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Shareholder Rights in Britain

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Abstract
This article examines the historical, doctrinal and theoretical bases of shareholder rights in British company law. These rights are, and always have been, essentially the product of private bargains, subjected to regulation of various explicit and implicit forms. This legal framework has significant normative advantages: it facilitates the development of innovative and efficient corporate structures. That is demonstrated through empirical evidence and examples from British corporate practice. One key example is how so-called 'indirect investors' in a company – the large and economically significant group of people who invest in a company through intermediaries such as nominees and depositaries – can be accommodated within the governance structure of the company, even though they are not themselves shareholders in the company and so are not directly party to its internal governance mechanisms. With this domestic legal background in mind, the article finally addresses and assesses the impact and effect of the proposed EU Shareholder Rights Directive on British company law and practice.

Keywords: company, share, shareholder, indirect investor, corporate structure, corporate governance, shareholder rights, corporate history, corporate theory, European company law, British company law, corporate practice.

1. INTRODUCTION

The Draft Shareholder Rights Directive[1] proposes various Community-wide fundamental rights for shareholders.[2] The Commission proposes to enshrine these rights in a Directive applicable across the European Union because of the growth

[1] COM (2005) 685 final (hereinafter, 'the Directive').

[2] Strictly speaking, rights in a British company attach to *members* of the company, that is, (in a company limited by shares) those *shareholders* whose names are on the company's register of members. See, most importantly, Companies Act 1985, ss. 14 and 22. In this article, the terms 'shareholder' and 'member' are used interchangeably, because someone who becomes a shareholder in a listed company will be placed on the company's register of members.

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in cross-border ownership of securities and the difficulties in exercising rights attached to those securities. The very opening paragraph of the Explanatory Memorandum to the Draft Directive sets out the issues succinctly and bears repetition in full.

> Shareholder participation is an essential precondition for effective corporate governance. However, EU-citizens holding shares in a listed company situated in another Member State often face severe problems when they wish to exercise the voting rights attaching to these shares and sometimes even encounter obstacles that make voting practically impossible. Nowadays, investors typically hold their shares through accounts opened with securities intermediaries, who, in turn, hold accounts with other securities intermediaries and central securities depositories in other jurisdictions. The legal constructs from which shareholders' rights emanate in the Member States are not always fully adapted to this modern form of intermediated holdings. The cross-border chains of intermediaries, therefore, make not only the communication process between issuers and shareholders, but also the voting process, more difficult.[3]

The Directive does not, however, unify the structures for shareholder governance within companies incorporated under the national laws of a Member State. That would be an immensely difficult task, given the very different legal and commercial traditions within the European Union. Indeed, it would be difficult to the point of inhibiting any useful development of shareholder rights at the Community level. Instead, the Directive builds on existing structures by insisting on certain minimum rights for shareholders, irrespective of how shareholders' rights are constituted in a company incorporated under the national laws of a particular Member State.[4]

Consequently, in order to understand the impact and implementation of the Directive in any given state, it is necessary to understand how the national laws of that state approach the question of shareholder rights. This article focuses on the impact of the Directive in the United Kingdom, or, more precisely, its impact on companies incorporated in Great Britain under the Companies Act 1985.[5]

The article will first explain the legal underpinnings of shareholder rights in Britain. These rights are fundamentally contractual, established by bargain between the shareholders in a company, and the rights are correspondingly variable, notwithstanding that their contractual basis has been subject to considerable

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[3] Explanatory Memorandum to the Directive, para. 1.1.

[4] The Directive is, by virtue of Art. 3, avowedly a minimum harmonisation directive.

[5] Companies are incorporated in Northern Ireland under the Companies (Northern Ireland) Order 1986 (SI 1986/1032) which very largely follows the Companies Act 1985.

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mandatory, statutory, regulation over the years.[6] This article will demonstrate why that essentially contractual régime remains important to this day, both for general reasons of legal theory and practice and for the specific purpose of implementing the Directive in the United Kingdom. Next, the article will examine the particular problem of those who, in the United Kingdom, are termed 'indirect investors', that is, those who invest in shares, but who have the registered title to the shares held for them by an intermediary, often a bank or other institution acting as a nominee or depositary. Though the right to vote shares in a British company attaches to the registered holder of shares, practising lawyers have adapted existing legal institutions – the right to cast votes by means of a proxy – to ensure some considerable measure of enfranchisement for indirect investors.[7] These techniques will soon be supplemented by legislation, namely Part 9 of the Companies Bill, which is currently before the UK Parliament. Finally, and with this understanding in mind, the article will assess the impact of the Directive in the United Kingdom.

2. THE LEGAL FRAMEWORK FOR SHAREHOLDER RIGHTS IN BRITAIN

Anyone who wishes to understand shareholder rights in British companies must be aware of history. A common law system is the product of history: a system of precedent is necessarily historical. Statute law in such a system might seem less beholden to history, because Parliament can write legislation afresh. Appearances are deceptive, however. In the United Kingdom, statutes are often re-enactments of previous legislation: a new Act of Parliament brings together ('consolidates') in one Act several previous Acts related to a single topic, and then repeals the old legislation. The new 'consolidating' Act has the same effect as the old legislation, unless Parliament indicated through the language of the Act that the law was to change.[8] Companies legislation in the United Kingdom follows this pattern.

2.1 **The basis in history**

The earliest UK companies legislation in a recognisably modern form was the Companies Act 1862, though that Act itself drew to an extent on earlier legislation,

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[6] This part of the article draws on the author's earlier and fuller examination of shareholder rights in English law, see R.C. Nolan, 'The Continuing Evolution of Shareholder Governance', 65(1) *Cambridge Law Journal* (2006) p. 92.

[7] This part of the article draws on the author's earlier and fuller examination of indirect investors' rights in English law, see R.C. Nolan, 'Indirect Investors: A Greater Say in the Company?', 3 *Journal of Corporate Law Studies* (2003) p. 73.

[8] As to the interpretation of consolidating Acts, see, e.g., *Grey* v. *IRC* [1960] A.C. 1; and, more generally, F. Bennion, *Statutory Interpretation*, 4th edn. (London, Butterworths 2002) pp. 515-518.

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in particular the Joint Stock Companies Act 1856. Over time, Parliament amended the 1862 Act and added to it, before all the relevant law was consolidated in the Companies (Consolidation) Act 1908. The cycle of amendment, addition and consolidation has since been repeated three times, culminating in (respectively) the Companies Act 1929, the Companies Act 1948 and the Companies Act 1985.

The 1985 Act is now the central piece of legislation which governs how the overwhelming majority of business corporations are formed and run in the United Kingdom. Since its enactment, the 1985 Act has itself been much altered and expanded. Other subsequent Acts also affect the constitution and operation of companies established in the United Kingdom. Indeed, yet another such Act will appear when the Companies Bill passes through Parliament and obtains the Royal Assent.

Be that as it may, the important point for understanding shareholder rights in Britain is that their basic structure was established in our earliest company law, and, notwithstanding a heavy body of regulation enacted subsequently, that basic structure still endures. That is why a survey of history is important for the purposes of this article.

The Companies Act 1862 said nothing about the rights of control shareholders were to have in a company. Indeed, it contained just five sections which specifically concerned how shareholders were generally to run their affairs within a company.

Section 49 of the 1862 Act, the opening section in a division headed 'Provisions for Protection of Members', required that a company was to have a general (i.e., shareholders') meeting each year.[9] Section 52 laid down four default rules to regulate the calling and conduct of general meetings, though these rules only applied in so far as a company's articles of association (constitution) made no other relevant provision.[10] Sections 53-54 required the registration and publication of 'special resolutions',[11] as defined in section 51.[12] Finally, section 67 required minutes of any meetings to be kept, provided for such minutes to be admissible as evidence in legal proceedings, and raised a presumption that the meeting and its proceedings were regular.[13] That was it. All the rest of the rules about what rights of governance shareholders were to have, and how they were to exercise them, were to be found in the company's constitution. So, for example, regulations 29-51

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[9] Section 49 followed Joint Stock Companies Act 1856, s. 32.

[10] Section 52 had no precursor in the Joint Stock Companies Act 1856.

[11] Elements of these sections drew on Joint Stock Companies Act 1856, ss. 35-36.

[12] This section followed Joint Stock Companies Act 1856, s. 34. A 'special resolution' is a resolution only passed by a weighted majority (essentially, 75 per cent of the votes cast) which is required for certain transactions, the number of which has increased markedly over the years. See below.

[13] This section followed Joint Stock Companies Act 1856, s. 40.

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of the standard default form of articles (contained in the First Schedule to the 1862 Act)[14] provided for the calling of general meetings, the form of their proceedings, the votes of members and the methods of voting.[15]

2.2 The enduring legal principles

In terms of principle, this necessarily meant that, subject to any statutory regulation, governance rights in a company were allocated by its articles of association,[16] which themselves were given effect by section 16 of the Companies Act 1862.[17] Most fundamentally, therefore, and subject only to very limited intervention by the 1862 Act, those who formed a company were given freedom by statute to order its governance as they saw fit. As Bowen L.J. put it, in *Harben* v. *Phillips*,

> [W]hen persons agree to act together in the conduct of a business, the way in which that business is to be carried on must depend in each case on the contract, express or implied, which exists between them as to the way of carrying it on. … When you come to statutory corporations you must look at the statute itself, and the rules which are created under it…[18]

This is a vitally important statement of legal principle, and it must be clearly understood, as it forms the basis of so much in British corporate law and practice.

A registered company limited by shares is indeed the creature of statute.[19] The point is that statute has itself granted shareholders in a company the general contractual freedom to organise their own affairs, and those of their company, as they see fit, subject always to any applicable regulation. (Parliament has not

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[14] Hereinafter, 'Table A (1862)'.

[15] These regulations drew largely on regs. 22-43 of Table B in the Schedule to the Joint Stock Companies Act 1856. They broadly presage what are now regs. 36-63 of the modern default form of articles, Table A in the Companies (Tables A–F) Regulations 1985 (SI 1985/805), hereinafter 'Table A (1985)'.

[16] The rest of this article will refer only to articles of association, because the overwhelmingly standard practice is to establish shareholders' governance arrangements in a company's articles rather than its memorandum. The author has surveyed the articles as at 16 January 2004 of all the companies constituting the FTSE 100 Index at that date. That survey showed all such arrangements to be in the respective companies' articles. For present purposes, therefore, all references to a FTSE 100 company's articles are references to its articles as they appeared in that survey.

[17] Section 16 drew largely on Joint Stock Companies Act 1856, s. 10. Section 16, after much intervening re-enactment, now forms section 14 of the Companies Act 1985.

[18] (1883) 23 Ch.D. 14, 35-36.

[19] See, recently, *Halifax plc* v. *Halifax Repossessions Ltd.* [2004] EWCA Civ 331, [2004] 2 B.C.L.C. 455, at [13], *per* Arden L.J., and also *Welton* v. *Saffery* [1897] A.C. 299 at p. 305, *per* Lord Halsbury L.C.

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necessarily granted equivalent freedom for shareholders to order their dealings with 'outsiders' to the company. This article, however, focuses on the internal governance of companies, where that freedom is fundamental.) As a matter of policy and history, English law has long recognised the general freedom of those who establish a business to order their own affairs amongst themselves. For example, arrangements between the members of a commercial partnership are simply a contract, and the partners enjoy normal freedom of contract when they make such arrangements, subject to any applicable regulation.[20] What Parliament did in 1862, drawing on earlier ideas, was to carry that general freedom of contract into the new statutory system of corporate law. Parliament created a simple mechanism by which private parties could request and obtain the Act of State necessary to establish a corporation, but Parliament also carried into that new system the contractual freedom for the parties to order their own affairs within the corporation, subject always to any applicable regulation. That freedom still forms a basic principle of company law in the United Kingdom.

