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M. Freeman Durham

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The Companies Act, 1980: Its Effects on British Corporate Law

The Companies Act, 1980,¹ makes basic and important changes in the corporate law of Great Britain.² It implements the European Economic Community Second Directive on Company Law,³ and also extends regulations on director conflicts of interest, introduces prohibitions on insider dealing, requires directors to take employee interest into account, and facilitates minority shareholder access to the courts.

The Act is divided into six parts. Part I redefines public and private companies and governs their formation or re-registration. Part II regulates the issuance of shares, payment for shares, class rights, and the maintenance of capital. Part III limits distributions by the company to shareholders. These three parts are primarily concerned with implementing the Second Directive standards for public companies. Those standards are aimed at harmonizing corporate law within the European Community. They reflect an emphasis on the maintenance of a company's capital for the protection of creditors and the stability of the company. The standards are not particularly stringent, and largely correspond to the pre-existing common law rules on the subject.⁴ However, following the continental pattern, these standards embody a more detailed and prescriptive approach than the British tradition of allowing considerable judicial discretion in company law matters.⁵ Parts IV, V, and VI of the Act were added to the original Bill to accomplish needed reforms, many of which were recommended by

¹ Companies Act, 1980, ch. 22, [hereinafter cited as 1980 Act].

² The statutory corporate law in Great Britain is contained in the Companies Acts, which are: Companies Act, 1948, 11 & 12 Geo. 6, ch. 38; parts I and III of the Companies Act, 1967, ch. 81; Companies (Floating Charges and Receivers) (Scotland) Act, 1972, ch. 67; section 9 of the European Communities Act, 1972, ch. 68; sections 1 to 4 of the Stock Exchange (Completion of Bargains) Act, 1976, ch. 47; section 9 of the Insolvency Act, 1976, ch. 60; Companies Act, 1976, ch. 69; Companies Act, 1980, ch. 22. The Companies Act, 1948, is a consolidation of earlier companies statutes.

³ 20 O.J. Eur. Comm. (No. L 26) 1 (1977) [hereinafter cited as Second Directive].

⁴ L. GOWER, *PRINCIPLES OF MODERN COMPANY LAW* 8 (4th ed. 1979).

⁵ 400 PARL. DEB., H.L. (5th ser.) 1245 (1979) (Viscount Trenchard, Minister of State Department of Industry).

the Jenkin's Committee⁶ and were proposed by earlier Companies Bills in 1973 and 1978.⁷ Part IV states a general duty of directors to employees and imposes further director controls in regard to employment contracts, substantial property transactions, and loans. Part V makes insider dealing a criminal offense. Part VI consists of miscellaneous provisions, including the power of a company to provide for its employees when shutting down, the qualifications of company secretaries, the increase in penalties under the Companies Acts, and the right of access to the courts by shareholders who are unfairly prejudiced.

This comment takes each part of the Act in succession and explains the changes and effects of its various provisions. In addition, it highlights the Act's international effects and compares it to some of the basic principles of corporate law in the United States. This approach is intended to make a complicated act⁸ more comprehensible to the international lawyer.

PART I: CLASSIFICATION AND REGISTRATION OF COMPANIES

Part I of the 1980 Act introduces new classifications for companies, new machinery for registration, and provisions for the transition to the new system. Section 1 effects a major change in the definition of public and private companies. The Companies Act, 1948,⁹ defined private companies as those that restricted the number of their shareholders to fifty, limited the transferability of their shares and debentures, and prohibited the offering of their shares and debentures to the public.¹⁰ Public companies under the 1948 Act were all companies not qualifying as private companies. Section 1 of the 1980 Act redefines a public company as a company limited by shares,¹¹ or a company limited by guarantee having a share capital,¹² whose memorandum of associa-

⁶ JENKINS COMMITTEE ON COMPANY LAW, CMD. 3, No. 1749 (1962) [hereinafter cited as THE JENKINS REPORT].

⁷ For a basic description of the earlier bills, see 958 PARL. DEB., H.C. (5th ser.) 929-48 (1978) (J. Smith, Secretary of State for Trade), and 867 PARL. DEB., H.C. (5th ser.) 923-43 (1974) (P. Walker, Secretary of State for Trade and Industry, and President of Board of Trade).

⁸ In debates in the House of Lords, Lord Lloyd of Kigerran referred to the Bill as "job-creation for hundreds of lawyers," 407 PARL. DEB., H.L. (5th ser.) 981 (1980), and some of its provisions have been referred to as "half-baked." *Id.* at 1046 (Lord Mishcon).

⁹ Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, [hereinafter cited as 1948 Act].

¹⁰ *Id.* § 28.

¹¹ A company limited by shares is "a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them." *Id.* § 1(2)(a).

¹² A company limited by guarantee is "a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up." *Id.* § 1(2)(b). A company

tion¹³ states that it is to be a public company, and which complies with the registration requirements of a public company. The major requirements are that the company has "public limited company," or "plc," at the end of its name,¹⁴ and that it has the minimum authorized share capital required of a public company.¹⁵ Under the 1980 Act, all companies not meeting these requirements are considered private companies. This change in definitions broadens the category of private companies by allowing companies with more than fifty shareholders and without restrictions on share transferability to be classified as private companies. On the other hand, it narrows the category of public companies by requiring a minimum share capital in order to be classified as public companies.

Originally, the separate classification of private companies was created to exempt certain smaller companies from several normal company law requirements.¹⁶ The Companies Act, 1967,¹⁷ removed the most important of these exemptions: the freedom from filing annual reports and the freedom from the restrictions against loans to directors.¹⁸ The remaining distinctions were generally minimal, but allowed private companies to be formed and run with slightly less formality and expense.¹⁹

limited by guarantee having a share capital is one which issues shares with liability limited to the amount unpaid, as well as guarantee shares.

¹³ The memorandum of association is the equivalent to a corporation's articles of incorporation in the United States.

¹⁴ 1980 Act, ch. 22, § 2(2). There is some dissatisfaction over the new name "plc." One Member of Parliament said that it "sounds rather like a plastic material of some sort," 972 PARL. DEB., H.C. (5th ser.) 79 (1979) (G. Page). But, as another said, there appears to be no better solution. *Id.* at 55 (C. Parkinson). The Welsh equivalent, "*cwmni cyfyngedig cyhoeddus*," or "ccc," seems to have met with more approval. 401 PARL. DEB., H.L. (5th ser.) 157 (1979) (Lord Elwyn-Jones).

¹⁵ 1980 Act, ch. 22, §§ 3(2), 4(2). The minimum is currently set at £50,000 by § 85(1).

¹⁶ The distinction is clearly made in the Company (Consolidation) Act of 1908, which follows the tentative approach of the 1900 Act. See L. GOWER, *supra* note 4, at 13.

¹⁷ Companies Act, 1967, ch. 81, [hereinafter cited as 1967 Act].

¹⁸ The exemptions for private companies under sections 129 and 190 of the 1948 Act were repealed by the 1967 Act. 1967 Act, ch. 81, § 130(4)(C).

¹⁹ Private companies may commence immediately upon incorporation, while public companies must obtain a certificate under section 4, (or formerly under section 109 of the 1948 Act). Private companies may have one director, whereas public companies are required to have at least two. 1948 Act, 11 & 12 Geo. 6, ch. 38, § 176. Private companies are not restricted in allotting shares, as are public companies, by the minimum subscription requirement and the prospectus or statement in lieu of prospectus requirements. *Id.* §§ 47, 48, 50, 51. Motions for appointments of directors must be separate for public but not private companies. *Id.* § 183. Age restrictions for directors are applicable only to public companies and their subsidiaries. *Id.* § 185. Private companies are given three months longer to file their annual reports, and the requirement for keeping past accounting records is three years shorter than for public companies. Companies Act, 1976, ch. 69, §§ 6(2), 12(9) [hereinafter cited as 1976 Act]. Prior to the 1980 Act, there were several other advantages. Private companies did not have to meet the statutory meeting and reporting require-

With the advent of the 1980 Act, the distinction again becomes important. The European Economic Community Second Directive applies only to public companies,²⁰ although the 1980 Act extends a number of its requirements to private companies as well.²¹ Many companies classed as public companies under the old definition could not have met all the new requirements, and so the definition was altered to narrow the public company classification.²² The remaining provisions of part I are not so much concerned with implementing the Directive as with simplifying and adjusting the procedures used to form a public company, making a few minor reforms, and governing the transition to the new classifications.

Section 1 also prospectively prohibits the formation of any companies limited by guarantee having a share capital.²³ This step will help clarify the distinction between commercial and other types of organizations, since companies limited by guarantee are usually charitable and quasi-charitable associations.²⁴ Although section 1 does not affect existing companies limited by guarantee having a share capital, it will prevent any more from being formed.

The formation process for public companies is provided for in sections 2, 3, and 4. The procedure is easier than that formerly required under the 1948 Act. These sections reduce the number of shareholders required from seven to two,²⁵ eliminate several formalities previously required,²⁶ and simplify the requirements for a public company to obtain a certificate entitling it to do business or exercise borrowing powers.²⁷ The only change in the formation of private companies is the definitional change which no longer requires them to maintain the

ments in section 130 of the 1948 Act, (repealed by 1980 Act, ch. 22, § 82) and could be formed by only two persons, instead of the seven required to form a public company by section one of the 1948 Act (modified by 1980 Act, ch. 22, § 2).

²⁰ See Second Directive, *supra* note 3, art. 1, at 2.

²¹ 400 PARL. DEB., H.L. (5th ser.) 1241, 1243 (1979) (Viscount Trenchard).

²² *Id.* at 1240. The new definition now excludes companies of minor substance but with a large number of members, such as tenant associations, which would have been classified as public companies under the old definition. 401 PARL. DEB., H.L. (5th ser.) 24 (1979) (Lord Lyell).

²³ See *supra* note 12.

²⁴ See Hare, *Companies Act 1980—I*, 124 SOLICITORS' J. 503 (1980). The Jenkins Committee on Company Law thought it inappropriate that a company formed with the intentions of making *pro rata* distributions to its shareholders could register as a company limited by guarantee. THE JENKINS REPORT, *supra* note 6, at 23, ¶ 70.

²⁵ 1980 Act, ch. 22, § 2(1).

²⁶ 1948 Act, 11 & 12 Geo. 6, ch. 38, § 130 (repealed by 1980 Act, ch. 22, § 82), required a statutory meeting and statutory report of companies within three months of commencing business.

²⁷ 1980 Act, ch. 22, § 4, replacing 1948 Act, 11 & 12 Geo. 6, ch. 38, § 109.

three restrictions in their articles.²⁸

Sections 5, 7, and 13 provide for re-registration of a private company, an unlimited company,²⁹ or a joint stock company³⁰ as a public company. These provisions mainly ensure that the company makes the necessary changes in its structure and meets the share capital requirements. The company must pass a special resolution³¹ to change its memorandum to state that it is a public company, and make any other necessary changes in its memorandum or articles.³² It must also produce the company's balance sheet and auditor's report to show the necessary share capital.

