

Practice questions for Chapter 20 – The constituents of a company

Essay question

In *Re Dorman Long & Co Ltd*,¹ Maugham J stated, in relation to general meetings, that ‘the dice are loaded in favour of the views of the directors.’

Discuss the current validity of Maugham J’s statement. How effective are general meetings as a forum for shareholder democracy?

Introduction

- Even though the general power to manage the company is vested in the directors, there is little doubt that significant power is placed in the hands of the shareholders by reserving certain decisions for them alone (e.g. amending the company’s articles).
- However, historically, there has been a perception that the rules and procedures by which general meetings are run operate in order to favour the views of the company’s directors, and prevent the members from exercising their decision-making powers.
- This essay will look at the procedures by which general meetings are run in order to determine whether Maugham J’s comment is still a valid one.

The calling of meetings

- The power to call meetings is a good example of how the procedures relating to general meetings favour directors. The Companies Act 2006, s 302 vests the power to call a general meeting in the directors. However, s 303 does grant the members the power to require the directors to call a general meeting. However, the Act does not make it easy for members to exercise this power.
- The directors will only be required to call a meeting if a sufficient percentage of the members require the meeting. In the case of companies with a share capital, the request must come from members representing at least 5 per cent of the company’s paid-up share capital. If the company does not have a share capital, the request must come from members representing at least 5 per cent of the voting rights of all the members.
- This will not be an easy requirement to meet, especially in the case of large private companies and public companies where the members may be numerous and highly dispersed. Certainly for many individual members, this will likely prove an insurmountable obstacle.

Controlling the agenda and the circulation of information

- The notices of general meetings are normally drawn up by the directors. This is an important power because of the rule that, apart from any matters designated as ordinary business in the articles, only those matters of which notice has been given can be discussed at a meeting.
- The directors are permitted to use the company’s funds bona fide and reasonably for the purpose of obtaining the best expression of the voice of the corporators in general meeting. Within the boundaries of their fiduciary duties, the directors can, at the company’s expense, send out circulars explaining why the shareholders should support their resolutions.

¹ [1934] Ch 635 (Ch).

- The members have the power to require the company to circulate a statement of not more than 1,000 words in relation to a matter referred to in a proposed resolution, or any other business dealt with at the meeting.² However, this power only arises if a sufficient number of members require the statement to be circulated, namely:
 1. Members representing at least 5 per cent of the total voting rights of all the members who have a relevant right to vote (*i.e.* to vote on a proposed resolution), or
 2. At least 100 members who have a relevant right to vote and hold shares in the company on which there has been paid-up an average sum, per member, of at least £100.
- If these requirements cannot be met, then the members will have to pay for the cost of sending the circulars themselves and this can be extremely expensive. Accordingly, this appears to be one area where the dice are still loaded in the management's favour. This is borne out in that in practice resolutions are nearly always proposed and moved by the directors, not by the members.

General meetings in practice

- An examination of general meetings in practice reveals the basis for the current feeling of dissatisfaction. It has been contended that general meetings, as a mechanism for shareholder democracy, can only be an effective form of governance if two conditions are met. Firstly, the majority of the shares should be held by members who are not directors. Secondly, all or most of the members should be willing to participate in general meetings. Unfortunately, only one or neither of these conditions are present in companies at either end of the size spectrum.
- As regards small owner managed companies, the shares are held wholly or mainly by the directors. These companies are run informally without reference to company law for the main. In such companies, where the directors and shareholders are the same people, formal general meetings serve little or no use. This was recognized when, in 1989, rules were introduced permitting private companies to dispense with the AGM by unanimous resolution. The Company Law Review Steering Group recommends extending this exclusion by totally removing the obligation upon private companies to hold an AGM, unless they choose to opt into the AGM regime.
- General meetings fail for a different reason in the case of large public companies. Here, there may be hundreds of thousands of members living in all parts of the UK and abroad. It is impracticable for more than a tiny minority of them to attend a general meeting.

Conclusion

- Most commentators agree that general meetings are a key mechanism in ensuring that the directors are made accountable to the members. However, the limitations discussed are also generally accepted by commentators. It appears that there is an unspoken feeling that general meetings, as a form of governance accountability, are becoming increasingly moribund.
- It could be argued that, in recent years, company law has moved away from the use of general meetings in certain ways. Private companies are not required to hold an AGM and many private companies need never hold a general meeting. Virtually every power exercisable by the members can be exercised via the written resolution procedure, which has undoubtedly reduced the importance of general meetings. Further, the Companies Act 2006 has simplified and made it easier to take decisions via written resolution.

