

Company Law

2008/09

LLB

Queen Mary, University of London

Course Documents

The Aims of the Course

- To develop a knowledge base of the foundational principles, key domestic and European Union statutory materials and case law relating to the creation and management of companies, issues of securities, and corporate governance in the UK and England and Wales (as appropriate).
- To develop transferable skills particularly research, critical analysis, logical argument, and communication skills relating to oral and written work.

Syllabus

2008/09

1. The history of company law
2. The various forms of business organisation
3. The legal personality of companies and “lifting the veil” of incorporation
4. Issues of securities and raising capital
5. The company’s constitution
6. The *ultra vires* principle
7. Majority shareholder rule and the protection of minorities
8. Management of the company
9. Directors’ duties
10. Corporate governance

Lecture Timetable

| Week commencing | Lecture topic | Seminar topic |
|-----------------|---|----------------------------------|
| 22 September | Introduction; History of company law | <i>No seminar</i> |
| 29 September | The nature of the company; various business organisations | <i>No seminar</i> |
| 6 October | The <i>Saloman</i> principle | Introduction |
| 13 October | “Lifting the veil” of incorporation | Introduction |
| 20 October | Raising capital (1): Lamfalussy | The <i>Saloman</i> principle |
| 27 October | Raising capital (2): Prospectuses | The <i>Saloman</i> principle |
| 3 November | <i>Reading week</i> | <i>Reading week</i> |
| 10 November | Raising capital (3): Transparency | Lifting the veil |
| 17 November | Raising capital (4): Insider dealing | Lifting the veil |
| 24 November | A company’s constitution | Issues of securities 1 |
| 1 December | The <i>ultra vires</i> principle | Issues of securities 1 |
| 8 December | Management of the company | Issues of securities 2 |
| | <i>Christmas vacation</i> | <i>Christmas vacation</i> |
| 5 January 2003 | Shareholders’ claims: majority rule | Issues of securities 2 |
| 12 January | Shareholders’ claims: minorities | The <i>ultra vires</i> principle |
| 19 January | Directors’ duties 1: | The <i>ultra vires</i> principle |
| 26 January | Directors’ duties 2: | Minority protection |
| 2 February | Directors’ duties 3: | Minority protection |
| 9 February | Corporate governance 1 | Directors’ duties |
| 16 February | <i>Reading week</i> | <i>Reading week</i> |
| 23 February | Corporate governance 2 | Directors’ duties |
| 2 March | Corporate social responsibility 1 | Corporate governance 1 |
| 9 March | Corporate social responsibility 2 | Corporate governance 1 |
| 16 March | <i>No lecture</i> | Corporate governance 2 |
| 23 March | <i>No lecture</i> | Corporate governance 2 |

THE DOCUMENTATION FOR THIS COURSE

There are four documents for this course:

Course Documents: these course documents will be used by Prof Hudson in lectures. Each examinable topic will be lectured in advance of seminars. As will be evident from the Lecture Timetable on the previous page, every seminar topic follows on from the lectures usually with more than one week's gap to allow plenty of time for your own reading. You are advised to read ahead of lectures: hence the provision of a lecture timetable.

Study Guide: Dr Dignam has always used a Study Guide for this course and so it is included in your documentation for this year. That Study Guide is linked in very closely with the Core Text which Dr Dignam writes with Prof Lowry: so you may want to use that text in conjunction with the Study Guide in preparing for seminars, and for reading in advance of lectures. This Study Guide is not intended to be a textbook in itself. It does, however, provide an enormous number of references for *further reading* which you should use to supplement your reading of the cases, statute and textbook. The Study Guide also contains a number of "self-test" questions which will help you to guide your own preparation.

Seminar Materials: the seminar materials contain all of the questions which you will be expected to prepare in advance of seminars. The seminar materials contain the questions which Dr Dignam has always used for seminar discussions, and also a former exam question for each topic.

Introduction to UK Securities Law: this document is a summary of securities law and "textbook" material which has been extracted and edited from Alastair Hudson's *Securities Law* (Sweet & Maxwell, 2008, 912pp) and his forthcoming *Law of Finance* (Sweet & Maxwell, 2009). It will be provided to you in hard copy.

WebCT: All of these documents will be made available on WebCT; except for copyright controlled material from Alastair Hudson which will be made available during the course on www.alastairhudson.com/companylaw.

READING

Textbooks post-2006

Shorter textbooks

- Alan Dignam and John Lowry, *Company Law*. (5e, Oxford University Press, 2009, "Core Text" series), 463pp.

The Study Guide for this course is centred on this textbook. This book is part of the Core Text series, and so is a cheaper, concise consideration of all of the main issues with

which you will need to be familiar to succeed in company law. (This book is referred to in these materials as “D&L”.)

- Janet Dine & Marios Koutsias, *Company Law* (6e, Palgrave Macmillan, 2007), 374pp

This is a short textbook which is engagingly written, cheap and with a lot of material on the corporate social responsibility aspects of the subject.

Longer textbooks

- Paul Davies, *Gower and Davies: Principles of Modern Company Law*. (8e, London: Sweet and Maxwell, 2008), 1,258pp.

Prof Gower was considered by many to be the person who created company law as an academic discipline; it is currently written by Prof Davies of LSE. This textbook is much longer and more detailed than any of the others which have been published after the Companies Act 2006. It also spends some time considering the purpose behind much of the legislation and case law, thus directing the reader into the theoretical questions which underpin it. (This book is referred to in these materials as “G&D”.)

- Mayson, French and Ryan, *Company Law* (25e, OUP, 2008), 747pp

This textbook is updated annually, which is its strength. Its written style too often tends to be in the form of “bullet pointed” lists – but there are times when that may seem like an advantage! (This book is referred to in these materials as “MFR”.)

Textbooks written pre-2006

- Brenda Hannigan, *Company Law*. (1e, London: LexisNexis, 2003), 943pp.

This excellent textbook – the successor to Professor Hudson’s personal favourite “Farrar’s Company Law” which was discontinued after Prof Farrar’s death – has not been republished since the Companies Act 2006. The next edition is not now due until April 2009.

- Morse, Girvin, Frisby and Hudson, *Charlesworth’s Company Law* (17e, Sweet & Maxwell, 2005), 744pp.

A new edition of this textbook will be published in 2009 under the authorship of Stephen Girvin, Alastair Hudson and Sandra Frisby. This book has a strength in being concisely and directly written. It is excellent on the case law pre-2005, under Professor Geoffrey Morse’s expert eye. The new edition will be focused on a student and academic audience, instead of a practitioner audience. (This book is referred to in these materials as “CCL”.)

Cases and materials books

- Len Sealy and Sarah Worthington, *Cases and Materials in Company Law*. (8e, Oxford University Press, 2007).

This is an excellent cases and materials book. Maybe it has lost some of the student friendly features of the previous editions due to its new editorship, and has acquired a large amount of Australian material for the same reason. The selection of cases on this

course have been made in large part to coincide with this book. (This book is referred to in these materials as “S&W”.) If you bring this book to lectures, you will find that Prof Hudson will frequently refer to extracts of cases in it in detail, in an effort to encourage students to focus on the precise dicta of the courts.

Securities Law books

- Alastair Hudson, *Securities Law*, (1e, Sweet & Maxwell, 2008).

This book covers in detail all of the material relating to “Securities Issues” and “Insider dealing” and “Market Abuse” which are required for this course. You will be furnished with some extracts from it by Prof Hudson. (This book is referred to in these materials as “HSL”.)

- Alastair Hudson, *The Law of Finance* (1e, Sweet & Maxwell, 2009)

This book is to publish in 2009 and deals with all the securities law and criminal law issues required for this course. You will be furnished with some heavily-edited extracts from it by Prof Hudson. (This book is referred to in these materials as “HLF”.)

Practitioner texts

- *Palmer’s Company Law* (Sweet & Maxwell, loose-leaf); General Editor: Geoffrey Morse; with Hudson, Davies, Worthington, Lomnicka, Bridge, Girvin, Frisby, etc.

This is the Rolls-Royce of practitioner texts on company law. It is incredibly detailed, written by a large cohort of well-known authors, and used by practitioners around the world. Yet its written style is concise and straightforward. You cannot live in company law practice without it.

- *Gore-Brown on Companies* (Jordans, loose-leaf)

This two-volume encyclopaedia is used by some practitioners, although it is less extensive than *Palmer*.

Statute books

Any statute book must have the Companies Act 2006 in it. The Companies Act 2006 is central to this course.

- Walmsley, K. (ed.) *Butterworth’s Company Law Handbook*. (Butterworths, 2008 Edition).
- French, D. (ed.) *Blackstone’s Statutes on Company Law 2007–2008*. (OUP)

Legal journals

- Generally: Modern Law Review (MLR); Oxford Journal of Legal Studies (OJLS); Journal of Law and Society (JLS); Law Quarterly Review (LQR); Cambridge Law Journal (CLJ).
- Specific to company law: *The Company Lawyer*, the *Journal of Corporate Law Studies* and the *Journal of Business Law*. There are also two dedicated company

law reports, *British Company Law Cases* (“BCC”) and *Butterworth’s Company Law Cases* (“BCLC”).

Three other, influential company law books

- J.E. Parkinson, *Corporate Power and Responsibility: issues in the theory of company law* (Oxford, Clarendon Press, 1993)
- B.R. Cheffin, *Company Law: theory and structure* (Oxford, OUP, 1997)
- R. Kraakman, et al, *The Anatomy of Corporate Law* (OUP, 2004)

These books take very interesting theoretical perspectives on company law. The first two are a little out-of-date now but should be used in the library for an overview of the topic.

References Used in These Course Documents

Under the headings either “**General reading**” or “**Specific Reading**”, the following references are, again:

G&D: Gower & Davies, *Company Law* (2008)

S&W: Sealy & Worthington, *Cases and Materials in Company Law* (2007)

D&L: Dignam & Lowry, *Company Law* (2009)

MFR: Mayson, French and Ryan, *Company Law* (2008)

D&K: Dine & Koutsias, *Company Law* (2007)

After a case name, a number in square brackets e.g. [2.01] is a reference to the extract of that case in Sealy & Worthington.

After a case name, a number in curly brackets e.g. {15} is nothing to do with you, cheeky. (Oh, if you must know, it refers to the 7th edition of Sealy, *Cases and Materials in Company Law* (Butterworths, 2001) which you will be able to acquire cheaply on amazon.co.uk if you want the case extracts to follow along in lectures (but *note* it has only the old statutory material).)

Topic 1

Introduction & Business Models

1. The scope of company law

General reading.

G&D: 3-53

D&L: 3-13

MFR: 1-7

1.1 What is company law?

- A new subject area?
- Contextual versus conceptual divisions in the law
- The law of obligations; the law of property

1.2 What is a “company”?

- A legal entity
- An employer
- An investment opportunity
- A means of raising funds
- An asset protection / holding / partitioning vehicle
- A dinner party ... “com” + “panio”

2. The historical development of company law from trust, partnership and joint stock company structures

General reading

*Alastair Hudson, *Securities Law*, chapter 4.

Alastair Hudson, *The Law of Investment Entities*, 103 *et seq.*

2.1 Fundamentals of the trust

- Legal title of trustee
- Equitable title of beneficiary: *Saunders v. Vautier* (1841) 4 Beav 115
- Low risk – breach of trust; Trustee Act 2000, etc.

2.2 Fundamentals of the partnership

- Contractual liability
- Fiduciary liability

2.3 Early corporations

- City corporations by royal charter
- The craft guilds
- The Tudor traders
- Cf. industrial and provident societies

2.4 The joint stock company

- Traders combining stock for sale in the new world
- The South Sea Company collapse: the “South Sea bubble”
- Charles Dickens, *Martin Chuzzlewit* – speculation fever.
- The joint stock company – built on contract and property

2.5 Investment vehicles

- The rise of the unit trust after the South Sea bubble
- Bi-cameral management structures
- Prohibition on investment through companies: *Smith v. Anderson* (1880) 15 ChD 247

3. Principles of partnership law

- Partnership Act 1890, s.1: “business in common with a view to profit”
- A contractual relationship: liability for gains and losses
- Title to partnership property
- Limited liability partnerships: Limited Liability Partnerships Act 2000

4. The nature of the company

4.1 Key concepts in company law ...

4.1.1 Dramatis personae

- The company – a legal entity in itself
- Directors – management through the “board of directors”
- Shareholders – investors or owners? Limited liability for shareholders

4.1.2 Other officers and people involved with the company

- Company secretary
- Auditor
- Employees; the place of an employer within a community
- Creditors:-
 - trade creditors
 - debenture / bond holders
 - banks under ordinary loans

4.1.3 Facets of the company

- Must companies trade?
- Buying companies off-the-shelf
- Insolvency

4.1.4 What manner of right does the shareholder get?

- Limited liability in relation to capital investment
- Property right in a transferable share
- Property right against company only in a winding up
- Investment

- Asset protection vehicle
- Entrepreneur's limited liability

4.1.5 The company as ...

- A nexus of contracts
- An employer
- A community
- A capital investment vehicle
- A cypher

4.2 How is a company constituted?

- Shareholders or members?
- "Membership", distinct from shareholding
- Cf. "company limited by guarantee", not shares

4.3 How is a company managed and controlled?

- Management distinct from shareholding
- Management distinct from directorship
- Who controls the company: shareholders, members, directors, managers, or other officers?

