A little more power to the people?

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Introduction
A recurring theme of corporate governance is the accountability of directors and executives to their shareholders. Corporate governance seems to evade exact definition, but one useful description is that it consists of the control mechanisms available for ensuring that managers and directors do not abuse their corporate **powers**.[1] An earlier attempt at definition was made by Sir Adrian Cadbury (as he then was) who suggested in his report that corporate governance was about the *way* in which companies were managed and run.[2] Since the early 1930's some commentators have even suggested that directors and managers have tended to become, *inter alia,* self-serving,[3] tending to ignore shareholders (and even the wider community)[4] altogether.
This article will consider the recent implementation of an EU Directive that may underline such accountability in the context of *listed* companies (i.e. those subject to the UK Listing Authorities jurisdiction). Statutory intervention in the past has sought to underline accountability by empowering shareholders to call meetings of the company (general meetings). In England and Wales we have also chosen to support accountability by the use of Codes.[5] The use of such Codes, rather than statutory intervention, may be seen as an unusual approach in a mixed-economy, such as the British one, where governments have been prepared to intervene by statutory means. Codes may be considered to be part of so-called "light-touch" regulation. Company legislation in the past has provided some direct support for accountability, notably the Companies Act 1948,[6] and the Companies Act 1985.[7]

A right to demand a meeting: the Companies Act 2006
Section 303 of the 2006 Act follows its two immediate predecessors by giving members the **power** to require directors to call a meeting.[8] Section 303 (2) stipulates a "required percentage" of shares that a member (i.e. a shareholder) must have in order to demand such a meeting, as 10 per cent of the paid up share capital of the company carrying the right to vote. But does putting such a right into shareholders' ***Cov. L.J. 29** hands ensure strong accountability? Could a minimum of 10 per cent prove too high a bar to climb over?
One problem some shareholders encounter in using this right stems from the small size of their holdings, and the need to find like-minded shareholders, so that meetings can be forced on unwilling directors by using s.303(1); how can just one shareholder coerce those of a similar disposition so as to require the calling of a meeting? A contrary view is that such minority shareholders should not be able to overrule the majority and that on acquiring their shares all shareholders are buying into a form of democracy, where the majority view should prevail. If the minority could continually impose their view how could the company ever progress? In any event, in *Automatic Self-Cleansing Filter Syndicate* [9] it was decided that the company, as a body of shareholders, cannot override the views of the directors. They have, in effect, delegated the **power** of management to the directors'. Or as Buckley LJ put it: "the directors are not servants...they are not agents appointed by and bound to serve the shareholders as their principals. They are the persons who may by the regulations [the articles of association] be entrusted with control of the business..."[10]

A little more power to the people: the Companies (Shareholders' Rights) Regulations 2009[11] ("the regulations")
The regulations,[12] by implementing EU directive 2007/36/EC and thereby amending Part 13 of the 2006 Act, provide that the minimum threshold in s.303(2) in order for shareholders to require directors to convene a meeting, is now only 5 per cent. Section 4 of the regulations amends s.303 by substituting 5 per cent for "...the required percentage..." contained in s.303(2) and also deletes sub-section (3) - which specified the 10 per cent rule, thereby somewhat simplifying the section. To further strengthen the right to demand a meeting, s.304 imposes a duty on directors to actually *call* the required meeting within 21 days of the shareholder request, and then *hold* it within 28 days of the notice calling the meeting.

The purpose of the regulations

Apparently the purpose is twofold:[13] to improve shareholder accountability; and to harmonise shareholder voting rights across EU member states. In particular they ensure that a shareholder residing in one member state has a straightforward means of voting when the general meeting is held in another member state. The second aim seems laudable enough, but will the first improve shareholder accountability that is the desired outcome of better corporate governance?

To put the question another way, will this new provision inspire shareholders (who may be better described as owners) to demand a meeting be called, rather than just ***Cov. L.J. 30** exit the company by disposing of their shares? It is to be hoped that a 5 per cent threshold will mean that notwithstanding the difficulties imposed by wide shareholder dispersal, fewer shareholders will now hesitate before challenging corporate management. Two features remain however. First, institutional shareholders, by the sheer weight of their holdings, could make any attempt at passing resolutions, deemed by them to be unattractive, look futile, and so considerably dampen any enthusiasm for calling a meeting in the first place. Secondly, recent evidence of the commercial behaviour by some British banks would seem to suggest that our Codes, on which so much corporate governance hope is pinned, are not working. The Cadbury Code 1992 (incorporated into the Combined Code 2008) makes non executive directors the key to corporate governance. Likewise, the Higgs review introduced a requirement for a senior independent director to be appointed amongst the non-executives. A possibly simplistic view is that on the evidence of the recent, and widely- felt, bank insolvencies, these two codified requirements have not been able to hold wrong-headed management and executives to account.

Conclusion

It is simply too much to hope that the amendment to s.303, by using a reduction from 10 to 5 per cent, will have much impact, given the scale of the problem (as possibly evidenced by some banks). Moreover, there is precious **little** evidence that those shareholders were minded to demand meetings to call directors to account, nor that non-executive directors were any **more** watchful of shareholder interests than their executive counterparts.

Those companies that desire a UK listing are required to either comply with the Combined Code or explain (the so-called comply or explain dichotomy) why they do not comply, and are subject to the continuing obligations of the UK Listing Authority. Given that the Listing Authority in the UK is actually the Financial Services Authority,[14] there is precious **little** current evidence that the Code is working, or that a simple reduction from 10 to 5 per cent will put greater accountability in the hands of shareholders. It is suggested that what is really needed is a considered change in the juridical nature of the relationship between owners and directors, ideally one that makes directors **more** accountable than Buckley LJ countenanced.

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1.
See Boyle and Bird's *Company **Law*** (Jordans 2009,7th ed), at page 357

2.
'Financial Aspects of Corporate Governance' 1992 and 'the Combined Code on Corporate Governance' 2008

3.
Notably Berle and Means, *The Modern Corporation and Private Property* (Transaction 2005 reprint); see also M. Stokes ' Company **Law** and Legal Theory' in W. Twining ed *Legal Theory and Common **Law*** (Blackwell 1986).

4.
See esp. the late Prof J. Parkinson *Corporate **Power** and Responsibility* (OUP 2002 reprint).

5.
See The Combined Code and *cf* Sarbanes-Oxley Act 2000 in the USA

6.
For example, see s.132 (1) of the 1948 Act.

7.
See s.368(1) of the 1985 Act.

8.
cf s.302 which deals with directors' **power** to call a meeting

9.
[1906] 2 Ch 34;

10.
In *Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89; see also *John Shaw & Sons* (*Salford) Ltd v Shaw* [1935] 2 KB.

11.
SI 2009 No 1623

12.
Which came into force on 3rd August 2009
13.
See the Explanatory memorandum to the regulations
14.
Established under the Financial Services and Markets Act 2000