The point is made plain by the very words of the Companies Act 1985. A company must have articles of association: it will either have its own, specially drafted articles, or else Table A (1985) will form its articles by default.[21] Section 14 of the Act then provides that:

> Subject to the provisions of this Act, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.[22]

Quite simply, this means that the shareholders (members) choose the terms of the arrangements between them, and the law gives effect to those arrangements, subject to any applicable regulation. That effect is explicitly contractual in nature, even though the effect is mandated by statute rather than by the common law.

So even the most fundamental rights of shareholders in a company, such as the right to attend and vote at general meetings, the number of votes each shareholder

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[20] See, generally, N. Lindley and R.C. l'Anson Banks, *Lindley & Banks on Partnership*, 18th edn. (London, Sweet & Maxwell 2002).

[21] Companies Act 1985, s. 8. The effect of section 8 will be continued by clauses 18-20 of the Companies Bill.

[22] There is a very great deal of detailed learning on – and glossing of – section 14 and its various predecessor provisions. See generally the Hon Mrs Justice Arden and D. Prentice, *Buckley on the Companies Acts* (London, Butterworths 2000) at [14.5]-[14.10]; and P.L. Davies, *Gower and Davies' Principles of Modern Company Law*, 7th edn. (London, Sweet & Maxwell 2003) pp. 58-65. None of that unsatisfactory detail, or glossing, is relevant for present purposes. What is relevant is the basic principle of statute giving legal effect to consensual arrangements. The effect of section 14 will be continued by clause 34 of the Companies Bill.

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has in respect of a share and the right to participate in the company's profits, are all established by the company's articles of association, not by a mandatory rule of law. Likewise, the rights which provide for expression of the fundamental control rights of shareholders, rights such as the right to speak at meetings, appoint proxies and so forth, all have their origin as rights established by a company's articles, though, as will be seen, some of these rights (such as the right to appoint a proxy) have in large measure been overtaken by mandatory statute law.[23]

2.3 The influence of context on principle

Of course, notwithstanding this original legal freedom to organise the internal governance structures of a company, the means of communication available in the nineteenth century significantly constrained how the members of a company could interact with each other and take decisions. Face-to-face meetings were the most practical way for members of a company to participate in its affairs, given the technologies available at the time. There were the possibilities of voting by post,[24] and later through a proxy deposited by telegraph,[25] but these never displaced the significance of meetings.

This meant that questions about the constitution and proceedings of company meetings came to be litigated, and when the express terms of a company's articles did not, by themselves, resolve the issue, the courts applied by analogy various principles established in cases which concerned meetings in other contexts, such as public meetings or the meetings of chartered corporations.[26] Some of those principles were default rules, which could be ousted or modified by a company's articles: for example, the principle that failure to give due notice of a meeting to all those entitled to such notice vitiates the meeting,[27] a rule which is now generally modified by a company's articles,[28] as well as rules governing the

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[23] For confirmation, see, e.g., Table A (1985) or the expressly drafted articles of association of a company such as BP plc.

[24] *McMillan* v. *Le Roi Mining Company Ltd.* [1906] 1 Ch. 331 adverts to this possibility, though the High Court in fact struck down a postal ballot held by the company, because it could not hold postal ballots consistently with its articles. However, the clear implication is that had the articles been different, so too might have been the result.

[25] *Re English, Scottish & Australian Bank* [1893] 3 Ch. 385 illustrates this possibility, though the case itself concerned a statutory meeting to approve a scheme of arrangement.

[26] See D. Impey, et al., *The Modern Law of Meetings* (Bristol, Jordans 2005); I. Shearman, *Shackleton on the Law and Practice of Meetings* (London, Sweet & Maxwell 2006); A. Hamer and A. Robertson, *Running Company Meetings* (Hemel Hempstead, ICSA Publishing 1997).

[27] *Smyth* v. *Darley* (1849) 2 H.L. Cas. 789, 9 E.R. 1293; *Musselwhite* v. *C.H. Musselwhite & Son Ltd.* [1962] Ch. 964; *Royal Mutual Benefit B.S.* v. *Sharman* [1963] 1 *WLR* 581.

[28] See, e.g., Table A (1985), reg. 39. Such an article is vitally important in practice, because English statute law contains no provision mitigating the common law consequences of failure

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adjournment of meetings.[29] Other examples of those principles might well be mandatory, drawing their force from considerations of public policy, such as the rule that requires notices of meetings to be fair, accurate and comprehensible, particularly as regards decisions which concern directors' own interests relating to the company.[30] Case law also elucidated terms used in the statute, or in a company's articles, such as the question of what actually amounted to a 'meeting'.[31]

Still, none of this law demanded any particular form of corporate decision making by shareholders. The law regulated general meetings, which originally were only required by section 49 of the Companies Act 1862 and by any relevant provisions of a company's own articles, and it filled any gaps in those articles. The key to shareholders' rights within a company, and the key to the exercise of those rights, were the governance structures adopted by the shareholders themselves, embodied in the company's articles of association and given effect by section 16 of the 1862 Act, the precursor to section 14 of the Companies Act 1985.

The matter did not rest there, of course. Over time, mandatory statute law came increasingly to regulate how shareholders in a company were to participate in its affairs. This regulation assumed that shareholders would make decisions at face-to-face meetings. These assumptions were reflected in the statutory drafting, and statute, drawing on those assumptions, all too often entrenched them.

3. THE DEVELOPMENT OF THE BASIC FRAMEWORK

Since the 1862 Act, shareholder rights in British companies have been subjected to increasing regulation. There has been some deregulation since 1985, but the overall trend has definitely been towards greater regulation. That trend is continued, at least in so far as listed companies are concerned, by Part 14 of the Companies Bill. Much detailed history is needed to explain precisely how this body of regulation grew, and that history is addressed extensively elsewhere.[32] For present purposes, however, three key points must be made.

First, regulation of the basic freedom for shareholders to make their own arrangements for the internal governance of their company, a freedom established by section 14 of the Companies Act 1985 (and its precursors), is found in various places. There is, in particular, the explicit regulation of Part IX, Chapter IV of the Companies Act 1985. There are the assumptions factored into various statutory definitions which affect how shareholders interact with each other. In addition, in

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to give due notice, unlike the laws of other Commonwealth jurisdictions, such as Australia (Corporations Act 2001 (Cth.), s. 1322) and Singapore (Companies Act, s. 392).

[29] See, e.g., *Byng* v. *London Life* [1990] Ch. 170.

[30] *Kaye* v. *Croydon Tramways* [1898] 1 Ch. 358.

[31] See again *Byng* v. *London Life* [1990] Ch. 170.

[32] Nolan, loc. cit. n. 6, at pp. 103-113.

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so far as listed companies are concerned, there are relevant provisions of the Listing Rules. Secondly, notwithstanding this regulation, many aspects of shareholder rights in British companies are still governed by the arrangements established *inter se* by the shareholders in a company and embodied in the company's articles of association. Some examples will make this clear. Thirdly, this system has much to recommend it in normative terms. Each of these points is important and deserves a little more attention.

3.1 **Regulating the basic framework**

3.1.1 *Explicit statutory regulation*

Part IX of Chapter IV of the Companies Act 1985 contains many provisions, first enacted over the years and consolidated into the present statute, which limit or regulate the extent to which shareholders may establish for themselves their rights in a company. Some important aspects of this regulation are as follows. A public company must hold an annual general meeting, much as a private company, unless it opts out of this requirement by unanimity of all the shareholders who may attend and vote at the meeting which elects to avail itself of the opt-out.[33] A certain percentage of members in a company (those holding at lease 10 per cent of its paid-up voting capital) may requisition a general meeting of the company.[34] A lesser percentage of members (members holding at least 5 per cent of the voting rights, or 100 members who, on average, have paid up at least £100 in respect of their shares) may insist on certain items being on the agenda of a general meeting, and they may require that a circular be sent to shareholders about a resolution.[35] A very small number of members (five, or, in some circumstances, fewer) may insist on a poll vote (rather than a mere show of hands) to decide on a resolution put to a meeting.[36] Companies limited by shares must allow voting by proxy.[37] There are also other, more detailed provisions about how meetings are to be run, some of which are mandatory rules (such as the minimum length of notice for a meeting), others of which are default rules (such as quorum requirements).[38]

3.1.2 *Implicit statutory regulation*

The business to be done by shareholders may also implicitly limit the means through which they can govern their company. Statutory definitions are the key

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[33] Companies Act 1985, ss. 366, 366A.
[34] Companies Act 1985, s. 368.
[35] Companies Act 1985, s. 376.
[36] Companies Act 1985, s. 373.
[37] Companies Act 1985, s. 372.
[38] See, e.g., Companies Act 1985, ss. 369, 370.

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issue here. The point is that where mandatory statute law requires adherence to a particular form for an act to be valid, private parties cannot override that requirement by the arrangements they have made between themselves.

Very often, a decision must be taken by special resolution,[39] and occasionally by extraordinary resolution.[40] The definitions of 'special resolution' and 'extraordinary resolution' are both currently found in section 378 of the Companies Act 1985. Both definitions require that votes be cast 'at a general meeting' in order for the resolution in question to be carried. (This surely includes votes on a poll called at the general meeting.[41]) Both definitions also require a 75 per cent majority of those voting *in person or by proxy* and not, for example, by post. Consequently, if a company wishes to pass a special resolution or an extraordinary resolution, it will have to hold a meeting, unless the number of members in the company is small enough to make it possible to obtain the unanimous consent of the members, which usually functions as a surrogate for any resolution passed at a meeting of shareholders.[42]

Over time, the constraints which flow from the definitions of 'special resolutions' and 'extraordinary resolutions' have grown in their practical importance. Under the Companies Act 1862, special resolutions were used only to change a company's articles,[43] and extraordinary resolutions were only used to begin the voluntary winding up of a company.[44] Consequently, a company rarely needed to convene a meeting in order to pass a special or an extraordinary resolution. Correspondingly, the definitions of such resolutions rarely constrained how shareholders took a decision. Nowadays, special resolutions are needed for many

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[39] Business requiring a special resolution, which might commonly be encountered at a company's general meeting, includes various alterations to the company's memorandum (Companies Act 1985, ss. 4-6, 17, 28, 43, 53), alterations to its articles (ibid., s. 9), disapplication of pre-emption rights over unissued capital (ibid., ss. 89, 95), reduction of capital (ibid., s. 135) and authorisation to buy back shares off-market or under a contingent purchase contract (ibid., ss. 164, 165).

[40] For example, the alteration of class rights under Companies Act 1985, s. 125(2), or voluntary winding up under Insolvency Act 1986, s. 84(1)(c).

[41] See *Shaw* v. *Tati Concessions Ltd.* [1913] 1 Ch. 292; *Spiller* v. *Mayo (Rhodesia) Development Co. (1908) Ltd.* [1926] W.N. 78 and *Holmes* v. *Keyes* [1959] Ch. 199.

[42] Such consent might be (i) pursuant to the company's articles, such as Table A (1985), reg. 53; (ii) in the case of a private company, pursuant to Companies Act 1985, ss. 381A-381C and Schedule 15A; or (iii) pursuant to the common law principle of informal unanimous consent (see, e.g., *Re Express Engineering Works Ltd.* [1920] 1 Ch. 466; *Re Duomatic Ltd.* [1969] 2 Ch. 365; *Cane* v. *Jones* [1980] 1 *WLR* 1451; *Wright* v. *Atlas Wright (Europe) Ltd.* [1999] 2 B.C.L.C. 301; *Re Torvale Group Ltd.* [1999] 2 B.C.L.C. 605; *Euro Brokers Holdings Ltd.* v. *Monecor (London) Ltd.* [2003] EWCA Civ 105, [2003] 1 B.C.L.C. 506, at [61]-[63], *per* Leslie Kosmin Q.C., [2003] EWCA Civ 105, [2003] 1 B.C.L.C. 506, at [57]-[63], *per* Mummery L.J.; and *EIC Services Ltd.* v. *Phipps* [2003] EWHC 1507 (Ch), [2003] BCC 931, at [121]-[122], *per* Neuberger J).

