder "inspection of the books of the minutes of the proceedings of the said company", it was held that the clause gave shareholders only power to inspect the books of minutes of the general meetings, and not the books of the minutes of the proceedings of the directors. [2/]

Although every company is required under Section 147, 1948 Act to keep proper books of accounts members of a company have no statutory or common law right to inspect the company's accounting records [3/] just as they have no right to inspect minutes of directors' meetings.

1/ R. v. The Mariquita and New Granada Mining Co. (1858), I.E. & E. 289; 120 E.R. 917.

2/ See S. 146, 1948 Act.

3/ Baldwin v Lawrence (1842) 2 Sim & St. 18; 57 E.R. 251.

It is clear, however, that if under the articles of association a shareholder has a right to inspect the books that right is absolute and the company is not entitled to refuse his request. And, of course, the right to inspect is generally construed to include the right to take copies. 1/ Thus it has been held in Mutter v. Eastern and Midlands Railway Co., 2/ that even if a person has taken his shares or stock in a company for the purpose of serving the interests of a rival company or other selfish or malicious motive this does not disentitle him to the assistance of the court in enforcing the statutory rights of inspection and perusal of the company's register.

Also in Holland v. Dickson 3/ it was held that the statutory right given to holders of stock and debentures to inspect the registers of a company is not confined to an inspection of the names and addresses only of the stock and debenture holders. It may be exercised without assigning any reason for requiring inspection, and can be enforced by an injunction restraining interference by the company with the stockholder in the exercise at all reasonable times of his statutory right, and it is not necessary for him to apply to the court for an order to compel the directors to allow inspection.

1/ Nelson v Anglo-American Land, etc. Agency [1897] 1 Ch. 13
2/ (1888) 38 Ch. D. 92.
3/ (1888) 37 Ch.D.669.

In view of the wideness of the power to inspect where conferred on members it is not surprising that although an additional power to inspect accounting records may be authorised by the company's directors the very delicate and confidential nature of such documents means that such a power is, in fact, rarely ever conferred.

Article 125 of Table A empowers a member to inspect his company's books and accounts but on condition only that the board of directors or a general meeting so authorises. That article provides:

> "The directors shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations the accounts and books of the company or any of them shall be open to the inspection of members not being directors, and no member (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by Statute or authorised by the directors or by the company in general meeting".

Although reference in that article to "book or document" might suggest a reference to registers and so on [1/] to which members ordinarily have a statutory right of access, it is submitted that the article only entitles the directors to refuse members access to books and further documents relating to accounts to which the members might wish to gain some access. The statutory rights of access conferred by the Act such as in Sections 113 and 146, 1948 Act, and Section 26, 1967 Act cannot be fettered or overidden by articles or by contract.

1/ That is, register of members; debenture holders; mortgages and charges; directors and secretaries and registers of director's interests as well as annual returns.

The power of directors under article 125 to refuse or restrict access to a company's accounts and books is subject to the qualification that the court will order production of the documents if they are necessary for the purposes of litigation. Thus in Cartland v Houston and The British, etc. Navigation Co. Ltd., 1/ the company's articles of association provided, *inter alia*

> "The managers shall from time to time determine whether, and to what extent, and at what time and place, and under what conditions or regulations the accounts and books of the company or any of them shall be open to the inspection of the members, and no member shall have any right of inspecting any account or book or document of the company, except as conferred by statute or authorised by the managers".

The plaintiffs, who were shareholders in the company alleged that the managers had taken from the company's funds certain commission to which they were not entitled and had received commission from the company's customers on behalf of the company without accounting for them. The managers had complete control of the company and never allowed the members access to any information other than those communicated to them. In the course of an action by the plaintiff an application was made against the managers and the company for an order to produce certain documents in their possession or power respectively, and for liberty to inspect the same. For the defendants, it was argued that the effect of the company's articles was that the plantiffs had on becoming shareholders, contracted to deprive

1/ [1912] W.N. 110.

themselves of the right to require production and inspection of the documents. Rejecting this contention Eve, J., held that the order sought for could be made. To accept the defendant's contention would be to allow such an article to become "an engine of dishonesty". 1/

Also in R. v. The Master and Wardens of the Merchant Tailors Company. 2/ Lord Tenterden C.J. held that an application by a shareholder to inspect a company's documents would be granted if it is shown that such inspection is necessary with reference to some specific matter which is the subject of litigation and the inspection will then only be granted to such extent as is necessary for that particular purpose. It will not be granted on mere suspicion or in order to discover information which will afford him ground for complaint.

The rationale for restricting members' access to some corporate information, and so denying full publicity, it is generally agreed, is based on expediency and business convenience.3 The right to inspect is sometimes resisted on the ground of suspicion of malicious intention on the part of the shareholder. It is also resisted on the ground that

---

1/ P. 111. In re Credit Company (1879) 11 Ch. D. 256 and Gourand v. Edison Gower Bell Telephone Co. Ltd. (1888) 59 L.T. 813, followed.

2/ (1831) 2 B. & Ad. 115; 109 E.R. 1086.

3/ See A.B. Levy, op. cit; 778 and O. Akanki, op. cit., 26.

divulging certain types of business information would be harmful to the company or its shareholders creditors', employees', etc, interest. In the event, however, a member who has a genuine reason for seeking information or who is simply inquisitive must surmount the up-hill task of proving in court that he is actuated by honest and rightful motives and he must be able to afford the time and expenses for such litigation. The realities of business life today is that this is not a very likely prospect and in practice shareholders are able to rely for information on accounts only in disclosures in the directors' reports and the now increasingly more informative Chairman's report in the company's annual accounts and reports.

Directors must not only supply the requisite information to shareholders, but are under a fiduciary obligation to ensure that information given to the shareholders is factually correct. In the Ontario Court of Appeal case of Goldex Mines Ltd. v. Revill. 1; an important and central feature in the judgement was that the dissemination of "misleading information" by the directors to the members violated the

---

1/ (1975) 54 D.L.R. (3rd) 672.

personal as well as the company's rights. As the Court stated:

> "If the directors of a company choose, or are compelled by statute, to send information to shareholders, those shareholders have a right to expect that the information sent to them is fairly presented, reasonably accurate, and not misleading". 1/

Thus, it was held, that a misleading annual report or information sent by the directors to the shareholders provided the basis for a personal action by a shareholder.

The reason for the above position is that a shareholder is entitled to adequate information from which he can form an intelligent judgment on the matters he is entitled to vote on. 2/ The decision is therefore an important guarantee that shareholders are reasonably able to control with a higher level of knowledge about the true state of facts.

The restrictions on members' rights of access to the company's books are to a degree compensated for by the powers of inspection and investigation into the affairs of a company under Sections 164-167 of the 1948 Act, and Part III of the 1967 Act. However, proceedings under those sections are so expensive and dilatory that they do not provide an effective means of control to shareholders who are being

---

1/ At 679.

2/ See also Garvie v. Axmith [1962] 31 D.L.R.(2d) 65 at 82-7 and Re. National Grocers Co.Ltd.[1938] 3 D.L.R.106,116,followed in Goldex.

deliberately denied access to vital corporate information. Moreover, like the right of dismissal access to information through inspection by a Department of Trade Inspector cannot be relied upon on a continuing basis, for this would seriously impede the smooth operation of the company. 1/ In any case and for all practical purposes inspection and investigation by the Department of Trade is more important as a means of protecting shareholders from directors' fraud than as a means for shareholders' control.

Lastly, the difficulty of getting through information to shareholders is made less of a hindrance to shareholders' control by the requirement of their approval of many categories of important policies and decisions. This requirement obliges the board to present these matters to the general meeting, but it stands to reason that the ability of shareholders to decide on such matters would depend on their reliance on adequate mechanisms for evaluation and information. How far the mechanisms provided by company law help in the process of shareholders' control will be examined in later chapters. Also shareholders can insist that directors manage in strict compliance with the provisions of the Company's constitution, which they can alter or modify as they wish by special resolution. The mechanism for achieving this through the general meeting will be the subject of a later chapter.

1/ That is, were they willing to intervene to provide information to shareholders as often as needed. It is now well-known that they are not so inclined. See Atiyah, "Thoughts on Company Law Philosophy" (1965) 8. The Lawyer, 20-21; John Hull, "Department of Trade Investigations", (1979) N.L.J.825. The Chairman of Prudential Assurance remarked in the 1980 Annual Report that the investigatory powers of the Department of Trade are less useful to enforcing shareholders rights than the right of direct action, provided the procedural difficulties are minimised. This was in the aftermath of their successful legal action against the directors of Newman Industries. Further reference will be made to this case.

4. Shareholders as Controllers:

When the Jenkins Committee reported in 1962, it observed that the constraints which the Cohen Committee held responsible for the low level of shareholders' control in 1947 were basically the same as those existing in 1962, but it was confident enough to say that Cohen's description of shareholders' control as 'illusory' had become something of an 'over-statement'. It took the view that:

> "The [1948] Act provides shareholders with powerful weapons providedthey choose to use them, and even if practical considerations make them difficult for the small investor to wield, the same cannot be said of the institutional investor who is not likely to submit to any major abuse of power by the directors of any company whose members include investors of that description. Moreover, where quoted companies are concerned the Stock Exchange requirements and the sanctions for them in the shape of refusal or suspension of quotations provide some protection". 1/

With the benefit of hindsight it is now clear that the well-meant views of the Jenkins Committee in 1962 were rather over-optimistic, for while the scale of institutional shareholders, indeed, continued to rise even, perhaps, faster than the Committee may have anticipated it is still a moot point whether or not institional investors are active controllers in companies in which they invest. 2/

1/ Cmnd 1749 para.106.

2/ The extent of Institutional shareholders' participation is to be examined later.

Concerning the issue of protection by the Stock Exchange requirements mentioned by the Committee, it is to be observed that the position of shareholders in listed companies is being increasingly strengthened largely through constant revisions and extensions of the regulations now codified in the "Yellow Book". The most important of these obligations in the listing agreement relate to the full and prompt disclosure of information and to a company's conduct towards its shareholders in relation to such matters as further issues of equity, the share register and the general and board meetings. The Wilson Committee, [1] considered the Stock Exchange listing agreement an important form of non-statutory regulation of the conduct of listed companies, noting:

> "In certain important respects the listing requirements go some way beyond those imposed by the Companies Acts. It is for example, the listing agreement rather than the Companies Acts which requires half-yearly and interim reports and the prompt publication of details of any major acquisition or disposal". [2]

The Committee found very few cases of breach of the regulations, adding that in practice the threat of suspension, and the consequent notoriety have usually proved sufficient to ensure compliance in all important respects. [3] Although the Stock Exchange regulations have, in general, proved an effective safeguard for shareholders the fact must not be overlooked that some of the requirements and the expenses for complying

---

1/ Cmnd 7937. Committee to Review the Functioning of Financial Institutions (Report) under the Chairmanship of Sir Harold Wilson (H,M.S.O.). (1980). Paras.1129-1142.

2/ Para.1140.

3/ Para.1142.

with them have caused greater problems for shareholders who attempt to exercise their powers of control. 1/

Be that as it may, it is sufficient to say briefly here that the 1962 hopes of the Jenkins Committee for more effective shareholders control have remained to a large extent, unfulfilled. It must be conceded, though, that institutionalshareholders' participation has increased to very considerable extent in recent years, so much so that any new and serious proposals for more effective shareholder control has, essentially, to revolve around them. To this end the growth of investment institutions and their systems of participation are examined at various points in this thesis and the section which follows immediately considers their position in the general profile of shareholders in the leading companies in the U.K.

5. Profile of Shareholders:

(i) Introduction:

In 1963, Professor Jack Revell, Cambridge University, commenced his pioneering survey of the pattern of ownership of quoted equities in the United Kingdom. 2/ Ever since that study, there has developed an increasing interest in similar surveys by companies, academics and government departments to ascertain, amongst others, the distribution

---

1/ A very important illustration of such difficulties is the experience of the Burmah Shareholders Action Group when they tried to circularise their views amongst the company's shareholders. See Chapter 5.

2/ Published in 1966 for the Department of Applied Economics at the University of Cambridge as, Jack Revell and John Moyle, The Owners of Quoted Shares - A Survey for 1963.

of shareholdings between private [1/] and institutional shareholders. [2/] These studies are important because the votes attached to these securities (that is excluding voteless shares) give the owners legal power to influence management in the conduct of the business and so it is wise to know in advance who these owners are. This is of immense significance to, among others, management in companies in times of crisis or a take-over when the support or opposition of a solid block of shares with voting rights can be crucial. [3/] One episode which illustrates this is the 1972 battle by Grand Metropolitan Hotel to take-over Watney Mann (W.M.) which was resolved by the decisive swing of the solid vote of institutional investors in favour of Grand Met even though the numerically superior individual shareholders of W.M. preferred the company to remain independent.

Again the immense importance of support by holders of large blocks of shares was recently demonstrated in the battle between Raccal and G.E.C. to take-over Decca - the ailing electronic company. Despite several months of hard negotiations it was not until Raccal could count on 50.4% of the voting shares in Decca that the bid was finally concluded and G.E.C. conceded defeat. In the end Raccal attributed its success to its power of persuasion over the U.K. institutions who lent their support - notably Prudential Assurance

---

1/ Private, refers to individual shareholders.

2/ The most importmant of these include insurance companies, pension funds, unit trusts and investment trust companies.

3/ See R.A.Vernon, M.Middleton and D.G.Harper, Who Owns the Blue Chips, A Study of Shareholding in a Leading Company. (Gower Press,1973),at pp.2-3. Hereafter, Vernon, Middleton & Harper.

and Kuwait Investment Trust with a combined holding of 17½% and other institutions collectively holding another 13%.

Of greater importance than the effect of private or institutional support in such take-over or other crisis situations is the degree of legal control which shareholders in general and these respective categories in particular exercise over corporate management. 1/

(ii) The Pattern of Distribution

The latest survey, 2/ intc the Ownership is quoted shares in the U.K. like the previous surveys indicates that while there has been a steady fall in the proportion of total market value of shares held by the personal sector since the first survey in 1963 there has been a steady rise in the proportion held by financial companies and institutions. 3/ The proportion for the private shareholders were 56% in 1963, 50% in 1969 and 40% in 1975. For institutional shareholders the figures are 30% in 1963, 36% in 1969 and 48% in 1975. 4/

1/ These are discussed in the Chapter on Shareholders Participation.

2/ M.J.Erritt, J.C.D.Alexander and A.J.Watson, The Ownership of Company Shares: A Survey for 1975, prepared by the Central Statistical Office, Department of Industry (H.M.S.O.) 1979. This survey also contains summaries of the broad trends in the distribution of beneficial ownership since the earlier Cambridge surveys of 1963 and 1969.See particularly paras.1.7. - 1.9.

3/ See Table 1. Infra.

4/ See also R. Dobbins and T.W.McRae, 'Institutional Shareholders and Corporate Management, University of Bradford Management Centre 1975. Richard Briston and Richard Dobbins, The Growth and Impact of Institutional Investors. A report to the Research Committee of the Institute of Chartered Accountants in England and Wales (1978) (Henceforth Briston and Dobbins).Although the figures cited by these reports have slight differences because of different methods of computations used by the authors,they nevertheless all indicate similar trends in the distribution patterns. It is not necessary to set out all these figures here.

Apart from such general surveys of share-ownership patterns in hundreds of companies there has also been, in recent years, more detailed privately commissioned surveys into some individual companies notable amongst which are The Fisons Shareholder Survey [1/] and Who Owns the Blue Chips? - A Study of Shareholding in a Leading Company.[2/] These two surveys show a distribution pattern similar to that found by the earlier Cambridge study for all quoted equities, that is to say, falling private shareholdings and increasing institutional holdings. The most recent of these studies is the fourth Fisons Survey - Profile for 1979.

Profile for 1979 [3/] once again indicates the gradual but steady drop in the percentage of total shares held by individual shareholders in Fisons Ltd. On the front cover of this report is a photograph of a gravestone which bears the inscription "The British Shareholder is not dead, Just Forgotten". This macabre message was the company's reaction to the demise of private shareholders which had become increasingly evident in their surveys conducted first in 1969 and subsequently in 1972, 1973 and 1978. In 1969 the private shareholders held 55% of the total shares. The next consecutive surveys showed a fall to 49% in 1972, 44%

1/ Fisons Ltd. is a leading agro-chemical company in the U.K. with extensive international operations. The first of their surveys was undertaken in 1969.

2/ Vernon, Middleton and Harper (1973).

3/ At p.14.

TABLE I

Distribution of Market Values of Shareholdings between Sectors of Beneficial Holder: 31 December 1963, 1969 and 1975

Percentage

Sector of beneficial * Shareholder	163	1969	1975
Personal Sector	56.1	49.5	39.8
Financial companies & institutions	30.4	35.9	48.1
Industrial and commercial companies	5.1	5.4	3.0
Public sector	1.5	2.6	3.6
Overseas sector	7.0	6.6	5.6
Total:	100.0	100.0	100.0

* Classified by the category definitions issued in the 1963 and 1969 surveys.

Source: Department of Industry Survey (1979 Table 1.1).

TABLE II

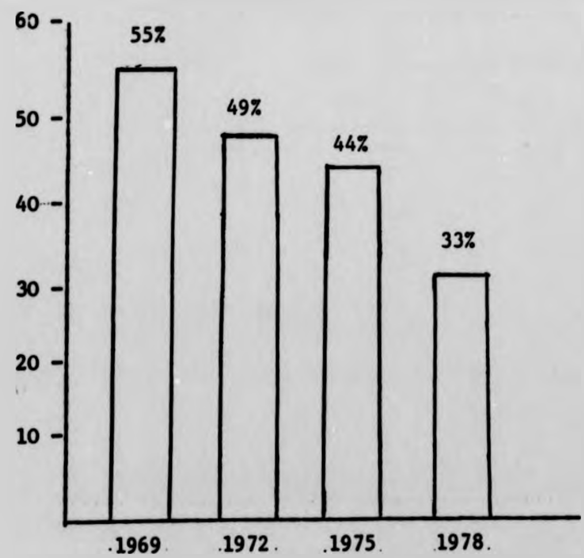
Number of Private Fisons Stockholders*

1969	30,874
1978	25,319

* U.K. registered excluding American Depository Receipts.

Source: Fisons' Profile.

CHART I Fisons Registered Ownership by Individuals



(Source: Fisons' Profile)

TABLE III

Fisons Stock Register: Average Holdings (nominal)

	1969	1978	% increase
Individuals	£420	£459	9%
Institutions	£4,282	£8,967	109%

Source: Fisons' Profile.

TABLE IV

Distribution of Shareholdings between Categories of Beneficial Shareholder: Comparison between Surveys for 1963,1969 and 1975.

Category of beneficial shareholder:	Percentage		
	1963	1969	1975
Persons	54.0	47.4	37.5
Insurance companies	10.0	12.2	15.9
Pension Funds	6.4	9.0	16.8
Unit Trusts	1.3	2.9	4.1
Investment trusts and other financial companies (5)	10.0	8.7	10.0

Source: Department of Industry Survey (1979). Table 3.2.

(Note: Figures for smaller categories of beneficial shareholders- charities, stockbrokers and jobbers, Banks, Industrial and Commercial companies, the public sector and overseas sector, have been omitted.)

in 1975, and 33% in 1973.[1] This means that over the previous 10 years, the number of private U.K. registered shareholders in the company had fallen by 20%. By contrast, it was found that institutional investors had increased the proportion of their holding by nearly 50%, that is, a nominal value of about £4,300 in 1969 to nearly £9,000 in 1978. [2] The head of the company's planning group, Dr.H.Redwood estimated that on the current trends private shareholders will own no more than 10% of Fisons shares in eight years time.

Although there were peculiar circumstances which almost certainly influenced the trends in the ownership patterns in Fisons shares it is obvious that the overall picture is representative of the trends in large public companies in the U.K. This, in fact, is acknowledged by the Wilson Committee's Report.

A break-down of the holdings by the major institutions shows that for the years 1963, 1969 and 1975, insurance companies' ownership was 10%, 12.2% and 15.9%; pension funds, 6.4%,9.0% and 16.8%; unit trusts 1.3%, 2.9% and 4.1%. Investment Trusts, and other financial companies held for those years, 10%, 8.7% and 10%. Apart from this latter group, therefore, the trend for institutional holdings was on the

1/ See Table II and Chart 1 ; (Source: Fisons Profile for 1979).

2/ See Table III.

increase. For pension funds, however, the figures were 54% in 1963, 47.4% in 1969 and 37.5% in 1975. 1/

The reason for this trend is that while institutional investors have been net buyers of equities, private investors have been net sellers. 2/ This has strengthened the power of institutions *vis-a-vis* the other shareholders in the power structure of the company. Private shareholders have become increasingly insignificant.

The growth in the size of institutions can be attributed to the shift in investors' preference to institutions rather than direct personal investment in a company - the reason being to minimise risks. For example, when the first investment trust company, the Foreign and Colonial Investment Trust Co.Ltd. was set up in 1868 it stated its objectives as being "to provide the investor of moderate means the same advantage as the large capitalist in diminishing risk in foreign and colonial stocks by spreading the investment over a number of stocks. 3/ This spreading of risks had continued to be a major advantage in investing in the securities in an investment institution

---

1/ See Table IV.

2/ See e.g. Richard Briston and Richard Dobbins, pp.9-14. See also Dr.K.Midgley, Companies and their Shareholders - The Uneasy Relationship (1975), p.53.

3/ See A.A.Arnaud Investment Trusts Explained, Woodhead Faulkner (Cambridge 1977),p.13; See also on the origin and development of the Unit Trust, Martin Day and Paul Harris, Unit Trusts (1974),Chapter,1.

rather than a direct investment by individual shareholders in the portfolio concern.

Other advantages of investing in institutions include the benefits deriving from professional management at low cost and taxation and having someone else look after the complicated business of investment overseeing, gearing, and the ability to buy into a portfolio of shares at less than its value and so be "able to sleep reasonably soundly in the knowledge that a part at least of one's assets is being looked after in a responsible way". 1/ Besides, indirect investment in equities via institutions relieves the private investor of the difficulty inherent in ownership and control relationship. 2/

The practical limitation in using institutions as a secure fom of investment is that institutions managers do not have any personal attachment to their investment in any one portfolio company and their behaviours in specific instances are liable to be motivated by considerations different from those which motivate a private shareholder. These factors have potential influences in institutional shareholders' participation in corporate administration. 3/

1/ Baum and Stiles, The Silent Partners (Syracuse University Press, N.Y.1965),at 155.

2/ See the Wilson Committee, Progress Report pp.20 & 21.

3/ Dismissing the view that institutional shareholders can exert considerable pressure on boards, Dr.Midgley in "Corporate Governance and Accountability" (No.1.)"To Whom Should the Board be Accountable... and for What?" stresses (para.26) that investment managers are not direct investors, but intermediaries. Thus, they "may not have the same intensity of interest in the profitability of their investment as the fairly large private shareholder". It is obvious at any rate that since their position and earnings depend on how successful their investments are, they cannot but show the greatest concern for the efficient management of their portfolio.

The growth of institutions and their ownership of large quantities of ordinary shares have given them considerable voting strength to influence decision-making. Besides, the legal and structural framework, 1/ in which shareholders are required to function is such that mostly institutional investors, and very rarely the private shareholders, are able to exercise any real influence in the making of decisions or ensuring the efficiency and competence of management. The present Company Law has not yet recognised the legal and institutional constraints to which the private shareholder is especially subject and thus it is inadequate to the extent that it assumes that all categories of shareholders have the same rights and responsibilities in the company. The Wilson Committee entertained this critical view, pointing out that:

> "Although on a strict interpretation, the obligations and responsibilities of institutional shareholders, like their rights, are no more and no less, share for share, than those of private shareholders, practical considerations demand a broader view". 2/

1/ As discussed in Chapters 5 & 8.

2/ Committee to Review the Functioning of Financial Institutions otherwise referred to as the Wilson Committee (H.M.S.O.) (Interim Report), Vol.3,p.90.para.1.

The realities of shareholders' participation as recently illustrated by the case of Prudential Assurance Ltd. v. Newman Industries Ltd. 1/ is that investment institutions wield substantially more power of control over corporate management than private shareholders do and possibly ever can. The extent to which shareholders, private and institutional, participate in corporate administration will be examined in a later chapter.

6. Conclusion:

For several centuries and until very recent years, U.K. Company Law had adhered in a rather unquestioning manner to the principle of shareholders' control. Though, as we have pointed out, this principle derives legal support from the notion of property rights, its ethical and even moral justification is tenuous. It is now popularly acknowledged that the modern large company serves a number of interests and purposes which go beyond shareholders and their profits. In one way or another the conduct and products of the company affect the interests of employees many of whom must have devoted the best parts of their lives to the service of the company, the consumers of the company's products and services and, indeed, the generality of the public. There have been demands, therefore, for the replacement

---

1/ (No.2) [1980] 2 Ch.D.841.

or supplementing of shareholders' control with workers' control, consumer control and even public control through special government appointed directors or for that matter, outright nationalization.

It is beyond the scope of this work to delve into the merits of these suggestions for an alternative form of control over companies, 1/ through control over board's policies, but one notes with interest the speech by Mr.Douglas Jay cited in Chapter 1 in which he promised a "reform in the structure and philosophy" of Company Law. Although he did not spell out what exactly he had in mind, it is obvious, in view of the debates on industrial democracy which followed afterwards and actively supported by the Labour Government, that any major reform of the structure and philosophy of the present Company Law is bound to affect the principle of shareholder control. Given the trends in the harmonization of the U.K. company with the EEC Directives, it is to be expected that it will not be long before shareholders alone cease to control and that a new philosophy of workers' control will be introduced in an yet uncertain form of workers' participation. 2/

Having examined the nature of the framework for corporate governance and the philosophy of shareholder control which is central to it, it is now appropriate to examine the relationship between those two important organs of the company, the board of directors and the shareholders in general meeting, for the way a company's business is conducted very much depends on the nature of this relationship.

1/ But see George Goyder, The Future of Private Enterprise (1961), one of the earliest and best considered proposals for a new philosophy of Company Law which involves workers' control.

2/ For an attempt to propose "an up-to-date philosophy of ethics and social aspirations" in corporate governance, see Niel Martin-Kaye, "The Theoretical Basis of Modern Company Law" (1976), J.B.L.235,241, See also Goyder, ibid.

CHAPTER 3

THE NATURE OF THE RELATIONSHIP BETWEEN THE BOARD OF DIRECTORS AND THE COMPANY IN GENERAL MEETING

1. Introduction

The present relationship between the company's principal organs, the board of directors and the shareholders in general meeting, is a culmination of historical developments. 1/ At Common Law there was no legal requirement for a company to have a board of directors. 2/ Even though boards of directors were already familiar features in companies the Companies Act of 1862 was held in Re. Bulawayo Market and Offices Ltd., 3/ not to contain any legal requirement for a board of directors. In that case the company registered under the 1862 Act passed a special resolution altering some of its articles of association. One of the new articles provided that until contrary provisions were made by the company in general meeting there were to be no directors in the company and the control and management of its business were vested in another company as a "manager". In a petition to have this action declared invalid, Warrington J. dismissed the plaintiff's argument stating:

1/ The process of development has been considered in Chapter 1.

2/ The "requirement" for a board at Common Law is considered by Robert A. Kessler in "The Statutory Requirement of a Board of Directors: A Corporate Anachronism". (1958-60), 27 U.Chi.L.R. 696 at p.704.

3/ [1907] 2 Ch.D.458.

"There is not a word in those provisions (of the 1862 Act) which in any way indicates that the Legislature at any time thought it was essential that there should ever be directors of a company at all, much less that the company should not be managed by a single director who might or might not be ... a registered company". 1/

The expansion in the scope of operation of large public companies and practical necessity made it imperative for companies to have directors or persons of whatever designation performing the functions of directors. This became obligatory with the passing of the Companies Act 1929. Section 139 of that Act required every public company registered after that year to have at least two directors. It was reasoned that the nature of directors' responsibilities and obligations in the business companies were such that any large company could not do without them. 2/ The 1929 Act made no requirements for private companies to appoint a director, but as the Cohen Committee reported in 1946:

"In view of the responsibilities and obligations placed upon directors under the Act, it is an anomaly that private companies need not be required to appoint any directors". 3/

Following the recommendations of that Committee requiring at least one director for private companies, all companies in this country, big or small are now obliged by law 4/ to have a board of directors. 5/

1/ At p.463.

2/ This same reason was given by the Cohen Committee in 1946 for requiring private companies to have a board of directors. See paras. 55 and 174.

3/ Para.55.

4/ Section 176. This section provides that every company registered on or after the first of November 1929 must have at least two directors. A company registered before that date and every private company shall have at least one.

5/ The present structure and size of boards is considered in a later chapter.

Although boards of directors are now common features in companies the assumed inevitability for their existence has not gone unchallenged. The difference in the roles of directors and shareholders in companies is founded upon a division of powers between the board of directors and the shareholders in general meeting. On occasions when disputes arise owing to this division questions are raised whether the business of corporate governance would not be made much easier by vesting all or virtually all the powers in one organ or the other. Their respective authorities as decision-making organs and the dispensability or superiority of one over the other come into question - and by far the most common argument in this regard is that the general meeting is a pointless nuisance and a hindrance to the freedom of management to manage. 1/

In defence of the necessity for a board of directors, the view is held by some writers that the whole idea of incorporation is based upon the understanding that a certain corporate form for the conduct of business shall be adopted in return for the creation of a legal entity recognised by the State. 2/ In this accepted corporate form, shareholders are merely investors with certain defined contractual rights in the company's constitutional instruments, while the board's powers with respect to management are also clearly defined. 3/ In

---

1/ See for instance Bayless Manning's review in (1958) 67 Yale L.J. 1477 where he urges a "de-emphasis of the role of shareholder voting", but not necessarily the scrapping of the entire shareholder voting machinery. The importance of shareholder participation will be discussed later.

2/ This is based on the "Concession Theory" of incorporation. See Lattin on Corporations, (1971) ed.174.

3/ See Oakbank Oil Co. v. Crum (1882) 8 App. Cas.65.

Oakbank Oil Co. v. Crum. the Court emphasised the need for compliance with form stating that the powers of the board and the general meeting are "entirely created by the law and by the contract founded upon the law which allows such companies to be constituted". 1/

Opponents of the above theory 2/ contend on the other hand that the mandatory requirements in the Companies Act for a board of directors is an over-zealous response to the obvious practical advantage of having one. At Common Law, as has been mentioned above, shareholders were not compelled to have a board of directors and even where a company had one there was nothing to prevent the shareholders from vesting in the general meeting power to do those things which are commonly vested in a board of directors, leaving the board without any powers. And so it is thought that the "assumption" by the law of the superior wisdom of the board and the need for it to have exclusive powers in certain matters is unjustifiable. Following from this argument Professor Kessler, for example, challenges the belief in some quarters that:

> "the board of directors [is] an ordained corporate priesthood not only as a necessity for any business which intends to assume the corporate form but as a body of corporate guardians whose pre requisites are ultimately "inviolable". 3/

1/ Per Lord Selborne L.C. at p.71.

2/ E.g. Robert Kessler, op.cit.

3/ Ibid at 701.

In his opinion the board of directors is a "corporate anachronism" 1/ which could be voted out and replaced by shareholders, transferring the powers to themselves or "managing agents". 2/ He argues that the powers of directors come by delegation from the shareholders, and since directors exercise their authority as agents of shareholders it follows that their powers can be limited by the shareholders to the extent that they choose and the directors may be removed for failure to carry out the wishes of the shareholders. This argument is, indeed, buttressed by the case of Alexander Ward v. Samyang Navigation Company, 3/ where it has been held that the absence of a validly appointed board of directors does not prevent a company performing certain management matters such as taking proceedings to recover its debts. 4/

Although the dispensability of the board is a tenable argument in the case of small companies, it is clearly unreasonable to suggest that the modern large public companies with very extensive and complicated businesses can do without boards and should transfer all the companies' powers to shareholders. There can be very little doubt that boards of directors are so vital to the governance of the large public company that had they not existed before they would have had to be created anyway.

1/ Ibid at 713.

2/ Ibid. The writer, however, recognises the great difficulties which this would involve as illustrated by the case of Automatic Self-Cleansing Filter Syndicate v. Cunninghame, and others. The power of the general meeting to override the board is discussed in detail later.

3/ /1975/ 1 W.L.R.673.

4/ Per Lord Kilbrandon. See also p.683.

Proponents of increased shareholders' involvement in corporate governance, amongst whom are opponents of the board, are generally inspired by the quite justified concern for greater shareholder control over directors sometimes referred to as "corporate democracy" or "shareholders democracy". However, the need for shareholders' control cannot be advanced too far in the name of corporate democracy, to the point of interfering with the general management of the company's business - for this would ultimately be against the best interests of the shareholders themselves. The purpose of shareholders democracy is and should be to ensure that shareholders' rights to be well informed and to be represented with a reasonable opportunity to vote intelligently on matters that come within their proper concern. It is not to be taken too literally lest it inspires measures which might ignore the practical demands of managing large complex businesses. Management brings to most corporate problems far more knowledge, training and experience than that possessed by the vast body of shareholders. Moreover, it is undesirable that the mass of shareholders should themselves take over the operation of the company because there are other sections of the community - creditors, customers, suppliers, the employees and the rest of the public who might be prejudiced thereby and who would want to see the efficient operation of the business in the most competent hands of management and certainly not in the hands of shareholders. As Roy Garrett comments: 1/

> "A publicly--held corporation is a means of conducting a large and usually complex business enterprise. Shareholders, creditors, employees, customers, suppliers and the general public generally are all concerned that such enterprises

---

1/ "Attitudes on Coroporate Democracy - A Critical Analysis", (1956). Nw. U.L.R.310.

> be managed efficiently. While shareholders are unquestionably entitled to the means of protecting their interests, the phrase "corporate democracy" must not be taken literally to the point of upsetting the fundamental separation of powers between the shareholders and directors. The successful management of large corporations rests largely upon this separation. 1/

Likewise, a proper understanding of the relationship between the two organs can only be achieved through an analytical survey of the division of powers between the board and the general meeting.

2. The Nature of Directors' Powers

Before embarking on a discussion of the allocation of powers between the company's principal organs, it will be useful, first, to examine the legal position of the directors.

The exact nature of directors' powers depends upon the purpose for which the powers are exercised and the manner in which this power affects other persons. In an endeavour to understand the nature of their powers, directors have often been likened to other entities such as trustees, agents or servants and are deemed to exercise like powers to those entities none of which is exactly the same as the office of a director, although they each bear some close resemblance to it. As Lord Russell of Killowen remarked in Regal (Hastings) Ltd. v. Gulliver: 2/

1/ At 311. The Wilson Committee made a similar remark with respect to institutional shareholders' participation. (Para.923 of the final report). Further reference will be made to this later.

2/ [1967] 2 A.C.134.

> "Directors of a limited company are the creatures of statute and occupy a position peculiar to themselves. In some respects they resemble trustees, in others they do not. In some respects they resemble agents, in others they do not. In some respects they resemble managing partners, in others they do not". 1/

The legal position of directors will now be examined against their similarities or dissimilarities with those entities.

(i) Directors as Trustees:

The office of director is often likened to that of trustee. Though an inadequate analogy, this description of very ancient origin has stuck ever since it was first applied, having been subsequently developed since the passing of the first Companies Act in the middle of the last century. The earliest forms of companies were formed by deeds of settlement and were managed by trustees. The deeds entrusted the running of the companies to the trustees and their agents and the shareholders remained passive while their interests were being strictly safeguarded. Thus as early as 1742, the directors of a Chartered Corporation who had misapplied its funds and were in breach of its by-laws were held liable as trustees for breach of trust in Charitable Corporation v. Sutton. 2/

Even with the passing of the Joint Stock Companies Act 1844, and the emergence of the modern structure in 1862, the common conception of directors as trustees remained unchanged. In 1866 J.W.Smith 3/ describing the features of the joint stock company wrote:

1/ At 147. He also cites Re.Forest of Dean Coal Mining Co.(1879) 10 Ch. D. 450 per George Jessel M.R. at 452.

2/ (1742) 2 Atk.400, 26 E.R.642

3/ Mercantile Law (1866) 3rd edition.

> "As the management of the company is confided by the deed of settlement to the directors and their agents, and the bulk of the shareholders must necessarily continue passive, the courts of equity are very strict in enforcing the due *execution of the trust* reposed in those functionaries". 1/

In (1878), Sir George Jessel M.R. stated in Re.Forest of Dean Co., 2/ that "directors are called trustees. They are no doubt trustees of assets which have come into their hands, or which are under their control...". 3/ Despite the popularity of this analogy, directors are not trustees in any legal sense and its application must be restricted. 4/ This point was emphasised by Lindley L.J. in Re. Land's Allotment Co. 5/ where he stated:

> "Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees for money which comes to their hands or which is actually under their control; and ... are held liable to make good money which they have misapplied upon the same footing as if they were trustees". 6/

1/ At pp.131-132. Emphasis mine.

2/ (1879) 10 Ch. D. 450.

3/ At 453.

4/ See Re.City Equitable Fire Insurance Co. [1925]. Ch.407, per Romer J 406 Dr.L.S.Sealey, "The Director as Trustee" (1967) C.L.J.83.

5/ (1894) 1 Ch.616.

6/ At 631

According to Professor Sealey, [1/] when it is said that a director is in a fiduciary relationship toward the company it "means no more than that in some respects his position is trustee-like; it does not warrant the inference that any particularly fiduciary principle or remedy can be applied". [2/]

How rigorously this conception of trusteeship affects the directors' exercise of their powers depends on the circumstances of each case but sometimes the application of agency principles tends to complicate the character of directors - a duality expressed by Lord Selborne in Great Eastern Ry. v. Turner. [3/] His Lordship in that case described directors as "mere trustees or agents of the company - trustees of the company's money and property - agents in the transactions which they enter into on behalf of the company". [4/]

The position therefore is that a director is for some purposes a trustee and for others an agent. [5/] But as agents they stand in a fiduciary relationship with their principal, the company, with the same obligations of good faith expected of trustees of settlements.

The trustee analogy breaks down anyway, when one considers the directors' duty of skill and care. [6/] Directors are subject to a more

---

1/ "Fiduciary Relationships", (1962). C.L.J.69.

2/ At 73. See also Gower, 4th ed. 571-572.

3/ (1872).L.R.8 Ch.149.

4/ At 152. See also Percival v. Wright [1902] 2 Ch. 421 where cases discussed above were referred to.

5/ Northern Counties Securities v. Jackson & Steeple Ltd. [1974] 1 W.L.R. 1133.

6/ See Gower, op.cit.

flexible and generally lower standard of skill and care than trustees. As businessmen they are expected to take greater risks than trustees as many of the business matters they deal with may be speculative in nature. A trustee is expected to be cautious and to avoid risks. Legal title to a company's property is in general vested in the company, and not the directors. Legal title to property under a settlement is usually vested in the trustees. These distinctions are only a matter of detail, and it is true to say that:

> "However much the company's purposes and the directors' duties, powers and functions may differ from the purposes of a strict settlement and the duties, power and functions of its trustees, the directors and such trustees have this undisputably in common - that the property in their hands or under their control must be applied for the specified purposes of the company or the settlement." 1/

The duty of directors to apply their powers for "proper purpose" and not to misapply or misappropriate the company's assets are but a few examples of the general fiduciary duties of directors which require *inter alia* that directors should not enter into a contract which involves a conflict between their own interests and those of the company, the duty not to make a secret profit, or enter into competition with or abuse the confidence reposed in them by the company. While, it is beyond the scope

---

1/ Per Ungoed-Thomas J., in Selangor United Rubber Estates Ltd. v. Craddock [1968]. 1 W.L.R.1555 at 1575. Also according to Professor Beck, "The Saga of Peso Silver Mines", [1971] 59, Canadian Bar Rev. 80 at 91, "the fact that there are differences in functions does not warrant a less strict application of fiduciary principles to directors".

of this thesis to go into details of these duties, [1] it is, nevertheless, to be made clear that directors are deemed to be trustees because they owe fiduciary duties to the company by reason of the fact that confidence is reposed in them to manage property for others. They do not owe fiduciary duties because they are trustees for they are not, *stricto sensu*, trustees. [2]

(ii) Directors as Employees:

Whether a director is an employee or not depends generally on whether he is a full time ("executive" or "inside") director or a part time ("non-executive" or "outside") director. A director cannot be deemed to be an employee merely from the fact that he performs the duties of a director such as attending board meetings but if he works full time and forms part of the company's labour force, then he may be deemed an employee. In Boulting v. A.C.T.A.T. [3] it was held that the two managing directors of the company could be regarded for some purposes as employees of their company, notwithstanding their managerial positions and it did not involve any conflict of loyalties merely because as a managing director they are also members of an employee's union.

1/ For details on the nature of director's fiduciary duties see the two articles by Sealey cited supra. Beck, "The Quickening of Fiduciary Obligations", Canadian Aero Services v. O'Malley (1975) 53 Can.B.R.771 D.D.Prentice "Directors Fiduciary Duties - The Corporate Opportunity Doctrine" (1972) 50 Can.B.R.623; Harold Marsh Jr. "Are Directors Trustees?" Conflict of Interest and Corporate Morality (1966) 22 Business Lawyer 35. Gower 4th ed.p.571 and Gore-Browne on Companies, chapter 27.

2/ See Regal (Hastings)Ltd. v. Gulliver /1942/ 1 All E.R.378 at 395. See generally, Gore Browne 43rd edition 27-9.

3/ Boulting v. Association of Cinematograph, Television and Allied Technicians /1963/ 2 Q.B.606 at 634. See also Re.Lee Behrens & Co. /1932/ 2 Ch.46.

The question of the employee status of directors often depends on the particular context in which it arises and this, in general, is more in the area of Labour Law than Company Law. [1]

(iii) <u>Directors as Agents:</u>

Lord Russell of Killowen in the speech quoted above [2] described directors as resembling agents in addition to trustees. Indeed, in respect of contracts entered into on behalf of their companies directors are in the eyesofthe law agents for their companies, and the law of agency regulates the relationship between the directors and the company. The application of agency principles was establised by Cairns L.J. in <u>Ferguson v. Wilson</u>, [3] where he stated that:

> "[Directors] are merely agents of a company. The company itself cannot act in its own person, for it has no person, it can only act through directors and the case is, as regards those directors, merely the ordinary case of principal and agent. Wherever an agent is liable these directors would be liable; where the liability would attach to those principals, and the principal only, the liability is the liability of the company". [4]

Even where directors contract in their own names, the other party to the contract can sue the company on discovering that it is the real principal. The principle of undisclosed principal applies as well as other agency rules of apparent or ostensible authority. The only qualification to the application of agency rules relates to pre-incorporation

---

1/ See Gore-Browne, <u>op.cit.</u> and <u>Boulting v. A.C.T.A.T.</u> <u>Ibid</u>.

2/ In <u>Regal (Hastings) Ltd v. Gulliver</u> p.147.

3/ (1866) L.R.2 Ch.77.

4/ At p.89.

contracts. There are two conflicting authorities here. In Kelner v. Baxter ,1/ a director bought goods as principal and not merely as agent of a non-existing company. It was held that the director was personally liable. But in Newborne v. Sensolid (Great Britain) Ltd. 2/ a director signed a contract by writing his name underneath the name of the pre-incorporated business. In this case the company was held liable.

Though apparently conflicting authorities those two cases indicate that the criterion is not whether or not a director signed his name in a pre-incorporated contract, but whether the parties intended that the director should be personally liable on the contract. If that was the intention then he can be sued upon the contract. 3/

The position of directors is sometimes regarded as being "more of managing partners of a firm than one of principal and agent...", and,"not like that of managing partners appointed to fill that post by a mutual arrangement between all the shareholders". 4/ According to this view the powers of directors are not exercised in a principal/agent manner but only as is contained in the memorandum or articles of association of the company of which all persons dealing with the company are deemed to have notice. One director cannot as agent bind another or others unless authorised to do so, as in the case of managing directors. Directors

---

1/ (1866) L.R.2 C.P.174.

2/ [1954] 1 Q.B.45.

3/ See Palmer's Company Law . 21st edition (1968) at p.524. See also the recent case of Rolfe Lubell and Co. v. Keith and Greenwood [1979] 2 Lloyds Rep.75 where a director was held personally liable on bills of exchange accepted by Grafton Manquest Ltd. and endorsed "For and on behalf of Grafton Manquest Ltd: AB Director, CD Secretary".

4/ Per Cozens-Hardy L.J. in Automatic Self-Cleansing Filter Syndicate v. Cunninghame, [1906] 2 Ch.34, 45.

can only bind when acting collectively as a board or an authority delegated by the board. As a rule, authority derives from the board as an organ of the company. Power is not vested in persons but in the company's organs.

3. The Division of Corporate Powers Between the Board of Directors and the Shareholders in General Meeting:

(i) Introduction:

A much admired feature of Company Law is its very flexible nature, in that it gives promoters considerable freedom and discretion in allocating the company's powers between the board of directors and the sareholders in general meeting. The division of corporate power between those two organs was established in the earliest companies by deeds of settlements. These sometimes provided that directors would have management powers (that is, power over day-to-day matters) to the exclusion of the ordinary shareholders but the usual form was that which gave the assembly of the proprietors acting as the general meeting full power to superintend, regulate and control all the affairs of the company. 1/ The effect of this was to make the directors general powers of management subject to the ultimate control of the majority of shareholders acting in general meeting. 2/

1/ See examples of governing regulations cited in Chapter 1.

2/ See e.g. Charitable Corporation v. Sutton, 26 E.R.642, where Lord Hardwicke L.C. stated that directors are "most properly agents to those who employ them in this trust, and who empower them to direct and superintend the affairs of the corporation". At p.644. Until the end of the 19th century it was generally accepted that the general meeting was the company whereas the directors were merely the agents of the company subject to the control of the company in general meeting. This view is well illustrated by the decision in Isle of Wight Railway Co. v. Tahourdin; (1883) 25 Ch. D.320.

After the early Companies Act it was thought that as agents directors of registered companies were amenable to the control of the proprietors as principal who represented the general will of the corporate entity. But it is now clear that directors are not strictly speaking agents, trustees or servants but occupy a position unique in itself and dependent on the provision of the company's constitution and, in particular, the distribution of powers amongst the company's organs.

(ii) The System of Allocation

The Companies Acts afford little guidance on the division of corporate power within the company, perhaps in tacit recognition of the great advantage in the freedom to allocate powers and responsibilities by articles according to the company's wishes and circumstances. 1/ Thus, the distribution of powers and responsibilities are normally to be found in the constitutional instruments of individual companies. This, for example, is expressly stated in Section 137(2) of the Ghana Companies Code 2/ which provides:

> "Subject to the provisions of this code, the respective powers of the members in general meeting and the board of directors shall be determined by the Company's Regulations". 3/

The intention is that a company should be free to allocate powers as it wishes and to amend them from time to time. Certain powers which would normally be exercised by the board can thereby be removed from them

1/ An obvious legacy of the 18th century practice. See Du Bois,291.

2/ Act 179.(1962).

3/ In this Code the word "Regulation" clearly means the companies' articles and not resolutions and so avoids the difficulties which have sometimes been encountered in the interpretation of Article 80. See infra, p.181

by appropriate alteration of the articles and vested in the general meeting or *vice versa*. But short of full compliance with the necessary procedure, "there is no universal rule that shareholders in general meeting may by ordinary resolution bind or represent the company with respect to anything and everything". 1/

Under the 1948 Act certain inalienable powers are conferred on the general meeting. These are powers for the:

(a) alteration of the company's objects (S.5)

(b) alteration of the company's articles (S.10)

(c) increase or reduction of capital (SS.61 and 66).

(d) removal of a director before the expiration of his term (S.184).

(e) voluntary winding-up (S.278).

(f) appointment of auditors (S.159 (1).

Most of the powers of the general meeting are quite comprehensible and rarely involve any controversy. 2/

The Act also provides for certain powers to be exercised by the board of directors, for example, the appointment of the company's auditors before the first annual general meeting 3/ and power to fill a casual vacancy in the office of auditor. 4/

1/ Per Jordan C.J. in Clifton v. Mount Morgan Ltd. (1940) 40 S.R. (N.S.W.) 31 at 34.

2/ Other powers may be found in Sections 18, 131, 148,156-158.

3/ S.159 (5).

4/ S.159 (6). In comparison with the general meeting the Act appears to be more concerned with the imposition of liabilities on directors and restricting their activities than on their positive powers.

Outside these functions for which the Act has vested express powers on the general meeting or the board, the two organs are entitled to arrange for the distribution of the remaining power between themselves. The articles may even confer authority on someone other than the directors or the general meeting. 1/

A company's proprietors as ultimate repository of the company's powers can allocate to the board as much or as little power as they wish. Re. Denham 2/ is a good example of an unusual distribution of powers which may result from this absence of any requirement of formalities. In that case the articles of association of a company vested in the directors, the vendor to the company and its chairman," the "supreme control" of its management and business, also, power "to the exclusion of the general meetings and the boards", to determine the amount of dividend, and, generally, power to exercise any of the authorities thereby conferred on the general

1/ For example powers of management may be delegated to a service or management company or any other company as in Re. Bulawayo Market and Offices Ltd. op.cit. or to a managing agent. See Lattin on Corporations p.254. Article 2 d of the EEC Second Directive provides that the memoranda and articles of a public company with a share capital must give information concerning, inter alia, the allocation of powers among bodies responsible for the administration, management, supervision, or control of the company. Although some aspects of the Second Directive were introduced in the 1980 Act this article was left out. It is also to be noted that the Bullock Committee also favoured a statutory restatement of the allocation of powers between directors and the general meeting. See infra. p.177 where their proposals are discussed further.

2/ (1884) 25 Ch. D. 752.

meetings and boards of directors, and in doing so to "supersede the authority of general meetings and boards". The articles then "subject and without prejudice to the authorities thereby given to Denham, vested the general conduct and management of the business of the company in the board of directors and required them to keep and render proper accounts and balance sheets. That style of allocation was described by Chitty J. as being "remarkable". 1/

Again in Miles v. Sydney Meat - Preserving Co.Ltd. 2/ the deed of settlement of a company were so drafted as to confer on the members "full powers to regulate and control all the affairs, management, capital, profits, dividends and concerns of the company", with the result that "they have throughout endorsed the action of the directors by adopting their reports and balance-sheets". 3/

To the small family company the division of powers between the board and the shareholders in general meeting is of little practical significance because the shareholders, at least the major ones, are often the same as the directors. To them the freedom to allocate powers by specially framed articles is not much use and instead the articles as set out in Table A are adopted. As for the large public company one would have expected that the distinct division between ownership and management would be great motivation for preparing carefully framed articles which allocate powers between the two in such a way as to reflect the reality of their circumstances. But quite often this is not

1/ At 764.

2/ (1912) 16 C.L.R.50 aff'd (1913) 17 C.L.R.639 (P.C.). The facts of the case are not necessary.

3/ Per Barton J. in (1912) 16 C.L.R. 50 at 67.

the case and the freedom of distributing the corporate powers given to the incorporators exists for the most part in theory only, the tendency of modern practice being to adopt articles along similar lines to those contained in Table A. 1/ Some of the notable powers allocated in Table A to shareholders include:

(a) Power to determine the remuneration of directors (Art.76)

(b) Power to fix the director's share qualification, if any, (Art. 77).

(c) Power to increase or reduce the number of directors (Art.54).

(d) Power to declare dividends, not exceeding the amount recommended by the board. (Art.114).

The powers commonly allocated to the board include:

(a) Power to make calls (Arts.15-21)

(b) Power to forfeit shares (Arts.33-39).

(c) Power to declare interim dividends (Art.115).

(d) Power to pay gratuities (Art.117). 2/

Of greater importance than any specific power vested in the board of directors is the rather omnibus Article 80 of Table A, 3/ which confers a general power of management in the board. This article provides:

1/ See Jenkins Report para.108.

2/ There are other board powers, e.g. in relation to liens, shares transfer, borrowing powers etc.

3/ This form of articles first appeared as Section 90 of the Companies Clauses Consolidation Act 1845. See p.155 infra for the full text of that section.