4.4 Five key features of the company ... summary

1. company is a distinct entity
2. limited liability of shareholders
3. specialised management separate from shareholders
4. ease of transfer of shares
5. rights of control and to receive profits vested in shareholders

5. THE FORMS OF BUSINESS ORGANISATION

Specific reading.

D&L: 3-13

MFR: 7-11

5.1 Non-company models

5.1.1 Partnerships

Partnership Act 1890

Geoffrey Morse, *Partnership Law*.

5.1.2 Unincorporated Associations

Hudson, *Equity & Trusts*, 2007, section 4.4

5.1.3 Sole traders

See *Study Guide*.

5.1.4 Limited Liability Partnerships

Limited Liability Partnerships Act 2000

5.1.5 Industrial and provident societies; credit unions and friendly societies

Hudson, *The Law on Investment Entities*, 2000, 259-309.

- “bodies corporate”
- Financial Services Authority regulation of insurance services
- common bond for credit derivatives

5.2 Different types of companies

Reading:

G&D: 13-33

Alastair Hudson, *The Law on Investment Entities* (Sweet & Maxwell, 2000)

Freedman J.; “Small businesses and the corporate form”, 57 *Modern Law Review* 555.

- Corporations by Royal Charter
- Public limited companies (“plc”)
- Private limited companies (“ltd”)
- Companies limited by guarantee
- “Not for profit” companies
- Open-ended investment companies (“oeics”)
- “Investment trusts”, in fact companies
- “Bodies corporate”

5.3 Groups of Companies

Adams v Cape Industries plc [1990] Ch 433 [2.19]

5.4 Separate corporate personality

Salomon v Salomon [1897] AC 22: the central text of modern company law. [2.01]

6. The Advantages and Disadvantages of Incorporation

Reading:

D&L: 5-13

- Freedman, J. ‘Small businesses and the corporate form: burden or privilege?’ [1994] *MLR*, 57, July, pp.555–584.
- Freedman, J. and M. Godwin ‘Incorporating the micro business: perceptions and misperceptions’ in Hughes, A. and D.J. Storey, (eds) *Finance and the Small Firm* (London: Routledge, 1994).

Advantages

- Limited liability for investors (shareholders)
- Simplification of contracts
- Access to capital markets for entrepreneurs
- Private companies may streamline their proceedings, unlike public companies

- Reputation, goodwill and trade marks

Disadvantages

- Bureaucracy / cost of incorporation
- Complexity of meetings formalities, accounts, etc.
- Public companies particularly carry more requirements: minimum capital; prospectus regulation; continuing obligations

William Blackstone, *Commentaries on the Laws of England*,
Vol 1, Chapter 18, p.455 (1e, 1765):-

“We have hitherto considered persons in their natural capacities, and have treated of their rights and duties. But, as all personal rights die with the person; and as the necessary forms of investing a series of individuals, one after the other, with the same identical rights, would be very inconvenient, if not impracticable; it has been found necessary, when it is for the advantage of the public to have any particular rights kept on foot and continued, to constitute artificial persons, who may maintain a perpetual succession, and enjoy a kind of legal immortality.”

7. THE SOURCES OF COMPANY LAW

Reading:

G&D: 53-79

S&W: 3-16

MFR: 11-27

EU law

- Companies Directives
- Securities regulation

UK statute

- Companies Act 2006
- Financial Services and Markets Act 2000
- Insolvency Act 1986
- Enterprise Act 2000

Financial Services Authority (“FSA”) regulation

- Listing Rules
- Prospectus Rules
- Disclosure and Transparency Rules
- Market Abuse Rulebook

English case law

“Soft” law

- e.g. Combined Code on Corporate Governance

Topic 2

The *Saloman* Principle: corporate personality

General reading

G&D: 193-209

S&W: 31-50

D&L: 14-30

MFR: 118-146

D&K: 21-27

1. THE SALOMAN PRINCIPLE

Smith v Anderson (1880) 15 Ch D 247

*****Salomon v A Salomon & Co Ltd* [1897] AC 22 {15, 16} [2.01]**

"The resolution of a problem about corporate personality is a contest of metaphor and symbol not of logic or deduction. The battle is won through eloquence and imagery, not through showdowns in pure reason." D. Millon.

Further reading.

- W. Blackstone, Commentaries on the Laws of England, Book 1. Ch 18. [S&W, p.71]
- *P. Ireland et al., "The conceptual foundations of modern company law", (1987) 14 *Journal of Law and Society* 149-165.
- Pettit, B. [1995] 'Limited liability – a principle for the 21st century' [1995] *CLP* 124.
- Grantham, R.B. and E.F. Rickett 'The bootmaker's legacy to company law doctrine' in Grantham, R.B. and E.F. Rickett (eds) *Corporate personality in the 20th Century* (Oxford: Hart Publishing, 1998).

2. Illustrations of the incidents of corporate personality

2.1 Asserting the legal personality of the company

Broderip v Saloman [1895] 2 Ch 323 (Vaughan Williams J, & Court of Appeal) [2.02]

*****Salomon v A Salomon & Co Ltd* [1897] AC 22 {15, 16} [2.01]**

**Macaura v Northern Assurance* [1925] AC 619 {18} [2.03] HL

**Lee v Lee Air Farming* [1961] AC 12 {17} [2.04] PC

2.2 Ownership of shares does not equate to ownership of business

Gramophone and Typewriter Co Ltd v. Stanley [1908] 2 KB 89 {19} [2.05]

Lonrho v. Shell [1980] QB 358 {20} CA (affirmed HL [1980] 1 WLR 627) [2.06]

2.3 General incidents of corporate personality

Lennard's Carrying Co. v Asiatic Petroleum [1915] AC 153 {34} [3.23]

R v ICR Haulage [1944] 1 All ER 691 {37} [3.26]

D.P.P. v Kent and Sussex [1944] KB 146. {36} [3.25]

Tesco Supermarkets v Nattrass [1972] AC 153 {38} [3.27]

**Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 3 All ER 918 [3.01/3.29] PC

2.4 Recent cases

Barings Plc (In Liquidation) v Coopers & Lybrand (No.4) [2002] 2 BCLC 364

Giles v Rhind [2003] 2 WLR 237

Shaker v Al-Bedrawi [2003] 2 WLR 92

3. The Directing Mind and Will of the Company

I.e. a sense in which corporate personality is predicated on the actions of individuals. See the following illustrations of how the mental state of human beings can influence the liability of the company. (This issue is considered again elsewhere in the course, especially in the last two lectures.)

Tesco Supermarkets v Nattrass [1972] AC 153 [3.27] {38}

El Ajou v Dollar Land Holdings [1993] 3 All ER 717, Millett J

El Ajou v Dollar Land Holdings [1994] 2 All ER 685, CA (overruling Millett J)

Crown Dilmun v Sutton [2004] 1 BCLC 468

(See Alastair Hudson, *Equity & Trusts* 2007, p.881-2, 887-889)

Topic 3

Lifting the veil of incorporation

Reading:

G&D: 193-209 again

S&W: 51-72

D&L: 31-50

MFR: 116-153

D&K: 27-39

Selected reading on the corporate veil:

- O Kahn-Freund (1944) 7 MLR 54
- S. Ottolenghi, "From peeping behind the corporate veil to ignoring it completely", (1990) 53 MLR 338.
- L. Gallagher & P. Zeigler, "Lifting the corporate veil in the pursuit of justice", [1990] JBL 292.
- F.G. Rixon, "Lifting the Veil between holding and subsidiary Companies" (1986) 102 LQR 415.

1. When the veil will be lifted: a rarely used doctrine.

1.1 It is rare to lift the veil today: an example

*S&W, page 53 "Note of Caution"

e.g. *Creasey v Breachwood Motors* [1993] BCLC 480, overruled by ...
Ord v Belhaven [1998] BCLC 447

1.2 Particular issues of groups of companies

The Albazero [1977] AC 774, [1975] 3 All ER 21, 28, *per* Roskill LJ {p.71}

**Adams v. Cape Industries plc* [1990] Ch 433, [1991] 1 All ER 929 {29} [2.19]

Atlas Maritime v Avalon [1991] 4 All E.R. 783, [1991] 1 W.L.R. 917.

Tate Access Floors Inc v Boswell [1991] Ch 512, 531, *per* Browne-Wilkinson VC [p.53]

1.3 Tax structuring, an example

ABC Ltd v M [2002] STC 78

2. Cases on lifting "the veil of incorporation"

2.1. Enemies at time of war

**Daimler v Continental Tyres* [1916] 2 AC 307 {22, 23} [2.12]

Continental Tyre and Rubber Co, etc., v. Daimler Co Ltd [1915] 1 KB 893 [2.13]

2.2. Perpetration of fraud

**Re Darby, ex p Brougham* [1911] 1 KB 95 {26} [2.16]

Aveling Barford v Perion [1989] BCLC 626

2.3. Breach of contract; evasion of existing obligation

Gilford Motor Co Ltd v Horne [1933] Ch 935 {27} [2.17]

Jones v Lipman [1962] 1 WLR 832 {p.68}

Re Polly Peck International PLC (in administration) [1996] 2 All ER 433.

2.4. Groups of companies

DHN Food Distributors Ltd v. Tower Hamlets LBC [1976] 1 WLR 852, [1976] 3 All ER 462 {28}

Adams v Cape Industries plc [1990] Ch 433 [2.19]

2.5. Agency

Re FG (Films) Ltd [1953] 1 WLR 615 {24} [2.14]

2.6. Limit on liability of shareholders in relation to the company

Multinational Gas v Multinational G and P [1983] 3 WLR 492 {141}

Wedderburn, "Multinationals and the antiquities of law" [1984] 47 MLR 87.

2.7. Exceptional trust relationship

Trebanog Working Men's Club v MacDonald [1940] 1 KB 576 [2.15]

2.8. The "controlling mind" concept and liability in tort

Yukong v Rendsburg [1998] 1 All ER 929

Williams v Natural Life [1998] 2 All ER 577 [3.22]

Standard Chartered Bank v Pakistan National Shipping Corp (No.2) [2003] 1 AC 959

Koninklijke Philips Electronics NV v Princo Digital Disc GmbH [2004] 2 BCLC 50.

3. Legislative interference with the corporate personality doctrine

3.1 Fraudulent Trading

Insolvency Act 1986, s.213:

'(1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company ...

(2) The court ... may declare that any persons who are knowingly parties to the carrying on of the business ... are liable to make such contributions ... to the company's assets as the court thinks proper.'

Re Todd Ltd [1990] BCLC 454

Re Patrick & Lyon Ltd [1933] Ch 786: fraud means '*actual dishonesty, involving, according to current notions of fair trading among commercial men, real moral blame*'.

Re a Company [1991] BCLC 197: *this provision is intended to exact punishment and not simply to extract compensation.*

Companies Act 2006, s.993:

'If any business of a company is carried on with intent to defraud customers of the company ... every person who is knowingly a party to the carrying on of the business in that manner commits an offence.'

3.2 Wrongful trading

Insolvency Act 1986, s.214: '*(2)(b) [if] that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation...*'

Re Produce Marketing Consortium Ltd (No. 2) (1989) 5 BCC 569 [1989] BCLC 520: *depends on nature of company; directors should realise company nearing insolvency because proper accounts and appropriate procedures.*

Topic 4

Raising capital: Issues of Securities 1

General reading

HSL: (extract provided from *Introduction*)

HLF: (edit provided from Part 10)

G&D: 829-934

S&W: (for background only)

MFR: 183-209

Alastair Hudson, *Securities Law* (Sweet & Maxwell, 2008)

1. THE SOURCES OF SECURITIES LAW

EC securities directives

Consolidated Admission and Reporting Directive 2001 (CARD)

Prospectus Directive 2004

Transparency Obligations Directive 2005

Markets in Financial Instruments Directive (“MiFID”) 2004

UK legislation

Financial services and Markets Act 2000 (“FSMA 2000”)

Companies Act 2006

Prospectus Regulations 2005

FSA securities regulation

Listing Rules (2005)

Prospectus Rules (2005)

Disclosure and Transparency Rules (2006)

English general law

(Especially the tort of negligence, for the purposes of this course)

2. THE LAMFALUSSY PROCESS

2.1 The process

Final report published in February 2001.

Four tiers for EU regulation in this area:

(1) Framework principles in Directives

(2) Commission technical regulations

(3) Guidance from the Committee of European Securities Regulators (“CESR”)

(4) Enforcement mechanism effected by the Commission

2.2 Themes

- Harmonisation – “approximation”, “co-ordination”
- Deep pools of liquid capital
- Gold-plating
- Passporting authorisation across the EU
- Provision of information

2.3 Examples

First recital to the Transparency Obligations Directive:

‘Efficient, transparent and integrated securities markets contribute to a genuine single market ... foster growth and job creation by better allocation of capital and by reducing costs. The disclosure of accurate, comprehensive and timely information ... builds sustained investor confidence and allows an informed assessment of their business performance and assets. This enhances both investor protection and market efficiency.’

To be achieved by means of ‘*transparency for investors through a regular flow of information*’.