[43] Companies Act 1862, s. 50.

[44] Ibid., s. 129. See *MacConnell* v. *E. Prill & Co. Ltd.* [1916] 2 Ch. 57 at p. 62, *per* Sargant J.

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more purposes.[45] At present, therefore, the definition of a special resolution constitutes a much greater practical limitation on how shareholders may effectively take decisions.

The definition of an elective resolution likewise anticipates a meeting of the (private) company in question,[46] unless there is unanimous consent of the company's members in lieu of a meeting.[47] However, such resolutions are quite explicitly designed to simplify the administration of closely held private companies and allow such companies to be run with less need for meetings so long as the resolutions remain in force. The form of elective resolutions does not, therefore, constitute an enduring limitation on how shareholders may choose to manage their affairs within a company.

There are other circumstances where the mandatory requirements of statute prescribe a certain form of decision making, and this will override the arrangements made by the shareholders in a company and embodied in its articles of association. Examples of this are cases where 'outsiders' to a decision by members of a company have rights to participate in the process which leads to decision (e.g., a director's right to protest at his removal)[48] or cases where the courts consider that statute has prescribed particular forms of decision making at least in part for the benefit of such 'outsiders' (e.g., a resolution by the members of a company to authorise it to purchase its own shares, which thereby affects creditors' interests).[49] In these cases, the shareholders in a company must adhere strictly to the relevant form(s) of decision making prescribed by statute.

Other statutory provisions may require members of a company to make a decision at a physical general meeting, or else by means of some other device approved by statute, such as a statutory written resolution, even though the relevant provisions do not give rights to anyone who is not a member of the company. For example, statute may require that members of a company 'pass a resolution' if they wish to achieve a certain result, and such language may then implicitly forbid other forms of decision making by the members, unless other provisions of statute explicitly authorise such conduct.[50] Again, a formal meeting may be necessary to persuade a court to exercise some discretion,[51] though

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[45] See n. 39 above.

[46] Companies Act 1985, s. 379A.

[47] Companies Act 1985, s. 381A(6).

[48] The right of shareholders in a company to remove a director of the company by passing an ordinary resolution to that effect, a right which cannot be ousted by private arrangements, is found in Companies Act 1985, s. 303. The director's right to protest at a proposal to remove him is in Companies Act 1985, s. 304.

[49] See, e.g., *Re R.W. Peak (Kings Lynn) Ltd.* [1998] 1 B.C.L.C. 193, and the more general statements of principle in *Wright* v. *Atlas Wright (Europe) Ltd.* [1999] 2 B.C.L.C. 301.

[50] See *Re R.W. Peak (Kings Lynn) Ltd.* [1998] 1 B.C.L.C. 193.

[51] See the possibility raised, though not the result reached, in *Re Barry Artist Ltd.* [1985] 1 *WLR* 1305.

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perhaps a valid statutory written resolution would now suffice. Interestingly, all the provisions of this nature which have come to court concern decisions by members of a company which can directly prejudice the interests of those who are not members of a company, such as the company's creditors. In such cases, the courts are, perhaps, particularly concerned to see strict adherence procedure as a safeguard for those who are directly affected by the decision but cannot formally participate in it.

3.1.3 *The influence of the Listing Rules*

A company must adhere to the Listing Rules in order to maintain a full listing on the London Stock Exchange. These Rules have also affected the freedom of a listed company to establish structures for participation by its shareholders in the company's affairs. For a long time, the Listing Rules required the articles to contain certain terms, some of which were relevant to participation by shareholders in the company,[52] though the Stock Exchange (then the listing authority) could always, in its discretion, waive compliance, either fully or in part.[53] Later editions of the Listing Rules removed nearly all the requirements for articles to contain certain terms, though the Stock Exchange, and then its successor as regulator, the United Kingdom Listing Authority, still required a listed company to submit its articles to scrutiny and control if they contained unusual terms.[54] More recently still, however, the United Kingdom Listing Authority has removed even this requirement of submission and control.[55] As a result, the current edition of the Listing Rules only controls the provisions (if any) of a listed company's articles which govern the form in which a member of the company may appoint a proxy, or which impose sanctions on a member of the company for failure to comply with section 212 of the Companies Act 1985 (disclosure to a company of interests in its shares).[56]

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[52] Listing Rules (1966 ed.) rule 1 and Appendix, section A; rule II(a)(iv) and Schedule VII, Part A, paras. F, H and L; (1973 ed.) rule 159 and Appendix 34, Schedule VII, Part A, paras. F, H, L; (1979 ed.) rules 1, 6 and Schedule VII, Part A, paras. F, H, L; (1984 ed.) section 2, chapter 1, rule 2.5 and section 9, chapter 1, paras. 6, 8, 12, 14; (1993 ed.) rules 13.8, 13.28, 13.29 and Appendix 1 to chapter 13, paras. 12, 13, 18, 19, 22; (2000 ed.) rules 9.26, 9.43, 13.28, 13.29; (2005 ed.) rules 9.3.6, 9.3.7, 9.3.9.

[53] Listing Rules (1966 ed.) Appendix, para. 1; (1973 ed.) Appendix 34, para. 2; (1979 ed.) Appendix, para. 1; (1984 ed.) section 1, chapter 1, para. 2; (1993 ed.) rule 13.3; (2000 ed.) rules 1.11-1.14; (2005 ed.) rule 1.2.1.

[54] Listing Rules (1993 ed.) rules 13.1 and 13.3; (2000 ed.) rule 13.3 (which followed the language of Amendment 14 of January 2000 to the 1993 ed.).

[55] See the Listing Rules (2005 ed.).

[56] Listing Rules (2005 ed.) rules 9.3.6, 9.3.7, 9.3.9.

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So the Listing Rules have, in their time, formed a constraint on the freedom of a listed company to establish the terms on which its shareholders will participate in the company's affairs. They have never been a major constraint on such freedom, however, as they never concerned more than a few aspects of these structures. They now have very little impact at all in this regard. Still, over time, the Listing Rules have driven the creation of particular terms of engagement between a listed company and its shareholders, and inertia – perhaps more accurately, path dependence – may mean that such terms still are common today, even though the Listing Rules are much less relevant for present purposes than was once the case.

The net effect of this regulation is to make company meetings a necessity for decision making by shareholders, unless the number of members in the company is small enough to make it possible to obtain the unanimous consent of the members, which functions as a surrogate for a resolution passed at a meeting in the vast majority of cases, and such informality is allowed (as it generally is). The irony is that this state of affairs is principally the result of unarticulated assumptions rather than conscious policy choices. The only conscious policy choices in favour of general meetings as the forum for the exercise of shareholders' governance rights are the requirement for an annual general meeting, in so far as it applies, and the ability of members to call a meeting of the company. Otherwise, shareholders' meetings are required because of assumptions: for example, because a meeting is needed in order to pass a special or an extraordinary resolution, as has been explained, or to perform certain acts such as sacking a director. The policy of requiring meetings in this age of electronic communications has not been extensively articulated in the United Kingdom.[57] Assumptions about how shareholders may practically organise their rights in a company and provide for the expression of those rights within the company – assumptions drawn from a bygone age – still inform the modern regulation of the shareholders' basic freedom to establish those rights and the means for expressing those rights through the terms of the company's articles of association.

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[57] As regards practitioner interest in the United Kingdom, see Company Law Review, *Company General Meetings and Shareholder Communication* (London, 1999) § 14. As regards academic interest, mostly abroad, see, e.g., S. Bottomley, 'From Contractualism to Constitutionalism: A Framework for Corporate Governance', 19 *Sydney Law Review* (1997) p. 277 and *The Role of Shareholders' Meetings in Improving Corporate Governance* (Canberra, Centre for Commercial Law, Faculty of Law, ANU 2003); R. Simmonds, 'Why Must We Meet? Thinking about why Shareholders' Meetings are Required', 19 *Company and Securities Law Journal* (2001) p. 506; F. Bonollo, 'Electronic Meetings', 14 *Australian Journal of Corporate Law* (2002) p. 95; E.J. Boros, 'Corporate Governance in Cyberspace: Who Stands to Gain What From the Virtual Meeting?', 3 *Journal of Corporate Law Studies* (2003) p. 149 and 'Virtual Shareholder Meetings: Who Decides How Companies Make Decisions?', 28 *Melbourne University Law Review* (2004) p. 265.

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3.2 The continuing relevance of the basic framework

The fundamental freedom of shareholders to organise their own rights of governance within a company, from the basic rights of voting and economic participation through to the means of exercising and expressing those rights, is still vital. Some further examples might be useful to emphasise this point.[58]

3.2.1 *Examples*

Articles often set out in much greater detail than Table A (1985)[59] the information which is to be given to shareholders by way of notice for a general meeting.[60] Multi-site meetings are permitted as a matter of general English law,[61] and a company's articles can work within this freedom to ensure that such meetings are not held invalid for want of notice or because of technical lapses in communication between the various sites of the meeting.[62] Particular items of business, or particular procedures attaching to particular items of business, can be highlighted, so that particularly important decisions – or the manner in which they are taken – are emphasised. All these things go to the good governance of a company. Articles also generally provide that accidental failures in the provision of notices for a meeting will not invalidate that meeting or the business done at it.[63] They can also make provision for unanticipated changes to the time or location of meetings, while preserving the validity of the meeting.[64]

Articles can control where meetings are to be held.[65] This might seem a minor matter, but it is rather less so in companies which are the result of cross-border mergers, where the company has to accommodate shareholder bases in more than one country and the sensitivities of those shareholders.

Articles facilitate the administration of general meetings. They may provide that the entitlement to vote is established at a particular record time before the

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[58] As well as Table A (1985), the articles of Amersham plc, Astrazeneca plc, BHP Billiton plc, BP plc and Carnival plc all contain useful examples of the use, and consequent importance, of this freedom. They are far from the only examples. They do, however, give a flavour of relevant current practice: they demonstrate qualitatively what can be, and has been, done. An exhaustive quantitative report on such practice is a project for another time.

[59] See Table A (1985), reg. 38.

[60] Amersham plc, Art. 50; Astrazeneca plc, Art. 33; BP plc, Arts. 59, 60; Carnival plc, Arts. 100-102. Contrast BHP Billiton plc, Art. 47, giving huge discretion to the company's board.

[61] *Byng* v. *London Life* [1990] Ch. 170.

[62] Amersham plc, Art. 51; Astrazeneca plc, Art. 34; BHP Billiton plc, Art. 53(5); BP plc, Art. 62; Carnival plc, Arts. 103-105.

[63] See, e.g., Table A (1985), reg. 39.

[64] Amersham plc, Art. 51.5; Astrazeneca plc, Art. 34.5; Carnival plc, Art. 107.

[65] BP plc, Art. 55.