"The business of the company shall be managed by the directors who may pay all expenses incurred in promoting and registering the company and may exercise all such powers of the company as are not, by the Act or by these regulations required to be exercised by the company in general meeting, subject, nevertheless to any of these regulations, to the provisions of the Act and to such regulations being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting".

Although only a model, Article 80 is adopted in *haec verba* or in substantially the same words by very many companies. That this is the practice is a strong indication that companies have found it a useful and convenient way to allocate powers for the conduct of their businesses. The uniformity in the regulations amongst companies also has much to commend in it in so far as it results in the potential or real benefit of shared experiences.

The usefulness of Article 80, it has been said, lies in the fact that where it is adopted "the directors can do anything which the company can do". 1/ It has also been stated that a general delegation of powers to directors as under Article 80 gives the directors "power to do everything that the company could do except where the authority of a general meeting is expressly prescribed". 2/

1/ Per Jessel M.R. in Re. Anglo-Danubian Steam Navigation v. Colliery Co. (1875) L.R.20 Eq. 339 at 341. See the following footnote.

2/ Per Lord Thankerton in Campbell v. Rofe [1933] A.C.91 (P.C.). at 99. There is some controversy whether statements such as these can be regarded as accurate expressions of the effect of this article, the precise scope of which is examined below.

As a prime source of the power for the general management of a company many commentators and writers 1/ have expressed the view that the essence of Article 80 is to vest *exclusive* management power on the board of directors. Since it is directors and not the members who are responsible for the conduct of the business on its day-to-day basis the board alone should exercise power over such matters. Shareholders in general meeting are entitled to alter the articles to give themselves power over specific matters or remove the directors, but it is argued, they cannot give direction to the directors on how to manage the business. As Samuel J.A. observed in Winthrop Investments Ltd. v. Winns Ltd: 2/

> "The shareholders may have ultimate control, because they can alter the articles or remove the directors; but they cannot interfere in the conduct of the company's business where management, as here, is vested in the board. The general meeting has power to intervene to resolve a deadlock other than the one produced by the application of power secured by the articles... which prevents the company's business from being carried on at all... but they have no general power to transact the company's business or to give effective direction about its management". 3/

1/ E.g. K.A. Aickin, "Division of Powers Between Directors and General Meeting As a Matter of Law and as a Matter of Fact or Policy", (1967). Melb. U.L.R.448; B.V. Slutsky, "The Relationship Between the Board of Directors and the Shareholders in General Meeting", (1968) Univ. of Br. Col. L.Rev. 81; and Cf. G.D. Goldberg, "Article 80 of Table A of the Companies Act 1948", (1970) 33 M.L.R., 177; and G.R. Sullivan, "The Relationship Between the Board of Directors and the General Meeting in Limited Companies" (1977) 93 L.Q.R. 569. See also Gower 4th ed. 143, Pennington 4th 523.

2/ [1975] 2 N.S.W.L.R.666

3/ At 683.

This view, of course, goes contrary to the much older and widespread belief that as agents directors are bound to obey the directions of the proprietors or a majority of them, 1/ or that the authority of the general meeting cannot be fettered. 2/ The understanding of the true purport of Article 80 is necessary for any meaningful analysis of the effect of the rule in the conduct of companies' businesses.

(iii) General Management Power Under Article 80:

The first regulation which attempted a distribution of the power of the company between the board and the general meeting was Section 90 of the Companies Clauses Consolidation Act 1845. 3/ That section provided:

> "The directors shall have the management and superintendence of the affairs of the company and they may lawfully exercise all the powers of the company, except as to such matters as are directed by this or the Special Act to be transacted by a general meeting of the company; ... *and the exercise of all such powers shall be subject to the control and regulation of any general meeting specially convened for the purpose....*" 4/

The above provision represented the views current at that time that the general meeting had superior control over the board in the conduct of the business. In one of the company law's earliest cases, Attorney General v. Davy 5/, (1741), the Lord Chancellor stated unequivocally:

1/ See Aicken, Ibid, at 449.

2/ See supra. pp.11.-13.

3/ But it may be noted that the distribution of power between boards and general meetings by the use of similar clauses was already being achieved as early as 1723, for example in the petition for Incorporation of the West Jersey Co. See Du Bois Footnote 80. See supra. p. 10.

4/ Emphasis mine.

5/ 2 Atk. 210,26 E.R.531.

"It cannot be disputed, that whenever a certain number are incorporated, a major part of them may do any corporate act; so if all are summoned, and part appear, a major part of those that appear may do a corporate act, though nothing be mentioned in the charter of the major part". 1/

Again Wigram V.C. in Foss v. Harbottle, 2/ stated:

"The result of these clauses is that the directors are made the governing body, subject to the superior control of the proprietors assembled in general meetings, and, as I understand the Act, the proprietors so assembled have power, due notice being given of the purposes of the meeting, to originate proceedings for any purpose within the scope of the company's powers, as well as to control the directors in any acts which they may have originated. There may possibly be some exceptions to this proposition but such is the general effect of the provisions of the Statute". 3/

And as Berle and Means put it, 4/ management in the early large companies was

"thought of as a set of agents running a business for a set of owners; and while they could and did have wider powers than most agents, they were strictly accountable and were in a position to be governed in all matters of general policy by their owners". 5/

This state of affairs changed with the passing of the 1862 Act.

In Table A of the Companies Act 1862 the relevant provision in the 1856 Act was reversed (though couched in substantially the same words as we have today under the 1948 Act, Table A) removing the board

---

1/ Ibid

2/ (1843) 2 Hare 461;67 E.R.189. This decision came years before the 1844 and 1845 Acts which introduced incorporation but it was made clear in the deeds that the members were the company and so could exercise complete control over the directors and trustees. See Sealey (1967) C.L.J. 83, 89-90; Slutsky (1968) U.B. C.L.R.81.

3/ At 492-3.

4/ The Modern Corporation and Private Property (Revised Edition), (1968).

5/ At pp.125-126.

from its subordinate position. [1] This, however, is not to say that the power relationship between the board and the general meeting is thereby made clearer. As Lord Clauson points out in Scott v. Scott [2]

> "It must be borne in mind that the professional view as to the control of the company in general meeting over the actions of the directors has, over a period of years, undoubtedly varied, as may be observed by a critical investigation of the statements about the law on the matter to be found in the earlier editions of well-known textbooks". [3]

Early textbooks which portray this divergence of views include Buckley's Company Law [4] in which the author expressed the view that the company in general meeting had power to direct and control the board. In contrast is the opinion of Lord Thring expressed in his Compendium on Joint Stock Companies. [5]

> "The ordinary members of a joint-stock company have no voice in its management, but elect directors or managers, to whom they commit the entire control of their affairs". [6]

1/ Article 80 has its origin in Article 46 Table B of the 1856 Act which itself derived from Section 90 of the Companies Clauses Consolidation Act 1845. Art. 46 was repeated as Article 55 of the 1862 Act which remained the principal Act until 1908, then through Art. 71 of 1908 Act, Article 67 of 1929 to Article 80, 1948. See Geoffrey Hornsey, "Some Aspects of the Law Relating to Company Control", (1950) 13 M.L.R.470 at 474-475.

2/ [1943] 1 All E.R. 582.

3/ At 585.

4/ (1897) 7th ed. p.530.

5/ (1861).

6/ Cited by Hornsey, op.cit. at 475.

These two points of view reflect the controversy which has continued to present times about the implications of a general delegation of power as under Article 80, but by far the more popular is the Lord Thring school of thought, although this is not necessarily a wholly correct interpretation.

The modern proponents of the popular view (of the exclusiveness) of the board's management powers rest their argument on the case of Automatic Self-Cleansing Filter Syndicate Co.Ltd. v. Cuninghame. /1906/, which is regarded as establishing the "managerial autonomy" of directors. That case is regarded by Professor Gower 1/ as laying down the modern English rule on the issue, and as the learned author writes in his leading textbook:

> "Under an article in the terms of Table A (Article 80) the members in general meeting cannot give directions on how the company's affairs are to be managed, nor can they over-rule any decision come to by the directors in the conduct of its business. And this applies even as regards matters not specifically delegated to the directors provided they are not expressly reserved to a general meeting by the Act or the Articles". 2/

1/ In Ghana Companies Draft Code, the Final Report of the Commission of Inquiry into the Working and Administration of the present Company Law in Ghana (1961), Ghana Publishing Corporation, Accra. At p.107.

2/ The Principles of Modern Company Law (1969) 3rd edition, p.132. See the 4th edition at 146 where the wording and the author's interpretation seem slightly modified to the extent that he now recognises as Lord Kilbrandon points out in Alexander Ward Co. v. Samyang Navigation that the fact that a general delegation is made to the board of directors "does not mean that no act of management... can validly be performed without the personal or explicit authority of the directors themselves". See p.146 note 54.

While Cuninghame is undoubtedly sound authority, to regard it as laying down all there is about the rule is, as would be seen below, an over-simplification and is misleading. The facts of that case are as follows. Article 96 of the company's articles of association vested in the directors "the management of the business and the control of the company" in terms similar to Article 80 of Table A except that the power was made "subject to such resolutions as may be made by *extraordinary resolution*". 1/ Article 97(1) specifically empowered them to sell any property of the company on such terms and conditions as they might think fit. The company passed an *ordinary resolution* directing the board to sell the company's undertaking but the directors disapproved of the proposed terms on the grounds that it was not for the benefit of the company and declined to carry out the sale. The Court of Appeal upheld the directors' refusal and emphatically rejected the argument that directors as agents of the company must exercise their powers subject to the rule that an agent must obey his principal - in this case, the general meeting. 2/ This was a rejection of the hitherto prevailing view that the shareholders in general meeting constitute the company and that the directors are their agents or delegates. 3/ The Court was of the view that the power to sell the company's property having been expressly vested in the directors by Article 97 the shareholders could not by an ordinary resolution usurp that power. Collin M.R. went further to remark in respect of shareholders' participation that if it is desired to alter the powers of the directors that must be done, not by an

---

1/ This was the crux of the case and differs from Article 80 which requires an ordinary resolution.

2/ See the argument of plaintiff's counsel at p.37 and his argument in the Court of Appeal, p.39.

3/ [1906] 2 Ch.34. Per Cozens-Hardy L.J. at p.45.

ordinary resolution but by an extraordinary resolution, required under Article 96. 1/

This case has also been regarded as deciding that a bare majority cannot control the directors in their conduct of the affairs of the company. But as Neville J. remarked in Marshall's Valve Gear Company Ltd. v. Manning, Wardle and Co.Ltd., 2/ the decision in Cuninghame turned on the terms of the articles which were that the directors should have the entire management of the affairs of the company subject to regulations, "not being inconsistent with these presents as may from time to time be made by extraordinary resolution". 3/ The decision is therefore of limited relevance when the different wordings of Article 80 requiring an ordinary resolution are in question.

In Marshall's Case, the relevant Article 4/ vested the management of the company in the board in the same manner as under Article 80 of Table A, that is, subject to resolutions as may be prescribed by the company in general meeting. Marshall was the majority shareholder and managing director of the plaintiff company which had been formed to exploit an invention which he had patented. The defendant company, in which the other three directors were interested, was alleged to be infringing the plaintiff's patent and Marshall, inspite of the opposition of his co-directors, as a majority shareholder, decided to bring this

---

1/ At p.52.

2/ [1909] 1 Ch.267.

3/ At p.373. This was the crux of the matter.

4/ Article 55 in Schedule 1 to the Companies Act 1862 which provided: "the business of the company shall be managed by the directors, who may... exercise all such powers of the company as are not by the foregoing Act, or by these articles, required to be exercised by the company in general meeting..."

action in the company's name to restrain the alleged infringement. Thereupon the directors moved the Court to strike out the name of the company as plaintiff and dismiss the action on the grounds that the name of the plaintiff company had been used without authority. Neville J. held that on the construction of the article, the majority of the shareholders had the right to control the action of the directors in this matter and so their motion was dismissed with costs. In his judgment his Lordship distinguished Cuninghame, stating that the present case involved no difficulty about the articles of association:

> "because there is no unusual contract between the members of the company with regard to the powers of the directors... and I think that under (Article 55) the majority of the shareholders in the company at a general meeting have a right to control the action of directors, so long as they do not affect to control it in a direction contrary to any of the provisions of the articles which bind the company". 1/

Those two cases indicate that the question whether or not the general meeting can control the board of directors is too complex to be resolved simply by a "Yes" or "No" answer. 2/ The truth is that it all depends on the circumstances, 3/ and the construction of the company's articles of association. As Greer L.J. said in John Shaw & Sons (Salford) Ltd. v. Shaw: 4/

1/ At p.274.

2/ To explain the apparent contradiction in both cases Professor Pennington has suggested that both the board of directors and the general meeting retain parallel authority exercisable in appropriate circumstances, despite Article 80. See Pennington's Company Law (4th edition,1979),524.

3/ E.g. whether the matter is one which falls within the day-to-day management of the company or can be so defined.

4/ [1935] 2 K.B.113.

> "A company is an entity distinct alike from its shareholders and its directors. Some of its powers, may according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise the powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles or if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove". 1/

That statement summarises the rule but at the risk of saying the obvious the rule can, for purposes of clarity and simplicity, be broken down into four inter-related principles:

(1) Where the Act or a company's articles of association require certain matters to be done by and vests the power therefor in the general meeting that power cannot be usurped by the board of directors.

Thus in Isle of Wight Railway Company v. Tahourdin 2/ a sufficient number of shareholders required the directors of the company to call a meeting for certain objects amongst which was to appoint a committee to inquire into the working and general management of the company and to perform certain specified matters in the management of the company. The directors refused to convene a meeting as required by the requisitionists, whereupon the latter issued a notice themselves calling a meeting. The directors brought an action in the name of the company to restrain the requisitionists from holding the meeting. It was held *inter alia* by Kay, J. that the part of the requisition which

1/ At p.134.

2/ (1884) 25 Ch. D.320.

went beyond the appointment of a committee was illegal, for it proposed to transfer the management powers of the directors to the committee, but otherwise the requisitionists were entitled to call the meeting. The shareholders had power to call a meeting under Clause 70 of the Companies Clauses Act 1845, then in force, and the Court was unwilling to be used to defeat the members' enjoyment of this power. The Court of Appeal in rejecting the board's application for an injunction stated:

> "It is a very strong thing indeed to prevent shareholders from holding a meeting of the company, when such a meeting is the only way in which they can interfere, if the majority of them think that the course taken by the directors, in a matter *intra vires* of the directors is not for the benefit of the company". 1/

Marshall's Case, already referred to, is another example where the Court was unwilling to act to defeat the exercise by shareholders of powers expressly conferred on them by contract. 2/

Also in Foster v. Foster 3/ the articles of association of the defendant company provided (*inter alia*) that every share would confer one vote both at general meetings of the company and at the meetings of the directors, and (by Article 89) that the business of the company should be managed by the directors. Article 93 provided that a director might contract with the company, but prohibited a director from voting in respect of any contract in which he was interested,

---

1/ Per Cotton L.J. at 329. Note that under the 1845 Act which was then in force Article 90 conferred on the general meeting power to overrule the board.

2/ See also Neville J's remarks quoted in p.161 supra. By virtue of S.20(1) of the 1948 Act the memo.and articles of association are contracts binding on all members of the company which require them to observe all the provisions of the (memorandum and) articles.

3/ [1916] 1 Ch.532.

and Article 99 empowered the directors from time to time to appoint one of their body to be managing director for such period and at such remuneration as they thought fit. The plaintiff who was appointed managing director at a remuneration was removed from office by a resolution at a board meeting moved by Mrs. F. and supported by the third director. By another resolution she was appointed the sole managing director at a substantial remuneration. The plaintiff opposed both resolutions and upon Mrs. F's appointment, demanded a poll. By means of her own votes there was a majority in favour of the resolution appointing her. In an action by the plaintiff challenging this, it was held *inter alia* that the appointment by Mrs. F. of herself as sole managing director was prohibited by Article 93 and so was invalid, but as it was competent for the general meeting to waive this irregularity and to confirm the resolution appointing her, the irregularity was not of such a character as to give a dissenting minority (the plaintiff) any right to sue. The Court cited with approval the observation of Lord Davey in Burland v. Earle 1/ that:

> "It is an elementary principle of the law relating to the joint stock companies that the court will not interfere with the internal management of companies acting within their powers and in fact has no jurisdiction to do so". 2/

It follows from the above remark that if a matter does not involve internal management the court will interfere. Thus in Clark v Workman, 3/ the defendant directors entered into an agreement to sell

1/ [1902] A.C.83.

2/ At 93.

3/ 1920 I.R.107.

a controlling interest in the company to an outsider but the shareholders intervened to prevent the transaction. Rejecting the defendant's contention that this agreement was within their power over the company's internal management it was held that the transfer of a controlling interest in a company is not a matter of mere internal management. Ross J. justified the shareholders' intervention in the following words:

> "It was a matter involving complete transformation of the company - a fundamental alteration of policy from a policy of isolation to a policy of cooperation with a great syndicate in England, about which very little was known in this country. This operation could in no sense be held to be mere management". 1/

The effect of these authorities therefore is that where the matter is one that can be properly undertaken by the majority in general meeting, for example, the making of fundamental change or policy, the board - and indeed the minority shareholders - cannot deny the majority the exercise of their power.

(2) Where *general* powers have been delegated to the board of directors as under Article 80 the effect is that the board is responsible for the day-to-day management of the company's business. The shareholders cannot therefore usurp this power themselves or transfer it to an outside body. Thus in Tahourdin's Case the general meeting was restrained from transferring the power over day-to-day management from the board to a committee. 2/ It could only do so if it first of

---

1/ At 117.

2/ One object of the resolution was "To appoint a Committee to inquire into the working and general management of the company, and the means of reducing the working expenses, to empower such committee to consolidate offices, to remove any of the officers and appoint others and to authorise and require directors to carry out the recommendations of the Committee". (1884) 25 Ch. D. 320.

all altered the articles or complied with the appropriate procedure. However, the view has been expressed 1/ that the numerical majority who can alter the articles can over-rule the directors without first altering the articles. In Gramophone & Typewriter Ltd. v. Stanley 2/ Buckley, L.J. stated that shareholders could control the board "by the statutory majority which can alter the articles", 3/ which could be construed to mean that a special resolution of the general meeting could be sufficient for the general meeting to control the board without first altering the articles. 4/ *Dicta* in the same paragraph at any rate raised doubts whether his Lordship intended to convey this meaning. The point had been urged upon his Lordship that an English Company which owned all the shares in a German Company could control the latter in the sense that it must do all that the English Company directs. The court rejected this argument and relying on Automatic Self-Cleansing Filter Syndicate Co.Ltd. v. Cuninghame stated that:

> "even a resolution of a numerical majority at a general meeting of the company cannot impose its will upon the directors when the articles have confided to them the control of the company's affairs...." "Directors are not, I think, bound to comply with the directions even of all the corporators acting as individuals". 5/

1/ See e.g. Buckley, L.J. in Gramophone & Typewriter Ltd. v. Stanley [1908] 2 K.B. 89.

2/ Ibid

3/ At p.106.

4/ See e.g. Slutsky (1968) U.B.C.L.R. 81,88. But see Slesser L.J. in Shaw v. Shaw at p.143 where he stated that an alteration of the articles by special resolution was necessary in respect of a matter which fell within the ambit of general management,to wit: instituting action in the company's name.

5/ At 105-106.

Even assuming the dicta of Buckley L.J. in Gramophone & Typewriter v. Stanley, does have the meaning imputed to it, [1] there is no question that most judicial authority support the view that the general meeting can interfere in a matter of internal management only after the articleshave first been altered to divest the board of its power over the specific subject matter. Thus in Imperial Hydropathic Hotel Comppany, Blackpool v. Hampson [2] the articles of association of a company contained no power to remove directors before the expiration of their period of office, but authorised the shareholders by special resolution to alter any of the articles. The shareholders passed a resolution removing the directors and appointing new ones. It was held that there must be a separate special resolution altering the articles so as to give power to remove directors before a resolution can be passed to remove any of them. [This was because there was no power under the 1862 Act as there is under S.184 of the 1948 Act to remove directors unless the articles had first been altered to introduce this power]. As Cotton L.J. stated:

> "Now in my opinion it is an entire fallacy to say that because there is power to alter the regulations you can by a resolution which might alter the regulations, do that which is contrary to the regulations as they stand in a particular and individual case. It is in no way altering the regulations. The alteration of the regulations would be by introducing a provision.... that directors be capable of being removed by the vote of a general meeting.... [What the shareholders attempted to do was] not a general alteration of the regulations of the company, but simply an attempt, without altering the rules for the purpose, to remove a director; his removal being, unless there is a general alteration, an illegal act on the part of those who attempt to remove him - by illegal I mean an act *ultra vires* and not supported by any regulation of the company". [3]

1/ That is, note 4 above.

2/ (1883) 23 Ch.D.I.

3/ At 11 - 12.

In Boschoeck Proprietary Company Ltd. v. Fuke, [1/] Swinfen Eady J. remarked that "[t]he articles, until altered, bound the shareholders in general meeting as much as the board", [2/] and so (relying on Imperial Hydropathic Hotel Co.Blackpool v. Hampton). "Articles must first be altered by special resolution before the altered articles can be acted upon". [3/]

Also in Scott v. Scott [4/] under the articles of a private company, the management of the business and the declaration of interim dividends, [5/] were both assigned to the directors. At the company's general meeting certain resolutions were passed to the effect:

(1) that weekly sums calculated at the paid up capital on preference shares be paid each preference shareholder as interest free advances until the payment of the dividend for the current year, that such sums be deducted from the dividend when declared and, if the dividend was insufficient, the deficiency be repaid to the company.

(2) that a firm of accountants be instructed to investigate the financial affairs of the company for the last two financial years.

1/ [1906] 1 Ch.148.
2/ At 163.
3/ Ibid
4/ [1943] 1 All E.R.582.
5/ Admittedly, a management matter.

The plaintiffs contended that these resolutions were invalid. It was held that the resolutions were invalid as being attempts by the company in general meeting to usurp the powers of the financial direction of the company which under the articles rested solely in the hands of the directors. According to Lord Clauson it seemed quite clear that the first resolution "if it is not aimed at declaring an interim dividend, is aimed at interfering with the management of the business by the directors and, as such it is in my view wholly inoperative and the general meeting had no power to pass it". 1/ The second resolution was rejected as being an attempt to do by an ordinary resolution what was required by the Act to be done only by special resolution.

In respect of the first resolution it was argued on behalf of the plaintiffs that under the company's articles, as in Article 80, the directors were authorised to "exercise all such powers of the company, as are not ... required to be exercised by the company in general meeting, subject... to such regulations not being inconsistent with the company's articles or provisions as may be prescribed by the company in general meeting". 2/ Those words, it was argued, limit the power and duty 3/ of directors to manage the business. His Lordship rejected this argument stating that a resolution which attempts to control the directors in the management of the business was itself inconsistent with the company's articles and so cannot be justified. 4/ His Lordship did not rely on

---

1/ At pp.584-585.

2/ At 585.

3/ It was his Lordship's opinion that only the "duty" of directors and not their "right" to manage was limited.

4/ See also Loreburn L.C. in Quin & Axtens Ltd. v. Salmon [1909] At 442.

any authority and one finds it difficult to follow the logic of his reasoning. Nevertheless, it is correct to assume that under Article 80 the general meeting is unlikely to involve itself in matters which relate to day-to-day management. The question then is what constitutes day-to-day management.

The description or definition of what amounts to management matters was expresed in that case in a somewhat rhetorical fashion when it was stated:

> "How can you manage a business without managing its finance.... How the directors can manage the business if they are to be interfered with in such an ordinary financial matter as to how to deal temporarily with balances which are for the moment not required for the purpose of the business, I confess I cannot conceive". 1/

And further:

> "How you can investigate the financial affairs of the company without interfering with the management of the company's financial affairs by the directors in the course of managing the business, I myself am quite unable to see...." 2/

It is understandable, even from the first few lines of Article 80 that the board and not the shareholders are responsible for the day-to-day control of the company. If the Courts' reasoning was to the effect that shareholders cannot also give general directions or recommendations on how the company's affairs are to be managed or that they cannot over-rule

1/ At p.584.

2/ At p.585.

any decision come to by the directors in the conduct of the business, then it would be difficult to agree with this. This writer agrees with the opinion expressed by Goldberg, 1/ that if, for example, a company has funds which have been taken out of the current accounts of its business, there is nothing in the case to say that the members in general meeting cannot by ordinary resolution order the directors to invest them in one manner rather than another. 2/ Moreover, it is difficult to see why investigation into a company's past financial affairs should be regarded as an interference with its management. Surely, one must suppose that his Lordship did not intend to deprive investors of this very important power of investigating how their investments are being managed and so divesting them of their rights just because the company's articles provide that "the business of the company shall be managed by the directors". The extent of interference must, of course, be a matter of degree and, in any case, shareholders could not interfere too frequently even if they so wished. 3/

1/ G.D.Goldberg, "Article 80 of Table A of the Companies Act 1948" (1970) 33 M.L.R.177.

2/ See p.183. Shareholders should at least be able to over-rule the board in major investment and policy matters, if not, routine financial transations.

3/ See pp137-138 supra. One difficulty here is that Courts are not likely to go into what constitutes "detailed" or "frequent" interference; the general unwillingness of Courts to delve into details of business management is well known. See e.g. Earle of Halsbury L.C. in Dovey v.Cory [1901] A.C.477: "What are profits and what is capital may be a difficult and sometimes an almost impossible problem to solve.... I foresee that many matters will have to be considered by men of business which are not altogether familiar to a Court of Law". At p.487. See also Atiyah, "Thoughts on Company Law Philosophy". (1965) 8 The Lawyer,16,20-21.

(3) It follows from the last two points that the general meeting can by ordinary resolution 1/ exercise power in matters not involving day-to-day management, 2/ even though such power has not been expressly vested in it by the Act or the Articles, 3/ provided:

(a) that such power has not been expressly delegated to the board, 4/ and

(b) that the exercise of the power does not amount to fraud or oppression of the minority. 5/

This principle was acted upon in Marshall's Case where the trial judge relying on Pender v. Lushington 6/ and Duckett v. Gover, 7/ stated that:

1/ But see Greer L.J. in Shaw v. Shaw [1935] 2 K.B. 113,114, approving the view of Buckley on Companies that a special resolution is necessary "even as regards matters not expressly delegated to the directors by the articles".

2/ That is to say, non-routine matters.

3/ But cf., Gower in passage quoted in p.158 supra.

4/ For example, power for appointing a Managing Director: Thomas Logan v. Davies (1911) 105 L.T.419; appointing additional directors: Blair Open Hearth Furnace Co.Ltd. v. Reigart (1913) 108 L.T.665. See also Clark v. Workman, supra and Automatic Self-Cleansing Filter Syndicate v. Cuninghame. See however, Hornsey, op.cit. who argues that the words in Article 80 entitle the shareholders to control the directôrs by ordinary resolution as regards those matters of management not expressly delegated to the directors by some other article.

5/ See Pender v. Lushington (1877) 6 Ch.D.70 Bamford v. Bamford [1970] Ch.212 and Winthrop Investments Ltd. v. Winns Ltd. [1973] 2 N.S.W.L.R. 666. According to Buckley J. in Hogg v. Gramphorn [1967] 1 Ch.254 "A majority of shareholders in general meeting is entitled to pursue what course it chooses within the company's powers, however wrong-headed it may appear to others, provided the majority do not unfairly oppress other members of the company", at p.268. See also G.R.Sullivan, op.cit.: at 576.

6/ 6 Ch. D.70.

7/ (1877) 6 Ch. D.82.

> "the principle has been acted upon that in the absence of any contract to the contrary the majority of the shareholders in a company have the ultimate control of its affairs, and are entitled to decide whether or not an action in the name of the company shall proceed". 1/

(4) Where the Act or Articles require a special procedure on any matter, whether delegated to the general meeting or the board, such requirements or provisions are enforced very strictly by the courts.

The Courts cannot over-ride the provisions of the Act and, a company's articles and regulations being contractual in nature, 2/ a Court will not vary any of its terms or seek to substitute its own judgment for terms which shareholders have contracted to regulate their relations in the company. 3/ The duty of the court is to give effect to the express provisions and terms of the articles. 4/ Thus in Quin and Axtens Ltd. v. Salmon, 5/ the 75th clause in the company's articles of association provided that the business of the company was to be managed by the directors, who might exercise all the powers of the company, "subject to such regulations (being not inconsistent with the provisions of the articles) as may be prescribed by the company in general meeting". The 80th article stated that no resolution of a meeting of the directors having for its object the acquisition or letting of premises should be

---

1/ Per Neville J. in [1909] 1 Ch. 267,272.

2/ That is, by virtue of Section 20(1).

3/ See e.g. MacDougall v. Gardiner (1874-75) 10 Ch.App.606: "the Court has no jurisdiction whatever to do that which it is for the company itself to do according to the provisions of the articles", per James L.J. at p.608. See also Bamford v. Bamford at 217.

4/ See Automatic Self-Cleansing Filter Syndicate v.Cuninghame - a decision which re-affirms the inviolability of contracts.

5/ [1909] A.C.442.

valid unless notice should have been given to each of the managing directors Messrs. Salmon and Axten and neither of them should have dissented therefrom. The directors passed a resolution with the object of acquiring and letting premises from which Salmon duly dissented. An extra-ordinary general meeting was then held at which the same resolution was passed by a simple majority of the shareholders. It was held unanimously by the House of Lords that upon the true construction of the articles the resolutions of the company were inconsistent with the provisions of the articles.

This rather short judgment [1/] is typical of the zealous attempt by courts to protect the "bargain" between shareholders as set out in the articles in dispute but certain aspects of the case raise serious questions. Although it was consonant with Article 80 that the other directors should not over-ride the right of Salmon to dissent one would have wished the Court to say why the general meeting could not by an ordinary resolution direct the board to acquire the property. Firstly, the Court might have taken the view that the acquisition or letting of premises was a management matter as it related to the day-to-day decisions which directors have to take. On the other hand, if it was a substantial acquisition which was likely to have a major effect on the company's business structure then the general meeting ought to have been given a say in deciding whether

---

1/ It is remarkable that most of the cases considered under this topic are about two to three pages long in the reports, which will appeal to students not too keen on reading very long judgments. However, the brevity of the decisions belies the complexity of the problems involved.

or not to carry out the transaction. [1] Secondly, the shareholders' resolution may have been seen as an attempt by the board to use the general meeting as a means of defeating the rights of Salmon and the contractual relations between him and the company. [2]

Again in Shaw v. Shaw [3] as a result of a dispute arising from the defendant's indebtedness to the plaintiff company the articles of association were altered so as to hand over all control of the financial affairs of the company and the management of its business to three independent persons known as "permanent directors". The defendants were divested of their voting rights and control in respect of their debts. Because of certain defaults in respect of the debts it was resolved by the "permanent directors" at a meeting to which none of the ordinary directors were summoned, that the present action be instituted against the two of the former directors. Before the hearing the shareholders at an extra-ordinary general meeting passed a resolution calling on the Chairman to direct that the proceedings be discontinued. It was held by the Court of Appeal by a majority of two to one that the action by the "permanent directors" was in order. According to Greer L.J., under the company's articles the power to give instructions for the institution of action was vested, not in the directors generally, but in the "permanent directors" alone, whose decision could not be over-ridden by the mere resolution of the shareholders.

1/ Quaere, whether a special resolution shouldn't be required in all matters affecting the fundamental character of the business rather than an ordinary resolution, whether or not this involves the alteration of the articles.

2/ Perhaps a special resolution (enough to alter the articles) rather than initiation through the board may have sufficed.

3/ [1935] 2 K.B.113.

In the final analysis it is to be noted that where powers are expressly conferred by constitution or contract on the general meeting and the board respectively neither can usurp the others. Where the Constitution is silent or there is no contract the board has power over matters of day-to-day management, while the general meeting has power over major policy or fundamental or structural change. It is clear therefore, that "the directors, and no one else are responsible for the management of the company ... (but this) does not mean that no act of management, such as instructing the company's solicitor, can validly be performed without the personal and explicit authority of the directors themselves". 1/ There can, of course, be no pretence that it will always be easy to say whether a specific matter is of a fundamental character or is one of everyday management, but most of the time this should be easily resolved. 2/

It is interesting too to ask what is the relevance of the decisions reviewed above in the conduct of the business of large public companies today. For these types of companies special articles like those in Automatic Self-Cleansing Filter Syndicate v. Cuninghame, Quin & Axten v. Salmon, Shaw v. Shaw, and so on, are the exception rather than the rule - the more common attitude being to adopt the regulations in Table A. This, however, cannot be said of the thousands of small private companies which operate today and to which these decisions are undoubtedly still of especial relevance. 3/ Two situations can immediately be envisaged where the analysis

---

1/ Per Lord Kilbrandon in Alexander Ward v. Samyang Navigation Co. [1975] 1 W.L.R.673 at 683.

2/ As in Clark v. Workman, supra.

3/ The Department of Trade Annual Report for 1979 shows that the effective number of private companies on the register in Britain for that year was 710,662 while for public companies the effective number was 16,015.

becomes relevant for large companies:

(1) Where there are interventionist shareholders wanting to wrest control from inefficient management or in take-over situations,[1/] and

(2) Where the dominant or more active shareholders decide to sue the directors. [2/]

The Bullock Report seems to have overlooked the several possibilities of action by shareholders to challenge the board of directors when it stated that "the effect of the managerial revolution in large companies has been to concentrate power in the hands of the directors....Shareholders have largely acquiesced in effective control by the board of directors". [3/] This statement, although to some extent true, amounts to a sweeping generalisation and G.R.Sullivan,[4/] in his criticism of this and other aspects of the Report, justly remarked that they involved "a radical dimunition in the existing legal powers of shareholders". [5/] The Committee's proposals if and when implemented would divest from the shareholders in general meeting and confer on the

1/ For example public companies were involved in the following cases: Teck Corporation Ltd. v. Miller (1972) 33 D.L.R.(3 d) 288; Bamford v.Bamford supra; and Winthrop Investments Ltd. v. Winns Ltd, supra.

2/ As in the recent case of Prudential Assurance Ltd. v. Newman Industries and Others (No.2), [1980], 2 Ch.D.841.

3/ Cmnd 6706 at p.21.

4/ Op.cit.

5/ At p.569.

board the right of final decision in some matters now delegated by the Act to the general meeting [1/] The Bullock Report thus far signals the death knell for the rights which shareholders now enjoy in the conduct of business. [2/] While the future of the Report remains unresolved and until the recommendations become law they should not at any rate constitute any problem to shareholders in the exercise of their powers.

Although, as has been contended, a correct interpretation of Article 80 precludes the general meeting from intervening or directing the board in management matters certain reservations exist as to why the power of the general meeting should be circumscribed in this manner. From the point of view of active shareholders' participation it is wrong that they cannot by a majority in general meeting issue directives to the board, say, in financial matters. It is difficult to see why directors should not be bound by resolutions passed by a majority of shareholders since, after all, a simple majority of members can dismiss the directors at any time and without having to state the reasons. [3/] Common sense

---

1/ The powers to be removed from the members include the following: (a) the winding-up of the company; (b) changes in the memorandum and articles of association; (c) recommendations to shareholders on the payment of dividends; (d) changes in the capital structure of the company; (e) disposal of a substantial part of the undertaking; and the appointment, removal, control and remuneration of management. Bullock Report - pp.77-78 . The Committee also went further to consider how these modifications to the existing boards in the U.K. will affect their relationship with senior management and the shareholders.

2/ The Committee defended these proposals by referring to some U.S. States which similarly leave shareholders only with a right of veto over board's proposals at best. See Chapter 8 para.30.

3/ By way of comparison in some U.S. jurisdictions, directors cannot be removed unless for good cause. These contrast with the U.K. position.

and logic would demand that as an alternative to dismissal shareholders should be free to adopt the less drastic course of giving them binding directions. 1/ The remedies of alteration of articles and dismissal of directors which only are available now have proved to be difficult and not readily available or utilized by shareholders. 2/ On the other hand the demonstrated willingness of shareholders to pass resolutions at general meeting on very important or controversial matters would prove to be more useful and readily available to them. 3/

On the grounds of policy, however, it is desirable that the general meeting should not constantly breathe over the backs of the directors and over-ride every decision reached by them, for if that were to happen the board would cease to manage at all. 4/ It would be very inconvenient, if not impossible, for the board to refer every one of its proposals to the general meeting for prior approval, as it would also be for the general meeting to interfere by requiring the directors to perform particular executive acts, to engage in particular kinds of business or to enter into particular contracts. 5/ General meetings are much

---

1/ See Gower 4th ed.146.

2/ It is very difficult for interventionist shareholders to muster enough votes to pass a special resolution and the exercise of their powers under S.184 is also quite difficult.

3/ There is, of course, the danger that shareholders may be insufficiently informed or misinformed before voting, but these are some of the inevitable shortcomings in a democracy - the ever present danger of misinformation.

4/ Jenkins Report (Cmnd 1749) para.109.

5/ Aickin, "Division of Power Between Directors and General Meeting as a Matter of Law, and as a matter of Fact and Policy"(1967) Mel. U.L.R. 448 at 463-4.

more expensive to convene than board meetings and if they were to be well attended it would be almost impossible to arrive at quick decisions which sometimes have to be taken in modern businesses. Moreover, the general body of shareholders is far less competent than the experts on the board to consider and take decisions which would be most beneficial to the company as a whole. 1/

As a matter of policy, directors must have a free hand to conduct the company's business and if they prove inefficient the general meeting should replace them with better people who agree with their views. 2/ It might also be wise to restrict in the articles the extent of the board's exercise of their powers such as how much they can borrow at any one time, how much loan to give, the value of contracts they can award and anything in excess of those specified in the articles should be submitted to the general meeting for approval. 3/ Likewise the general meeting should be able to make recommendations to the board which they may or may not act upon. This would ensure that Article 80 is seen, in the words of Sullivan, as "a compromise between securing some degree of directorial autonomy and preserving the residual authority of the general meeting as the supreme organ of the company". 4/

1/ Shareholders are entitled to pursue only their private interests and to use their votes for that purpose: See N.W.Transportation v.Beatty (1887), 12 App.Cas.589.Pender v. Lushington (1897) 6 Ch.D.70, see also Gramophone & Typewriter v. Stanley: "Corporators" are not engaged in carrying on the business of the corporation. "To say that they are involves a complete confusion of ideas ", per Buckley J. at [1908] 2 K.B.89,105.

2/ Gramophone Typewriter Ltd. v. Stanely,supra at 98 per Fletcher Moulten L.J.se also Howard Smith Ltd. v. Ampol Petroleum Ltd [1974] A.C.821,837, per Lord Wilberforce.

3/ For example, section 47 of the 1980 Act requires the directors to secure the prior approval of the general meeting in respect of directors' service contracts for a period exceeding five years which cannot easily be terminated by the company. See p. 211

4/ G.R.Sullivan, op.cit. at 577. The residual authority of the general meeting is considered below.

(iv) The Phraseology of Article 80

It is to be observed that much of the difficulty in this area of company law stems from the difficulty in the interpretation of Article 80 and that the Article would be made clearer by adopting a simpler phraseology. Much of the difficulty arises in the interpretation of the second half of the Article wherein it is provided that directors shall manage:

> "subject nevertheless, to any of these regulations, the provisions of the Act and to *such regulations*, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors...."

A most confusing interpretation of that clause is that of Lord Clauson in Scott v. Scott, 1/ who thought that the words "such regulations" refer to the articles or amendments to the articles. It is these, he says, and not resolutions of the general meeting that the board shall manage subject to. As his Lordship put it:

> "I do not take the view that those limiting words 'subject nevertheless' and so forth, have anything to do with the duty cast upon the directors in the first two lines of the articles to manage the business of the company. However, that may be and if I am wrong in that and if I ought to treat the duty cast upon them to manage the business as being 'subject to any regulation of these articles' - which of course it must necessarily be - 'and to

1/ [1943] 1 All.E.R.582. See also Quin& Axtens Ltd. v. Salmon [1909] A.C.442 where Loreburn L.C. in a strong dictum expresses the view that "regulations" throughout the articles meant "articles", at 444.

> such regulations being not inconsistent with the aforesaid regulations or provisions as may be prescribed by the company in general meeting' the question is whether the company by prescribing this.. regulation if it be a regulation are prescribing something which is inconsistent with the aforesaid regulations or provisions. One of the aforesaid regulations or provisions is this provision about the business of the company being managed by the directors and I find the greatest difficulty in seeing how any resolution of the company in general meeting, controlling the directors in the management of the business, can possibly be justified under the terms of this article". 1/

It seems obvious that the words "such regulations" in Article 80 are used in distinction from "the aforesaid regulations or provisions" - of the Act, and the clause would make sense only if the words "such regulations" are understood to mean the company's resolutions, rather than articles. 2/

Moreover, reference to the Ghana Companies Code would indicate that the English legislature probably meant the word regulation in the second limb of Article 80 to mean shareholders' resolutions or "instructions" or "directions". The Ghana Code avoided the hazard in Article 80 by breaking down that article into simple intelligible parts as follows:

Section 37:

(3) Except as otherwise provided in the company's Regulations the business of the company shall be managed by the board of directors who may exercise all such powers of the company as are not by this Code or the Regulations required to be exercised by the members in general meeting.

1/ At 585.

2/ See Goldberg, op.cit. at 178 and 182 and Gower 4th ed. at 145, who regards Loreburn's interpretation as "tautologous".

(4) Unless the Regulations shall otherwise provide, the board of directors when acting within the powers conferred upon them by this Code or the Regulations shall not be bound to obey the directions or instructions of the members in general. 1/

It is to be expected that when the time comes for a major reform of English Company Law the opportunity would be taken up to break the present Article 80 into subsections as in Ghana. One may add, however, that Professor Gower's interpretation of Article 80 as reflected in the Ghanian section is more restrictive of shareholders' power of control than the case law indicates. It ought therefore to be possible to adopt a new phraseology of Article 80 without diminishing the existing powers of shareholders.

1/ Compare with the second limb of Article 80 in pp. 181 *supra.* The words "directions" or "instructions" of the members in general meeting" is clearly safer than "Regulations" or even "Resolutions" of the company.

CHAPTER 4

THE RESIDUAL POWER OF SHAREHOLDERS IN GENERAL MEETING 1/

Introduction:

Although as a general rule, a general delegation of power to the board under Article 80 precludes the general meeting from detailed management *dicta* abound in several cases to the effect that in certain circumstances the power may revert to the company in general meeting. 2/ In these circumstances shareholders exercise a residual power over matters commonly regarded as exclusive to the board. 3/ Thus it was held in Foster v. Foster, 4/ that where directors were disqualified and unable to exercise the powers conferred upon them by the articles the company in general meeting could act on their behalf.

1/ This chapter is, in effect, a continuation of the consideration of the relationship between the board of directors and the shareholders in general meeting commenced in Chapter 3. It has been made a separate chapter for reasons of convenience and to ensure that Chapter 3 does not become too long and unwieldy.

2/ See e.g. the quotation from Winthrop Investments Ltd. v. Winns Ltd. (1975), 2 N.S.W.L.R. 66 at 682-683, cited supra in p.154

3/ Whether the powers to be discussed hereunder are regarded as "residual" or "concurrent" is more a matter of preference than of substance, Segev, op.cit. for example, regards them as concurrent. This writer prefers to regard them as residual in the general meeting in that they are not usually exercised simultaneously - or better concurrently - with the board but contingent on the appropriate circumstances. For an example of concurrent power see Isaacs v. Chapman (1916) 32 T.L.R.237. See also Pennington, 524. Also Peter Loose, The Company Director (1975) regards the Board, and not the general meeting as having the residual power but this seems to be the other way round: 3 - 09. However, the situations discussed in the two cases which follow are "genuine examples" of residual powers as opposed to situations in Bamford v. Bamford and others, where the power comes only by default. See K.W.Wedderburn "Control of Corporate Litigation", (1976), 39 M.L.R. 327, 328.

4/ Discussed supra

In Barron v. Potter [1] it was held that where the articles of association of a company gave to the board of directors the power of appointing an additional director, and owing to differences between the directors no board meeting could be held for the purpose, the company retained the power to appoint additional directors in general meeting. [2]

The most common areas for the exercise of the residual powers include the following:

(i) Ratification

The residual power of the general meeting has been found very useful by directors who wish to have their actions ratified or confirmed by the general meeting, but the power has, however, been occasionally abused in the process. The potential for its misuse can be seen in cases where directors wish to have ratified the allotment of shares [3] which they have made *ultra vires*. For example, in Bamford v. Bamford [4] a public company, by its articles of association vested

---

1/ [1914] 1 Ch.895.

2/ These contingencies are admittedly less likely in large public companies than in private companies of the sort involved in that case. See also Worcester Corsetry Ltd. v. Witting [1936] Ch.640. where the company's articles provided: "Until otherwise determined by a general meeting the number of directors shall not be less than two nor more than seven".Other articles delegated general powers to the board. It was held that the power of appointing additional directors had not been delegated to the directors so as to exclude the inherent power of the company in general meeting to appoint directors.

3/ This is particularly important for large companies who rely on public issue of shares as a method of raising capital. The need for ratification in this regard has been pre-empted by section 14 of the 1980 Act which requires that the director's power to issue securities shall not be exercised unless they have been authorised to do so by (a) the company in general meeting, or (b) the articles of the company. The maximum amount of securities to be allotted will also have to be authorised.

4/ [1970] 1 Ch.212.

in the directors, power to allot the unissued shares. In order to frustrate a take-over bid by another company, the directors allotted the remaining unissued shares to a principal distributor of the company's products. The plaintiffs, two shareholders in the company, issued a writ against the directors and the company claiming a declaration that the allotment was invalid on the grounds that the directors had exercised their power not bona fide but from an improper motive, as their primary purpose was to frustrate the take-over bid. To counter the writ the directors gave notice convening a general meeting of the shareholders of the company to consider a resolution ratifying and approving the allotment. At the meeting the resolution was passed by a substantial majority of the shareholders even though the allotted shares were not voted. The plaintiffs claimed a declaration that any resolution passed at the meeting was a nullity. A preliminary point which arose was whether the allotment was capable of being ratified and approved by the general meeting. Plowman J. held 1/ (at first instance), that it was and that since the allotment had been approved by the shareholders it was thereby validated, even if the directors had acted from an improper motive in making the allotment. This decision was affirmed by the Court of Appeal which added that an ordinary resolution ratifying such an issue of shares by the directors is not itself an issue of shares. 2/ The Court accepted the following argument of the defendants Counsel: Firstly, that unless there were contrary provisions in the articles, the power to issue capital validly created is in the company in general meeting. 3/ Secondly, this power is less extensive than the company's inherent power, which is not

---

1/ [1968] 2 All E.R.655.

2/ At 228. The Court relied on Hogg v. Gramphorn Ltd [1967] Ch.254, which was based on similar facts and decided on the same principle. This case is discussed below.

3/ Irvine v. Union Bank of Australia (1877) A.C.366 cited with approval.

subject to any such implied limitation. Thirdly, the company as the repository of all powers has a residual power in general meeting of allotment, the only limitation being that it cannot except by special resolution be exercised in such a way as to conflict with the power expressly vested in the directors. Fourthly, [1/] since the board had exceeded their power of allotment it was competent for the extra-ordinary general meeting to exercise the company's residual power and this did not involve a conflict with the director's powers. Support for these arguments was found in the judgment of Sir Barnes Peacock in Irvine v. Union Bank of Australia [2/] where he stated:

> "Their Lordships think that it would be competent for a majority of the shareholders present (though not a majority of the shareholders of the company) at an extra-ordinary meeting convened for that object, and of which object due notice had been given, to ratify an act previously done by the directors in excess of their authority". [3/]

1/ There were in fact six points of argument but those not relevant to this discussion are excluded.

2/ (1877) A.C.366: Articles of company adopted the 1862 Act which provided that subject to the powers given at meetings of shareholders, the directors should have powers to borrow on the property of the company any sum "not exceeding in the aggregate one-half of the paid-up capital". The articles further provided that one-half of the votes of the shareholders called for the purpose should be "necessary" to enlarge, extend, rescind or alter all or any of the provisions contained therein. The directors exceeded their borrowing powers. HELD: The Limitation of the power of borrowing was merely a limitation of the authority of the directors, and was not part of the consitution of the company. The act of the directors might be ratified by the company at a half-yearly meeting, but such ratification would not enlarge the borrowing powers of the directors for the future.

3/ At 375.

He stated further that if the object of the resolution was to give the directors in future an extended authority beyond what was given by the company's articles then that would amount to an alteration of the provisions which could only be done by a special procedure. "There is a wide distinction", he said, "between ratifying a particular act which has been done in excess of authority, and conferring a general power to do similar acts in future." 1/

It was the contention of Mr.Francis, Counsel for the plaintiffs and minority shareholders that the power to allot shares is a fiduciary power for the protection of the minority which if you allow to be exercised in general meeting would be exercised by persons who are entitled to consult their own interests and who unlike the directors are not bound to consult only for the benefit of the company. 2/ This underlines the fear about the potential for injustice to minority shareholders and investors by directors' misuse of the company's residual powers for the ratification of their acts which would otherwise amount to a breach of their fiduciary duties. Hogg v. Gramphorn Ltd. 3/ a case followed by Plowman J. in Bamford v. Bamford, illustrates the nature of the problem. A take-over bid was made for the shares of a company whose articles conferred on the directors a power similar to that conferred in Bamford. The directors, acting in good faith and believing that their actions were for the benefit of their company, devised a scheme the primary purpose of which was to ensure that the board would retain control of the company.

1/ Ibid. But the 1975 decision in Winthrop ,op.cit.now appears to permit the ratification of a contemplated future breach. For a discussion of the full implications of this decision see H.H.Mason, "Take-overs and Disputed Shares Issues. Ratification of the Directors' Acts". (1977) 51 A.L.J.89.

2/ Bamford v. Bamford at 223. See also Pender v. Lushington, etc. at p.129.

3/ [1967] Ch.254.

Buckley J. held that the power to issue shares was a fiduciary power and if it was exercised for an improper motive, the allotment was liable to be set aside even if it was made in the *bona fide* belief that it was in the interest of the company. More significantly it was held also that the primary purpose of the scheme being to retain control for the directors, the issue of shares pursuant to that scheme was *ultra vires* the board and invalid unless ratified by the company in general meeting. "If the company in general meeting elects to ratify what the board has done, there will be no objection", 1/ to their unauthorised acts. But ratification will not be allowed if the matter is illegal or *ultra vires* the company. 2/

A fundamental question of policy arises when this power of the company in general meeting is related to the actual mechanics of its exercise. It is very essential that a public company that is dependent on public financing should be able to have its shares allocated by the board whenever they consider it fit and to do so despite their lack of power in the hope that the allotment would subsequently be ratified. But it is also a known fact that in the large public companies the board of directors has *de facto* control over the general meetings and the voting

---

1/ At 271.

2/ Ratification is only permissible if ultra vires the directors; Grant v. United Kingdom Switchback Rys. (1888) 40 Ch.D.135, and not if illegal or ultra vires the company: Ashbury Ry. Carriage Co. v. Riche (1875) L.R.7 H.L.653; or if it would amount to a fraud on the minority. See Ngurli Ltd. v. McCann (1953) 90 C.L.R.425, Cook v. Deeks [1916] 1 A.C.554 and Clemens v Clemens Bros. [1976] 2 All E.R.268. See E.E.Palmer, D.D.Prentice and B.Welling, Canadian Company Law, Cases,Notes and Materials (2nd ed.) 1978, Chapter 6-158.

machinery, so that when the public is told that the general meeting has ratified or confirmed violations of the articles or breaches of the directors' fiduciary duties the chances are there that the directors have actually ratified their own wrongs. Thus, when directors illegally allot shares to their friends or award loans to or enter into contracts with themselves in breach of their contractual or fiduciary duties they can also manipulate the "residual" power of the company in general meeting to approve and ratify them - and so use the general meeting to "whitewash" their acts and obtain approval and forgiveness for their sins. 1/ It would seem therefore, that the contractual and equitable obligations imposed upon directors could so easily be flouted by the activities of the management. 2/ There is no reason to suppose that this possibility is merely academic 3/ and even though there are provisions in the Act restraining management from these abuses shareholders should be alive to their own responsibilities. It is for them to see that their residual powers to ratify breaches of director's duties are not usurped by management and used by them for their own ends.