Section 9 requires the re-registration of companies classified as public companies under the old definition (old public companies) by March, 1982.³³ Section 8 provides that old public companies may re-register as public companies if the directors take the necessary steps and if the company is able to meet the relevant standards, or as a private company if the shareholders pass a special resolution to that effect. Similarly, under section 10, a special resolution of the shareholders is required for a public company re-registering as a private company. In both cases, a court may at its discretion set aside these special resolutions on the application of a minority shareholder under section 11. This provision is intended to provide a safeguard for minority shareholder interests, since becoming a private company extensively affects the marketability of shares and the rights of shareholders.³⁴ Section 12 also gives the court authority to take into account such considerations when confirming a reduction in the share capital³⁵ of a public company

²⁸ See *supra* notes 9-15 and accompanying text. Articles are the equivalent of corporate by-laws in the United States. Private companies may continue to maintain the three restrictions in their articles if they so choose. 401 PARL. DEB., H.L. (5th ser.) 25 (1979) (Lord Lyell). For the three restrictions, see *supra* text accompanying note 10.

²⁹ Unlimited companies are companies formed without limited liability. 1948 Act, 11 & 12 Geo. 6, ch. 38, § 1(2)(c).

³⁰ A joint stock company is "a company having a permanent paid-up or nominal share capital of fixed amount divided into shares, also of fixed amount, . . . and formed on the principle of having for its members the holders of those shares . . . and no other persons." 1948 Act, 11 & 12 Geo. 6, ch. 38, § 383.

³¹ A special resolution requires a three-fourths majority. *Id.* § 141.

³² The articles are the equivalent of a United States corporation's bylaws.

³³ 1980 Act, ch. 22, 9(1); STAT. INST. 1785. The Companies Act, 1980 (Commencement No. 2) Order 1980 fixed 22 December 1980 as the appointed day for the purpose of section 9(1), as allowed by section 90(3).

³⁴ See *infra* text accompanying note 50. See also Hare, *Companies Act—II*, 124 SOLICITORS' J. 520 (1980).

³⁵ Court confirmation of reduction of a company's share capital is required by the 1948 Act, to protect creditors. 1948 Act, 11 & 12 Geo. 6, ch. 38, § 66(1).

which brings the share capital below the minimum capital requirements, forcing it to become a private company.

Before the 1980 Act, public companies usually acted through subsidiary³⁶ private companies because of the ease of formation and the slightly less stringent regulation.³⁷ This practice is likely to continue under the 1980 Act. British or foreign subsidiaries which are registered in Britain, regardless of where they are located, are classified as public or private companies on their own accord.³⁸ Wholly-owned subsidiaries would have no incentive to register as public companies, since they are not concerned with the marketability of their shares, and they certainly are not eager to take on any additional restrictions. Partially-owned subsidiaries must weigh the benefits of a market for their shares against the costs of additional regulation. The new Act, however, should not discourage the British registration of subsidiaries of international companies, since it continues to allow registration as a private company and does not regulate private companies as much as public companies.

The distinction redrawn and further developed by the Act between public and private companies in Britain corresponds to distinctions in the United States. In the United States, the federal securities laws and regulations apply only to companies whose shares are publicly traded.³⁹ Likewise, Delaware, following a trend started by North Carolina in 1955, has established special provisions relating to close corporations.⁴⁰ These provisions allow greater flexibility in management and variance from some corporate law norms.⁴¹ Delaware's definition of a close corporation is substantially the same as the old definition of a private company under the 1948 Act in Britain.⁴²

³⁶ A company is a subsidiary of another company if some of its shares are owned by, and the composition of its board is controlled by, that other company, if more than one-half of its equity share capital is owned by that other company, or if it is a subsidiary of a subsidiary of that other company. *Id.* § 154.

³⁷ See L. GOWER, *supra* note 4, at 118. See also *supra* note 19.

³⁸ 401 PARL. DEB., H.L. (5th ser.) 22 (1979) (Lord Lyell).

³⁹ The Securities Act of 1933 exempts transactions not involving any public offering from coverage. 15 U.S.C. § 77d(2) (1976). Certain sections of the Securities Exchange Act of 1934 apply only to securities listed on a national exchange. 15 U.S.C. §§ 78i, 78j (1976). Others also apply to companies with assets over \$1,000,000 and more than 500 shareholders. 15 U.S.C. § 781 (1976).

⁴⁰ W. CARY & M. EISENBERG, *CORPORATIONS* 14 (5th ed. 1980).

⁴¹ Delaware allows the shareholders of a close corporation to agree to restrict the discretion of the directors and to manage the company directly, and also makes special provisions for the resolution of disputes. DEL. CODE ANN. tit. 8, §§ 350-355 (1979).

⁴² Compare DEL. CODE ANN. tit. 8, § 342 (1979), with 1948 Act, 11 & 12 Geo. 6, ch. 38, § 28.

PART II: THE CAPITAL OF A COMPANY

Part II implements the Second Directive requirements applicable to the capital of a public company, though some of these requirements have been extended to private companies as well. Sections 14 to 19 govern the issue of share capital. Shareholders receive increased control over the issue of capital in the form of the restrictions on director authority to allot shares in section 14 and the pre-emption rights in sections 17, 18, and 19. These provisions were considered valuable protections warranting their extension to private, as well as public, companies.⁴³

Section 14 provides that directors of a company must have proper authorization before they can allot shares.⁴⁴ Authorization may be qualified or unqualified, and may be given for a period up to five years by the company's articles (bylaws) or by a resolution of a general meeting of the shareholders. The authorization may be revoked or modified by a vote of the shareholders. Section 14, therefore, gives ultimate control over the growth of the share capital of the company to the shareholders.

Section 17 requires a company to offer any new shares to its existing shareholders in proportion to their current holdings before it offers them for cash to anyone else. This pre-emption right permits a shareholder to maintain his proportional holding in a company when it issues new shares, and is similar to a Stock Exchange Listing Agreement provision.⁴⁵ The pre-emption right also ensures that the value of the shareholder's interest in the company will not be diluted by the company selling shares below their true value. In this case, the shareholder may sell his right to purchase shares,⁴⁶ and thereby receive the difference between the price and their true value without actually purchasing the shares. The pre-emption right does not extend to allotments made wholly or partially for non-cash consideration.⁴⁷ This exemption allows the company the freedom to exchange shares for property or for shares in another company, enabling it to acquire

The only substantive difference is that Delaware limits the number of shareholders to 30, while the 1948 Act limited the number to 50.

⁴³ 972 PARL. DEB., H.C. (5th ser.) 56 (1979) (C. Parkinson, Minister of State, Department of Trade).

⁴⁴ Under section 87(2), shares are "allotted" when a person acquires the unconditional right to be included in the company's register of members with respect to those shares.

⁴⁵ 400 PARL. DEB., H.L. (5th ser.) 1242 (1979) (Viscount Trenchard).

⁴⁶ 1980 Act, ch. 22, § 17(3)(b).

⁴⁷ *Id.* § 17(4).

needed assets or conduct a merger or consolidation with another company without being frustrated by pre-emption rights.

Where authorization to allot shares under section 14 has been given, section 18 provides that the articles or a special resolution of the shareholders may waive or modify pre-emption rights. Private companies may retain pre-existing arrangements contained in their memorandum or articles which are inconsistent with the 1980 Act pre-emption rights.⁴⁸

Shareholder control over capital in a private company protects investors, who have a personal stake in the company, from losing their voice or proper share in the company. It is questionable whether this same protection is equally needed by shareholders in large public companies. In practice, public company shareholders are likely to give up such rights regularly to provide the directors with flexibility in using their business judgment to raise capital. The 1980 Act gives public company shareholders control over capital that they do not really need, and which they are likely to waive every five years, or whenever the directors ask for their waiver.⁴⁹

Private companies may not issue their shares or debentures to the public.⁵⁰ This prohibition replaces the former requirement of a statement in the company's articles to that effect.⁵¹ However, issuing shares or debentures of a private company to the public is now a criminal offense, which can subject the company and any officer involved to a fine.⁵²

Any new offering of shares by a public company must be fully subscribed before any of the shares are allotted,⁵³ unless the offer states that shares may be allotted in any event or upon specific conditions.⁵⁴ This provision should keep issues of new shares at the level reasonably expected to be subscribed, and, in effect, requires the issue to be withdrawn where the expectations of both the company and the investors were not fulfilled.

⁴⁸ *Id.* § 17(9).

⁴⁹ The Stock Exchange required pre-emption rights for listed companies prior to the 1980 Act. 400 PARL. DEB., H.L. (5th ser.) 1241 (1979) (Viscount Trenchard). This author is not familiar with the effect of that requirement and bases his conclusion on United States practices.

⁵⁰ 1980 Act, ch. 22, § 15(1).

⁵¹ See *supra* text accompanying note 10.

⁵² The fine for violating section 15 may be up to the statutory maximum of £1,000. See *infra* note 226.

⁵³ 1980 Act, ch. 22, § 16(1)(a).

⁵⁴ *Id.* § 16(1)(b). Even if the offer states that the offering does not have to be fully subscribed, the minimum amount to be raised, as stated in the prospectus, must be subscribed before any shares are allotted. 1948 Act, 11 & 12 Geo. 6, ch. 38, § 47.

Sections 20 to 31 regulate the payment for shares. Section 20, requiring shares to be paid up in money or money's worth, and section 21, prohibiting discounts, are largely restatements of the law and apply to both public and private companies. Sections 22 to 31 add new requirements to British law, and apply only to public companies.⁵⁵

The section 20 requirement that shares, and any premium on them, be paid up in money or in money's worth changes the law in that it explicitly excludes undertakings to do work or perform services as payment for shares.⁵⁶ It also provides the company with a right of action against a person receiving the shares on such an undertaking for the value of the shares. However, this section expressly allows goodwill and know-how as payment for shares, and does not exclude work or services already provided.

The House of Lords, in *Ooregum Gold Mining Co. of India v. Roper*,⁵⁷ established the rule against issuing shares at a discount. Lord Macnaughten stated: "[t]he dominant and cardinal principle of . . . [the Companies] Act . . . is that the investor shall purchase immunity from liability beyond a certain limit, on the terms that there shall be and remain a liability up to that limit."⁵⁸ This is to say, the shareholder is liable up to the value of his shares, and may not by agreement alter the amount of his liability. Discounted shares were treated as not fully paid up, with the shareholder remaining liable to contribute the balance when called upon to do so.⁵⁹ This rule was weakened in practice, however, by issuing shares in return for over-valued non-cash consideration,⁶⁰ the payment of underwriting commissions,⁶¹ and the allowance of discount with permission from the court.⁶² The rule in *Mosely v. Koffyfontein Mines, Ltd.*,⁶³ however, precluded discounting through the use of convertible debentures.

⁵⁵ 972 PARL. DEB., H.C. (5th ser.) 56 (1979) (C. Parkinson).

⁵⁶ Undertakings to do work or perform services have been accepted as payment for shares in the past. Under the 1980 Act, companies must have discharged such undertakings. 1980 Act, ch. 22, §§ 6(1)(c), 8(1)(b).

⁵⁷ 1892 A.C. 125.