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meeting.[66] This facilitates verification of votes tendered at the meeting, by allowing the company to use records for that purpose which it will actually have in its possession at the meeting. (Precisely up-to-date records will not be available to a company whose shares are traded continuously.) Articles can provide protection from errors in the voting process, which (in small measure, at least) are almost inevitable when casting and counting the many millions of votes held by the various shareholders of a large listed company.[67] Articles also commonly give many powers to the chairman of a company's general meeting, most of them administrative (such as powers of adjournment, powers to call a poll and powers to maintain good order), some of them substantive (such as a casting vote).[68]

Articles can categorise items of business or resolutions to be addressed at general meetings. For example, in recent times, companies have drawn and used distinctions between 'substantive' and 'procedural' resolutions, in order to control how business is done at a general meeting.[69] Articles provide that a 'substantive resolution' (as defined) can only validly be considered or passed at a meeting if the text of the resolution was set out exactly in the notice by which the meeting was convened. Thus, no amendment to a substantive resolution can be adopted at the meeting without thereby making it impossible to pass the resolution.[70] This control over amendments might seem to advance the interests of directors over shareholders, enabling the directors to exert a tighter grip on the agenda of a meeting. In fact, the opposite is true. It enables shareholders who do not attend a meeting to know exactly what business will be done at the meeting, so they can appoint and instruct proxies accordingly.

Another issue which companies' articles of association nowadays address in growing detail is security at general meetings. Articles therefore often contain explicit provision for directors (and management generally) to put in place security arrangements at general meetings, and shareholders' rights are subjected to those arrangements.[71] While a company most likely has an implied default

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[66] BP plc, Art. 60(D).

[67] See the different techniques adopted by Amersham plc, Art. 74; Astrazeneca, Arts. 43, 55; BHP Billiton plc, Arts. 55(4), 55(1); BP plc, Arts. 71, 80; Carnival plc, Arts. 135, 144, 153.

[68] See, e.g., Table A (1985), regs. 45, 46(a), 47-51, 58; Amersham plc, Arts. 55, 57-58, 59(a), 60-64; Astrazeneca plc, Arts. 38, 40-41, 42(a), 43-47; BHP Billiton plc, Arts. 48, 50-56; BP plc, Arts. 64, 66-67, 70(i), 71-74, 80; Carnival plc, Arts. 110, 114-115, 117-119, 133(a), 135, 137-139, 141, 144.

[69] BHP Billiton plc, Arts. 2, 54; BP plc, Arts. 2, 69. To similar effect are Amersham plc, Art. 58 and Astrazeneca plc, Art. 41. Carnival plc, Art. 117 envisages amendments to substantive resolutions, but enables the chairman to adjourn consideration of an amended substantive resolution.

[70] Amendments to correct clerical or manifest error are commonly permitted: ibid. See also *Re Moorgate Mercantile Holdings Ltd.* [1980] 1 *WLR* 227 as regards the amendment of a resolution that requires exact notice (in that case, a special resolution).

[71] Amersham plc, Art. 52.2; Astrazeneca plc, Art. 35.2; BHP Billiton plc, Art. 53(2); BP plc, Arts. 63, 74-75; Carnival plc, Art. 110.

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power at common law, exercisable through its board, to institute security arrangements at its general meetings,[72] specific articles are much clearer and often more wide-ranging. The exercise of these powers can be a very sensitive issue indeed, particularly where protesters against the company's business or activities are shareholders and make a scene at the company's general meeting in a manner which may be threatening to others present.

Articles can also place restrictions or limitations on shareholders' voting rights. Such restrictions are very commonly used as a means of putting practical pressure on shareholders to comply with other obligations. So, for example, shares are commonly disenfranchised while calls made on their holder remain unpaid.[73] Again, shares are very often disenfranchised in cases where a public company serves a notice pursuant to section 212 of the Companies Act 1985 to discover who is beneficially interested in its shares and there is a failure to comply with the notice.[74] Indeed, articles often impose even more onerous restrictions on shares which are the subject of an unanswered section 212 notice: the company may refuse to pay dividends otherwise payable on the shares, and it may in certain circumstances refuse to register transfers of the shares.[75]

There are many other examples of the various ways in which a company's articles of association can determine how shareholders will exercise their rights within a company. For the present, it is worth mentioning the extent to which articles govern the appointment and revocation of proxies;[76] the way in which articles can be used effectively to enfranchise those with interests in shares who are not, however, the legal owners of the shares;[77] the provision which can be made for purely consultative meetings[78] or for interested non-shareholders to view

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[72] Hamer and Robertson, op. cit. n. 26, at p. 86, paras. 10.2, 10.4. Note *Barton* v. *Taylor* (1886) 11 App. Cas. 197 at p. 204, *per* Lord Selborne and *John* v. *Rees* [1969] 2 *WLR* 1294 which concerned meetings, but not company general meetings, as well as *Byng* v. *London Life* [1990] Ch. 170 at p. 187, *per* Sir Nicholas Browne-Wilkinson V.-C.

[73] Amersham plc, Art. 70; BP plc, Art. 79; Carnival plc, Art. 151. Forfeiture for non-payment of calls does not amount to an unlawful reduction of capital (*Trevor* v. *Whitworth* (1887) 12 App. Cas. 409 at p. 417, *per* Lord Herschell, p. 429, *per* Lord Watson and p. 438, *per* Lord Macnaughten), and so it can be authorised by a company's articles irrespective of the statutory procedures for the reduction of capital or the redemption or repurchase of shares.

[74] Amersham plc, Arts. 71-72; Astrazeneca plc, Arts. 53-54; BHP Billiton plc, Art. 64; BP plc, Art. 87; Carnival plc, Arts. 155-156. See also n. 50 above and its accompanying text.

[75] Ibid.

[76] See, e.g., Table A (1985), regs. 60-63; Amersham plc, Arts. 76-79, 81; Astrazeneca plc, Arts. 58-61, 63; BHP Billiton plc, Arts. 68-71; BP plc, Arts. 81-86; Carnival plc, Arts. 161-167, 169. This is so, even though the right of a shareholder to appoint a proxy is now enshrined in statute by Companies Act 1985, s. 372, as indicated in the text to n. 37 above.

[77] See, e.g., Amersham plc, Art. 80; Astrazeneca plc, Arts. 135-142; BP plc, Arts. 157-170. See below, and also Nolan, loc. cit. n. 7.

[78] BAE plc, Art. 105(B).

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meetings without participating in them;[79] and the additional provision which can be made for a single corporate shareholder to appoint several representatives at a company's general meeting.[80]

3.2.2 *Summary*

In order to understand shareholder rights in a British company, therefore, it is necessary to look first at the company's articles of association and see what rights are established there. These rights – these express terms – are supplemented by default implied terms, which apply in so far as the express terms do not make any relevant provision.[81] In turn, the fundamentally contractual arrangements between the shareholders are subjected to regulation, discussed above, which prohibits certain terms of those arrangements and insists on certain others.

There is, therefore, no single statement of shareholder rights in a British company. Correspondingly, it is entirely wrong to think that positive law (whether statute or case law or both) directly establishes or lists most, let alone all, of a shareholder's rights in a British company: to look at positive law alone as the basis for such rights is to misunderstand the position entirely.

3.2.3 *The advantages of the basic framework*

To someone unused to it, the British framework for shareholder rights might seem inelegant at least. There is no single, tidy statement of shareholder rights. Shareholder rights are not necessarily uniform between companies – even between listed companies. It all might look a little chaotic and primitive. Far from it.

The foregoing survey of history and current practice shows that the rules which govern shareholders' exercise of their rights in a company – and, indeed, those rights themselves – have evolved, through the repeated, iterative interaction of various parties. Shareholders and companies – or, more accurately, the legal practitioners who draft the internal corporate arrangements that the shareholders ultimately adopt – have devised various structures through which shareholders (and others) can participate in the governance of a company. They have done so

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[79] See, e.g., BP plc, Art. 62(C).

[80] See, e.g., Amersham plc, Art. 80. It is at least arguable that, on its true construction, Companies Act 1985, s. 375 only allows a corporate shareholder to appoint one representative: see P. Myners, *Review of the Impediments to Voting UK Shares: Report by Paul Myners to the Shareholder Voting Working Group* (London, 2004) p. 27. The ability for a single corporate shareholder to appoint more than one representative is vitally important where the shareholder is a nominee for many different beneficiaries: see ibid., and see also the discussion of Art. 13 of the Directive, below.

[81] Such implied terms can exist at common law (see, e.g., *Birch* v. *Cropper* (1889) 14 App. Cas. 525 establishing a default presumption of equality amongst shares) or under statute (e.g., Companies Act 1985, s. 370).

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to the extent admitted by changing companies legislation, though regulation, both statutory and non-statutory, may sometimes limit what they can do. They have learnt from each others' work, and they have in turn adapted their practice accordingly. They have also interacted with, and reacted in response to, the courts when the structures they devised came to be challenged. Much less frequently – though one might not think so at present – they have lobbied for changes in the law and so brought the process of legal evolution back to focus on legislation.

There are two main grounds for continuing to prefer the present approach. They are liberalism and efficiency.

Why liberalism? British company law manifests deliberate choices in favour of allowing shareholders to exercise residual and ultimate control in companies, and these choices have been confirmed in the United Kingdom for the foreseeable future at least.[82] This choice has very substantial support, at least outside the academy,[83] and it necessarily implies that companies are, so far as their shareholders are concerned, voluntary associations in which they, the shareholders, exercise residual and ultimate control. So long as that choice continues to command such support, legislation should continue to proceed from a presumptive premise that shareholders should be allowed to order their own affairs within their company. Naturally, very different considerations come into play when considering the 'proprietary' aspects of company law, such as rules on capital and limited liability, where the interests of non-consenting parties are affected by the rules chosen.[84] None of this, however, denies the possibility of regulating even the internal structures of companies. It simply establishes a presumption in favour of free association and demands reasons to depart from that presumption.

Why efficiency? In order to answer the question, it is necessary to recall that efficiency is an instrumental good: it assumes a desired goal. In the present case, that goal is, for reasons just noted, to facilitate the creation of voluntary associations (companies) in which the members of those companies can, at least

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[82] The question of altering the model of the company was squarely posed for the Company Law Review: *Modern Company Law for a Competitive Economy* (London, 1998) § 3.7. The Review gave an equally clear answer to the question in favour of retaining the present, shareholder-focussed model: see *The Strategic Framework* (London, 1999) chapter 5.1; *Developing the Framework* (London, 2000) chapter 3; *Completing the Structure* (London, 2000) chapter 3.5. The UK government adopted the conclusions of the Reviews: *Modernising Company Law* (Cm. 5553 (2002)) § 3.3. None of this means that any other model of associative enterprise must necessarily be rejected: it simply means that the Companies Acts embody one model and will continue to do so. Other models, such as friendly societies and community interest companies, are provided by other statutes for use in other, appropriate, contexts.

[83] E. Ferran, *Company Law and Corporate Finance* (Oxford, Oxford University Press 1999) at p. 132.

[84] As to the 'proprietary' aspects of corporate law, see J. Armour and M.J. Whincop, *The Proprietary Foundations of Corporate Law*, University of Cambridge CBR Working Paper 299, available at: <http://www.econ.cam.ac.uk/cgi-bin/cbr_wpfull3.pl?series=cbrwps&filename=cbr2005&=WP299>.

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presumptively, order their own affairs. So what is efficient in that context? Law which allows companies and their lawyers to devise the internal structures of companies is much more likely to evolve into useful, efficient forms, with variations that reflect different circumstances, than rules made by a legislature, which often form a single set of rules, or at most one set of rules for private companies and another for public companies.[85] Legislation could very helpfully provide default rules for companies, so that small companies are not necessarily put to the expense of changing their articles in order to take advantage of new developments. Nevertheless, legislation should not set a certain practice in stone and thereby freeze innovation, as has happened in the past.[86] Again, however, none of this involves rejecting any thought of regulating a company's internal structure: it too raises a presumption in favour of free association and demands reasons to depart from that presumption.