3. THE POLICIES UNDERPINNING THE EC SECURITIES DIRECTIVES

3.1 Consolidated Admissions and Reporting Directive

- Listing
- “co-ordination should first be limited to the establishment of minimum conditions” (r.6)
- “closer alignment” of national regulatory rules
- “coordinating the [various national] rules and regulations without necessarily making them completely uniform” (r.9)
- Passporting
- Investor protection

3.2 The Prospectus Directive

3.2.1 The general policies

- Over-arching policy objective of creating a single internal market for the EU (r.4)
- To facilitate the creation of a viable Europe-wide securities market with “deep, liquid pools of capital”.
- An “instrument essential to the achievement of the internal market” as part of the Risk Capital Action Plan.
- Single passport to each issue of securities: authorisation by the competent authority in one member state shall be recognised in all other member states (r.4)
- The “country of origin” principle: the issuer’s home state regulator assumes control (r.14)
- The issuer bears an “ongoing disclosure obligation” to make “reliable information” available to the investing public throughout the life of the security (r.27).

- Jurisdictional “differences should be eliminated by harmonising the rules ... to achieve an adequate degree of equivalence of the safeguards [for investor protection by means of] provision of information” (r.30).

3.2.2 The Prospectus Directive central principles

Recital 41:-

- *the need to ensure confidence in financial markets among small investors ...;*
- *the need to provide investors with a wide range of competing investment opportunities and a level of disclosure and protection tailored to their circumstances;*
- *the need to ensure that independent regulatory authorities enforce the rules consistently, especially as regards the fight against white collar crime;*
- *the need for a high level of transparency ...;*
- *the need to encourage innovation in financial markets if they are to be dynamic and efficient;*
- *the need to ensure systemic stability of the financial system by close and reactive monitoring of financial innovation;*
- *the importance of reducing the cost of, and increasing access to, capital;*
- *the need to balance, on a long-term basis, the costs and benefits to market participants ... of any implementing measures;*
- *the need to foster the international competitiveness of the Community’s financial markets without prejudice to a much-needed extension of international cooperation;*
- *the need to achieve a level playing field for all market participants by establishing Community legislation every time it is appropriate;*
- *the need to respect differences in national financial markets where these do not unduly impinge on the coherence of the single market;*
- *the need to ensure coherence with other Community legislation in this area, as imbalances in information and a lack of transparency may jeopardise the operation of the markets and above all harm consumers and small investors.’*

3.3 The Transparency Obligations Directive

The general principle

‘This Directive establishes requirements in relation to the disclosure of periodic and ongoing information about issuers whose securities are already admitted to trading on a regulated market situated or operating within a Member State.’ (art.1)

- Votesholder information
- Gold-plating

4. PROSPECTUSES

4.1 The current legislation

- EC Prospectus Directive implemented by the UK Prospectus Regulations (S.I. 2005/1433); in turn amending existing sections of Part 6 of FSMA 2000 and also introducing new sections to that Part 6.
- FSA Prospectus Rules (2005) implemented the detailed Commission regulations.

- Public Offers of Securities Regulations 1995 (S.I. 1995/1537) revoked by Prospectus Regulations, Sch.3.
- Financial Services and Markets Act 2000 (Official Listing of Securities) Order 2001 (S.I. 2001/2958) revoked by Prospectus Regulations, Sch.3.

4.2 Offers of transferable securities require prospectus: the key provision

s.85(1) of FSMA 2000:

'It is unlawful for transferable securities to which this subsection applies to be offered to the public in the United Kingdom unless an approved prospectus has been made available to the public before the offer is made.'

4.3 Definition of "securities"

Prospectus Directive, art.2(1)(a):

'- shares in companies and other securities equivalent to shares in companies,
 - bonds and other forms of securitised debt which are negotiable on the capital market [sic] and
 - any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement
 excluding instruments of payment.'

4.4 Requests for admission to trading on a regulated market require a prospectus

s.85(2) FSMA 2000:

'It is unlawful to request the admission of transferable securities to which this subsection applies to trading on a regulated market situated or operating in the United Kingdom unless an approved prospectus has been made available to the public before the request is made.'

4.5 Breach of s.85 duties grants right to compensation

s.85(4) FSMA 2000:

'A contravention of subsection (1) or (2) is actionable, at the suit of a person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.'

Tort of "breach of statutory duty simpliciter": *X (minors) v Bedfordshire County Council* [1995] 2 A.C. 633

4.6 Exemptions and exclusions from s.85

4.6.1: Schedule 11A FSMA 2000

1. government and similar securities
2. not-for-profit organisations
3. two further types of security which do not constitute "transferable securities"

4.6.2: s.86 of FSMA 2000

1. offers made to or directed at "qualified investors"
2. offers made to fewer than one hundred people

3. large issues beyond the reach of ordinary, retail investors in which the minimum consideration is at least 50,000 euros
4. large denomination issues where the securities being offered are denominated in amounts of at least 50,000 euros
5. small issues where the total consideration for the transferable securities being offered cannot exceed 100,000 euros
6. where non-qualified investor engages a qualified investor to act as his agent and where that agent has discretion as to his investment decisions

4.6.3: s.85(5)(b) FSMA 2000: FSA power to exempt issues

4.7 Issuer may elect to have a prospectus

s.87 FSMA 2000

4.8 The general duty of disclosure of information in prospectuses

4.8.1 The requirement of “necessary information”

s.87A(1) FSMA 2000:

‘The competent authority may not approve a prospectus unless it is satisfied that-

- (a) the United Kingdom is the home State in relation to the issuer of the transferable securities to which it relates,
- (b) the prospectus contains the **necessary information**, and
- (c) all of the other requirements imposed by or in accordance with this Part or the prospectus directive have been complied with (so far as those requirements apply to a prospectus for the transferable securities in question).’

4.8.2 The definition of “necessary information”

s.87A(2) FSMA 2000:

‘The necessary information is the information necessary to enable investors to make an informed assessment of –

- (a) the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the transferable securities and of any guarantor; and
- (b) the rights attaching to the transferable securities.’

4.8.3 Four significant elements

(1) *Duty applies only to prospectuses submitted to the competent authority*

(2) *The “informed assessment” criterion*

s.87A(4) FSMA 2000:

‘The necessary information must be must be prepared having regard to the particular nature of the transferable securities and their issuer.’

- Not “reasonableness”
- Not information which a professional advisor would require
- s.87A(2) FSMA 2000 refers only to “investors” making an informed assessment
- Distinction between informed investors and idiots?
- Cf. FSA Conduct of Business Sourcebook classification of customers: market counterparties and inexpert, “retail” clients.

(3) *Information to be provided*

- the assets and liabilities of the issuer,
- the financial position of the issuer,
- the profits and losses of the issuer, and

- the prospects of the issuer.

(4) *Information as to the rights which will attach to the securities*

4.9 Prospectus must be comprehensible and easily analysable presentation

s.97A(3) FSMA 2000:

'The necessary information must be presented in a form which is comprehensible and easy to analyse.'

Dictionary definition of "comprehensible" = "may be understood"; but by whom?

4.10 Requirement for supplementary prospectus

s.87G FSMA 2000:

'if, during the relevant period, there arises or is noted a significant new factor, material mistake or inaccuracy relating to the information included in a prospectus [or in a supplementary prospectus] approved by the competent authority.'

4.11 The required contents of a prospectus

(1) *The central duty of disclosure: s.87A FSMA 2000*

(2) *The form of a prospectus*

If one document, s.87A(5) FSMA 2000: a "summary must, briefly and in non-technical language, convey the essential characteristics of, and risks associated with, the issuer, any guarantor and the transferable securities to which the prospectus relates."

(3) *Building blocks: the regulatory pizza – base with selected toppings*

4.12 Omission of information in a prospectus

s.87B FSMA 2000: FSA may permit omission if:

"its disclosure would be contrary to the public interest; or
would be seriously detrimental to the issuer (provided that its omission would be unlikely to mislead the public); or
where the information is only of minor importance."

4.13 The general obligation to obey the Prospectus Rules

s.91(1A) FSMA 2000: contravention = penalty from FSA; or censure

4.14 Listing Particulars

Required only under Ch.13 Listing Rules for limited issues, despite s.79 FSMA.

5. Civil Liability for Preparation of Prospectuses

5.1 The approach of the old cases to issues of securities

New Brunswick, etc., Co. v. Muggerridge (1860) 1 Dr. & Sm. 363, 383, Kindersley V-C

'Those who issue a prospectus, holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality, of the privileges and advantages which the prospectus holds out as inducements to take shares.'

Central Railway of Venezuela v. Kisch (1867) L.R. 5 H.L. 99, 123, Lord Chelmsford

5.2 The central principle of the tort of negligent misstatement

Hedley Byrne v Heller [1963] 2 All E.R. 575, [1964] A.C. 465

Caparo Industries plc v Dickman [1990] 2 A.C. 605, 638, per Lord Oliver:-

'What can be deduced from the Hedley Byrne case, therefore, is that the necessary relationship between the maker of a statement or giver of advice (the adviser) and the recipient who acts in reliance on it (the advisee) may typically be held to exist where (1) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given, (2) the adviser knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose, (3) it is known, either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent inquiry and (4) it is so acted on by the advisee to his detriment. That is not, of course, to suggest that these conditions are either conclusive or exclusive, but merely that the actual decision in the case does not warrant any broader propositions.'

Possfund v Diamond [1996] 2 All E.R. 774, [1996] 1 W.L.R. 1351, [1996] 2 B.C.L.C. 665, per Lightman J:-

'In 1963 the House of Lords in Hedley Byrne v Heller & Partners Ltd established that at common law a cause of action exists enabling the recovery of damages in respect of a negligent misrepresentation occasioning damage and loss where the necessary proximity exists between the representor and representee. It is clearly established (and indeed common ground on these applications) that in a case such as the present, where the defendants have put a document into more or less general circulation and there is no special relationship between alleged between the plaintiffs and the defendants, foreseeability by the defendants that the plaintiffs would rely on the prospectus for the purposes of deciding whether to make after-market purchases is not sufficient to impose upon the defendant a duty of care in such a situation requires a closer relationship between representor and representee, and its imposition must be fair, just and reasonable.'

5.3 Negligent misstatement in relation to a takeover

JEB Fasteners Ltd v. Marks, Bloom & Co [1981] 3 All E.R. 289

***Caparo Industries plc v Dickman** [1990] 2 A.C. 605, per Lord Bridge:-

'If a duty of care were owed so widely, it is difficult to see any reason why it should not equally extend to all who rely on the accounts in relating to other dealings with a company as lenders or merchants extending credit to the company''.

James McNaughton Papers Group Ltd v. Hicks Anderson & Co. [1991] 1 All E.R. 135

Morgan Crucible Co plc v Hill Samuel Bank Ltd [1991] 1 All E.R. 148

5.4 Negligent misstatements in relation to share issues

5.4.1 Issue limited to small class of placees

***Al-Nakib Investments (Jersey) Ltd v. Longcroft** [1990] 3 All E.R. 321, Mervyn Davies J

5.4.2 Issue not limited to placees; whether purchasers in after market have rights

**Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All E.R. 774, [1996] 1 W.L.R. 1351

5.4.3 The effect of the principles of FSA Prospectus Rules

Alastair Hudson, *Securities Law*, p.626

5.5 Examples of misrepresentations in the old case law

Henderson v. Lacon (1867) L.R. 5 Eq. 249, Page-Wood V-C: "golden legacy"

Re London and Staffordshire Fire Insurance Co. (1883) 24 Ch. D. 149.

Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate [1899] 2 Ch. 392

Re Pacaya Rubber and Produce Co. Ltd [1914] 1 Ch. 542

R. v. Kyslant [1932] 1 K.B. 442

5.6 Compensation under s.90 FSMA 2000

5.6.1 Persons responsible for the contents of the prospectus

In relation to equity securities, the persons responsible for the prospectus are:

- the issuer;
- directors and those authorising themselves to be named as responsible for the prospectus;
- any other person who accepts responsibility for the prospectus;
- in relation to an offer, each person who is a director of a body corporate making an offer of securities; in relation to applications for admission to trading, each person who is a director of a body corporate making an offer of securities; and
- other persons who have authorised the contents of the prospectus. (PR, 5.5.3R)

In relation to securities which are not equity securities, the persons responsible for the prospectus are:

- the issuer;
- anyone who accepts and is stated in the prospectus as accepting responsibility for the prospectus;
- any other person who is the offeror of the securities;
- any person who requests an admission to trading of transferable securities; any guarantor for the issue in relation to information about that guarantee;
- and any other person who has authorised the contents of the prospectus. (PR, 5.5.4R)

That someone has given advice in a professional capacity about the contents of a prospectus does not make that person responsible for the contents of the prospectus in itself (PR, 5.5.9R); unless they consent to being so named or they authorise those contents of the prospectus which are the subject of the action, and even then they are liable only to the extent that they have agreed to be so liable (PR, 5.5.8R).

5.6.2 The basis of the right to compensation under s.90 FSMA 2000

*s.90(1) FSMA 2000:

'Any person responsible for listing particulars is liable to pay compensation to a person who has

(a) acquired securities to which the particulars [or the prospectus] apply; and

(b) suffered loss in respect of them as a result of

- (i) any untrue or misleading statement in the [prospectus];
- (ii) or the omission from the [prospectus] of any matter required to be included by [the duties of disclosure in] section [87A or 87B]’.

5.6.3 *Defences to liability under s.90*

Schedule 10, FSMA 2000

- when the defendant believed in the truth of the statement that was made in the prospectus;
- when the statement was made by an expert which is included in a prospectus or a supplementary prospectus with that expert’s consent and is stated in that document to be included as such;
- when there has been publication, or taking of reasonable steps to secure publication, of a correction;
- when reasonable steps have been taken to secure the publication of a correction of a statement made by an expert;
- when the statement was made by an official person or contained in a public, official document, provided that the statement was accurately and fairly reproduced;
- if the court is satisfied that the investor acquired the securities with knowledge that the statement was incorrect, and therefore that the investor was not misled by it.