1/ Bamford v. Bamford [1969] 1 All E.R. 969 at 973. In such situations as in Burland v. Earle [1902] A.C.83 and N.W. Transportation v. Beatty (1887) 12 App.Cas.589, where the directors have de facto control, to seek ratification from the general meeting would as B.H. McPherson puts it be like Caesar appealing to Caesar. "Directors Duties and the Powers of Shareholders", (1977) 51 A.L.J.460 at 469; See also R.Baxt, "Judges in their Own Cause : The ratification of Directors' Breaches of Duty" (1978) 5 Monash U.L.R.16, and also Queensland Mines Ltd. v. Hudson (1978) 52 A.L.J.R.399.

2/ See the hypothetical question posed by K.W.Wedderburn in "Going the Whole Hogg v. Gramphorn" (1968) 31 M.L.R.688 at 692-3.

3/ Indeed, the Jenkins Committee (Para. 111) referred to the point that general delegation of power to management may be used by them for selfish ends without the shareholders realising it.

2. Legal Proceedings in the Company's Name

Another common instance in which the residual power of the company may be invoked is in the institution of proceedings by shareholders in the name of their company. As a general rule, the commencement of proceedings on behalf of a company is a matter of general management and so vested in the board. 1/ If it were otherwise, then frequent litigation would throw the company's business into a state of continuous chaos. 2/ Moreover, litigation is a very expensive business to engage in.

The general attitude of courts to discourage litigation wherever possible is perhaps nowhere expressed as much as in Company Law. As a rule Courts are generally reluctant to interfere in the exercise of management's discretion - the right to sue in the company's name being assumed to be within this scope. The effect of this has been to restrict the "real" exercise of shareholders' power to seek redress by action. Consider for instance the remarks of Mellish L.J. in McDougall v. Gardiner 3/ where he said:

> "Looking to the nature of these companies, looking at the way in which the articles are formed, and that they are not all lawyers who attend these meetings, nothing can be more likely than that there should be something more or less irregular done at them - some directors

---

1/ See Shaw v. Shaw [1935] 2 K.B.113, 134 per Greer L.J. and 143 per Slesser L.J.; and Alexander Ward Co. v. Samyang Navigation, op.cit.

2/ See K.W.Wedderburn, "Shareholders' Rights and the Rule in Foss v. Harbottle" (1957) Camb L.J. 194,195.

3/ (1875) 1 Ch.D.13.

> may have been irregularly appointed, some directors as irregularly turned out or something or other may have been done according to the proper construction of the articles. Now, if that gives a right to every member of the company to file a bill to have the question decided, then if there happens to be one cantankerous member, or one member who loves litigation everything of this kind will be litigated; whereas, if the bill must be filed in the name of the company, then unless there is a majority who really wish for litigation, the litigation will not go on. Therefore, holding that such suits must be brought in the name of the company does certainly greatly tend to stop litigation" 1/

This rule which restricts litigation - The Rule in Foss v. Harbottle 2/ is that if a duty sought to be enforced is one owed to the company, such as a complaint against a director for breach of their fiduciary duty or duty of skill and care then the proper plaintiff in the action is the company. In that case Wigram V.C. generalised that the result of the clauses delegating power of general management to the board is that the directors are made the governing body, subject to the superior control of the proprietors assembled in general meeting. And, "the proprietors so assembled have power, due notice being given of the purpose of the meeting, to originate proceedings for any purpose within the scope of the company's powers, as well as control the directors in any Acts which they have originated". He admitted that there may be exceptions to this general proposition. 3/

1/ At 25. See also the similar judgment of James L.J. at 22-23.

2/ (1843) 2 Hare 461, 67 E.R.189.

3/ See Wigram V.C. (1843) 2 Hare pp.492 -493.

Mellish L.J. in MacDougall v. Gardiner, relied upon that general proposition,[1] and explaining the rule stated that:

> "if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having a litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes. Is it not better that the rule should be adhered to that if it is a thing which the majority are the masters of, the majority in substance shall be entitled to have their will fulfilled? If it is a matter of that nature, it only comes to this, that the majority are the only persons who can complain that a thing which they are entitled to do has been done irregularly". [2]

The above general rule, [3] is consistent with the rule that if the majority shareholders are abusing their powers or depriving the minority of their rights then the oppressed minority are entitled to seek redress by action. But if the complaint is that something which the majority are entitled to do has been done or undone irregularly, then nobody except the company itself can challenge the act.

The view that the board of directors under their general management power has *exclusive* control over the right to sue in the company's name has been rejected in many judicial and academic circles. In Danish Mercantile Co.Ltd. v. Beaumont, [4] one of two directors in a company

---

1/ Mozley v. Alston, 1 Ph. 790 applied.

2/ At 25.

3/ The Rule in Foss v. Harbottle cannot be discussed fully within the scope of this thesis. For detailed analysis of this rule see K.W.Wedderburn (1957) C.L.J.194; (1968) 31 M.L.R.688 and (1976) 39 M.L.R.327. See also Anthony Boyle,"Minority Shareholders' Suits for Breach of Directors Duties" (1980) 1 Co.Law 3, which contains a list of referenceson the subject.

4/ [1951] 1 All E.R.925.

was given wide powers of management in the following terms: "Mr.Sheridan shall manage and conduct the affairs of the company as he in his sole discretion shall think fit", and was empowered "to do all acts and things and execute all documents necessary to carry this agreement into effect". Jenkins L.J. in the Court of Appeal, agreed with the trial judge that that agreement did not extend to authorise the director to commence proceedings in the company's name. 1/

Although dicta in Shaw and Sons (Salford) Ltd. v. Shaw, 2/ suggest that a delegation of general management powers to the directors give them exclusive control of corporate litigation Danish Mercantile Co. v. Beaumont 3/ makes certain that under normal articles either the board or the general meeting can initiate, discontinue or prevent or ratify such litigation. Were the Shaw v. Shaw 4/ suggestion correct that would destroy the entire substratum of the Foss v. Harbottle 5/ rule which provides that it is for the majority to decide whether or not to sue for a wrong against the company. 6/ For example, it was held in Pender v. Lushington 7/ that where the directors frustrate the attempts of an undisputed majority by refusing to register its votes upon a resolution, a Court being satisfied that a real majority decided to bring an action, will entertain it despite objections by the directors - until a general meeting has been convened and the wishes of the members ascertained in a proper manner. That case was followed by Neville J. in Marshall's Case 8/ where he stated that unless there was a contract to the contrary the majority of shareholders

---

1/ At 296-7.

2/ Supra p.191 ,note 1.

3/ [1951] 1 All E.R. 925.

4/ Ibid.

5/ (1843), 67 E.R. 189.

6/ See K.W. Wedderburn (1957) C.L.J. 194 200-203.

7/ (1877) 6 Ch. D. 70.

8/ [1909] 1 Ch. 267.

in a company have the ultimate control of its affairs and are entitled to decide whether or not to maintain an action in the company's name. 1/

In Imperial Hydropathic Hotel Co. Blackpool v. Hampson, 2/ certain shareholders of a company were appointed directors by a general meeting, in place of existing directors, and brought action in the name of the company against the existing directors to restrain those who had been removed from acting. The Court held that the new directors were not duly appointed and so refused the relief prayed for. But as the plaintiffs substantially represented the wishes of the majority of the shareholders, the costs were ordered to be paid out of the company's assets, even though they had not got the company's authority to sue. In Danish Mercantile Co.Ltd. v. Beaumont Jenkins L.J. explained the usual Court practice where the right of a plaintiff to sue in the company's name is challenged:

> "It is common practice in such cases to adjourn any motion brought to strike out the company's name with a view to a meeting being called to see whether the company desires the action to be brought or not". 3/

Assuming that the dicta in Shaw's Case is correct it is still possible for the general meeting to sue since it is well established that even minority shareholders will be allowed to sue in the company's name on prove that the directors in *de facto* control have refused to sue

---

1/ See also Re. Argentum Reductions (U.K.) Ltd. [1975] 1 All E.R. 602.

2/ (1883) 23 Ch. D.1

3/ At 930. See also Worcester Corsetry Ltd. v. Witting. [1936] Ch. 640.

to redress a wrong done to the company, despite members' request to do so. Action would be allowed in this instance under the "Fraud on the minority" exception to the rule in Foss v. Harbottle.[1/] Thus in Prudential Assurance Ltd. v. Newman Industries Ltd., a minority shareholder was allowed to sue in the company's name [2/] despite objections by the board of directors.

Lastly, the right to sue, not in the company's name but on behalf of the company's interest has been held in Wallersteiner v. Moir [No.2] [3] as residing in a minority shareholder acting in a sense as the "agent" of the company by way of "derivative" action, when a "fraud" has been committed by those in control.

It seems clear therefore that where the common form of articles are adopted both the general meeting and the board of directors have power in appropriate circumstances to commence proceedings on the company's behalf.

3. Disposal of Company's Assets

Controversy exists as to whether directors have power under general delegation to sell or dispose of their company's assets or undertaking. For example, B.V.Slutsky [4/] expresses the view that "in spite

---

1/ See Atwool v. Merryweather (1867) L.R.5 Eq.464

2/ In terms of Procedure, this case is remarkable for being the first ever to combine a direct/personal, derivative and representative action in one and the same suit.

3/ [1975] 2 W.L.R.389 per Lord Denning M.R. and Lords Scarman and Buckley.

4/ The Duties and Powers of Management in the Company Law of Canada and England (unpublished Ph.D.Thesis at the L.S.E.) 1971.

of the absence of a firm judicial decision on the point, the board of directors must be taken to have the right to dispose of all the company's assets without the consent of the shareholders pursuant to the general powers delegated to them in Article 80". 1/ This view is inconsistent with a proper interpretation of the scope of Article 80 and the general power of management under it, as well as opinions expressed in some academic treaties on the issue. 2/

Although there is, admittedly, a dearth of cases on this subject a few can be referred to which support the proposition that the board can only exercise such power subject to the consent of the shareholders in general meeting. Firstly, in Wilson v. Miers. 3/ by a deed of settlement of a company, the powers of the directors were defined to be, amongst other things, "the building or purchasing or hiring of steam-vessels as they should see fit", "the selling and letting to hire and chartering of vessels", "the general conduct and management of the business of the company.... the controlling, managing and regulating, in all other aspects except as by those presents otherwise provided, of all matters relating to the company and the affairs thereof". The directors, thinking it expedient to sell all the vessels belonging to the company employed plaintiffs, ship-brokers, to procure a purchaser. Plaintiffs accordingly negotiated a sale of the vessels upon the terms fixed by the directors, with C. The negotiations, however, went off, upon an objection urged by C's solicitor that the directors had no power to sell

1/ At p.102.

2/ See Chapter 3.

3/ (1861) 10 C.B.N.S. 348,142,E.R.486.

the whole of the vessels, except in the event of the winding-up of the company with the consent of the shareholders, which had not been obtained. It was held that the directors could contract to sell the ships.

It is noteworthy that one of the company's articles expressly empowered the directors to sell. That, notwithstanding, they took the prudent step of securing at an extraordinary general meeting a resolution "that the directors be instructed to sell the vessels and realise the property of the company with as little delay as is consistent with the interest of the shareholders..."[1/]

Again in <u>Re. H.H.Vivian and Co.Ltd.</u> [2/] a company carried on its undertaking in three distinct branches, and issued debentures operating as a floating charge upon the property of the company. The debentures were secured by a covering trust-deed under which the company covenanted to carry on their business in a proper and efficient manner. The company resolved to sell to another company the stock-in-trade and plant of one of the branches of the business which had been carried on at a loss. In an action by the debentureholders, it was held that the sale could not be restrained, as it was not contrary to the terms of the debentures or trust-deed, and was consistent with the carrying on of the business of the company in a proper manner. In reaching his verdict Cozens-Hardy J. referred [3/] to the company's article which vested the management of the business of the company in the board as entitling the directors to dispose of an unprofitable

1/ 142 E.R.490. In addition a Committee was appointed "to advise with the directors for the purpose of carrying out the above resolution". Ibid.
2/ <u>Metropolitan Bank of England and Wales Ltd. v. H.H.Vivian & Co.Ltd.</u> [1900] 2 Ch.654.
3/ At 658.

part of their business. This, however, did not decide whether or not the board had an exclusive power to dispose of the company's assets or whether the general meeting had a residual power.

In Automatic Self-Cleansing Filter Sundicate v. Cunninghame, a case already discussed above, the directors were held entitled to refuse to comply with a resolution of the general meeting directing them to sell the company's assets. The decision in that case, however, turned on a question of construction of a special article vesting special powers on the board. It is submitted, however, that under the usual articles the question whether directors have power to sell a company's undertaking would depend, firstly, on whether such a sale amounts to a fundamental or structural change in the nature of the company's business. Where this is the case it appears from the authorities [1/] that except with the consent of the shareholders in general meeting the board cannot sell. This is more so if the company's business is in a very healthy condition. [2/] On the other hand, if the sale does not threaten to alter the structure of the business then the directors may, as a matter of general management or even business prudence, decide to effect a sale. The same is true if the business is in such unsatisfactory condition that the directors consider it more prudent to sell as it certainly was in the case of Wilson v. Miers. As Willes J. remarked in that case:

1/ Wilson v. Miers and Clark v. Workman, supra .

2/ It is submitted that even if the directors sold in such a situation at a profit but without shareholders' approval action can be taken against the directors for acting *ultra vires*. Where the sale is at a loss the action would be one for negligence or misfeasance.

"The directors have the duty to protect the general interests of the shareholders according to their judgment. If the ships could only be navigated at a loss, they may let, cease to navigate, or lay them up, or, if it would be profitable, sell. If they sold, they might keep the proceeds to be reinvested if the company did not choose to dissolve, or to be distributed in winding-up if they did.... I therefore think the general authority extended to validate the sale" 1/

It was also emphasised that at a period when delay might take place in summoning a meeting of the shareholders for the purpose of agreeing to a dissolution an opportunity was afforded for selling the vessels at a sum which it could not be hoped would validly be obtained for them at a subsequent period. Under those circumstances it is clearly the duty, as it is the interest of the directors to convert the assets into money at a favourable price, and retain the money in their hands until the shareholders decide what should be done to it.

It has been indicated in Grant v. U.K. Switchback Rys, and Irvine v. Union Bank of Australia, that an excessive use of limited powers to sell property (or borrow) by the directors can be ratified by the general meeting. But in Bamford v. Bamford, Plowman J. noted, in reference to those two cases:

"I accept however that they are not themsleves decisive of the question whether, whenever a limited power is conferred on directors, a residual power is necessarily left in the company. Whether any such residual power does or does not exist in any particular case will depend not only on the general law but also on the memorandum and articles of association of the company in question." 2/

1/ At 493.

2/ [1968] 2 All E.R. 655 at 668.

In order to remove any doubts the Jenkins Committee deemed it necessary for legislation to exclude from the general delegation of powers to directors any sale of the whole or substantially the whole of the company's undertaking and assets. 1/ The Committee accepted the evidence of the Federation of British Industries, 2/ that "it is already standard practice among well-conducted companies to obtain the consent of the shareholders to a sale of a substantial part of the company's undertaking". 3/ Wilson v Miers is the one case where this was done.

It is important to note also that the Jenkins Committee agreed with the evidence of the Institute of Chartered Accountants in England and Wales that "in general the principle should be that the function of the directors is to manage the shareholder's business, not to dispose of it". 4/

While very few would deny some form of statutory requirement for shareholders approval, 5/ it has been very difficult to arrive at a consensus as to when a transaction deserves such approval, especially because what amounts to a fundamental or structural change in a company's activities in each case depends on a host of factors. In relation to this problem, the Jenkins committee admitted that:

1/ Para.113.

2/ Now the Confederation of British Industries.

3/ Para.117. See also the Bullock Report (Cmnd 6607) p.81.

4/ Evidence to the Jenkins Committee p.1403 para.34.

5/ Except for example, the Bullock Committee whose view of the law is that a proposal to dispose of a substantial part of the Company's undertaking does not require prior shareholders approval. Ibid. But cf. Clark v Workman, Supra.

> "it would be difficult, particularly where the nature of the business is gradually changing shape, to define the circumstances in which, and the point of time at which, a fundamental change would be said to be in the making...it would also be difficult to extend such a provision to the activities of subsidiary and associated companies and .... unless the provisions were so extended it could easily be evaded by the acquisition of investments in subsidiary and associated companies for this purpose..." 1/

For these reasons the committee declined to recommend new requirements for shareholders' approval in respect of fundamental changes in their companies' activities. Instead they recommended the notification of changes of activities to shareholders in the balance sheets 2/ and that:

> "notwithstanding anything in the memorandum or articles of associatinn the directors of a company should not be able without the specific approval of the company in general meeting to dispose of the whole or substantially the whole of the undertaking or assets of the company" 3/

The limitation in this recommendation is that even though the fundamental character of a company's activities may have been greatly altered, the shareholders may be denied the right of approval on the grounds that the whole or substantial parts of the company's assets or undertaking has not been disposed of. 4/ For example, the directors of a shipping company with extensive landed property holdings might feel obliged only

---

1/ Para.118.

2/ Para.122.

3/ Para.122 (e)

4/ Cf. Wilson v. Miers, and ipso facto the company may continue in businesses which are intra vires.

to notify the company's shareholders of the sale of all their vessels while retaining the company's buildings and landed property for incidental businesses. It would clearly be better, therefore, to require that the prior approval of shareholders before any sale which would have the effect of changing the fundamental character of a company - that is - its main business and not incidental ones. Directors should not be free to do indirectly, that is, to alter the character of a business, what they cannot do directly. 1/

Since 1962 when the Jenkins Report was published certain qualifications and extensions to the rights of shareholders to ratify the board's activities have been suggested. For instance, Lord Chorley and Eric Wolff 2/ in 1963 recommended that directors negotiating for the transfer of all the assets or a substantial part of the shares of their company be regarded as agents of the shareholders to whom they are under an obligation to report on all stages of the negotiations. The Institute of Chartered Accountants in a memorandum submitted to the Board of Trade in 1969 recommended by way of a qualification to the Jenkins Committee proposals that shareholders' approval is not necessary where the sale is to an organisation in which the company has directly or indirectly at least 75% interest.

1/ Note that under Section 16(1) (a) of the 1967 Act the directors' report is required to contain particulars of any significant changes in the fixed assets of the company - perhaps in response to the proposals of Lord Chorley and Eric Wolff. See below.

2/ "Commercial Law and Company Law" in Law Reform Now. G.Gardiner and A. Martin, ed. (1963), 150, 191-193.

Until the passing of the 1980 Act the principal rule for regulating the disposal of companies' assets has been the Stock Exchange Listing Agreement 1/ requiring the notification to the Quotations Department without delay *inter alia* "particulars of acquisitions or realisation of assets" 2/ and any decision by the board "to change the general character or nature of the business of the company or of the group". 3/ Compliance with these regulations are mandatory as a condition for the Listing of companies, and except for the inevitable limitations in the alertness of shareholders, these provisions would substantially prevent in (large) listed companies possible abuses by directors in unconscionable disposal of the company's assets. The Stock Exchange Listing Agreements, it is generally agreed, is not a substitute for statutory regulation. It is therefore gratifying that the 1980 Companies Act has introduced new rules in these matters, albeit, the relevant section deals only with transactions with directors and connected persons.

Under Section 48 of the Act the approval of the general meeting is required for any contract to transfer to or acquire from, a director of a Company or its holding Company, or anyone connected with such a director, a non-cash asset exceeding in value £50,000 or 10% of the

---

1/ Admission of Securities to Listing. Issued by Authority of the Stock Exchange (1979). Schedule VII. Part A.

2/ Para.5 (a).

3/ Para.5 (f).

company's net assets, whichever is the smaller. [1/] Any contract entered into in contravention of this section will be voidable by the company [2/] but may be affirmed by the general meeting. The effect of Section 48(i) is to prohibit a company from entering into an arrangement whereby:

(a) a director of a company or its holding company or a person connected with such a director acquires one or more non-cash assets of the requisite value from the company; or

(b) the company acquires one or more non-cash assets of the requisite value from such a director or a person connected with such director,

unless the company has first approved of the arrangement in question by resolution in general meeting. An arrangement made with a director of a

---

1/ This apparently leaves directors and connected persons with the freedom to acquire non-cash assets of up to either £50,000 or 10 per cent of the total assets. To some companies this would represent a substantial proportion of the total assets and the new section seems thus less drastic than might be expected.

2/ Exceptions to contracts voidable under this section are set out in subsection (3). These are:

(a) Where restitution is no longer possible or where the company has already been indemnified for the loss;

(b) Where a third party's rights are involved who have acquired their rights for value and without notice, or,

(c) Where the arrangement is affirmed within a reasonable period by the general meeting.

Company's holding company or a person connected with such a director must not only be approved by a resolution of the general meeting of the company in question but also by resolution of the general meeting of the holding company.

There are a number of issues which are raised by the section but left unresolved by the Act. For example, the term "arrangement" used by the section is nowhere defined by the Act but the term has been defined in Manning v. Eastern Counties Railway 1/ though in a different context, as "a very wide and indefinite one". 2/ Accordingly, Victor Joffe 3/ has suggested that it would include not only agreements enforceable in law but also *de facto* agreements or transactions not identifiable as agreements or contracts *stricto sensu*. Evidence of a specific oral or written agreement is also not necessary to constitute an "arrangement", provided the conduct of the company and some other person demonstrated that that person and the company had accepted mutual obligations.

Also it is a question of fact to be determined in each case whether, and if so, when the arrangement is concluded, the parties to it and its precise terms. So is the question of severance of the objectionable parts out of a contract embracing other matters.

1/ (1844) 13 L.J. Ex. 265; 152 E.R. 1185

2/ At p. 253; E.R. 1192

3/ In The Companies Act 1980 : a practical guide. (1980) 9.203.

Although the Act is silent on the point it seems that the section would cover indirect or circuitous arrangements, the purpose of which is ultimately to achieve the sort of transfer prohibited by the section. However, where, for example, a non-cash asset is acquired by a third party from a company and then acquired in good faith by a director of the company or of its holding company or by a person connected with such a director, from the third party, the director's or connected person's acquisition of the non-cash asset will not fall within the prohibition. The position would be the same in the case of a bona fide acquisition by the company from a third party, of a non-cash asset acquired from a director or connected person.

Although the Act does not specifically mention it, it is obvious that unless the articles otherwise provide, the arrangement can be approved by ordinary resolution.

In contravention of the section, the director and the connected person and any other director of the company who authorised the arrangement or any transaction entered into in pursuance of the arrangement shall be liable:

(a) to account to the company for any gains which had been made directly or indirectly by the arrangement or transactions; and

(b) to indemnify the company for any loss or damage resulting from the arrangement or transaction. This liability affects the persons concerned jointly and severally.

Limited defences are provided by subsection (5) which states that where an arrangement is entered into by a company and a person connected with a director of the company or of its holding company in contravention of the section the director will not be liable under sub-section (4) if he shows that he took all reasonable steps to secure the company's compliance with that section. Also a person so connected or the director in question shall likewise not be liable if he shows that at the time the arrangement was entered into, he did not know of the relevant circumstances constituting the contravention (S.48(5)). The section does not over-ride any other liability which may be imposed elsewhere in the Companies Acts or under the general law. 1/

It is to be observed that the company is not required by the section to make a copy of the proposed arrangement available for inspection by the members prior to the meeting nor even at [illegible] the meeting itself. It is to be expected, however, that the directors would disclose this in the notice of the meeting to the shareholders, or if the arrangement came too late for this, at the meeting itself. It would be more appropriate at any rate, to send copies of the arrangement to the members at least several weeks before the meeting in

1/ A company which is a wholly-owned subsidiary within the meaning of Section 150, 1948 Act is exempted from the provisions (S.48(6)). So is any body corporate which is neither a company within the meaning of the 1948 Act nor required to be registered under Part VIII of that Act.

order to allow them enough time to make a well-informed decision on how to vote. This section, no doubt, represents a major step in ensuring for shareholders the power to prevent directors or their close family members or associates from misappropriating the company's assets, as indeed most unreasonable disposal of corporate assets in the past have been for this purpose. Wherever the general meeting considers the "arrangement" beneficial to the company their approval should, one expects, be easily obtained.

4. New and Further Scopes for the Exercise of Residual Powers by the General Meeting

(i) Substantial Contracts : (A New Scope for Shareholders Approval)

Apart from the traditional areas in which the approval of the general meeting is generally deemed essential, new impetus has been introduced by the 1980 Act to the necessity for shareholders' approval in two significant areas. One of these in Section 48 discussed above and the other is in relation to substantial contracts entered into by a company with directors or other outside interests. One important principle of Company Law is that a director must not enter into a contract in which his personal interest and that of his company may conflict. If he does, then the contract will not be valid unless it is ratified by the company in general meeting. But as the 1948 Act provides qualifications to this (for example, that it will be valid if permitted by the company's articles 1/ and by enabling the interested directors to vote on the question) 2/ the severity of the

1/ For example Article 84 of Table A.

2/ That is, after disclosure under Section 199 and Section 16(1) of the 1967 Act.

the requirement for disclosure to and ratification by the general meeting is mitigated. [1/]

The Stock Exchange rules have attempted to prevent possible abuses by directors avoiding to submit the transaction in question to the general meeting. One example is where companies enter into long service contracts with directors. Typically, these contracts are rarely in the interest of the companies and the terms are usually weighted in favour of the directors, particularly as regards the remuneration, the right to terminate, rights over patents and inventions, restrictive covenants and so forth. It is, therefore, clearly important that the general meeting be entitled to know the terms of these contracts particularly where they are for an unduly lengthy period and to reserve the power to approve or reject them. Thus, the Stock Exchange Listing Agreement requires that any service contract of ten years or longer duration granted by the company or any of its subsidiaries to any director or proposed director of the company must be made subject to the approval of the company in general meeting. [2/]

In order to prevent the frustration of the will of the general meeting the Stock Exchange rules [3/] provide that the articles

---

1/ See C.D.Baker, "Disclosure of Directors' Interests in Contracts", (1975) J.B.L. 181 and John Birds "Excluding the Duties of Company Directors", (1976) 39 M.L.R.394.

2/ Para.11(a). Para.11(b) provides that copies of all service contracts should be made available to the shareholders from the date of the notice convening the AGM and 11(c), it is to be stated in the notice that such contract will be available for inspection.

3/ Sched.VII Part A. Articles of Association, D(2).

of association of a listed company must exclude the right of a director to vote on any contract or arrangement in which he has a "material interest". 1/

While the Stock Exchange regulations are far-reaching one wonders if the restriction period of 10 years is not too high. It would be enough for a company to enter into a service contract for five years without having to submit it for the general meeting's approval, but if the period exceeds five years, then the general meeting must be entitled to know about it and to give or withhold their approval to it.

The 1977 White Paper "The Conduct of Company Directors" indicated a preference by the Labour Administration for this view and so proposed "that for all companies, director's service contracts for periods longer than five years shall not be valid unless approved by the company in general meeting". 2/ This point was taken up by the Government and is now contained in Section 47 of the 1980 Act.

That section provides that unless the term is first approved by a resolution of the company in general meeting, a company must not incorporate in any agreement a contractual term of the type specified in sub-section (2). This includes any term by which a director's employment

---

1/ Exceptions may be allowed to companies only with the consent of the Quotations Committee.

2/ Cmnd 7037 p.5. Cf. the S.E. Listing Agreement which provides for ten years.

with the company of which he is a director is to continue, or may be continued, otherwise than at the instance of the company (whether under the original agreement or under a new agreement entered into in pursuance of the old agreement), for a period exceeding five years, during which the employment:

(a) cannot be terminated by the company by notice; or

(b) can be so determined only in specified circumstances.

The prohibition also applies to any such term in any agreement between a company and a director of its holding company involving the director's employment within the "group". 1/ In this case the term must first be approved both by resolution of the company in general meeting and by resolution of the holding company in general meeting. It is provided in sub-section (3) that where a person is, or is to be, employed with a company under an agreement which the company cannot terminate by notice, or can be terminated only in specified circumstances, and more than six months to the end of the current employment the company enters into a new agreement, the result of which is to extend the period of a director's employment to a total period of more than five years, the new agreement must be approved by the company in general meeting.

1/ "Group", in relation to a director of a holding company, means the group which consists of that company and its subsidiary. "Employment" includes employment under a contract of service and contract for services. See S.47 (7) (b) and (a).

In order to allow sufficient time for renewal of contracts the section permits a new agreement for another five year period of employment to be entered into during the last six months of the original employment.

Also in order to ensure that the members are not deceived into giving their approval to a prohibited contract, it is provided that the necessary resolution shall not be passed unless a written memorandum setting out the proposed agreement incorporating the term of the contract is available for inspection by the members, both at the registered office of the company not less than 15 days before the meeting and at the meeting itself. It is the final terms of the proposed agreement that must be filed and not merely its draft terms. And by requiring the filing with the Registrar the Act ensures that all members, whether or not entitled to attend and vote at the general meeting, are able to discover the terms of any proposed agreement before the general meeting at which the approval is sought.

It is not indicated what type of resolution is required for the approval but it seems that an ordinary resolution would suffice unless the articles of association require otherwise.

Lastly it should be pointed out that it is only the prohibited terms in the director's contract of employment that is rendered void in the event of contravention of the section. The Act does not render the rest of the contract invalid. The section also does not affect the usual right under Section 184 of the 1948 Act to dismiss directors or the company's liability thereunder for damages for wrongful dismissal. Also certain types of companies are excluded from the operation of the section and these include a wholly-owned subsidiary of any body corporate, and any body corporate which is not a company within the meaning of the 1948 Act or registered under Part VIII of that Act. 1/

1/ Section 47(b).

(ii) Contribution to Political Parties : (A further scope for Shareholders' Approval)

The increasing dominance of large companies in public life has seen the close involvement of some with political parties and other pressure groups. In recent times questions are being asked as to how far the owners of these companies - the shareholders - may control the expenditure of corporate funds in furtherance of the policies of political parties or pressure groups or organisations.

Initially, the extent to which companies may go in spending their money on non-commercial activities was limited by the operation of the *ultra vires* doctrine. This requires that a company may only undertake or incur expenditure in connection with such businesses as are authorised by the company's constitution or which are reasonably incidental to carrying out its authorised objects or which otherwise contribute to the profitable performance of its business. On the application of this principle certain acts of corporate benevolence to charities, educational establishments and so forth have been held justifiable. 1/ It has been held, for example, that:

> "[a] railway company.... might send down all the porters at a railway station to have tea in the country at the expense of the company". 2/

1/ For Example, Evans v. Bruner.Co.Ltd.[1921] 1 Ch.359. A company passed a resolution authorising directors to distribute to such universities or other scientific institutions in the UK as they may select for the furtherance of scientific education and research..." HELD. Valid. Also in A.P.Smith Mfg. Co.v. Barlow [1953] 346 U.S.861, a company donation to Princeton University challenged by a shareholder was held valid. The power of the company to do this was regarded as a "major though unwritten corporate power" and in the Court's opinion a "solemn duty".

2/ Per Bowen L.J. in Hutton v. West Cork Ry. (1883) 23 Ch.D.654.

Although company benevolence to employees and charities may be justified as being of a long-term advantage to the company the desirability of contributions to political parties is much more suspect. The problem becomes very worrisome in view of the dubious and surreptitious manner in which some of these contributions are made and the wave of scandals which contributions, kickbacks and bribes especially by multinational companies have generated in recent years. 1/ In view of the way the public has reacted to these activities it is necessary that such partisan donations represent the democratic intentions of the company in general meetings and not just those of management. Shareholders intervention in this regard should, of course, be limited only to contributions of a partisan nature and other expenditure intended to further the company's business should be accepted as part of the general management concern of the board, provided the expenditures are not outrightly *ultra vires* or illegal. It is necessary for Company law to afford shareholders the right to ratify or withhold approval from partisan donations of which they disapprove.

The issue of political contributions has not featured much in company litigation and in the absence of clear judicial authority on the point, it is not surprising that Professor Lord Wedderburn considered it one of the areas in which the present Company Law has proved inadequate 2/ Perhaps the most important case in which this question has been considered is the House of Lords decision in Morgan

---

1/ See Tom Hadden, Company Law and Capitalism, second edition,317-320.

2/ Hansard (House of Lords) 25 June 1979 at Col.1265.

v. Tate & Lyle [1] The facts: In 1949 the Labour Party Executive issued a statement of policy which threatened the nationalization of sugar refining industry in Britain. The statement gave the board of directors of the defendant company cause for concern and they accordingly decided to "take every legitimate step to oppose the nationalization". After they failed to persuade the Labour Party against the nationalization an extra-ordinary general meeting of the company's stockholders was held at which the following resolution was passed:

> "Believing as we do that nothing but harm to workers, consumers and stockholders alike can spring from the nationalization of the sugar refining industry, the members of the company hereby empower the board of directors to do everything in their power to meet the threat of the nationalizers..."

Accordingly, they contributed more than £15,000 to pro-Tory organisations to mount a propaganda campaign against nationalization. This action (a case stated) was instituted by the Inland Revenue Department and two questions were raised for determination:

1. Whether the donation is *ultra vires*, and
2. Whether, if *ultra vires*, it is tax deductable.

1/ [1955] A.C.21.

The Tax Commissioner found that the expenditure "was money wholly and exclusively laid out for the purposes of the company's trade and was admissible deduction from its profits for income tax purposes...". Appeal by the Inland Revenue Dept. against this finding was rejected by the Court of Appeal and the House of Lords which found that the payments had been made in the honest belief that it was necessary to preserve the company's assets from expropriation, and so to enable the company to carry on its business and earn profits.

It is easy to think of several reasons why companies may wish to contribute funds to political parties. For example the removal of prices and dividend restraints, favourable export policies, to mention a few, but the 'real' likelihood and imminent threat of nationalization which actuated the board of directors of Tate & Lyle are less present today. 1/ Undoubtedly, the Labour Party, particularly the left of the party is a constant threat of nationalization to many industrialists and businesses and the intimate relationship between the party and the unions to whom employers stand in awe means that the "enemies" of the Labour Party are the "natural allies" of employers. The Conservative Party has always stood to benefit from this and by a not surprising coincidence receives an immensely disproportionate part of companies' contributions to political parties. 2/

1/ But the threats of future nationalization by a Labour Government that have been issued by some prominent members of the Labour Party is bound to cause some anxiety in some business circles.

2/ A recent survey by Labour Research found that from March 1977 to March 1978, 378 companies contributed £1,439,594. Of this £771,000 went direct to the Conservative Party and £172,000 went direct to pro-Tory organisations like the Economic League and AIMS. In contrast the Liberal Party got none at all.

Objections to the sponsorship of the Conservative Party by companies is always very quickly countered by the opposing argument that the Labour Party gets the unions' financial backing as well. The weakness of this justification,if it is such is that contributions by unions come from the voluntary contribution of union members. 1/ The Trade Union Act of 1913 requires that a trade union which wishes to make political payments must set up a separate political fund, into which must be paid only special contributions paid as a separate political levy by the union members. 2/ Every member of a trade union thus has the right to contract out and become an exempt member, relieved from contributing to the political fund. The shareholder on the other hand is not consulted by the directors when computing the profits and deciding what proportion of it to donate to a party and worse still he is not consulted as to what party to support. The board, it is assumed, has to do the thinking for him and as a general management matter determine the party whose assistance would further the long-term interest of the company. This seems like pushing the idea of the board's superior business judgment to its extreme limit and some other justification has to be adduced to show why the majority of shareholders in general meeting should not be allowed to determine among themselves which political party should get their financial support or whether to offer any at all. And by an analogy with the right of an exempt member of the

---

1/ Professor Wedderburn dismisses the argument, in justification of political donations in Parliamentary Debates (H.L.) 25 June 1979.

2/ The Trade Unions political funds are administered by the Certification Officer and his 1978 report shows that 73 trade unions have political funds and 19% of the 10 million members decided to contract out of the political levy.

Trade Union to contract out of contribution to the political fund it ought also to be possible for minority or dissentient shareholders to opt out of their companies' contributions to political parties. The case for minority shareholders may be met in two ways.

Funds donated to political parties should normally be deducted from the amount which is available for dividends and members who notify their companies of their objections should then have their proportion of that amount added to their dividends so that in the end the amount given out as such donation would be seen as having received the direct or even tacit approval of the other shareholders.

An alternative approach would be to stipulate that any company which intends to contribute money to political parties must set up a special fund into which shareholders may voluntarily contribute. If there is a convincing reason that it would be in the interest of the company to support any particular party or political purpose one expects that shareholders would freely contribute to such a fund.

During the Standing Committee's debates of the Companies Bill which was to be the 1967 Act several members argued in favour of giving shareholders a say in companies' contribution to political parties, in addition to the Clause being then debated requiring disclosure of such contributions in the annual accounts and reports. 1/ The then Minister

---

1/ See for example, speech by Mr. Ben Ford, M.P. in Parliamentary Debates (H.C.) Companies Bill (H.L.). Standing Committee E, Eleventh Sitting (1967) Columns 544-545.

of State, Department of Trade, Mr. George Darling, expressed his support for the requirement for disclosure: "Contributions out of funds of a company for purposes that have nothing to do with the company's activities", he said, "must be disclosed to the shareholders. They should know what is going on and what the directors are doing with the company's money. This is part of Company law and we take a firm stand on that point". 1/ The Minister refused, however, to lend his support to the proposal that dissentient shareholders should as in trade unions be entitled to contract out. He said:

> "we cannot control political expenditure of companies in this way. One cannot apply the trade union approach to companies. One cannot have the definition without going the whole way of trade union law. One cannot spatchcock trade union law into the Companies Bill." 2/

One would have liked the Minister to offer reasons of substance why a method of contribution used by the trade unions cannot be applied by companies, but the reason he gave amounts to a desire for retaliation against the Labour Party who benefit from trade unions' contributions. This was that "if we are to spatchcock trade union law into Company law on this point... we should [also] bring up to date the 1913 [trade union's] rules", and introduce very strict conditions about disclosure of all the contributions that the union may make outside the activities of the union itself which would include their own contribution to, say, the Labour Party. 3/ Accordingly, this question was omitted in the 1967 Act, and in view of the vested interest involved and the way in which most people appear to have accepted the status quo it now seems little more than academic to argue in favour of more democratic methods of contributing corporate funds to political parties.

1/ Col. 553.

2/ Col. 557.

3/ See Col. 558.

Our contention here, it must be emphasised, is not that contribution to political parties is illegal. On the contrary it is perfectly legitimate for a company to make such a contribution if empowered by its articles of association and if the expenditure is reasonably incidental to the carrying on of the company's business provided that as required under Section 19 of the 1967 Act particulars of contributions for political purposes must be disclosed in the directors' report. That section requires that if a company or its subsidiary have made donations for charitable or political purpose of an amount exceeding 50 pounds the director's report must disclose certain particulars such as the identity of the party, the amount of money given and the identify of each recipient of donations for political purposes.

The problem of companies' contributions to political parties has often been treated by textbook writers with brevity, if at all. It appears to be generally accepted that the requirements in the 1967 Act for disclosure in the company's annual accounts of details about such donations has brought to conclusion all there is to say about the question. It is contended here, however, that the rights of investors to be consulted before the donations are made and to dissent from such donations if necessary, is of great importance although Parliament in]967 did not treat it as such. It is important because, for example, if too large a sum is given out this might reduce the amount of dividends available and it would be too late for shareholders to do anything about it at the general meeting before which the accounts in which the disclosures have been made are laid. Besides, some companies are known to have resorted to devices in order to avoid disclosure. One company which felt disinclined to allow such publicity when the 1967 Act was passed simply cancelled its registration as a registered company in order, as The Times reported "... to stop snoopers finding out more about us than they need do". 1/

The remedies commonly suggested for shareholders who disagree with the spending of their companies' money in this manner are the usual familiar ones: "they can dismiss the directors", 2/ and "they

---

1/ 11 April 1973.

2/ Lord Harmer-Nicholls, Hansard (H.L.) 25 June 1979, 1271.

can raise the matter (in general meeting or the Press?).... They can sell their shares individually and invest in another company". 1/ In other words, vote with their feet! It is common knowledge that although the remedy of dismissal is often assumed to be available to shareholders for numerous reasons, some of which have been discussed in Chapter 2, it is rarely an effective one. 2/ To leave shareholders only with the remedy of selling off amounts to ignoring their interests entirely and lends support to the view that they are merely lenders of capital without any rights of participation. A solution to this rarely explored legal problem is to ensure that payment by companies for party politics is made only after the approval of the company has been obtained in general meeting, and it is as well that statutory regulations be introduced for effective compliance by those concerned. There is truth in the findings of Barbara Shenfield 3/ that most companies which make political donations view it as a matter of business judgment and in the absence of shareholders' objections will almost certainly continue to make gifts to political parties. Unless shareholders are given this right to object very little will be achieved by a few Labour Party or Trade Unionists shareholders raising largely fruitless protests at A.G.Ms against political gifts. It is, at any rate, gratifying that in the meantime a few companies are, as Barbara Shenfield notes, 4/ planning to obtain the formal consent of their shareholders to making political gifts - though, of course, this cannot be a substitute for the statutory right to be consulted.

1/ Viscount Trenchard, ibid, 1281.

2/ The way in which the late Sir Eric Miller of Peachey Properties Ltd. doled out contributions to charities including Jewish organisations, may be recalled. See Peachey Property Co.Ltd., Dept. of Trade Report, 1979.

3/ Company Giving (1970) pp.517-518.

4/ Political donations were not one of her primary concerns in the book.

PART II

THE MECHANISM FOR CORPORATE ADMINISTRATION
(The Legal Position)

This Part consists of a description of the legal machinery for corporate governance at a formal level only: in other words, the rules, processes and procedures which Company Law establishes for regulating the conduct of shareholders in general meeting and the Board of Directors and the exercise of their respective powers. This description is undertaken in order to provide the necessary background against which the nature and extent of participation by the corporate organs can be analysed. While shareholders function only through the general meetings, directors are actively involved both at these general meetings and at board meetings. It is a known fact, which is further illustrated in this work that the operation of these organs does not run in strict accordance with company law theory, and this leads to critical examination of existing mechanisms. However, in the Chapter which follows immediately the primary concern will be to describe and analyse the bare legal requirements paying particular attention to certain inadequacies concerning the rules relating to the attendance of meetings, proxy rules, requisitioning of meetings and so on, which make it difficult for shareholders' rights to be enforced and enjoyed. Chapter 6 adopts the same approach in considering the rules which regulate the conduct of boards of directors.

CHAPTER FIVE

SHAREHOLDERS IN GENERAL MEETING 1/

1. Introduction

The principle that a company is a separate legal entity independent of the shareholders makes it necessary for the legal position of shareholders to be clearly distinguished from that of the company. The shareholders are not the company; rather they have definite rights in its property and operation, definite obligations toward it and to some extent, definite responsibilities with regard to it. This is so even if one shareholder owns the majority of the shares. In principle, it may be said that even if one shareholder owns all the shares his rights and duties are to be distinguished from those of the company, 2/ although in some cases the corporate status may be disregarded and the shareholders' acts may be treated as those of the company and *vice versa*. 3/

The rights of shareholders are usually exercised in general

1/ In Chapter 2 the Resources for Shareholders' participation in corporate governance was discussed. In this Chapter it is intended to consider the Process of their Participation.

2/ Salomon v. Salomon & Co. (1897) A.C. 22.

3/ This is described as "lifting the veil" of incorporation. See Gower, 4th edition, Chapter 6. See also Clive M.Schmitthoff, "Salomon in the Shadow", (1976) J.B.L. 305, in which he argues that while "Salomon v. Salomon is still law ... it has been dethroned" from its position of importance due to the increasing willingness of the courts to lift the veil of incorporation.

meetings. This applies to such matters as the election and dismissal of directors, amendment of the articles, alteration of capital, approval of dividends and re-organisation, consolidation, merger and voluntary liquidation.

The general meeting is intended to be the means by which the members exercise control and direction over the management of the company. Though the rules for the regulation of a company's meetings is basically a matter for the constitutional instruments of each individual company, there is in practice great uniformity amongst companies because of their adoption of the common pattern in Table A. Thus, for example, in conformity with article 52 of Table A most companies provide the business of the annual general meetings to include, the declaration of dividend, consideration of accounts, consideration of directors' and auditors' reports, election of directors, appointment and remuneration of auditors and any special business which may be brought up. This form is invariably adopted by most companies, as if it were a statutory requirement.[1/] It may be said, however, that the absence of any uniformity could create results which would perhaps be more of a nuisance than contributing in any material manner to the effective participation by the shareholders. Moreover, for Listed Companies, the need to comply with Stock Exchange Regulations also means that there is less room for wide variations. In recognition of the need Professor Gower

---

1/ Uniformity is perhaps a good thing except that the peculiar circumstances in some companies would demand special provisions to cater for those circumstances.

for example, recommended in the Ghana Companies Code that most rules relating to companies general meetings should be laid down in the Code itself in order to make for greater uniformity.[1/]

The nature of these rules are now to be examined.

2. Types of General Meetings

(i) Annual General Meetings:

By section 131 of the 1948 Act the holding of an annual general meeting (AGM) is a mandatory requirement for every company. That section provides that every company must in each year hold a general meeting as its AGM in addition to any other meetings in that year, and must specify the meeting as such in the notices calling it. Not more than 15 months shall elapse between the date of one AGM of a company and that of the next. It suffices, however, if the first AGM is held within eighteen months of formation even though this is not in the first and second year of its incorporation. If there is failure to hold such a meeting the Department of Trade may, on the application of any member, call or direct the calling of, a general meeting in addition to other reliefs which it may also grant. Failure to comply with those requirements renders the company and

---

1/ See p.4 of the Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana, (1961). (to be cited sometimes as Final Report).

every officer of the company who is in default liable to a fine not exceeding the "statutory maximum" under the 1980 Act.[1/]

By section 14(1) of the 1976 Act[2/] every company is required to appoint at each general meeting before which accounts are laid an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next such general meeting. This is the only statutory duty for the AGM and none of the Companies Acts provides any further list of matters to be dealt with at this meeting. It is thought, however, that those matters which recur annually are proper businesses for the AGM. These are set out in Article 52 above.[3/]

It is for the Directors, under their general management power in Article 80, to call the AGM. In default, the Department of Trade may on the application of any member call it on such terms as the Department considers fit and may direct that one member

---

1/ S.131(5). The term "statutory maximum" is defined in Section 80 (interpretation) as £1,000 or any other sum fixed by order under S. 61 of the Criminal Law Act 1977. Henceforth, reference to the statutory maximum shall convey this meaning.

The Department of Trade Annual Report for 1979 indicates that for that year there were 4 prosecutions under this section all of which ended in conviction. There was no prosecution in 1978 while all 10 prosecutions in 1977 ended in conviction.

2/ See also sections 17 and 39 of this Act.

3/ At p.226 .

present in person or by proxy, shall constitute a meeting.[1/]

The AGM is a general meeting and anything which can be done at any general meeting can as well be done at the AGM. The importance of this meeting is that it affords protection to the members, being the one occasion when they can be sure of having an opportunity of meeting the directors and questioning them on their annual reports accounts and the company's overall performance and prospects. This occasion also offers them the opportunity of appointing the directors to whom for the time being are charged the running of the company. It provides the occasion to re-elect those retiring directors more sympathetic to their views or generally more honest and competent, and to dismiss those of whose performance or policy they disapprove. Shareholders who feel sufficiently motivated to want to move their own resolutions find the annual general meeting the best occasion for this. It would save them the time and expense of having to requisition an extraordinary general meeting which the directors may feel inclined to oppose and which might be less well attended.

The directors, whether they like it or not must hold one AGM each year, and some militant shareholders might find that rather than

---

1/ Section 131(2). The Department of Trade Annual Report for 1979 shows that nine applications under this section were received by the Department during that year. Of these, six were not proceeded with and the remaining three were refused. For 1978 there was no application under this section at all, while for 1977 of the three applications received only one was approved and the other two refused. This suggests that the section is of little avail to members.

requisition an extraordinary general meeting (EGM) a wiser course is to conserve their resources and keep their powder dry until this occasion, for any business which can be done at an EGM can also be done at an AGM, provided that where *special business* 1/ is contemplated its nature and details must be specified in the notice calling the meeting.

Directors cannot normally postpone an AGM once it has been convened, 2/ but may adjourn it. This is to ensure that they do not attempt to prevent an opportunity for shareholders' debate or to avoid a show-down. A meeting may, however, be postponed where, for example- it has become clear that the accounts intended to be laid at the AGM would not be ready in time, 3/ or where it has become clear that no quorum would be available. There is, however, no reason to expect company meetings would be postponed where a company is under the management of diligent directors and the need may arise only in extreme cases. The inconvenience to members and the expense in time and money of convening another meeting is so much that most large companies would wish to avoid the need if possible and it is very seldom that AGMs are postponed.

1/ Meaning, any business other than the usual business of a general meeting as set out in article 52.

2/ Smith v. Paringa Mines Ltd. [1906] 2 Ch.193.

3/ See Cmnd.1749, para.457.

(ii) Extraordinary General Meeting

The AGM is sometimes used to pre-empt the need for an EGM by doing at the former, non-routine matters, and even the passing of special or extraordinary resolutions. But more often companies hold their EGMs immediately after the AGM even though this procedure is unnecessary as the AGM could have covered those matters held over for the EGM.[1/] Aside from the Statutory meeting, any meeting other than the AGM is called an EGM, and companies' articles commonly provide for the directors to call such meetings whenever they think fit.[2/] Management would much wish to exercise this power only where pressing circumstances demand it and certainly not when the matters sought to be brought before the meeting do not meet their liking. Section 132(1) provides that the directors must convene an extraordinary general meeting of the company on the requisition of members holding at the date of the deposit of the requisition not less than one-tenth of the paid-up capital carrying voting rights. If the directors do not within 21 days of the deposit of the requisition proceed to convene a meeting, the requisitionists or a prescribed number of them[3/] may

---

1/ See Gower, 475 and Midgley (1975) p.50.

2/ Article 49, Table A. This power must be exercised bona fide: Pergammon Press Ltd. v. Maxwell, [1970] 2All E.R.809.

3/ Those representing half of their total voting rights. S.132(3).

convene the meeting.[1]

A requisition for EGM must state the object of the meeting[2] and, unless the articles otherwise provide, it will be impossible to insist of any other matter being included in the notice of the meeting.[3] As all business at an EGM is *Special business* they must all be specified in the notice.

The power of shareholders to requisition a general meeting is obviously important as one which ensures for them an adequate opportunity for participation in corporate administration. Where the management is conducting the affairs of the company in a manner unsatisfactory to the members or where they, the members, have a positive contribution of their own to offer they can secure their involvement by availing themselves of the provisions of section 132 despite any oppositions from a reluctant board of directors. But sometimes directors' oppositions and other organisational problems which requisitionists encounter can be frustrating. For instance,

---

1/ The company is required to pay all reasonable expenses and will recover the money from the defaulting directors: S.132(5). Extraordinary general meetings may also be convened under article 49.

2/ The most common object is to pass resolution to increase the capital. Others include alteration of articles, alteration of Directors, borrowing powers, redemption of preference shares, etc.

3/ In Ball v. Metal Industries 1957 S.C.315, a resolution was proposed at an EGM for the removal of a director from office under S.184. HELD: The proposed resolution was incompetent, as the EGM was convened on a requisition which did not include among its objects the removal of the director, and since it was not otherwise open to a shareholder under the company's articles to propose such a resolution except at an ordinary meeting.

management may seek to evade the requisitionists' attempt by giving notice for a meeting at a distant future instead. The Jenkins Committee considered this problem and recommended the amendment of the section to enable the requisitionists to convene a meeting if one has not been convened by the directors for a date within say, twenty-eight days of the notice convening the meeting.[1/]

For the very large public companies there is even a greater problem. The number of requisitionists required is holders of not less than one-tenth of the paid-up capital, carrying voting rights, or any of them representing more than half of the total voting rights. In large companies this number can be very substantial, running into thousands. In view of the geographical dispersal of shareholders alone it would be almost impossible for dissident shareholders to run around collecting a sufficient number of signatures. Even if they were so inclined, the expenses at the end of the exercise might even exceed the benefits and unless there are enough rewards in anticipation, not many shareholders would be bothered to participate in the process.[2/] These problems can, of course, be avoided if the articles require a smaller number of requisitionists,[3/] but companies

---

1/ Para.458.