⁵⁸ *Id.* at 145. See also *supra* note 11.

⁵⁹ *Ooregum Gold Mining Co. of India v. Roper*, 1892 A.C. 125, 137 (Lord Watson). See also *infra* note 66.

⁶⁰ See L. GOWER, *supra* note 4, at 219. The company's valuation of consideration was accepted as conclusive, *In re Wragg, Ltd.* [1897] 1 Ch. 796, unless it was inadequate on its face, *In re White Star Line, Ltd.* [1939] Ch. 458, or if there was evidence of fraud or the lack of any bona fide valuation, *Tintin Exploration Syndicate v. Sandys* [1947] 177 L.T.R. 412.

⁶¹ 1948 Act, 11 & 12 Geo. 6, ch. 38, § 53.

⁶² *Id.* § 57.

⁶³ [1904] 2 Ch. 108. The company proposed issuing debentures at a discount which could later be exchanged for fully paid up shares of an amount equal to the face value of the debentures. The

Section 21 restates the rule against discounts and eliminates the exception to the rule with court approval.⁶⁴ Further, independent valuation requirements should prevent public companies from issuing shares for over-valued non-cash consideration.⁶⁵ The Act does not disturb the payment of underwriting commissions.

Shares of a public company are to be paid up to at least one quarter of their nominal value and all of any premium before they are allotted.⁶⁶ Though it is the general practice to fully pay up shares within a short time of issue,⁶⁷ this provision establishes a minimum to avoid abuse. Section 23 requires that payment for shares in the form of an undertaking must be performed within five years.⁶⁸ This provision is concerned with the company getting something for its shares within a reasonable time.

Section 24 provides that a qualified independent expert must value non-cash consideration and report to the company before any public company shares can be allotted for that consideration.⁶⁹ A violation of the requirement causes the holder of the shares to be liable to the company for their nominal value. The requirement is waived in situations where the company is making a tender offer for shares in another company or is involved in a merger, thus avoiding difficult valuation problems and leaving the decision to the directors' judgment. The person making the valuation is empowered to require relevant company information.⁷⁰ Any person knowingly or recklessly making false or misleading statements is subject to a fine or two years imprisonment or both.⁷¹

Independent expert valuation of all non-cash assets transferred between a public company and a subscriber to the memorandum is required within two years of the formation of the company, or between the company and the shareholder within two years of that company's re-registration as a public company, if those assets equal or exceed ten

Court of Appeal held this would result in shares being issued at a discount and enjoined the issuance of the debentures.

⁶⁴ 1980 Act, ch. 22, § 21.

⁶⁵ *Id.* §§ 24, 25.

⁶⁶ *Id.* § 22. Payment of the full nominal value of a newly issued share may not be immediately required. Shares are said to be paid up to the extent that their nominal value has been paid by the holder.

⁶⁷ See J. CHARLESWORTH & T. CAIN, *COMPANY LAW* 211 (11th ed. 1977).

⁶⁸ Undertakings to do work or perform services are prohibited. 1980 Act, ch. 22, § 20.

⁶⁹ *Id.* § 24(1),(4).

⁷⁰ *Id.* § 25(1).

⁷¹ *Id.* § 25(5).

percent of the nominal value of the company's issued capital.⁷² The company's shareholders must also approve such a transfer by resolution. These requirements are in addition to the valuation requirements of section 24 for non-cash consideration for the allotment of shares. A violation of the provisions of this section voids the transfer, unless it is for the allotment of shares. An exception to the requirements is allowed where to acquire such assets is in the company's ordinary course of business.⁷³

Where liability is imposed for failure to make proper payment for shares, the court, under section 28, may grant relief if it appears just and equitable to do so, considering any payment or the likelihood of payment and the degree of culpability involved. The company and any officers involved may also be fined for not requiring the proper payment for shares.⁷⁴

Sections 32 and 33 clarify and extend the law concerning the variation of class rights. If a company has more than one class of shares, class rights are usually set out in the company's articles (bylaws), which also usually provide that alterations can be made with the consent of a prescribed majority of the class.⁷⁵ If rights are set out in the memorandum and there is no provision for variation, section 206 of the 1948 Act allows alterations with the approval of three-fourths of the class and the court.

Under section 32, if class rights are granted in the memorandum, they may be varied in a way provided in the original articles, though if the variation of rights concerns the authority to issue or reduce capital, three-fourths of the class must approve. If there is no provision for varying rights granted in the memorandum, those rights may be varied only by the unanimous agreement of the shareholders, or through the judicial powers under section 206 of the 1948 Act.⁷⁶ If the class rights are granted other than in the memorandum, such as in the articles, these rights may still be varied according to a provision of the articles. If there is no provision in the articles, or if the variation concerns the authority to issue or reduce capital, rights granted other than in the

⁷² *Id.* § 26. The subscribers to the memorandum are those people who sign and register the memorandum of association to form the company, and who agree to take and pay for shares in the company. See 1948 Act, 11 & 12 Geo. 6, ch. 38, §§ 1, 12, 26.

⁷³ For example, a real estate company could purchase real estate from a subscriber to the memorandum within two years without obtaining independent expert valuation and shareholder approval.

⁷⁴ 1980 Act, ch. 22, § 30.

⁷⁵ See THE JENKINS REPORT, *supra* note 6, at 70, ¶ 188. Minorities could appeal such a change to the court under the 1948 Act, 11 & 12 Geo. 6, ch. 38, § 72.

⁷⁶ 1980 Act, ch. 22, § 32(5).

memorandum may be varied only with the approval of three-fourths of the class. Any class rights which are not stated in the memorandum, articles, or a registered resolution, and any variation of those rights must be filed with the registrar of companies.⁷⁷

Sections 34 to 38 are concerned with the maintenance of a company's capital. A mandatory general meeting must be held if the net assets of a public company fall to half the company's called up share capital.⁷⁸ This provision is meant to call the attention of the shareholders to a major drop in assets.⁷⁹ It at least forces the management to explain itself in the event of a drastic fall in assets and could prompt the shareholders to change management or make decisions concerning the future of the company. Additionally, the common law rule that companies cannot acquire their own shares is codified and is applicable to both public and private companies.⁸⁰ This rule was established in *Trevor v. Whitworth*⁸¹ on the grounds that such an acquisition would amount to an unauthorized reduction of capital to the detriment of creditors. The acquisition of shares in a reduction of capital with the consent of the court, as provided by sections 66 to 71 of the 1948 Act, is not affected. Companies may also take gifts of fully paid-up shares directly.⁸² The rule does not prohibit the calling in of fully paid redeemable preference shares using profits or the proceeds of a new issue,⁸³ the purchase of minority interests by the company under a court order,⁸⁴ or the forfeiture or surrender in lieu of forfeiture for failure to make the required payments on such shares.⁸⁵

Section 36 states that shares issued to a nominee of the company or partially paid up shares acquired from a third party by a nominee of the company shall be treated as held by the nominee as his own; the company shall have no beneficial interest in them. Liability for any

⁷⁷ *Id.* § 33.

⁷⁸ *Id.* § 34. Called up share capital is that part of issued capital which has been paid up by the shareholders. It is usually equal to the issued capital. See *supra* notes 66-67 and accompanying text.

⁷⁹ 401 PARL. DEB., H.L. (5th ser.) 32 (1979) (Viscount Trenchard).

⁸⁰ 1980 Act, ch. 22, § 35(1).

⁸¹ 1887 A.C. 409. Several of their Lordships also concluded that the purchase of the company's own shares was outside the objects of the company set forth in the memorandum, and was, therefore, *ultra vires*. *Id.*

⁸² 1980 Act, ch. 22, § 35(2). Formerly, under the common law, a nominee of the company could receive a gift of the company's shares to hold in trust for the company. *Kirby v. Wilkins*, [1929] 2 Ch. 444.

⁸³ 1948 Act, 11 & 12 Geo. 6, ch. 38, § 58, allows this practice.

⁸⁴ The court may require the purchase of minority interests under certain circumstances. *Id.* § 5; 1980 Act, ch. 22, §§ 11, 75.

⁸⁵ 1980 Act, ch. 22, § 35(4).

amount payable on those shares, however, is imposed on any director or subscriber to the company's memorandum involved in such an issuance, as well as on the nominee.

Section 37 regulates the short-term holding by a public company of its own shares to ensure that such holdings do not distort the control or the account of the company. A public company must cancel any shares forfeited or surrendered in lieu of forfeiture, or any shares in which the company has a beneficial interest, within three years. The company must also make the necessary adjustments in the amount of its share capital, and, if necessary, of its classification as a public company.⁸⁶ Shares held by the company or by a nominee of the company may not exercise any voting rights, and if the nominee received company assistance in acquiring the shares, the period for cancellation is reduced to one year. Where a public company's books show its own shares or an interest in those shares as an asset, an equivalent amount of profits available for distribution must be placed in a reserve fund. Finally, section 38 prohibits public companies from establishing liens or charges over their own shares, except to secure payment of any amount unpaid on those shares or where such liens are made in the ordinary course of business.⁸⁷

Most of the general principles of part II correspond to principles in corporate law of the United States. Generally, stockholders in the United States have less control over the capital of publicly held corporations. The authority to issue shares is often given to the board with such limits as may be found in the certificate of incorporation.⁸⁸ Of course, power to increase any limits set in this way remains with the shareholders. Pre-emption rights are generally recognized in the United States, but most states allow limitations on those rights,⁸⁹ or exclude such rights unless the certificate of incorporation explicitly provides for them.⁹⁰ United States law is similar to British law in requiring lawful consideration for stock.⁹¹ Future services are generally

⁸⁶ If the company fails to re-register as a private company when necessary under this section, it will continue to be treated as a public company except that it is prohibited from selling shares to the public. *Id.* § 37(6).

⁸⁷ Two other exceptions are applicable to liens which pre-date re-registration as a public company under the 1980 Act. *Id.* §§ 38(2)(c), (d).

⁸⁸ See DEL. CODE ANN. tit. 8, § 120(a)(4) (1979).

⁸⁹ See N.Y. BUS. CORP. LAW § 622 (McKinney 1963) (pre-emption may be limited by the certificate of incorporation).

⁹⁰ See DEL. CODE ANN. tit. 8, § 102(b)(3) (1979) (pre-emption rights do not exist unless expressly granted in the certificate of incorporation).