Topic 5

Raising capital: Issues of Securities 2

General reading

HSL: (as Topic 5)

HLF: (as Topic 5)

G&D: (as Topic 5)

S&W: (for background only)

MFR: 183-209 again

continued from last topic ...

6. TRANSPARENCY OBLIGATIONS

6.1 Source

Transparency Obligations Directive 2004/109/EC implemented by Part 43 of Companies Act 2006 and FSA “Disclosure and Transparency Rules” (“DTR”).

6.2 Objectives

- “Transparency” means the provision of information, effectively
- Maintain a flow of information to the investing public *after* securities have been admitted to trading on a regulated market
- Voteholder information: s.89B(1) FSMA 2000
- Financial information

6.3 Voteholder information

- “Voteholder information” means “information relating to the proportion of voting rights held by a person in respect of the shares” (s.89B(3) FSMA 2000).
- Monthly disclosure “to the public” the total number of voting rights and capital in respect of each class of issued shares (DTR, para 5.6).
- Voting rights under common control: “voting rights” are rights attaching to a share which permit the shareholder to vote at company meetings (s.89F(4) FSMA 2000); and “common control” includes
 - people who hold a majority of voting rights in other persons, or
 - who have the right to alter the composition of another person’s board of directors, or
 - who control the voting rights in another person perhaps by virtue of some shareholders’ agreement, or
 - who either have a legal right to exercise a dominant influence over another person or who “actually exercise” a dominant influence over that other person (s.89J(2) FSMA 2000).
- “Voting rights include (s.89F(3) of FSMA 2000):
 - being a shareholder in the issuer; or

- having an entitlement to deal with those voting rights under an agreement where parties are acting in concert in relation to the use of those shares, or where the shares are “lent” or held as collateral, or
- where the shares held on trust (whether subject to a life interest, or on discretionary trust or on bare trust), or where the rights in the shares are controlled by some other undertaking, or where control is exercised by an agent as a proxy; or
- having rights under a derivative, e.g. a call option.
- Notification obligations when thresholds are crossed (TOD, art.9): 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%. Including derivatives to acquire shares (TOD, art.13).

6.4 Misleading statements in discharge of transparency obligations

s.90A(3) FSMA 2000:

- (a) acquired such securities issued by it, and
- (b) suffered loss in respect of them as a result of-
 - (i) any untrue or misleading statement in a publication to which this section applies, or
 - (ii) the omission from any such publication of any matter required to be included in it.'

s.90A(4) FSMA 2000:

- 'The issuer is so liable only if a person discharging managerial responsibilities within the issuer in relation to the publication-
 - (a) knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading, or
 - (b) knew the omission to be dishonest concealment of a material fact.'

7. THE LISTING RULES

7.1 Nomenclature

- Official listing of securities: Part 6 of FSMA 2000
- Official List in the UK is the list maintained by the “competent authority” under the EC *securities directives* for the purposes of Part 6.
- FSA is the UK Listing Authority (“UKLA”)
- The Official List is regulated by means of the *FSA Listing Rules*.

7.2 Securities transactions are contracts

The heart of any securities transaction under the general law is a contract.

7.3 The definition of “transferable securities”

7.3.1: MiFID definition

MiFID, art.4(18):

- “Transferable securities” means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:
 - (a) shares in companies and other securities equivalent to shares in companies, partnership or other entities, and depositary receipts in respect of shares;

- (b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
- (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures'

To summarise:-

- shares,
- bonds, and
- securitised derivatives

7.3.2: FSMA 2000 definition

An “offer of transferable securities to the public”, as defined in s.102B(1) FSMA 2000:

‘For the purposes of [Part 6 FSMA 2000] there is an offer of transferable securities to the public if there is a communication to any person which presents sufficient information on—

- (a) the transferable securities to be offered, and
- (b) the terms on which they are offered,

to enable an investor to decide to buy or subscribe for the securities in question.’

7.4 Private Companies May Not Offer Securities to the Public

s.756 of CA 2006

7.5 The Listing Principles

These principles inform all of the Listing Rules. They are in Chap. 7 of the Listing Rules.

The Listing Principles are as follows:

| | |
|--------|---|
| Prin 1 | A listed company must take reasonable steps to enable its directors to understand their responsibilities and obligations as directors. |
| Prin 2 | A listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations. |
| Prin 3 | A listed company must act with integrity towards holders and potential holders of its listed equity securities. |
| Prin 4 | A listed company must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities. |
| Prin 5 | A listed company must ensure that it treats all holders of the same class of its listed equity securities that are in the same position equally in respect of the rights attaching to such listed equity securities. |
| Prin 6 | A listed company must deal with the FSA in an open and co-operative manner. |

8. CONTINUING OBLIGATIONS

8.1 Conditions as to the nature of the issuer itself

s.75 FSMA 2000:

'Admission to the official list may be granted only on an application made to the competent authority in such manner as may be required by listing rules.'

8.2 The principles in outline

8.2.1 General conditions for admission to listing (Chap 2, LR)

- company duly incorporated,
- securities duly authorised for listing under the company's constitution,
- shares must be freely transferable,
- shares must be admitted to trading on an RIE's market for listed securities,
- issuer's securities must have a minimum capitalisation,
- an approved prospectus must be published.

8.2.2 Further general conditions for admission to listing (Chap 6, LR)

- company must have published and filed audited accounts for at least three previous years,
- company must have an independent business,
- company's business activities must have continuous for the previous three years
- must have a minimum working capital identified in the rules,
- securities themselves must be 25% in public hands after the issue within the EU and EEA,
- securities must be capable of electronic settlement.

8.2.3 Special conditions on a particular listing application

- UKLA may impose special conditions "solely in the interests of protecting investors"

8.2.4 That the issuer must have consented to the listing

8.2.5 Conditions to be satisfied in relation to the securities themselves

- securities to be listed must be admitted to trading on a recognised investment exchange's market for listed securities;
- securities must be validly issued according to the law of the place of the applicant's incorporation, must accord with company's constitution, and any necessary statutory or regulatory consents must have been obtained;
- securities must be "freely transferable";
- securities must be eligible for electronic settlement.
- aggregate market value of all securities to be listed must be at least £700,000 for shares and £200,000 for debt securities, although UKLA "may admit securities of lower value if satisfied that there will be an adequate market for the securities."

8.3 The application procedure for admission to the Official List

- Specific to the type of security, or entity

8.4 Sponsors

- There is a requirement for a sponsor in relation to any listing (LR, 8.2.1R).

- Sponsors are usually regulated investment firms required to vet the suitability of an issue of securities, and to warrant that suitability to the FSA.
- Advise issuer and supply information to UKLA
- Sponsors' general duties:
 - exercise due care and skill in advising the listed company;
 - take reasonable steps to ensure that the directors of the listed company understand the nature and extent of their obligations under the listing rules;
 - deal with the FSA in an open and co-operative manner, dealing promptly with all of the FSA's enquiries and disclosing any "material information" of which it has knowledge to the FSA in a "timely manner";
 - required to be independent of the listed company and to complete a form attesting to its independence in relation to each admission for listing in which it participates.
- Sponsors' duties in relation to the listing:
 - form a "reasonable opinion", after making due and careful inquiry, that applicant has satisfied all of the requirements of Listing Rules and Prospectus Rules,
 - ensure the directors of the applicant have put in place adequate procedures to enable the applicant to comply with the listing rules, and
 - ensure the directors of the applicant have also put in place procedures on the basis of which they are able to make "proper judgments on an ongoing basis" as to the applicant's financial position and prospects.

8.5 General Continuing Obligations in the Listing Rules

- Continuing obligations to keep the FSA informed of administrative matters (LR, 9.2.11R)
- Continuing obligations as to the equal treatment of shareholders (LR, 9.3.1R)
- Continuing obligations relating to publicise financial information through RIS (LR, 9.7.1R); unless "contrary to the public interest or seriously detrimental to the listed company" (LR, 9.7.3R) but provided that omission would not be "likely to mislead the public with regard to facts and circumstances, knowledge of which is essential for the assessment of the shares" (LR, 9.7.3R).
- Continuing obligations in relation to market abuse, see below.
- Continuing obligations in the FSA Disclosure and Transparency Rules: notify RIS "as soon as possible" of any inside information which "directly concerns the issuer" unless the issuer (on its own initiative) considers the prevention of disclosure to be necessary to protect its own "legitimate interests" (DTR, 2.5.1R).
- The obligation to communicate information so as to avoid the creation or continuation of a false market in such listed equity securities (Fourth Listing Principle).
- Circulars (LR, section 13.8) in relation to constitutional matters, decisions affecting securities, takeovers, etc..

8.6 Penalties for breach of the Listing Rules

- Where any contravention of the listing rules (s.91 FSMA 2000);
- Where any contravention of Part 6 of FSMA 2000 or of the Prospectus Rules (s.91(1A) FSMA 2000).
- The penalty is such as the FSA considers appropriate.

8.7 Discontinuance of listing

- discontinue or to suspend listing further to s.77 of FSMA 2000;
- suspend or prohibit an offer of transferable securities to the public under s.87K of FSMA 2000;

- suspend or prohibit admission to trading on a regulated market under s.87L of FSMA 2000; and
- suspend trading in a financial instrument on grounds of breach of the disclosure rules under s.96C of FSMA 2000.

9. Market Abuse and Insider Dealing

9.1 Sources of law

9.1.1 Insider dealing

EC Insider Dealing Directive (89/592/EC, [1989] O.J. L334/30)

Part V of the Criminal Justice Act 1993 (“CJA 1993”), ss.52-64, Schedules 1 & 2

9.1.2 Market abuse regulation

Market Abuse Directive

FSA Market Abuse Rulebook

FSA Model Code in FSA Disclosure and Transparency Rules

A. Insider dealing

9.2 The three offences of insider dealing

9.2.1 The offences in outline

Three offences relating to insider dealing:

- insiders who deal in “price-affected” securities using “inside information”
- encouraging others to deal in price-affected securities
- disclosing inside information

9.2.2 The power of the Financial Services Authority

FSMA 2000, s.402: FSA has power to prosecute insider dealing.

9.3 The principal offence of insider dealing in s.52(1) CJA 1993

s.52(1) CJA 1993:

‘(1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.’

The six elements of the offence:

1. the offence is committed by an individual
2. that individual must have information as an “insider”
3. the individual must “deal” in securities
4. the securities in which the individual deals must be “price-affected securities”
5. the securities must be price-affected securities “in relation to the information”
6. as s.52(3) CJA 1993, acquisition or disposal on regulated market, etc.

s.52(3) CJA 1993:-

'(3) The circumstances referred to above [in s.52(1)] are that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary.'

9.4 The two inchoate offences relating to insider dealing in s.52(2) of CJA 1993

s.52(2) of CJA 1993:

'(2) An individual who has information as an insider is also guilty of insider dealing if –
(a) he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or
(b) he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person.'

9.5 Definition of terms in the statutory offences

9.5.1 The definition of “dealing in securities”

s.55 CJA 1993:

'(1) For the purposes of this Part, a person deals in securities if –
(a) he acquires or disposes of the securities (whether as principal or agent); or
(b) he procures, directly or indirectly, an acquisition or disposal of the securities by any other person.

s.55(2) and (3) CJA 1993:

'(2) For the purposes of this Part, “acquire”, in relation to a security, includes –
(a) agreeing to acquire the security; and
(b) entering into a contract which creates the security*.
(3) For the purposes of this Part, “dispose”, in relation to a security, includes –
(a) agreeing to dispose of the security; and
(b) bringing to an end a contract which created the security.'

*includes derivatives (e.g. options)?

9.5.2 Securities to which Part V applies

Schedule 2, CJA 1993:

- shares,
- debt securities,
- warrants,
- depositary receipts,
- options,
- futures, and
- contracts for differences.

9.5.3 The definition of “inside information”

s.56(1) CJA 1993:

'(1) For the purposes of this section and section 57, "inside information" means information which –

- (a) relates to particular securities or to a particular issuer of securities or to particular issuers of securities and not to securities generally or to issuers of securities generally;
- (b) is specific and precise;
- (c) has not been made public; and
- (d) if it were made public would be likely to have significant effect on the price of any securities.

Points of note:

- limits scope of information
- "relates to specific securities" = one issuer, a group of issuers, or entire market?
- "particular issuers of securities" suggests numerous – e.g. irt takeover
- "specific and precise" – not mere nervousness nor mere management concerns; but would include specific impact of business unit on financial condition of company. In Australia, *Ryan v Triguboff* [1976] 1 NSWLR 588, at 596, *per* Lee J: the information should be "unequivocally expressed and discerned" and not require too much deduction on the part of its recipient.
- "has not been made public" – e.g. RIS publication = no longer *inside* information; but what of speculative journalism? What of "market rumours"? What of leaks to the press? Cf. the film *Wall Street* and how information leaked to the Press.
- "significant effect on the price" – not mere tittle-tattle. A movement of fifty pence on a share worth £20 would be less *significant* than a movement of fifty pence on a share worth £2. See fears over Lehman Bros in press over summer 2008.

9.5.4 The definition of "price-sensitive information"

s.56(2) CJA 1993:

'(2) For the purposes of this Part, securities are "price-affected securities" in relation to inside information, and inside information is "price sensitive information" in relation to securities, if and only if the information would, if made public, be likely to have a significant effect on the price of the securities.'