2/ The general attitude of shareholders toward participation is to be examined later.

3/ For example, section 297(1) of the Ghana Companies Code provides that the directors of a public company must on the requisition of members of the company holding not less than one-twentieth of the shares of the company forthwith proceed duly to convene an EGM of the company. This requires just half of that necessary under s.132, even then the author of the Code, Professor Gower, regards holders of 1/20th of the shares too large for large public companies. See page 212 of the Final Report.

have been unable to avail themselves of this opportunity because of the common adoption of Table A, and so, the higher proportion of shareholders required under it.[1/]

Additional powers to convene an EGM is afforded by section 135 which provides for requisition by the Court either of its own motion or on application from any director of the company or a member entitled to vote at the meeting, where for some reason it is impracticable to call a meeting of the company or to conduct the meeting in accordance with the provisions of the company's Constitution. The meeting requisitioned by the Court is then to be conducted in accordance with the rules set down by the Court, which may include a direction that one member should form a quorum.

To prevent the victimisation of Auditors who disagree with management, the 1976[2/] Act provides a right for an auditor who resigns to requisition a meeting for the purpose of the meeting, receiving and considering his explanation of the circumstances connected with his resignation which he may wish to bring to the attention of the company.

The Companies Act 1980 contains an innovative provision

1/ Article 49 requires the same number of requisitionists as that provided by S.132, which is holders of not less than one-tenth of the paid-up capital carrying voting rights.

2/ Section 17(1)

which imposes an obligation on directors of a public company to convene an EGM in the event of serious loss of capital.[1/] Section 34 provides that where the net assets of a public company fall to half or less of the amount of the company's called-up share capital the directors must within 28 days from the day on which that fact comes to their knowledge, convene an EGM for a date not later than 56 days from that day. The purpose of the meeting would be to consider whether any, and if so what, measures should be taken to deal with the situation. Any director who knowingly and wilfully authorises or permits the failure to continue after the meeting should have been held is liable to a fine not exceeding the statutory maximum.

A big problem under this section is the question of valuation. Because of the application of different accounting rules by different companies it will not be easy to determine when a company's assets have fallen to the level envisaged by the section. Moreover, in the days of inflation half of a company's share capital may not be too large a sum, so that in real terms the diminution in the company's assets could be much greater than first meets the eye from the bare statistics.[2/]

The "novel" attempt by section 34 to boost the role of shareholders in general meetings as a primary organ of policy and decision-

---

1/ Section 34, which is introduced in compliance with the Second Directive of the E.E.C.

2/ Some of these fears were raised in Committee but not resolved. See Standing Committee A. Debate on the Companies Bill 1979, 4th Sitting, Col.204.

making in companies is much welcome, but what actual contribution it will actually make to shareholders control remains to be seen.

(iii) Statutory Meeting

Every public company limited by shares is required under section 130 of the Act to hold a general meeting of the members of the company, to be called "the statutory meeting", within a period of not less than one month and not more than three months from the date at which the company is entitled to commence business. The Statutory meeting is usually the very first meeting in the life of a public company and its usefulness rests on the fact that it is the first opportunity for the shareholders to know how the company stands.1/ Besides this, this general meeting is of no practical significance from the point of view of shareholders' participation, particularly as it comes up only once in the life of a company. Even then, the necessity for it has often been avoided in the past by promoters who start off by incorporating a private company for which a statutory meeting is not required and then later on converting it to a public company. For these reasons arguments have for long been made for the abolition of the Statutory meeting at no cost to the efficienct conduct of business as no ostensible harm seems to have resulted from its

1/ These are to be gathered from the disclosures in the Statutory Report. S.130(3) enumerates matters to be specified in the Statutory report; these include (a) total number of shares allotted (b) total amount of cash received (c) abstract of receipts of the Company and payment made (d) names, addresses and description of directors and auditors, and (e) particulars of contracts.

avoidance in the past.

Doubts about the usefulness of the Statutory meeting have now been resolved in the UK with the recent implementation of the EEC Directive on reclassification of companies under the 1980 Act which repeals S.130 of the 1948 Act. Previously, the 1948 Act defined private companies while public companies formed the residual category. But under the new Act the reverse is now the case and a Statutory meeting would be unnecessary for Public Companies 1/ who satisfy the requirements for registration. Promoters who wish to form a public company should now be able to do so straightaway without having to go the round-about way of first forming a private company and then later going public. The inconvenience in this process far exceeds the presumed advantages of the statutory meeting. Nor would the change under the 1980 Act on its own diminish the standards of accountability of promoters and directors since the new provisions to regulate the registration and re-registration of the Public Limited Companies are stringent enough to protect shareholders from the dangers which the statutory meeting was supposed to prevent. 2/

1/ A "Public Company" is defined by section 1, 1980 Act as any company limited by shares (or by guarantee) and having a share capital, whose memorandum states that the company is to be a public company and in relation to which the provisions in the Act for registration or re-registration as a public company have been complied with.

A private company is now any company that is not a public company. Thus, section 28, 1948 Act is repealed.

2/ These provisions are contained in Ss.3-13 of the Act.

3. <u>Notice</u>

If a shareholder is to play any useful role by his presence in general meetings, it is essential that he should receive adequate notice of the meeting which leaves him enough time to prepare for it. The law therefore insists that, *prima facie*, all shareholders entitled to attend should be served notice of the meeting.[1/]

The rules about notice are governed partly by the Companies Acts and partly by the articles. Section 133(1) of the 1948 Act provides that any provision of a company's articles shall be void in so far as it provides for the calling of a meeting by a notice shorter than 21 days in writing in the case of an AGM, or a meeting for the passing of a special resolution, or 14 days notice in other cases. Section 133(3) makes an exception, to the effect that a meeting may be deemed to have been duly called, even though convened on shorter notice if it is so agreed by a majority in number of members having a right to attend and vote at the meetings and holding not less than 95% in nominal value of the shares giving a right to attend and vote; provided that in the case of annual general meetings all the members entitled to attend and vote must agree if a shorter notice is to be valid. In the case of a special resolution the members must agree to that specific resolution being passed on short notice.[2/]

1/ See <u>Young v. Ladies' Imperial Club</u> [1920] 2K.B.523; cf. <u>Smyth v. Darley (1849) H.L.Cases 789.</u> See also s.14(7) 1967 Act which gives the auditors of a company the same rights as members to receive notices, to attend and be heard at general meetings when the business of the meeting concerns them in their capacity as auditors.

2/ Section 141(2).

These exceptions are useful mostly to private companies with a small membership for which the formality of a notice would serve no purpose. Indeed, it may be possible for such companies to dispense completely with the need for a notice if they meet the requirements of the above sections. However, the very different nature of large public companies makes it unrealistic to expect that sufficient number of shareholders would be found to agree with the dispensation of notice. If they were so easily accessible and responsive then that would be indicative of their close involvement in the affairs of their companies, but there is no evidence to suggest that this is the case. For such companies, therefore, proper notice must be sent to all those entitled to it.

A member holding a class of shares has a right to attend a meeting if such a right has been conferred by the articles or terms of issue but where precluded by the articles or terms of issue from voting he is not entitled to any notice.[1/]

Service of notice on the members entitled to it is to be conducted according to the regulations prescribed by individual companies but where a company's articles do not make provisions on this matter the notice has to be served in the manner in which notices are required to be served by the model articles in Table A for the time being in force.[2/] These are articles 131-134.

1/ Re Mackenzie [1916] 2 Ch. 450.

2/ Section 134(a)

Article 131 requires the notice to be served personally or to be sent by post to the members' registered address. Service of notice by post is deemed to have been effected at the expiration of 24 hours after posting a properly addressed prepaid letter containing the notice.1/

Article 132 provides for the sufficiency of a notice to joint holders where only the holder first named in the register is actually notified.2/ Also notice to persons entitled to shares by devolution in the event of death or bankruptcy, etc. of the first holder is sufficient if given in a manner in which the first holder was entitled to be notified. By way of summary, article 134 enumerates those to whom notice of every general meeting shall be given as including:

(1) every member except those who cannot be contacted unless at great costs to the company

(2) every person upon whom the ownership of shares has devolved, and

(3) the auditor for the time being of the company.

1/ It is not stated whether this includes second class mail but even in respect of first class mail this section is now unrealistic because they are not always received within 24 hours of posting.

2/ Article 133.

This article ends by specifically stating that no other person shall be entitled to receive notices of general meeting.[1/]

It is usually provided that an accidental omission to give notice to a member or non-receipt of notice shall not invalidate the proceedings.[2/] Article 50 requires the specification of the place, day[3/] and hour of meetings.

Compliance with the requirements for valid notice is scrupulously enforced by the Courts.[4/] For example, in *Cannon v. Trask*,[5/] Baron V-C. restrained directors from holding an annual general meeting earlier than was usual in order to prevent new shareholders from voting. The shareholders had no vote until three months after registration of their shares. Also in *Adams v. Adhesive Property Limited*,[6/] requisitionists were restrained from holding a meeting at a time which could result in many shareholders being unable to vote.

1/ This provision does not appear to serve any useful purpose because non-members of the company who are sufficiently interested in attending a general meeting, e.g. the Press, would rely on other sources for notice about forthcoming meetings. Moreover, most Listed Companies are obliged to advertise notice of general meetings "in at least one leading London daily newspaper". S.E.Listing Agreement, Para.H.1.

2/ Art.51.

3/ Reference to day means clear days: Re Hector Whaling [1936] Ch.208.

4/ See e.g. Normandy v. Ind Coope & Co.Ltd. [1908] 1 Ch.84.

5/ (1875) L.R.20 Eq.669.

6/ (1932) 32 S.R.(N.W.S.) 398.

An essential part of the notice is a statement of the business to be transacted at the meeting. In respect of special businesses,[1/] the general nature of the business is to be specified.[2/] It is not sufficient to notify, for example, that an alteration of the articles is to be proposed. The nature of the alteration has also to be specified.

If an AGM is called solely for the purpose of transacting ordinary business,[3/] the notice need do no more than describe it as an annual general meeting. But if anything else is to be done in addition, its general nature must be stated. Thus, in Choppington Collieries v. Johnson,[4/] a notice which specified the business of a meeting as being "to elect directors" was held to have sufficiently specified the nature of the business to elect up to the number of directors permitted by the articles.

No business can be transacted at any meeting which is not put on the agenda in the way described at the time the shareholders are informed thereof, and a resolution passed without such communication would be void, for shareholders are entitled to know what to expect at a meeting. But it is a matter of judicial construction to be determined in every case whether any particular notice is to be regarded as giving sufficient information, and as covering the substance of the matter before it and the courts are very liberal in

---

1/ That is, any business other than ordinary business. See below.

2/ Article 50.

3/ These are matters set out in Article 52, see p.226.

4/ [1944] 1All E.R.762. But in Ballie v. Oriental Telephone Co.Ltd. [1915] 1 Ch.503 a notice of a resolution for the approval of some improperly paid remuneration was held insufficient because it failed to state the amount.

construing notices. There is a tendency to uphold the resolution if the substance could be gathered and understood from the notice, if it were read as a businessman would understand it in the ordinary sense.[1/] If, however, the effect of a resolution will be to enable the directors to obtain a benefit, the purpose for which the meeting is called will not be deemed to have been properly stated unless the intended benefit is also disclosed.[2/] It is absolutely important for shareholders to know what they are called up to approve.[3/]

4. Special Notice

The requirement for *Special Notice* was first introduced by section 3 of the 1947 Act. It is a technical term used in section 142 of the 1948 Act for a notice to the company[4/] to be given by a party who proposes to move certain types of ordinary resolution at a forthcoming general meeting. A special notice is required on a motion for the appointment of an auditor other than the retiring one or not to appoint one,[5/] for the removal of a director[6/] and for any resolution appointing or approving the appointment of a director over

---

1/ Choppington Collieries v. Johnson, ibid; see also Alexander v. Simpson (1889) 43 Ch.D.139 at 147.

2/ Hutton v. West Cork Ry. (1883) 23 Ch.D.654.

3/ Goldex Mines Ltd. v. Reville [1975] 54 D.L.R. (3rd) 672.

4/ That is, not to the members.

5/ Section 160

6/ Section 184 (2)

70 years old.[1]

The proposer of any of the above resolutions must give notice to the company of his intention to move it, not less than 28 days before the meeting. The company must then give notice thereof to the members at the same time and in the same manner as it gives notices of its meetings, or if this is not practicable, may advertise it in a newspaper having an appropriate circulation,[2] or in any mode allowed by the articles but not less than 21 days before the meeting. If on the other hand, the directors call the meeting less than 28 days after the Special Notice is served on the company, then the notice is still valid.

The limitation in this requirement is that a proposer of a resolution requiring the Special Notice is unlikely to have seen the accounts and directors' reports before the AGM is actually held. It is possible that there are subsequent disclosures contained in those documents but unknown to him which renders his proposed resolution unnecessary. This possibility does not, at any rate, render the provisions unnecessary.

5. <u>Procedure at Meeting</u>

(i) <u>General</u>

With the increased number and dispersal of shareholders it

1/ Section 185(5).

2/ See Admission of Securities to Listing. Schedule VII, Part A; Articles of Association; H.1.

70 years old.[1/]

The proposer of any of the above resolutions must give notice to the company of his intention to move it, not less than 28 days before the meeting. The company must then give notice thereof to the members at the same time and in the same manner as it gives notices of its meetings, or if this is not practicable, may advertise it in a newspaper having an appropriate circulation,[2/] or in any mode allowed by the articles but not less than 21 days before the meeting. If on the other hand, the directors call the meeting less than 28 days after the Special Notice is served on the company, then the notice is still valid.

The limitation in this requirement is that a proposer of a resolution requiring the Special Notice is unlikely to have seen the accounts and directors' reports before the AGM is actually held. It is possible that there are subsequent disclosures contained in those documents but unknown to him which renders his proposed resolution unnecessary. This possibility does not, at any rate, render the provisions unnecessary.

5. Procedure at Meeting

(i) General

With the increased number and dispersal of shareholders it

1/ Section 185(5).

2/ See Admission of Securities to Listing. Schedule VII, Part A; Articles of Association; H.1.

has become increasingly difficult for a simple shareholder or group of shareholders in any large company to elicit the support of their own fellows when introducing resolutions on their account. Even the ability and opportunity to do so is now merely theoretical. 1/ It is desirable, said the Cohen Committee,

> "to devise provisions which will make it difficult for directors to secure the hurried passage of controversial measures, and as far as possible to encourage share-holders carefully to consider any proposals required by law to be put before them by the directors". 2/

In endeavouring to help shareholders overcome their difficulty the Committee recommended the granting to a certain minority of them the right to request the circularisation of their views and statements, because

> "the machinery by which the shareholders can be approached is in the hands of the company and we believe that with reasonable safe-guards this should be made available to the members". 3/

The Committee's recommendation in this regard was implemented and is contained in what is now Section 140 of the 1948 Act, which section represents a major step toward advancing shareholders' participation in companies' general meetings.

1/ Cmd.6659, para.124.

2/ Ibid.

3/ Para.128.

That section provides that a company shall on the requisition in writing of such number of members as specified and at their expense circulate statements not exceeding 1,000 words in length with respect to any business to be dealt with at any meeting, including any resolutions intended to be moved. This right is open to members representing not less than one-twentieth of the total voting rights of all members having a right to vote at the meeting or not less than one hundred members holding shares on which there has been paid up an average of £100 each - which amounts to at least £10,000. The section gives the opposition a right to use the company's machinery for the dispatch of circulars whether in support of their own resolutions or in opposition to any resolutions proposed by the board, provided the requisition is deposited not less than one week before the meeting This section recognises that since directors may circulate their propaganda and canvass shareholders' votes at the company's expense it would be unfair not to extend the same facility to dissentient share-holders. The alternative to a shareholder would involve huge personal expenses and because of the sheer size of most companies he would find it extremely difficult to bring his own point of view to a wide section of shareholders. Nevertheless, the assistance available under Section 140 does not add up to much because the requisitionists are expected to bear the cost of circularisation unless the company resolves otherwise. Only very rich and determined dissidents would thus be minded to engage in this sort of costly exercise. Moreover, the limit of 1,000 words is unduly restrictive.

Even where a determined shareholder has surmounted all these hurdles the directors may frustrate his efforts by applying to the Court to be relieved from their obligation to circulate the representation on the ground that the section is being abused to "secure needless publicity for defamatory matter". 1/

The general effect of these provisions can be summed up with Gower's description that they are

> "heavily weighted in favour of the existing directors"

and

> "even as regards matters requiring to be undertaken in general meetings. If one believes that companies should function democratically it is obviously vital that something should be done to improve the position of the members in this respect". 2/

Although there is a paucity of cases on this problem the shortcomings in Section 140 have been ably illustrated by the events which transpired in Burmah Oil Company Limited in 1978. 3/ Before the company's Annual General Meeting for that year the appropriate number of requisitionists gave notice under Section 140 of its desire to put

---

1/ Section 184(3) 1948 Act.

2/ See the Final Report (of the Commission of Enquiry into the Working and Administration of the present Company Law of Ghana) 1961, p.117. Section 158 of the Ghana Companies Code provides additional right for a member to have his statement circulated if it is not more than 1,000 words, provided a written request and the statement is deposited with the company not less than 10 days before the meeting, and he deposits a reasonable sum to meet the company's expenses in circularising it.

3/ The events are noted by J.M.L.Stone, "An Uncertain Aspect of Shareholders' Protection. (1980) N.L.J. 152, 153-154. The author is Honorary Treasurer of the Burmah Shareholders Action Group (BSAG) and what follows is essentially based on his account of the episode.

before the members at the forthcoming general meeting a resolution, and for the company to circulate an accompanying statement. The requisitionists deposited a sum of money in accordance with Section 140, on a "without prejudice" basis, pending determination of the correct sum which was actually payable to the company for distributing the representation. After the AGM, Burmah sought from the requisitionists the staggering sum of £16,592 for expenses incurred. The company was advised by leading Counsel on the interpretation of Section 140 and took the wide view that it had to

> "be analysed in the circumstances of the company's constitution, its obligations to the Stock Exchange, the City Panel or other bodies if relevant, its statutory obligations and its practice".

Burmah's Counsel maintained that the words "to give notice" in Section 140(4)[1/] have to include complying with, for example, the Stock Exchange Listing Agreement, in accordance with which the Company is obliged to send out a proxy card, and that if a company has to take steps which are "ancillary to the notice" the cost to which a company is put in taking those steps have to be borne by the requisitionists. He went further to suggest that the expense of carrying out normal administrative

---

1/ Section 140(4) provides "a company shall not be bound...to give notice of any resolution or to circulate any statement unless... there is deposited or tendered with the requisition a sum reasonably sufficient to meet the company's expenses in giving effect thereto".

processes such as numbering and matching proxy cards, had to be paid for by the requisitionists.[1/]

The Burmah Shareholders Action Group on behalf of the requisitionists argued on the other hand that a shareholder has a basic contractual right to ensure that the company's constitution is duly performed and that the provisions of the article relating to the convening and holding of meetings are honoured irrespective of the circumstances; that the expense incurred by a company in complying with its basic obligations under its articles and under the companies Acts must not be visited on requisitionists exercising their rights under Section 140 simply by virtue of the requisition, and that it would be an extraordinary and nonsensical consideration of the section, if at the same time as extending the rights of shareholders it imposed greater financial burdens on them than existed prior to its enactment.

Mr. Stone notes from his review of the episode that the wording of Section 140

> "is such that a large company, seeking to take advantage of the marginal lack of clarity, can defeat one hundred bona fide requisitionists *in limine* by making demands for the tendering or depositing of excessive sums as prerequisite to the giving of notice . . . .

1/ The full list of costs claimed by the company included the following: (i) the cost of printing the notice of resolution (ii) the cost of printing the new proxy cards relating thereto, (iii) the cost of numbering and matching of the new proxy cards with the existing ones, (iv) the cost of collating the notice of resolution, BSAG statement and new proxy cards with other documents, and (v) the additional cost of inserting the notice of resolution, new proxy cards and BSAG statement (but not the Chairman's letter) into envelopes.

of resolution sought by them".[1/]

It is remarkable that he was not prepared to go so far as to say that Burmah's interpretation of the section was not made bona fide or that it was wrong. His purpose was merely to argue that the mis-understanding resulted from the failure of that section to reflect unequivocally the intentions of the Cohen Committee which it was meant to be enacted. This writer agrees that the Burmah interpretation was correct even though it puts requisitionists in an unenviable situation. Indeed, proceeding under Section 140 is fraught with such inestimable handicaps that Professor Gower has advised against it.[2/]

It is to be regretted that the Jenkins Committee did not as Gower did for Ghana recommend amendments to Section 140 to make its effective utilization possible. They appeared not to have envisaged the type of problem which arose in Burmah. Section 157(1) of the Ghana Code provides that a

> Company shall at its own expense, on the request in writing of any member entitled to attend and vote at a general meeting, include in the notice of that general meeting notice of any resolution which may properly be moved and is intended to be moved at that meeting and, at the like request, include such notice and statement of not more

1/ At p.154. It is to be noted that an initial payment of a preliminary "without prejudice" deposit as was made in this case is a convenient arrangement which requisitionists might become encouraged to take advantage of.

2/ 4th Edition, at 537. The BSAG is reported to have recently proceeded again under Section 140 to notify about 150, 000 Burmah Shareholders of the Company's request to the Government urging them to return the Bank of England's one-fifth holding in BP to Burman. The Bank acquired the 20.15 per cent stake in B.P. at the time of its rescue operation of Burmah in 1975. See Financial Times, May 28 1980.

> than 500 words with respect to the matter referred to in the proposed resolution or any other business to be dealt with at that meeting..."

Provided the resolution and statement are lodged with the company not less than six weeks before the meeting, any member entitled to attend and vote can insist of their being circulated at the company's expense. The provisions of this section substantially eliminate the restrictive effects of Section 140 and it is hoped that the Ghanian experience will serve as a guide for future reform.

It may happen that a director falls into disfavour with the board, perhaps, due to his disagreement with them on certain issues or his scrupulous determination to safeguard shareholders' interests by opposing policies which conflict with them. In the event of a resolution to remove such a director 1/ at a general meeting there are provisions supplementing Section 142 which entitle him to state his case to the members. He is entitled to notice of the resolution and may make representations which he may require to be circulated to the members. If this has been done the company must in the notice of the meeting state that representations have been made and must send a copy to every member to whom notice of the meeting is sent. If the representations were received later and could not be sent with the notice or the company defaulted in sending them, the director or auditor may require them to be read out at the meeting. The Court

---

1/ Or auditor, if that is the case.

may, on the other hand, order that these provisions be dispensed with if satisfied that they are being abused to secure needless publicity for defamatory matter.[1/] While this restriction has been necessary to prevent the publication of libellous material it, nevertheless, severely limits the opportunity for members to be informed of any shady behaviour or improprieties which might have led to the victimisation of a diligent director. It is hoped that the Courts would only exercise this power where the representation is clearly designed by a disgruntled man to discredit the company and its officers before he quits. It should not be used to stifle opposition.

(ii) Quorum

A quorum must be present before any business can be done at a meeting. A company is free to stipulate its own quorum as it deems fit. Article 53 of Table A requires three members present in person for a public company and two members present in person or by proxy for a private company.[2/] It is sufficient that there is a quorum at the beginning of a meeting when it "proceeds to business".[3/] Generally, at least two persons must be present throughout a meeting.[4/] One person cannot normally constitute a quorum or a meeting except at a class meeting where he holds all the shares of that class and where

---

1/ S.184(3). See also S.160(3) which relates to written representations by a retiring auditor.

2/ See also S.134(d).

3/ Re Hartley Baird Ltd. /1954/ 3 ALL E.R. 695.

4/ Re London Flats /1969/ 2 ALL E.R. 744., M.Harris Ltd. 1956 S.C.207.

the Court or the Department of Trade Order otherwise provides under S.135 or 131 of the Act.

"Presence" at a meeting,prima facie, means present in person and not by proxy unless the articles otherwise provide.

Article 54 distinguishes between a meeting called on the demand of members and one convened by the directors. While the former stand *dissolved* the latter shall stand *adjourned* for a week if within half an hour after the time appointed for the meeting a quorum is not present. Obviously, if members who requisitioned a meeting are not themselves present to form a quorum there is little point in adjourning it and it should rightly be dissolved. If at any adjourned meeting recalcitrant minority shareholders use the quorum requirement to frustrate the wishes of the majority by deliberately absenting themselves, the Court will break the deadlock by calling a meeting under section 135.

The continued acceptance of a quorum of say three members for many large companies which operate today to decide affairs affecting the interests of some thousands of other shareholders is one of the ridiculous anomalies of Company Law. A general meeting of only three shareholders occuping a hall arranged for hundreds or thousands makes a farce of the notion of shareholders' control. A more realistic approach would be to stipulate a quorum of a certain percentage of the total shareholders, say 10%. If this can be achieved the AGMS would be transformed into a lively forum for important debates, but it is unlikely that such a provision, if made, can be implemented.

(iii) Voting Rights

Where a company's articles are silent and Table A does not apply, every member of a company originally having a share capital shall have one vote in respect of each share or each ten pounds of stock held by him.1/ As most large companies have articles similar to Table A it seems that in most cases every member present in person is entitled to a vote on a show of hands or one vote for each share he holds, on a poll.2/ No member is entitled to vote at any general meeting unless all calls or other sums presently payable by him in respect of his shares in the company have been paid.3/

A company may choose to confer voting rights on its shares in whatever manner it chooses. As D.Votaw4/ writes:

> "Not all shares carry a right to vote. Some have no vote at all: others get to vote only on special issues; still others vote only when the corporation is in financial difficulty. The voting rights with regard to a particular share will depend on the terms of issue...Nevertheless, a company without any voting shares would be an anomaly and usually at least one class or series of shares have the voting right". 5/

1/ Section 134.

2/ Article 62.

3/ Article 65.

4/ D.Votaw, Modern Corporations, (Prentice-Hall), 1965.

5/ At.64-65.

It is particularly common to deny voting rights to preference shares or to limit the right to some specified contingencies.[1] Voteless shares may even be issued, denying the shareholders the important right of participating in the determination of the affairs of the company.

The question of "voteless shares" was considered at length by the Jenkins Committee[2]. Opposition was raised by witnesses before the Committee against its use, some of the arguments being that it would perpetuate inefficient management if shareholders were unable to vote out unsatisfactory directors. More generally it was argued that voteless shares amount to a "de jure" severence of ownership from control which frequently arises, *de facto* from the indifference by shareholders.[3] The majority report of the Jenkins Committee was, in spite of the more convincing argument of the opposition, persauded to recommend the retention of this class of shares on the grounds of their convenience for the raising of funds without altering the company's voting structure and on the basis of the argument that its abolition would be an "unwarranted interference with freedom of contract".[4] They recommended, firstly, that all concerned should be exhorted to ensure that voteless shares are clearly designated and,

---

1/ For example, when dividends are in arrears.

2/ Paras. 123-136. See also Lord Chorley and Eric Wolff in Law Reform Now (1963), op.cit at 188.

3/ Para. 126.

4/ Para. 128.

secondly, that all shareholders should be entitled to receive notices of general meetings and the Chairman's statement. One wonders, what use it is for a shareholder to receive notice of a meeting in which he cannot vote, for whatever impression he gets from reading the Chairman's statement there is no way his opinion would be made known or the company benefit therefrom since he cannot attend, much less vote on any resolution. A suggestion that non-voting shareholders should be entitled to attend meetings was rejected on "grounds of administrative difficulties". The minority, in their Note of Dissent,[1/] took the view that the development of non-voting equity shares is "undesirable both in principle and practice" and inconsistent with the declared principle of the Jenkins Report itself as well as its predecessors that ultimate control over the directors should be exercised by the shareholders in order to "strengthen the already high credit and reputation of British Companies".[2/]

The question of non-voting shares is still very much one which evokes controversy as it offends the very principle on which business corporations rest: that those who supply the risk capital should be able to determine what they want to do with it. So long as shareholders' rights can be restrained by factors such as these the responsiveness of corporate management to their needs cannot be guaranteed.

1/ Cmnd 1749 page 207.

2/ Cmd.6659 para.5.

The Stock Exchange has taken some steps towards diminishing the impact of voteless shares in the corporate scene by requiring that "where the capital of (a) company includes shares which do not carry voting rights, the words "non-voting" must appear in the designation of such shares", in the articles of association.[1]

Where the equity capital includes shares with different voting rights, the designation of each class of shares, other than those with the most favourable voting rights, must include the words "restricted voting or limited voting".[2] Adequate voting rights must in appropriate circumstances be secured to preference shareholders.[3] Compliance with these regulations should at least serve as a *caveat emptor* in respect of non-voting shares or shares with restricted voting rights and so reduce the incidence of innocent buyers.[4]

What is left of the fight - and a substantial one at that - toward the total abolition of these types of shares has long been taken up by the National Association of Pension Funds (NAPF), who have already scored a considerable success in Lloyds Bank.

1/ Articles of Association (Schd.VII Pt. A) Para.K.1.

2/ Ibid, Para. K.2.

3/ Ibid., F.1.

4/ Recent figures published in the Financial Times 30 April 1980, p.7. indicate that of the 86 companies with non-voting shares listed on the Stock Exchange only 46 note the restrictions which apply on each class of shares as required by the regulations. The other 40 companies do not.

Lloyds Bank had operated a voting system based on a 115-year old article which gives every shareholder one vote per share to a maximum of 500 votes. Sixty per cent of Lloyds' shares are owned by institutions which became increasingly incensed that the rule diluted their effective voting power to less than 25 per cent. Their dissatisfaction came to a head at the 1979 annual general meeting when the Post Office pension funds demanded a change in the rules to one share one vote. For over a year the pension funds continued to exert pressure on Lloyds but to no avail. The board only began arranging for the change when further pressure applied by a special Committee set up by the NAPF. At its general meeting on June 19 last, attended by 30 of the Bank's 80,000 shareholders the necessary changes to the articles were at long last passed on a show of hands with only a few dissensions.1/ The NAPF hailed this as a welcome precedent and expects to carry the struggle through the list of forty guilty companies which it has compiled.

The NAPF has also approached the Stock Exchange Quotations Department to help in the abolition of these shares and it is expected that a recent study undertaken by the Council for the Securities Industry (C.S.I.) would make some further recommendations for their abolition. It is to be hoped that the report of this body will provide enough basis for their statutory prhibition in the next Companies Act.

1/ The shareholders were compensated by a one for 20 scrip issue to a maximum of 25 per shareholder. This is thought an equitable compensation for the loss of 'relative' voting rights, although there were some dissatisfaction expressed about the terms by small shareholders.

(iv) Voting:

Voting at general meetings is usually on a show of hands. In fact, under Table A votes cannot be conducted through post and attendance by person or proxy is essential.[1/] There is a presumption of one vote per member unless the resplutions provide otherwise.[2/] Generally, proxies cannot vote on a show of hands. The articles of association may provide a different apportionment of votes . The company's register may be referred to where needed to find out the number of shares held by each member and, consequently, the number of votes to which he is entitled on a poll.

Quite often a vote by show of hands is sufficient to determine the issue, but in some controversial cases or where voting by show of hands gives a false picture of the true opinion of the meeting an appropriate number of aggrieved shareholders as specified in the articles may demand a poll.

The Chairman's declaration of the result on a show of hands is normally undisputed and in the case of a special and extraordinary resolution such declaration shall be conclusive.[3/]

1/ This provides an opportunity for oral discussions before decisions are reached.

2/ Ernest v. Lona Gold Mines (1897) 1 Ch.1 C.A.

3/ S.141(3). See also Mac Dougall v. Cardiner (1875) 1 Ch.D.13 and Foss v. Harbottle (1843) supra.

(v) The Right to Demand a Poll

The right to vote generally includes the right to demand a poll, but the members' rights in every case would depend on the provisions of the company's articles. However, any provisions in a company's articles would be invalid in so far as it would have the effect:

(a) of excluding the right to demand a poll at a general meeting on any question other than the election of the Chairman of the meeting or the adjournment of the meeting; or

(b) of making ineffective a demand for a poll on any such question which is made

(i) by not less than five members having a right to vote at the meeting; or

(ii) by a member or members representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or

(iii) by a member or members holding shares in the company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

In addition a proxy can also demand or join in demanding a poll,[1/] and a demand made by him as a proxy for a member shall, for these purposes be the same as a demand by the member.

1/ S.137(2)

(vi) Conducting a Poll

A poll duly demanded must be taken at such time and in such manner as the Chairman may direct having regard to the articles and the Act. In matters which can easily be proceeded with, such as the election of a Chairman or for an adjournment, a poll must be taken once demanded. If however, the question is one of great importance, a poll demanded shall be taken at such future time as the Chairman directs and the meeting may proceed to other business upon which no poll has been demanded pending the taking of the poll.

The Chairman cannot close the poll while votes are still coming in unless the hours during which the poll is to be held had been specified. But he may declare the poll closed after a reasonable time, when ever in his opinion no more voters are expected to turn up. Votes are usually taken in writing and a record is kept of how many votes each shareholder is entitled to give and actually gives. A shareholder who was not present or did not vote at the meeting may vote on a poll. He is free to use his voting rights in any way he pleases and need not cast all his votes in the same way. Where any voter is improperly excluded the result of the poll is rendered invalid.

Where a poll takes place at a later date than the meeting the resolution will not be deemed to have been passed until the result of the poll is declared, and the meeting will be regarded as continuing until then.

Where there is an equality of votes, whether on a show of hands or on a poll the Chairman of the meeting at which the show of hands takes place or at which the poll is demanded shall be entitled to a casting vote.[1/]

Whereas direct presence is required for a member to be entitled to a vote on a show of hands, there is no apparent reason why he should not be able to vote on a poll by a postal ballot. Since voters on a poll are not required to have been at the meeting at which it was demanded, it should be made possible for members who are unable to attend but are interested in registering their voters on the matter, to do so by postal ballot. In this event it would be necessary to allow a period of say two weeks during which all postal ballots should have been sent. This way a much greater number unable to attend or send a proxy might be able to participate in the decision making process.

(vii) Proxies at General Meeting

At Common Law a member could only attend and vote at general meetings, in person. But with the development of industrial capitalism from small scale to large scale enterprises and the changed circumstances, it became impracticable for the shareholders to attend in person. The right to appoint an agent or proxy to attend and vote at general meetings on the members' behalf was therefore developed in order to make these meetings more democratic and this has been given

---

1/ Article 60.

statutory recognition since the Companies Clauses Act, 1845.

Article 67 of Table A recognises the right to appoint a proxy, stating that

> "On a poll votes may be given either personally or by proxy",

and companies articles usually contain similar provisions, so that members who cannot attend and vote personally can appoint a proxy to act on their behalf.[1/]

A proxy need not be a member and in the case of a private company, has the same right as the member to speak at the meeting. He is not entitled to vote except on a poll.

In order to bring the existence of this right to the awareness of shareholders it is required by section 136(2) that in every notice calling a meeting of a company having a share capital shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy, that one or more proxies may vote instead of him (if the articles allow this) and that a proxy need not be a member. Failure to comply with the section is punishable by a fine not exceeding one-fifth of the statutory maximum.

1/ See S.136(1). Representatives of corporate shareholders have the status of members, not proxies. Art.74 and S.139.

Any provision which would have the effect of requiring the deposition with the company of an instrument appointing a proxy or any other instrument showing the validity or otherwise relative to the appointment of a proxy, more than 48 hours before a meeting or adjourned meeting shall be void.[1/] Where invitations to appoint a proxy has been issued to some members at the company's expense,[2/] all other members must also be sent such invitations, otherwise officers guilty of default are liable to a fine not exceeding one-fifth of the statutory maximum. This would ensure that management do not discriminate against shareholders who are likely to oppose their position by refusing to send them invitations.

The denial of the right to speak for a proxy in public companies is hard to justify. It was initially designed to ensure that shareholders do not appoint paid advocates or legal practitioners to delay the meeting by lengthy harangues, perhaps on technical issues which may be of no value to the meeting. The weakness of this argument is that a member who felt so inclined could achieve the same purpose by simply transferring one of his shares to his legal representative who would then be able to attend as any other shareholder.

1/ S.136(3).

2/ This was held permissible in Peel v. London and North-Western Ry.Co. [1907] 1 Ch.5.

It seems therefore that the injustice in the exclusion of the right of a member to speak through his representative, acting as a proxy, far outweighs the advantages expected to be derived from it. In the absence of any justification for this provision its continued existence in the Law cannot be supported.1/

Under the ordinary proxy forms, shareholders are invited by the directors to appoint them to vote on their behalf. For those shareholders who complete their forms they do so without fully realising what their signatures involve and the nature of the resolution they will be used to support, and proxies once submitted are rarely withdrawn. For this reason the Cohen Committee considered the desirability of the "two-way proxy" as an alternative, and found it a practical move toward giving greater reality to shareholders' control of directors.2/ The Committee, nevertheless, felt it would not be practicable to impose the "two-way proxy" system on companies by legislation, because of possible complications and peculiarities which might exist in different companies. Instead, they decided to leave the matter to the regulations of the Stock

---

1/ Indeed, the Cohen Committee called for its removal: stating that a proxy should be entitled to speak as well as vote, "if not, the right loses a great deal of its value; moreover, in the absence of such a provision the Chairman would experience great difficulty in the conduct of the meeting". Para.133.

2/ At para.132.

Exchange Committee which had been in force since 1943. The Stock Exchange rules on the two-way proxy required as a condition for obtaining permission to deal in new securities, that every company should undertake to word proxy forms in such a way that a shareholder or debenture-holder may vote either for or against the resolutions in question in all cases, where proposals other than of a purely routine [1/] nature are to be considered. [2/]

Under the present rules all Listed Companies are always required to send proxy forms to all those entitled to vote and should provide for two-way voting. [3/] The company's articles must not preclude two way proxies and corporate shareholders may execute proxy forms by the signature of an authorised officer. [4/] Preference shareholders are to be given "adequate voting rights ... in appropriate circumstances", [5/] which obviously includes the right to vote by proxy.

The above are conditions for quotation and must be implemented by all Listed Companies. To this extent the Stock Exchange Rules have moved further than Company Law to increase the members' power of control over directors - but they have no statutory sanctions, which

---

1/ That is, all business at an EGM and those outside Art.52.

2/ Further, the proxy statement must be unambiguous and clearly couched.

3/ Schd.VIII Pt.A. Listing Agreements, Para.12.

4/ Schd.VII Pt.A. Para. L.1.

5/ Ibid., para.F.1.

only legislation can impose. Perhaps, it is this difficulty of enforcing the Stock Exchange Regulations which accounts for the fact that as recently as last April there were still as many as 86 Listed Companies which had not complied with the requirements.[1/]

(viii) Resolutions

Decisions taken by companies are normally in the form of resolutions. There are three[2/] kinds of resolutions under the 1948 Act, namely, Ordinary, Extraordinary and Special resolutions.

An ordinary resolution, as the name suggests is one passed by a bare majority. It is not defined by the Companies Acts but it is a resolution sufficient to effect any transaction within the powers of the company which are not required by the articles or the Act to be effected by an extraordinary or Special resolution.

1/ As per the list compiled by the Quotations Department of the Stock Exchange. The Data-Stream Computer lists over 100 such companies. Figures given in The Financial Times, 30 April 1980.

2/ Cf. Halsbury's Laws of England, 4th Edition (1974) Vol.7, 580, which lists four types - the fourth being resolutions requiring special notice. This separate categorisation seems unnecessary, since an ordinary resolution, for example, does not cease to be such merely because it was on special notice: for instance, an ordinary resolution for the dismissal of a director, though on special notice is, nevertheless, an ordinary resolution.

An <u>extraordinary resolution</u> is one passed by a majority of not less[1/] than three-fourths of such members voting in person or by proxy at a meeting of which notice specifying the intention to propose the resolution as an extraordinary resolution has been duly given.[2/] Extraordinary resolution is commonly required for, inter alia, insolvency.[3/]

There is no particular reason for continuing to retain this type of resolution. Clause 77(4) of the aborted 1973 Bill proposed a substitution of a special resolution for every case where extraordinary resolution is required. Although this amendment was not taken up in the 1980 Act its demise cannot be very far off.

A <u>Special resolution</u> is one passed by a three-fourths majority (as an extraordinary resolution) at a general meeting of which not less than 21 days notice, specifying the intention to propose the resolution as a special resolution has been duly given.[4/] The twenty-one days notice may be dispensed with and a lesser period specified if so agreed by a majority in number of voting members, who together hold not less than 95 per cent in nominal value of the shares giving a right to attend and vote or representing not less than 95 per cent of the total voting rights at the meeting of all the members.[5/] Special resolution is required for any fundamental or important constitutional

---

1/ Articles which require more than 75 per cent are probably invalid; see <u>Avre v. Skelsey's Adamant Cement Co.Ltd.</u> [1904] 20 T.L.R.587.

2/ S.141.

3/ S.278(i)(c). Others include matters coming under ss.245, 303(1)a, 306 and 341.

4/ S.141(2).

5/ Ibid, but see the proviso.

change such as

(1) Change of name (s.18)

(2) Alteration of objects (s.5)

(3) Alteration of articles (s.10)

(4) Reduction of capital (s.66)[1/]

Proposed resolutions must be set out verbatim in the notice and a copy filed with the Registrar within fifteen days.[2/]

The question recently arose in Re Moorgate Mercantile Holdings Ltd.,[3/] whether a special resolution can be validly passed in a form differing from that in which it was notified to the members of the company. In that case, the company sought confirmation by the Court of a special resolution for the cancellation of its share premium account, amounting to over £1m, which it had lost in operations. Shortly before the notices convening the extraordinary general meeting were posted, the company issued a few more shares at a premium of about £321 and had correspondingly increased the amount of the share premium account to be cancelled by the special resolution. But as this new addition could not rightly be regarded as lost, and there was no other valid reason for cancelling it the Chairman was advised to propose the same resolution in an amended form reducing the share premium account

---

1/ Others include voluntary winding up (s.278(1)(b) and authorising sale of assets by Liquidator in exchange for shares (s.287).

2/ Ss.141, 143.

3/ [1979] 123 S.J.551; noted in (1980) 1 Co Law 36.

to about £321 instead of cancelling it altogether. No member or creditor of the company opposed the subsequent petition for the Court's confirmation of the resolution, but the Court asked for argument from an *amicus curiae*. Slade J. held that he had no jurisdiction to confirm the amended resolution on the ground that the wordings of section 141(2) do not allow for amendments. In the course of his judgement, he enunciated seven principles applicable to special resolutions:

(1) A valid notice of "the intention to propose the resolution" must identify the resolution, by specifying either its text or its entire substance.

(2) To be validly passed, as "the resolution" so notified, it must be the same resolution as that specified by the notice.

(3) This does not preclude the correction of errors, or other changes in the text, so long as there is no departure from the substance of what has been notified.

(4) The statutory definition leaves no room for departing from this substance, even on the *de minimis* principle - as this case indicates.

(5) It follows therefore that an amendment can properly be proposed only if it involves no departure whatever from the substance of the circulated notice.

(6) The required contents of the notice should be contained in a single document, and

(7) Amendments, like other departures from the statutory requirements, can nevertheless be validly made with the unanimous

agreement of the shareholders concerned.[1]

This decision seems at first glance to conflict with the earlier authority of Torbock v. Lord Westbury,[2] which decided that the terms of a special resolution can be amended provided that the resolution as amended remained within the scope of the notice. It is to be noted, however, that that case was based on Section 51 of the 1862 Act which spoke of "notice specifying the intention to propose such resolution" whereas S.141(2) of the 1948 Act speaks of "notice specifying the intention to propose the resolution". Re Moorgate has now established that the substitution of "the resolution" for "such resolution" in the 1948 Act is not merely semantic.

Slade J. based his apparently inflexible interpretation on grounds of public policy. The 1948 Act, he said, requires the passing of a special resolution for special purposes. Since the legislature clearly intended that members should receive precise notice of what is intended no subsequent change of plan can be permitted.

> "If amendments were allowed, there would be a risk of unfair prejudice to some of the members (notably those who were not present at the meeting and so able (sic) to change their votes), and of embarrassment for the Chairman in deciding whether a particular amendment was permissible".[3]

1/ S.143(4). See also Re Pearce, Duff & Co. [1960] 1 W.L.R. 1014 and Re Duomatic Ltd. [1969] 2 Ch.365.

2/ [1902] 2 Ch.8 71.

3/ (1980) 1 Co.Law, 36, 37.

Lastly, resolutions to appoint two or more directors in a public company must be proposed separately unless a resolution to appoint the 'package' is approved unanimously.[1/] This is to ensure that members can vote for the director they want without their votes counting in favour of another in the package of whom they disapprove.

A General Remark on the Effectiveness of the General Meeting.

It would be useful by way of conclusion to this chapter to evaluate the effectiveness of the general meeting as a mechanism for shareholders' democracy and, in particular, to explore the question whether, and if so, how far the members who are not satisfied with the information furnished in the annual accounts and other "formal" channels of communication can put questions to the directors and demand explanation of or information concerning the company's state of affairs. The general meeting as a machinery for shareholders' participation is, as has been seen, firmly under the control of the directors and the Chairman and it follows that the processes for questioning and so on which it affords cannot be successfully enjoyed unless with the full co-operation of the Chairman and the directors. And because the sort of questions which discerning shareholders tend to raise are by their very nature often embarrassing to the board it is hardly surprising that "the Chairman and directors are generally unfavourable to such requests, and are often disinclined to give the explanation asked for".[2/] There is very little

---

1/ S.183.

2/ A.B. Levy, 647.

that the general meeting can do about this for in general shareholders have no legal right to demand an answer to any question. As such, debates in general meetings very seldom lead to practical results in securing information which had not already been given in documents submitted to the meeting.

It is to be noted by way of comparison that under German Company Law [1/] a shareholder is entitled to require the board of management to provide the general meeting with information about the company's affairs and its relations with associated undertakings to the extent that such information is necessary for the proper discussion of the matters on the agenda. [2/] The board may, however, refuse to give any information if, but only if,

(i) in the opinion of a prudent business man its disclosure would be likely to cause considerable harm to the company or to an associated undertaking;

(ii) it relates to the acceptability of balance sheet items for tax purposes or to the calculation of particular taxes;

(iii) it relates to any difference between the value at which assets are entered on the balance sheet and their higher relisable value;

(iv) it relates to the methods of assessment and depreciation employed in preparing the balance sheet, provided that the annual report explains such methods sufficiently clearly to provide an understanding of the state of the company's assets and trading position;

1/ The material on German Law here derives from H. Wurdinger, German Company Law, R.R. Pennington, ed., (1975), pp.55-56.

2/ S.131(1) AktG.

(v) the disclosure would make the board of management liable to prosecution.

If the board of management refuses information on any of the above grounds a shareholder may demand that his request for the information and the reason for refusal be recorded in the minutes. He can then apply to the court for a ruling as to whether the refusal of information was justified. If the general meeting passes a resolution on any matter in respect of which information was refused, an application can be made to the court to rule on the justifiability of the refusal by any shareholder who declares his opposition to the resolution in the minutes. Such shareholder may also apply to the court to invalidate the resolution if the refusal to give information was not justified. 1/

If the board of management has provided information to a shareholder or to the supervisory board outside the general meeting, any shareholder may require that such information shall be given to him at a general meeting, even if it is in no way connected with the agenda of the meeting.

In view of the statutory rights of the German shareholder to require corporate information, it might be tempting to propose the extension of similar rights to the U.K. shareholder. It is submitted, however, that under the existing structure of corporate governance in the U.K. such a proposal would be ill-advised and comparison with Germany in this area would be unhelpful as their existence there can be directly attributed to

---

1/ S.243(4).

the relatively weaker position of the German shareholder as against the board of management. For example, the need to give wide power to require information may be justified in Germany by reason of the fact that the shareholders cannot as in the U.K. dismiss members of the top management. Moreover, were such a provision to be introduced into the U.K. to require directors to supply information to shareholders on request, it would be difficult to enforce. A number of reasons can be put forward why it would be difficult under the existing mechanisms for shareholders to insist upon and obtain additional information in the general meeting.

Firstly, the board might just refuse to give the explanation demanded on the ground that to do so would involve the divulging of confidential information that could have disruptive effects in the shares market 1/ or be taken advantage of by competitors, or perhaps encourage protests from employees or even from consumers. Similarly information might be denied on the ground that the question relates to the day-to-day administration of the company and so is outside the concern of the inquirers.

Secondly, the directors or the Chairman of the meeting might simply give an answer that begs the question but is, nevertheless, an answer and then quickly move on to another question or the next point on the agenda. Alternatively, it would be fairly easy for the question to be avoided altogether unless the voices of dissent are so strong as to make it virtually impossible for the Chairman or directors to dodge the issue.

1/ If price sensitive information is given to some shareholders it would be in the directors' interest to make it available to the other shareholders as to do otherwise would expose them and possibly the recipient of the information to risks of liability for insider trading. See Sections 65-67 of the Companies Act, 1980.

Thirdly, the board might simply have recourse to the majority at the general meeting to defeat the request for additional information by voting out the issue. Thus only extraordinary circumstances and suspicion of grave irregularities are likely to secure a vote from the majority ordering explanations to be given when the directors oppose the motion or if the Chairman is plainly hostile to the request. 1/

To sum up it can be fairly said, therefore, that the legal mechanism for participation in corporate governance available to shareholders does not amount to much since the board of directors has immense influence in the exercise of their powers. The constraints which make the general meetings rather ineffective will, however, await discussion in Part III.

The purpose of this chapter has been to present the legal process for shareholders' control against which the *de facto* position of corporate governance can be assessed. But before that the next chapter will consider the legal process for board's operations.

1/ See A.B. Levy, 647.

CHAPTER SIX

BOARD MEETING

1. Introduction

As required by the 1948 Act every Public Company must have at least two directors and every private company, at least one.[1/] In addition, every company must have a Secretary but a sole director must not also be the Secretary.[2/] These provisions represent, among other reasons, an attempt to prevent any one man having too much power in a company and the fraudulent machinations which tend to occur under an autocratic regime of a one-man management. The dangers that a company may encounter under a one-man management, albeit,in a private company, are aptly illustrated by Re H.R.Harmer, Ltd.[3/] The facts of that case, in so far as they are relevant here were as follows: H, the father, had founded a company of which he held virtually the whole shares. By a subsequent arrangement he transferred to his two sons C and B major beneficial interests in the company but a minority of votes. His wife also had shares but these were often voted according to H's direction. By the company's articles, H was appointed governing director for life, but no special rights were attached to that office. C and B each became a life director and their father was appointed Chairman of the Board of Directors with a casting vote.

1/ S.176; that is, those registered on or before November 1 1929.

2/ The Secretary may be a director's wife.

3/ [1958] 3 All E.R. 689.

The father considered that he was entitled to disregard resolutions of the board as long as he held the voting control. He assumed powers which he did not possess and exercised them against the wishes of C and B. As a result of these actions the sons petitioned for an order under Section 210[1/] complaining that the company was being conducted in a manner oppressive to some part of the members, including themselves. Roxburgh J. accepted that a case had been made out for the order and his judgement was upheld on appeal. However, an arrangement was worked out whereby the father would be employed as a consultant only, and should not interfere in the affairs of the company except in accordance with the resolutions of the board. As a "face-saving device" he was appointed life "president".

In legal principle, the administration of the company is vested in the board of directors collectively and the board of directors must, as a general rule attend to decide on these matters at board meetings.[2/] This principle ensures that through the direct presence of directors and the mutual exchange of ideas in board deliberations, the collective wisdom of the board is available to the company on important matters before making decisions. Channell, B. described this principle as follows in D'Arcy v. The Tamar, Kit Hill and Callington Ry.Co.[3/]

1/ An alternative remedy to winding-up in cases of oppression.