The reasons for advocating these views have nothing whatsoever to do with the inherent capabilities of those who work in the private or public sectors – far from it. There are, however, other good reasons. The United Kingdom has a large number of highly sophisticated commercial and corporate lawyers. The transactional lawyers amongst them (and that is a very substantial majority of them) deal with vastly more relevant cases through which corporate structures are created or refined than do the policy-makers and lawyers in the public sector. Transactional lawyers also deal with each case in much greater detail, and with far greater intensity than Parliament – or any legislature – possibly could. Again, there are far more transactional lawyers, who collectively (and sometimes individually) possess far greater resources (in terms of time, finance and information) than those dealing with internal corporate structures in the public sector. Transactional lawyers also spread their expertise swiftly when designing new structures through which shareholders participate in companies, so that evolution of new forms is fast and vigorous. This is partly because the relevant specialist lawyers operate mostly within an interconnected community, the City of London, where new developments spread quickly,[87] but partly also because the results of their work, articles of association, are publicly available from Companies House (and now via the internet), so that anyone interested has immediate access to an exact record of new developments for the nominal sum of £1 per downloaded copy.[88]

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[85] Note the distinctions between private and public companies in Companies Act 1985, Part IX, chapter IV.

[86] See the above discussion of unintentional regulation based on outdated assumptions.

[87] For a highly pertinent example of this process, consider the rapid spread of techniques (discussed below) for enfranchising the holders of depositary receipts backed by shares of companies incorporated in Britain. From BP plc adopting this technique in December 1998, it spread rapidly to other companies. See further Nolan, loc. cit. n. 7.

[88] See: <http://www.companieshouse.gov.uk> and <http://direct.companieshouse.gov.uk>.

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All this adds up to the very vigorous evolution of internal corporate structures through the frequent interaction of private parties, and the rather less frequent interactions of those parties with state or Community entities, such as the courts, the Parliaments (national and European) and the Commission. This system for creating and developing the internal structures of companies acknowledges that law, and the arrangements made pursuant to law, are necessarily provisional, and will need to evolve, because law, and the arrangements made pursuant to it, are founded on bounded information and rationality deployed in an ever-changing context. In other words, the system rests on pragmatic, rather than idealistic, assumptions about the process of forming legal structures.[89] This approach is, it appears, shared by the Commission.[90] (The question of how the goals of the law are, and should be, set is another matter, but one which is settled for the moment as regards company law in the United Kingdom.[91]) Consequently, the system allows for trial – and error. It demands a minimum acceptance of the risk that there may be undesirable results. Yet would modern corporate law (let alone contract law) exist if an aversion to risk had always governed the law? It is highly unlikely. Risk is the inescapable cost of innovation.

4. NON-SHAREHOLDERS – INDIRECT INVESTORS – IN BRITISH COMPANIES

As it happens, a particularly good example of innovative practice in British companies, and a subsequent legislative response, is the enfranchisement of indirect investors. (Indirect investors have the registered title to shares held for them by an intermediary, often a bank or other institution acting as a nominee or depositary.) Lawyers in private practice, without waiting for legislative intervention, pressed old techniques (proxy voting) into new service, to give indirect investors an effective voice in companies. Now Parliament (in the United Kingdom) is enacting reforms to simplify the means of enfranchising indirect investors.[92] The state, acting through Parliament, has learnt from the experiments of lawyers in private practice and the structures they created to enfranchise indirect investors. As a result, Parliament can now build on that experience to create new, improved and simpler means of enfranchising indirect investors. This section examines and explains these developments in rather more detail.

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[89] Note D. Goddard, 'Company Law Reform – Lessons from the New Zealand Experience', 16 *Company and Securities Law Journal* (1998) p. 236 at n. 42.

[90] Note, for example, the speech of Commissioner McCreevy, 'The Future of the Company Law Action Plan', Speech/05/702 (17 November 2005).

[91] See n. 82 above.

[92] See clauses Part 9 of the Companies Bill.

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4.1 **The problem**

There is a basic problem when shares are registered in the name of an intermediary (such as a depositary) on behalf of someone else. In those circumstances, the power to act as a responsible shareholder and the economic incentives to act as such are divided. The registered, non-beneficial owner of shares (the intermediary) has all the powers and privileges attaching to those shares as against the company which issued them, but little incentive to use the powers unless the indirect investor can and does demand their exercise. This is because any advantage of exercising the powers will accrue to the indirect investor in the shares, not to their registered owner. By contrast, the indirect investor may have great economic incentive to see that the powers are exercised, in order to secure its own well-being, but the indirect investor has no direct rights against the company simply by virtue of its investment.

4.1.1 *The relevant law*

The law which brings about this result is easily understood, and there are perfectly sound reasons for it. The question is whether it is possible to respect those reasons and yet still allow a greater role for indirect investors in companies.

The registered owner of shares in a British company is entitled to all the powers and privileges attaching to the shares simply by being a member of the company.[93] As against the company, any trust or other arrangement affecting the shares does not alter that fact. This result is brought about by a combination of statute law and provisions which may be (and, so far as the author is aware, always are) found in a company's articles of association.

The relevant statute law is section 360 of the Companies Act 1985, which re-enacts earlier provisions in the same general terms going back to section 30 of the Companies Act 1862. Section 360 provides that:

> No notice of any trust, express, implied or constructive, shall be entered on the register, or be receivable by the registrar, in the case of companies registered in England and Wales.

Regulation 5 of Table A (1985) is a typical example of the sort of provision in a company's articles of association that supplements section 360:

> Except as required by law, no person shall be recognised by the company as holding any share upon any trust and (except as otherwise provided by the articles or by law) the company shall not be bound by or recognise any interest in any share except an absolute right to the entirety thereof in the holder.

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[93] This is because it is a party to the company's articles, its constitutional contract, by virtue of Companies Act 1985, s. 14, as supplemented by s. 22.

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These provisions allow a company to register a transfer of shares without reference of any trust affecting them,[94] and to remain unaffected by relations between the trustee of shares and their beneficiary,[95] unless the company intermeddles in the trust.[96] Nevertheless, when the company claims some interest in its own shares (such as a lien), these provisions do not allow the company to assert its rights in the shares free of other people's rights in those shares.[97]

4.1.2 *The reasons for the law*

There is a good reason for section 360 and articles such as regulation 5: they facilitate a company's administration of its own shares.[98] If there were no such provisions, any transfer of shares which a company has to register might result in the company being sued over some breach of duty relating to the transfer. Again, if there were no such provision, a company might easily become embroiled in a dispute between the trustees and beneficiaries of some shares about the way in which votes attaching to the shares were cast. Nevertheless, the present law does not leave the mere beneficiary of shares unprotected: the beneficiary can always take court action to protect his or her rights and, in the mean time, seek a stop order or notice to prevent or regulate any dealings with the shares.[99]

The precise converse of the almost exclusive relationship between company and registered shareholder is the virtual absence of any relationship between the company and an indirect investor in its shares: the indirect investor, as such, has no rights of management in the company. Nevertheless, the present law allows essentially two means through which that indirect investor can bring influence to bear on the company. First, the indirect investor, if absolutely entitled as against the registered owner, can instruct the registered owner how to deal with the shares.[100] (If needs be, in cases where the registered owner of shares holds for someone who, in turn, holds his or her rights in the shares for someone else, then instructions can be passed up the chain of those interested in the shares, from the

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[94] *Société Générale de Paris* v. *Walker* (1885) 11 App. Cas. 20.

[95] *In re Perkins* (1890) 24 Q.B.D. 613.

[96] See, generally, *Snell's Equity* (London, 2005) at §§ [28-45]-[28-46].

[97] *Bradford Banking Co* v. *Briggs & Co* (1886) 12 App. Cas. 29; *Mackereth* v. *Wigan Coal & Iron Co Ltd* [1916] 2 Ch. 293.

[98] See *Salomon* v. *Salomon & Co Ltd* [1897] A.C. 22 at p. 55, *per* Lord Davey.

[99] See Part 73 of the Civil Procedure Rules.

[100] *Kirby* v. *Wilkins* [1929] 2 Ch. 444 at p. 454, *per* Romer J. Pending any instructions about voting from the beneficial owner, the registered holder can vote the shares in the beneficiary's interests: see ibid. To the extent that *Butt* v. *Kelson* [1952] Ch. 197 casts doubt on the latter proposition, it must be regarded as inconsistent with the fundamental principle that the trustees manage the trust estate impartially, of their own motion and for the benefit of all the beneficiaries, a principle restated in *Nestle* v. *National Westminster Bank plc* [1994] 1 *All ER* 118 at p. 135, *per* Staughton LJ.

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beneficiary with the ultimate right to direct how votes are cast through to the registered owner who will actually cast the votes.) Secondly, the registered owner may appoint the indirect investor as a proxy in respect of the shares, with discretion as to how the votes attaching to the shares should be cast.[101] The current means of enfranchising indirect investors in a company press these two well-established legal mechanisms into service, and the next part of this article will show just how they do so.

4.2 **The solutions**

Section 360 of the Companies Act 1985 does not stop a company from appreciating a factual situation – that its shares are held by intermediaries – and making provision accordingly to empower those for whom the intermediaries hold the shares. Several companies have now done so.[102] BP plc is a good example of such a company, and it was one of the first companies to make such provision.

4.2.1 *Enfranchising indirect investors using proxies*

Many of BP's shares are registered in the name of JPMorgan Chase Bank, which holds them as a depositary and has issued depositary receipts for them (American Depositary Shares or ADSs) to investors.[103] Many of these ADSs are the result of BP's acquisition of two American companies, Amoco in 1998 and ARCO in 1999, which involved equity swaps. In those deals, BP issued ADSs (rather than ordinary shares) for two main reasons: issuing ADSs mitigated the impact of US securities regulation and it created a security denominated in US dollars, which is more marketable in the United States than shares denominated in sterling. Nevertheless, BP has been very keen to enfranchise the holders of ADSs and to treat them for governance purposes as much as possible like registered shareholders.[104] Consequently, BP's articles provide that the 'Approved Depositary' (currently JPMorgan Chase Bank) appoints each holder of ADSs as its proxy in respect of ordinary shares which are held by (or for) the Approved Depositary and are equivalent in number to the shares represented by those ADSs. Such a proxy is entitled essentially to all the rights of a registered shareholder in BP, including

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[101] Recall that section 372 of the Companies Act 1985 ensures that a shareholder will always have the right to appoint a proxy.

[102] See generally Nolan, loc. cit. n. 7.

[103] See: <http://www.bp.com/sectiongenericarticle.do?categoryId=2010213&contentId=2014600>.

[104] Ibid. Precisely equivalent treatment is not possible, because of differences in securities regulation between the United Kingdom and the United States. For example, rules differ between the two countries about when a company can set its record date for determining who is entitled to vote at a particular company general meeting.

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the right to receive notices and documents, the right to delegate powers by appointing a further proxy, and the right to use BP's sophisticated legal and technical provisions for electronic voting.[105] However, the ADS holders are not party to the statutory contract by which the articles are given effect,[106] and so cannot claim rights under the articles. Nevertheless, BP's articles are backed by contractual arrangements between BP and JPMorgan Chase Bank, which ensure that the Approved Depositary will allow ADS holders to take advantage of the governance opportunities afforded by those articles.