9.5.5 What manner of information relates to a particular issuer

9.5.6 A person having information in a capacity as an insider

s.57 CJA 1993:

'(1) For the purposes of this Part, a person has information as an insider if and only if –

- (a) it is, and he knows that it is, inside information; and
- (b) he has it, and knows that he has it, from an inside source.'

Two requirements here:

- insider must know the information is inside information
- insider must know that information acquired from an "inside source"

"inside source" s.57(2) CJA 1993:

'(2) For the purposes of subsection (1), a person has information from an inside source if and only if –

- (a) he has it through –

- (i) being a director, employee or shareholder of an issuer of securities; or
 - (ii) having access to the information by virtue of his employment, office or profession; or
- (b) the direct or indirect source of his information is a person within paragraph (a).'

9.5.7 Information "made public"

s.58 CJA 1993:

'(1) For the purposes of section 56, "made public", in relation to information, shall be construed in accordance with the following provisions of this section; but those provisions are not exhaustive as to the meaning of that expression.

(2) Information is made public if –

- (a) it is published in accordance with the rules of a regulated market for the purpose of informing investors and their professional advisors;
- (b) it is contained in records which by virtue of any enactment are open to inspection by the public;
- (c) it can be readily acquired by those likely to deal in any securities-
 - (i) to which the information relates; or
 - (ii) of an issuer to which the information relates; or
- (d) it is derived from information which had been made public.'

Publication of information takes place in one of four contexts.

- publication in accordance with the ordinary rules of a regulated market
- "records" made available for inspection by the public; including published accounts and information as to directors' remuneration
- information which can be "readily acquired" by those who are "likely to deal" in those securities or in relation to that information, e.g. analysts' reports
- generally, information being derived from information which has been made public

s.58(3) CJA 1993:

'(3) Information may be treated as made public even though –

- (a) it can be acquired only by persons exercising diligence or expertise;
- (b) it is communicated to a section of the public and not to the public at large;
- (c) it can be acquired only by observation;
- (d) it is communicated only on payment of a fee;
- (e) it is published only outside the United Kingdom.'

9.5.8 The meaning of the term "issuer"

s.60(2) CJA 1993:

"issuer" = "means any company, public sector body or individual by which or by whom the securities have been or are to be issued".

9.6 Defences

s.53(1) CJA 1993

9.7 The private law enforceability of contracts

s.63(2) CJA 1993: 'No contract shall be void or unenforceable by reason only of s.52'.

9.8 Why criminalise insider dealing?

B. OFFENCES RELATING TO MARKET MANIPULATION

9.9 The offence of making misleading statements

9.9.1 The activity which will give rise to the offence

s.397(1) FSMA 2000:

'(1) This subsection applies to a person who –

- (a) makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular;
- (b) dishonestly conceals any material facts whether in connection with a statement, promise or forecast made by him or otherwise; or
- (c) recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular.'

9.9.2 The further requirement of inducing behaviour in the representee

s.397(2) FSMA 2000:

'(2) A person to whom subsection (1) applies is guilty of an offence if he makes the statement, promise or forecast or conceals the facts for the purpose of inducing, or is reckless as to whether it may induce, another person (whether or not the person to whom the statement, promise or forecast is made)-

- (a) to enter or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement; or
- (b) to exercise, or refrain from exercising, any rights conferred by a relevant investment.'

9.9.3 The statutory defence

s.397(4) FSMA 2000:

'(4) In proceedings for an offence under subsection (2) brought against a person to whom subsection (1) applies as a result of paragraph (a) of that subsection, it is a defence for him to show that the statement, promise or forecast was made in conformity with –

- (a) price stabilising rules;
- (b) control of information rules; or
- (c) the relevant provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments.

9.10 The offence of creating a false or misleading impression as to the market

9.10.1 The components of the offence

s.397(3) FSMA 2000:

"(3) Any person who does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments is guilty of an offence if he does so for the purpose of creating that impression and of thereby inducing another person to acquire, dispose of, subscribe for or underwrite those investments or to refrain from doing so or to exercise, or refrain from exercising, any rights conferred by those investments."

9.10.2 The statutory defence

s.397(5) FSMA 2000

"(5) In proceedings brought against any person for an offence under subsection (3) it is a defence for him to show –

- (a) that he reasonably believed that his act or conduct would not create an impression that was false or misleading as to the matters mentioned in that subsection;
- (b) that he acted or engaged in the conduct –
 - (i) for the purpose of stabilising the price of investments; and
 - (ii) in conformity with price stabilising rules; ...
- (c) that he acted or engaged in the conduct in conformity with control of information rules; or
- (d) that he acted or engaged in the conduct in conformity with [regulations for] buy-back programmes and stabilisation of financial instruments.”

C. MARKET ABUSE REGULATION BY THE FSA

This section on FSA regulation is primarily intended to allow you to compare civil regulation of market abuse with the criminal offences already considered.

9.11 The Market Abuse Directive

9.11.1 The policy underpinning the directive

- the preservation of “market integrity”
- an “integrated and efficient financial market”
- “economic growth and job creation” in the EU
- “market abuse harms the integrity of financial markets and public confidence in securities and derivatives”
- to develop a pool of liquid capital needs the confidence of a concomitant pool of investors

9.11.2 “Inside information”

“Inside information” is:

“information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments”. (MAD, art.1(1))

9.11.3 “Market manipulation”

“Market manipulation” is:

(a) transactions or orders to trade:

- which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments; or
- which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level,

unless the person who entered into the transactions or issued the order to trade establishes that his reasons for so doing are legitimate and that these transactions or order to trade conform to accepted market practices on the regulated market concerned;

(b) transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance;

(c) dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumours and false or misleading news, where

the person who made the dissemination knew, or ought to have known, that the information was false or misleading. In respect of journalists when they act in the professional capacity such dissemination of information is to be assessed [...] taking into account the rules governing their profession, unless those persons derive, directly or indirectly, an advantage or profits from the dissemination of the information in question.'

9.12 The scope of the market abuse provisions

s.118 of the FSMA 2000, as amended to give effect to MAD, provides that:

- '(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) which -
- (a) occurs in relation to –
 - (i) qualifying investments admitted to trading on a prescribed market,
 - (ii) qualifying investments in respect of which a request for admission to trading on such a market has been made, or
 - (iii) in the case of subsection (2) or (3) behaviour, investments which are related investments in relation to such qualifying investments, and
 - (b) falls within any one or more of the types of behaviour set out in subsection (2) to (8).'

There are therefore seven types of behaviour which will constitute market abuse.

9.12(1) Dealing in a qualifying investment: "insider dealing"

s.118(2) FSMA 2000:

'The first type of behaviour is where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question.'

9.12(2) Disclosure of inside information: "improper disclosure"

s.118(3) FSMA 2000:

'The second is where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties.'

The FSA gives two examples of behaviour which it considers would fall within this head of behaviour in MAR:

- (1) disclosure of inside information by the director of an issuer to another in a social context; and
- (2) selective briefing of analysts by directors of issuers or others who are persons discharging managerial responsibilities.'

9.12(3) Use of inside information in breach of standard of reasonable behaviour on the market: "misuse of information"

s.118(4) FSMA 2000:

- 'The third is where the behaviour (in falling within subsection (2) or (3)) –
- (a) is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would be, or would likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments should be effected, and
 - (b) is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.'

9.12(4) Causing a false or misleading impression: "manipulating transactions"

s.118(5) FSMA 2000:

'The fourth is where the behaviour consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which –

- (a) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments, or
- (b) secure the price of one or more such investments at an abnormal or artificial level.'

9.12(5) Employing fictitious devices or contrivances: "manipulating devices"

s.118(6) FSMA 2000:

'The fifth is where the behaviour consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.'

9.12(6) The dissemination of information giving a false or misleading impression: "dissemination"

s.118(7) FSMA 2000:

'The sixth is where the behaviour consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading.'

9.12(7) Failure to observe standard of behaviour reasonably expected of a person in that market: "misleading behaviour and distortion"

s.118(8) FSMA 2000:

'The seventh is where the behaviour (not falling within subsection (5), (6) or (7) [the three preceding types of behaviour]) –

- (a) is likely to give a regular user of the market a false or misleading impression as to the supply of, demand for or price or value of, qualifying investments, or
- (b) would be, or would be likely to be, regarded by a regular user of the market as behaviour that would distort, or would be likely to distort, the market in such an investment,

and the behaviour is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.'

9.13 Definitions

9.13.1 The meaning of the term "insider"

s.118B FSMA 2000:

'For the purposes of this Part an insider is any person who has inside information–

- (a) as a result of his membership of an administrative, management or supervisory body of an issuer of qualifying investments,
- (b) as a result of his holding in the capital of an issuer of qualifying investments,
- (c) as a result of having access to the information through the exercise of his employment, profession or duties,
- (d) as a result of his criminal activities, or
- (e) which he has obtained by other means and which he knows, or could reasonably be expected to know, is inside information.

9.13.2 The general definition of "inside information"

S.118C(2) FSMA 2000:

'(2) In relation to qualifying investments, or related investments, which are not commodity derivatives, inside information is information of a precise nature which

- (a) is not generally available,
- (b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and
- (c) would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related investments.'

9.13.3 Whether or not information is "precise"

s.118C(5) FSMA 2000

'(5) Information is precise if it –

- (a) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and
- (b) is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.'

9.13.4 Whether or not information will have a "significant effect"

s.118C(6) FSMA 2000:

'(6) Information would be likely to have a significant effect on the price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions.'

9.13.5 Generally availability of information

s.118C(8) FSMA 2000:

'(8) Information which can be obtained by research or analysis conducted by, or on behalf of, users of a market is to be regarded, for the purposes of this Part, as being generally available to them.'

Topic 6

The constitution, capacity and management of companies

General reading

G&D: 151-191

S&W: 101-168,

D&L: 243-260

MFR: 72-105

D&K: 46-74

1. TYPES OF COMPANY

1.1) Companies Act 2006, s.3 “Limited and unlimited companies”

(1) A company is a "limited company" if the liability of its members is limited by its constitution.

It may be limited by shares or limited by guarantee.

(2) If their liability is limited to the amount, if any, unpaid on the shares held by them, the company is "limited by shares".

(3) If their liability is limited to such amount as the members undertake to contribute to the assets of the company in the event of its being wound up, the company is "limited by guarantee".

(4) If there is no limit on the liability of its members, the company is an "unlimited company".

1.2) Companies Act 2006, s.4 “Private and public companies”

(1) A "private company" is any company that is not a public company.

(2) A "public company" is a company limited by shares or limited by guarantee and having a share capital--

(a) whose certificate of incorporation states that it is a public company, and

(b) in relation to which the requirements of this Act, or the former Companies Acts, as to registration or re-registration as a public company have been complied with on or after the relevant date. ...

(4) For the two major differences between private and public companies, see Part 20. [e.g. that private companies may not make offers of shares to the public, s.755]

1.3) Companies Act 2006, s.123 “Single member companies”

“(1) If a limited company is formed under this Act with only one member there shall be entered in the company's register of members, with the name and address of the sole member, a statement that the company has only one member.”

2. THE COMPANY'S ARTICLES OF ASSOCIATION; ITS CONSTITUTION

2.1) The effect of the company's constitution

Companies Act 2006, s.33(1):

"The provisions of a company's constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions."

Once the articles stood literally as a contract between the members: this notion still persists, thanks to s.33. The older cases limited the right to members of the company.

Wood v Odessa Waterworks Co (1889) 42 Ch D 636 [4.35] – *members could enforce constitutional obligation to pay dividend to shareholders contained in the articles.*

Eley v Positive Government Security Life Assurance Co Ltd (1876) 1 Ex D 88, CA [4.36] – *non-members may not rely on terms in the company's constitution*

Hickman v Romney Marsh Sheep-Breeders Association [1915] 1 Ch 881 [4.37] – *shareholder may not rely on articles in non-shareholder capacity, e.g. sheep owner seeking to enforce arbitration clause in articles.*

Rayfield v Hands [1960] Ch 1 [4.38] – *members may sue one another on this contract without joining the company to the litigation.*

2.2) The powers and rights of shareholders through Annual General Meeting

- Ever since *A-G v Davy* (1741) 2 Atk 212 (Lord Hardwicke LC) *it has been held that a majority of the members of a company (in that case a corporation created by Royal charter) may make corporate decisions. Legislation has adapted that power today.*
- Companies Act 2006, s.336(1):
"Every public company must hold a general meeting as its annual general meeting in each period of 6 months beginning with the day following its accounting reference date..."
- Companies Act 2006, s.437(1):
"The directors of a public company must lay before the company in general meeting copies of its annual accounts and reports."
- Private companies need not have such a meeting.
- Companies Act 2006, s.168: power to remove directors (see below)

2.3) Requirement for articles of association "prescribing regulations for the company"

Companies Act 2006, s.18(1)

"(1) A company must have articles of association prescribing regulations for the company.

(2) Unless it is a company to which model articles apply by virtue of section 20 (default application of model articles in case of limited company), it must register articles of association.

(3) Articles of association registered by a company must--

- (a) be contained in a single document, and
- (b) be divided into paragraphs numbered consecutively.”