2/ The presence of every director is not necessarily required for a director is not bound to attend every board meeting, but he ought to attend whenever in the circumstances he is reasonably able to do so : per Romer J. in Re City Equitable Fire Insurance Co. [1925] AC 407.

3/ (1867) L.R. 2 Ex. 158.

> "Without saying that the board are bound to meet at any particular place, yet when an authority is given to a less number to bind the whole body, they must meet in some place where all may be present, and may have the opportunity of expressing their assent or dissent". 1/

In that case the company's articles of association vested the "management and superintendence of the affairs of the company" on the board of directors. Another article provided the mode in which this was to be done: they were to hold meetings at which was present, a quorum of three and questions at such meetings were to be determined by a majority of voters. The Secretary affixed the seal of the company to a bond, after having obtained the written authority of two directors at a private interview, and at another private interview, the verbal promise of a third to sign the authority. In an action to enforce this bond against the company, it was held that the company were not liable as their seal was affixed without lawful authority. Said Martin B. "it is quite clear that the directors are to act together, and in a meeting", 2/ but this had not been done.

2. Procedure for Board Meetings

The proceedings at board meetings are regulated by the

1/ At 162-163.

2/ At 161. See also Re Portugues Consolidated Copper Mines Ltd. (1889)42 Ch.D.160.

company's articles and other rules which the directors may have made for themselves.[1/] Article 98 of Table A, for example, provides that "Directors may meet together for the dispatch of business, adjourn and otherwise regulate their meetings as they think fit". Also any director may call a board meeting at any time and the Secretary must do so at his request.[2/] Resolutions are passed by a majority of voters and in the case of an equality of voters the Chairman[3/] exercises his second or casting vote.

(i) Notice

At times, it may be impracticable for the board to meet formally to discuss a matter upon which a decision is needed, and, in order to enable the board to consider matters under such circumstances, articles usually provide that a resolution in writing signed by all the directors entitled to receive a notice of a board meeting shall be effective as if passed at a board meeting.[4/] This dispenses with a formal meeting. But under normal circumstances due notice must be given of board meetings, otherwise the meeting is irregular.[5/] Thus, for example, in Re Homer District Consolidated Gold Mines[6/]

1/ Re Haycraft Gold Reduction and Mining Co. [1900] 2 Ch.230.

2/ Ibid.

3/ Elected under Article 101. If no Chairman is elected or if a Chairman is not present within five minutes from the time appointed for commencement, the directors may choose one of their number to act as Chairman for the meeting.

4/ Article 106.

5/ Re Homer District Consolidated Gold Mines (1888)39 Ch.D.546.

6/ Ibid.

a board meeting was held at 2 O'clock on a few hours' notice to two other directors who did not attend, of whom one did not receive his notice until the following day, and the other gave notice that he could not attend till three. It was held that the meeting was void.

It has also been held in Young v. Ladies' Imperial Club Limited,[1/] that the omission to summon an absent member of a Committee invalidates the proceedings of that body. In addition the notice must state the object of the meeting with sufficient particularity.

For most large companies, the times and places of meetings are designated by the articles and so there is no need for notices of each separate meeting. Where also by the articles all powers are vested in certain directors then other directors not entitled to any vote at the meeting need not be given any notice.[2/] It is very unusual, though, these days to find public and, in particular, listed companies whose articles restrict the powers of directors in this manner.

(ii) Quorum

Unless a number is fixed by a company's articles or by the

1/ [1920] K.B.523. See also in re Portugues Consolidated Copper Mines Ltd. supra.

2/ See Shaw v. Shaw [1935] K.B.113.

board, the quorum for a board meeting of a public meeting is two.[1/] Where there are no provisions in the company's articles, a majority of the directors, of two or more can validly act, unless the number to form a quorum is established by the usual board practice.[2/]

A quorum must be made up of disinterested directors who are entitled to vote on the particular resolution before the board. Where a director has an interest in a transaction which is to be discussed at the meeting, he may be excluded by the articles[3/] from voting or being counted in the quorum. If two directors are interested in a combined transaction one cannot vote or be counted in a quorum to approve it for the other. Nor can the transaction be articifically split up so as to defeat this requirement.[4/]

If the number of directors of the company is less than the quorum required by the articles, no valid board meeting can be held, unless the articles give them power to act notwithstanding the vacancies,[5/] but a subsequent meeting of the board with an effective quorum may ratify an invalid resolution of the board.[6/]

1/ Art 99.

2/ See Lyster's Case (1867) L.R. & Eq.233; Cork Tramways Co.v. Willows (1882) 8 Q.B.D. 685.

3/ Eg.art.84.

4/ Re North Eastern Insurance Co.Ltd. [1919] 1 Ch.198; Re Greymouth Point Elizabeth Ry and Coal Co. [1904] 1 Ch.32, followed.

5/ Re Scottish Petroleum (1883) 23 Ch.D.413.

6/ The absence of a quorum at a meeting does not affect outsiders because of the Rule in Turquand (Royal British Bank v.Turquand (1856) 6E.4B.327 Exch.Ch.) according to which they are not obliged to ensure that the internal regulations of the company have been complied with.

(iii) The Validity of Directors' Acts

Companies' articles often authorise the directors to delegate any of their powers to committee of directors[1/] and to appoint one or more of their body to act as managing director.[2/] The board cannot through such delegations abdicate its power to act in any particular matter, nor can it deprive itself of power to control the company's business.[3/]

The board cannot delegate a power which it does not have itself. A director acting alone cannot bind the company unless he excersis a power specially delegated to him. And by Section 179, a provision requiring or authorising something to be done by or to a director and the Secretary is not satisfied by its being done by or to the same person acting in both capacities.

Directors cannot act without a resolution of the board meeting but when a resolution in writing is signed by all or a majority of the directors that will suffice,[4/] unless the articles provide otherwise.[5/]

1/ E.g.articles 102-105.

2/ Arts.107-109.

3/ Horn v. Faulder & Co. [1908] 99 L.T.524.

4/ But see Re Portuguese Copper Mines (1889) 42 Ch.D.160 at 167 where Fry L.J. suggests that directors have to "meet in order to think", because the collective opinion expected of a board as contemplated by the Act is one arrived at at a board meeting after oral discussions.

5/ Art.106.

Directors must not exclude from their meeting any of their body and unless the company has by resolution declared that it does not desire a director to act, an excluded director can obtain an injunction restraining his continued exclusion.[1/]

3. Conclusion

The wide discretion which Company Law allows companies in the regulation of board (and for that matter, general) meetings, gives rise to considerable laxity in compliance with these rules and in some cases actualıy operate against the effective involvement of the corporate organs in the performance of their proper roles in the company. For example, the law leaves it to the directorsto regulate their own procedure for their meetings, to elect a Chairman for such a period as they think fit[2/] and to vest in him the right to exercise certain powers at these meetings as they think fit. This discretion has, however, been abused in the past by Chief Executives in a number of cases, especially where they also happen to be Chairmen of the boards. In some companies, board meetings are not called at all because, unlike the Annual General Meeting there is no obligation to do so,[3/] so the Chief executive runs the company as a "one-man show". As a result, the ostensible attempt by sections 176 and 177

1/ Pulbrook v. Richmond Consolidated Mining Co. (1878) 9 Ch.D.610.

2/ Art.101.

3/ One wonders if article 106 does not actually discourage the calling of a board meeting. That regulation permits the dispensation of one if a resolution in writing is signed by all the members entitled to attend.

of the 1948 Act to secure corporate governance through the machinery of the board is rendered ineffective.

In some other companies, despite the requirement of Section 145 (1) of the Act requiring that every company must record minutes of all proceedings of its directors on such minutes are ke t.[1/] Flagrant violations of this section were rife in Dowgate and General Investment Ltd.[2/], a company investigated by the Department of Trade. Obviously, the threat of a fine of £5 for every day during which non-compliance with the section continued had not been sufficient deterrent against violations. But the old penalty under section 145(4) has been repealed and is now punishable by a fine not exceeding one-fifth of the statutory maximum or, on conviction after continued contravention, a default fine not exceeding one-fiftieth of the statutory maximum which is encouraging.

Another major concern is the question of access to minutes of board meetings, where minutes are kept at all. If anyone is to exercise any degree of influence or control over the way the company's affairs are conducted it stands to reason that the least that could be expected is that they would be conversant with the investment and other policies of the company. It is well known that the annual reports contain no useful information in this regard.[3/] The board

---

1/ Section 145(1) requires that every company must cause minutes of all proceedings of general meetings, and board meetings to be entered in books kept for that purpose.

2/ Report of Department of Trade Inspectors (HMSO) 1979.

3/ See e.g. Derriman, Company-Investor Relations, (1969). The effect of restriction of information to shareholders and directors must await further discussion in Part III on the *de facto* structure of participation.

often argues that such information of confidential nature could not be disclosed in annual reports but in confidential documents accessible only to directors.[1] Only the directors would have such access and knowledge about the policies pursued by the company, the way that decisions are reached and the details of the conduct and performance of the company. That being so, grave concern is aroused by the recent decision in Conway v. Petronius Clothing Co.Ltd.[2] in which it was held that although directors have a common law right they have no statutory rights to inspect their Company's books of accounts and other documents.[3]

In that case the plaintiffs, all being directors of P.Ltd. attempted to inspect the books of accounts and other records of the company. Their intention was to investigate suspected misapplication of the assets of the company by M.Ltd., a holding company which had control of P.Ltd. and Q who in turn was in effective control of M.Ltd. Their attempt was frustrated by the board of directors of M.Ltd. and so they instituted proceedings against the two companies, Q and two other directors for an order, *inter alia* for the production of the documents in question and permission to take copies thereof. The

---

1/ See p.108 supra, on the members rights of access to books and records.

2/ [1978] W.L.R.72.

3/ Minutes books were not specifically mentioned in the case, but on the authority of McCusker v.McRae 1966 S.C.253, it would appear that the same rules apply. In that case it was held that a director has a Common Law right to inspect minutes of board meetings, but no statutory right. Both the director and a named Chartered Accountant were allowed access to the minutes both of the General and Board meetings. This case is important for giving a member the right to appoint an expert (an accountant in this case) to inspect and explain to him details which otherwise would make no sense to him.

dependants contended that the plaintiffs' motive in seeking information and copies of documents was to render assistance to certain of P.Ltd.'s trade competitors and further that inspection should not be ordered at least until the result was known of a forthcoming general meeting of P.Ltd. at which a resolution for the removal of the plaintiffs as directors would be considered. The defendents' contention was accepted and the order refused. In so doing the Court applied the decision in Burn v. London and South Wales Coal Co. and Risca Investment Co. 1/ and the Australian case of Edman v. Ross. 2/ In the former, the plaintiff brought an action to obtain inspection of and take copies of documents belonging to a company of which he was a director. The documents were in the custody of the company's solicitor. On the question whether a director has a right to see and take copies of documents belonging to his company, North J., held that he had such right not only at meetings. He emphasised the inconvenience that would arise if it were otherwise, from the delay and obstruction at meetings, and that the very object of a directors' having access to such documents was that he might be able to prepare himself to act at meetings. In the course of the judgement, he observed that it was necessary that confidence should be reposed in a director that he would use his knowledge for the benefit of his company,

> "and if a company had not confidence in their directors their course was to remove them". 3/

1/ (1890)7 T.L.R. 118

2/ (1922)22 S.R. (N.S.W.)351.

3/ At 119.

In Edman v. Ross, Street C.J., having referred to Burn's Case stated:

> "The right to inspect documents, and if, necessary, to take copies of them is essential to the proper performance of a director's duties, and, though I am not prepared to say that the Court might not restrain him in the exercise of this right if satisfied affirmatively that his intention was to abuse the confidence reposed in him and materially to injure the company, it is true nevertheless, that its exercise is, generally speaking, not a matter of discretion with the Court and that he cannot be called upon to furnish his reasons before being allowed to exercise it. In the absence of a clear proof to the contrary the Court must assume that he will exercise it for the benefit of his company". 1/

Although no statutory right is conferred by the 1948 Act 2/ on a director to compel the delivery of documents for his inspection, the authorities indicate the existence of a Common Law right to inspect. 3/ That being so Courts retain a residue of discretion whether or not to order inspection - which discretion must be sparingly exercised, unless as in the Conway case there are reasons to suppose that the right might be abused or where the directors' removal from office seems imminent. Otherwise, refusal of the right to inspect would seriously threaten the right of directors to be actively involved in the performance of their duties and so put the monitoring and

---

1/ At 361.

2/ Certainly not by section 147: Plaintiff's contention in Conways v.Petronious was based on the existence of a right under this section. The section requires every company to keep proper books of account default of which is punishable by a fine or imprisonment. The DOT Annual Report for 1979 shows that there were 7 convictions under this section last year.

3/ Indeed the Court in Conway acknowledged the existence of this right at Common law which is "merely implicitly recognised" by Section 147, 1948 Act.

supervisory functions of the board in serious jeopardy, more so, if he is a special interest or minority shareholder nominee. 1/ The decision in Conway must ben seen, therefore, entirely in the particular circumstances of the case and not as limiting generally the right of directors to inspect documents belonging to their company. In any case, by reason of Section 12(6) of the 1976 Act (and as Professor Gower has put it), the decision in Conway is "no longer good law so far as account books are concerned". 2/ That subsection requires that the accounting records of a company must be kept at the company's registered office or at such other place as the directors deem fit and "shall at all times be open to inspection by the officers of the company". This right is absolute and it seems unlikely to be denied even where a directors' or officer's motives are suspect. It seems therefore that Conway is now only good law in respect of other corporate documents minus the books of accounts.

Having described the legal structure of corporate governance in the last two chapters the next Part is designed for a consideration of the *de facto* situation. This will provide the necessary basis from which the adequacy of the existing framework for participation is to be evaluated.

1/ There is a discussion of nominee directors in Chapter 9.

2/ P. 504. Emphasis mine.

PART III

THE MECHANISM FOR CORPORATE ADMINISTRATION [THE *DE FACTO* POSITION]

In this Part it is designed to examine the extent to which the corporate organs actually perform the functions ascribed to them in theory. Chapter 7 considers the extent of directors' participation in corporate governance, and Chapter 8 the extent of shareholders' participation.

CHAPTER 7

BOARDROOM PARTICIPATION

1. The Practice

The legal theory about participation by the board of directors, it will be recalled, presupposes the supremacy of the board over all the company's officers. Power to manage the company belongs to the board as a body. The directors are expected to act collectively as one body and one director may act alone only under the authority of the board. The board is empowered to appoint any one of their body to be chairman or managing director to whom they may delegate some of their powers but the board does not by so doing rid itself of its authority over such officials. It is required to appoint other corporate officials and managers into the non-directorial echelons on the company's management structure; to make policy save those of major structural or fundamental importance, relying on advice from management and to ensure that policies formulated by it are discharged by management. While the above description fits the role fulfilled by boards in small companies it does not present an accurate assessment of the *de facto* system of operation of boards in large public companies. Whereas it is usually provided that "the business of the company shall be managed by directors...", in practice directors, as a board, seldom manage the business in large public companies. As J.Baker writes: 1/

1/In Directors and Their Functions - A Preliminary Study,12,(1945).

"Under the system of directorates which has developed ... among large, listed companies directors are unable to 'manage' corporations in any narrow interpretation of the word... Directors do not and cannot 'direct' corporations in the sense of operating them".

This assessment of the nature of participation by the board is shared by many other writers on the subject, [1/] and it highlights a notable feature in the governance of the large company in contrast from the small private concern.

The realities of boardroom participation reveal a divergence from the model presupposed by legal theory which has been variously described by writers as a "skew" between belief and reality; [2/] a divergence between"theory and practice" [3/] or between "myth and reality". [4/] As a matter of fact, but not in law, the typical board in large companies does not select management and it neither sets business policies nor manages the business for these are management [5/] and not board functions. [6/]

1/ See for example, R.A.Gordon, Business Leadership in the Large Corporation (1961); M.L.Mace. Directors : Myth and Reality (1971) R.E.Pahl and J.T.Winkler, "The Economic Elite : Theory and Practice" in Stamworth and Giddens, Elites and Power in British Society (1974).

2/ Melvin Aron Eisenberg, "Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants", (1975) 63. Cal.L.R.375.

3/ Pahl & Winkler, supra.

4/ Mace, supra.

5/ Meaning the executives.

6/ See supra.

Two of the most influential studies of boardroom participation were published in 1945 in the U.S. In Business Leadership in the Large Corporations, 1/ Robert A. Gordon found that there was little or no indication that the boards of large companies initiated decisions, specific or general, in both financial and non-financial matters. He writes that although the board's approval function was more important than its initiating activities, "even with respect to approval, many boards in these large companies are almost completely passive", and that the final approval function was usually exercised by the Chief Executive in conjunction with either his immediate subordinates an executive or finance committee of the board, or a few influential directors acting as his informal advisors.2/ In his preface to the 1961 edition he writes:

> "Granted the legal authority of the board and the unquestioned influence of some individual directors, it is still true that the essential business decisions are made chiefly by salaried executives, not by the board of directors as a formal body". 3/

In the other study published in 1945, John C. Baker, 4/ similarly found that major policies in production, marketing, finance and personnel were usually formulated by the executives and not even formally confirmed by the board, while in such matters as addition of new

---

1/ See supra. 2/ See pp.128-146.

3/ At VIII.

4/ Directors and their Functions, supra.

products, preparation of operating budgets and negotiation of collective bargaining agreements, the board's role was limited to receipt and consideration of after-the-fact reports. 1/

One of the most incisive studies of the functioning of boards undertaken in this country is that of two sociologists, Pahl and Winkler published in 1974. 2/ The main aim of their research was to study how directors perceived and negotiated their roles. 3/ They found in the process, that the ability of the board to formulate policy was limited 4/ but they recognised its importance as a "legitimating institution". As they put it:

> "To be sure, the final yea or nay at a board meeting may be seen as the decision point, and may so appear in corporate histories... But the board action we have observed are better interpreted we feel, merely as ratifications of decisions made earlier and elsewhere, sometimes

1/ At 131-132. J.K.Galbraith in The New Industrial State (1968) advances this argument further by claiming that the direction of the corporation is not really set by the board and the managers, many of whom sit on the board, but rather by what he regards as the "Technostructure". See Chapter 6.

2/ "Economic Elites: Theory and Practice", supra. Other notable U.K.based studies on boardroom participation include, Sir Walter Puckey, The Boardroom : A Guide to the Role and Function of Directors (1969); R.I.Tricker, The Independent Director, A Study of the Non-Executive Director and of the Audit Committee (1978), and P.S.Florence, Ownership Control and Success of Large Companies (1961). In the context of industrial democracy see Eric Batstone, Industrial Democracy : European Experence (1970).

3/ Part of the research involved following each executive director of the companies studied, through one complete day of work and observing and recording his activities and interaction.

4/ The study confirmed the critics argument "that directors are not necessarily taking the decisions imputed to them" ; p.103.

> by much more junior men, about which the board had no practical alternative. The distinction between "making" and "taking" decisions is relevant. *Boards of directors are, we feel,* best conceived as decision-taking institutions that is, as legitimating institutions, rather than as decision-making ones". 1/

The writers identified two types of boards: pro-forma boards and functioning boards. 2/ They reported that pro-forma boards function in practice neither as a decision-making nor as a consultative body but exists only to conform with the requirements of company law. In some cases these boards do not meet even though fictious board resolutions and minutes are kept. 3/ Pro-forma boards in these companies become merely superfluous or an encumbrance on the company. This occurs when a company is dominated by one man whose personal approval is required for every action of any significance or when it is controlled by a small cabal, which might be formed by a small number of executives who work in close physical proximity and are thus "in continuous executive session", in the case of a superfluous board. 4/ A board becomes an encumbrance, according to their definition, when it is in part filled with men who are seen by those in effective control of the company, as irrelevant to its functioning. In companies with pro-forma boards, the rule is, according to the authors, that no board meetings are held and if they take place at all, are merely for the purpose of ratifying decisions taken earlier by the autocrat or the top management cabal.

1/ At 110.

2/ Described in pp.104-107.

3/ This is a very obvious violation of Section 145(1).

4/ See also S.P.Florence, Ownership, Control and Success of Large Companies, (1961), 80.

The other type of board identified by them ; the "functioning board", they described as one which plays some role, albeit small, in the operation of a company. This role, at the minimum, consists *inter alia* in the power to veto some types of management proposals. Companies with this type of board are characterised by regular board meetings which is the focus around which all other corporate and individual time scheduling is oriented. In such companies preparatory meetings and other activities by managers are very much evident before the board meetings.

Even in the so-called functioning boards the preparatory activities and pre-board meetings organised by management, are ironically the basis of the board's weakness because they anticipate the questions which are likely to be raised at board meetings and by skilfully structuring the information available to the board are able to pre-empt possible opposition at board meetings. By sealing off any source of contradictory information management is able to manipulate the board successfully.

In his book, Directors : Myth and Reality, based on empirical research in the U.S. Professor Mace constructs a model of boardroom participation which, though not of universal application, is quite typical of boards of large public companies. 1/ The author found that boards perform the following functions:

1/ As Pahl and Winkler study subsequently revealed, the practice in boards in the U.K. is not dissimilar to what Mace found in the U.S. An earlier writer, George Goyder in The Responsible Company (1961) had written that the American and German board practices differ from the British Boards. p.19. While the German situation is obviously quite different there is, from the evidence available, not much difference between the American and British boards.

(1) To provide advice and counsel.

(2) To serve as some sort of discipline, and
(3) To act in crisis situations;

and he dislodged the commonly held belief in the board's effectiveness based on the view that it:

> "establishes the basic objectives, corporate strategies and broad policies of the company..., that it selects the president and that it serves as a forum for asking discerning questions about the company".

Evidence was adduced on each of these points and he argued that none of those functions is in fact performed by the board. "Management", as one of his executive interviewees told him, "creates the policies. We decide the course we are going to paddle our canoe in. We tell our directors the direction of the company and the reasons for it... We communicate with them. But they are in no position to challenge what we propose to do". 1/

Such empirical evidence as that referred to above leaves the legal theory on board's participation gravely faulted and lends some support to the conclusion that the common notion presupposed by law about the role of boards in large companies is unrealistic. 2/ The question which immediately arises is who then does the managing, appointment of officials, setting of policy and generally directing the operation of the business since the board does not perform these functions. The question has been

---

1/ At 14.

2/ Incidentally, there is no definition by Company Law of the word "manage" when it is said that the board is to manage the business of a company. This point is taken up by Prof. Detlev F.Vagts in "Directors : Myth and Reality", (1976) 31 Bus. Lawyer 1227,1230.

partly answered by those who have pointed out that it is management and not the board that does the managing; but that is only half-truth and does not completely answer the question. The answer is that the problem of operating large companies is extremely complex that quite often it is impossible to say that one man or one body of persons has responsibility for decision or policy:

> "The process of formulating policy can begin at the top level with a group of senior managers or the board itself; it can then involve the whole of the managerial hierarchy, or a group of companies, subsidiary boards and their managers;it might then work its way back up to board level for a final decision or for the seal of approval. Many internal and external pressures may affect those involved in devising a policy and taking a decision". 1/

To understand the nature of the structure of decision-making in companies one must ascertain the nature of the alleged functions of the board and how the board is organised to discharge them.

2. The Functions of the Board

What is generally regarded as the "role" of the board resolves into managerial and supervisory functions - and this is a distinction which is rarely drawn by analysts of the boards powers. 2/

1/ Bullock Report (Cmnd 6706), pp.67-68.

2/ By contrast under German Company Law this distinction is clearly drawn. See R.R.Pennington, ed., German Company Law. European Commercial Law Library No.3.1975.

"Are directorial and managerial roles identical?" asks Sir Walter Puckey. [1/] "If not, how do they differ?" His answer is that both roles are "too closely related"; his evidence being that when for instance "senior company executives are promoted to director status they often think and act as executive managers while sitting at the board table. They are board executives rather than directors". [2/] Many writers especially in the management sciences do not sufficiently keep these two roles apart and by lumping both roles together demonstrate the same shortcomings as in the legal theory.[3/] The Bullock Report exhibited a tendency to adopt this approach when it drew up a list of matters for which boards usually have ultimate responsibility to include

(a) appointing senior managers, reviewing their performance and fixing their remuneration;

(b) setting the company's objectives and strategic plans and ensuring that adequate machinery exists in the company for planning;

(c) controlling the financial affairs of the company including the approval of capital programmes and capital expenditure, and allocation resources between operations.

1/ The Boardroom. supra.

2/ At xi.

3/ See e.g. Harold Koontz, The Board of Directors and Effective Management (1967), Chapter 2. But see George Bull, The Directors' Handbook (1969) at 37. In a letter to The Times a reader challenges the view by Prof.Moore, Deputy Principal of the London Graduate School of Business Studies that directors and managers are synonymous. The reader correctly disagrees with.this writing that "one of the fundamental fallacies in commerce and industry" is the belief that members of the board are super managers. "It is true that they are generally appointed to a board as a result of a career in management, but it should not be assumed that their function remains that of a manager". The Times June 29,1978.

(d) agreeing the company's organisation to meet the objectives and delegating authority for certain functions within the company;

(e) considering policy on take-overs and mergers;

(f) monitoring and evaluating performance;

(g) setting overall guidelines for employment and personnel policies. 1/

The Report, however, immediately qualifies the above position by stating that:

> "although it may have *overall responsibility* in these areas, the extent to which a main board exercises detailed control of policy is inevitably limited. In most companies it is the apex of decision-making hierarchy and the focus of managerial authority. It cannot exercise detailed influence over every aspect of the company's affairs and it is largely reliant on the proposals and policies put to it by management". 2/

Although the board performs some of these functions directly as a body it "performs" others only indirectly by its approval of policies initiated and presented to it by management. Those functions which the board may perform directly as one body are examined below. 3/

1/ At 66-67.

2/ At 67. Emphasis is mine. It is clearly important to draw a distinction between matters which the board has responsibility for and matters which the board as a body do themselves perform.

3/ But compare the remark of the distinguished American scholar, Prof. C.C.Brown, that "Most boards of directors...don't know exactly what they are supposed to do". Putting the Corporate Board to Work, (1976),5.

The nature of the board's functions is described in the opening lines of Guidelines for Directors, issued by the Institute of Directors 1/ as follows:

> "Primarily the board of directors establishes policy and controls management. To achieve this the board has two main responsibilities.
>
> (1) to set up and maintain the most suitable executive structure, and
>
> (2) To ensure that the board itself is so constructed that it can supervise efficiently the carrying out of the company's long-term objectives". 2/

It has been established that the board does not set policy, but the factors which make the board unable to establish policy do not affect its ability to establish control over or supervise management. Indeed, the board is enabled to do this by retaining power to select and monitor the company's executive structure and to ensure that the board itself is so constituted as to be able to exercise its supervisory functions efficiently. Thus, the functions of the board as described in the Guidelines for Directors may be set out as including the (a) selection and removal of executives, and (b) supervisory/monitoring functions.

Mace's findings indicate that even these functions are of very little consequence. He found that even though the board selects or appoints the Chief Executive (C.E.O.) it is, generally, not responsible for the appointment of other executives. Even with respect to the Chief Executives the board is rarely responsible for their appointment except

1/ (1974).

2/ At 13.

in cases of disaster or in a sudden emergency when the board is suddenly propelled into a decision-making function. Selection of the chief executive is, therefore, only a *de jure* function of the board, the *de facto* power being in the incumbent C.E.O. Usually, an out-going chief executive will have a great deal to say in the selection of a successor and would under normal circumstances not leave the matter to the board. According to Juran and Louden, 1/

> "Some C.E.O's have resorted to the "sealed letter" method of selecting their successors in an emergency. They have named their successors and the reasons for their choice but have not amounced this. Instead, they have recorded it in a sealed letter which is not to be opened unless they meet with some sudden emergency". 2/

Regarding the board's supervisory or monitoring function, the statement of one chief executive responding to Mace's question on the issue is quite illustrative:

> "When the board is monitoring the management, it is watching what is going on. As long as it is happy with what is going on, whether the member asks abrasive questions or whether they don't ask... is really unimportant. But if the company starts faltering, and it becomes obvious for one reason or another that the company doesn't have proper management, a group of outsiders needs to make the key decisions - whether to change the management". 3/

1/ The Corporate Director, American Management Association (1966).

2/ At 104.

3/ At 28.

The fact that most boards are often powerless and the consequences which tend to follow the complacency of directors have been highlighted in a number of Department of Trade Reports.

The Lonrho saga is a case in point. 1/ News about this company first hit the headlines in March and April 1973 when eight Lonrho directors attempted to remove the managing director and chief executive, Mr. "Tiny" Rowlands from executive office. He took legal action to prevent the board from implementing this proposal until such time as a shareholders' meeting could give its decision on the matter. The Court action failed and the eight directors agreed to defer action until after an extra-ordinary general meeting called for 31 May 1973. At this meeting Lonrho shareholders supported Mr.Rowland, and the eight directors who had sought to remove him were themselves dismissed.

The principal complaint by the eight directors against Mr.Rowland were brought out in a series of affidavits during the court action. They were:

(1) That Mr.Rowland either entered into important transactions on behalf of the company without the approval of the board, or that in certain instances he misled the board as to the nature of the transaction in order to obtain approval for it; and

(2) That some of the transactions were improperly entered into for the benefit of directors. 2/

1/ Lonrho Ltd.,Department of Trade Report (H.M.S.O.) 1976.

2/ There were several other criticisms against Mr.Rowlands, but it is not necessary to set these out here.

Mr. Allan Heyman, Q.C. and Sir William Slimmings, CBE, C.A. were appointed inspectors by the Department of Trade under Section 165(b) of the 1948 Act to investigate the affairs of the company. Their report was very critical of the way the company had been conducted and Mr.Rowland was on a number of occasions in the report criticised for being wholly or partly responsible for withholding information from the Lonrho board or from shareholders, or of giving them misleading information. One of the company's directors in his evidence at the investigations had this to say about the situation which existed on the board:

> ""Tiny" (was in charge of the management of Lonrho). It was patently obvious very soon after one joined that he was the moving spirit in the whole thing, and that he was the one in the end to whom most decisions went one way and another". 1/

And as for the chairman Alan Ball,

> "It became fairly obvious that he was not - although supposedly chairman, Tiny was the boss". 2/

Mr. Rowland's view of the role that a board should play was summarised by him as follows:

> "....We had established a pattern of behaviour... and so I assume that the way we were carrying on, most companies were carrying on. I always thought and heard that Harley Drayton..." has decided that .... " and the people used to troop into his various investments, 17 or 18 companies, and Harley would say "Well, we are going to sell this, we are

---

1/ At 10.05 Evidence of Major Mackenzie

2/ Ibid.

going to buy this, and incidentally,
he has got this, and I have done that",
and this was the pattern and the right sort of
behaviour, and the rest was sort of Christmas
tree decorations". 1/

However, not all Lonrh o directors were prepared to play the "Christmas tree decoration" role and they promptly resigned. One director gave his reasons for resigning as follows:

> "As a non-executive director, the second reason for my resigning is [that]... I have felt for a long timm... that Tiny pays little heed to any advice or any views which his co-directors might offer him and that the company is run more as Tiny's private empire than as an important public company". 2/

Tiny himself admitted this fault and some of his co-directors volunteered to educate him on how to run a public company, but apparently their advice had little impact.

The Inspectors held Mr.Rowland "primarily responsible for the policy that was followed in the company", "which reflects a course of conduct that we condem". 3/ They nevertheless acknowledged the man's achievements:

> "Lonrho as it is today is very largely Mr.Rowland's creation. He is a man who has vision, negotiating ability, determination

---

1/ At para.10.30.

2/ 10.36 Mr. Caldecott's reasons for resigning. The first was his disagreement with the policies of the management.

3/ At 12.62.

> and personality in unusual measure, coupled with unbounded energy to apply his talents. He has a determination to get his way... when he decides that he wants something, events move at a great speed. The application of these talents externally in the commercial development of the group have been the basis of its success, but turned inwards and applied in relation to the Board's control of the group or his own personal affairs they have led to the criticisms set out in our report". 1/

> "The lesson is that a company needs a Board that can provide an independent check on its executive, that it is fully and fairly informed of the group's affairs; that is in a position to monitor the actions of the executive and that, in consequence, is in a position in the event of some unexpected happening ... to give shareholders an immediate and convincing account of the situation". 2/

The Lonrho Report and the report into the affairs of the late Sir Eric Miller, in Peachey Property Corporation 3/ illustrate how redundant a board becomes under an autocratic, one-man management. The latter was also an investigation under Section 165(b) 1948 Act by Rayman Kidwell Q.C. and Stanley Samwell F.C.A.,inspectors appointed by the Department of Trade. To the outside world Sir Eric Miller, chief executive and chairman of Peachey, was well known as a rich man in his own right. He seemed to know every important dignitary worth knowing and everyone assumed that his style and his connections were explanation enough for the gifts and all the money he was throwing around, including a champagne party given by way of a surprise at No.10 Downing Street

1/ At 12.134.

2/ At 12.136.

3/ Peachey Property Corporation Ltd. Department of Trade Report,1979. (H.M.S.O.).

to mark Prime Minister Harold Wilson's resignation. He ran huge bills at the Churchill Hotel at the company's expense, took loans from the company without security, entered into agreements for which huge commissions were paid as if he was acting on the board's authority and generally used the company's money as if it belonged to him. It was not possible to know when Sir Miller was running expenses in his own name and when he was doing it in the company's name. Within the company his fellow executive directors seem to have concluded that it was not for the likes of them to ask the reasons for each transaction that came to their knowledge. They were not, as one explained to the inspectors; "men in the Miller mould". What he gave them to sign,they largely signed. Mr. Thompson, latterly the only continuing executive director, "never aspired to know what was going on in the higher reaches of company policy...., he played no effective role on the board since it was not in his nature to question the decisions or the conduct of the chairman". 1/ Asked by the inspectors: "Are you saying that effectively the board meetings were merely a rubber stamp for...the expenditure?", he answered tersely, "Yes". 2/

The report, regarded by some as generous to a fault, 3/ perhaps because of Sir Eric Miller's suicide which made it impossible to receive evidence from the principal witness, concluded:

1/ Para.43.

2/ Para. 44.

3/ The Guardian, Editorial, January 31 1979.

"We have tended to exonerate each member of the board from any heavy responsibility, though we must later make some individual criticisms. It is not inconsistent for us to criticise the board as a whole as being unduly compliant, uncritical and gullible, at certain times and in certain respects. The board had a weak construction, which is not to say that its individual components were necessarily weak. Each member, if he had his time over again, would doubtless be a tower of strength against a dominating chairman. The most important lesson is for future directors, since a repetition of the 'Peachey Affair' might attract a less compassionate appraisal". 1/

With due respect, the sentiments expressed by the Inspectors in the last two sentences might be just wishful thinking, for this is not the first time that able and competent directors have remained docile whilst the chief executive plunders the company and it is the contention in this thesis that unless the basic structure for board's operations is modified, the 'Peachey Affair" might still repeat itself. For example, in <u>First Re-Investment Trust Limited</u> 2/ a company whose affairs were investigated by the Department of Trade and reported in 1974, the directors of a listed company, all experienced city businessmen, were found to have stood by while the chairman was able fraudulently to purchase the company's assets for himself at a price which represented only a fraction of their true market value. Although all the directors were found in breach of their duties the Inspectors were also compassionate on some of the directors whom they considered less guilty. 3/

1/ Para.69.

2/ <u>Australian Estates Co.Ltd.</u> Etc. Also referred to as <u>First Re-Investment Trust Ltd.</u>, Department of Trade Report (1974) H.M.S.O.

3/ See para.272.

The fact that in these companies, the majority of, if not all directors, were competent businessmen and that it took a relative "outsider", 1/ to expose the mis-management raises serious questions. 2/ And one must ask why the boards have so often remained passive until some catastrophe jolts them into action. An attempt is made in the next section to answer this question.

3. The Reasons the Board Does Not Manage

For over half a century now it has become widely acknowledged that the decision-making power in companies rests, not with the owners but with management, who they appoint to oversee the operation of the company. Management exercises both power over the day-to-day administration of the company and over those other functions traditionally associated with ownership. Similarly, the power conventionally attributed to the board of directors are quite often exercised not by the board *per se* but by management acting as the board. Generally, the "non-management" directors 3/ on the board have little or no say in the making of board policy, decisions or, indeed, day-to-day management. In general, only in a very restricted sense does the *de facto* structure of corporate governance correspond with the *de jure* structure.

1/ This is not necessarily "outside directors" but directors outside the "cabal" that surrounds the chief executive such as was Lord Mais in Peachey and Mr.Mills in First Re-Investments Ltd.

2/ The reports discussed above are only a few of the numerous cases that have been investigated by the Departments, and examples are not hard to come by. See also the reports on Hartley Baird Ltd., Ashbourne Investments Ltd. A useful list of other reports is set out in a Table by Tom Hadden in (1980) 1 Co. Law, 14-16, with a brief note on the nature of the inspectors' report on each company investigated and the action taken.

3/ That is, non-executive directors.

Although much research has been undertaken to ascertain the reasons for the drift of power of ownership to management, [1] relatively little has been done to investigate the reasons for the drift of decision-making power of the board to management. The reasons for the drift become apparent from an analysis of the internal structure of the board especially with reference to its size, composition and the several constraints which inhibit the proper exercise by some directors of their powers.

(i) Structural Problems

In Company Law directors are appointed by the shareholders, [2] but in practice boards have almost complete freedom to determine how they are constituted. Limitations on the scope to which a board may design its own composition (except the initial directors at formation) is largely voluntarily imposed by them and even though the shareholders have legal powers so to do, they rarely limit the authority of board or modify their composition by special articles. This leaves management free to arrogate to itself power to perpetuate itself and has seriously undermined the provisions of the Act relating to the composition and conduct of the board. [3]

It is important to consider the composition of boards because a board's effectiveness in corporate administration depends *inter alia*

1/ See references on this in Chapter 2.

2/ Except that the board may fill casual vacancies or appoint additional directors. Art.95.

3/ See, for example, Arts.98-109, Table A.

on its size, the balance of "executive" and "non-executive" members [1/] their qualifications, and so on. A combination of some or all of these factors helps in determining the *de facto* role of the board.

(i) The Problem of Size:

As the law does not fix a maximum number of directors for companies the number in each company depends on individual needs. The Bullock Committee in 1975-76 analysed the boards of The Times 1,000 companies with a view to finding out the size range of company boards and how many of them had non-executive directors and in what proportion. [2/] The study showed that of the companies studied only 46 had more than 15 directors, and over 755 had ten or less. The analysis confirmed the common generalisation that small companies tend to have small boards of directors while large companies have large boards. [3/] Of the 184 companies with under 1,000 employees only 15 had a board with more than 10 directors. On the other hand 97 of the 155 companies with over 10,000 employees had a board with more than 10 directors. [4/]

1/ These terms are sometimes referred to, respectively, as "insiders" and "outsiders", "full-timers" and "part-timers". However, definitions for classifying directors into these categories vary and are sometimes vague. See for example, C.S.Vance, Boards of Directors: Structure and Performance (1964), 5 and cf. Harold Koontz, The Board of Directors and Effective Management (1967) 122-134.

2/ See Bullock Report, pp.63 and 64.

3/ These figures are supported by the recent Korn/Ferry Internationals Boards of Directors Study, 1980.

4/ What is an 'ideal' size of a board is debatable. Whereas Harold Koontz (at p.121) believes thirteen to be a good number, Sir Walter Puckey thinks even that number is too large. A 1978 survey by the Institute of Directors and Booz Allen & Hamilton found that most directors of 300 companies interviewed, considered 12 to be the maximum number of directors for the effective running of a large company - which comes close to Harold Kootnz's figure. This is a matter that is usually determined by the needs of each company and at any rate the latest figures available show that the average number of directors in U.K. companies is 9. (The Korn/Ferry Internationals, Boards of Directors Study 1980). The Bullock Report proposed a minimum number of 11. Details of these proposals have been discussed in Chapter 1.

As a general proposition, it is important that in order to operate efficiently and effectively a board should neither be too small to permit proper representations of varied experiences and points of view and not too large and unwieldy to allow adequate free discussion of issues before it. 1/ But where a board is weak by reason of size this has often been because it is too large and unwieldy.

A large board may result out of a desire to afford representation of varied outside interests as, for example, in financial companies where it may be desirable or even essential to have directors drawn from as wide a source as possible in the hope that they could bring their knowledge and possible custom into the board or that the board could through their influence secure assistance from outside. A board may also seek specialist representation, product representation and racial or geographical representation. In addition, a variety of interests may be represented on a board depending on the company's history or background. 2/ For example, in many cases of mergers and consolidations the board of a merged company by retaining the former directors 3/ and other ownership interests 4/ might become larger than desirable. A certain category of people whose presence unnecessarily leadsto large boards are entrepreneurs and founders of companies. Because of their earlier capital investments

1/ See H. Koontz,119.

2/ See Pahl and Winkler,op.cit. 105-106.

3/ Usually such arrangements are entered into in order to win the support of the existing directors in the merger or take-over bid.

4/ For example, a minority or nominee shareholder whose support has been instrumental to the successful outcome of the merger arrangement.

and emotional attachment to the company these executive directors are usually unwilling to retire from the board to make room for outsiders and younger people who are scarcely trusted as being capable of carrying on the business. The best that could happen in such companies is that the old man retains his seat while fresher and younger people are appointed into the board, and this ultimately adds up to a larger number than desirable. 1/

There are compelling reasons for the type of executives described above to seek representation, at least, as a temporary measure even though this might inevitably lead to an excessively large board. It is reasonable to expect that majority shareholders - corporate or individual-would seek to be represented on the board for this sustains confidence that their interests would be more adequately protected by seeking a place on the board. In the case of a take-over the new owners would seek to retain the old management especially when this is one of the most valuable assets of the company taken over. These retained directors add up to a substantial number.

Other interests that commonly get places on the board include major suppliers and directors of related companies who may influence business toward the company. So also are senior members of the company's legal, accounting, or technical advisers.

1/ A remarkable example of the unwillingness of an ageing director to step down is the case in Re.H.R.Harmer [1959] 1 W.L.R.62., and also the chairman of DECCA who clung to office until his recent death.

The problem with an over-sized board is that not all the directors are sufficiently 'employed' in undertaking those basic functions which an active board should perform. Communication between the directors is poor and there is a tendency for some directors to be simply complacent or devote less attention to policies and other matters in the hope that some others are performing these functions. Usually, the executive directors are left to do all the initiating jobs and the board only meets to approve their proposals. On the other hand, a "moderately" sized board ensures that board meetings are not unwieldy, allows for free discussions and enables the sense of the meeting to be more easily ascertained, by eliminating verbosity and encouraging the members to actively partake in deliberations and so contribute to issues.

(ii) Other Constraints:

Apart from the general problem of size which precipitates a docile board or a one-man dominated board, there are a number of other constraints which affect a director or group of directors on a board, leaving the exercise of the board's powers in a few hands. The non-executive directors are particularly affected by and vulnerable to these constraints but the executives are not totally free. The constraints include the method of appointment and lack of security of tenure for directors as well as limitations of time and information.

(a) Method of Board Appointments:

The method by which directors are appointed is such that when they get onto the board they become economically or psychologically dependent on the company's executives, particularly the chief executive, and this is irrespective of whether the appointee is an executive or non-executive director. Sir Walter Puckey writes that:

"The ambition of most managers is to attain board membership, and when they do it should indicate, I believe, that they have earned it by superior management skill".* They would naturally not do anything to jeopardise their position. The fact is that executive directors do not demonstrate their superior skill *qua* directors. Their skills are exercised at pre-board management meetings and briefings, 1/ and generally, proposals are in a "finished form" by the time they get to the board. The executive director is unlikely to adopt a different line from that presented to the board by the chief executive on whom he is dependent for both his promotion to the board and even his retention of his job. The position and attitude of executives on boards were described to Mace as follows:

> "The vice-president inside-director type is in precarious position at board meeting. He just can't say anything in disagreement with his boss, so what he usually does is sit quietly and wait until he is called upon to speak. 2/
>
> ....
>
> Insiders don't ask questions or raise issues at board meetings because their points of view and contributions have all been expressed at meetings of management prior to the board meeting. All the insiders have been through the monthly performance review. Rarely - no, never - does the head of one operating group raise a question at the board meeting concerning the performance of another operating group. He would not do that at a board meeting". 3/

1/ Juran & Louden called these "rigged" meetings. They report one described to them by an interviewee: "Before a board meeting, I get together with the rest of the management team, which includes some inside directors. Our management meetings have a good deal of freedom of discussion, and we do get real challenges to everyone's views, including mine. However, we also agree that the differences in the management team should be cleared up before we go into the board meeting and that we should present a united front to the board. This is what actually takes place". At 174.

2/ At 119-120.

3/ At 120.

* At p. xii.

In some companies such attitudes are institutionalized:

> "... We have a sort of rule round here - we've even formalised it in a sense. Now, we fight like cats at the management meetings. But if any of our key inside people on the board feels strongly opposed to something the president is asking the board to approve - and again, this doesn't happen very often - rather than go to the meeting and vote for it contrary to his judgment, he just doesn't go to that particular board meeting. This is sort of a screwy idea, but that's the way its done here". 1/

Non-executives are, in this respect, only marginally better. Usually they are persons who have full-time jobs elsewhere such as executive directors in some other companies and so their non-executive directorships are only part-time. A non-executive director is, therefore, less economically dependent on the instant company than his executive colleagues, on the same board. 2/ However, some non-executives are appointed even though their skills are irrelevant to the company and sometimes for reasons which have nothing to do with the contribution they can make to the business. It may be just "because theyare old friends of the chairman, because they are the company's solicitor or accountant, because they are well-known and prestigious, because a merchant banker thought an outside name would be useful at the time of going public, etc." 3/ Although these reasons do not warrant strong economic ties, they certainly make the directors psychologically tied to the chief executive, who can always

---

1/ Ibid.

2/ The Korn/Ferry survey shows that on average non-executive directors earn £4,422 a year; £28,380 for executive directors. A 1979 survey by the Bank of England considered £7,500 to be the maximum remuneration for non-executives. Bank of England Quarterly Bulletin, Dec.1979.

3/ Pahl & Winkler, 106. The Korn/Ferry Survey confirms that these reasons are still factors for non-executive appointments.

count on the loyalty of his friends, colleagues, etc, to go along with him on the board and "rubber stamp" policies or proposals submitted for their consideration.

(b) Security of Tenure:

The problem of security of directors' appointments is related to their economic dependence on their board appointments. This affects the effectiveness of a board in the sense that directors who are dependent on remuneration from their directorships are unlikely to adopt an attitude at board meetings which would put their appointments at risk; nor would they resign in disagreement over unwise policies adopted by the board. More importantly as most directors owe their appointments to the chief executive, they are also liable to be removed at his instance at any time, for "(i)n general the chairman and chief executive [in U.K. companies are] inclined to regard board appointments as very much their prerogatives almost in the same way as Prime Ministers regard Cabinet making...." 1/

Usually in making his choice of a director, particularly the non-executive the chief executive takes into consideration whether a candidate can be counted on not to "rock the boat". One of Professor Mace's respondents told him:

1/ "The Board of Directors - A Survey of its Structure, Composition and Role", Management Survey Report, No.10 BIM 1972.

> "In the companies I know, the outside directors always agree with management. That's why they are there. I have one friend that's just the greatest agreer that ever was, and he is on a dozen boards...." 1/

It has become an accepted "ethic" of the directors' profession that the chief executive has complete power of control over the board and is not to be challenged at board meetings. Members of the board who elect to challenge the C.E.O's powers are advised to resign or do so before being asked, as opposition to C.E.O's is considered "unethical". For directors who care enough it is better to save your honour than face dismissal for failing to "toe the line". 2/

(c) Limitation of Time:

The law requires that a director is not bound to attend every board meeting although he should endeavour to attend whenever in the circumstances he is reasonably able to do so. 3/ The effect of this is that some directors rarely attend board meetings and even some of those who do, spend very little time to prepare for such meetings and generally the amount of time spent by some directors is deplorably inadequate for such an important body.

The 1980 Korn/Ferry International Survey on U.K. companies shows that on average boards meet ten times a year. If a board is to be effective and if its members are to exercise due care and prudence in

---

1/ Mace, 99.

2/ This was a recourse adopted by many directors in Lonrho Ltd. and many other DoT Reports. So did Angus Murray, the non-executive director who first alerted the Prudential Assurance Ltd. to the conspiracy in the Newman Industries Board after he failed to persuade his colleagues to the right path. The Financial Times, March 3,1980. described him as "The man who stood up for his principles".

3/ Re. City Equitable Fire Insurance Co. [1925] AC 407.

directing the affairs of a company, it is difficult to see how under normal circumstances, board responsibilities can be discharged without at least 12 meetings a year. Since board meetings last only a few hours the indication is that only a few boards spend up to 40 hours (an equivalance of one working week) for meetings every year.

Ironically, it is sometimes suggested that board meetings are meant to be short,ususally not more than a few hours - boards are not "debating societies" it is argued, and it is evidence of lack of homework on the part of the executives if an issue tabled by them to the board becomes a subject of protracted debate lasting several hours.

The limitation of time factor makes it impossible for the typical board of modern large companies to "manage" the business in any true sense. Most businesses are too complex to be managed by persons who devote only an average of ten days a year - for certainly, such complex organisations concerned with complex choices and policies cannot be "managed" on a part-time basis. [1/]

There are, admittedly, circumstances where regular, such as monthly meetings may not be required for a board to maintain appropriate contact with a company, its plans and operations.[2/] For example, regular meetings may be supplemented by enough special informal meetings to give a director adequate contact with the company. Also companies with wholly

1/ See Eisenberg, 379; Mace 185.

2/ Where there are such informal contacts, frequent board meetings become unnecessary except where simultaneous action by all directors is desired.

executive boards may need only a few regular board meetings each year. In some of such cases, a board meeting may actually not be necessary at all since what is really held is a "management meeting". Again, a number of companies operate through executive and other committees, so that the real work of the board is done by these committees. In this event the whole board may find it unnecessary to meet more than say, quarterly.

However, there is another side to the above argument. Firstly, special informal meetings cannot and should not supersede or replace board meetings as the decision-making forum for directors, and so cannot derogate from the necessity for board meetings. Secondly, holding management meetings in place of board meetings appears to encourage an "evil" which board meetings are supposed to forestall, that is "managerial autocracy". Thirdly, where a substantial part of the board's work has already been done by committees, there is a danger that non-executive board members would abdicate their directorial responsibilities and be kept further in the dark, as they are usually not members of such special committees. This would defeat the potential advantages of having them on the board in the first place.

The time constraint particularly inhibits participation by non-executives because they generally have less time to devote to each of the several companies on which they sit. 1/ This is one weakness 2/

1/ Perhaps, this accounts for their higher average number of attendances per year which stands at thirteen as against ten for the whole board, (Korn/Ferry). However, they are less likely to spend time in between meetings for the company's business and they are not usually at the management's preparatory meetings.

2/ That is, from the point of view of active board supervision.

in the system of interlocking directorates which, though now popular amongst large companies, exposes the non-executive directors to easy manipulation by the executives and managers who know more than they about the companies.

Given the other constraints which together with time limitation face them, directors need to meet more frequently than they do at present if they are to be able to change the growing conception of the board as being largely symbolic - a "rubber stamp" rather than a "rudder".

(d) Limitation of Information

Management's power to control, structure and manipulate information reaching the board is one of the serious constraints against the board's effectiveness in carrying out its monitoring or supervisory functions. In most largecompanies there is a "conscious collusion among the management.... to present a united front to the board". 1/ This strategy of information control is one which according to Pahl and Winkler is generally adopted by employees to preserve their autonomy *vis-a-vis* their organisation and, in relation to the board, is employed to the greatest effect. 2/

It is obvious that if the board is to discharge its functions adequately all relevant information has to be at its disposal. The type of information required includes both general and specific information,

1/ Pahl and Winkler, 109.