⁹¹ See DEL. CODE ANN. tit. 8, § 151 (1979).

disallowed, though a few states have broken from the rule.⁹² Some states do not allow the exchange of shares for particular knowledge and experience,⁹³ a practice expressly allowed under the 1980 Act in Britain. The rule against issuing shares at a discount is also common in the United States,⁹⁴ but this rule is weakened by the absence of independent valuation requirements.⁹⁵ Class rights in the United States are usually found in the certificate of incorporation.⁹⁶ They may be altered in the normal manner of amending the certificate, which in Delaware, for example, involves obtaining the approval of a majority of each class of stock entitled to vote on the issue, unless the certificate itself contains a provision requiring some greater proportion.⁹⁷ A company's acquisition of its own shares is much less restricted in the United States than in Britain. It is usually freely allowed unless it would impair the capital of the corporation.⁹⁸ However, as under British law, shares held by a United States company cannot be voted by the company.⁹⁹

Overall, British standards are slightly more restrictive than those in the United States. However, the British standards are not too burdensome, since shareholder authorization to allot shares and remove pre-emption rights should be easy to obtain in public companies, and the valuation requirements for non-cash consideration and substantial transfers of assets are not applicable to the great majority of transactions. The British limitations on a company acquiring its own shares may cause some inconvenience, but it does not limit any important corporate function. Offsetting any additional burden, the British standards may be more effective than their United States counterparts in protecting the integrity of a company's capital. It is questionable whether creditors actually rely on a company's stated capital when extending credit or making a loan, and, therefore, these requirements may have little effect on them except if the company is wound up. Still, these requirements directly affect the shareholders, and ensure that each makes a properly proportional contribution to the company.

⁹² See, e.g., MICH. COMP. LAWS § 450.1315(1) (1982); VA. CODE § 13.1-17 (1978).

⁹³ See *Brown v. Watson*, 285 A.D. 587, 588, 139 N.Y.S.2d 628, 630 (1955).

⁹⁴ See DEL. CODE ANN. tit. 8, § 153(a) (1979).

⁹⁵ See *id.* § 152 (directors' valuation of consideration conclusive in the absence of actual fraud).

⁹⁶ See *id.* §§ 102(a)(4), 151.

⁹⁷ See *id.* § 242(c)(1).

⁹⁸ See *id.* § 160(a).

⁹⁹ See *id.* § 160(c).

PART III: RESTRICTIONS ON DISTRIBUTION OF PROFITS AND ASSETS

Part III of the Act represents the first attempt to codify and reform British law governing the distribution of profits to shareholders.¹⁰⁰ The general common law rule, established in such cases as *Flitcroft's Case*,¹⁰¹ was that dividends could only be paid out of profits. Such distributions could not be made if it would result in the company's inability to pay its debts.¹⁰² Losses of circulating assets during the current year had to be made good before dividends could be distributed,¹⁰³ but losses and depreciation on fixed assets,¹⁰⁴ and, in England though not in Scotland, losses from previous years¹⁰⁵ did not have to be considered. Profits from previous years,¹⁰⁶ realized capital gains,¹⁰⁷ and, in England though not in Scotland, unrealized capital gains¹⁰⁸ could also be distributed as dividends. Because these rules ignored losses from previous years and losses on fixed assets, their overall restrictive effect was minimal, and they did little to constrain a company from depleting

¹⁰⁰ The Minister of State, Department of Trade, Cecil Parkinson, summed it up, "[the] law in this area is, to say the least, confused." 972 PARL. DEB., H.C. (5th ser.) 58 (1979).

¹⁰¹ *In re Exchange Banking Co.*, [1882] 21 Ch. D. 519. The directors knowingly included bad debts as assets on the company's balance sheets, creating a false profit which was distributed as dividends. The Court of Appeals stated the distribution was an improper use of capital and held the directors liable.

¹⁰² *Lee v. Neuchatel Asphalte Co.*, [1889] 41 Ch. D. 1 (distribution of dividends had no effect on the company's ability to pay its debts, and was not invalid on that ground).

¹⁰³ *In re National Bank of Wales*, [1899] 2 Ch. 629 (losses of circulating assets, used in procuring returns, must be deducted from those returns in order to determine distributable profits, but the bank showed annual profits, and did not have to consider losses due to bad debts from previous years).

¹⁰⁴ *Lee v. Neuchatel Asphalte Co.*, [1889] 41 Ch. D. 1. Even though the company's primary asset, a mining concession, was being consumed by annual operation, the diminution of value did not have to be considered to determine profits, and dividends could be paid as long as revenues exceeded current operating expenses and the company retained sufficient assets to pay its creditors.

¹⁰⁵ *Ammonia Soda Co. v. Chamberlain*, [1918] 1 Ch. 266. The English court ruled that the company's losses from previous years, though they might reduce capital, *id.*, did not have to be made up before current profits could be distributed. In *Niddrie & Benhar Coal Co. v. Hurl*, [1891] 18 R. 805, the Scottish court suggested that the current earnings must first be applied to the losses from the previous year before dividends could be paid.

¹⁰⁶ *In re Hoare & Co., Ltd. and Reduced*, [1904] 2 Ch. 208. The Court approved of the company's retention of part of its reserve fund of previous years' profits and premiums and the payment of profits from that fund, even though a severe loss of assets necessitated a reduction of the company's capital.

¹⁰⁷ *Lubbock v. British Bank of S. Am.*, [1892] 2 Ch. 198. The sale and repurchase of the bank's business in Brazil resulted in a capital gain of £205,000, which is distributable profit.

¹⁰⁸ *Dimbula Valley (Ceylon) Tea Co. v. Laurie*, [1961] Ch. 353, 370-374. The English court held that any unrealized profit resulting from a revaluation of fixed assets may be distributed as a dividend or capitalized. In *Westburn Sugar Refineries v. Inland Revenue*, 1960 S.L.T. 297, the Scottish court held that the amount of unrealized profit resulting from a revaluation of fixed assets which was capitalized by the company was not subject to tax since it was not a distributable sum.

its capital. A company's memorandum could, however, impose further restrictions if desired.¹⁰⁹

The 1980 Act replaces most of these rules.¹¹⁰ All companies, both public and private, may now only distribute profits available for distribution. Profits available for distribution are defined as accumulated realized profits less accumulated realized losses.¹¹¹ This definition means that all past losses, both losses on fixed assets and operating losses,¹¹² must be made up before any dividends may be paid. The common law requirement that the distribution not render the company unable to pay its debts, and the allowance of further restrictions by the company itself, should remain in effect along with the statutory provisions.¹¹³

Public companies must meet a further requirement before paying dividends. Section 40 requires that the net assets of a public company both before and after any distribution must be at least equal to the capital of the company and undistributable reserves. It includes among undistributable reserves an account equivalent to the amount by which the accumulated unrealized profits exceed its accumulated unrealized losses. This requirement means public companies must cover any unrealized losses which exceed unrealized gains before paying a dividend.¹¹⁴

Section 41 contains special distribution rules for investment companies. An investment company is one whose business consists of investing its funds "mainly"¹¹⁵ in securities and is prohibited by its memorandum or articles from distributing capital profits. It may distribute any excess of accumulated realized revenue profits less accumulated realized or unrealized revenue losses if its assets are fifty percent greater than its liabilities before and after any distribution. Section 42 applies to insurance company distributions, and defines profit or loss as any surplus or deficit in an insurance fund, which is the difference be-

¹⁰⁹ *In re Oxford Benefit Building & Investment Society*, [1886] 35 Ch. D. 502. The company's memorandum required that dividends be paid only out of realized profits. The directors were held liable for dividends distributed on the basis of estimated profits without any reference to realized profits.

¹¹⁰ 1980 Act, ch. 22, § 39.

¹¹¹ *Id.* § 39(2).

¹¹² *Id.* § 45(4).

¹¹³ See L. GOWER, *supra* note 4, at 233. See also 1980 Act, ch. 22, § 45(5).

¹¹⁴ 400 PARL. DEB., H.L. (5th ser.) 1244 (1979) (Viscount Trenchard).

¹¹⁵ "Mainly" was used in order to give such companies greater flexibility in their investments: it will probably be interpreted as "more than half." See *Fawcett Properties Ltd. v. Buckingham County Council*, 1961 A.C. 636, 669 (Lord Morton of Henryton).

tween the assets of that fund and its liabilities as determined by actuarial investigation.

Section 43 provides that the application of part III of the Act is to be determined by reference to the company's properly prepared annual or interim accounts. Section 44 provides that any shareholder who knows or has reasonable grounds for believing that a distribution is made in violation of this part of the Act is liable to repay it to the company. The common law also made directors liable to refund dividends paid on fictitious profits,¹¹⁶ and the courts may extend this liability to violations of the 1980 Act, as well. Section 45 exempts bonus shares, redemptions of preference shares, reductions of share capital, and any distributions upon winding up a company from the coverage of these requirements. These activities either do not have an adverse effect on creditors, as in the case of bonus shares, or are sufficiently regulated by other provisions of the Companies Acts.¹¹⁷

In the United States, there are four basic approaches, often found in combination, to limiting the distribution of dividends.¹¹⁸ Some states prohibit distribution which would cause or worsen company insolvency.¹¹⁹ Some states require that distributions be made only out of surplus, the excess of net assets over capital.¹²⁰ Some states have limitations based on current earnings.¹²¹ Some states have limitations allowing distribution only out of earned surplus, the corporation's accumulated profits.¹²² The earned surplus test differs from the surplus test in that the earned surplus test disallows distributions from paid-in surplus (the premiums paid on issued stock), from reduction surplus (the amount by which stated capital can be reduced in some circumstances), and from revaluation surplus (the unrealized appreciation on fixed assets). The earned surplus test is the closest to the approach of the 1980 Act in regard to public companies, and the insolvency test is equivalent to that in British common law.¹²³

¹¹⁶ See *supra* note 101.

¹¹⁷ 1948 Act, 11 & 12 Geo. 6, ch. 38, § 58 (governs redeemable preference shares); *id.* §§ 66-71 (govern reductions of share capital); *id.* §§ 271-365 (govern winding up).

¹¹⁸ See W. CARY & M. EISENBERG, *supra* note 40, at 1336.

¹¹⁹ See MASS. ANN. ch. 156B, § 61 (Michie/Law Co-op. 1982) (insolvency used as the sole test); N.Y. BUS. CORP. LAWS § 510(a) (McKinney 1963).

¹²⁰ See N.Y. BUS. CORP. LAWS § 510(b) (McKinney 1981); DEL. CODE ANN. tit. 8, § 170 (1979).

¹²¹ See KY. REV. STAT. § 271A.225 (1978); DEL. CODE ANN. tit. 8, § 170 (1979).

¹²² See PA. CONS. STAT. § 1702(A)(1) (1967).

¹²³ See *supra* note 102 and accompanying text.

PART IV: DUTIES OF DIRECTORS AND CONFLICTS OF INTEREST

Section 46 of part IV requires directors to take into account the general interests of employees of the company, as well as its shareholders. This is an addition to the general duty to act "bona fide in what they consider . . . is in the interests of the company as a whole."¹²⁴ Previously, the duty to act in the company's interest left no room for consideration of employee interests unless they coincided with the interests of the shareholders.¹²⁵ While these interests often coincide because it is in the shareholders' interests to ensure employee cooperation and thereby increase productivity, previously the directors bore the burden of proving that actions in the interest of employees were actually made for the benefit of the company.¹²⁶ In contrast, section 46 imposes a positive duty on directors, which will raise the standard of care in considering employee interests¹²⁷ and provide a shield against challenges to actions which benefit employees.¹²⁸ How the interests of the shareholders and the employees are to be balanced is apparently left up to the directors' discretion.