2.4) Form of articles of association

2.4.1 Articles must be registered if not in form of model articles Companies Act 2006, s.18(2)

2.4.2 The model articles apply in default of any other articles of association Companies Act 2006, s.20

“(1) On the formation of a limited company--

- (a) if articles are not registered, or
- (b) if articles are registered, in so far as they do not exclude or modify the relevant model articles,

the relevant model articles (so far as applicable) form part of the company's articles in the same manner and to the same extent as if articles in the form of those articles had been duly registered.”

2.5) Alteration of the articles of association

Companies Act 2006, s.21(1):

“A company may amend its articles by special resolution.”

Allen v Gold Reefs Co. of West Africa (1900) 1 Ch 656, *per* Lord Lindley MR:

“[The power to alter articles must be] exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed.”

2.6) Entrenched provisions of the articles of association

Companies Act 2006, s.22(1):

“A company’s articles may contain provision [on formation, s.22(2)] ... to the effect that specified provisions of the articles may be amended or repealed only if conditions are met, or procedures are complied with, that are more restrictive than those applicable in the case of a special resolution.”

2.7) Supremacy of articles of association

2.7.1 Where articles of association limit the powers of the company in general meeting, then such powers may not be exceeded without alteration of articles

Imperial Hydropathic Hotel Co v Hampson (1882) 23 Ch D 1, CA

2.7.2 Where articles give complete power to management, then shareholders may not give directions to the board by ordinary resolution

Automatic Self-Cleansing Filter Syndicate v Cuninghame [1906] 2 Ch 34, CA

2.8) Meetings

2.8.1 Companies Act 2006, s.282 Ordinary resolutions

(1) An ordinary resolution of the members (or of a class of members) of a company means a resolution that is passed by a simple majority.

2.8.2 Companies Act 2006, s.283 Special resolutions

(1) A special resolution of the members (or of a class of members) of a company means a resolution passed by a majority of not less than 75%.

3. THE COMPANY'S OBJECTS

3.1 A company's objects

Companies Act 2006, s.31(1):

"Unless a company's articles specifically restrict the objects of the company, its objects are unrestricted."

3.2 Use of objects clauses

Some companies nevertheless have objects clauses, in which case the following issue arises as to what happens if the company purports to act in excess of those stated objects.

4. THE *ULTRA VIRES* DOCTRINE, AND BINDING THE COMPANY

4.1 The meaning of *ultra vires*

Used effectively as a defence by companies before 1989

4.2 The company's capacity

Companies Act 2006, s.39(1):

"The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution."

4.3 The role of the memorandum of association

Companies Act 2006, s.8 "Memorandum of association"

"(1) A memorandum of association is a memorandum stating that the subscribers--

(a) wish to form a company under this Act, and

(b) agree to become members of the company and, in the case of a company that is to have a share capital, to take at least one share each.

(2) The memorandum must be in the prescribed form and must be authenticated by each subscriber."

4.4 The registration of companies at the outset

4.4.1 Companies Act 2006, s.9 "Registration documents"

“(1) The memorandum of association must be delivered to the registrar together with an application for registration of the company, the documents required by this section and a statement of compliance.”

4.4.2 Companies Act 2006, s.16 “Effect of registration”

“(1) The registration of a company has the following effects as from the date of incorporation.

(2) The subscribers to the memorandum, together with such other persons as may from time to time become members of the company, are a body corporate by the name stated in the certificate of incorporation.

(3) That body corporate is capable of exercising all the functions of an incorporated company.”

4.5 Objects clauses are optional: CA 2006, s.31(1)

4.5.1 Companies Act 2006, s.31 “Statement of company's objects”

“(1) Unless a company's articles specifically restrict the objects of the company, its objects are unrestricted.

(2) Where a company amends its articles so as to add, remove or alter a statement of the company's objects--

(a) it must give notice to the registrar,

(b) on receipt of the notice, the registrar shall register it, and

(c) the amendment is not effective until entry of that notice on the register.

(3) Any such amendment does not affect any rights or obligations of the company or render defective any legal proceedings by or against it. ...”

4.5.2 Where a company still uses old style objects clauses: what constitutes “ultra vires”?

Ashbury Railway Carriage and Iron Co Ltd v. Riche (1875) LR 7 HL 653, 672, *per* Lord Cairns LC: *an act need not be ‘illegal’ to be ultra vires; merely beyond the powers of the company.*

4.5.3 Where a company still uses old style objects clauses: distinguishing between the objects of the company and mere powers

The “objects” are the fundamental purposes behind the company's existence, whereas “powers” are mere capabilities to do acts incidental to the company's objects.

Ashbury Railway Carriage and Iron Co Ltd v Riche (1875) LR 7 HL 653 (HL) [3.02] {65}: *under this old approach, only objects permitted in the memorandum could be carried on by the company. However, provisions in the articles of association can now be altered under statute.*

**Cotman v Brougham* [1981] AC 514 [3.03] {67} – equal-weight clauses ‘... a pernicious practice of registering memoranda of association ... confusing power with purpose and indicating every class of act which the corporation is to have power to do ...’, *per* Lord Wrenbury, 523. Nevertheless, such clauses found to be valid.

Bell Houses v City Wall Properties [1966] 2 QB 656 {69} – open powers clauses; that is, company's directors may decide on the company's objects from time to time

**Re Introductions Ltd.* [1970] Ch 199 [3.04] {70} – incidental powers or core objects? Company created to bring visitors to the Festival of Britain, later hired deckchairs, later still sought to borrow money from a bank to go into pig-breeding – held, the power to borrow was merely incidental to the main objects of the company and pig-breeding was *ultra vires* the company.

**Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1982] 3 All ER 52 [3.07/3.17] {73, 104} – an act is not *ultra vires* the company simply because the directors did it for an improper purpose, provided that it is within the memorandum of association. Here guarantees were extended to one of the directors personally otherwise than for the company's purposes.

5. THE POSITION OF DIRECTORS WITHIN THE COMPANY'S CONSTITUTION

5.1 Directors' duties

See Topic 8 below.

5.2 The power to elect and to remove directors

5.2.1 Companies Act 2006, s.168, "Resolution to remove director"

(1) A company may by ordinary resolution at a meeting remove a director before the expiration of his period of office, notwithstanding anything in any agreement between it and him.

(2) Special notice is required of a resolution to remove a director under this section or to appoint somebody instead of a director so removed at the meeting at which he is removed.

(3) A vacancy created by the removal of a director under this section, if not filled at the meeting at which he is removed, may be filled as a casual vacancy. ...

5.2.2 Companies Act 2006, s.169 "Director's right to protest against removal"

(1) On receipt of notice of an intended resolution to remove a director under section 168, the company must forthwith send a copy of the notice to the director concerned.

(2) The director (whether or not a member of the company) is entitled to be heard on the resolution at the meeting. ...

5.2.3 Special provisions

Bushell v Faith [1970] AC 1099 – special voting rights in articles of association may prevent director from being dismissed.

5.3 The powers of directors to bind the company

5.3.1 Protection of third parties from *ultra vires* doctrine

Companies Act 2006, s.40(1):

"In favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution."

5.3.2 Shareholders' right to seek injunction, etc.

Companies Act 2006, s.40(4):

"This section does not affect any right of a member of the company to bring obligation arising from a previous act of the company. But no such proceedings lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company."

5.3.3 Exception

Companies Act 2006, s.41:

A transaction between a director and "a person connected with any such director" is "voidable at the instance of the company".

6. Aspects of conducting business with a company

6.1 Contracts and the company

- The company as a nexus of contracts
- Contracts are created by a company either under its common seal or through the agency of a person "acting under its authority": Companies Act 2006, s.43.
- Pre-incorporation contracts (that is, contracts created before the company has actually come into existence) bind the person who purported to make the contract on behalf of the putative company: Companies Act 2006, s.51.

6.2 Membership of the company

The members of a company are "the subscribers of a company's memorandum" and must be entered as such on the register of members; anyone else validly entered on that register also becomes a member: Companies Act 2006, s.112.

6.3 Limited liability

Cheffins B., *Company Law*, pp.497-508 (short loan collection)

- Shifts risk from members to creditors; when company fails, creditors bear loss.
- Does this encourage shareholders to take risk at creditor's expense?
- [Do directors take risks with other people's money in any event?]
- [Are creditors protected entirely by contract and by taking security?]
- Maintains liquidity in equity (share) markets by reducing purchaser's risk
- [Separates ownership of the company from risk capital investment in equity markets]
- A matrix of limited risk across the economy – companies may not be able to recover from their debtors as well as not be able to pay their own creditors
- Furthermore, costs savings in not having to negotiate contracts to give you similar protection to limited liability

See also Freedman J and Finch V., 'Limited Liability Partnerships: have accountants sewn up the "Deep Pockets" debate?' [1997] *Journal of Business Law* 387-423

7. Agency

7.1 The organic theory

The organic theory suggests that the directors act as the *organs* of the company. The question is as to the possibility of attributing to the company the acts of such persons. To what extent does this defeat the *Saloman* principle and to what extent is that necessary in any event to achieve reality?

7.2 The directing mind and will of the company.

Lennard's Carrying Co. v Asiatic Petroleum [1915] AC 153 {34} – *the directing will and mind, "active spirit" of company knew that ship was unseaworthy.*

D.P.P. v Kent and Sussex [1944] KB 146 {36} - *intent to deceive: 'the officers are the company for this purpose'*

**Tesco Supermarkets v Natrass* [1972] AC 153

El Ajou v Dollar Land Holdings [1993] 3 All ER 717, Millett J

El Ajou v Dollar Land Holdings [1994] 2 All ER 685, CA (overruling Millett J)

Yukong Mines v. Rendsberg Investment (The Rialto) [1998] 1 WLR 294

Williams v. Natural Life [1998] 2 All ER 577 {42}

Crown Dilmun v Sutton [2004] 1 BCLC 468

(See Alastair Hudson, *Equity & Trusts* 2007, p.881-2, 887-889)

7.3 Vicarious liability in tort

Campbell v. Paddington Corporation [1911] 1 KB 869 {40} – a company may be liable in tort. *'The resolution [to erect a stand which would obstruct the view of the company's paying guests] was the resolution of the corporation, and the act which caused the damage, no matter for whose benefit it was done, was the act of the corporation and not of the individual councillors who resolved to do it.'*

Poulton v. London & South West Railway (1867) LR 2 QB 534 {41} – *a company cannot be liable for the act of an agent where that act could not lawfully have been done by the company; there cannot be implied authority in such circumstances.*

Williams v. Natural Life [1998] 2 All ER 577 {42} – *quaere: has there been an assumption of responsibility such that the agent becomes personally liable beyond the vicarious liability of the company, and vice-versa?*

8. Auditors

8.1 Reasonable skill and care required of an auditor

Re London and General Bank (No 2) [1895] 2 Ch 673; {152}

Caparo Industries plc v. Dickman [1990] 2 AC 605, [1990] 1 All ER 568; {155}

Al Saudi Banque v. Clark Pixley [1990] Ch 313

Barings plc v. Coopers & Lybrand [1997] 1 BCLC 427

BCCI (Overseas) Ltd v. Price Waterhouse [1998] BCC 617

8.2 Limits on auditor's liability

Re Kingston Cotton Mill Co (No 2) [1896] 2 Ch 279; {153}

8.3 Extent of investigations

Re Thomas Gerrard & Son Ltd [1968] Ch 455, [1967] 2 All ER 525; {154}

Topic 7

Shareholders' rights:

Majority Rule & Minority Protection

General reading

G&D: 681-707

S&W: 498-582

D&L: 172-238

MFR: 360-408

D&K: 250-276

1. MAJORITY RULE

1.1 The rule in *Foss v Harbottle*

**Foss v Harbottle* (1843) 2 Hare 461 [11.01] {233}

**Mozley v Alston* (1847) 1Ph 790 [11.02]{234}

**MacDougall v Gardiner* (1875) 1 Ch D 13, CA [11.04] {235}, *per* Mellish LJ:

‘In my opinion, if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes.’

**Edwards v Halliwell* [1950] 2 A11 ER 1064 {239}, *per* Jenkins LJ:

‘... the rule [in *Foss v Harbottle*] is not an inflexible rule and it will be relaxed where necessary in the interests of justice.’

1.2 Exceptions to the rule in *Foss v Harbottle*

1.2.1 Fraud on the minority

**Prudential Assurance Co v Newman Industries (No.2)* [1982] 1 All ER 354 {247}

Estmanco v GLC [1982] 1All ER 437 {248}

1.2.2 When action on an exception may be barred

Smith v Croft (No.2) [1988] Ch 114 {249}

- C.Baxter "The true spirit of *Foss v Harbottle*" [1987] 38 NILQ 6

2. MINORITY PROTECTION

2.1 “Unfairly prejudicial conduct” under statute

Companies Act 2006, ss.994-996

In essence, a right to petition the court in relation to conduct which is, or which would be, unfairly prejudicial to the interests of members generally or of some part of its members.

Part 30 **Protection of Members Against Unfair Prejudice** *Main provisions*

994 Petition by company member

(1) A member of a company may apply to the court by petition for an order under this Part on the ground--

(a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or

(b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

[(1A) For the purposes of subsection (1)(a), a removal of the company's auditor from office--

(a) on grounds of divergence of opinions on accounting treatments or audit procedures, or

(b) on any other improper grounds,

shall be treated as being unfairly prejudicial to the interests of some part of the company's members.]

(2) The provisions of this Part apply to a person who is not a member of a company but to whom shares in the company have been transferred or transmitted by operation of law as they apply to a member of a company.