2/ At 113.

general information in this sense, meaning those about the state of the business as a whole, and specific information, those demanded on specific objectives, major expenditure, investments and so on. The entire board and the non-executive group in particular, is not in any position to gather this information by itself. In the first case, general information is accumulated gradually through informal channels, like general experience, visits to company facilities, occasional briefings, periodic committee meetings and so on. In the second case, specific information on specific issues demands careful research into data. However, the basic data and the tools for data processing and analysis are in the hands of the management and the board's needs for specific information can be met only by management. But the extent to which the management and some chief executives can go to keep information on operating details away from the board is immense. A chief executive may go so far as to impose a censorship on his subordinates and to ensure that the "over-enthusiastic" or inquisitive non-executives are kept at bay.

Juran and Louden report 1/ the experience of an outside director who at the first meeting he attended, found that the information package was actually chained to the table, so that it could not be removed by the directors. In some more generouscircumstances the information package remains on the company's premises and is not to be removed by the directors. In such circumstances, the only opportunity for directors to study the

---

1/ At 265.

information package is at the board meeting itself. As the uninformed director cannot possibly examine the information contained critically within the limited time available, it is scarcely surprising that they nod their heads in approval to virtually all the proposals. 1/

Managements' manipulative exercises are also commonly achieved through the use of committees as *circumvention devices*. Where a board makes use of a working executive or management committee, that committee usually discusses board matters in the absence of other directors, notably the non-executives who are thus circumvented in the information traffic. This grouping of insiders with information into committees in which the ignorant non-executives are not represented has become a legitimate system of restricting the flow of information from the board and so ultimately weakens it. 2/

This policy of deliberate restriction of information is often defended by executives. It is usually their contention that a distinction should be drawn between the functions of the board and the functions of the operating management. If a board is allowed access into every kind of information, they argue, members might get into operating matters and this ultimately would undermine the authority of those entrusted with the management of the company. Some executives feel that certain plans may be of a confidential nature and that government security

---

1/ 95 to 99% of items put to the company's board,according to Pahl & Winkler, go through on the nod. At 110.

2/ By contrast it is expressly provided under German Company Law (S.107(3)) that such devices cannot beused to exclude employee representatives from the supervisory board. Other manipulative devices sometimes used are described by Mace in "The Changing Role of Directors in the 1970s" (1976) 31 Bus.Lawyer 1209. For a most humourous description of manipulation in Boards and Committees, see C.Northcote Parkinson, Parkinson's Law : or the Pursuit of Progress (1979) edThe Chapter on "Directors and Councils or Co-efficient of Inefficiency",p.31.

regulations in defence work in some cases demand restriction on information. It might be dangerous, it is thought, to make such information available to non-executives who have only a small commitment to the company and whose allegiance to other outside interests may outweigh their interest to the company. In addition, it is feared that a dissident or majority group might use such confidential information to attempt to gain control or take-over the company. 1/

Another main reason that has been identified for the board's difficulty in getting important information is the fact that it has no staff of its own to evaluate, receive or gather information directly and so it has of necessity to rely on executives. 2/ If the executives refuse to cooperate with a non-executive director who seeks additional information from those presented to the board meeting, he has to take the necessary steps himself to get at them. But very often a non-executive director would not know what relevant additional information he should request, nor where to find it. Should he wish to demand information by legal action the fact that he is not sure of what exactly he wants would be a problem.

The whole question about the limitation of information goes beyond the problem of access by non-executives because even if the information were available to the chief executive it is often considered "just plain bad manners" 3/ to ask discerning questions at board meetings.

1/ The use of employee directors is particularly liable to be opposed on similar grounds, but the rule in Bents Brewery Co.v. Hoggan [1945] 2 All E.R. 570, prevents abuse by employee directors of information obtained from the board for purposes of collective bargaining. The general duty of directors not to abuse their confidence is also a deterrence to this form of abuse.

2/ See Eric Batstone, Industrial Democracy : European Experience (1970) pp.19-20.

3/ Mace, op.cit.54

This therefore involves, once again, the issue of independence of directors, their subordination and subservience to their chief executive bosses, as well as "business ethics".

When one considers that a board is the highest authority in a company's management hierarchy and that all the members are elected representatives of shareholders even if in theory only, it becomes the more imperative that every director, executive or non-executive, must be allowed unlimited and unrestricted access to all available information on every material aspect of the company. Since the board has the authority to appoint lower management one expects that the directors and not management should have to make rules about access to information about plans and operating data. It is an irony that the reverse is the case now and that executives in practice determine the amount and nature of information which gets to the board. The policy of giving only the barest minimum of information to the board conflicts with the principles of Common Law, 1/ which gives directors the right to all information about the company's operations.

4. Conclusion

It will be apparent from the above analysis that whether or not the board effectively participates in corporate governance depends on the degree to which the directors are inhibited by the several constraints described and this varies from one company to another according to individual circumstances. This means, of course, that not all boards

---

1/ See e.g. Conway v. Petronious Clothing Co.Ltd. [1978] 1 W.L.R., and the text accompanying its discussion in Chapter 6 and also M'Custer v. M'Rae 1966 S.C.253.

are ineffective, depending on the presence of the constraints to a greater or lesser degree. But because the conventional conception that all boards "manage" does not stand the test of empirical analysis one begins to see more clearly what Melvin Aron Eisenberg has described as the "dysfunctional consequences" 1/ for Company Law. These consequences are instanced:

> "For example, by proceeding from the assumption that officers play a subordinate role to the board, the rules governing the authority of officers frequently embody an unrealistically restrictive view of an officer's power of position. Standards of care, by the same token, often seem to be pitched to the outside director rather than the executive, as if the former were really running the business. In duty-of-loyalty cases the courts have often given disproportionate weight to the fact that outside directors have approved a transaction in which executives are interested, while the legislature have sometimes gone so far as to provide that approval by outside directors is sufficient to sterilize an otherwise infected transaction". 2/

The limited scope of this thesis does not permit an exhaustive discussion of the dangers which emanate from this "skew"between law and reality but one only has to look at the very lax state of the law of director's duty of skill and care and the numerous instances of breach of fiduciary duty revealed in the Department of Trade Reports and in court cases to know that the danger is real. It cannot be overemphasised that unless the basic

1/ 63 Cal.L.R. at 383.

2/ At 384. See also Leech and Mundheim, "The Outside Director of the Publicly Held Corporation" (1976), 31 Bus.Lawyer,1799 at 1804.

structure of director's participation in corporate governance is reformed all other attempts would be mere cosmetic or a "quack-cure" for the problems of boardroom participation which would fail ultimately to eradicate the disease.

CHAPTER 8

SHAREHOLDERS'PARTICIPATION IN CORPORATE ADMINISTRATION

1. The Attitude of Shareholders Toward Participation

Although in theory shareholders exercise the ultimate right to control the company by their vote at general meetings a number of surveys stretching over several years have now shown that in practice this is not so: shareholders are generally ignorant and too "passive" and "apathetic" about exercising their ownership functions and playing any significant part in the affairs of their companies. In effect, participation by the shareholders in the running of their companies is the exception rather than the rule. In the large public company shareholders are too many and too dispersed to perform the ownership functions. Apart from the problem of "quantity" which renders it impossible to have a gathering of everyone or a majority of the shareholders in a large company to attend general meetings, [1/] another reason which has been suggested for the rarity of shareholders' participation is their attitudes of general disinterestedness toward general meetings. [2/]

The most recent and detailed illustrations of these findings are contained in Who Owns The Blue Chips [3/] and Dr. Midgley's book, Companies and Their Shareholders - The Uneasy Relationship [4/] - the

1/ See Sargant P. Florence, op. cit. 213.

2/ Despite implied suggestions in recent studies to the contrary, it is to be observed from the historical analyses in Chapter 1 that the "traditional" lethargy of shareholders isn't a recent phenomenon for as far back as 1854 their general disinterestedness toward general meetings was already a cause for concern.

3/ By Vernon, Middleton and Harper (1973).

4/ (1975).

former corroborating the lackadaisical attitude of shareholders and the latter, their low attendance at general meetings.

In Who Owns the Blue Chips, the authors found a correlation between the method by which a shareholding was acquired and managed and the degree to which shareholders took active part in participation. They found that inheritance was a common cause for acquisition of shares and even where shares were purchased directly by their owners this, in many cases, was done with inherited money. 1/ The personal interviewees commonly gave as their reasons for buying shares the following: "I wanted to do something with the little money that I had saved", 2/ and "I was given some money and my father thought it would be a good idea if I bought some shares with it". 3/ Some shareholders' attitudes were influenced by family background and personal contact. For example, some interviewees whose relatives were involved in stock exchange investment were influenced toward similar investment. Some others were influenced by opinion expressed by supposedly more knowledgeable persons, and at times in very unlikely circumstances. One person described the circumstances whereby he came to be a shareholder in these words:

> "I used to go to and from the office in the train and I used to read all about shares in the paper. I used to listen to the businessmen talking and I thought that this was a good thing and I decided to save and get into the share business. I was a clerk and I had no intention of being a clerk always and so I made up my mind to get some shares. When I heard the men in the train say that such and such was a good share I bought it." 4/

1/ See Chapter 6.

2/ At p.84.

3/ Ibid.

4/ At 84-85.

A few shareholdings were said to have been started as a hobby. One shareholder stated:

> "I retired recently and I needed something to give me a full-time exercise. Something I would enjoy and give me some mental stimulus"; 1/

and another

> "I was sick in bed after a coronary for about three months. A stockbroker friend suggested that I pass away the time with a little flutter on the stock market". 2/

It is unlikely that any "full time exercise" or "mental stimulus" will derive from share ownership unless the shareholder takes active part in general meetings and follows up developments in the conduct of the business and takes keen interest in whatever information comes through from annual reports, press releases, and so on. One wonders also whether the anxiety generated by sharp rises or falls in the value of shares in the stock market would do much good to a coronary convalescent. The evidence gathered by the authors, however, indicate that shareholders who are personally active and interested in investment were more likely to have attended a general meeting or voted by proxy during the previous two years.

1/ Page 85.

2/ Ibid.

But they add

> "It is difficult to distinguish interest in the management of the Company as such from interest in the shares purely as a financial investment, but it seems that a minority of active shareholders display some concern about their companies. Not surprisingly, this does not normally extend to the point of taking a day off to go to London to attend a general meeting." 1/

There is little doubt that the principal motivation for share ownership is the desire to make profitable use of money saved or received as a windfall. Share acquisition is essentially financially motivated and the expectation is the satisfactory return on the Capital. Shareholders generally do not expect to get involved in the business of running a Company or questioning those in charge of its management, nor are they inclined to do so. Vernon, Middleton and Harper, found that a large number of shareholders took no interest in their portfolio and knew virtually nothing about them. The view of most of these shareholders was summed up in this remark:

> "I don't know anything about my shares and as long as they bring in an income I am perfectly happy". 2/

1/ Ab p. 123. Some writers often attempt to distinguish the interest of shareholders in Corporate Management from interest in their investment but this distinction is of little consequence because anyone interested in the good performance of their investments would naturally be interested in ensuring good management performance. Nor is interest in management for its own sake such a popular hobby!

2/ Ab p. 113.

While a very high proportion of the interviewees indicated that they read the Company's circulars and documents the shareholders had a wide range of reactions to them. According to one:

> "I read the company circulars and the reports very carefully and I also look at the comments in the press". 1/

Another stated:

> "It depends on how busy I am. Sometimes I put them straight into the waste-paper basket. Other times I read them through",

and another:

> "I do feel there is a shocking waste of money and effort in all the stuff that goes into the reports. I am not in the least bit interested in seeing what the factory in East Africa looks like." 2/

This attitude of disinterestedness reflects itself in shareholders' attendance and voting at general meetings as in other control activities.

Midgley's findings on the activities of shareholders indicate a fall in the trends in attendance at Annual General Meetings. Of the 37 companies whose attendance records he investigated, Midgley found that the average attendance at AGM's for 1969 was 80 shareholders. Although a few

---

1/ Ab p. 122.

2/ Ibid. T.A. Lee and D.P. Tweedie in The Private Shareholders and The Corporate Report, (1977) have found that while the annual report appears to provide shareholders with a considerable amount of information most shareholders do no more than merely skimming through. Only 28% read both Account and the Balance Sheet. Chapter 5.

large popular companies such as Guinness, I.C.I. and Marks and Spencer had over 100 shareholders in attendance the median attendance was only 47. Even this number substantially consisted of the companies' directors and employee shareholders - in fact, some companies with the highest attendance figures had many employee shareholders in attendance. Other factors that had some influences on attendance at meetings include the popularity or public image of the company, the location of the meeting and the existence of some adverse publicity, ginger group activity, scandal or other cataclysmic events. 1/ The general trend in attendance at AGM's in the last 10 or so years before the survey in 1969 indicated that the level of attendance of all shareholders entitled to vote had, in fact, deteriorated slightly.

Guinness Ltd., had the best percentage attendance of 362 members out of 38,878 and this could be accounted for by the popularity of this company's "Guinness Stouts" and other products and the fact that the company made a point of making members welcome at meetings.

The provision of hospitality for shareholders has decisive effect on the level of attendance and the conduct of general meetings. For example, Alex Rubner reported that when a new Chairman was appointed to Bowater Paper and he cancelled the free lunch which had traditionally followed the AGM's, shareholders attendance dropped from an average of

---

1/ The highest number of attendance encountered by Midgley during his survey was where shareholders were opposed to proposals to re-elect a director. See pp. 37-38.

3,000 to 350. [1] In respect of the same Company James Derriman [2] refers to how the Company had taken shareholders by special trains from many parts of the country to attend the AGM in different mills and factories or in the Royal Festival Hall. The withdrawal of these free services followed the passing of the Finance Act, 1965 under which expenses for entertainments were no longer allowed for taxation purposes. Midgley reports that the attendance for this company's AGM for 1967 came down to only 103 - some of whom probably included a number of invited non-members such as the Press and the Company's Auditors.

Extra-ordinary general meetings tend to be less well attended than AGM's especially as most companies hold their EGM's immediately after the AGM. [3] Although an appropriate number of shareholders may requisition an EGM, the legal right to do this is rarely exercised because of the considerable expense involved in time and money. [4]

Again, although shareholders have a legal right to appoint a proxy this right is rarely exercised. [5] Indeed, to Berle and Means, the

---

1/ See Alex Rubner, The Ensnared Shareholder. (1965) 133. But he criticises such hospitality as "a fatuous disposition of mind" which is essentially a patronising attempt by directors to divert shareholders' interest from high dividends. This criticism is rejected by James Derriman, Company - Investor Relations. (1969).

2/ Ibid. 106.

3/ The wastefulness of this practice has been drawn out in page 231 supra.

4/ See supra. Chapter 5, p.233

5/ The right to vote by proxy is examined in p. 262.

right to vote by proxy marks the beginning of the weakening of shareholders' power of control over the direction of the enterprise. Although designed to enable the absentee shareholder to attend and vote at general meetings through someone else of his own choice "in reality...

> The proxy is almost invariably a dummy chosen either by the management [or other body] seeking to assume control. The proxy machinery has thus become one of the principal instruments not by which a stockholder exercises power over the management of the enterprise, but by which his power is separated from him". 1/

The obligation under the General Undertaking of the Stock Exchange for listed Companies to provide their voting members with proxy forms has not had any remarkable effect in generating greater use of proxies. Midgley reports that in Companies where no proxy form was provided members did not on their own submit any. Even where forms were provided by the Company the level of submission varied considerably according to the ease of completing and submitting it. A form which is printed on a page of the Company report and which could be cut out, inserted in an envelope and addressed was much less likely to be returned than a detachable, stamped addressed postcard. 2/

Further reasons which have been suggested for lack of enthusiasm by shareholders in corporate governance is the fact that most shareholders, including the business-like and intelligent are unlikely to attend to the business of any one Company in which they have shares, because they also have shares in many other companies in all of which they could not possibly be closelyinvolved. Moreover, the vast majority of shareholders usually hold

1/ The Modern Corporation. (1968), 129.

2/ At 51.

a very small proportion of the total voting capital and so one member's vote could not possibly have any impact on the decision reached were he to attend the general meeting. 1/ As for the appointment of a proxy this has always been regarded as a formality, not only by shareholders, but even by corporate officers, as Midgley's survey indicates. He reports the statement of a Secretary who told him that:

> "The issues and return of proxies for the normal routine items of an AGM, is of course, a pure formality, as the resolutions are almost invariably dealt with on a show of hands: one can, therefore, perhaps forgive the 90 per cent who do not trouble; one interesting fact, however, is that of the 820 who returned their cards, 343 failed to stamp them!" 2/

The fact is that directors do not normally wish shareholders to be actively involved in the conduct of the company. In a letter to the Financial Times 3/ a writer derides the conduct of the Chairman of Lonrho Limited at their last AGM in which he was reported as answering questions "brusquely". The writer came away from their AGM depressed by the attitude of the "platform" to critics. "Sycophantic pleasantries from the floor were lapped up. Critics were given short shrift, pertinent questions were considered impertinent,the chief executive was mute". This attitude was corroborated by another writer 4/ who said he had attended many AGM's at all of which he had spoken, commented on proposals and sometimes had criticised excessive auditors' renumeration, while the majority of other shareholders neither expressed their support nor dissent.

1/ See Florence, 216-217.

2/ Midgley, 51.

3/ 15 May 1980.

4/ Financial Times, May 28 1980.

However, he often meets with "harsh criticism, after meetings for exercising shareholder rights".

In short, most Chairmen are apt to believe that it is when shareholders take active interest and turn out at AGM's in large numbers that you look out for trouble. 1/ To guarantee shareholders' passivity and minimise their intervention in the "programmed" format of general meetings directors have striven to maintain a bare minimum level of profit and pay dividends at regular intervals, even though this may be only a fraction of, say, the auditors' fees. The history of businesses in post-war period, particularly the behaviour of businesses in the 1950s show this clearly. With the increase in Consumer demand and the relaxation of government control during that period directors were enabled to pay shareholders rising dividends without generating strong incentives to intervene in the affairs of the Company. The divorce of ownership from management became very glaring. The director

> "regarded the company as his company. Dividends and lip service had to be paid to shareholders once or twice every 12 months, but for the rest of the year management, often fiercely loyal to the concept of "Our Company", preferred to ignore shareholders and to get on with the job." 2/

Whenever directors need shareholders' votes they are able to use the Company funds to communicate with them and solicit their support. 3/

1/ Derriman, op,cit. 94. Or else some Chairmen regard shareholders who attend as mere "cranks" and "busy bodies". Florence, 219.

2/ H. Redwood, "The Fisons Shareholder Survey". Long Range Planning, April 1971, 3.

3/ Peel v London and North Western Rly Co. [1907] 1 Ch. 5.

The Company circular or report would usually request the shareholder to express support for the management proposals by returning the completed proxy forms. And because the directors are usually the ones who fire the first shots in a proxy battle, they can generally count on receiving enough proxies in their favour to defeat any opposition.

It is, therefore, only very rarely that there is a dissentient shareholder or group of shareholders willing or able to take on management in the proxy battle. All these problems which confront shareholders in the modern company are well described by Maugham, J in Re: Dorman Long & Co. Ltd., and Re South Durham Steel & Iron Co. Ltd. 1.

> "In these days, in many of the cases that come before me, only a fraction of the persons who are concerned can get into the room where the meeting is proposed to be held, and in the great majority of cases the proxies given to the directors before the meeting begins have in effect settled the question of the voting once and for all. It is perhaps not unfair to say that in nearly every big case not more than five per cent of the interests involved are present in person at the meeting. It is for that reason that the Court takes the view that it is essential to see that the explanatory circulars sent out by the board of the company are perfectly fair and, as far as possible, give all the information reasonably necessary to enable the recipients to determine how to vote ... In a sense, in all these cases, the dice are loaded in favour of the views of the directors. The notices and circulars are sent out at the cost of the Company, the board have had plenty of time to prepare the circulars, all the

---

1/ [1934] Ch. 635, 657-658.

facts of the case are known to them, proxy forms are made out in favour of certain named directors and, although it is true that the word "for" or "against" may be inserted in the modern proxy form, the recipients of the circulars very often are in doubt as to whether the persons named as proxies are bound to put in votes by proxy with which they are not in agreement".

It is of course, management's practice to determine most matters on a show of hands and the occasion rarely arises where they might consider "rigging" the proxy votes. Observations of the actual mechanics of shareholder control leads Dr. Midgley to write in a recent paper:

"The low level of shareholder participation points to what might be described as the procedural facade of company control rather than to lack of responsibility on the part of shareholders, though fecklessness is often attributed to shareholders by those who find it convenient to perpetuate this myth. In fact it is probably nearer the truth to say that shareholders are realistic rather than irresponsible about formal control procedures. For most companies, in most situations, the ritual of the Annual General Meeting and the voting machinery provides little more than a pointless charade, and shareholders, private and institutional find other means of exercising influences...". 1/

The extent of these influences is considered later.

1/ Dr. K. Midgley "To Whom Should The Board Be Accountable... And For What" in Corporate Governance and Accountability" (No.1). (1979) 15, 17 and also Midgley "How Much Control do Shareholders Exercise?" Lloyds Bank Review (1974). 37.

2. Shareholders' Activism.

On a number of occasions, some major financial institutions with a large concentration of share ownership - and votes - have been able to challenge the Management of the Portfolio Companies, but as will be seen below intervention by Institutions is an 'off-stage' affair. On some other occasions the votes of small private shareholders have been mobilised by "ginger group" activists and umbrella organisations like the Shareholders Protection Association, The Association of Investors Ltd. and so on. Outstanding in the organisations which have emerged to champion the cause of the private shareholders in this country were the Investors Protection Facilities Limited formed by Sir Julian Hodge in 1955 and Shareholders Association Ltd formed by Miss Freda Spurgeon in 1964. In The Ensnared Shareholder, Alex Rubner, recalls one of Sir Julian's most spectacular interventions as follows: 1/

> "This modern Welsh wizard contrives to obtain a higher purchase price from company raiders. His biggest success was in 1957 when Massey-Ferguson sought to obtain control of Standard Motors. The Chairman of Standard Motors backed the offer, and Massey-Ferguson started with the initial advantage of owning 25% of the 25m votes. Hodge was able to rally 12m votes against the bid, and this beat off the attack. Later Massey-Ferguson tried to obtain control through the back-door... but again Hodge's intervention aborted the attempt". 2/

1/ Julian Hodge is reputed to be one of the most active "nationally known Champion(s) of minority shareholders in Britain. His most frequent appearances were made during take-over bids and his biggest success, according to Rubner, was in 1957 when Massey-Ferguson sought to obtain control of Standard Motors. See Rubner, 139. (Pelican Edition).

2/ Ibid.

In Rubner's general view, however, the "ginger group" was not very effective 1/ as Hodge began to "mellow with age" after its formation.

Midgley also recounts how Sir Julian's and Miss Spurgeon's ginger groups soon ran into difficulties. In the case of the latter, she relinguished her leading role in the ginger group after six years of efforts. The reasons, as Midgley writes is that

> "she was disillusioned with what she referred to as 'the collective apathy of most shareholders', the failure of the Association to be self-supporting and the unhelpfulness of officialdom' which makes enforcement of company law such a farce that exposing fraud is virtually a waste of time". 2/

She is reported to have later joined what she referred to as a partnership of "Company Doctors" having come to understand that prevention of mismanagement through the board is better than cure via shareholder activisms, *ex post facto*.

1/ Ibid. See also Peter MacMahon 'Shareholders Put To The Test' Social Audit, (1974), 4.

2/ Companies And Their Shareholders. 71.

In Rubner's general view, however, the "ginger group" was not very effective [1/] as Hodge began to "mellow with age" after its formation.

Midgley also recounts how Sir Julian's and Miss Spurgeon's ginger groups soon ran into difficulties. In the case of the latter, she relinguished her leading role in the ginger group after six years of efforts. The reasons, as Midgley writes is that

> "she was disillusioned with what she referred to as 'the collective apathy of most shareholders', the failure of the Association to be self-supporting and the unhelpfulness of officialdom' which makes enforcement of company law such a farce that exposing fraud is virtually a waste of time". 2/

She is reported to have later joined what she referred to as a partnership of "Company Doctors" having come to understand that prevention of mismanagement through the board is better than cure via shareholder activisms, *ex post facto*.

1/ Ibid. See also Peter MacMahon 'Shareholders Put To The Test' Social Audit, (1974), 4.

2/ Companies And Their Shareholders, 7].

The demise of those two groups did not at any rate mark the end of ginger groups for there is a proliferation of them, amongst which is the BSAG in Burmah.[1/] It is, however, by no means surprising that shareholders' intervention have commonly arisen where the issue at stake involves far larger sums of money than the very large sums needed first to attract the shareholders' attention and support or in take-over situations. Peter Macmahon recalls [2/]. the occasion when two shareholders in Burmah Oil Company invested about £70,000 in a campaign to oust the management in the belief that under a new management with new policies the company's share would have gained an upward revaluation of at least £2 per share. The principal backer of this scheme who owned 850,000 Burmah shares stood to gain a lot from its success.

In 1972-73 the small shareholders in the shipping group P & O successfully voted against the proposed merger with Bovis. Even then a vast majority of the P & O shareholders were ignorant of the issues involved in the take-over bid. A survey of the shareholders carried out by The Sunday Times concluded that

---

1/ The activities of this group was referred to supra p.247. Others like the Battersea Redevelopment Action Group in Morgan Crucible Ltd have been in the news lately. The Financial Times, June 30 1980 reports, that Morgan Crucible Co. was planning to take legal action against the Ginger Group for continuously opposing the Company's redevelopment plans and challenging the Chairman at AGM's. An injunction was sought to restrain the group from attending the 1980 AGM. The attempts by a "ginger group" to reconstruct the board of Milford Docks, the troubled Port in South Wales is reported in the Financial Times, Jan. 8 1980.

2/ In "Shareholders Put To The Test", Social Audit, Vol. 1, No. 4 Spring (1974), 2,3.

> "...the great majority of them had not the faintest clue, at any given moment, who they were voting for, or why, or whether it would cost them money or gain it. 1/

Besides their impact in take-over situations the only other way in which private shareholders have been able to influence their companies' managements' decisions is indirectly through the effect of their sale or purchase of shares, thereby influencing the value of the shares. A weak share price exposes the company to a take-over or merger and the prospects of these make management more amenable to shareholders' feelings. However, the net result of this form of intervention is always uncertain and may not always be advantageous to the shareholders. 2/ Moreover, where a company has enough retained earnings for self-financing it is less dependent on and less affected by the difficulties of a weak share market.

While the impact of small shareholders has thus been minimal in intervention cases the same cannot be said of Institutional Shareholders. The erstwhile belief that Institutions are no more active than private shareholders are, can no longer be supported. But because their intervention has never been universally acknowledged or even deemed desirable, the extent to which they do or should participate in corporate governance

---

1/ Cited by Peter Macmahon, Social Audit, Ibid, at p.3. It is obvious that in some cases shareholders are also actuated by sheer instinct to support management irrespective of what the issues are. It may be recalled that in the Lonrho Affair of 1973 and the Newman case in 1975 the general meeting had given their unreserved support to the Chief executives even though later revelations were to confirm the criticisms of the opposition.

2/ See The Wilson Report, para. 896.

has never been agreed in the literature. 1/ Indeed, it is yet to be fully explored. 2/ The next parts of this chapter will therefore examine the mechanism and extent of Institutional shareholders' participation in corporate governance.

3. The De Facto Position of Institutional Participation.

Although the vote is obviously of great importance, undue emphasis seems often to have been devoted to it as the machinery for shareholders' control. It is true that aside from matters falling within the day-to-day administration of corporate affairs, management cannot, at least in theory, lawfully take any decision or pursue any policy unless and until such decision or policy has been approved by a vote of the board of directors and in matters involving major or fundamental changes by a vote of the shareholders in general meeting. There are, however, instances in which management takes certain courses of action on which there has been no vote or which may only be subsequently ratified by vote.

The erroneous equation of the vote with power to participate in corporate decision-making has led to frequent assumptions 3/ which

---

1/ Some managers of investment institutions do not see it as their function to intervene in the running of Companies; See Midgley, 50; Wilson Report, 901. See also "Pension funds Should Concentrate on Pensions and not try to run British Industry" The Guardian April 28 1979. The contrary is by far more popular.

2/ See e.g. Richard Briston and Richard Dobbins, The Growth and Impact of Institutional Investors. A report to the Research Committee of the Institute of Chartered Accountants in England and Wales. (1978), who call for further study on this topic, pp.5. 54-77.

3/ See below.

are not completely true either in relation to the individual private shareholders' or institutional shareholders' participation. These assumptions will be examined against the actual mechanics of institutional participation.

Studies of the role of institutional investors 1/ have come up with the conclusion that apart from a few controversial instances such as the events leading to the dismissal of Sir Bernard Docker from the Chairmanship of B.S.A. Ltd., institutional shareholders are no different from private shareholders as regards attendance and voting at meetings. Institutions, it is said, prefer to use "velvet gloves" and too often give automatic support to management and their proposals. They are believed to live by the so-called "Wall Street Rule" 2/ - an euphemism which describes the attitude commonly adopted by institutions summed up in this statement.

> "When we buy into a corporation, we buy management. We, therefore, support management as long as we are in a corporation. If we don't like management, we sell". 3/

1/ For example, Midgley, op.cit, Mark Weinberg, "Industry and Shareholding", paper prepared for a Seminar held on June 4 1971 and published by the Industrial Education and Research Foundation; Dobbin and McRae, op.cit. Chap. 2.

2/ See Baum and Stiles, <u>The Silent Partners</u>. op.cit. 63-66 and Midgley, 77-81.

3/ See Baum and Stiles, ibid.

Midgley cites the remarks of a company secretary who told him that "... it has not been the practice of the larger institutional stockholders in this country to attend or participate in the meeting." 1/ Of course, there is no use in attending a general meeting, since management already has the institutions' support and it is more convenient in that case to send in proxy cards to support management's proposals.

Institutions often claim, as an excuse, that they are in the business of investment and not the management of companies in which they invest. This was the essence of the Insurance Company Association's evidence before the Wilson Committee, in which they explained that

> "their activities as investors should not be considered in isolation from their primary function of providing a service to policy holders. Their role as investors is the result of the service they provide, not the object of their existence, and this fact is reflected in the prudential constraints imposed, externally and internally on their investment policies." 2/

Similar sentiments were expressed by the National Association of Pension Funds who stressed in their evidence that

> "their investment policies must be judged in the context of their duty toward pension scheme members. The objective of a pension fund is to maximise the rate of return by investments which involve an acceptable level of risk and have regard to the nature of the liabilities. As trustee funds bound by legal restraints they cannot take too wide a view". 3/

1/ Midgley, 50.

2/ Committee to Review the Functioning of Financial Institutions, Progress Report, (1979), p.22, para. 75.

3/ At para. 77.

Adolf Berle, in Power Without Property [1] typically overstates the weakness of institutions in the following passage:

> "There is ample evidence for the proposition that the institutional holders of common stock do not use and do not wish to use, the voting power of the stock they have accumulated. They do not get together to concert action. They do not as a rule enter into proxy fights. They almost invariably vote their stock for the management slate. When they seriously dislike the managements of corporations in which they have holdings, their policy is to sell. Therefore, they say, "We cannot be considered part of the power pyramid", and they say it in all sincerity." 2/

Remarks as these provide the critics with the bases for charging institutional investors for not intervening in Corporate affairs. Were the attendance and voting at general meetings the only modes of intervention or participation this charge would be true, but as there are other approaches open to them institutions in actual fact wield more power than they have openly admitted. To see the vote as the only weapon in their arsenal is to ignore the interplay of many potent forces that come to play behind the facade and which institutions apply with utmost effectiveness.

1/ (1960)

2/ P. 55. See also R.A. Gordon, op. cit, who claims that "insurance and investment companies and certain other types of institutions are frequently not in a position to exert much influence through ownership". At p. 36.

It ignores the commercial imperative for investors to maintain the closest attention to and concern in the administration of the business enterprise as well as the enormous influence from informal contacts and other individual or collective measures which institutions have now been known to exert in order to achieve desired objectives. These factors are considered below.

4. Factors That Motivate Institutions To Participate

The Obligations on Institutions:

Although investment institutions as a rule like to have a reasonable spread of their assets in different companies and in the case of the larger ones, to not more than 5 per cent, the latest figures available (1975) indicates there were already 23 holdings by insurance companies of more than 5 per cent in the 165 U.K. companies which then had equity capital with a market value of more than £40 million. 1/ Under such a situation in which there is a lot at stake, institutions are obliged to ensure optimum use of their investments by an efficient and competent management.

Predicting the future role of institutions in corporate management in the 1970's Dr. H. Redwood of Fisons Ltd., underlined this commercial imperative when he wrote in 1971 that

> "The increasing concentration of share ownership through the medium of the institutions is gradually organising shareholders into a potentially cohesive movement. This movement

---

1/ See Wilson Report, 897.

> is forming reluctantly, almost involuntarily. The more traditional institutions do not particularly want to exercise an active voice in industry but the pressure of competition and the responsibilities which institutional management carries on behalf of its own prime investors, are propelling the movement inexorably towards the use of its growing power to influence management. 1/

Speaking on the same theme in 1979 the Governor of the Bank of England in an address to the Institute of Directors described the inevitability of intervention very concisely:

> "In a situation where institutions hold approaching 50 per cent of total listed United Kingdom equities, and where in some companies the holdings of the major institutions are sufficiently large for it to be impossible to dispose of their holdings without sharply adverse price movements, it may well be a matter of simple self-interest to seek improved performance, which in turn may well coincide with the national interest". 2/

1/ The Fisons Shareholders Survey. (1971) p.3. See also Briston and Dobbins, 56.

2/ The Rt. Hon. Gordon Richardson "The Joint Stock Company - Adapting To Change", in The Director. Feb. 1979, 63, 64.

It has become increasingly necessary for institutions to judge management performance and take whatever measures they deem appropriate in the circumstances. As institutions generally tend to undertake long-term investment it is not in their interests that shares should be immediately disposed of even assuming such recourse were readily available in a troubled company. If a portfolio company gets into serious difficulties institutions with substantial holdings can seldom dispose of them unless at considerable financial loss. Even when the difficulties are less evident it is in the interest of at least the large institutions, if not the whole Company, to commit their resources to trying to improve a Company's management, rather than simply disposing of their holdings, as shares sold by one institution are almost invariably taken up by another. 1/

Apart from purely commercial considerations there is also a legal obligation on managers of investment institutions to investigate the company both before and after investing in it and this is an obligation owed to all their own members. Briston and Dobbins write that:

> "In order to protect theinterest of policy holders and pension fund contributions, insurance companies need to involve themselves in corporate management alongside representatives of employees and consumers. Investment trust companies and unit trusts have similar responsibilities to their shareholders and unit holders. 2/

1/ Wilson Committee's Report, para. 898.

2/ Op.cit. at 54.

Directors and managers of investment companies are not unmindful of legal action by their own shareholders who suffer losses in their investments as a result of questionable transactions and negligence to safeguard their investments. 1/ For this reason alone, managers of investment institutions would hardly feel safe to abandon every aspect of the affairs of the portfolio company entirely to its incumbent management, unless they are satisfied with the policies currently being pursued. Nor would they readily cast their votes in support of management's proposals unless they are satisfied about its efficiency.

One important instance in which this obligation would arise is where there is a proposal for a structural change to the business, for example, a disposition of a major or valuable aspect of the company's business or a replacement of the entire board. While institutional shareholders' reluctance to intervene might be excused in cases of the latter kind on the grounds of difficulty in finding suitable replacement for the dismissed directors, reluctance can hardly be excused in cases of the first kind. In this respect there is a clear fiduciary obligation on institutions to use their best judgements to ensure that a vital part of the Company's business is not siphoned away. It is submitted, that a case can be made out against the directors of institutions by their own shareholders, policy or unit holders for consequent damages, resulting

---

1/ See Heyting v Dupont [1964] 1 W.L.R. 843 where the Court of Appeal left open the question whether Controllers should be liable for misfeasance without fraud. Pavlides v Jensen [1956] Ch. 565, however, remains an obstacle to derivative action but the recent case of Prudential Assurance v Newman Industries (No. 2) [1980] 2 Ch. D.841 may open new scope in this area.

from failure to fulfil this obligation. 1/

5. Methods of Intervention

1. Informal Contacts.

Perhaps the commonest way in which institutions involve themselves in corporate governance is through the informal contacts which they have with management of portfolio companies. 2/ Institutions often try to avoid confrontation with the board of directors in companies in which they have invested as this tends to undermine confidence in that company and so do more damage than the one they sought to correct in the first place. Their preference is to act "behind the scenes".

Midgley reports one investment manager he interviewed as stating that his insurance company had over a period of 18 months to December 1971 intervened in 25 cases but little publicity was given to the interventions. One large pension fund which testified before the Wilson Committee reported that it held talks with 300 companies on a regular basis, making at least one visit a year to each. The Committee, however, thought this the exception rather than the rule. 3/

1/ The problem for the plaintiff would, however, be how to prove causation. Also De minimis non curat lex. But as Eisenberg submits, (57 Cal. L.R. 1,50) "unless an institutional investor is prepared to sell every time a structural change is proposed, it is under a fiduciary obligation to use its best judgement in voting on the matter".

2/ See A.A.Arnaud, Investment Trusts Explained, op.cit, (1977), 118

3/ Wilson Committee Report, para. 900.

Judging from the evidence available and the figure of 300 cited to the Wilson Committee, (their reservations about it, notwithstanding) one is inclined to believe that institutions have merely been publicity-shy, not generally inactive. It has often been argued that publicity in cases of intervention would be counter-productive, but one wonders whether Companies' equities in the U.S. have any special immunity against adverse publicity. Judging by the huge publicity received by cases of intervention in that Country [1/] one is inclined to believe that the relatively smaller publicity in this country may not be so much-for fear of its adverse effect on equities as what Professor Gower has referred to as the "national characteristic", [2/] in this respect, the tendency of Britons to be too "diplomatic" in situations likely to evoke controversy and publicity.

Secondly, institutions, it would appear, show a marked preference for informal, behind the scene, contacts where there is a stronglikelihood that any moves initiated by them is likely to be defeated by a board backed up with a huge bulk of votes. For this reason they were never able to confront openly the domineering Chairman and Board of DECCA about the need for change, until events decided the recent take-over by RACAL. [3/]

1/ Of which the most celebrated is the crisis in Montgomery Ward that culminated in the retirement of Sewell Avery. This episode is discussed by Baum and Stiles, op.cit, 70, Midgley, 78, Gower (1955-58) 11 Business Lawyer, 52 and Eisenberg 57 Cal. L.R.1.

2/ See Gower, Ibid, 39, 53.

3/ On this point see the Financial Times. Jan. 19 1980. The events leading to the take-over of Decca by Racal was mentioned briefly in Chapter Two. Wide newspaper coverage was given to this episode. Apart from the numbers already cited, See also the Financial Times for Jan. 26, Feb. 2, Feb. 5 and the announcement of Racals successful bid in Feb. 15,1980 .

This, notwithstanding, a number of recent cases have now established beyond any doubt the willingness of institutions to come out openly to oppose management where informal contacts and prodding prove futile.

The first is the "novel" action by the Prudential Assurance Company against two directors of Newman Industries, Messrs Alan Bartlett and John Laughton. [1/] The action arose from the two directors' conspiracy and attempt to "trick and mislead" shareholders of Newman Industries into accepting a deal which was not in the financial interest of the company. The deal involved a take-over by Newman of assets of Thomas Poole Gladstone China (TPG). T.P.G. which had a 2[illegible].6% holding in Newman was itself 33% owned by Strongpoint (S), a company wholly-owned by Messrs Bartlet and Laughton. In June 1975, a deal was constructed and signed by Laughton without approval from Newman Shareholders to buy a package of T.P.G.'s assets. These assets excluded the Newman shares and a £100,000 debt owed by S. In consideration Newman was to assume all TPG's liabilities amounting to £1,117,000 and a payment of £325,000 in cash. Later that month Mr. Bartlett sent a circular to Newman Shareholders which the Prudential, a minority shareholder, claimed had been intended to induce the approval of the scheme, designed to benefit T.P.G. at the expense of Newman. Despite objections by the Prudential and one of the Newman's non-executive directors to the scheme the two directors went ahead and were able to secure the approval of the general

1/ Op.cit. The two men were the Chairman and Vice-Chairman of Newman Industries Ltd respectively. The celebrated case which took nearly five years to complete was delivered in a 250 page judgement over a period of one-and-a-half days. Costs for the action was estimated at £750,000 and the two directors were expected to pay damages of at least £450,000. This case, involves at any rate, more of directors' fraud than mismanagement.

meeting. [1/] The Prudential instituted the action.

The trial judge Mr. Justice Vinelott observed that a shareholder reading the "tricky and misleading circular" would be quite unable to form any assessment of the merits of the transaction in question.

The accounting firm of Deloitte & Co. who were asked by Newman to value the TPG package, were misled by the dishonest statements or concealments of material facts by Mr. Bartlett and Mr. Laughton and increased their valuation from £235,000 to £325,000 after a telephone conversation with Mr. Laughton - a figure far in excess of the true market value of the assets. The Judge remarked:

> "He (Mr. Bartlett) knew that if the true facts as to the financial position of TPG, and the market value of its assets became known to the Newman board and shareholders there would be no prospect that they could be persuaded to accept them at a price sufficient to enable him to salavage TPG and avoid embarrassing disclosures of the use made of TPG's and Newman's money...
>
> "Having embarked upon the scheme it was carried through with the cooperation of Mr. Laughton by means which involved the deliberate deception of the board and shareholders of Newman". 2/

1/ In a way, this compares with the fact that during the Lonrho crisis in 1973 the company's general meeting passed a vote of confidence on Mr. Tiny Rowland and his policies and dismissed the eight directors who had opposed his policies and yet these directors were quite justified in doing this from the legal point of view.

2/ As reported in The Times Feb. 20 1980.

It was held that the Prudential and other shareholders had suffered damage as a result of the conspiracy. Prudential prevailed but at a greater personal cost than most private shareholders can afford.

The second case of intervention is that of the National Association of Pension Funds (NAPF) in Allied Breweries. The events involved started when Allied Breweries obtained shareholders' approval to increase its authorised capital by 25 per cent, but then used that spare capital to issue shares for the take-over of J. Lyons. The N.A.P.F. one of Allied's large shareholders argued in objection that such a large diversification of Allied's business into J. Lyons 1/ would have needed the prior approval of the shareholders. While the talks were still going on N.A.P.F. closely monitored companies seeking to increase their authorised capital by 25 per cent or more. It won assurances from the boards of such companies as Metal Box and Unigate that they would not do as Allied. The dispute between Allied and N.A.P.F. eventually led to the introduction of changes to the Stock Exchange regulations imposing tighter controls on directors who make big acquisitions without seeking shareholders approval. 2/

1/ Food manufacturers, Hoteliers and Caterers with International Operations.

2/ The new regulations are contained in the revised "Yellow Book", the Stock Exchange's list of regulations governing quoted companies. The regulations require prior shareholders approval if the company to be acquired had assets or pre-tax profits amounting to 25% or more of the enlarged group. In addition, the shareholders would have to approve take-over where the price, either in shares or cash, equals a quarter or more of the bidder's assets or earlier equity base.

A third example, is the highly publicised intervention, again, by the NAPF in Lloyds Bank which led that Company to abolish its antiquated article which permitted the issue of shares with restricted voting rights. 1/

These cases show the readiness with which large institutions are now prepared to come out openly to intervene in portfolio companies. The Prudential Case, in particular, has broken new grounds and proved that institutions do not always vote with their feet. But it is still far from certain that institutions would be prepared to act in every case of management's wrongdoing. As *The Times* Editorial surmises:

> "If it is a matter of managerial incompetence, rather than the issue of 'tricky and misleading circulars', the questions for the fund manager will be what they have always been; whether to stand and fight or sell the problem on to someone else". 2/

Be that as it may, one can only wonder whether action as that taken by the Prudential can be motivated by general good to all shareholders or only by special benefit hoped for irrespective of incidential benefits to others.

(ii) Presence and Silence as Signs of Approval

It is not only by positive action that investment institutions can participate in influencing the direction of the company. Their mere presence has a way of affecting the management of the Company. Most

---

1/ See p. 257 supra.

2/ The Times, Feb. 20, 1980.

investment institutions are very reputable financial experts whose business judgements and associates are well respected and their presence in any company is regarded as a sign of approval in that Company. Smaller investors often feel that if the larger and reputable institutions are in one company then such a company must be a safe place to invest and its management must be trustworthy. This way more potential shareholders are attracted. 1/ It is generally believed that if the management were inefficient or if the profitability of the Company were in doubt, then institutions would not be there in the first place or that they would pull out their investment as soon as things go bad. This would be a signal for smaller shareholders to do the same. By their presence, therefore, institutions create a good impression about the Company and literally give it a good name!

Even their silence can in certain circumstances be demonstrative of institutional shareholders' support for management's formulations or proposals. For instance, at the 1979 AGM of Mercantile Investment Trust Company a resolution was tabled by dissentient 'rebel' shareholders calling on the company to commit a corporate *hara kiri*, that is, for voluntary liquidation, unitisation or an agreed bid. The resolution was heavily

---

1/ There is, however, no concrete evidence to suggest any inclination amongst U.K. institutions toward a concentration in "favourite" top companies as there is in the U.S. See Briston and Dobbins pp.2-3 and passim. But Pension Funds say they are now being forced by circumstances to concentrate upon those companies with a large market capitalisation in which there is a viable market. See Wilson Committees - Interim Report, Vol. 3, p.142, para. 48(1).

defeated. 1/ The remarkable thing about the case was that only 36 per cent of the shareholders voted while the institutions who owned 60 per cent of the equity, unwilling to support the dissentient shareholders abstained from voting. However, the apparent lethargy of the institutions was seen as a warning to the M.I.T. board, even by the act of abstention, that they had to put its house in order. 2/

Where management has established in shareholders confidence in their efficiency, it is usual for the latter, including the institutional shareholders to allow management freedom to manoeuvre by not challenging them even if the specific proposals involved in an instant case is neither easily comprehensible nor commercially feasible at least in the short run. Silence in such circumstances constitutes tacit approval. However, such a "declaration of neutrality" would have the effect of discouraging other shareholders, particularly private shareholders, who as in the MIT Company had possibly hoped to challenge management with institutional shareholders support. 3/

1/ The facts which led to the tabling of the special resolution were that the Company has for long been undergoing liquidity crises and the group led by one Mr. Christopher Campbell has constantly applied pressure on the board to devise a scheme to reduce the huge discount in the Company's share price. With the defeat of last year's special resolution the same group adopted a different tactic at the 1980 AGM by proposing an ordinary resolution urging the company to "take all appropriate steps necessary" to reduce the discount between the share price and net asset value. See the Financial Times March 13 1980. The result of this proposal is not available to this writer.

2/ See The Lex Column, Financial Times, 25 April 1979. See also the Montgomery Ward - Sewell Avery - Wolfson episode referred to, supra.

3/ Inaction in these circumstances amounts to tacit support for management. It does not abrogate their power which simply goes by default to the entrenched incumbent management.

(iii) Collective Action

Investment institutions have often demonstrated a singular lack of enthusiasm for cooperative action with private shareholders even though this is possible and desirable in principle. In practice institutions are quite reticent about such cooperation and tend to be apprehensive over the possibility that 'ginger group' leaders might fail to handle situations with the necessary finesse and tact and that undesirable publicity will result. 1/ But between themselves institutions do sometimes act by concerted action, and, indeed, have a long history of cooperation.

Cooperation amongst institutions dates back to the early 1930s when the Association of Investments Trusts and the British Insurance Association's Investment Protection Committee (I.P.C.) embarked on the collective protection and promotion of the interest of shareholder members. 2/ The initial pre-occupation of both associations was to protect their members' interests in the face of boards of directors undertaking capital re-organisation in the wake of the 1929 crash, and, in latter years the protection of members against government action as in taxation matters. In more recent times the primary concern has been how to improve the quality and efficiency of corporate management through institutional shareholders' intervention. The Institutional Shareholders Committee (I.S.C.) and the different institutional shareholders' I.P.C's have been important vehicles in achieving this objective.

1/ See Midgley, 78.

2/ An earlier attempt by a group of investment institutions to set up a Shareholders Protection Association in 1864, proved futile. See J.B. Jeffreys, op.cit., Chapter 10, p. 401.

At the initiative of Lord O'Brien, former Governor of the Bank of England, a Working Party 1/ was created by the Bank in 1972 whose terms of reference were:

> "To examine and report upon a possible structure and method of operation of a central organisation through which institutional investors in collaboration with those concerned, would stimulate action to improve the efficiency in industrial and commercial companies where this is judged necessary." 2/

The Working Party submitted its report in December 1972 and all the representatives with the exception of the British Insurance Association (B.I.A.) agreed to establish such an organisation. The B.I.A., whilst agreeing to cooperate in individual cases, felt unable to be a member of an organisation of the sort proposed because it did not wish to appear as accepting the prime responsibility for monitoring and improving the management of companies and also because it was reluctant to join an organisation that it felt was likely to be prejudicial to the control of any investigations by the institutional shareholders of the companies concerned. However, after some compromise alteration to the structure and method of operation of the organisation had been agreed, the B.I.A. finally felt able to join. The Institutional Shareholders' Committee was thus created in 1973.

1/ The membership consisted of representatives of the Bank of England, The Accepting Houses.Committee, The Association of Investment Trust Companies, The Association of Unit Trust Managers, The British Insurance Association, The Issuing Houses Association, The National Association of Pension Funds and an observer from the Committee of London Clearing Banks.

2/ See Bank of England Quarterly Bulletin. (1973), 20. Emphasis Mine.

Although it is commonly assumed that the I.S.C. has been actively involved in the affairs of companies in which the members are represented it has not always been easy to find out the extent of their intervention. The I.S.C. is very conscious that cooperation of company management very much depends on the absence of publicity and, in fact, made it absolutely clear right from the onset that no public statements will be made about any of the activities of the case committees - the administrative organs through which the I.S.C. operates. However, some details were made available to the Wilson Committee which throw some light into the extent of their intervention. It was indicated that between the I.S.C's formation in 1973 and 1979 it had dealt with 37 cases, of which seven led to formal case committees and 19 were thought more appropriate for independent action. The remaining 11 had either already gone too far for anything to be done in reprieve or had been overtaken by events such as a successful take-over bid. 1/

The I.P.C's handle most cases of intervention and like the I.S.C., operates through case committees. The insurance companies, pension funds and the unit trusts each have their own I.P.C's organised and staffed in conjunction with the relevant trade association and consists of senior investment managers. The insurance I.P.C., the oldest of all, for example, has 17 members, three of whom are elected each year, and a permanent secretariat of 10. On the other hand, the investment trusts do not have a formal IPC as such, but form *ad hoc* committees to perform a comparable function. 2/

1/ Para. 912.

2/ Para. 909.

Judging by its activities through its I.P.C. the NAPF has proved itself to be a force to be reckoned with when it comes to intervention in companies' affairs. This might well be accounted for by the fact that it is a majority shareholder in some of these companies in which it has intervened. 1/

6. Conclusion.

This picture of increased institutional shareholders activities is salutary and gives room for optimism about the future role of shareholders in corporate governance. It indicates that despite their traditional reluctance to intervene institutions could yet through their increased equity concentration and power help in the corporate decision-making process and thereby improve their lot and that of weaker and smaller shareholders. Accordingly, the final part of this thesis will examine how an improved performance by Shareholders and the Board might be achieved.

1/ Their intervention in Allied Breweries and Lloyds Bank have already been noted. Mention may also be made of the Equity Capital for Industry which has most of the major institutional long-term investors as shareholders. Its prime purpose is to make funds available for companies in immediate need of capital, but it has always been envisaged that it could have a secondary role as a vehicle for affective action with shareholders, creditors, etc, if circumstances demand.

PART IV

THE PROPOSALS FOR AN ALTERNATIVE FRAMEWORK FOR CORPORATE GOVERNANCE.

The U.K. Company Law is at the moment undergoing changes with such frequency as has never been witnessed before. So far, none of the "piece-meal" legislation has affected the organisational structure of companies significantly but it is to be expected that this will come about in the near future. Having in mind the likelihood of major legislation to modify the "structure and philosophy" of the present law, especially if a Labour Government succeeds the present Administration, this Part will examine some proposals for such an alternative organisational structure.