The duty to have regard for employee interests is owed to the company and is enforceable in the same manner as other fiduciary duties owed to the company.¹²⁹ This normally means that only the company can bring suit to enforce it.¹³⁰ It is unclear if and under what circumstances a shareholder derivative action might be brought, but it seems evident that employees may enforce the duty only if they also hold shares in the company.¹³¹

The remainder of part IV is concerned with transactions which are particularly susceptible to conflicts of interest between the director and the company as a whole. Sections 47 to 53 restrict certain types of transactions and sections 54 to 61 relate to disclosure requirements.

Shareholder approval is required for all contracts of employment,

¹²⁴ *In re Smith & Fawcett, Ltd.*, [1942] 1 Ch. 304, 306 (Lord Green, M.R.).

¹²⁵ See *Hutton v. W. Cork Ry. Co.*, [1883] 23 Ch. D. 654; *Parke v. Daily News Ltd.*, [1962] 1 Ch. 927. In both cases, the directors were restrained from paying compensation to employees for the loss of their jobs when the company was being wound up because the compensation would further no business purpose of the company.

¹²⁶ *Parke v. Daily News Ltd.*, [1962] 1 Ch. 927, 954.

¹²⁷ See 407 PARL. DEB., H.L. (5th ser.) 1019 (1980) (Lord Mackay of Clashfern, citing a Law Society memorandum).

¹²⁸ 401 PARL. DEB., H.L. (5th ser.) 88 (1979) (Lord Elwyn-Jones).

¹²⁹ 1980 Act, ch. 22, § 46(2).

¹³⁰ *Foss v. Harbottle*, [1843] 67 Eng. Rep. 189. See also *infra* text accompanying notes 231-44.

¹³¹ "The employee does not enter the company stage as a litigant unless he becomes something else. If he buys a share, then he may bring a shareholder's action where that is permitted" 407 PARL. DEB., H.L. (5th ser.) 1028 (1980) (Lord Wedderburn of Charlton).

including contracts for services,¹³² between the director and the company which exceed five years in length and which do not allow termination by notice of the company for any reason.¹³³ This approval requirement also applies to employment contracts between the director and the company entered into more than six months in advance of the expiration of a current contract which would have the effect of guaranteeing employment for more than five years.¹³⁴ The contravention of these requirements voids the term concerning the duration of the contract, and allows the company to terminate it by notice at any time. Shareholder approval is also required for any substantial purchases or sales of non-cash assets between a company and the director of that company or a director of its holding company or any person connected with such a director.¹³⁵ Approval is necessary if the transaction involves an asset or assets valued over £50,000 or valued over £1,000 and exceeding ten percent of the amount of the company's net assets.¹³⁶ If the transaction is not approved, it is voidable by the company except when: (1) restitution is no longer possible; (2) the company has been indemnified for any loss; (3) the avoidance would affect third parties who were unaware of the violation; or (4) the transaction is approved by the shareholders within a reasonable time.¹³⁷ The director or the connected person involved and any director who knowingly authorized the violation are accountable to the company for any gains to them, and liable to the company for any loss or damage to it.

The intention behind the provisions related to employment contracts and substantial property transactions is to eliminate the weaknesses of prior regulations exposed in a number of inspector's reports.¹³⁸ The provisions are similar in nature to provisions in the Stock Exchange Listing agreement, though those provisions only cover employment for over ten years.¹³⁹ Contracts with directors have long been voidable at the insistence of the company,¹⁴⁰ but the company's

¹³² British law makes a distinction between contracts *of* service, where a person is hired full time as part of the company, and contract *for* services, where a person hires himself out as an independent agent, such as a consultant. The distinction often is hard to determine at the margin. See *id.* at 1093-95 (Lord Wedderburn of Charleton).

¹³³ 1980 Act, ch. 22, § 47(2).

¹³⁴ *Id.* § 47(3).

¹³⁵ *Id.* § 48(1).

¹³⁶ *Id.* § 48(2).

¹³⁷ *Id.* § 48(3).

¹³⁸ 407 PARL. DEB., H.L. (5th ser.) 1044 (1980) (Lord Lyell).

¹³⁹ 401 PARL. DEB., H. L. (5th ser.) 103 (1979) (Lord Mishcon).

¹⁴⁰ *Aberdeen Ry. Co. v. Blaikie Bros.*, [1854] D. 470; *Boulting v. Association of Cinematograph, Television & Allied Technicians*, [1963] 2 Q.B. 606, (Diplock, L.J.).

articles (bylaws) often modified this general rule.¹⁴¹ These provisions ensure shareholder awareness of such contracts, and remove any limitations on their voidability if they are not properly authorized.

Neither the approval requirements for employment contracts nor for substantial property transactions with directors apply to wholly-owned subsidiaries, whether incorporated in Britain or overseas, or to foreign holding companies of a British subsidiary.¹⁴² Exceptions for wholly-owned subsidiaries seem justified by the absence of any opportunity for self-dealing to the detriment of minority shareholders. The exception for foreign holding companies of British subsidiaries avoids having an extra-territorial effect when no real British interests are involved. The approval requirements, however, are applicable to contracts and transactions between directors of British holding companies and any non-wholly-owned subsidiary, whether British or foreign.¹⁴³

Sections 49 to 53 regulate company loans to directors. They replace section 190 of the 1948 Act which was often avoided in practice.¹⁴⁴ Section 49 prohibits any company from making a loan to one of its directors or to a director of its holding company. It also prohibits a public company, and any private company connected with a public company, from making a loan, quasi loan,¹⁴⁵ or entering a credit transaction as a creditor¹⁴⁶ to such a director or any person connected with such a director.¹⁴⁷ This section also prohibits any company from guaranteeing or providing security on any prohibited transaction, or from arranging for the assignment to the company or the assumption by the company of any rights, obligations, or liabilities under such a transaction,¹⁴⁸ or from participating in any arrangements whereby another person enters such a transaction.¹⁴⁹

¹⁴¹ See L. GOWER, *supra* note 4, at 586.

¹⁴² 1980 Act, ch. 22, §§ 47(6), 48(6).

¹⁴³ *Id.* §§ 41(1)-(2), 48(1).

¹⁴⁴ CONDUCT OF COMPANY DIRECTORS, CMD. 3, No. 7037, at 2, ¶ 8 (1977).

¹⁴⁵ A quasi loan is a transaction under which the "creditor" pays a sum of money for the "borrower" or reimburses expenditures incurred for the "borrower" where the "borrower" will then pay back the "creditor." 1980 Act, ch. 22, § 65(2)(a).

¹⁴⁶ A credit transaction is a transaction where the "creditor": (1) supplies goods or sells land under a hire purchase or conditional sale agreement; (2) leases or hires goods or land in return for periodic payments; or (3) disposes of land or supplies goods or services where payment is to be deferred. *Id.* § 65(3).

¹⁴⁷ *Id.* § 49(1)(b). Connected people are spouses; minor children or stepchildren; a company in which the director or a connected person owns one fifth of the share capital or one fifth of the voting power; a trustee where the director or a connected person is a beneficiary of the trust; or a partner of the director or a connected person. *Id.* § 64(1).

¹⁴⁸ *Id.* § 49(2)(b), (3).

¹⁴⁹ *Id.* § 49(4).

Section 50, however, sets out various exceptions to the prohibitions in section 49. Holding companies may make loans, quasi loans, and guarantee or provide security on loans and quasi loans to their subsidiaries regardless of any interests in that subsidiary owned by a director of the holding company.¹⁵⁰ A subsidiary may make loans, quasi loans, enter credit transactions as a creditor, and guarantee or provide security on any loan, quasi loan, or credit transaction to its holding company.¹⁵¹ A company is also allowed to do anything to provide funds to its directors to meet expenditures for company purposes, as long as the action has been approved by the shareholders or is done on the condition that if it is not approved by the shareholders, the transaction will be discharged within six months.¹⁵² For public companies and companies connected with public companies, this exception is limited to amounts not exceeding £10,000.¹⁵³ The prohibitions on quasi loans and credit transactions applicable to public companies and companies connected with public companies are also set aside if the quasi loan does not exceed £1,000 and is to be paid within two months,¹⁵⁴ or if the credit transaction is either less than £5,000, or if it is made in the ordinary course of business of the company on the usual terms and for any ordinary amount.¹⁵⁵ Money lending companies may make loans, quasi loans, and guarantee or provide security on loans and quasi loans to directors and connected persons if it is done in the ordinary course of business on the usual terms and for an ordinary amount.¹⁵⁶ This amount is limited in the case of money lending companies which are not banks to £50,000. Money lending companies may also make a loan of up to £50,000 to a director at more favorable terms than usual to facilitate the purchase or improvement of the director's main residence if such loans are ordinarily made to its employees on the same terms.

The company may void any transaction or arrangement in violation of the section 49 prohibitions unless restitution is no longer possible, or the company has already been indemnified for any loss, or such an avoidance would affect a third party who was unaware of the violation.¹⁵⁷ Any director or connected person involved, and any director who knowingly authorized the violation, are accountable to the com-

¹⁵⁰ *Id.* § 50(1).

¹⁵¹ *Id.* § 50(4).

¹⁵² *Id.* §§ 50(4)(c), (5).

¹⁵³ *Id.* § 50(5).

¹⁵⁴ *Id.* § 50(2)(b).

¹⁵⁵ *Id.* § 50(3).

¹⁵⁶ *Id.* §§ 50(6), (7).

¹⁵⁷ *Id.* § 52(1).

pany for any gains to them and liable to the company for loss or damage to it.¹⁵⁸ A director who authorizes or permits, or any person who procures, the involvement of a public company or a company connected with a public company in a transaction which that person knows or has reasonable cause to believe was a violation of these prohibitions is subject to criminal penalties (fines and up to two years imprisonment).¹⁵⁹ Likewise, a company involved in a transaction prohibited to it is guilty and subject to fine, unless the company did not know the relevant circumstances.¹⁶⁰

Sections 54 to 61 require disclosure of certain contracts and transactions with directors. Section 54 requires disclosure of any loans, quasi loans, or credit transactions made by the company or its subsidiary to a director of the company, a director of its holding company, or a connected person, and disclosure of any guarantee or provision of security made by the company or its subsidiary on loans, quasi loans, or credit transactions made by a third party to such a director or connected person. Any other transactions of a company or its subsidiary in which a director of the company or a director of its holding company had a material interest must also be disclosed, including contracts for services.¹⁶¹ A credit transaction, or a guarantee or provision of security thereon, which does not exceed £5,000 and any material interest which does not exceed £5,000 or which does not exceed one percent of net assets and £1,000 are exempt from the disclosure requirement.¹⁶² Section 56 also requires a statement of the outstanding amount of any loan, quasi loan, or credit transaction to any non-director officer of the company.

Banks are excused from the disclosure requirements of section 54 and the requirements in regard to non-director officers of section 56, but are required by section 56 to state the outstanding amount of any loan, quasi loan, credit transaction, or guarantee or provision of security on a loan, quasi loan, or credit transaction to a director or connected person.¹⁶³ Where the amounts exceed £1,000, banks must also make the information required by section 54 available for inspection by the

¹⁵⁸ *Id.* § 52(2).