(3) In this section, and so far as applicable for the purposes of this section in the other provisions of this Part, "company" means--

(a) a company within the meaning of this Act, or

(b) a company that is not such a company but is a statutory water company within the meaning of the Statutory Water Companies Act 1991 (c 58).

995 Petition by Secretary of State

(1) This section applies to a company in respect of which--

- (a) the Secretary of State has received a report under section 437 of the Companies Act 1985 (c 6) (inspector's report);
- (b) the Secretary of State has exercised his powers under section 447 or 448 of that Act (powers to require documents and information or to enter and search premises);
- (c) the Secretary of State or the Financial Services Authority has exercised his or its powers under Part 11 of the Financial Services and Markets Act 2000 (c 8) (information gathering and investigations); or
- (d) the Secretary of State has received a report from an investigator appointed by him or the Financial Services Authority under that Part.

(2) If it appears to the Secretary of State that in the case of such a company--

- (a) the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members, or
- (b) an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial,

he may apply to the court by petition for an order under this Part.

(3) The Secretary of State may do this in addition to, or instead of, presenting a petition for the winding up of the company.

(4) In this section, and so far as applicable for the purposes of this section in the other provisions of this Part, "company" means any body corporate that is liable to be wound up under the Insolvency Act 1986 (c 45) or the Insolvency (Northern Ireland) Order 1989 (SI 1989/2405 (NI 19)).

996 Powers of the court under this Part

(1) If the court is satisfied that a petition under this Part is well founded, it may make such order as it thinks fit for giving relief in respect of the matters complained of.

(2) Without prejudice to the generality of subsection (1), the court's order may--

- (a) regulate the conduct of the company's affairs in the future;
- (b) require the company--
 - (i) to refrain from doing or continuing an act complained of, or
 - (ii) to do an act that the petitioner has complained it has omitted to do;
- (c) authorise civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the court may direct;
- (d) require the company not to make any, or any specified, alterations in its articles without the leave of the court;

(e) provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly.

2.2 Cases decided on the basis of the now-repealed s.459, CA 1985

Scottish CWS v Meyer [1959] AC 324 {250}
Re Harmer [1959] 1 WLR 62 {251}
**Ebrahimi v Westbourne Galleries* [1973] AC 360 {288}
Re. R.A. Noble and Sons [1983] BCLC 273
In re Carrington Viyella [1983] 1 BCC 98,951
Re Whyte Petitioner [1984] SLT 330
Re London School of Electronics [1986] Ch 211 {252}
Re Saul D Harrison & Sons plc [1995] 1 BCLC 14
**O'Neill v Phillips* [1999] 2 All ER 961, [1999] 1 WLR 1092, HL

- D.D. Prentice, "The theory of the firm: Minority shareholder oppression : section 459-461 of the Companies Act 1985." (1988) 8 O.J.L.S. 55.

2.3 Winding up order under s.122, Insolvency Act 1986

Ebrahimi v Westbourne Galleries [1973] AC 360 {288}

2.4 Minority protection through the general meeting

See above.

3. Derivative actions

3.1 Derivative actions under statute

Companies Act 2006, s.260 "Derivative claims"

"(1) This Chapter applies to proceedings in England and Wales or Northern Ireland by a member of a company—

- (a) in respect of a cause of action vested in the company, and
- (b) seeking relief on behalf of the company.

This is referred to in this Chapter as a "derivative claim".

(2) A derivative claim may only be brought—

- (a) under this Chapter, or
- (b) in pursuance of an order of the court in proceedings under section 994 (proceedings for protection of members against unfair prejudice).

(3) A derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.

The cause of action may be against the director or another person (or both)."

Companies Act 2006, s.261 Application for permission to continue derivative claim

(1) A member of a company who brings a derivative claim under this Chapter must apply to the court for permission (in Northern Ireland, leave) to continue it.

(2) If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a prima facie case for giving permission (or leave), the court—

- (a) must dismiss the application, and
- (b) may make any consequential order it considers appropriate.

3.2 Case law

**Eley v Positive Government* (1876) 1 Ex D 88 {46}

**Hickman v Kent and Romney Marsh* [1915] 1Ch 881 {47}

Allen v Gold Reefs [1900] 1 Ch 656 {58}

Wallersteiner v Moir (No 2) [1975] 2 QB 273

4. Procedural democracy: a summary of the foregoing.

4.1 The requirement of proper notices

**Tiessen v Henderson* [1899] 1Ch 861 {80}

Kaye v Croydon Tramways [1989] 1 Ch 358

Bailee v Oriental Telephone [1915] 1 Ch 503

4.2 Protection of director

**Bushell v Faith* [1970] AC 1099 {116}

4.3 Negligence as a fraud on the minority

Prudential Assurance Co Ltd v Newman No2 [1982] 2 WLR 31; {247}.

4.4 Limitation on directors' liability e.g. during takeovers

Hogg v. Cramphorn [1967] Ch 254 {137}

Gething v Kilner [1972] 1 WLR 337

4.5 Appointees of the Secretary of State

Pergamon Press v Maxwell [1970] 1 WLR 1167 {269} – role of inspectors

4.6 Powers in articles to be exercised bona fide for the benefit of the company

**Allen v Gold Reefs* [1900] 1 Ch. 656 {58}

**Greenhalgh v Arderne Cinemas* [1951] Ch. 286 {63}

4.7 Winding up must be “just and equitable”

**Ebrahimi v Westbourne Gal.* [1972] 2 All ER 492 {288}

4.8 Setting aside of exercise of power if oppressive of a minority

**Clemens v Clemens Bros* [1976] 2 All ER 268 {88}

**Estmanco v GLC* [1982] 1 All ER 437 {248}

Topic 8

Directors' Duties

It is important to know how the common law and equitable duties of directors function because the statutory duties are based on them to a large extent.

General reading

G&D: 475-605
S&W: 273-370
D&L: 298-354
MFR: 455-505
D&K: 185-249

- Sealy, "Reforming the Law on Directors' duties" (1991) 12 Company Lawyer 175.

TO WHOM IS THE DUTY OWED?

Companies Act 2006, s.170(1): *duties are owed to the company*

A. DIRECTORS' DUTIES AT COMMON LAW

1. Duty of Care and Skill.

1.1 General duty of care

**Re City Equitable Fire Insurance Co* [1925] Ch 407 {139}
Lagunas Nitrate v Lagunas Syndicate [1899] 2 Ch 392
Re Brazilian Rubber Plantations [1911] 1 Ch 425

1.2 Duty to act only for a proper purpose

**Punt v. Symons & Co Ltd* [1903] 2 Ch 506 {136}
**Hogg v Cramphorn* [1967] Ch 254 {137}

1.3 Limits on liability

**Multinational Gas v. Multinational Gas, etc., Services Ltd* [1983] 2 All ER 563 {141}
**D'Jan of London* [1994] 1 BCLC 561 {140}
Norman v Theodore Goddard [1991] BCLC 1028
Neptune Vehicle Washing Equipment [1996] Ch 274

2. Duty of good faith.

Re Smith and Fawcett [1942] Ch 304, 306: *directors must exercise their powers 'bona fide in what they consider – not what a court may consider – is in the best interests of the company, and not for any collateral purpose', per Lord Greene MR.*

Dorchester Finance v. Stebbing [1989] BCLC 498, 501: *'A director must exercise any power vested in him as such, honestly, in good faith and in the interests of the company ...', per Foster J.*

N.B. cases dealing with bona fides in the context of changes to the articles of association are relevant here.

3. Collateral purpose.

**Re Smith and Fawcett* [1942] Ch 304 {220}, as above.

Hogg v Cramphorn [1967] Ch 254 {137}

**Regal Hastings v Gulliver* [1942] 1 All ER 378, see below.

**IDC v Cooley* [1972] 1 WLR 443, see below.

4. Limitation on directors during takeovers

Hogg v. Cramphorn [1967] Ch 254 {137}

Gething v Kilner [1972] 1 WLR 337

B. DIRECTORS' DUTIES IN EQUITY

1. Fiduciary (director) making unauthorised profits

Specific reading

Alastair Hudson, *Equity & Trusts*, section 12.5

1.1 The basis of liability: avoidance of conflicts of interest

**Keech v. Sandford* (1726) 2 Eq Cas Abr 741, per Lord King LC:

"This may seem hard, that the trustee is the only person of all mankind who might not have [the trust property]: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease ..."

**Bray v Ford* [1896] AC 44, [1895-99] All ER Rep 1009, 1011, per Lord Herschell:

"It is an inflexible rule of the court of equity that a person in a fiduciary position ... is not, unless otherwise expressly provided [in the terms of the that person's fiduciary duties], entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as had been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to law down this positive rule."

See, e.g. Parker LJ in *Bhullar v Bhullar* [2003] 2 BCLC 241, para [17] referring to the “ethic” in these cases.

1.2 The leading cases

**Boardman v. Phipps* [1967] 2 AC 46

***Regal v Gulliver* [1942] 1 All ER 378

1.3 The defence of authorisation; who may authorise?

**Queensland Mines v. Hudson* (1978) 18 ALR 1; (1979) 42 MLR 771

**Industrial Development Consultants v Cooley* [1972] 2 All ER 162

Equiticorp Industries Group Ltd v The Crown [1998] 2 NZLR 485 (only shareholders may authorise)

2. The corporate opportunity doctrine

Specific Reading:-

Alastair Hudson, *Equity & Trusts*, para 12.5

Lowry and Edmunds, ‘The Corporate Opportunity Doctrine: The Shifting Boundaries of the Duty and its Remedies’ [1998] MLR 515

2.1 Authorisation predicated on appropriate disclosure

Regal v Gulliver [1942] 1 All ER 378 (directors may not authorise other directors)

**Queensland Mines v. Hudson* (1978) 18 ALR 1; (1979) 42 MLR 771

Framlington Group plc v. Anderson [1995] BCC 611 – extension of this flexible approach

Cf. *Miller v. Miller Waste Co* 301 Minn 207 (Minnesota Court of Appeal) – meaning of corporate opportunity

2.2 Where there was no maturing business opportunity

Island Export Finance Ltd v Umunna [1986] BCC 460

Balston v Headline Filters Ltd [1990] FSR 385

In Plus Group Ltd v Pyke [2002] 2 BCLC 201

Ultraframe v Fielding [2005] EWHC 1638 (Ch)

2.3 Where there is an opportunity and insufficient disclosure is made

**Industrial Development Consultants v Cooley* [1972] 2 All ER 162

Crown Dilmun v Sutton [2004] 1 BCLC 468

2.4 Equitable compensation

Boardman v. Phipps [1967] 2 AC 46

Guinness v. Saunders [1988] 2 All ER 940

3. Conflicts of Interest

3.1 Director permitting conflict between personal interest and fiduciary responsibility

**Regal v. Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134n. {129}

**Boardman v Phipps* [1967] 2 AC 46.

IDC v. Cooley [1972] 1 WLR 443

3.2 Where an individual is a director of more than one company, possibly in competition with each other:

London & Marshonaland Ltd v. New Marshonaland Ltd [1891] WN 165 – no restriction on being director in two companies; director not required to give whole time to one company

Cf. *Re Cardiff Savings Bank* [1892] 2 CH 100, where Marquis of Bute became President and a director of the bank when only six months old; no requirement that director expected even to attend the company.

3.3 Nominee directors on the board as representative of another person

Boulting v. ACTT [1963] 2 QB 606, 626, per Lord Denning: ‘There is nothing wrong with it ... But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful.’

**Selangor United Rubber Co Ltd v. Cradock (No.3)* [1968] 1 WLR 1555, [1968] 2 All ER 1073 – imposition of constructive trust for misapplication of funds by nominee directors.

Kuwait Bank v. National Mutual Life [1990] 3 All E.R. 404

4. Fiduciary liability of directors: abuse of company property

**Boardman v Phipps* [1967] 2 AC 46 – use of confidential information.

Attorney-General for Hong Kong v. Reid [1994] 1 AC 324

Cf. *Westdeutsche Landesbank v. Islington LBC* [1996] AC 669

5. Profits from bribes

Specific Reading:

Alastair Hudson, *Equity & Trusts*, para 12.4.1

5.1 The leading case: constructive trust over property acquired with the bribes; plus personal liability if value of property falls

***Att-Gen for Hong Kong v. Reid* [1994] 1 All ER 1, 4-5; [1994] AC 324, 330; [1993] 3 WLR, per Lord Templeman:-

“A bribe is a gift accepted by a fiduciary as an inducement to him to betray his trust. A secret benefit, which may or may not constitute a bribe is a benefit which the fiduciary derives from trust property or obtains from knowledge which he acquires in the course of acting as a fiduciary. A fiduciary is not always accountable for a secret benefit but he is undoubtedly accountable for a secret benefit which consists of a bribe. In addition a person who provides the bribe and the fiduciary who accepts the bribe may each be guilty of a criminal offence. In the present case the first respondent was clearly guilty of a criminal offence. / Bribery is an evil practice which threatens the foundations of any civilised society. In particular bribery of policemen and prosecutors brings the administration of justice into disrepute. Where bribes are accepted by a trustees, servant, agent or other fiduciary, loss and damage are caused to the beneficiaries, master or principal whose interests have been betrayed. The amount of loss or damage resulting from the acceptance of a bribe may or may not be quantifiable. In the present case the amount of harm caused to the administration of justice in Hong Kong by the first respondent in return for bribes cannot be quantified.”