CHAPTER 9

PROPOSALS FOR MORE EFFECTIVE SHAREHOLDERS' PARTICIPATION

1. Introduction

It is important to state here that the proposals to be considered below concentrate on how shareholders can make better use of their existing power of control. They are not proposals for increasing shareholders' powers. This, of course, is not to say that it is not important to increase or advocate the increase of shareholders' power of control. Quite the contrary, for Company law is a very dynamic subject in need of constant revision and its provisions, including those relating to shareholders control, are not in a state of finality.[1/] However, one observation of the Jenkins' Committee which is very apposite in this area is that legislation can only proceed on the basis that if enacted would be of "real value to the persons receiving it ...".[2/] One must also bear in mind the warning of successive Company Law Revision Committees about "the undesirability of imposing restrictions which would seriously hamper the activities of honest men in order to defeat an occasional wrongdoer, and the importance of not placing unreasonable fetters upon business which is conducted in an efficient and honest manner".[3/] Also

---

1/ See Prof. Kahn-Freund "Company Law Reform" (1946) 9 M.L.R. 235. See also Cmnd 1749 para. 9.

2/ Cmnd.1749 para. 13.

3/ Ibid. para.11, citing the Greene and Cohen Committees.

to be considered is the question whether any proposal to increase shareholders' rights "would involve an amount of work disproportionate to its value" which would make it impossible for the company's business to be "managed at all".1/ These are some of the points which have to be weighed in deciding whether to give shareholders greater power of control but the main interest here lies in a different direction.

2. The Proposals:

For a very long time now there has been much exhortation to private and institutional shareholders to involve themselves more in corporate governance in the belief that through organised action can they be able to affect the decision-making process. One of the best considered calls for greater shareholder activities is the proposal by the Confederation of British Industries (C.B.I.) contained in the Watkinson Report.2/ It expressed the view that "the shareholders cannot disown the responsibilities of the Company of which they are members" and suggested that

> "Shareholders, as the owners of the business, have a responsibility that extends beyond the actual buying and selling of shares. They must exercise this responsibility more fully in the future and be provided with the proper information on which they can form their judgment in so doing". 3/

1/ Ibid, paras. 13, 14.

2/ The Responsibilities of the British Public Company (Final Report). C.B.I. (1973),

3/ Para. 25.

It encouraged all types of shareholders to question Chairmen and board members at general meetings, and to write letters to companies in any matter which affects their interests. The report, on a most significant note, called out on Institutional Shareholders to "take a leading role and set an example to the whole body of shareholders".[1/] This is a role which institutions have continuously been called upon to play but which up until recently they have showed little inclination to assume. As was shown in the last Chapter the exhortations are now bearing results.

In point of fact, the institutions have by themselves done a lot to perpetuate the belief that they are neither keen nor able to involve themselves with company management owing to a number of reasons as the Wilson Committee reported:

> "In theory they could act collectively in influencing company management, but such centralisation would have disadvantages and they regard the present system, where the institutions usually act independently, as a method of decision-making better able to cope with the uncertainties that are always present in a particular situation. Individually, they do not have the Staff or expertise to become closely involved in the running of the companies they invest in, and they do

---

1/ Para. 26. The Minister of Trade, Mr. Cecil Parkinson, expressed a similar view recently. "We believe that ... institutions should be concerned not just to step in when things go badly wrong in the Companies in which they invest but also as major shareholders to keep up an active pressure on companies". Parliamentary Debates (H.C.) Feb. 26, 1980. See Financial Times Feb. 27, 1980.

> not feel they could justify to their shareholders and depositors the administrative cost of setting up such expertise. Moreover, it would be improper for a quoted Company to give inside information to an institutional shareholder that was not available to other shareholders. Their approach is to assume that companies should be left to run their own affairs on most matters, and that the true discipline on inefficient management is the discipline exerted by the Stock market, and the consequences of changes in performance and prospects on a Company's share rating". 1/

Having become familiar with the realities of institutional participation one can no longer be persuaded by these excuses for non-intervention by institutions. Surely, there might be genuine fears by institutions about running foul of the law against insider trading if they come by secret information while seeking to monitor management. After all, an important factor is fulfilling their primary obligation to their own members is the ability to move in and out of an investment and this ability will be jeopardised if they became tainted with secret information. In answer

---

1/ Wilson Committee's Progress Report, p.26.

to this it is to be pointed out that the new law on insider trading has been so carefully worded that only in cases of obvious violations would institutions be in fear of breach of the law. Indeed, the government have been at pains to emphasise that the law is merely designed to act as a deterrent and that convictions under it are unlikely.[1/] The mechanism for enforcing it leaves one in no doubt about this.[2/]

Besides, there are institutional mechanisms to make intervention less onerous or hazardous for institutions. The most important of these is the use of Case Committees for investigating Companies. The existence of a case Committee is usually known only to the consulted institutions of the relevant I.P.C. and there is no obligation on all those holding shares in the Company to join or support it. This means that the intervention can be undertaken discretely. Also institutions who elect to stay out unrepresented retain their freedom to deal without any risk of being accused of insider dealing.

Acting through the I.P.C.s and the I.S.C. also considerably reduces the amount of time and money which would be involved if only one institution or private shareholder or a group of them decided to take up the issue on their own.

1/ See the Financial Times, Feb. 27, 1980.

2/ Final Report, para. 552. (Wilson Committee.)

It is sometimes argued that the effect of greater institutional intervention than there is at present would further enhance the chances of institutions being able to benefit themselves at the expense of the smaller and private Shareholders.[1/] In answer to this it is to be noted that institutions usually monitor managements' performance by in-house analysis of published information, by reports from, and discussions with, Stockbrokers and by direct contact with the companies. There is nothing in these methods themselves which either increases or decreases the chances of getting privileged information. Admittedly, however, most large institutions, as the Wilson Committee reports,[2/] usually maintain small staffs of financial analysts, actuaries, accountants and economists, etc, at great expense. It is only natural, therefore, that they should be able at any time to form a more enlightened appraisal of the available information than private shareholders or even smaller institutions. In this respect companies can do a lot to protect the smaller shareholders by ensuring that the price-sensitive information is released to all shareholders simultaneously and that financial journalists and analysts are briefed frequently to ensure that the value of the shares relative to other companies is well represented so that small shareholders who deal can do so at a fair price. Indeed, large institutions

---

1/ See the Final Report, para. 904.

2/ Para. 899.

It is sometimes argued that the effect of greater institutional intervention than there is at present would further enhance the chances of institutions being able to benefit themselves at the expense of the smaller and private Shareholders.[1/] In answer to this it is to be noted that institutions usually monitor managements' performance by in-house analysis of published information, by reports from, and discussions with, Stockbrokers and by direct contact with the companies. There is nothing in these methods themselves which either increases or decreases the chances of getting privileged information. Admittedly, however, most large institutions, as the Wilson Committee reports,[2/] usually maintain small staffs of financial analysts, actuaries, accountants and economists, etc, at great expense. It is only natural, therefore, that they should be able at any time to form a more enlightened appraisal of the available information than private shareholders or even smaller institutions. In this respect companies can do a lot to protect the smaller shareholders by ensuring that the price-sensitive information is released to all shareholders simultaneously and that financial journalists and analysts are briefed frequently to ensure that the value of the shares relative to other companies is well represented so that small shareholders who deal can do so at a fair price. Indeed, large institutions

---

1/ See the Final Report, para. 904.

2/ Para. 899.

might even find this source of information attractive. The advantage of this would be that "reliance by institutions on stockbrokers' analyses (would reduce) demands on managements time as well as on the institutions' own analytical resources".1/

3. Potential Uses of Institutional Power.

It was urged upon the Wilson Committee that there is a danger in increased institutions' participation of creating two classes of shareholders - those who exercise the privileges and responsibilities of Ownership, (the institutions) and those who do not (the small private shareholders). Although conflict is certainly not inevitable given the proprietary right of individual shareholders to use their vote as they please,2/ it is by no means certain that in every case where institutions

1/ Para. 906.

2/ See N.-W. Transportation v Beatty. (1887) 12 App. Cas.589. But see Clemens v Clemens Bros. Ltd., /1976/ 2 All E.R. 268 where a shareholder having a dominant power in the Company (55%) was held not entitled as of right to exercise her majority votes in any way she pleased so as to injure other shareholders. Her contractual right was subject to equitable consideration which made it unjust for her to use it oppressively against a minority shareholder so as to ensure that she (the minority shareholder) would never get control of the company. It is unlikely, though, that the principle in this case will restrict the freedom of shareholders in the large company to use their votes in any manner and for whatever motive they desire.

exercise the responsibilities of Ownership, conflict will necessarily result. And while the relative imbalance between institutional and private shareholders has potentially inequitable consequences to the detriment of the latter, it is true that they also stand to benefit by a more effective use of institutions' power.

In general, a substantial community of interests exists between institutional and other shareholders. It is, for example, in everybody's interest that weak or inadequate management should be challenged and that efficient management should not be allowed to rest on its laurels. In undertaking this function the institutions will be acting in a way which is advantageous to all shareholders, big or small.[1/] However, differences might exist between the different classes of shareholders in say dividend policy. Institutions would normally adopt a long term view, while the private shareholders are often more interested in immediate returns on capital. Secondly, for all the optimism that the risks are negligible, institutions might through greater access to companies gather price-sensitive information. Thirdly, there might be conflict when the volume of institution's holdings necessarily lead them to challenge the entrenched rights of private shareholders. The recent events in Lloyds Bank may be recalled.

1/ Wilson Committee Report. para. 905.

Another obvious use which institutions can make of their powers is in the appointment of non-executive directors. Special shareholders nominee directors become relevant for two reasons. First, there is a considerable communication gap between boards of directors and company members. This is because the annual accounts and reports for reasons which have been considered are neither read nor easily comprehensible to even highly educated people. The attempt to correct this by requiring an ever increasing amount of disclosure is roundly criticised by those who rightly in this writer's opinion believe that what is needed is much simplified information "specially tailored to the needs of the ordinary shareholder".[1/] Secondly, although directors are, as of now, supposedly elected by shareholders this is not true *de facto*. It is management's own nominees that are usually approved by shareholders who rarely take any part in the nominations. It ought, therefore, to be possible to evolve a special machinery through which shareholders can thus be genuinely represented.

1/ This is one of the suggestions of the Chairman of BAT Industries as reported by the Financial Times, June 19, 1980. He welcomed "changes to simplify and clarify" presentation of corporate information, but is "less enthusiastic about adding to reporting responsibilities" which means that "already complicated reports and accounts will become much more expensive and perhaps less useful". However, his idea of minimising expenses by sending statutory information only to those who wish to receive it would be a dangerous move, whose full consequences cannot yet be fully envisaged but it will certainly make shareholders far more apathetic and removed from details about their companies affairs than they already are now.

An idea which immediately suggests itself is the introduction of Cumulative Voting, a system commonly used in many jurisdictions in the United States to enhance the chances of proportional representation of shareholders on the board. The system gives each shareholder as much votes as the number of directors to be appointed times the total number of shares he holds.[1/] Its application, to an extent, helps to prevent the situation which now operates in many U.K. companies whereby all the seats on the board can be filled up by management or a substantial shareholder[2/] who commands more than 50 per cent of the votes cast at the meeting. Although the idea has been debated in this country for a long time now, Cumulative voting is not available for U.K. Companies and it is difficult, if not impossible, for an ordinary private shareholder to pull together enough votes to appoint a director of his choice. The only shareholders who are influential and powerful enough to do this are the institutions. Their chances are even better if there is an agreement by a number of them to act by collective action.

The desirability of shareholder board representation through institutional shareholders power is acquiring wide recognition and support. J.M. Keynes, in a 1928 address first postulated the idea that

---

1/ See "Should Cumulative Voting for Directors Be Mandatory? - A Debate". (1955-56) 11 Bus. Lawyer, 9.

2/ Often substantial shareholders' votes are aligned with Management.

"Co-operative action between insurance offices, and a committee representing them might be able to play the part of the reasonable, well-informed shareholder able to make his views and wishes felt, which is at present so signally lacking in the existing scheme of things". 1/

The case for minority shareholders' nominee was give a boost by Lord Chorley's and Mr. E. Wolff's proposals in 1963 that quoted and other large public companies should have one director specifically appointed by the members to look after their interests generally and to report to them as an "Ombudsman". 2/

Fifty years after Keynes, Briston and Dobbins suggested that

"By protecting their interests as shareholders financial institutions represented on the board may indirectly promote the welfare of smaller investors". 3/

In his statement accompanying the 1977 Annual Reports and Accounts, the Chairman of Prudential Assurance included the following sentence:

1/ "Principles of Investment Policy", an unpublished address to the National Mutual Life Assurance Society, London, 25th Jan. 1928, quoted by Alex Rubner, op. cit, 150-151

2/ In Law Reform Now, (1963) op. cit. p.193.

3/ P. 62.

> "Institutional investors seem likely to develop closer contacts with industrial managements, and to do more to promote a better mutual understanding of the common long term interests of investors and the companies in which they invest".

Despite this abundant optimism one should add that unless and until a special code of responsibility is introduced or legislation enacted by Parliament for this purpose there is no guarantee that institutional shareholders or their nominee directors would always consider private shareholders and their own members' interests on an equality basis. To Prof. Pennington it is sheer delusion to think that instituions "champion the cause of the small shareholders" by adopting "seemingly altruistic positions" for example, in deciding to take legal action against directors[1/] - or, one may add, in their nomination.

The desirability of institutional shareholders' nominee was also emphasised by Mr. Edmund Dell, former Secretary of State for Trade. Addressing a meeting of the National Association of Pension Funds in Edinburgh in April 1979, he put up a firm defence of the status quo by urging the institutions to preserve their present role and structure eschewing concentration, and resisting calls to intervene in industry.

1/ R.R. Pennington, The Investor and The Law, (1968), 412.

> "Institutional investors seem likely to develop closer contacts with industrial managements, and to do more to promote a better mutual understanding of the common long term interests of investors and the companies in which they invest".

Despite this abundant optimism one should add that unless and until a special code of responsibility is introduced or legislation enacted by Parliament for this purpose there is no guarantee that institutional shareholders or their nominee directors would always consider private shareholders and their own members' interests on an equality basis. To Prof. Pennington it is sheer delusion to think that instituions "champion the cause of the small shareholders" by adopting "seemingly altruistic positions" for example, in deciding to take legal action against directors[1/] - or, one may add, in their nomination.

The desirability of institutional shareholders' nominee was also emphasised by Mr. Edmund Dell, former Secretary of State for Trade. Addressing a meeting of the National Association of Pension Funds in Edinburgh in April 1979, he put up a firm defence of the status quo by urging the institutions to preserve their present role and structure eschewing concentration, and resisting calls to intervene in industry.

1/ R.R. Pennington, The Investor and The Law, (1968), 412.

Instead of that, Mr. Dell advocated that institutions should seek an improved role for non-executive directors who will sit on the board to monitor the conduct of management.[1/] While it is apparent from evidence that the N.A.P.F. clearly rejected the argument in defence of the status quo in so far as they do actively intervene, it is to be hoped that they take heed of Mr. Dell's proposed alternative.

The role of small shareholders' protector is one which the Wilson Committee also thrusts upon institutions when it accepted the general view that "one of the most appropriate ways for the institutions to discharge their responsibilities as part-owners will, ... be to ensure that Company boards include a number of competent [non-executive] directors".[2/]

Not every one, though, supports these suggestions for special nominee directors. Shortly after Mr. Dell's speech some institutional investors were quick to voice their resentment at the suggestion openly. Frances Cairncross, a financial columnist of The Guardian, reports her experience at a Conferencc on the power and responsibility of the institutional investors in which a Chairman of one of Britain's biggest

---

1/ See The Guardian, April 28, 1979, and the Financial Times Editorial, April 27, 1979.

2/ Final Report, para. 917.

industrial companies argued forcefully for a scheme to link non-executive directors with institutional shareholders through a new City Committee. He was promptly attacked by the Chief executive of one large Assurance Company and the investment manager of another.1/

Suggestions for an increased role for shareholders derive mostly from comparison with the European experience, especially Germany, but the Wilson Committee criticised this comparison as being "unfavourable"2/ and pointed to some basic differences in the relationships between institutions and industry in the U.K. and European countries, where direct intervention by financial institutions in the decision-making process is quite commonplace. The Bow Group, for example, in their evidence to the Committee proposed "the creation of non-executive <u>supervisory boards</u> including representatives of institutional shareholders, to oversee company management and to influence the appointment and removal of directors".3/ But this was opposed on the grounds that the international comparisons with Europe were misleading:

> "in Germany for instance the bank's close involvement with industry through equity holdings is sometimes regarded as a disadvantage and the greater intervention [in the U.K.] by institutional shareholders would strike at the roots of the

---

1/ <u>The Guardian</u>, April 28, 1979.

2/ Final Report, para. 892.

3/ Progress Report, p. 26-27 (para. 89). Emphasis, mine.

limited liability concept, which stimulated the growth of industry by enabling companies to raise capital from anonymous investors and by severing the link between ownership and management". 1/ This argument was accepted by the Committee.

With due respect, one begs to defer from the above view for two reasons. Firstly, there is a greater danger that if company law persists in the belief that it is only by increasing emphasis on publicity and disclosure provisions in the statutes which publicity is often incomprehensible to the average shareholder it is this rather than greater institutional shareholders' intervention and shareholders' control, that will help to perpetrate the "mistrust felt by the man in the street for securities".[2/] Greater institutional participation is more likely to increase public confidence in the limited liability system than discourage it by helping to sustain an understanding that Ownership, if well organised, can still exercise their basic right of control over directors.

Secondly, while the Wilson Committee rightly observed[3/] that

---

1/ Ibid. In the Final Report the Committee accepted this argument in general. See paras. 892-895.

2/ Atiyah "Thoughts on Company Law Philosophy", (1965) 8 The Lawyer, 16, 18. Mismanagement and some types of government policies have been known to have greater influence on investment attitudes. See e.g. Fison's Ltd,s Profile For 1979 where some of these factors are discussed.

3/ Para. 895.

the relationship between investment institutions and industry in the U.S. is not closer than that between them in the U.K., it failed to address itself to the effect of the "important institutional differences between the two systems". These include the "higher standards of disclosures enforced by law on public companies, the use of audit committees and the greater leverage given to individual shareholders by the use of class actions and contingent legal fees", available in the U.S. but not in the U.K. As the U.K. shareholder is not exposed to such institutional control mechanisms as his U.S. counterpart it is only reasonable that control through special nominee directors would be a welcome alternative. This need not imply the setting up of a two-tier board system as such nominess can serve under the unitary boards as presently constituted. To deny them this entirely clearly puts them in a worse situation than their U.S. or German counterparts.

The use of a special shareholder nominee director raises a number of questions, particularly as regards his relations with the rest of the board and the precise nature of his functions.[1] The Wilson Committee considered this problem and warned that such directors should not be seen as representatives of the appointing institutions.[2]

1/ Reservations about his relationship with other shareholders mentioned supra p. 376.

2/ Para. 917.

The legal position of a nominee director has always been considered an "invidious one". On the one hand, he is appointed usually for a singular purpose - to promote the interests of those to whom he owes his appointment. On the other hand, he is subject to the over-riding fiduciary duties of directors to promote the interests of the whole company. The appointment of nominee directors to company boards was approved by Lord Denning M.R. in Boulting v A.C.T.AT. 1/ of which he remarked:

> "There is nothing wrong with it. It is done everyday". But then he cautions, "Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interest of the company which he serves". 2/

It is precisely this balancing of interests that gives rise to problems. In Scottish Co-operative Wholesale Society v Myers 3/ it was held that a nominee director appointed by a Holding Company on the board of its

---

1/ [1963] 2 Q.B. 606.

2/ At p.626. Nominee directors like other directors can enter into agreement which binds the board but any agreement by such director to vote in accordance with the agreement between him and his nominators would be unenforceable, as to how they shall vote at a future board meeting. See Gore Brown, Chapter 27-28.

3/ [1959] A.C. 324.

subsidiary is in breach of his fiduciary obligations if he so used his power as to frustrate the business of the subsidiary in order to help his appointors. Yet, it is quite clear that if a nominee did not do as he is directed he would lose his office. Indeed, it is not unknown for nominators to procure undated resignations from nominees and these can easily be completed to remove disobedient nominees. Moreover, a nominee director can be dismissed by ordinary resolution under section 184 by the nominator almost as easily as the appointment was made in the first place.

The contradictory (legal and moral) obligations of nominee directors have become familiar especially on the German scene in relation to worker directors and their position is likely to assume added dimension if and when employee representation is introduced into the U.K. 1/ The German-type two-tier board system it may be noted, is expected to minimise the areas of conflict and the dangers of disloyalty by representative directors by keeping separate the supervisory and management groups but in practice conflicts often arise. Under the German system the Labour or personnel director (Arbeitsdirektor) is in a particularly odd position. Every company in the Coal and Steel business is required to appoint the labour director, usually somebody who is acceptable to the employee representatives on the board of management. He is charged specifically to promote industrial relations and all aspects of safety and welfare of

1/ Already there is some concern about the possibility of such conflicts. See for example, D.D. Prentice, "Employee Participation in Corporate Government. A Critique of the Bullock Report." (1978) 56 Canadian B. R. 277, 295.

employees. It has been argued that the dual role of the labour director as an employee and as a member of the board of management creates divided loyalty. The Biendenkopf Commission [1] which looked into this question indicated to the contrary that despite the methods of their selection labour directors have never been expected and have never in fact sided with their appointors against the collective view of the executive boards. The report elsewhere indicates unamimity in decisions of the supervisory board. In fact, in two-thirds of the companies surveyed the neutral member had never been called upon to break a deadlock. [2/] In the remaining third where the casting vote had been used it was more often in favour of shareholders than employees.

1/ Biendenkopf Report on Co-determination (1970) English Translation (1977) paras. 60-61 cited by Tom Hadden, Company Law and Capitalism. (1977) p.450.

2/ See Tom Hadden, ibid, 455. The composition of German company boards are carefully structured so as to minimise conflict but this has not prevented occasional dissatisfaction. In a recent court action in Karlsruhe, Germany, 9 big companies and 29 employee associations challenged the 1976 Co-determination Act arguing that the Act by giving employee representatives numerical equality on company supervisory boards infringed the constitutional rights to private property, freedom of association and freedom to conduct business. The Court rejected all the counts, emphasising that the Act's provisions for numerical equality did not amount to parity because of the second tie-breaking vote given to the Chairman. Since he was invariably drawn from the shareholders' side, the Court noted, the ultimate control of shareholders over their Company was unaffected by the new make-up of supervisory boards under the Act. Despite the 50-50 representation of employees and shareholders on the boards, the workers were in effect at a disadvantage. Herr Otto Esser, president of the BDA (employers' federation) though disappointed with some aspects of the decision saw it as a re-affirmation of the right of management to manage. See the Financial Times, 2 March 1979.

Although the German type of board representations has been marked more by success than by failure and occasional conflicts are easily contained the dilemma in which employee directors sometimes find themselves should not be underestimated. Professor Detlev Vagts reports two decisions in which German Courts have been called upon to decide on such cases of conflicts. 1/ The first case 2/ concerned the Metal Workers Union's strike in 1955. Before the strike one of the employee members of the supervisory council had been active in urging the workers to go on strike and after the strike began he became Chairman of the strike committee and played an active role on the picket line. The other employee members of the Council also supported the strike, though less actively. The court found that this behaviour was in breach of their duty of loyalty to the company, since they had been chosen not just "to represent special workers' interests but to conduct their functions solely for the good of the company and its employees while taking account of the common welfare".

1/ Prof. D.F. Vagts, "Reforming the Modern Corporation Perspectives from the German", (1966-67) 80 Harv. L.R. 23 at 82.

2/ Judgement of January 20 1956 in 11 DER/BETRIEBSBERATER 240 Landgericht Munchen), aff'd Judgement of September 19, 1956 in id. at 999 (Oberlanders gericht Munchen), noted by Vagts in 80 Harv. L.R. 74-75.

In the second case [1], members of the supervisory council of the Hamburg Electricity Works appointed by the City of Hamburg (one of the stockholders), resisted a rate increase felt by the other shareholders to be essential. The court took the view that the primary duty of a member is to the company, not the person who appointed him, and that he is not only legally free to disregard instructions given to him by the shareholders who selected him, but must put the company's interests first. [2]

The apparently contradictory obligations of representative directors was considred by the Bullock Committee in the context of industrial democracy including the duty not to disclose confidential information which could be damaging to the company. It admitted the existence of difficulty in certain situations such as where employee directors come by information relating to an impending plant re-location, redundancy or closure of a company. The credibility of the employee representatives, said the Committee, would be severely impaired if while they possessed such vital information they kept quiet and failed to disclose it to those who would be gravely affected by its implementation. [3] As such the Committee took the view

---

1/ Judgment of January 29 1962, 36 BGHZ 296, 307 noted by Vagts, ibid, p.82.

2/ In fact the decision went against the dissentient shareholders on a procedural ground.

3/ See also D.D. Prentice, op. cit. 56 Can. B.R. 277, 299.

In the second case [1], members of the supervisory council of the Hamburg Electricity Works appointed by the City of Hamburg (one of the stockholders), resisted a rate increase felt by the other shareholders to be essential. The court took the view that the primary duty of a member is to the company, not the person who appointed him, and that he is not only legally free to disregard instructions given to him by the shareholders who selected him, but must put the company's interests first. [2]

The apparently contradictory obligations of representative directors was considred by the Bullock Committee in the context of industrial democracy including the duty not to disclose confidential information which could be damaging to the company. It admitted the existence of difficulty in certain situations such as where employee directors come by information relating to an impending plant re-location, redundancy or closure of a company. The credibility of the employee representatives, said the Committee, would be severely impaired if while they possessed such vital information they kept quiet and failed to disclose it to those who would be gravely affected by its implementation. [3] As such the Committee took the view

---

1/ Judgment of January 29 1962, 36 BGHZ 296, 307 noted by Vagts, ibid, p.82.

2/ In fact the decision went against the dissentient shareholders on a procedural ground.

3/ See also D.D. Prentice, op. cit. 56 Can. B.R. 277, 299.

that it was "essential to the success of board level representation that employee representatives, should be in close touch with their constituents. They must make it their regular job to report on what the board is doing or proposing to do and why".1/ Though aware of the difficulties that would thereby arise the Committee offered very little by way of recommendation except to leave it to the board to determine by themselves what information is to be treated as confidential believing, hopefully, that "breaches of confidentiality as a result of board level representation [would be] extremely rare". 2/

On the question of directors' duties in general the Bullock Committee proposed that all directors "should have the same legal duties and liabilities", the basic duty being to act in "the best interests of the Company" balancing a number of interests. It drew a parallel between employee representative director and nominee directors, appointed by a specific shareholder interest", and proposed that their "job will be the same as it is now: to weigh up the differing and conflicting interests in the Company in order to reach decisions which they genuinely believe to be in the Company's overall best interest". 3/

1/ P. 87 para. 49.

2/ P. 90 para. 57.

3/ P. 85 para. 39.

Although U.K. Company law has yet to resolve the contradictory position of nominee directors, there is little doubt that the conventional notion of the "interests of the company" has been too inflexible and rather dogmatic on this score and the view now prevalent is that directors, irrespective of the special interests they represent should be allowed enough room for manoeuvre in balancing the apparently conflicting interests. 1/ In the New South Wales case of Re Broadcasting Station 2 G.B. (Proprietary) Ltd. 2/ Jacobs, J. held that the appointment of nominee directors is not "reprehensible unless it could also be inferred that such nominees would act in the interests of [their nominators] even if they were of the view that their acts were not in the best interest of the company". Moreover, "it is to ignore the realities of company

---

1/ See e.g. Vagts, in 80 Harv. L.R. 23 at 75. In relation to employee representatives, the Bullock Committee's answer on this score is that it would be "unreasonable and unrealistic" not to expect them to argue strongly at board level for the interests of their nominators. "Indeed one of the objectives of putting them on the board in the first place is to make sure that the employee's voice is heard at the very highest level of the company". However, "an employee representative would be in breach of his duty if he voted in a particular way solely because of the instructions of his trade union. He must be a representative, free to express his opinions and to reach his own conclusions about which policies will work for the greater good of the company, not a delegate, told how to vote by his constituents". P. 85 para. 40. The test therefore is whether a nominee is acting on his own initiative or whether he is acting on instructions from his nominators. If he has not been specially mandated the representative may lawfully pursue the interests of his nominators. See D.D. Prentice, op.cit; pp.297-298. The idea is that a director must not fetter his discretion.

2/ (1964-65)N.S.W.R. 1648. See also Levin v Clarke (1963) 80 W.N. (N.S.W.)

organisation and it would make the position of a nominee representative director an impossibility if it were the law that each director must approach each company problem with an open mind". Special nominee directors must therefore be accepted now as a normal feature of the boards of large companies, and further use of them are to be encouraged.

Whilst no one interest out of several in a company is exactly the same as another they all have one thing in common - that the interests of particular groups will be ultimately enhanced with the fortunes of the company itself. In the uncommon event of a serious dispute likely to lead to the disintegration of the company nominee directors must disregard the special interests they are supposed to represent and act in every case in the general interest of the company; afterall, the overall interests of all depend on the continued existence of the company.[1/] This in no way defeats the purpose of appointing a nominee. But also the mere fact that a nominee director puts emphasis on safeguarding the interests of those he represents does not automatically amount to a disregard of his fiduciary obligation to the company. As Latham C.J. pointed out in Mills v Mills[2/] it should be remembered that directors

---

1/ But see Scottish Co-operative Wholesale Society v Myers, supra. This case is, however, an exception to the general rule.

2/ [1938] 60 C.L.R. 150 (Australian High Court).

are

> "not required by the law to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be present to the mind of any honest and intelligent man when he exercises his powers as a director". 1/

This advice should mollify antagonists of nominee directors.

In order to clarify the exact position of nominee directors it will be useful to have a provision explaining the general fiduciary obligations of directors along the lines of Section 203 of the Ghana Companies Code. Sub-section (3) provides:

> "In considering whether a particular transaction or course of action is in the best interests of the company as a whole a director may have regard to the interests of the employees, as well as the members, of the company, <u>and</u>, <u>when appointed by, or as a representative of, a special class members, employees, or creditors may give special, but not exclusive, consideration to the interests of that class</u>. 2/

1/ At 164.

2/ Emphasis mine.

It is common knowledge that as at now some nominee directors have not been able to do anything on their boards to further the interests which they were supposed to represent due mostly to practical difficulties, 1/ but also for fear of liability for breach of duty. There is every reason to believe that a law setting out the scope of directors' duties as in the Ghanian Code will be great impetus to any meaningful representation which is both helpful to the special interests represented and the over-all interests of the company. 2/

4. Proposed Method For the Appointment of Shareholders Representative Directors.

A number of other practical difficulties 3/ which are raised by the proposals for special shareholder representative directors may be considered here. The most important question relates to how such representatives are to be appointed but also important is how they can be removed or dismissed and the general questions of their accountability and so on. Quite apart from the fact that these matters, or at least some of them can be settled in the articles of association of the different companies 4/ it is difficult to devise a scheme which will be applicable

---

1/ See e.g. John Thackray "America's Changing Boardrooms" Management Today, May 1978, 58, 61.

2/ Other practical difficulties like the method of appointment of different shareholders' nominees are matters which can be settled in the articles.

3/ That is, beside their legal duties as discussed above.

4/ It is possible for an arrangement to be made by special provision in the articles of association giving power to a shareholder or class of shareholders or indeed a major creditor, to appoint some or all the directors of a company, subject to the ultimate control of the general meeting. See the Bullock Report, p. 83 para. 33, and infra.

to every large company in view of the obvious variations which exist amongst such companies. However, it would be useful to consider first, though briefly, the two methods of appointment of representatives directors which have been applied in some jurisdictions and in the context of industrial democracy on the Continent.

(a) Classification of Shares and Directorships

Special provision may be made for the appointment of a special shareholder representative by creating classes of shares with identical rights but a right being conferred separately on each class to elect designated directorships. For example, if a board consisted of five directors positions, A to E, each class of shares may be entitled to elect and remove one of these directors. Thus a minority shareholder or group of shareholders who holds class A of the issued shares would be entitled to appoint (and remove) director A. [1/]

(b) Another method which is more suitable for large public companies is the cumulative voting system, [2/] its main feature being that instead of the "straight" voting system whereby a shareholder is entitled to cast one vote per share for each vacancy and so enabling a bare majority to elect the full board, minority shareholders are afforded the opportunity of electing a number of directors in proportion to the strength of their

---

1/ See A.B. Afterman, Company Directors and Controllers (1970), p. 29, who provides a model article which can provide this sort of power. A company may be able to adopt such an article in the U.K. but it is more suitable for small companies than large ones.

2/ Brief mention has been made above of the effects of this voting system.

shareholdings. Thus a minority shareholder with say 10 per cent of the equity capital is assured of filling at least one out of ten vacancies if he voted all his shares for one nominee.

The cumulative voting system is a notable feature in the U.S. but is largely unknown under English law. The main argument in its favour may be summarised as follows:

(1) It is the fairest system for minority shareholders because it affords them board representation in proportion to their shareholding;

(2) It maintains the principle of majority rule in that provided they voted their shares properly they will be able to elect a majority of the board;

(3) It allows the minority or special interests groups a "voice" on the board to press forward their points of view.

(4) It provides a channel of communication through the nominee on the board to the shareholders.

On the other hand the system has been criticised on the following grounds:

(1) The election of partisan directors is incompatible with the basic function of the board to represent all interests in the company;

(2) It creates disharmony on the board which can diminish management's performance;

(3) It increases the risks of a partisan director divulging confidential information;

(4) It encourages situations which might make the Company more susceptible to take-over, or battle for control by a faction of the board.

(5) It leads unfairly to the minority gaining control if the majority fails to cumulate their votes properly. 1/

The opponents of the cumulative voting system tend to exaggerate the point that representative directors will necessarily be trouble-makers and be disruptive to the smooth operation of the board. On balance, however, the arguments against the system seem to have prevailed and it certainly does not now command in the U.S. the popularity which it once enjoyed. 2/

Professor Gower has underlined the unpopularity of advocating cumulative voting in the U.K. 3/ He explains that its absence in England is due to two reasons. Firstly, it is an "obstacle to complete and immediate majority control", and secondly, it conflicts with the basic English view that "boards of directors as supervisory managers,... should be united in policy and outlook with the rest of management, rather than as representatives of divergent interests overseeing the managers". Even at the time of his writing, the learned Professor apprehended that the

---

1/ See Afterman, op. cit., 33-36.

2/ See L.C.B. Gower, "Corporation Law in England and America", (1955-56) 11 Bus. Lawyer, 39, 53; "Some Contrasts Between British and American Corporation Law", (1956)69 Harv. L.R. 1369, 1390-91. See also C.C. Brown, Putting The Corporate Board to Work, (1976), pp. 23-24.

3/ Ibid.

above view was already somewhat "anachronistic", but it is clear that this is more so in the present times when the demands for special interests representations have become more widespread and more serious, especially in relation to employee representation on boards.

Since the methods for the appointment of representative directors discussed above are generally not available in the U.K. and seem unlikely, it would be useful to consider the method of appointment operated under the co-determination system on the Continent and those considered in the Bullock's Report and the references therein to shareholders' representation.

The Bullock Committee opined that the extension of genuine industrial democracy can only be achieved "if there is a direct representation [1/] of employees on company boards in just the same way as there is direct representation of shareholders on boards at present" [2/] With due respect the above statement begs the question whether at present directors are in practice "direct" representatives of shareholders. It has been our contention in this thesis that nearly always directors in large companies are the nominees of the Chief executives or the board and that although their nominations are "approved" by the general meeting they cannot in all reality be considered "direct shareholder representatives". Our proposal therefore is to devise a scheme which allows investors to be directly represented.

1/ Original emphasis.

2/ P. 71 para. 1. My emphasis.

In Germany, for example, members of the supervisory board, one of the three principal organs of corporate governance, other than employees' representatives are appointed by the general meeting. The Biendenkopf Commission reported that the appointments there are, in fact, made not by the individual shareholders but by banks and institutions. This is because "many small shareholders there deposit their shares with banks and other financial institutions which may then secure the election of a representative on the supervisory board".[1/] Thus, one in four of the total number of seats on the supervisory boards under the co-determination system are held by banks [2/] who are in essence agents of the diverse numbers of small shareholders whose shares they hold.

A major shareholder may also appoint himself into the supervisory board by using his own votes. Even minority shareholders are afforded an opportunity for direct representation by clauses which entitle them to submit proposals for resolutions to general meetings for consideration, which may include a resolution allowing them to appoint a representative to the supervisory board. [3/] To ensure election through this method, though, the minority would have to count on the support or co-operation of the majority or other shareholders if his resolution is to go through.

It might be tempting to dismiss any analogy with the German practice as unhelpful on the ground that the U.K. unitary board system

---

1/ See Tom Hadden (1977), op.cit., 449.

2/ Ibid.

3/ SS. 127 and 137 (AKt G).

cannot incorporate a mechanism designed for the appointment of shareholders' representatives to a supervisory board. The reports by Eric Batstone and P.L. Davies which were heavily relied upon by the Bullock Committee have now established that no fundamental distinction exists between the U.K. governing structure and the Continental models, and that the U.K. companies maintains a *de facto* two-tier system in so far as there is a separation between the "management" and supervisory functions of the board, albeit, a difficult distinction to maintain in practice. 1/ Accordingly, P.L. Davies has argued that as is the case under the Danish system it is not necessary to make any laboured distinction between one-tier and two-tier systems. 2/

Under the Danish law companies with capital of Kr. 400,000 or more are as P.L. Davies notes, 3/ required to have two organs:

(1) a shareholders' meeting and

(2) a board of directors with minority employee representation and a management of one or more members appointed by the board. Although a majority of the board must consist of persons who are not managers of the company, a complete separation of personnel between board and management is unnecessary, neither is a complete separation of functions between both.

1/ Eric Batstone and P.L. Davies, Industrial Democracy : European Experience (1976), 22.

2/ P. 53.

3/ P. 55.

The Law provides that "the management shall be in charge of the current management of the company" and"the board of directors shall secure a warrantable organisation of the company's activities", but in respect of setting fundamental corporate policy the board and management share responsibility. It is obvious therefore that direct shareholders' (or other interests', for that matter) representations, like employee representation under the Danish system would not require the establishment of a supervisory organ. Indeed, the advantage of maintaining representative directors on a unitary board would be to prevent or at least minimise the dangers of circumvention of such representatives which is not unknown under Continental practices.

Applying the above analogy of European systems of board representation to the U.K. companies, therefore, it should be provided that a proportion of the board of every public limited company, say at least 40 per cent, must be comprised of non-executive directors who are to be directly appointed by shareholders in general meeting. In other words, where a company has, for example, ten directors at least four of them must be non-executive directors who will be appointed at the nomination of shareholders.

The remaining directors who will be predominantly but not solely executives are to be appointed under the present system whereby a list of names is presented by the chief executive, usually after consultation with the board, at the general meeting. A biographical note about each candidate will be circulated to the shareholders who shall approve the nominations or decide otherwise. Judging by the present system little opposition seems likely to arise in respect of such candidates.

The method of appointing the other group will be somewhat more complicated. We propose, however, that the law should require that a representative director (who must be non-executive) shall be appointed at the nomination of a shareholder or group of shareholders. It should then be left to the articles to spell out the procedure by which such appointments will be made. Such a clause might, for instance, require that a candidate for appointment to the office of a non-executive representative director shall be nominated by:

(a) a shareholder or group of shareholders holding not less than 10 per cent of the issued share capital of the company having a right to vote, or

(b) not less than 100 shareholders of the company holding not less than 5 per cent of the issued share capital of the company having a right to vote.

While senior executives are to be appointed as executive directors, nominees for appointment as non-executive directors will be expected to come from outside the company. Thus they could as in Germany be the representatives of banks or institutions or senior executives from other companies or other reasonably qualified persons. In addition a majority shareholder will retain the right to appoint himself using his own votes and at his own nomination, provided that in this case he has satisfied requirement (a) above.

It will be expected also that institutions (including groups of institutions) will more readily secure the appointment of their nominees under requirement (a) above while private shareholders and ginger groups will avail themselves of requirement (b).

In order to prevent one shareholder or group of shareholders dominating or monopolising the appointment system it should also be provided that no shareholder or group of shareholders shall have more than one representative director at any one time, provided that where no nominations have been made to fill a vacant office by other shareholders, a second representative may be elected by a shareholder or group of shareholders having a right under the proposed article to do so.

The elections shall be by majority vote so it is clear that it will not always be possible for every nominee to get appointed subject, of course, to the rule that each shareholder shall have only one representative director at any one time.

A director whether executive or non-executive may be dismissed by ordinary resolution as under the present system, without prejudice to his rights to claim compensation for wrongful dismissal. [1/]

This proposal obviously involves some practical difficulties and in particular raises two questions:

(1) whether private shareholders would take any interest in making any nominations and in seeking a representation, and

(2) whether institutions will not dominate the process thereby acquiring further privileges than they already enjoy.

With regard to the first question it is to be pointed out that no satisfactory answer is possible as to whether private shareholders will take any interest until the proposal actually takes effect, but we believe that it can only increase shareholders' enthusiasm if they realise that there is an opportunity to secure a board representation. Ginger groups, in particular, should be able to appoint non-executive nominees if they command the support of a sufficient number of members or voting equity which will be more likely than not.

1/ Section 184(6), 1948 Act. Cf. Section 120(1) of the Australian Uniform Companies Act which empowers the nominators of the dismissed director to appoint his successor. For a discussion of the full scope of that section see AFterman, op. cit. pp. 20-21.

It must be admitted that where vacancies are keenly contested by institutional investors, ginger groups and individual shareholders would not stand much chance of having their nominees elected unless there is a higher level of attendance at general meetings and interestedness on the part of small private shareholders in participation. The desire and prospects of appointing a representative to the board should, however, bring about greater co-operation amongst private shareholders and groups of shareholders and encourage participation through collective and more effective channels as investment institutions and ginger groups. This would in turn lead to greater exercise of shareholders' power both individually and collectively than there is at present.

The answer to the second question is that the requirement against having more than one director at a time will be a protection against the domination of appointments by one investment institution. It would ensure on the one hand that an institution wishing to do so can have a direct representative while, on the other hand, not denying from the private shareholders any right which they actually enjoy under the present system. But in view of what has been said above regarding the relative levels of participation by both groups of shareholders it is indeed likely that institutions would avail themselves more of the right to appoint nominees. However, the presence on the board of institutions' nominees need not necessarily be against the interest of other shareholders. Already there are now a number of companies on whose boards institutions are represented [1/]

1/ See *infra*, p. 422

and this writer is unaware of any case where such representatives have been antagonistic to the interests of other shareholders not represented.

We have already considered the legal duties of nominee directors above but in respect of their accountability representative directors, it is submitted, should be required to report to all the shareholders in general meeting and not just to their nominators, although accountability to these is presupposed. This should be in addition to the general duty of the board at present to present to the annual general meeting the annual accounts and reports. The shareholders will be afforded the opportunity at the general meeting to receive the report of the representative directors and to put questions to them.

In making the above proposals regard has been had to the Bullock Committee's proposals about the accountability of representative directors within the broad context of industrial democracy. This thesis does not however deal with the general question of employee representation and how its introduction will affect the system of shareholders' representation. This question has been extensively covered by the Bullock Report. The point which is to be stressed here is that it is important to ensure that any genuine system of shareholders' representation (with or without the issue of employee representation) must permit the nomination of representatives by the shareholders themselves and not by the management. The result of the failure in Germany to ensure this has been highlighted by Professor Rodiere who described the German supervisory board as being "an honorary gathering and this writer is unaware of any case where such representatives have been antagonistic to the interests of other shareholders not represented.

We have already considered the legal duties of nominee directors above but in respect of their accountability representative directors, it is submitted, should be required to report to all the shareholders in general meeting and not just to their nominators, although accountability to these is presupposed. This should be in addition to the general duty of the board at present to present to the annual general meeting the annual accounts and reports. The shareholders will be afforded the opportunity at the general meeting to receive the report of the representative directors and to put questions to them.

In making the above proposals regard has been had to the Bullock Committee's proposals about the accountability of representative directors within the broad context of industrial democracy. This thesis does not however deal with the general question of employee representation and how its introduction will affect the system of shareholders' representation. This question has been extensively covered by the Bullock Report. The point which is to be stressed here is that it is important to ensure that any genuine system of shareholders' representation (with or without the issue of employee representation) must permit the nomination of representatives by the shareholders themselves and not by the management. The result of the failure in Germany to ensure this has been highlighted by Professor Rodiere who described the German supervisory board as being "an honorary gathering of distinguished people, neither capable nor inclined to exercise any real control", 1/ even though charged in law with supervising the activities of the management board. Also P.L. Davies,citing the report of the German Government Commission headed by Professor Biendenkopf, writes that

> "except where one or a few shareholders control a company, the managing board has a decisive say in the selection of shareholder representatives to the supervisory board. Moreover, management sees the task of those elected as being not to represent the interests of the shareholders but to advise the company. In such circumstances the supervisory board ceases to be an instrument of supervision of management and becomes a mere provider of advice". 2/

If the system of genuine shareholder representation which has been advocated here is developed and encouraged by companies (with or without compulsion by statute) now or in the immediate future this would facilitate a fairly adequate system of shareholder representation within the context of industrial democracy when it is introduced, eventually.

But for the present the advantages of the shareholders' nominee would be to provide an essential link between shareholders and management instead of the wide gulf or "divorce" which now exists between these two organs. He would ensure that shareholders' views are easily communicated to the board where most policy decisions are taken, and through the nominee the board's views can be communicated to the shareholders on a more informal level than the general meetings. He would also serve as a link between the groups of shareholders he represents, if this is the case, and so help to improve communication and, presumably, co-operation amongst shareholders.

1/ Cited by P.L. Davies, Industrial Democracy, (1976) p. 57.

2/ Ibid, at 58.

5. <u>Nature of the New Relationship Between Directors and Shareholders</u>.

Increased shareholders' intervention does not imply that institutions have to interfere in the day-to-day management of the company and question every investment and other policies of the board. Indeed, as the Wilson Committee pointed out too close a contact between institutions and company management might be counter-productive in that management would be apprehensive about taking risky, long-term investment policies which might make little sense to the less imaginative outlook of financial analysts. Also too frequent interference would be costly in management's time, and "[a]nswering too many questions or conducting too many interviews with outsiders could detract from managements' performance to the detriment of the business".[1/] There is also the increased chances of institutions coming into contact with confidential information.

All these potential disadvantages of contact can however be minimised if institutions relied more on the study of published information. This may be supplemented by establishing regular personal communication with the companies in which they invest. An increasing number of companies that gave evidence before the Wilson Committee accept this

---

1/ Para. 903.

type of relationship, initiating meetings with substantial shareholders themselves, sometimes individually and sometimes by way of a general presentation. They believe that "by listening to their views and keeping them informed they gain the stability of sympathetic long-term holders of their shares and a valuable sounding board".1/ The advantages of such a relationship, though real, are not easily quantifiable.

6. Conclusion .

While institutional intervention would be most effective if a number of them acted by collective action, this need not always be the case and situations might arise where an institution might have to act alone, even adopting a point of view which is not identical with that of other smaller institutions or private shareholders. Indeed, to an extent, the success of some institutions depends on their ability to out perform their competitors. Differences between groups of shareholders might in fact be to the advantage of more efficient management by providing a wider range of options to the solution of the company's problems.

1/ Para. 901.

Private shareholders need also to become more active through ginger groups, and here again the signs point to an increasing trend.

The role of the A.G.M.s might also be developed by introducing the method of giving advanced notice of shareholders' questions as in the House of Commons and the answers circulated to the shareholders before the A.G.M.s, in which supplementary or *ex tempore* questions should be allowed. Through their effective organisation and such changes, shareholders might yet transform companies' general meetings into lively forums for important debates.

CHAPTER 10

THE PROPOSALS FOR MORE EFFECTIVE DIRECTORS' PARTICIPATION

1. The Role For Boards.

The purpose of this section is not to prescribe *a role* for the board but to explain, in the light of their structure and constraints described earlier on, the role which boards are designed to perform in the large public company and from there to examine how its performance can be achieved.

Any corporate organ that operates under any of the constraining conditions described above can rarely be able to "manage" the company's business or make business policy. "It can be useful in providing advice and counsel to the chief executive's office, playing a formal role in the approval of major corporate projects, and providing a modality for the exercise of influence and control by non-executives, but for the most parts these functions are either relatively unimportant or can be easily located elsewhere".[1/] Although the board has proved incapable of formulating policy it has the capability to monitor and supervise

---

1/ Eisenberg, 63 Cal. L.R. 402. By its functioning as a "modality for the exercise of ... control" he means that outside interests and "minority" shareholders are able to take-up non-executive directorships in order to avoid the high risk of liability for executive directorships. No legal or other evidence exists to substantiate this as a reason for a preference of non-executive rather than executive directorships.

Management by ensuring that policies taken by the board are executed to the last letter and not manipulated out of recognition by the executives.

Notwithstanding their unsuitability for policy-making, non-executive directors on a board are essential for the proper discharge of its supervisory functions. Indeed, it could not be otherwise, for executives cannot be expected to monitor and supervise themselves. This would be better done by outsiders whose appraisal of all executive performances would be more detached and disinterested. Even though U.K. companies boards operate a unitary board system, the experience of the supervisory boards in the German two-tier system[1/] has been useful in trying to develop the supervisory role of boards here.

Under German Law [2/] the management and supervisory functions of the board are kept separate and vested in two distinct organs: the

---

1/ Other European countries which operate the two-tier system include France, Sweden, Denmark and the Netherlands.

2/ S. 76(1) AKt G. The main source of information on German Law is R.R. Pennington, ed, German Company Law, (1975).

board of management (Vorstand) and the Supervisory Council (Aufsichsrat) respectively. The management board has the power and the duty to manage the company's undertaking without reference to the wishes of the general meeting and its independence cannot be restricted by the company's regulations. The board must "manage the company on its own responsibility". The concept of "management" under this law is quite wide but roughly corresponds to those which have already been identified as proper management functions for board executives in this country. 1/ In Germany they comprise the organisation of production and the preparation and execution of long-term planning for that purpose and consideration of the whole trading, investment and earnings policy of the company. Such routine matters like keeping of books and records, drafting the annual report, convening general meetings, putting proposals to the general meetings as to the application of the profits shown by the company's balance sheets and any other business specified in the company's regulations fall under "management matters" and are known collectively as "management of the business" or "management of the company". 2/

The principal powers of the supervisory boards are, on the other hand, the appointment and dismissal of the members of the management board, the supervision of the management and the approval of the annual accounts. 3/ Like the management board the supervisory board also

---

1/ But what constitutes "manage" is nowhere defined by the law here.

2/ Pennington, ibid., 45.

3/ Ibid, 48.

operates independently of the general meeting. Managerial functions cannot be conferred upon the supervisory board and it cannot give directions to the management board in respect of such matters. It can, however, make certain acts of the management board dependent on its approval - usually as a pre-emptive step by exercising a veto power.

In particular the supervisory board must be kept informed by the management board about its trading policy and all important matters of management of the company's business. 1/ The supervisory board is entitled to require information on such matters from the board at any time.

The supervisory board has the right to inspect the company's books and correspondence and to verify the state of the company's assets. 2/

It must convene a general meeting and draw up an appropriate agenda if the company's interests so require. Members of the management board who are guilty of breaches of their duties may be dismissed by the supervisory board; the board performs this function on its own responsibility, and does not require the approval of the general meeting.

1/ S. 90 AKt G.

2/ S. 101(2) AKt G.

The supervisory board is further empowered to litigate in the company's name to enforce claims for damages against members of the management-board for breaches of their duties. 1/

The supervisory board is responsible to the company for the diligent exercise of its supervisory powers, in the same way as members of the board of management are responsible for their management of the company's business. 2/

The supervisory board has its own Chairman, who presides over meetings, making sure that the decisions of the supervisory board are not influenced in any way by the Management board. Likewise, the supervisory board, as a supervisory organ, is inherently incapable of giving direction to the board. Although the supervisory board only has power to dismiss directors on the management board, this may be done only if there are substantial grounds to do so, such as a breach of duty by a director, his incapacity for management or loss of confidence in him by the general meeting. 3/

The separation of functions between both boards is strictly enforced and no member of the supervisory board may be appointed to the

---

1/ S.112. AKt G.