¹⁵⁹ *Id.* § 53.

¹⁶⁰ *Id.*

¹⁶¹ See *supra* note 132. Contracts of service are not required to be disclosed under section 54 of the 1980 Act because they are already required to be registered under section 26 of the 1967 Act, as modified by the 1980 Act. *Id.* § 61. See also *infra* text accompanying note 165.

¹⁶² 1980 Act, ch. 22, §§ 58(1), (3).

¹⁶³ *Id.* §§ 54(5), 56(3), (4).

shareholders fifteen days before the company's annual meeting.¹⁶⁴

Section 61 amends section 26 of the 1967 Act. The 1967 Act requires that the company keep director contracts of service¹⁶⁵ on file and available for shareholder inspection. The 1980 Act additionally requires a contract of service between a director of the company and a subsidiary of the company to be kept on file.¹⁶⁶ It excepts, however, contracts of service with the company where the contract requires the director to work wholly or mainly outside the United Kingdom. In those cases the 1980 Act merely requires the name of the director involved and the duration of the contract to be noted.¹⁶⁷ This exemption was provided to preserve the confidentiality of details of foreign contracts of service with directors to avoid possible embarrassment abroad.¹⁶⁸

Sections 62 to 67 include supplemental provisions. A shadow director is defined as a person in accordance with whose instructions the directors are accustomed to act (not including professional advisors such as lawyers and accountants), and is to be considered the same as an actual director in regard to this part of the Act.¹⁶⁹ Additionally, the Secretary of State may extend the disclosure provisions of this part of the Act to unregistered companies, which are incorporated bodies not registered in accordance with the Companies Acts.¹⁷⁰ These include bodies incorporated by Royal Charter or Private Act of Parliament, which would otherwise not be covered by the Act.¹⁷¹

The British approach to the conflict of interest problem differs significantly from that in the United States. Rather than prohibiting certain types of transactions, the United States system relies on general fiduciary duty principles. Contracts in which a director has an interest are generally not void or voidable if approved by a disinterested majority of the board or ratified by the shareholders.¹⁷² Many states require

¹⁶⁴ *Id.* § 57.

¹⁶⁵ See *supra* notes 132 and 161 and accompanying text.

¹⁶⁶ 1980 Act, ch. 22, § 61(1).

¹⁶⁷ *Id.* § 61(2).

¹⁶⁸ 407 PARL. DEB., H.C. (5th ser.) 1085 (1980) (Lord Lyell).

¹⁶⁹ 1980 Act, ch. 22, § 63.

¹⁷⁰ *Id.* § 67.

¹⁷¹ 979 PARL. DEB., H.C. (5th ser.) 1158 (1980) (R. Eyre, Under-Secretary of State, Dep't of Trade).

¹⁷² DEL. CODE ANN. tit. 8, § 144(a) (1979). See also *Tenison v. Patton*, 95 Tex. 284, 292-93, 67 S.W. 92, 95 (1902). The Texas court decided that the disinterested directors had the power to bind the corporation in a transaction with another director as long as that director made full disclosure of all facts known to him, took no advantage of his position, and concluded a fair contract.

disclosure of material facts in the process of ratification or approval.¹⁷³ It is also generally required that the transaction be objectively fair.¹⁷⁴ Under the 1934 Securities Exchange Act, Rule 14a-3 also requires disclosure of director interests in proxy statements.¹⁷⁵ Overall, the United States' approach is much less structured and requires less disclosure.

The British approach has loopholes that the 1980 Act is meant to correct. Whether the 1980 Act has blocked all the possible means of evasion will be seen in the future. Although it is probable that someone will find a way to abuse the system, the approach has the advantage of having definite rules which businessmen can understand and which are easier to enforce. Furthermore, the disclosure requirements may have a general beneficial effect by giving the shareholder and public authorities more information and encouraging the directors to avoid the appearance of impropriety.

PART V: INSIDER DEALING

Part V introduces prohibitions against insider trading. Previously, there were no legal sanctions aimed specifically at dealings by insiders.¹⁷⁶ The 1948 Act,¹⁷⁷ the 1967 Act,¹⁷⁸ and the 1976 Act¹⁷⁹ require disclosure of holdings and dealings by directors and substantial shareholders in a company's securities and prohibit directors from buying options, but these have been described as "somewhat half-hearted restraints."¹⁸⁰ The Stock Exchange Listing Agreement and the City Code on Take-overs and Mergers impose certain restraints on directors, but these lack the authority of law, and, therefore, impose no truly effective sanctions.¹⁸¹

The fiduciary duty of directors under common law imposes some restrictions on insider dealing. These restrictions, however, are rela-

¹⁷³ N.Y. BUS. CORP. LAW § 713 (McKinney 1963); DEL. CODE ANN. tit. 8, § 144(a) (1980). See also *Tenison v. Patton*, 95 Tex. 284, 67 S.W. 92 (1902).

¹⁷⁴ See W. CARY & M. EISENBERG, *supra* note 40, at 605.

¹⁷⁵ 15 U.S.C. § 78n(a) (1976); 17 C.F.R. 240.14a (1982). See also *Gladwin v. Medfield Corp.*, 540 F.2d 1266, 1270-71 (5th Cir. 1976) (full details of a contract in which one of the directors had an interest were not disclosed in the proxy statement, constituting a material omission).

¹⁷⁶ CONDUCT OF COMPANY DIRECTORS, *supra* note 144, at 7, ¶ 23.

¹⁷⁷ 1948 Act, 11 & 12 Geo. 6, ch. 38, § 195.

¹⁷⁸ 1967 Act, ch. 81, §§ 25-34.

¹⁷⁹ 1976 Act, ch. 69, §§ 24-27.

¹⁸⁰ See L. GOWER, *supra* note 4, at 55.

¹⁸¹ CONDUCT OF COMPANY DIRECTORS, *supra* note 144, at 7, ¶ 23. The sanctions which can be imposed under these restrictions, suspension of the involved stockbroker's membership on the Stock Exchange and suspension of the quotation of the company's shares, are generally thought to be insufficient. See 401 PARL. DEB., H.L. (5th ser.) 136 (1979) (Lord Elwyn-Jones).

tively slight. In the case of *Percival v. Wright*¹⁸² the court held that directors dealing in company shares were not under any fiduciary duty to disclose any inside information unless there was some element of unfair dealing, such as direct solicitation of the transactions. In *Briess v. Woolley*,¹⁸³ liability was imposed for fraudulent misrepresentation by a director in a securities transaction, evincing another limit on insider dealing. But these decisions did not foreclose a wide range of abuse of inside information. Company directors and officers were free to use inside information in market transactions, leading to widespread insider dealing on the Stock Exchange¹⁸⁴ and leaving other traders at a distinct disadvantage. There was general agreement that criminal sanctions were necessary to discourage the practice.¹⁸⁵

Under section 68, individuals connected with a company¹⁸⁶ are prohibited from dealing on the Stock Exchange¹⁸⁷ in the company's securities if they possess what they know is unpublished price-sensitive information¹⁸⁸ which they hold by virtue of their position and which would reasonably be expected not to be disclosed by them except in the proper performance of their functions. The trading prohibitions extend to the securities of any other company if the unpublished price-sensitive information relates to any actual or contemplated transaction between their company and the other company.¹⁸⁹ These same trading prohibitions apply to government employees who possess unpublished price-sensitive information about the company whose securities they wish to trade.¹⁹⁰ Finally, an individual contemplating or who has con-

¹⁸² [1902] 2 Ch. 421, 426.

¹⁸³ 1954 A.C. 333. The director neglected to tell the purchasers of the company that the apparent profits were due to engaging in illegal practices.

¹⁸⁴ Gleeson, *Why the City has Qualms Over Insider Dealing*, *The Times* (London), 1 Nov. 1978, at 23 (quoting David Hopkinson).

¹⁸⁵ 400 PARL. DEB., H.L. (5th ser.) 1251 (1979) (Lord Elwyn-Jones).

¹⁸⁶ 1980 Act, ch. 22, § 73(1). This section defines an individual connected with a company as a person who is a director of the company or a related company, or a person who occupies a position as an officer or employee of that company, or who has a business or professional relation to that company which might be reasonably expected to give him access to unpublished price-sensitive information which would be reasonably expected not to be disclosed by him except in the proper performance of his functions.

¹⁸⁷ The Stock Exchange is the recognized exchange under the 1948 Act, 11 & 12 Geo. 6, ch. 38, § 455(1). Any dealings not on the Stock Exchange, including off-market dealings and dealings on a foreign exchange, are considered to be dealing otherwise than on a recognized exchange.

¹⁸⁸ Unpublished price-sensitive information is defined as information relating to specific matters (rather than general matters) relating to or of concern to a company, which is not generally known to investors, but if known would be likely to affect the price of the company's securities. 1980 Act, ch. 22, § 73(2).

¹⁸⁹ *Id.* § 68(2).

¹⁹⁰ *Id.* § 69.

templated a take-over offer for a company may not deal in that company's securities in another capacity if he knows that the fact that the offer is contemplated or no longer contemplated is unpublished price-sensitive information.¹⁹¹

An individual who has knowingly obtained, directly or indirectly, from a connected person or a government employee, information which the individual knows is unpublished price-sensitive information and knows or has reasonable cause to believe that the connected person or government employee held this information by virtue of his position and would reasonably be expected not to disclose it, is also prohibited from dealing on the Stock Exchange in the securities of that company.¹⁹² An individual is also prohibited from dealing on the Stock Exchange in a company's securities if he has knowingly obtained from a person contemplating or who has contemplated a take-over offer from the company, what he knows to be unpublished price-sensitive information about that offer.¹⁹³ Further, any person prohibited from trading on the Stock Exchange in a company's securities may not counsel or procure any other person to deal in those securities or communicate the unpublished price-sensitive information to any other person, if he knows or has reasonable cause to believe that that person will make use of the information to deal, counsel, or procure another person to deal in those securities on the Stock Exchange.¹⁹⁴

All the references to dealing on the Stock Exchange are also applicable to dealing as an off-market dealer,¹⁹⁵ making a market¹⁹⁶ in advertised securities,¹⁹⁷ and dealing through such an off-market dealer knowing that he is an off-market dealer making a market in advertised securities.¹⁹⁸ The prohibitions on counseling or procuring another person to deal and on communicating information also extend to situations where the individual knows or has reasonable cause to believe that a person will deal on a stock exchange outside Great Britain.¹⁹⁹

¹⁹¹ *Id.* § 68(4).

¹⁹² *Id.* §§ 68(3), 69(1).

¹⁹³ *Id.* § 68(5).

¹⁹⁴ *Id.* §§ 68(6), (7).

¹⁹⁵ An off-market dealer may be any licensed or exempted dealer in securities or a member of the Stock Exchange or of a recognized association of dealers in securities. *Id.* § 70(3).

¹⁹⁶ "Making a market in securities" is defined as an off-market dealer holding himself out to prospective buyers and sellers of those securities as willing to deal in them otherwise than on the Stock Exchange. *Id.* § 73(4).