BP's articles (Art. 161) and the additional contractual arrangements between BP and JPMorgan Chase Bank also provide for the Approved Depositary to manage the ADS system, so that:

> JPMorgan Chase Bank … as the BP ADR depositary performs the roles of the transfer agent, registrar, record-keeper and dividend paying agent. JPMorgan Chase also coordinates the proxy voting process and arranges for custody of the BP Ordinary shares underlying the BP ADS shares and manages the process of exchanging Amoco and ARCO common shares into BP ADS shares.[107]

The Approved Depositary can then provide BP with the information it needs to manage and verify the voting process at any company meeting: the identities of those who hold ADSs on the relevant record date; the number of ADSs each of them holds at that time; the votes to which each is then entitled at the meeting by virtue of the Approved Depositary's delegation of its voting powers; the identity of any proxy appointed by the holder of ADSs; and so forth.[108]

This system for enfranchising direct investors clearly works, and it has been adopted by a number of leading British companies for a variety of reasons.[109] A working system today is of far greater utility to the end-users of corporate vehicles than endless mere theorising, however elegant. Yet the system has drawbacks. First, it is necessarily a little clumsy, given the basic problem that shareholder rights in a British company emanate from, and must be derived from, the shareholder who is a party to the company's articles of association by virtue of sections 14 and 22 of the Companies Act 1985. For this reason, a shareholder has to delegate rights through a proxy mechanism to indirect investors. Secondly, it is only practically possible to enfranchise one identifiable tier of indirect investors using this system. A shareholder (the depositary or other primary intermediary) maintains a list of indirect investors in its shares. That list in turn determines which indirect investors are enfranchised as proxies of the shareholder. Yet the

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105 See the current version of BP's Articles of Association at Articles 157-170.
106 Companies Act 1985, s. 14.
107 See n. 103 above.
108 See n. 105 above.
109 See Nolan, loc. cit. n. 7, Appendix 1.

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shareholder can only put on the list those who own entitlements as against it. It cannot practically discover, verify and record every sub-entitlement. So, where a shareholder owns shares on behalf of indirect investor A, and indirect investor A holds its entitlement to the order of indirect investor B, the system will operate to enfranchise indirect investor A, rather than the ultimate economic interest-holder, namely indirect investor B, because there is no practical way that the shareholder can necessarily discover B's existence and entitlement, at least without very onerous enquiries. This problem can, of course, be expanded beyond two layers of indirect investors.

The first of these drawbacks – the slight technical (or even aesthetic) inelegance of enfranchising indirect investors through a proxy mechanism – will be resolved in the United Kingdom when clause 145 of the Companies Bill are enacted and brought into force. This clause will allow the owner of shares to nominate another person (in practice, likely to be an indirect investor) to exercise the governance rights attached to the shares in question.[110] The second drawback – the difficulties of enfranchising the second and more remote tiers of indirect investors – can be resolved by reforming the relationship between intermediaries and indirect investors.

4.2.2 *Enfranchising indirect investors through their intermediaries*

If a nominee or depositary (an intermediary) who holds shares takes voting instructions from his or her beneficiary, and then acts on those instructions, the beneficiary (the indirect investor) is effectively enfranchised. If the beneficiary in turn holds for someone else, then he or she too could take instructions from his or her principal, and so on. This method of enfranchising indirect investors is already possible: English law already allows a beneficiary to give instructions to his or her nominee.[111] Equally, if a nominee who holds shares grants a proxy to his or her beneficiary, the beneficiary is effectively enfranchised. Again, the delegation of the proxy could go further if the beneficiary in turn holds his or her rights for someone else. However, the mere existence of these possibilities may not be adequate to enfranchise indirect investors in shares. It may well be necessary to put further pressure on intermediaries to realise those possibilities: at present, for example, even where an intermediary is instructed to vote shares held for an investor, the instructions are not always duly executed.[112]

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[110] This reform adopts and very closely follows the suggestions made in Nolan, loc. cit. n. 7, at pp. 93-96. However, the reforms do still contain coercive powers to compel companies to avail themselves of the new provisions, and those powers remain politically questionable: see ibid., at pp. 96-99.

[111] See n. 100 above.

[112] See the *Report of the Committee of Enquiry into UK Vote Execution* (London, National Association of Pension Funds 1999) § 1.7; and Myners, op. cit. n. 80.

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It is perfectly practical to require intermediaries to seek instructions from the investors from whom they hold shares (or rights to shares), and it will likely become easier still in the near future, with the continuing, and very rapid, improvement in electronic communications. As the UK Company Law Review noted,

> it was put to us that, at least in regard to the right to vote, practical advances in the use of electronic technology would very soon make it feasible, at low cost, for the intermediary who is the registered holder to collect diverse instructions from beneficial owners, reflect them accurately in proxy voting instructions passed to the company registrar, and obtain and pass back to the beneficial owners confirmation that the votes had been recorded.[113]

As well as being practical, this suggestion is economically appropriate. First, the intermediary already will, or should have, all the information about the beneficial owners of the shares (or rights) it holds and whether any particular beneficiary is absolutely entitled to those shares (or rights) so as to claim control over the governance powers attached to the shares (or rights). This is because one of the most basic duties of a trustee is to know his or her trust.[114] Furthermore, if an intermediary is regulated by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000,[115] the intermediary will also need to know about its client (the indirect investor) and communicate with the client in order to comply with the FSA's Principles for Business.[116] So, in contrast to the company concerned, the intermediary would not be put to much (if any) extra expense were it required to know which of its beneficiaries – which investors – should exercise governance powers in respect of shares (or rights) held by the intermediary. Secondly, though there would undoubtedly be additional costs in compelling the intermediary to pass on communications from companies to investors, and in turn pass on instructions from investors to companies, those costs would be borne either by the intermediary or by the investor, as is wholly appropriate in cases where one or more of them (rather than the company which issued shares) is actually responsible for the shares being held through intermediaries.

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[113] Company Law Reform: *Final Report*, Vol. 1 (London, 2001) § 7.3.

[114] A. Underhill and D.J. Hayton, *The Law of Trusts and Trustees* (London, Butterworths 2003) pp. 466-467.

[115] Financial intermediaries will be *prima facie* subject to regulation by the FSA, because they will conduct a business which requires authorisation from the FSA, see Financial Services and Markets Act 2000, supply security. 19, 22, 23, 31, Part IV and Schedule 2, Part I. Under Art. 66 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) a few intermediaries might be exempted from regulation by the FSA, but it unlikely that many firms whose business includes acting as a financial intermediary will fall within this exemption.

[116] The Principles for Businesses Instrument 2001.

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In fact, these extra costs might not be so very great. Trustees are already under duties to communicate with a beneficiary when a capital or income payment becomes due to the beneficiary.[117] Furthermore, the FSA's Principles for Businesses require appropriate communication between intermediary and client.[118] So the new duties on intermediaries, outlined above, would simply increase the number of communications between people who should already be in touch with each other.

These are also solutions that have found favour in the United States. The Securities and Exchange Commission (SEC) generally requires a nominee who holds securities to forward information received about those securities (annual reports, etc.) to each beneficiary for whom the nominee holds. In addition, for the purposes of any meeting of the company which issued the securities, the SEC requires the nominee to grant (or effectively transfer) a proxy to the beneficiary, or else to solicit voting instructions from the beneficiary and then act on such instructions as are given.[119]

5. NORMATIVE IMPLICATIONS

The examples and arguments put forward in the preceding sections have not sought to deny any role for public authorities in regulating or structuring the internal affairs of companies. Yet they do have implications which concern the incidence, extent and form of any such regulation. These implications are directly relevant to an evaluation of the Draft Shareholder Rights Directive.

Shareholders in a British company can, to a very great extent, establish and mould their rights in their company, and the means through which those rights are expressed. Indeed, they can make some very useful (if not comprehensive) provision to enfranchise indirect investors in the company. The shareholders' choices are legally expressed in the company's articles of association. In present circumstances, shareholders are regularly amending the articles of their company in response to new technological developments and in response to new developments

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[117] Underhill and Hayton, op. cit. n. 114, pp. 610-611. The duty may not arise when there is no need for a trustee to inform a beneficiary of some entitlement to a payment, because the beneficiary will already know about it, for example, when a payment is made directly to the beneficiary pursuant to a mandate from the trustee.

[118] The Principles for Businesses Instrument 2001, Principle 7. The more detailed requirements for communication, set out in chapter 8 of the FSA's Conduct of Business Rules (Conduct of Business Sourcebook Instrument 2001), may well not apply to an intermediary because of chapter 11 of those rules.

[119] See rule 14b-2(b)(3) of the General Rules and Regulations promulgated under the Securities Exchange Act of 1934, discussed in S.M. Klein, 'Rule 14b-2: Does it Actually Lead to the Prompt Forwarding of Communications to Beneficial Owners of Securities?', 23 *Journal of Corporation Law* (1997) p. 155 and L. Loss and J. Seligman, *Securities Regulation* (New York, Aspen 2001) § 6-C-6.

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of legal practice observed in other companies.[120] General experience suggests that this pace of change is unlikely to slacken. Yet the nature of any relevant change is very hard to foresee. Twenty years ago, who would have imagined the internet or its present importance? In other words, corporate practice is in the early stages of evolving in response to a series of new demands on it, and this evolution is likely to continue for some time.

The appropriate legislative and regulatory response should therefore accommodate the ongoing evolution of corporate practice, in order to promote the acknowledged goal of corporate law reform – the facilitation of modern, responsible, competitive business within the Single Market.[121] It should do this first by retaining the basic facultative principles of UK corporate law, derived from our nineteenth century forebears, who themselves lived in equally fast-changing times. These principles allow participants in a company, and their advisors, to adapt the arrangements they make for their governance of the company to meet new and often unforeseen developments. Unfortunately, legislators have in the past often proceeded by enacting specific solutions, which are often cumbersome, or at least limiting, and can only be adapted by further legislation.[122] Equally, regulation should not consist of any general codification of how shareholders in a company, and any indirect investors in the company, should engage with each other and with managers of the company. The structures through which shareholders (and indirect investors) participate in companies are developing rapidly in response to many new stimuli, and this looks set to continue indefinitely. Consequently, any such project of codification is entirely inappropriate at present and likely to remain so for the foreseeable future.

The response of regulation should also involve specific legislation or regulation where necessary to address specific problems revealed by experience. In order to avoid creating implicit and often unintended barriers to innovation, it should also be

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[120] This is immediately apparent from the author's own survey of FTSE 100 articles of association (see n. 16 above): 89 per cent of the articles surveyed had been adopted or amended in the previous four years.

[121] See, e.g., Communication from the Commission to the Council and the European Parliament, Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, COM (2003) 284 final.

[122] For example, consider the reforms introduced by Companies Act 1985, ss. 381A-381C and Schedule 15A (unanimous written resolutions). The amendments to the law governing the use of electronic communications in relation to general meetings (see the legislative amendments made by the Companies Act 1985 (Electronic Communications) Order 2000 (SI 2000/3373)) also form a specific solution to a problem and may well in time become restrictive, as anticipated by the Company Law Review: see the Company Law Review, *Strategic Framework*, op. cit. n. 82, at § 5.7.19; *Completing the Structure*, op. cit. n. 82, at § 5.39; and *Final Report*, op. cit. n. 113, at § 7.11. The temptation to enact specific legislation is not unique to the United Kingdom: in Australia, see Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Company: Final Report* (Sydney, 2000) pp. 63-74; in Delaware, see General Corporations Law, § 211.

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careful that legislation and regulation – and the definitions used in them – do not rest on assumptions that are outmoded, or may quickly become so. In particular, it should be very cautious of regulating the means by which shareholders participate in companies, because those means are now in such a state of flux.

In theoretical terms, the point is that inductive, minimally categorising, 'bottom up' methods of rule making were used in the earlier stages of developing a system, when understanding of the system was sketchy, and deductive, generally categorising, 'top down' methods were used once a significant body of knowledge had accumulated to form the premises in this process of reasoning.[123] There is much to commend such an approach: it takes account of the varying – let it be hoped expanding – boundaries of knowledge; it accepts that hasty intervention, in ignorance, can stifle innovation and even be counterproductive; but it also accepts that there is a very useful role for legislation and regulation to clarify the law and to deal in a principled fashion with the problems revealed by experience rather than by conjecture, however well informed.