2/ S.116 AKt G.

3/ S. 84(3) The general meeting cannot direct the Supervisory Council to dismiss any director on the board of management. But the Supervisory Council may dismiss a management director in order to give effect to a well founded wish of the Shareholders.

management board of the same company and vice versa.

Variant forms of the German-style two-tier board system have been adopted by many European Countries, and the indication is that the new structures have been largely successful. 1/ With the entry of Britain into the E.E.C. the demands for the adoption of the German system gained momentum. The high point in the debate on the introduction of the two-tier system came during the Bullock Committee's consideration of the question of employees representation at board level in the private sector. 2/ The Committee's remit was:

> "Accepting the need for a radical extension of industrial democracy in the control of companies by means of representation on boards of directors and accepting the essential role of trade union organisations in this process, to consider how such an extension can best be achieved, taking into account in particular the proposals of the Trade Union Congress report on industrial democracy as well as experience in Britain, the E.E.C. and other countries. Having

---

1/ Except in France. See Bullock's Report, p. 74.

2/ That is, as far as domestic developments are concerned. At the Community level there is the Proposed Statute of a European Corporation which also closely follows the German model. See Hans Claudius Ficker in (1971) J.B.L. 167, 174-177 and J.C. Davies "The European Company: a Stumbling Block", (1972) 116 Sol. J. 227, 228-229.

management board of the same company and vice versa.

Variant forms of the German-style two-tier board system have been adopted by many European Countries, and the indication is that the new structures have been largely successful. 1/ With the entry of Britain into the E.E.C. the demands for the adoption of the German system gained momentum. The high point in the debate on the introduction of the two-tier system came during the Bullock Committee's consideration of the question of employees representation at board level in the private sector. 2/ The Committee's remit was:

> "Accepting the need for a radical extension of industrial democracy in the control of companies by means of representation on boards of directors and accepting the essential role of trade union organisations in this process, to consider how such an extension can best be achieved, taking into account in particular the proposals of the Trade Union Congress report on industrial democracy as well as experience in Britain, the E.E.C. and other countries. Having

---

1/ Except in France. See Bullock's Report, p. 74.

2/ That is, as far as domestic developments are concerned. At the Community level there is the Proposed Statute of a European Corporation which also closely follows the German model. See Hans Claudius Ficker in (1971) J.B.L. 167, 174-177 and J.C. Davies "The European Company: a Stumbling Block", (1972) 116 Sol. J. 227, 228-229.

> regard to the interests of the national economy, employees, investors and consumers, to analyse the implications of such representation for the efficient management of companies and for Company Law". 1/

The Committee received several proposals in favour of the introduction of industrial democracy along the German lines, but after considering the differences in industrial developments in both countries came to the belief that the fact that the two-tier system has proved a success in Germany, was no guarantee that it would also succeed in the U.K. "In our view ... an attempt to impose the rigidity of the statutory two-tier system on British companies at the present stage in their development could be damaging to their efficiency and could restrict their ability in the future to alter their structures at top level to meet new demands on their business". 2/ Any attempt to draw a sharp distinction between management and supervisory functions to be vested in two distinct bodies, they thought, would as in France lead to considerable disruption to their management structure or would be inoperable. 3/ They therefore proceeded to propose a system of employee representation based on a modified form of the present unitary board. 4/ Some companies have already introduced employee directors to their boards but on a voluntary basis. 5/

1/ Page V.

2/ At p.73.

3/ At p.74.

4/ At p.77.Details of the recommendation were mentioned in Chapter One.

5/ See for example the case of Bonser Engineering Company as reported in The Director, June 1978, 44.

Since the reason for seeking "outside" representation on the board is to increase its influence over policy-making and the supervision of executives then the same purpose will be achieved by means other than a two-tier board Structure. 1/ The present unitary board system with necessary modifications will achieve the same objectives. This has been substantially achieved in the U.S. largely due to the stringent regulations and activities of the Securities and Exchange Commission 2/ - notably, the increasing use of non-executive directors and audit Committees. 3/ This "wind of change" which has been blowing in the U.S., changing the

---

1/ This is no longer mandatory under the Fifth European Community Directive 1972. But it has been said that U.K. Companies de facto operate a two-tier system. As Eric Batstone writes, there is evidence to suggest "that the distinction between a supervisory and a management board is a difficult one to maintain in practice since the effective fulfilment of either role demands close involvement with the other", in Eric Batstone and P.L. Davies, Industrial Democracy: European Experience. Two reports prepared for the Industrial Democracy Committee (1976) at 22 (HMSO).

2/ See 31 Bus. Lawyer, 1208.

3/ The use of Committees and the different types is not fully discussed in this thesis. On that see D.M. Saunders, "The Executive Committee in Corporate Organisation - Scope of Powers" (1943) 42 Mich. L.R. 133. See also R.I. Tricker, The Independent Director, 1978. Harold Krontz, op cit. 170.

attitudes of corporate managements and directors have been felt in the U.K. with increasing intensity in recent years.

2. Trends in Non-Executive Directorships In The U.K.

Surveys in recent years have indicated a trend toward a greater non-executive representation on all boards, although resentments do exist against their use. 1/ In 1970 only 25 per cent of the Times top 1000 companies had non-executive directors. In 1975-76 the Bullock Committee reported that nearly 25 per cent of the Companies in the current Times 1000 had no non-executives but that the overwhelming proportion of the companies had between one and five non-executive directors. A little over 10 per cent had more than five non-executives. 2/

In the most recent survey undertaken by the Bank of England 3/ in 1979 designed to find out the extent to which popular preference for non-executive directors 4/ has been translated into practice, and using the same list of companies in *The Times* 1,000 it was found that the use

---

1/ See e.g. "The Pros and Cons of Non-executive Directors" in the Financial Times, Feb. 19, 1980. See also Financial Times, Nov. 15, 1979.

2/ The Bullock Report, p. 64.

3/ "Composition of Company Boards", Bank of England Quarterly Bulletin, Vol. 4, Dec. 1979.

4/ As well as Audit Committees.

of non-executive directors has become more widespread since the previous Bullock Committee's survey. The proportion of companies with three or more such directors had risen from just over a third to just over half, whereas those without any had fallen from 25 per cent to 12 per cent. More significantly, the survey found that the larger companies tended to have a large number of non-executive directors. Of the top 250 companies 63 per cent had three or more and 34 per cent had five or more. Of the remaining 750 only 19 per cent had five or more while 13 per cent had none. 9 per cent of the top 250 had no non-executives. In an accompanying statement the Bank remarked:

> "It has become more widely recognised that companies can benefit substantially from the advice of experienced and detached outside directors who, while not involved in the day-to-day running of the business, nor dependent on it as a principal source of income, can offer advice and guidance on long-term strategy and help to scrutinize management-performance". 1/

Similar sentiments are often expressed in the letters and financial columns in the popular press, in journals, in academic and business Conferences and Seminars as well as in speeches by distinguished

1/ At p. 392.

personalities in the City.

The advance in the use of non-executives has evidently been as a result of the relentless campaign particularly from the City, in its favour over recent years. Notable among the proponents of the virtues of non-executive directors is the British Institute of Directors which launched its campaign early in the '70s. [1/] In an illuminating article entitled "The Powerful case for Part-Time Directors", [2/] the late Sir Maurice Dean, who ran the Institute's non-executive director service, in 1976 explained how part-time directors can bring a wealth of experience and insight to Britain's boardrooms. Speaking on behalf of the Institute he expressed the view that a reasonable proportion of non-executive directors is an essential constituent of a well constructed board, although this role is often misunderstood and in fact opposed in some quarters. In order to achieve fuller understanding of the non-executives' role, he thought it essential to formulate a definition and evaluation of his duties.

1/ It is interesting to note, by way of comparison that the spread in the use of non-executives in the U.S. is attributed to the campaign by the American Institute of Management: Harold Koontz, 129; Juran and Louden, 175.

2/ The Director, June 1976, 52.

Many other proponents of the introduction of non-executives have also expressed the view that it is imperative to spell out clearly by Law the duties of non-executives if they are not to constitute a clog in the machinery, causing more problems than they solve and becoming easy targets for criticisms. 1/ The role of non-executives, it has been continuously emphasised is not to replace but merely to complement the full-timer or executive board member. To be able to perform these functions well the framework for boardroom participation must achieve an over-all structural balance which would permit a freer information traffic, board independence and easy access to all necessary tools for the performance of their functions.

3. Potential Contributions of a well Balanced Board.

There are obvious advantages in a board being well balanced in terms of its executive and non-executive composition to act efficiently and effectively. However, the difficulty of having a well balanced board is not so much as to the numerical mix of both types of directors as to the extent of individual contributions of directors in terms of their skills, how much time they can devote to the business, their allegiance

1/ Thus, the White Paper "The Conduct of Directors" Cmnd. 7037 (H.M.S.O.), 1977, attempted to set out special functions which the non-executives are to perform in company boards, such as resolving conflict of interest problems involving directors.

to the company and a host of other imponderable and unpredictable factors. Executives and non-executive directors each have special attributes which benefit the board.

The primary advantage of the executive director on a board lies in his familiarity with the business, and with his superior knowledge of the company's operations and his involvement in previous actions taken as well as his personal incentive to see the company succeed. 1/ With these the executive director can make much intelligent and highly motivated company policy. He is usually more available for company board meetings and presumably has the time to give necessary study and deliberation to company matters.

There is a common feeling among chief executives that

> "You ought to have several inside operating and functional executives on the board when the company is a large, diversified operation. The reason is that if questions arise with regard to marketing, finance, or the problem of an operating division, or subsidiary, or what have you, there is an executive at the board table to whom you can turn and say, "All right, now here's a question. You answer it ...". 2/

1/ These involve technostructural incentive which are not easily quantifiable or identifiable. But see J.K. Galbraith's Economics and The Public Purpose (1973), Chapters 10 and 11.

2/ Mace, Directors: Myth and Reality, p.112.

Another advantage of having executives on the board is that such exposure serves as an education in top management practices which is quite important for top executives especially the incumbent of the post of Chief executive.

Also where a board includes a number of outsiders the mixing of both executives and non-executives increases their acquaintance with one another and so ensures that the job of choosing a new successor is done in a harmonious atmosphere and so eliminating tension in periods of transition.

Against those advantages it is to be pointed out that a board which consisted solely or predominantly of executive or inside directors can easily become introverted and the potential disadvantages in such a board cannot be easily overlooked. On such a board there will be no independent member to ask the awkward questions which executives dare not ask and no one will be there to act as a "window on the world". A board that is solely or predominantly executive would, therefore, fail in the important duty of supervising and monitoring management in its conduct of the business of the company, and would easily become a "rubber stamp" for sanctioning the dictates of the Chief executive and the tiny cabal that surrounds him.

Freed of the constraints which may inhibit their performance non-executives have much to contribute to the board's effectiveness through the special attributes which they bring with them, and these are generally qualities that the executives lack. These essentially are their psychological and financial independence and "outside look" which entails drawing on their experience outside the company and their awareness of other factors external to the company. But they need not be unnecessarily antagonistic or obstructionists in their pursuit of information as this would undermine the rapport which should normally exist in a company and "make good management virtually impossible". 1/

In order to enjoy the full contributions of a non-executive director on the board it is highly essential that he remains independent of the Chairman and his co-directors. Accordingly, it is important that the methods of appointment of non-executive directors are free from any ties or links which might jeopardise the element of independence, but the evidence available suggests that this has so far not been sufficiently ensured. The Korn/Ferry International Survey 2/ found that the main source of introduction to the Company of the non-executive directors was most often the Chairman followed by the directors. 3/ This reinforces the

---

1/ See Niel Martin-Kaye, "The Theoretical Basis of Modern Company Law", (1976) J.B.L. 235, 243.

2/ Boards of Directors Study 1980.

3/ For very large companies 53.29% of non-executives were introduced by Chairman; 29.61% by Directors; 2.63% by Shareholders and 3.95% by Advisers.

commonly held belief that most non-executive directors are chosen "on the old boy network". This should not necessarily imply that the Chairman and the board sacrifice efficiency for the appointment of their friends. Indeed, the same Korn/Ferry survey shows that the main grouping of non-executive directors who serve in large companies comprise mainly of the Chairman and managing directors of other companies, followed by employees' or shareholders' representatives. Most of them came from the accounting, banking and legal professions but they also included politicians. Although it was not mentioned in the study it is likely that some large companies have academics from diverse areas of knowledge on their boards. It is to be hoped that as an increasing number of companies realise the potential advantages of having outsiders on their boards the <u>actual</u> contributions of such appointees continue to justify the expectations. One hopes also that those responsible for introducing such appointees [1/] will broaden their "catchment areas" so as to include those constituencies [2/] whose needs can be satisfied or better appeciated through a board representation. In this regard it is to be noted that the proportion of shareholders' representatives in relation to the total number of non-executives on the boards of large companies as indicated in the Korn/Ferry Study is rather too low at just over 6 per cent. [3/] Still lower is the proportion of

---

1/ See the proposals for non-executive appointments in p. 390 supra.

2/ Such as employees, consumers, suppliers and so on.

3/ For the largest group of companies the background of non-executives were as follows: Chairman 32.89%; Managing Directors 8.55%; Financial Directors 3.9%; Banking 1.32%; Law 1.97%; Previous Employees 1.97% and Shareholders' Representatives 6.58%.

those appointed on the introduction of shareholders which stands at 2.63%. 1/ The indication, therefore, is that there is a real scope for the appointment of a larger number of shareholder representatives than there is at present and one hopes that this opportunity will be taken up by shareholders and company boards.

4. Board Committees.

Only a brief mention can be made here about the use of Committees and the potential contributions they can make to the performance of the supervisory function of boards. 2/ The reason for this is that it is a matter of detail for each company whether the supervisory element is to be improved by a given proportion of balance between executives and non-executives, the use of one type of committee

---

1/ See footnote 3 in page 422.

2/ For a most detailed study of the use of Audit Committees in the U.K. see R.I. Tricker, The Independent Director. A Study of The Non-Executive Director and of The Audit Committee (1978) Chapter 6.

or the other or even whether to adopt a two-tier board system, that is, in the absence of legislation setting out specific requirements. 1/ In addition, it is thought that the need for information for non-executives can be met by the provision of staff assistance to such directors. While this might be desirable in principle the potential contribution of this has to be weighed against the inevitable increase in administrative costs and bureaucracy. 2/

The use of non-executive directors has come to be seen as closely involving the use of the audit committee, an association which derives from the U.S. and Canadian practices developed in recent years whereby the boards of public companies appoint an audit committee composed wholly or substantially of non-executive directors. 3/ In those countries the main functions of the audit committees are to review the financial statements and to review the audit arrangements and the company's financial controls, working closely with the auditors who are normally invited to attend its meetings. They have often been found useful in strengthening the influence of non-executive directors and the position of the auditors. 4/

1/ See Temple Lang, 12 C.M.L.R. 155, 166-167.(1975).

2/ See Eisenberg, 63 Cal. L.R. 375, 389-90. (1975).

3/ See Cmnd 7037 (1977).

4/ Ibid. Para. 21.

Despite its growing popularity amongst U.K. companies the Korn/Ferry Internationals survey has found that the audit committee ranks a distant fourth in the types of committees used by large companies with a turn-over in excess of £500 million. 1/ The figures were 61·11 per cent for Executive Committee, 52·78 per cent for Remuneration Committee, 38·89 per cent for Financial Committee and 36·11 per cent for Audit Committee. Although it was generally agreed that the role of the committees includes the monitoring of company performance it was found that "the role of the Audit Committee in monitoring companies and executive performance was not always possible..." because of the predominance of executive directors in them. 2/ This finding adds increased momentum to demands for the appointment of more non-executives in those companies in which the supervisory and monitoring elements are currently lacking for executives cannot be left to supervise themselves.

5. Pressures For Structural Change and Trends In Law Reform.

The pressure for change in the structure of boards as part of the wider demands for the reform of Company Law is due to several

1/ At pp. 11-12.

2/ At p. 12.

factors which are not altogether consistent with one another. Prof. Tricker [1/] identifies five different concerns for requiring change which include [2/]:

1) a concern about corporate control and the authority of directors,

2) a concern about the prerogative of management and the power to decide,

3) a concern about accountability,

4) possible effects from Britain being part of the European Community, and

5) particular concerns being expressed within the auditing profession.

It is the first of these concerns that this thesis examines.

The concern for corporate control has been prominent for a long time now and even though the Companies Acts of 1967, 1976 and 1980 covered some aspects of this problem the structural framework in the system of control has been little affected despite promises of more comprehensive legislation. There have, however, been a lot of pressure and legislative initiatives though these have often met with failure, but

---

1/ The Independent Director (1978).

2/ At p. 5.

events in recent years have given increased momentum to these attempts which bore some result in the 1980 Act. Firstly, a succession of highly critical reports by Department of Trade Inspectors condemning the practices of directors has done much to address public attention to the unsatisfactory state of boardroom practices. 1/ Secondly, the 1977 White Paper on the "Conduct of Directors", 2/ indicating an inclination toward the encouragement of the use of non-executives and audit committees added renewed interest in board structures. The White Paper expressed the opinion that "non-executive directors can perform a useful function in helping to resolve problems of conflict of interest as well as in other ways". 3/ A flurry of proposals and recommendations by such bodies as the CBI 4/ and BIM 5/ have also had marked influence. So has been the Wilson Committee's Report.

"The pressure for change" for the purpose of enhancing corporate control, according to Tricker, "come from the wish to regulate the authority that directors exercise by extending the existing corporate

---

1/ Some of these have already been discussed in Chapter 7.

2/ Cmnd 7037. (1977).

3/ Para 20.

4/ "The Responsibility of the British Public Company", (Final Report) 1973.

5/ The Board of Directors, Management Survey Report No 16 (1972): British Institute of Management.

framework". [1] The board has, therefore, to be regulated in such a way that it is enabled to carry out, not a "managerial" function which it is not suited to perform but a supervisory and monitoring function, which, it has been argued, it can perform. The appropriate framework in which this role can be achieved should be the goal of future legislation. [2]

The most important and articulated initiatives at statutory regulation to strengthen the supervisory functions of boards through the use of non-executives are due to the several efforts and "sturdy individualism" of Sir Brandom Rhys Williams, M.P. In 1970 he introduced a private member's Bill in which he recommended that all major public companies should have at least three non-executive directors. A great defect in that Bill was that it failed to recommend any particular functions or responsibility for the non-executive directors. A further clause introducing specific functions [3] led to opposition which defeated the Bill. In 1976 the M.P. drew on North American practice [4] to

1/ At p. 5.

2/ See p. 433 infra.

3/ That "The non-executive directors shall make a statement annually of their view of management of the company and the use of the Company's assets, together with such information as they consider material for the appreciation of the efficiency and the propriety of the conduct of the Company's affairs".

4/ It is obligatory for every company seeking a quotation on the New York Stock Exchange to have an audit Committee and at least three independent directors. Two are required under the American Stock Exchange.

recommend that in major public companies there should be a requirement that at least three non-executive directors should form an audit Committee but this was rejected as being superflous and premature in this country. An elaborate and detailed recommendation was introduced by the same M.P. by way of an amendment to the 1979 Conservative Government's Companies Bill. 1/ In Clause 3 of his amendment Sir Rhys Williams proposed that

> "Every major public company shall have in addition to any other directors not less than three directors who shall be non-executive directors of the company". 2/

The purpose of his amendment was to make the non-executive directors an effective supervisory element on the board. To that end it was provided in Clause 6 that

> "The non-executive directors of major public companies shall make a statement at each annual general meeting of the Company in which they shall express their confidence in the executive

---

1/ See Parl. Deb. (H.C.). Standing Committee A on Companies Bill, First Sitting, Nov. 1979. at Col. 17-18.

2/ "Major Public Companies" who alone are meant to be affected by the clause were as defined, to include approximately the top 200 companies in the U.K.

direction and management of the company and in the way in which the assets of the company are employed". 1/

Sub-section (2) required that each non-executive must either sign the statement 2/ or resign from the board. One of the objections to the recommendations was that if there is a set of compliant non-executives on a board this can institutionalise fraud, deceit and misfeasance by giving the erroneous impression that management was under the board's supervision. Worse still, if such directors served under an autocratic or authoritarian C.E.O. or Chairman they would merely be "yes-men" and make it even more difficult for suspicions of fraud or incompetence in such a company to be easily discovered or established. 3/ These dangers can, however, be guarded against in the procedure for the appointment of non-executives, such as a prior circulation to all members of biographical notes of the candidates, their names and all necessary details which would be of importance to shareholders voting to appoint such non-executive directors and who

---

1/ This could have had the additional advantage of giving AGMs an increased importance. Moscow, in "The Independent Director", 28 Bus. Lawyer 9, even suggests that non-executives could vote as proxies for absent shareholders.

2/ The statement was to be attached to the balance sheet and laid before the company or AGM. See C L.6(3).

3/ See Standing Committee A on Companies Bill. First Sitting. Nov. 1980. Col. 30.

will be thus sufficiently forewarned about the characters of the persons they are appointing.

It is a matter for regret that although the Minister of State in the Department of Trade, Mr. Cecil Parkinson found the proposals agreeable "in principle" he was opposed to any statutory requirement to introduce them in the few large companies intended to be affected. The Minister conceded that there is a growing trend toward increasing use of non-executives which is evidence of their popularity, but relying on certain responses to a certain Departmental circular details of which were not given, 1/ he pointed out that although

---

1/ Perhaps the Minister had in mind the then recent joint survey by the Institute of Directors and Booz Allen and Hamilton, a firm of management Consultants. The report [The Responsibilities and Contributions of Non-Executive Directors on the Boards of U.K. Companies] found that the majority of Company Directors and Chairmen interviewed believed that existing composition of 25 to 30 per cent outside directors and 70 to 75 per cent executive directors is the right balance, but this conflicted with the sentiments expressed by the Institute's Director-General, Mr. Walter Goldsmith that the ratio should be 2 to 1 in favour of non-executives as in the U.S. He described non-executive directors as one of the least understood but potentially most important contributions to the direction and management of a Company. The Institute is, however, opposed to any legislation making the use of non-executives compulsory.

companies favoured the use of non-executives they were opposed to any statutory provision making their use compulsory, hence he too was against the introduction of the amendment clauses. He was, at any rate, willing to leave open the opportunity for wider debate of the issue in the full House where the proposals were eventually dealt the final blow - may be only for the moment. 1/

The Wilson Committee was also of the general view that non-executive directors are often valuable to effective board performance but rejected demands that their use be made compulsory. But they recognised and recommended that as a necessary accompaniment to greater institutional shareholders participation they should ensure that company boards include a number of non-executives, whose "catchment" area should be diverse enough to retain their potential contribution to boardroom participation. 2/

If the Statutory requirement for the appointment and use of non-executives has to be rejected because of the element of compulsion involved then it seems a reasonable alternative to make it a condition for quotation for large listed companies. Given the success of this

---

1/ See Parl. Deb. (H.C.) Feb. 26 1980.

2/ Paras. 917-919. See also the Chairman's Statement in Prudential Assurance Annual Report and Accounts for 1978.

approach with companies quoted in the New York Stock Exchange and its adoption by subsidiaries of some of those companies in the U.K. and given the demonstrated trend toward their increasing use one hopes that a system such as the one we have proposed in Chapter 9 would be accepted in the near future to extend this practice to the few companies that have yet to embrace it. It may be, as Sir Williams has argued, that it is amongst the few companies averse to active board supervision by non-executive directors that real danger of abuse and inefficiency may be found.

6. <u>The Role Of Law</u>.

The appointment and use of non-executives may ultimately be made a condition of quotation under the Stock Exchange Listing Agreements, but it is really through Statutory regulation that uniformity in practices, which is vital to business in general and investors in particular, can be attained. It is through Company law reform that business efficiency can be attained: "if we leave companies to find out for themselves how they can best operate, they may in some cases take an inordinately long time, and we need Company law so that the laggard are encouraged to hasten to bring themselves up to the standard recognised and automatic in the best". 1/ It is for Company Law to ensure effective participation in the running of the company by

---

1/ Sir B. Rhys Williams, Standing Committee A. First Sitting. Col. 24. (1979).

making it possible to get directors adequately to perform their supervisory functions. This, it is believed, can be achieved by the appointment of directors who are sufficiently independent of the executives and the establishment of a system of adequate flow of information to these directors and the entire board. 1/

One would agree with the assessment of Leech and Mundheim though made in the U.S. context, that

> "Effective auditing of management performance by outside directors presupposes a fundamental change in the psychology of the relationship between management and the board (particularly the outside members of the board)". 2/

In most companies at the moment, the Chief executive still considers the board as *his board,* selects members and determines who does what or what information gets to whom. Until these practices and attitudes change, the board will continue to be more of a symbolic than a realistic organ for corporate governance. The role of law is, therefore, to establish institutional arrangements through which this psychology of boardroom practices can be changed.

1/ See Sir Gordon Richardson, op cit, The Director, Feb. 1979.

2/ N.E. Leech and R.H. Mundheim "The Outside Director of the Publicity Held Corporation", (1976) 31 Bus. Lawyer 1799 at 1826.

GENERAL CONCLUSION

Writers who have considered the problem of reforming the traditional system of corporate governance have generally adopted one or a combination of three approaches:

(1) Proposing ways of increasing shareholders' rights;

(2) Proposing greater requirements for publicity and disclosure, and.

(3) Proposing radically alternative measures which would allow "client-groups of the corporation such as employees, suppliers and customers" 1/ to play a formal role in the governance of the company. 2/

It is impossible, within a work of this scope to consider all the different approaches in great depth and with full justice. However, we have considered various aspects of shareholders' rights and endeavoured to draw attention to the importance which the philosophy of disclosure has enjoyed in the history of company legislation up to the 1976 Act which it is to be hoped "will provide the framework for a more effective enforcement policy", 3/ and then aspects of the recent 1980 Act. On the other hand, we have also drawn attention to the danger of over-emphasis on and indefinite increase of disclosure requirements which by reason of their

---

1/ M.A. Eisenberg, The Structure of The Corporation (1976) cited by P.L. Davies, op.cit; 56 Can. B.R. 281.

2/ See P.L. Davies, ibid, 278-281.

3/ Ibid. 280.

quantity, complexity and the general control which management has over their preparation, 1/ are of very limited importance to shareholders who (together with creditors) they were originally designed to protect. Indeed, the indication now is that with the exception of the further requirements about accounts and audits which are to be introduced with the implementation of the Fourth Directive of the EEC and other Draft Directives no major legislation in relation to accounts are likely. 2/ Rather there is likely to be a change of direction from the volume of disclosure to the technique of presentation of accounts which will make them more useful to their recipients. 3/

In spite of this there are some, however, who suggest that it is futile to try to resuscitate the general meeting and that the best way of controlling management is through increased emphasis on disclosure requirements and radical alternative approaches to corporate control. It is submitted, however, firstly, that disclosure and publicity would by themselves be largely ineffective without active shareholders' control. For example, the requirements for disclosure under Sections 47 and 48 of the 1980 Act would, in the absence of active shareholders' control,be easily frustrated and circumvented by management who would easily secure the general meeting's approval of the prohibited transactions with proxy votes.

1/ See Tom Hadden (1977), 331-332.

2/ See for example, John Birds, "Government wants to reduce Disclosure requirements again". (1980) 1 Co. Law. 203.

3/ Views expressed by Dr. Paul Burns, lecturer in SIBS University of Warwick, in a private interview.

Moreover, there is an extent to which the legislature has always been ready to intervene and, presumably, will want to intervene in questions of internal management and much still appears to be left under existing law for shareholders to decide in general meeting. 1/ For this reason the proposals in this thesis for a new approach or mechanism (not merely new rights) for shareholders' participation and the strengthening of the supervisory role of the board become very important, relevant and practical. This writer strongly believes that the general meeting in the U.K. is in danger of being abandoned as a lost cause and being replaced by rather hasty radical measures without having sufficiently exploited or exhausted its potentials. Dr. Tom Hadden has described how the role of the general meeting has been resuscitated in the U.S. due largely to "the activities of a few well-known 'professional shareholders' like the Gilbert brothers". 2/ The same learned author has described "the shortcomings in existing procedures for the disclosure of accounts and directors' reports", 3/ which have led to growing emphasis on improving the supervisory element in companies as represented in "the concept of management audit". This, writes the author, "is in effect a logical extension

---

1/ The Bullock Report envisages that some important powers like the veto power will still remain with the general meeting even when employee representation comes into operation. See for example, p.82 para. 31.

2/ Company Law and Capitalism (1977), at 327.

3/ Ibid., 331.

of the principle of disclosure in giving investors a fuller and more searching picture of the state of their company's affairs than is possible on the current system of reports and accounts". [1] It is believed that the proposals in this thesis including that for the appointment of more representative and non-executive directors would go toward achieving some control over corporate management in addition to but not in replacement of existing rules for disclosure, prohibition and so on.

It will be apparent from the analysis of the proposals for change which have been considered that the potential is there for increased shareholders' activities and a more effective supervisory role for the board. To an extent, these are already being achieved by many shareholders and companies who have acted on their own initiatives. However, the mechanisms for their participation need strengthening.

Greater shareholder involvement is, of course, not an end in itself. Institutions could not solve every management problem even if they intervened in every case. Neither is the increased use of non-executive directors a panacea for all corporate problems. However, the absence of these factors has discouraged or tended to discourage public attitudes to investment and encouraged mismanagement. What this thesis proposes is, therefore, a limited goal: that is, the enchancement of shareholders' control by providing a mechanism for improving the decision-making process and the fulfilment of the board's functions of supervising and monitoring management's performance.

1/ Ibid., 332.

BIBLIOGRAPHY

BOOKS

AFTERMAN, A.B., Company Directors And Controllers : Their Duties to the Company and the Shareholders. Australia, 1970.

BAKER, J.C., Directors and Their Functions. Harvard Business School, 1945.

BAUM, D.J., and STILES, N.B., The Silent Partners: Institutional Investors and Corporate Control. Syracuse University Press, 1965.

BERLE, A.A., Power Without Property, Harcourt-Brace, 1959.

——— and MEANS, G.C., The Modern Corporation and Private Property. Harcourt Brace (Revised Edition) 1967.

——— New Directions In The New Word. Harper, 1940.

BLACKBURN, Robin, ed., Ideology In Social Science. Readings in Critical Social Theory. Fontana/Collins, 1972.

BRISTON, Richard and DOBBINS, Richard, The Growth and Impact of Institutional Investors; A Report to The Research Committee of the Institute of Chartered Accountants in England and Wales, 1978.

BROWN, C.C. Putting The Corporate Board to Work. Mcmillan, 1976.

BULL, George, The Directors' Handbook. McGraw-Hill, 1969.

CARSWELL, J. The South Sea Bubble. Cresset Press, 1960.

DAHRENDORF, Ralph, Class and Class Conflict in Industrial Society. Routledge, 1959.

DAY, M., and HARRIS, P. Unit Trusts. Oyez, 1974.

DERRIMAN, James, Company-Investor Relations. University of London Press, 1969.

DU BOIS, A.B., The English Business Company After The Bubble Act, 1720-1800, New York, 1938.

FLORENCE, P.S. The Logic of British and American Industry. A Realistic Analysis of Economic Structure and Government. Routledge & Kegan Paul, 1972 edition.

——— Ownership. Control and Success of Large Companies. Sweet and Maxwell, 1961.

ERNST and WHINNEY, The Fourth Directive. Kluwer, 1980.

FORMOY, R.R., The Historical Foundations of Modern Company Law, Sweet and Maxwell, 1923.

GALBRAITH, J.K., The New Industrial State, Penguin, 1968.

——————— Economics and The Public Purpose, Penguin, 1973 edition.

GARDINER, G, and MARTIN, A., ed. Law Reform Now, Victor Gollancz Ltd., 1963.

GASKIN, M., The Scottish Banks : A Modern Survey, George Allen & Unwin, 1965.

GILBERT, M., ed. The Modern Business Enterprise, Penguin, 1972.

GOWER's Company Law, 4th Edition, Stevens, 1979.

GORE-BROWNE, On Companies, 43rd Edition, Jordan, 1977.

GORDON, R.A. Business Leadership In The Large Corporation, University of California Press, 1961 edition.

GOYDER, George, The Responsible Company, Blackwell, 1961.

HADDEN, Tom, Company Law and Capitalism, Weidenfeld and Nicolson, 1977 edition.

HALSBURY'S Laws of England, 4th Edition, Butterworths 1973.

HARPER, D.G., See Vernon, etc.

HOLDSWORTH, Sir William., A History of English Law, Sweet & Maxwell, 2nd Edition (1937), Volumes 8 and 15.

HUNT, B.C., The Development Of The Business Corporation in England, 1800-1867, Harvard University Press, 1936.

JOFFE, Victor, assisted by HOCHHAUSER, A., The Companies Act 1980 : a practical guide. Oyez, 1980.

JURAN, J.M. and LOUDEN, J.K., The Corporate Director. American Management Association, 1966.

KERR, A.W., History of Banking In Scotland. Adam & Charles Black, 1902.

KOONTZ, Harold, The Board of Directors and Effective Management, McGraw-Hill, 1967.

LARNER, R. Management Control and The Large Corporation, Dunellin, 1970.

LATTIN, On Corporations, The Foundation Press Inc., 1971 edition.

LEVY, A.B., Private Corporations And Their Control, Routledge & Kegan Paul, 1950, Vols. I and II.

FORMOY, R.R., The Historical Foundations of Modern Company Law, Sweet and Maxwell, 1923.

GALBRAITH, J.K., The New Industrial State. Penguin, 1968.

——————— Economics and The Public Purpose. Penguin, 1973 edition.

GARDINER, G, and MARTIN, A., ed. Law Reform Now. Victor Gollancz Ltd., 1963.

GASKIN, M., The Scottish Banks : A Modern Survey. George Allen & Unwin, 1965.

GILBERT, M., ed. The Modern Business Enterprise. Penguin, 1972.

GOWER's Company Law, 4th Edition, Stevens, 1979.

GORE-BROWNE, On Companies, 43rd Edition, Jordan, 1977.

GORDON, R.A. Business Leadership In The Large Corporation. University of California Press, 1961 edition.

GOYDER, George, The Responsible Company. Blackwell, 1961.

HADDEN, Tom, Company Law and Capitalism, Weidenfeld and Nicolson, 1977 edition.

HALSBURY'S Laws of England, 4th Edition, Butterworths 1973.

HARPER, D.G., See Vernon, etc.

HOLDSWORTH, Sir William., A History of English Law. Sweet & Maxwell, 2nd Edition (1937), Volumes 8 and 15.

HUNT, B.C., The Development Of The Business Corporation in England, 1800-1867. Harvard University Press, 1936.

JOFFE, Victor, assisted by HOCHHAUSER, A., The Companies Act 1980 : a practical guide. Oyez, 1980.

JURAN, J.M. and LOUDEN, J.K., The Corporate Director, American Management Association, 1966.

KERR, A.W., History of Banking In Scotland, Adam & Charles Black, 1902.

KOONTZ, Harold, The Board of Directors and Effective Management, McGraw-Hill, 1967.

LARNER, R. Management Control and The Large Corporation, Dunellin, 1970.

LATTIN, On Corporations, The Foundation Press Inc., 1971 edition.

LEVY, A.B., Private Corporations And Their Control, Routledge & Kegan Paul, 1950, Vols. I and II.

LEE, T.A. and TWEEDIE, D.P., The Private Shareholder And The Corporate Report. A Report to the Research Committee of The Institute of Chartered Accountants in England and Wales, 1977.

LOOSE, Peter, ed., The Company Director. Jordan & Sons, 1975.

LOUDEN, J.K., See Juran and Louden.

MACE, M.L., Directors: Myth and Reality. Harvard Business School, 1971.

MARRIS, Robin, Economic Theory of Managerial Capitalism. Macmillan, 1964.

MARTIN, A. (See Gardiner and Martin).

MARX, Karl, Capital. Vol. 3., Charles Kerr & Co., 1909.

MEANS, G.C. (See Berle and Means).

MIDGLEY, Kenneth, Companies and Their Shareholders - The Uneasy Relationship. Published by the Institute of Chartered Secretaries and Administrators, 1975.

NAYLOR, Guy, Guide To Shareholders' Rights. George Allen & Unwin, 1969.

NICHOLS, Theo., Ownership Control and Ideology : An Enquiry into Certain Aspects of Modern Business Ideology. George Allen & Unwin, 1969.

OLAWOYIN, G.O. The Status and Duties of Directors. Ife, Nigeria, 1977.

PALMER's Company Law, 21st Edition, Stevens & Sons, 1972.

PALMER, E.E., PRENTICE, D.D. and WELLING, B. Canadian Company Law, Cases Notes and Materials. 2nd Edition, Butterworths, 1978.

PARKINSON, C.N. Parkinson's Law; or The Pursuit of Progress. John Murray, 1979.

PAYNE, P.L., British Entrepreneurship in the Nineteenth Century (Studies in Economic History). Macmillan, 1974.

PENNINGTON, R.R., The Investor And The Law. MacGibbon & Kee (1968).

German Company Law. European Commercial Law Library (No. 3), Oyez, 1975.

Pennington's Company Law. 4th Edition, Butterworths, 1979.

PUCKEY, Sir Walter, The Boardroom; A Guide to the Role and Functions of Directors. Hutchinson, 1969.

ROSTOW, W.W., British Economy of the Nineteenth Century. Oxford, 1947.

RUBNER, Alex, The Ensnared Shareholder. Penguin Books, 1965.

SCOTT, W.R. The Constitution And Finance of English, Scottish and Irish Joint-Stock Companies to 1720, Peter Smith, 1951.

SHENFIELD, Barbara, Company Giving, George Allen & Unwin, 1971.

STILES, N.B. (See Baum and Stiles).

TOUCHE, A.G., Accounting Requirements of The Companies Acts, Butterworths, 1967.

TRICKER, R.I. The Independent Director, A Study of The Non-Executive Director and of The Audit Committee, Tolley, 1978.

VANCE, C.S., Boards of Directors : Structure and Performance, University of Oregon Press, 1964.

VERNON, R.A., MIDDLETON, M. and HARPER, D.G. Who Owns The Blue Chips, A Study of Shareholding In a Leading Company. Gower Press, 1973.

VOTAW, D., Modern Corporations, Prentice-Hall, 1965.

WHINNEY. See Ernst.

WILLIAMSON, O.E. The Economics of Discretionary Behaviour : Managerial Objectives In a Theory of The Firm, Prentice-Hall, 1964.

WILLOTT, R., Current Accounting Law and Practice, Sweet & Maxwell, 1978.

WÜRDINGER, H., German Company Law, R.R. Pennington, Ed., Oyez., 1975.

ARTICLES, PAPERS AND NOTES

AICKIN, K.A. "Division of Powers Between Directors and General Meeting As a Matter of Law and as a Matter of Fact or Policy", (1967) Melb. U.L.R. 448.

AKANKI, O. "The Legal And Practical Significance of Disclosure and Publicity of Company Information", (1976) Vol. XIII Nigerian Bar Journal, 13.

ATIYAH, P.S. "Thoughts on Company Law Philosphy", (1965) 9, The Lawyer, 16.

BAXT, R., "Judges In Their Own Cause : The Ratification of Directors' Breaches of Duty", (1978) 5 Monash U.L.R. 16.

BAKER, C.D. "Disclosure of Directors' Interests in Contracts", (1975) J.B.L. 181.

BECK, Stanley M., "The Saga of Peso Silver Mines", (1971) 49 Can. B.R. 81.

———————— "The Quickening of Fiduciary Obligation : Canadian Aero Services v O'Malley", (1975) 53 Can. B.R. 771.

BIRDS, John, "Excluding The Duties of Company Directors" (1976) 39 M.L.R. 394.

———————— "Government Wants to reduce disclosure requirements again" (1980) 1 Co. Law, 203.

BOYLE, Anthony, "Minority Shareholders' Suits For Breach of Directors' Duties", (1980) 1 Co. Law 3.

CARR, Lord, "The Function of Ownership and The Role of Institutional Shareholders", Booklet No. (4) in <u>Corporate Governance and Accountability</u>, published by the Institute of Chartered Secretaries and Administrators, London, 1979.

CARTOON, B.J., "The Removal of Company Directors", (1980) J.B.L. 17.

CHORLEY, Lord and WOLFF, E., "Commercial Law and Company Law", in <u>Law Reform Now</u>, (1963), 150, Gardiner and Martin, ed.

DAVIES, J.C. "The European Company : a Stumbling Block", (1972) 116 Sol. J. 227.

DEAN, Sir Maurice, "The Powerful Case For Part-Time Directors, <u>The Director</u>, June 1976, 52.

EDITORIAL, "House of Lords Sanctions Evasion of Companies Acts", (1970) J.B.L. 1.

EISENBERG, M.A., "Modern Corporate Decision Making", (1969) 57 Cal. L.R. 1.

——————— "Legal Models of Management Structure in the Modern Corporation : Officers, Directors, and Accountants". (1975) 63 Cal. L.R. 375.

FICKER, Hans C., "The Proposed Statute of a European Corporation", (1971) J.B.L. 167.

FLORENCE, P.S. "The Statistical Analysis of Joint Stock Company Control", (1947) 110 J. of Royal Statistical Society, 2.

GARRETT, Ray, "Attitudes on Corporate Democracy - A Critical Analysis", (1956) 51 Nw. U.L.R. 310.

GOLDBERG, G.D. "Article 80 of Table A of the Companies Act 1948", (1970) 33 M.L.R. 177.

GOWER, L.C.B., "Corporation Law in England and America, (1955-56) 11, Bus. Lawyer, 39.

——————— "Some Contrast Between British and American Corporation Law" (1956) 69 Harv. L.R. 1369.

HADDEN, Tom, "Fraud in the City : Enforcing the rules", (1980) Co. Law 9.

HORNSEY, Geoffrey, "Some Aspects of the Law Relating to Company Control", (1950) 13 M.L.R. 470.

HULL, John, "Department of Trade Investigation", (1979), N.L.J. 825.

KAHN-FREUND, O., "Company Law Reform" (1946) 9M.L.R. 235.

KESSLER, R.A., "The Statutory Requirement of a Board of Directors : A Corporate Anachromism", (1959-60) 27 U.Ch.L.R. 696.

LANG, Temple, "The Fifth EEC Directive on The Harmonization of Company Law" (1975) 12 C.M.L.R. 155.

LEECH, N.E., and MUNDHEIM, R.H., "The Outside Director of The Publicly Held Corporation", (1976) 31 Bus. Lawyer, 1799.

MACE, M.L., "The Changing Role of Directors in the 1970s". (1976) 31 Bus. Lawyer, 1209.

MACMAHON, Peter, "Shareholders Put To The Test", (1974) Social Audit, 4.

MANNING, Bayless, "Book Review" (1957-58) 67 Y.L.R. 1477.

MARSH, Harold J., "Are Directors Trustees? Conflict of Interest and Corporate Morality", (1966) 22 Bus. Lawyer, 35.

MARTIN-KAYE, Niel, "The Theoretical Basis of Modern Company Law", (1976) J.B.L. 235.

MASON, H.H. "Take-Overs and Disputed Shares Issues. Ratification of Directors' Acts (1977) 51. A.L.J. 89.

McPHERSON, B.H. "Directors' Duties and The Powers of Shareholders", (1977) 51 A.L.J. 460.

MIDGLEY, Kenneth, "How Much Control Do Shareholders' Exercise?", (1974) Lloyds Bank Rev. 37.
"To Whom Should The Board Be Accountable... And For What?", in Corporate Governance and Accountability (No. 1) published by the Institute of Chartered Secretaries and Administrators, (1979), 15.

MOSCOW, C, "The Independent Director" (1972-73) 28 Bus. Lawyer, 9.

PAHL, R.E., and WINKLER, J.T., "The Economic Elite : Theory and Practice", in Stanworth and Gibbens, Elites and Power in British Society, (1974), 102.

PENROSE, L.S., "The Elementary Statistics of Majority Voting", (1946), 109 Journal of Royal Statistical Society, 53.

PRENTICE, D.D. "Directors' Fiduciary Duties - The Corporate Opportunity Doctrine" (1972) 50 Can. B.R. 623.

———— "Removal of Directors From Office" (1969) M.L.R. 693.

———— "Companies Act 1976", (1977) 40 M.L.R. 314.

———— "Employee Participation in Corporate Government. A Critique of the Bullock Report", (1978) 56 Can. B.R. 277.

REDWOOD, H. "The Fisons Shareholder Survey". in Long Range Planning, April 1971, 3.

RICHARDSON, Sir Gordon, "The Joint Stock Company - Adapting To Change", The Director, April 1979, 63.

SAUNDERS, D.M., "The Executive Committee in Corporate Organisation - Scope of Powers, (1943) 42 Mich. L.R. 133.

SAUNDERS, Pieter, "The European Company", (1968) J.B.L. 184.

SCHMITTOFF, Clive M. "Salomon in the Shadow", (1976) J.B.L. 305.

SEALEY, L.S. "Fiduciary Relationships", (1962) C.L.J. 69.

———— "The Director as Trustee", (1967) C.L.J. 83.

SLUTSKY, B.V., "The Relationship Between The Board of Directors and The Shareholders in General Meeting", (1968) Univ. of Br. Col. L.R. 81.

SUGARMAN, David, "Bar Propose that DoT investigations should be replaced by a Commission", (1980) 1 Co. Law 302.

———————— "Wilson does not shut the door on a British SEC", (1980) 1 Co. Law 304.

SULLIVAN, G.R., "The Relationship Between The Board of Directors and The General Meeting In Limited Companies", (1977) 93 L.Q.R. 569.

STONE, J.M.L., "An Uncertain Aspect of Shareholder Protection, (1980) N.L.J. 152.

THACKRAY, John, "Americas Changing Boardrooms", Management Today, May 1978, 58.

VAGTS, D.F. "Reforming the Modern Corporation : Perspectives from the German", (1966-67) 80 Harv. L.R. 23.

———————— "Directors : Myth and Reality", (1976) 31 Bus. Lawyer, 1227.

WEDDERBURN, K.W. "Shareholders Rights and the Rule in Foss v Harbottle", (1957) Camb. L.J. 194.

———————— "Going The Whole Hogg v Cramphorn", (1968) 31 M.L.R. 688.

———————— "Control of Corporate Litigation", (1976) 39 M.L.R. 327.

WEINBERG, Mark, "Industry and Shareholding" Paper prepared for a Seminar held on June 4, 1971 and published by the Industrial Education and Research Foundation.

U.K. STATUTES

1720 Bubble Act (6 Geo.1, c.18)

1825 Bubble Companies Act (6 Geo. 4. c.91)

1837 Chartered Companies Act (7 Will. 4 & 1 Vic. c.73).

1844 Joint Stock Companies Act(7 & 8 Vict. cc.110 & 111).

1845 Companies Clauses Consolidation Act (8 & 9 Vict. c.16).

1847 Joint Stock Companies Act (10 & 11 Vict. c.78)

1855 Limited Liability Act (18 & 19 Vict.c.133).

1856 Joint Stock Companies Act (19 & 20 Vict. c.47)

1862 Companies Act (25 & 26 Vict. c.89).

1867 Companies Act (1862) Amendment Act (30 & 31 Vict., c.131)

1877 Companies Acts Amendment Act (40 & 41 Vict., c.26)

1879 Companies Act (42 & 43 Vict., c. 76)

1890 Companies (Memorandum of Association) Act(53 & 54 Vict., c.62)

—— Directors Liability Act (53 & 54, Vict., c.64).

1900 Companies Act. (63 & 64 Vict., c.48)

1907 Limited Partnership Act (7 Edw., VII c.24)

—— Companies (Amendment) Act (7 Edw., VII c.50)

1908 Companies (Consolidation) Act (8 Edw. 7 c.69)

1929 Companies Act (19 & 20 Geo. 5. c.23).

1947 Companies Act (10 & 11 Geo. 6 c.47)

1948 Companies Act (11 & 12 Geo.6 c. 38).

1967 Companies Act (c.81)

1976 Companies Act (c.69)

1980 Companies Act (c.51)

PARLIAMENTARY REPORTS AND OTHER OFFICIAL PUBLICATIONS (1900-1980)

BATSTONE, E. and DAVIES, P.L. Industrial Democracy : European Experience, 1976, H.M.S.O.

BULLOCK's REPORT : Report of the Committee of Inquiry on Industrial Democracy, under the Chairmanship of Lord Bullock, 1977. H.M.S.O. Cmnd. 6706.

COHEN's COMMITTEE on Company Law Reform, 1943, H.M.S.O. Cmnd. 6659.

COMPANY ACCOUNTING AND DISCLOSURE : A Consultative Document. 1979, H.M.S.O, Cmnd 7654.

THE FUTURE OF COMPANY REPORTS : A Consultative Document, 1977, H.M.S.O., Cmnd 6888.

THE CONDUCT OF COMPANY DIRECTORS , White Paper, 1977, H.M.S.O. Cmnd. 7037.

GREENE'S COMMITTEE on Company Law Reform, 1926, H.M.S.O. Cmnd. 2657.

JENKINS' COMMITTEE on Company Law Reform, 1962, H.M.S.O. Cmnd. 1749.

LOREBURN's COMMITTEE on Company Law Reform, 1906, H.M.S.O. Cd. 3052.

PARLIAMENTARY DEBATES

WILSON COMMITTEE REPORT:

Committee to Review the Functioning of Financial Institutions; 1977-1980, H.M.S.O. (Report 1980. Cmnd 7937).

GHANA

The Final Report of the Commission of Enquiry into the Working and Administration of the present Company Law of Ghana. Printed and published by the Ghana Publishing Corporation, Accra, Ghana, 1961.

DEPARTMENT OF TRADE : INSPECTORS' REPORTS

Ferguson and General Investments Ltd. (Dowgate and General Investments Ltd.) 1979.

First Re-Investment Trust Ltd., etc., 1974.

Lonrho Ltd., 1976.

Peachey Property Corporation Ltd., 1979.

Savoy Hotel Ltd., 1954.

DEPARTMENT OF TRADE : ANNUAL REPORTS

Companies in 1977.

Companies in 1978.

Companies in 1979.

DEPARTMENT OF INDUSTRY STATISTICS

ERRITT, M.J., ALEXANDER, J.C.D. and WATSON, A.J. The Ownership of Company Shares. A Survey for 1975. Studies in Official Statistics No. 34.

UNPUBLISHED THESIS

JEFFERYS, J.B. Trends in Business Organisation in Great Britain since 1856, with special reference to the financial structure of companies, the mechanism of Investment and the Relations between the shareholder and the Company. Unpublished Ph.D. Thesis, University of London, 1938.

SEGEV, J. The Powers of the General Meeting and the Board of Directors in the Company Law of Britain and Israel. Unpublished Ph.D. Thesis, London School of Economics, 1973.

SLUTSKY, B.V. The Duties and Powers of Management in the Company Law of Canada and England. Unpublished Ph.D. Thesis, London School of Economics, 1971.

PROFESSIONAL REPORTS AND SURVEYS

"The Board of Directors - A Survey of its Structure, Composition and Role". Management Survey Report, No. 10, British Institute of Management, 1972.

The Corporate Report : Accounting Standards Steering Committee, 1975.

Board of Directors Study. Korn/Ferry International, 1980.

"Composition of Company Boards", Bank of England Quarterly Bulletin, Vol. 4 Dec. 1979.

Fisons Ltd. Profile for 1979.

Guidelines for Directors. Institute of Directors, 1974.

"The Responsibilities of the British Public Company", under the Chairmanship of Lord Watkinson. The Confederation of British Industry, 1973.

"The Responsibilities and Contributions of Non-Executive Directors on Boards of U.K. Companies". A Survey by the Institute of Directors and Booz Allen and Hamilton, 1979.

OTHERS

Admission of Securities to Listing. Issued by Authority of the Stock Exchange, 1979.

References have also been made to the Annual Accounts and Reports of some companies, The Director, The Financial Times, The Guardian, Management Today and The Times.