¹⁹⁷ Advertised securities are securities listed on the Stock Exchange, or securities where information regarding the prices at which persons are willing to deal in those securities has been published within the six previous months. *Id.* § 70(3).

¹⁹⁸ *Id.* § 70(1).

¹⁹⁹ *Id.* § 70(2).

The Act does not, however, cover direct dealings on a foreign stock exchange by a connected person, government employee, or individual contemplating a take-over, nor any foreign off-market deals. These prohibitions do apply to securities of a company regardless of where the company is incorporated.²⁰⁰

Sections 68 and 69 exempt from these prohibitions any actions of an individual which lack the intent of making a profit or avoiding a loss for himself or another person by use of the information. This exemption is meant to provide protection for innocent dealings which were not motivated by the possession of inside information.²⁰¹ Also exempted are liquidators, receivers, and trustees in bankruptcy who are acting in good faith, as well as anything done by a jobber²⁰² in good faith in the normal course of his business with information reasonably expected for him to have obtained.²⁰³ Trustees or personal representatives who would be prohibited from dealing may deal if acting on the advice of someone who appeared to him to be an appropriate advisor not prohibited from dealing. Also, a person involved in a transaction which would cause him to be prohibited from dealing, counseling, procuring, and communicating may do anything to facilitate the completion or carrying out of the transaction without violating those prohibitions.²⁰⁴ An exemption is also provided for good faith actions by issue managers of international bond issues (Eurobonds),²⁰⁵ or their officers, employees, and agents.²⁰⁶ Many well-established practices of the Eurobond market might have been affected by the prohibitions, and it was not considered necessary to extend the insider dealing provisions to them.²⁰⁷

²⁰⁰ *Id.* § 73(5).

²⁰¹ CONDUCT OF COMPANY DIRECTORS, *supra* note 144, at 7, ¶ 25.

²⁰² A jobber acts as a middleman between brokers who wish to buy and sell a company's securities on the Stock Exchange.

²⁰³ 1980 Act, ch. 22, § 68(8).

²⁰⁴ *Id.* § 68(10). For example, a broker may purchase shares of a company requested by his client even though the broker possesses inside information relating to that company. 407 PARL. DEB., H.L. (5th ser.) 1135 (1980) (Viscount Trenchard).

²⁰⁵ International bond issues are debentures of a company offered by an off-market dealer and denominated in sterling. Additionally, not less than 50% in nominal value of the debentures must be offered to persons who are not citizens of the United Kingdom and Colonies or companies incorporated or formed under the law of the United Kingdom. 1980 Act, ch. 22, § 71(2). "While many recognize a Eurobond when they see one, it is especially difficult to define it [*sic*]." 979 PARL. DEB., H.C. (5th ser.) 1168 (1980) (C. Parkinson).

²⁰⁶ 1980 Act, ch. 22, § 71(1).

²⁰⁷ 407 PARL. DEB., H.L. (5th ser.) 1142 (1980) (Viscount Trenchard). It was thought that the Eurobond market did not have the same need for insider dealing regulation because of its professionalism and because it is not greatly affected by information about particular companies.

Section 72 provides criminal penalties (fines and up to two years imprisonment) for any violations of the insider dealing provisions. The imposition of any new civil liability was thought impracticable since the identity of a victim is usually unknown and untraceable due to the volume and impersonality of transactions on the Stock Exchange.²⁰⁸ It might be possible for an identifiable victim to bring an action under the common law limitations on insider dealing, or compensation could be awarded under the Powers of the Criminal Courts Act 1973²⁰⁹ which allows the court to order a convicted person to pay compensation in favor of an identified person.

The requirements for gaining a conviction are fairly stringent. In all cases the prosecution must prove knowledge that the information was unpublished price-sensitive information. This knowledge, however, may be inferred from a deliberate choice to utilize the information to deal.²¹⁰ To gain a conviction for counseling or procuring another person to deal, the prosecution must prove that the individual knew or had reasonable cause to believe that that person would deal, or for communicating the information, that that person would deal, counsel, or procure another person to deal. It has been suggested²¹¹ that "reasonable cause to believe" imposes an objective test of what a reasonable man would believe under the circumstances.²¹² To gain a conviction for acting on unpublished price-sensitive information originating from and passed on by a connected person or a government employee, the prosecution must prove the defendant knew or had reasonable cause to believe that the information was from such a person, and knew or had reasonable cause to believe that it was obtained by such a person by virtue of his position and was reasonably expected not to be disclosed by him. These requirements make it unlikely that a person receiving information from someone other than the insider would be convicted, since the requisite knowledge or belief would

²⁰⁸ CONDUCT OF COMPANY DIRECTORS, *supra* note 144, at 7, ¶ 24.

²⁰⁹ ch. 62, § 35. This section states, in pertinent part: "(1) . . . a court by or before which a person is convicted of an offense, . . . may, on application or otherwise, make an order . . . requiring him to pay compensation for any personal injury, loss or damage resulting from that offense"

²¹⁰ *Ashe, Companies Act 1980—I*, 130 NEW L.J. 672, 674 (1980).

²¹¹ 407 PARL. DEB., H.C. (5th ser.) 1128 (1980) (Viscount Trenchard).

²¹² It might possibly be interpreted to require actual belief, as in *Rex v. Banks*, [1916] 1 K.B. 621. This case, however, involves a reasonable belief defense to the offense of having intercourse with a girl under 16, which would seem to justify implying a requirement of actual belief more than under this Act. The Act's clear distinction between knowledge and reasonable cause to believe would also seem to indicate actual belief is not requisite to obtaining a conviction.

probably be missing.²¹³

The British approach under the 1980 Act differs greatly from the approach in the United States under the Securities Exchange Act of 1934.²¹⁴ Section 16(b) of the Securities Exchange Act is narrow in its application, allowing the company to recover any profit realized in trading in the company's securities by a director, officer, or substantial stockholder within a six month period. This rule is applicable regardless of whether the director, officer, or substantial stockholder actually had any inside information or intended to make a profit.²¹⁵ Section 10(b) of the Securities Exchange Act is much broader than 16(b), prohibiting the use of any manipulative or deceptive device in connection with the purchase or sale of securities. This prohibition has allowed private suit against individuals trading with inside information.²¹⁶ Economic incentives aid in the enforcement of the provisions, as companies under 16(b) and individuals under 10(b) are directly rewarded for bringing successful actions. The ambiguous limits on the 10(b) private right of action and the problems over causation between the insider dealing and any injury to the plaintiff have been the subject of much litigation, however.²¹⁷

The British approach is somewhere between the two relevant United States provisions. It gives less discretion to the court in defining illegal insider dealing and molding a remedy than section 10(b), but it is much less mechanical than section 16(b). It therefore should avoid the pitfalls of section 10(b), while the detail provided in the 1980 Act should pick up most abuses. Because of the exception for innocent intent, it will also avoid picking up innocent transactions that might be included in the scope of section 16(b). Yet, it may not be as effective as the United States provisions, since its enforcement is in the hands of the public authorities who do not have the economic incentives provided by the United States approach, and because of the difficulty in

²¹³ Ashe, *supra* note 210, at 673.

²¹⁴ 15 U.S.C. § 78(a) *et. seq.* (1976).

²¹⁵ See *Smolowe v. Delendo Corp.*, 136 F.2d 231, 236 (2d Cir. 1943) (defendants held liable for trading profits even though it was conceded that they had made no unfair use of inside information).

²¹⁶ See *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa. 1947) (two shareholders bought out the other two shareholders without informing them of an agreement to sell the corporation to a third party).

²¹⁷ Compare *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1974) (causation unless relationship shown between the buyer and the seller), with *Fridrich v. Bradford*, 542 F.2d 307 (6th Cir. 1976) (refusing to assume causation unless relationship shown between buyer and seller).

proving all the necessary elements of the offense under the 1980 Act.²¹⁸

PART VI: MISCELLANEOUS AND GENERAL

Part VI makes miscellaneous changes in company law not covered by the other parts of the Act. Section 74 is meant to specifically repeal the rule in *Park v. Daily News Ltd.*,²¹⁹ which held that a company could not make provisions for its employees when winding up, since there was no longer any interests of the company to be served in doing so. By explicitly allowing for provision for employees and former employees when closing down the whole or part of any business regardless of the interests of the shareholders, this section removes any doubt about the application of section 46 to this type of situation, where there is a direct conflict between the interests of the employees and the shareholders.²²⁰ The section requires that such provisions for employees must be ratified by a shareholder resolution, unless the company's memorandum or articles (by laws) allow a director resolution to suffice or require a special resolution by the shareholders.²²¹

Basic considerations in choosing a secretary²²² for a public company are also established.²²³ Boards must choose only people who appear to have the requisite knowledge and experience, and who now hold or have recently held a position as a public company secretary, or who are members of specified accounting associations, or who are barristers, advocates, or solicitors, or who appear capable of handling the position by virtue of holding or having held some other office or being members of other associations.²²⁴ For all their specificity, these requirements still give a fairly open-ended choice to the board, and seem to amount to little more than a requirement to act in good faith in choosing a secretary.

The penalties under the Companies Acts are increased in order to provide a more realistic deterrent to violations and catch up with inflation.²²⁵ Monetary penalties are now stated in terms of the statutory maximum to facilitate future readjustments.²²⁶ Section 83 revives parts

²¹⁸ See 407 PARL. DEB., H.L. (5th ser.) 1126 (1980) (Lord Lloyd of Kilgerran).

²¹⁹ See *supra* note 121.

²²⁰ See *supra* notes 124-31 and accompanying text.

²²¹ See *supra* note 31.

²²² The secretary is a company officer, required by the 1948 Act, who keeps the company's records, countersigns documents, etc. 1948 Act, 11 & 12 Geo. 6, ch. 38, § 177.

²²³ 1980 Act, ch. 22, § 76.

²²⁴ *Id.* § 79(1).

²²⁵ *Id.* § 80.

²²⁶ Section 28 of the Criminal Law Act 1977, ch. 45, fixes the statutory maximum at £1,000, and section 61 of that act provides the procedure for changing that amount.

of the Protection of Depositors Act, 1963,²²⁷ which had been repealed by the Banking Act, 1979.²²⁸ The Protection of Depositors Act, 1963, required certain standards and financial reports from companies holding and soliciting deposits. The Banking Act, 1979, replaced the former standards and requires companies to obtain a license in order to take deposits. The Banking Act, however, did not consider existing accounts with companies who did not obtain the new license. The 1980 Act reinstates the Protection of Depositors Act in regard to those companies without a license who, though no longer able to take deposits, still hold accounts.²²⁹

Possibly one of the most dramatic changes in British company law is accomplished by section 75. This section is designed to open up the courts to shareholders on a much broader basis than has previously been allowed.²³⁰ The 1843 case of *Foss v. Harbottle*²³¹ greatly restricted the right of shareholders to bring derivative suits. *Foss v. Harbottle* states that in the case of a wrong done to the company, the company is the proper plaintiff, and where a wrong could be ratified by a simple majority of the shareholders, no individual member could bring an action.²³² Four basic exceptions are recognized to the rule in *Foss v. Harbottle*.²³³ The first exception is where the company's actions or proposed actions are *ultra vires*.²³⁴ The second exception is where a special resolution of the company is required but has not been obtained.²³⁵ The third exception is where a suit is brought to protect a personal right of a shareholder.²³⁶ Suits protecting a personal right include the two previous exceptions²³⁷ and where the company is acting

²²⁷ 1963, ch. 16.