5.2 Who will be a fiduciary in these circumstances?

Reading v Att-Gen [1951] 1 All ER 617 (Army officer)

Brinks v Abu-Saleh (No 3) [1996] CLC 133 (security guard)

Brown v. Bennett [1999] B.C.C. 525

Petrotrade Inc v Smith [2000] 1 Lloyd's Rep 486 (no fiduciary office, no constructive trust)

5.3 Applications of the Reid principle

Mercedes Benz AG v Leiduck [1996] AC 284, 300 (in relation to interim relief)

Ocular Sciences Ltd v Aspect Vision Care Ltd [1997] RPC 289

Fyffes Group Ltd v Templeman [2000] 2 Lloyd's Rep 643 (where this case was obiter)

Dubai Aluminium Company Ltd v Alawi [2002] EWHC 2051

**Tesco Stores v Pook* [2003] EWHC 823

***Daraydan Holdings Ltd v Solland International* [2004] EWHC 622, [2004] 3 WLR 1106, [2005] Ch 1

5.4 Alternative approaches not following Reid

nb: *Lister v. Stubbs* (1890) 45 ChD 1 [now over-ruled by *Reid*]

Halifax Building Society v Thomas [1996] Ch 217, 229 (applying *Lister v Stubbs*)

A-G v Blake [1997] Ch 84, 96, per Sir Richard Scott V-C

6. Contracts with the company

Aberdeen Railway Co. v. Blaikie (1854) 1 Macq 461, director obliged to make disclosure to the company in general meeting.

7. Relief under statute

CA 2006, s.1157 – relief where the director 'ought fairly to be excused'
Dorchester Finance v. Stebbing [1989] BCLC 498

C. DIRECTORS' DUTIES UNDER THE COMPANIES ACT 2006

The Companies Act 2006 sets out a range of important directors' duties, as follows. We begin with a provision which explains the extent of these duties, and their relation with the old case law.

- Worthington, 'Reforming Directors' Duties' [2001] *MLR* 439

1. The Scope of the Statutory Duties

Chapter 2 General Duties of Directors

Introductory

170 Scope and nature of general duties

(1) The general duties specified in sections 171 to 177 are owed by a director of a company to the company.

(2) A person who ceases to be a director continues to be subject–

(a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and

(b) to the duty in section 176 (duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director.

To that extent those duties apply to a former director as to a director, subject to any necessary adaptations.

(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

(5) The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.

2. The Duty to Act Within Powers

The general duties

171 Duty to act within powers

A director of a company must–

(a) act in accordance with the company’s constitution, and

(b) only exercise powers for the purposes for which they are conferred.

3. The Duty to Promote the Success of the Company

172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to–

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

I the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

4. The Duty to Exercise Independent Judgment

173 Duty to exercise independent judgment

(1) A director of a company must exercise independent judgment.

(2) This duty is not infringed by his acting—

(a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or

(b) in a way authorised by the company's constitution.

5. The Duty to Exercise Reasonable Care, Skill and Diligence

174 Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

(b) the general knowledge, skill and experience that the director has.

6. The Duty to Avoid Conflicts of Interest

175 Duty to avoid conflicts of interest

(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.

(4) This duty is not infringed—

(a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or

(b) if the matter has been authorised by the directors.

(5) Authorisation may be given by the directors—

(a) where the company is a private company and nothing in the company's constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or

(b) where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.

(6) The authorisation is effective only if—

(a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and

(b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

(7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

7. The Duty Not to Accept Benefits

176 Duty not to accept benefits from third parties

(1) A director of a company must not accept a benefit from a third party conferred by reason of—

- (a) his being a director, or
 - (b) his doing (or not doing) anything as director.
- (2) A “third party” means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.
- (3) Benefits received by a director from a person by whom his services (as a director or otherwise) are provided to the company are not regarded as conferred by a third party.
- (4) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.
- (5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

8. The Duty to Declare Interests in Transactions

177 Duty to declare interest in proposed transaction or arrangement

- (1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.
- (2) The declaration may (but need not) be made—
- (a) at a meeting of the directors, or
 - (b) by notice to the directors in accordance with—
 - (i) section 184 (notice in writing), or
 - (ii) section 185 (general notice).
- (3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.
- (4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.
- (5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question.
- For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.
- (6) A director need not declare an interest—

(a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;

(b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or

If, or to the extent that, it concerns terms of his service contract that have been or are to be considered—

(i) by a meeting of the directors, or

(ii) by a committee of the directors appointed for the purpose under the company's constitution.

9. The effect of a breach of duty

Supplementary provisions

178 Civil consequences of breach of general duties

(1) The consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied.

(2) The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.

179 Cases within more than one of the general duties

Except as otherwise provided, more than one of the general duties may apply in any given case.

D. DIRECTORS' DUTIES TO PEOPLE OTHER THAN THE COMPANY

1. Duty to the shareholders?

**Percival v Wright* [1902] 2 Ch D 421 *no fiduciary duty to shareholders individually*{121}

**Heron International v Lord Grade* [1983] BCLC 244, *takeovers* {123}

Re A Company [1986] BCLC 383 {264}

Dawson International v Coats Patons PLC [1988] SLT 854 {265}

Coleman v Myers [1977] 2 NZLR 225 {p.264}

Allen v Hyatt [1914] TLR 30 {122}

2. Duty to creditors?

- Editorial, "Company Directors and insolvent companies: A new reality?" (1991) 12 Company Lawyer 82
- D.D. Prentice, "Creditor's Interests and Director's duties" [1990] OJLS 265.
- C.Riley, "Director's duties and the interests of creditors" 10 Company Lawyer 87.

- H. Rajak, “Company directors-the end of an era 1&2” (1989 NLJ 1374-5 and 1458-1460).

Multinational Gas v. Multinational Gas, etc., Services Ltd [1983] 2 All ER 563{141}

**Winkworth v Edward Baron* [1987] 1 All ER 114

**Brady v Brady* [1988] 2 All ER 617, 632 {174}.

Re Welfab Engineers Ltd [1990] BCC 600

West Mercia v Dodds [1988] BCLC 212 – ‘*In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company’s assets. It is in a practical sense their assets and not the shareholders’ assets ...*’, quoting *Kinsela v. Russell Kinsela Pty Ltd* (1986) 4 ACLC 215, 223, per Street CJ

Topic 9

Corporate Governance 1: Theoretical perspectives

General reading

D&L: 356-375

C Mallin, *Corporate Governance* (2e, OUP, 2007)

1. General theoretical questions as to corporate governance

Some theoretical questions among corporate governance theorists.

Specific reading

- Berle and Means, *The Modern Corporation and Private Property* (1932, NY: Macmillan)
- Coase, 'The Nature of the Firm', (1937) IV *Economica* 13-16
- <http://leadership.wharton.upenn.edu/governance>

1.1 Agency theory

1.2 Separation of ownership and control

1.3 Transaction economics

1.4 Stakeholder theory

1.5 Asset management

2. The impetus for corporate governance reform

2.1 Corporate scandals

HSL, Chapter 4

- The Maxwell / Mirror Group pensions scandal
- Enron
 - B. McLean and P. Elkind, *The Smartest Guys in the Room* (updated edition, Penguin, 2004). Also made into a film / DVD.
 - L. Fox, *Enron: the rise and fall* (John Wiley & Sons, 2003).
- World Com
 - L. Jeter, *Disconnected – deceit and betrayal at WorldCom* (John Wiley & Sons, 2003).

2.2 The UK developments

See the next topic: Corporate Governance 2.

2.3 Marketing companies

FSA Listing Rules – good management is good business

2.4 Excessive corporate pay

3. A selection of possible reading

- Parkinson J.E. *Corporate Power and Responsibility*
Dignam, A. (2000) 'Exporting Corporate Governance: UK Regulatory Systems in a Global Economy' *Company Lawyer*, Vol.21, No. 3, March, pp.70-76.
- Midgley K. "How much control do shareholders exercise?" (1974) 114 *Lloyds Bank Review* 24.
- Prentice D. "Some aspects of the corporate governance debate." In *Contemporary issues in corporate governance*, D. Prentice and P. Holland (ed).
- Scott J. "Corporate control and corporate rule : Britain in an international perspective" (1990) *British Journal of Sociology* 351-373
- Pickering M.A. "Shareholder voting rights and company control" [1965] 81 *LQR* 248
- Xuereb P.G. "The limitation on the exercise of majority power." (1985) 6 *Company Lawyer* 199.
- Mayas A. "Power of the court to convene a meeting of shareholders" (1991) 12 *Company Lawyer* 23.
- *Ireland P. "Corporate Governance, Stakeholding and the Company" [1996] *Journal of Law and Society* 23(3) 287.

On international developments see Dignam, A. & Galanis, M. (1999) 'Governing The World: The Development Of The OECD's Corporate Governance Principles.' *European Business Law Review*, Vol 10 Sept/Oct, pp.396-407 ISSN: 0959-6941.

2. Institutional Investors.

- Coffee J.C. "Liquidity versus control: institutional investors as corporate monitor" (1991) 91 *Columbia Law Review* 1277-1368
- Davies P.L. "Institutional Investors in the U.K." in D. Prentice and P. Holland, as above.
- Rock E.B. "The logic and (uncertain significance of institutional shareholder activism." (1991) *Georgetown Law Journal* pp445-506

3. The EU Company Law Harmonisation Programme

3.1 General perspectives

- Du Plessis & Dine, "The fate of the draft fifth Directive on company law: accommodation instead of harmonisation." [1997] *Journal of Business Law*, 23-47
- Lord Wedderburn, "Companies and Employees: Common Law or Social Dimension?" [1993] 109 LQR 221.

3.2 European perspectives

- Simon Deakin. "Two types of regulatory competition: competitive federalism versus reflexive harmonisation: a law and economics perspective on *Centros*." *Cambridge Yearbook of European Legal Studies* 1999, 2, 231-260
- Helen Xanthaki. "Centros: is this really the end for the theory of the siege reel?" *Comp. Law*. 2001, 22(1), 2-8
- Pedro Cabral and Patricia Cunha, "'Presumed innocent': companies and the exercise of the right of establishment under Community law." *E.L. Rev.* 2000, 25(2), 157-164
- Eva Micheler. "The impact of the *Centros* case on Europe's company laws." *Comp. Law*. 2000, 21(6), 179-182.

3.3 Comparative perspectives

- Simon Deakin and Alan Hughes, 'Comparative corporate governance: an interdisciplinary agenda.' *J. Law & Soc.* 1997, 24(1), 1-9.
- Scott J., "Corporate control and corporate rule : Britain in an international perspective" (1990) *British Journal of Sociology* 351-373
- W.Bratton, J.McCahery, S.Picciotto and C.Scott (eds.), *International Regulatory Competition and Coordination*, (Oxford, Clarendon Press, 1996).

Topic 10

Corporate Governance 2: UK initiatives

General reading

D&L: 377-396

HSL: 188-195 (on Combined Code)

D Mallin, *Corporate Governance* (2e, OUP, 2007)

1. The Cadbury Report.

- Cadbury A, "Highlights of the proposals of the committee on Financial aspects of Corporate Governance" in D. Prentice (as above)
- Finch V., "Board performance and Cadbury on Corporate Governance (1992) JBL 581.
- Riley C.A., "Controlling corporate management: U.K. and U.S. initiatives" (1994) Legal Studies 244.
- Belcher, A., "Compliance with the Cadbury Code and the reporting of corporate governance" (1996) *The Company Lawyer* 17(1) 11-17
- Sheikh S & Rees W., *Corporate Governance and Corporate Control*.

2. The Greenbury Report

- Company law: directors. [I.C.C.L.R. 1996, 7\(3\), C53-54](#)
- Non-executive directors: are they superfluous? [Comp. Law. 1996, 17\(6\), 162-165](#)
- (Editorial) Executive remuneration after Greenbury. [I.C.C.L.R. 1995, 6\(9\), 301-303](#)
- The Greenbury Report: fond hope, faint promise? [J.I.B.L. 1995, 10\(11\), 471-477](#)
- Greenbury: benefit or burden. [I.B.F.L. 1995, 14\(6\), 58-63](#)

3. The Hampel Committee Report

- Dignam, A., (1998) 'A Principled Approach to self-regulation? The Report of the Hampel Committee on Corporate Governance' *Company Lawyer*, Vol. 19, No.5, May, pp. 140-154 ISSN: 0144-1027.
- Company law Corporate governance: Cadbury, Greenbury and Hampel – a review. *J.F.R. & C.* 1999, 7(1), 57-67
- Company law Corporate governance in the UK. [I.C.C.L.R. 1998, 9\(10\), 275-280](#)
- The Hampel Committee Report: a transatlantic critique. [Comp. Law. 1998, 19\(4\), 110-115](#)

4. The Turnbull Guidelines

- Financial services Senior management responsibilities. [J.I.B.L. 2000, 15\(3\), 66-70](#)
- Legal profession The management of risk. *Legal Week* 2001, 3(15), 14,16
- Company law Turnbull – placing 'risk' within the board? *Bus. L.R.* 2000, 21(3), 57-61
- Company law Turnbull: an opportunity for lawyers or just another box for ticking? [I.C.C.L.R. 2000, 11\(7\), 248-252](#)

- Company law (Editorial) Turnbull Report: a help or hindrance? [I.C.C.L.R. 1999, 10\(12\), 335-338](#)

5. The Combined Code on Corporate Governance

[Materials to be provided in hard copy.]

Topic 11: Theoretical Perspectives: materials to follow

End of Course