6. THE DRAFT SHAREHOLDER RIGHTS DIRECTIVE

The Draft Shareholder Rights Directive adopts the pattern of regulation which the UK government has adopted hitherto in relation to British companies. The Directive does not affect the basic means by which the corporate law of a Member State provides for the rights of shareholders in a company incorporated under the laws of that state. In Britain, therefore, the fundamentally contractual model will continue,[124] subject to regulation of which, in due course, laws implementing the Directive will form a part. In fact, current regulation deals with most of the stipulations in the Directive: the Directive will require surprisingly little by way of implementation in the United Kingdom. In order to demonstrate this, it is necessary to examine the substantive provisions of the Directive, found in its second chapter (Arts. 4-15 inclusive).

6.1 **Provisions of the Directive which will necessitate little or no change to the law in the United Kingdom**

6.1.1 *Article 4*

Article 4 provides for the equal treatment of shareholders in the same position within a listed company. This is already established by rule 9.3.1 of the Listing

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[123] As regards the different types of rule, see H.L.A. Hart, *The Concept of Law*, 2nd edn. (Oxford, Clarendon Press 1994) pp. 124-136.

[124] Clauses 34 and 112 of the Companies Bill will continue the effect of sections 14 and 22 of the Companies Act 1985.

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Rules, implementing Article 65(1) of the Combined Admissions and Reporting Directive.[125]

6.1.2 *Article 5*

Article 5 of the Directive (general meeting notice) will make a few minor changes to the present state of the law in Britain. Article 5(1) will increase the minimum length of notice for general meetings of shareholders to thirty days. Presently, the minimum for a limited company is twenty-one days in the case of an annual general meeting or in the case of a meeting at which a special resolution will be put.[126] This increase has been criticised in Parliament in the United Kingdom[127] as making notice requirements too lengthy for a general meeting of a listed company. This criticism may be overstated in the light of corporate practice. In reality, given number of a listed company's shareholders, and the time it takes to print and circulate a notice of meeting (and any accompanying documentation) to such a number of shareholders, it is impossible to call a meeting of a listed company with any great haste. The difference between twenty-one days and thirty days is not, in that context, so very great. Still, neither is there any great reason to prefer thirty days' notice over twenty-one.

Article 5(2)(a)-(d) deals with the contents of a notice of meeting.[128] It makes very little difference, if any, to the requirements of the common law,[129] as supplemented for listed companies by rule 9.3.3 of the Listing Rules. Articles 5(2)(e) and 5(3) require a notice to contain the relevant company's internet address and also require certain information about the company and the meeting to be posted on the company's website. That is not required by existing law or regulation in the United Kingdom, but it is good (indeed very common) practice already.[130] So Article 5 will make very few changes to the law in Britain, and even fewer changes to the existing practice of listed companies.

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[125] Directive 2001/34/EC.

[126] See Companies Act 1985, ss. 369, 378. This will change (for public companies, and therefore for listed companies) under clause 314 of the Companies Bill to twenty-one days' notice for an annual general meeting and fourteen days' notice in other cases where no specific requirement is imposed.

[127] Select Committee on European Scrutiny, Nineteenth Report, at § 4.15.

[128] Very briefly, Art. 5(2)(a)-(d) will require the notice of meeting to state the time, place and agenda of the meeting; formalities and record dates that establish entitlements to vote at the meeting; the means by which shareholders can participate in the meeting, and how to discover the full text of resolutions to be proposed at the meeting.

[129] See Shearman, op. cit. n. 26, chapter 5. The basic common law requirements for the contents of a notice will be codified by clause 318 of the Companies Bill. See also clause 344 of the Bill as regards public companies.

[130] At the time of writing, see, e.g., <http://www.bp.com/sectiongenericarticle.do?categoryId=9007311&contentId=7015211> in relation to BP plc's 2006 annual general meeting.

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6.1.3 *Article 6*

Article 6 (agenda and resolutions) will make a small technical change to the minimum stake for a shareholder (or shareholders acting together) to add business or resolutions to the agenda of a listed company's general meeting. In so far as annual general meetings are concerned, the current minimum in Britain is 5 per cent of the total voting rights in the company concerned, or at least 100 shareholders who, on average, have paid up at least £100 in respect of their shares.[131] Article 6 will change this to a minimum equal to 5 per cent of share capital (not 5 per cent of voting rights which, given the possibility of differential voting rights, may not be equivalent) or a stake with a minimum nominal value of €10 million, whichever is lower. This could hardly be called a major change. Slightly greater change will affect other general meetings. At present, there is no right to add business to such meetings. Such a right will have to be introduced into the United Kingdom's company law in order to implement Article 6. At present, the only relevant right is for members holding at least 10 per cent of a company's voting capital to procure a general meeting which will then consider such business as they see fit.[132]

6.1.4 *Articles 7 and 8*

Articles 7 and 8 call for very little comment. Article 7 (admission to the general meeting) is generally consistent with existing practice in the United Kingdom. There is one issue that merits comment. This concerns how a company may set a record date by reference to which it determines who is entitled to cast the votes attaching to a share. At present, this is a matter entirely for a company's articles,[133] save where the company makes use of the CREST electronic settlement system for dealings in their shares, in which case a record date can be no more than forty-eight hours before the time fixed for the meeting in question.[134] In order to implement Article 7(3), therefore, law in the United Kingdom will for the first time have to specify a general maximum limit for record dates, a limit of less than

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[131] As regards annual general meetings, see Companies Act 1985, ss. 376-377. See also the continuation of these minima for public companies (and thus for listed companies) in clauses 345-347 of the Companies Bill.

[132] Companies Act 1985, s. 368, whose effect will be continued by clauses 310-312 of the Companies Bill.

[133] See, e.g., BP plc, Art. 60(D). The only generally applicable statutory provision of even tangential relevance to the ascertainment of rights to cast the votes attached to shares is Companies Act 1985, s. 372(5). That sub-section renders void any provision in a company's articles which requires the deposit of proxy documentation more than forty-eight hours in advance of the meeting to which it relates.

[134] Uncertificated Securities Regulations 1995 (SI 1995/3272) reg. 34(1).

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thirty days in advance of the relevant meeting. Though this will be a change in the law, it need not affect current practice.[135]

The UK government is unhappy that a record date could be set so far in advance of a meeting – indeed, as early as the very day on which notice of the meeting is given.[136] This could cause practical problems with 'stock lending', as it is known. If shares were temporarily registered in one person's name, pursuant to a contract to lend the shares for a specified period, and notice of a meeting were given on the record date, the shares could not be subsequently retrieved and voted by their original owner: even as notice of the meeting was given, it would be too late to transfer the shares so that the recipient could cast the votes attached to them. This is a fair criticism of a very generous provision for record dates well in advance of the meetings to which they apply. However, from a purely national perspective, the UK government could always impose a more stringent requirement on British companies that the time between record date and meeting should be much shorter – perhaps as short as the present UK standard of forty-eight hours. The Directive is, after all, a minimum harmonisation directive.[137]

Article 8 (participation in the general meeting by electronic means) is already reflected in the common law.[138] Nevertheless, out of caution, the government might seek to clarify the law.

6.1.5 *Article 10*

The effect of Article 10 (proxy voting) is largely prefigured by section 372 of the Companies Act 1985. That section, however, does not give proxies in a public company the right to speak at a meeting, though a public company's articles of association frequently do.[139] However, all proxies will soon have a statutory right to speak at a meeting,[140] which will make law in the United Kingdom comply with Article 10(3) in so far as that grants proxies the right to speak at meetings.

6.1.6 *Article 11*

Article 11 (appointment of proxy holders) will require some widening of the current regulation of restrictions on the appointment of proxy holders. The present provisions forbid a company's articles from requiring that documents relating to the appointment of a proxy be submitted to it (or anyone else) more than forty-

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135 See, e.g., n. 130 above.
136 Select Committee on European Scrutiny, Nineteenth Report, at § 4.16.
137 See Art. 3 of the Directive.
138 *Byng* v. *London Life* [1990] Ch. 170.
139 See, e.g., BP plc, Art. 85(C).
140 See clause 331 of the Companies Bill.

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eight hours in advance of the meeting in question.[141] Article 11 will require a more general prohibition on excessive formalities relating to the appointment of proxy holders.

6.1.7 *Article 13*

Article 13 (voting upon instructions) is the final substantive provision of the Directive. It requires little comment. From a British perspective, there is not much new in this article. That will be clear from the previous discussion of the means through which indirect investors can bring their influence to bear on a company in whose shares they are interested.

The only aspect of Article 13 worthy of note for the purposes of implementing the Directive in the United Kingdom is Article 13(4). This provision requires that an entity holding shares for various beneficiaries should be able to split its votes to reflect the differing voting instructions of different beneficiaries. Currently, there is no mandatory legal provision to this effect in Britain; that will have to change once the Directive is adopted. Indeed, the statutory provision for voting by the representatives of corporate shareholders seems (on one reading, at least) to deny the possibility of a split vote by a single corporate shareholder.[142] That is not the end of the matter, however. The present law is sufficiently ambiguous to allow someone chairing a company's general meeting to take a different view and allow such a split vote, though that may generate practical problems, such as ensuring that the right number of votes is cast, and not too many.[143] Furthermore, a company's own articles can make provision to allow for this sort of split vote: they can, for example, allow a single corporate shareholder to appoint several representatives at the company's general meeting, each in respect of a tranche of shares in the company, so that each representative can reflect the views of particular indirect investors in the company.[144] Finally, a single proxy holder can cast his appointor's votes in different ways if instructed to do so.[145] That means a

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[141] Companies Act 1985, s. 372(5), to be largely re-enacted (with some minor modifications) by clause 334 of the Companies Bill.

[142] Companies Act 1985, s. 375.

[143] Myners, op. cit. n. 80, at p. 27. See also the guidance 'Corporate Representation at General Meetings', produced by the Institute of Chartered Secretaries and Administrators, available at: <http://www.icsa.org.uk/images/pdf/Guidence/040310.pdf>. The result of a vote, even where there has been an irregularity in the vote, is usually protected from subsequent challenge by a company's articles: see, e.g., Table A (1985) reg. 58 and BP plc Art. 80.

[144] See, e.g., Amersham plc, Art. 80. Rather surprisingly, clause 330 of the Companies Bill, which does allow a corporate shareholder in a company to appoint more than one representative at the company's general meetings, apparently does not allow those representatives to cast votes in different ways, because of clause 330(4)(b).

[145] Companies Act 1985, s. 374, which applies to the member's voting rights whether the member casts his votes personally or through a proxy.

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registered holder of shares who wishes to reflect the differing views of various beneficiaries interested in those shares can appoint a proxy to cast some votes attaching to the shares one way, and some another. Still, Article 13(4) will require a change to the existing law in Britain to ensure that all listed companies recognise split votes cast by the representative of a corporate shareholder.

6.1.8 *Summary*

None of the provisions so far merit much normative comment from a British perspective. In general, they are all consistent with the basic contractual, but regulated, framework of shareholder rights in British companies. In their specific provisions, either they make no change to the present law (or at least to common present practice within that law), or else they make only minor changes to aspects of regulation or practice which, in their broad outline at least, are already well known and accepted in the United Kingdom.

6.2 **Provisions of the Directive which will necessitate more significant change to the law in the United Kingdom**

Three provisions of the Directive merit more substantial comment, however. These are Articles 9, 12 and 15.