²²⁸ 1979, ch. 37.

²²⁹ 1980 Act, ch. 22, § 83.

²³⁰ *Id.* § 75.

²³¹ [1843] 67 Eng. Rep. 189.

²³² *Id.* at 490, 494. See also J. CHARLESWORTH & T. CAIN, *supra* note 67, at 377.

²³³ See *Edwards v. Halliwell*, [1950] 2 All E.R. 1064, 1067.

²³⁴ See *Bagshaw v. Eastern Union Ry. Co.*, [1849] 68 Eng. Rep. 46, *aff'd*, [1850] 42 Eng. Rep. 151. A misapplication of corporate funds *ultra vires* to the company was successfully challenged by a shareholder.

²³⁵ See *Baillie v. Oriental Tel. & Elec. Co.*, [1915] 1 Ch. 503. An improperly passed special resolution could not disallow a shareholder's suit contesting director compensation.

²³⁶ See *Pender v. Lushington*, [1877] 6 Ch. D. 70, 80-81 (Sir G. Jessel, M.R.). A shareholder's suit to have his vote recorded involves an individual right which he may enforce.

²³⁷ See *Simpson v. Westminster Palace Hotel Co.*, [1860] 8 H.L.C. 712, 717 (Lord Campbell, L.C.). A shareholder has a personal right to contest acts which are *ultra vires* to the company. See also *Edwards v. Halliwell*, [1950] 2 All E.R. 1064, 1066. A union's disregard of a special resolution requirement was a wrong done to each member individually, allowing a member to maintain an action.

contrary to its articles (bylaws).²³⁸ The fourth exception is where the acts or proposed acts constitute a fraud on the minority. As the term is used, fraud on the minority does not require actual deceit, but rather refers to an abuse of power similar to the misuse of a fiduciary position.²³⁹ Fraud on the minority includes expropriations of company²⁴⁰ or shareholder property²⁴¹ and breaches of a director's duty of good faith.²⁴² A possible fifth exception is where the interests of justice require.²⁴³ Even with these exceptions, however, the rule in *Foss v. Harbottle* significantly hampered shareholder actions and thereby limited court involvement in company affairs.²⁴⁴

Instead of bringing a derivative suit, a shareholder may also petition the court under the 1980 Act for an order winding up the company under sections 222 and 224 of the 1948 Act if it is "just and equitable."²⁴⁵ Winding up orders have generally been confined to companies dependent on personal relationships and to situations outside the contemplation of the parties upon becoming shareholders.²⁴⁶ The effect of a winding up order is to cause the company to go out of business and to distribute its assets. This is a very drastic remedy, and consequently there must be some serious problem to justify its application, and it is uncommon in practice.²⁴⁷

Section 210 of the 1948 Act provided the shareholder an alterna-

²³⁸ See L. GOWER, *supra* note 4, at 654, J. CHARLESWORTH & T. CAIN, *supra* note 67, at 381.

²³⁹ See *Estmanco (Kilner House) Ltd. v. Greater London Council*, [1982] 1 W.L.R. 2. The vote by the Greater London Council, as the only voting shareholder in a tenants association, to drop a suit against itself constituted a fraud on the minority, allowing a tenant to sue. The judge discussed the term "fraud on the minority," and, though he avoided any attempt to clarify its limits, stated that it did not require any actual fraud.

²⁴⁰ See *Menier v. Hooper's Tel. Works*, [1874] 9 Ch. App. 350. The majority shareholder caused the company to abandon a suit, and it alone received benefits from the adverse party. The minority shareholder was allowed to bring suit to recover these benefits.

²⁴¹ See *Brown v. British Abrasive Wheel Co.*, [1919] 1 Ch. 290. The majority shareholders attempted to change the articles to allow them to require the minority shareholder to sell his shares. The minority shareholder was allowed to contest the proposed alteration.

²⁴² See *Mason v. Harris*, [1879] 11 Ch. D. 97. Fraud committed by a director who commanded a majority of votes and was aided and abetted by the other directors allowed a shareholder to bring suit.

²⁴³ *Foss v. Harbottle*, [1843] 67 Eng. Rep. 189, 202 (Wigram, V.C.). This exception has not been articulated and is generally thought to be impractical. See *Prudential Assurance Co. v. Nemman Industries (No. 2)*, [1982] 2 W.L.R. 31.

²⁴⁴ The rule and its exceptions have also created a good deal of confusion, taking the matter "into the realms of near incomprehensibility." 407 PARL. DEB., H.L. (5th ser.) 1023 (1980) (Lord Lloyd of Kilgerran).

²⁴⁵ 1980 Act, ch. 22, § 75(1).

²⁴⁶ *Ebrahimi v. Westbourne Galleries Ltd.*, 1973 A. C. 360. One of three shareholders was removed from office and excluded from the business.

²⁴⁷ See J. CHARLESWORTH & T. CAIN, *supra* note 67, at 385.

tive to petitioning for a winding up order. Under this section the court could make any order it saw fit, after a member proved that the affairs of the company were being conducted in a manner oppressive to some part of the members, and that it was just and equitable to wind up the company, but that such a winding up would unfairly prejudice the oppressed members. The procedure under this section, however, was rarely used successfully²⁴⁸ because of the heavy requirement of showing that it was just and equitable to impose the drastic remedy of a winding up order, and because of restrictive interpretation by the courts of the term "oppressive" as requiring conduct which was "burdensome, harsh and wrongful."²⁴⁹

Section 75 of the present Act replaces section 210, and allows any shareholder to petition the court on the ground that the company's affairs are being, have been, or are proposed to be conducted in a manner unfairly prejudicial to a part of the shareholders.²⁵⁰ If the petition is well founded, the court can order any remedy it feels appropriate, including, but not limited to, regulating the company's affairs, authorizing the institution of a derivative suit, requiring the purchase of shares of any shareholder by other shareholders or the company, and making or prohibiting any alterations in the company's articles or memorandum.²⁵¹ These provisions remove most of the limitations on shareholder access to the court and give the court wide discretion in fashioning remedies.²⁵² They allow the rule in *Foss v. Harbottle* to be circumvented with the approval of the court. They lower the requirement of showing oppressive conduct to that of merely showing unfair prejudice. They introduce a duty not to act unfairly which is enforceable by a shareholder.

One apparent limitation on the availability of remedies under this section is that the prejudice must affect *a part* of the shareholders. This language may eliminate the possibility of using this section to redress

²⁴⁸ One commentator states that there are only two reported cases where the process has been successfully used. L. GOWER, *supra* note 4, at 662.

²⁴⁹ See *Meyer v. Scottish Co-op. Wholesale Soc'y*, 1959 A. C. 324, 342 (Viscount Simonds). The Majority was attempting to destroy the company while appropriating the goodwill of the company's business.

²⁵⁰ 1980 Act, ch. 22, § 75(1).

²⁵¹ *Id.* §§ 75(3)-(5).

²⁵² The court of appeals has considered section 75 twice since its passage. In *In re Bovey Hotel Ventures, Ltd.*, Transcript Assoc. (June 10, 1982), one of two equal shareholders complained that the other, her ex-husband, was uncooperative and had taken money from the company. The court balanced interests and allowed her to buy out the ex-husband. The court in *In re Cyphon Developments Ltd.*, Transcript Assoc. (Mar. 3, 1982), affirmed the trial judge's order allowing a shareholder derivative action over disputed property. The court stated that it would not interfere with the trial court's discretion unless it was unreasonable.

wrongs done to the whole company.²⁵³ Such wrongs, which are also within the *Foss v. Harbottle* rule, would then be left to the company itself. As long as the interests of a group of shareholders is not prejudiced in relation to the rest, it would seem within the power of the directors and a majority of shareholders to decide whether or not it is in the interest of the company as a whole to bring suit.

Another possible limitation on court involvement is the British version of the business judgment rule in the United States.²⁵⁴ The British courts have expressed an unwillingness to interfere in a company's affairs unless the directors acted in bad faith.²⁵⁵ This unwillingness may result in the court refusing to redress actions prejudicial to a part of the shareholders if such action was made in what the directors honestly considered to be in the interests of the company as a whole.

It also remains to be seen to what extent shareholders will take advantage of section 75. Public company shareholders may feel litigation is not worth their time and expense, even though they might easily bring an action under section 75. Private company shareholders are much more likely to take advantage of the section, since they lack a ready market for their shares and often have more of a personal stake in the company.²⁵⁶

Section 75 catapults the British into many areas long handled by derivative suits in the United States. However, the British enter the field without the accumulated rules and requirements built up by statutory and common law in the United States. It will be interesting to see whether such rules develop as the courts begin to deal with the potential mass of litigation, or whether the courts retain the great amount of discretion implied by the Act. Because of the latitude given in selecting remedies, the court has license to become involved in corporate affairs to an extent unknown in the United States. Here again, whether the courts take up this opportunity and use it fully is yet to be seen.

CONCLUSION

The Companies Act 1980 makes important changes in British

²⁵³ See L. GOWER, *supra* note 4, at 670.

²⁵⁴ See *Kamin v. American Express Co.*, 86 Misc.2d 809, 383 N.Y.S.2d 807, *aff'd*, 54 A.D.2d 654, 387 N.Y.S.2d 993 (1976). Errors of judgment are not sufficient grounds for the court to interfere in the management of a corporation.

²⁵⁵ See *Lee v. Neuchatel Asphalte Co.*, [1889] 41 Ch. D. 1, 18. The court is unwilling to interfere if the board fairly and reasonably acted in ascertaining whether the dividend was proper. See also *Dovey v. Cory*, 1901 A.C. 477 (directors are not liable for honest and reasonable mistakes).

²⁵⁶ The two cases involving section 75 which have reached the court of appeals have both involved private companies. See *supra* note 252.

company law, and additional modifications are likely as future EEC directives are issued. Parts I, II, and III of the Act are largely technical in nature, clarifying and rationalizing the laws concerning a company's capital. The major changes involve the definitions of private and public companies, which increase the requirements for public company status, and the creation of renewed distinctions between the regulatory standards applicable to each.

Part IV, by regulating employment contracts, substantial property transactions, and loans involving directors, also introduces some large changes. It closes a number of loopholes in past legislation and the common law, but it does not change the overall approach. The new duty imposed on directors to regard employee interests is not a radical shift, but rather, reflects current practices.

Part V, which makes insider dealing a criminal offense, could have a significant impact on trading in British securities. It remains to be seen how it will work in practice and whether its detailed approach will catch the undesirable activities within its bounds, and whether the public authorities can effectively enforce it.

Finally, the new provisions under section 75 for court involvement in company affairs could have a significant impact on the amount of litigation over company-related matters. What effect it will have on company policies and how far the courts will go, however, remains unclear.

M. Freeman Durham