² Companies Act 2006, s 314(1).

Problem question

In *John Shaw & Sons (Salford) Ltd v Shaw*,³ Greer LJ stated that '[a] company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to the articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in directors, they and they alone can exercise these powers.' Do you agree with this statement? In particular:

- Discuss the balance of power between the directors and the members
- Provide examples of decisions that are reserved for the members alone, and
- In what circumstances will the general power of management revert back to the members?

Introduction

- This question involves a discussion of the division of power between the directors and the members. To this end, the balance of power between the directors and members will be discussed. It will be seen that the general power to manage the company is usually vested in the directors, but there are a number of significant decisions that are reserved for the members alone. Further, in certain situations, the general power to manage will revert to the members.

The balance of power between the directors and the members

- The power to run a company is initially vested in its members. In small companies, where the number of members is very low or where the members are the directors, this poses no problems. However, in larger companies, where there are numerous members, it is not practical for the members to manage. In such cases, the power to manage the company is usually delegated to others. As all companies are required to have at least one director (with public companies requiring a minimum of two), the directors are usually the persons to whom the power to manage is delegated. Accordingly, the directors only have such power as is delegated to them by the members. However, the Court of Appeal in *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame*⁴ has stated that the members cannot interfere in those powers that have been delegated to the directors.
- This delegation of power is a matter for the company's articles, so the contents of the articles become crucial. The model articles for private companies limited by shares and the model articles for public companies, art 3 states that '[s]ubject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.' Accordingly, there is a significant amount of power placed in the hands of directors, but this power is subject to the articles. Therefore, the power of the directors can be limited by the company's articles. The case of *Salmon v Quin & Axtens Ltd*⁵ provides a good example of this.

Decisions reserved for the members alone

- As discussed above, the general power to manage the company is usually vested in the directors by the company's articles. However, the Companies Act 2006 and the Insolvency Act 1986 provides the members with considerable powers that only they can exercise. These powers are exercised in general meeting or via the written resolution procedure. Examples of such powers include:

³ [1935] 2 KB 113 (CA).

⁴ [1906] 2 Ch 34 (CA).

⁵ [1909] 1 Ch 311 (CA).

1. Only the members can amend the company's articles⁶
2. Only the members can convert a private company to a public company⁷ and vice versa⁸
3. Only the members can convert an unlimited company to a limited company,⁹ and vice versa¹⁰
4. The members have the power to remove a director or directors from office¹¹
5. Numerous loans and other transactions involving directors will only be effective if the members' approval is obtained
6. A director's service contract that is capable of lasting over two years is only valid if the members approve¹²
7. Director conduct that amounts to negligence, default, breach of duty or breach of trust can be ratified by the members¹³
8. The members can petition the court to have the company wound up.¹⁴

Reversion of managerial power to members

- Although the Model Articles vest general power to manage in the directors, there are several situations in which the general power to manage will revert back to the members. Examples of such situations include:
 1. Where the directors are unwilling or unable to exercise the powers of management conferred upon them, then those powers revert back to the members.¹⁵
 2. In order to carry out business, the board of directors must be quorate. If a quorum cannot be established, then the power of management reverts back to the members.

Conclusion

- Greer LJ's statement is generally correct. The division of power is indeed a matter for the company's articles and, if the articles vest a general power of management in the directors, then the members cannot interfere with this power unless the articles provide for such interference. However, even if the articles do vest managerial power with the directors, there are several situations in which this power will revert back to the members.

⁶ Companies Act 2006, s 21(1).

⁷ *Ibid*, s 90(1).

⁸ *Ibid*, s 97(1).

⁹ *Ibid*, s 105(1).

¹⁰ *Ibid*, ss 102(1) and 109(1).

¹¹ *Ibid*, s 168(1).

¹² *Ibid*, s 188.

¹³ *Ibid*, s 239.

¹⁴ Insolvency Act 1986, s 122(1)(a).

¹⁵ *Barron v Potter* [1914] 1 Ch 895 (Ch).