6.2.1 *Article 9*

Article 9 of the Directive will introduce a generalised right for shareholders to ask questions at their company's general meetings. Such questions would normally be directed at the company's management. As a generalised right, this would be an innovation for company law in Britain. The word 'generalised' is very important, however. While company law in Britain may not include a single right for shareholders to ask questions at a general meeting of their company, it is completely untrue that shareholders have no rights to ask such questions. As well as their legal rights, of course, they have their economic power, and they can use that to ensure that directors answer their questions. A little more explanation is nevertheless useful, because the relevant law, regulation and practice are not terribly well known, even in the United Kingdom itself.

At common law, the members of a company in general meeting have a right to debate the business of the meeting.[146] That might seem a much narrower right than a general right to ask questions, but the right must be seen in the context of the business that has to be done at a listed company's general meetings, particularly at its annual general meetings. A listed company has to lay before each

[146] See, e.g., *Wall* v. *London & Northern Assets Corporation Ltd.* [1898] 2 Ch. 469.

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annual general meeting its annual accounts, the directors' report for the year, the report on its directors' remuneration, as well as a report by the company's auditors on the accounts, directors' report and relevant parts of the remuneration report.[147] Discussion of these documents will, therefore, necessarily form part of the business of the meeting, on which members may comment and raise questions. The contents of these various documents, taken together, are so wide-ranging, and will cover such a huge part of the company's activities, that the members will consequently be able to speak and ask questions about virtually any aspect of the company's affairs. Other likely business at the annual general meeting, such as the election or re-election of directors,[148] will likewise permit a huge range of questions from members. Furthermore, the Companies Bill will introduce a requirement for every listed company to produce a 'Business Review',[149] which will involve 'forward-looking reporting' and be laid before the company's general meeting.[150] This will increase still further the scope of the business before that meeting and correspondingly increase scope of shareholders' rights to speak and ask questions at the meeting. How much of an increase this will be is another matter. Modern directors' reports deal with a huge range of the company's affairs, so the increase may well not amount to much.

Of course, these rights of shareholders are common law default rights. In principle, this means that they could be modified or abrogated by the contractual counter-stipulation of the shareholders in a company, in other words, by the company's articles of association. In practice, such modification or abrogation is never encountered.[151] More importantly, perhaps, any such modification would be contrary to the *Combined Code on Corporate Governance*, which applies to listed companies.[152] Indeed, a company's articles may expand the opportunities for shareholders to ask questions at a meeting of their company, for example by establishing the possibility of purely consultative meetings at which no decisions will be taken.[153] Adherence to publicly established best practice will likewise ensure that shareholders have ample opportunity to raise questions at a general meeting of the company.[154] The gap between Article 9 and current law and

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147 Companies Act 1985, s. 241. There has to be a (non-binding) vote by members of a company on the directors' remuneration report for the company's preceding year: Companies Act 1985, s. 241A.

148 See Financial Reporting Council, *The Combined Code on Corporate Governance* (London, 2003), which applies to all companies listed in the United Kingdom, at § A.7.

149 See clause 423(5) of the Companies Bill.

150 See clauses 445-446 of the Companies Bill.

151 The author has never encountered such abrogation or modification either in his academic study of FTSE 100 articles (see n. 16 above) or in legal practice.

152 See *The Combined Code on Corporate Governance*, op. cit. n. 148, Part D and in particular at § D.2.

153 See, e.g., BAE plc, Art. 105(B).

154 See the guidance issued by the Institute of Chartered Secretaries and Administrators in 1996, drafted by a working party of the Institute supported by the Department of Trade and

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regulation in the United Kingdom is really not at all wide. Narrower still is the divergence between Article 9 and current practice here.

One difference between the Directive and current law in the United Kingdom concerns the rights of proxies. Articles 9 and 10(3) of the Directive, read together, will give proxy holders the right to ask a question to the same extent as their respective appointors. Proxy holders have no such legal right at the moment in relation to a public (and therefore in relation to a listed) company, though these companies can and already do provide for such rights through specific articles of association.[155] Even this difference will be eliminated, however, when proxy holders, as a matter of law, become entitled to speak at general meetings for which they are appointed.[156]

Another difference between Article 9 and current law in the United Kingdom, but again a difference with much less substance than might first be thought, is that Article 9(2) will compel listed companies to respond to questions, while there is no such corresponding general right at present in the United Kingdom. Yet it is very strongly arguable that were the chairman of a meeting simply to allow a company, through its directors, to refuse to answer legitimate questions, he would be in breach of his fiduciary duties: his powers to direct the meeting are fiduciary powers and to be exercised so as to facilitate the business of the meeting.[157] Equally, a director who unreasonably refused to answer a question from a member could well find himself in breach of his basic duty to act in good faith in the best interests of the company,[158] and possibly in breach of his duties of care and skill as well.[159] And all this is quite aside from the clear obligations on directors under *The Combined Code on Corporate Governance*.[160]

The UK Department of Trade and Industry did consult several years ago about the introduction of a generalised right for shareholders to ask questions at a meeting, though it did not suggest any general right to an answer.[161] After consultation, the DTI decided against any change to the present law. Indeed, its

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Industry: 'A Guide to Best Practice for Annual General Meetings', particularly at § 2.6. The guide is available at: <http://www.icsa.org.uk/images/pdf/agm_guide.pdf>.

155 See n. 139 above and its accompanying text.

156 See clause 331 of the Companies Bill.

157 Consider, e.g., the principles articulated in *Byng* v. *London Life* [1990] Ch. 170.

158 As to the basic duty, see, e.g., *Regentcrest plc* v. *Cohen* [2001] 2 B.C.L.C. 81 at [121]-[123], *per* Jonathan Parker J. For the future, see clause 173 of the Companies Bill.

159 As to the basic duty, see, e.g., *Re Barings plc* (*No. 5*) [1999] 1 B.C.L.C. 433 at pp. 486-489, *per* Jonathan Parker J (approved, in so far as raised for its decision, by the Court of Appeal, [2000] 1 B.C.L.C. 523 at pp. 534-535). For the future, see clause 175 of the Companies Bill.

160 Again, see *The Combined Code on Corporate Governance*, op. cit. n. 148, Part D and in particular at § D.2.

161 The Department of Trade and Industry, *Shareholder Communications at the Annual General Meeting* (London, 1996).

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proposals would not have advanced shareholders' rights to ask pertinent questions beyond the present law. More importantly, the DTI recognised that such rights could undermine the authority of the chairman at a general meeting to bring a debate to a sensible conclusion if the rights were too broadly stated. They could therefore make such meetings unmanageable. Indeed, the main criticism of Article 9 is just that: it is not clear that the rights of issuers under Article 9(2) to ensure 'good order' at meetings of shareholders would allow the issuer, through the meeting's chairman, to prevent debate meandering on uselessly *ad nauseam*. Some redrafting of Article 9(2) is in order.

In short, the differences between Article 9 of the Directive and existing law in Britain are not at all great. The main difference is the overly broad scope of the right proposed in Article 9. That is indeed a cause for concern.

6.2.2 *Article 12*

The next part of the Directive for comment is Article 12. This allows for postal and electronic voting by the shareholders of a listed company in advance of a general meeting. Currently this is not practically possible in Britain. Admittedly, there is no bar in principle to postal or electronic voting in advance of a company's general meeting, provided that the company's articles of association made appropriate express provision.[162] (The possibility of voting *in absentia* would not be an implied term of a company's articles.[163]) However, as noted earlier, the definitions of 'special' and 'extraordinary' resolutions make it practically impossible to provide for voting *in absentia*:[164] special resolutions are very often put to a general meeting, and in order to pass the resolution, voting in person or by proxy is necessary. It is odd, therefore, that this inflexibility in the law will be entrenched by the Companies Bill.[165] If Article 12 is adopted in due course, the Bill – most likely by then an Act of Parliament – will need alteration within a very short time. This is obviously unsatisfactory.

Still, the need for Article 12 is far from clear. Exactly the same practical result – a vote cast by a shareholder *in absentia* – can be achieved through the shareholder giving a proxy for the meeting in question, either by post or electronically. Article 12 does seem to involve changing the law to no practical purpose. Indeed, proxies have some advantages to a vote cast directly by post or electronically. A shareholder who gives a proxy can change his mind by one of two means, whereas a vote once cast cannot be revoked. The shareholder can revoke his proxy at any time before the meeting, or before the effective time for revocations

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162 See n. 24 above.
163 See *Harben* v. *Phillips* (1883) 23 Ch.D. 14.
164 See the text accompanying n. 24 and following.
165 Companies Bill, clauses 288-290, defining how members may take decisions.

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stipulated by the articles of the company in question (often forty-eight hours before the relevant meeting).[166] He can then give another proxy, assuming there is still time to do so. Alternatively, the shareholder can turn up and vote at the meeting, and his vote will count to the exclusion of any vote cast by the proxy holder.[167]

6.2.3 *Article 15*

Finally there is Article 15, which provides for the publication on a listed company's website of the votes cast on resolutions put to the company's general meeting. This is already very common practice, though not an obligation.[168] The Companies Bill will impose such an obligation, however, whether or not the Directive is adopted, though the Bill will have to be amended to require the publication of the percentage vote for and against each resolution.[169]

7. CONCLUSIONS

The Directive is, in its current form, entirely consistent with the established model of internal governance structures in British companies. It does not restrict the basically contractual model of shareholder governance, but simply subjects the shareholders' arrangements to certain regulatory standards. In its approach, it is consistent with a century and a half of regulation in the United Kingdom. This is welcome. The system for internal governance arrangements adopted in the United Kingdom has proved remarkably resilient over the years. It has provided the space within which many innovative developments can occur: it provides an open, flexible structure within which the inventiveness and drive of the private sector can set to work and establish institutional arrangements within companies to suit their respective circumstances.

The Directive is also quite light-touch. It does not place too many demands on companies which they are ill-suited to satisfy. So long as the United Kingdom implements it in a satisfactory manner, the Directive should not prove unduly burdensome to business. Indeed, most of what it will require is already either the

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166 See n. 76 above.

167 The shareholder's vote impliedly revokes the proxy: *Knight* v. *Buckley* (1859) 5 Jur. (N.S.) 817; *Cousins* v. *International Brick Co. Ltd.* [1931] 2 Ch. 90. (The proxy holder is, after all, simply the agent, usually the agent at will, of the shareholder: *Re English, Scottish & Australian Bank Ltd.* [1893] 3 Ch. 385.) In the author's experience, this implication is never contradicted by any express term of a company's articles of association.

168 See, e.g., <http://www.bp.com/sectiongenericarticle.do?categoryId=9007321&contentId=7015251>.

169 Companies Bill, clause 348.

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law in Britain, or at least best practice. The exception to this is Article 9 (the right to ask questions). It is questionable whether this single, generalised right is needed in the United Kingdom, given the existing situation which results from interaction of the common law, statute and regulation (principally the Listing Rules). Article 9 does have the potential to make company general meetings unwieldy, to say the least.

The main concern for the future is that the UK government, fearful of potential liability under the *Francovich* principle for failing (or failing adequately) to implement the Directive,[170] may just enact the Directive as an additional layer of regulation on British listed companies, without integrating it into existing UK law, or, where appropriate, taking no action because UK law is already compliant with the Directive. The potential for confusion in such a course of action is obvious, as is the extra burden of complying with several layers of existing and new regulation which, quite unintentionally, may not match together perfectly. That, however, is a matter for Her Majesty's Government in the United Kingdom. It is not the fault, if fault there be, of the Directive and the Community institutions which sponsored it.

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[170] ECJ, Case C-6/90 *Francovich* v. *Italy* [1991] *ECR* I-5357.

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