

RECONSIDERING THE RULE ON SHAREHOLDERS' EXERCISE OF VOTING POWERS

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I INTRODUCTION

Shareholders wield significant and substantial powers over the company¹, the exercise of which may have and have had profound and adverse consequences for the enterprise and consequently, the economy and society. For example, the Kay Review observed that, even before the 2008 global financial crisis, GEC, Britain's top electrical company in the late 1960s, pursued an aggressive programme of acquisitions and disposals in order to increase share price in the short-term, which ultimately led to the company being wound up.² More recent examples including the Royal Bank of Scotland (RBS) and HBOS sagas were given in the report to illustrate how a majority of

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¹ These powers include but are not limited to: dismissing directors at any time without cause by majority vote (s 168 of the Companies Act 2006 (CA)); unilaterally altering the articles by supermajority vote (s 21 CA); dictate to or overrule the directors by altering the articles (*Bamford v Bamford* [1970] Ch 212 at 220; *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34 at 38 (CA)); voluntarily winding up a company by special resolution (s 84 of the Insolvency Act 1986); compelling directors to call a general meeting at any time at the company's expenses by members holding 5% of the voting capital or voting rights (s 303 CA); directing the directors to take or refrain from taking specified action by special resolution (Article 4(1) of the Model Articles); ratifying breach of duties by directors (s 239 CA); approving mergers (s 895-899 CA); approving substantial property (s 190 CA) and loan (s 197-214 CA) transactions between the company and directors; approving directors' remuneration policy (s 439A); and approving transactions that exceed 25% of the value of a listed company (UK Listing Authority Listing Rule 10.1.1).

² J. Kay, *The Kay Review of UK Equity Markets and Long-term Decision-Making, Final Report* (Department of Business, Innovation and Skills, 2012) at [1.16].

shareholders had acted against the interests of the companies.³ As far back as 1999 the Company Law Review Steering Group (the CLRSG) had noted that powerful institutional shareholders placed significant pressure on directors and managers to pursue short-term gains.⁴ The sense was that directors were all too aware that failing to heed the wishes of such shareholders could result in dismissal without cause.⁵ The CLRSG distinguished the interests of the company and those of shareholders as it highlighted the “undue focus [by directors] on the short term and the narrow interests of members at the expense of what is in a broader and a longer term sense the best interests of the enterprise.”⁶ Indeed, a learned judge has noted that “the central problem” is “why should we expect corporations to chart a sound long-term course of economic growth, if the so-called investors who determine the fate of their managers do not themselves act or think with the long term in mind?”⁷

Against this background, there have been proposals and reforms to align shareholders’ and managerial interests with the long-term interests of the company such as reforming managerial compensation; incentivising shareholders to act in the long-term;⁸ encouraging shareholders to

³ Ibid at [1.28], noted that “Many of the responses to our call for evidence took the view that the central problem of relationships between companies and their shareholders was that there was insufficient accountability of companies to shareholders and that shareholders were insufficiently engaged. *The corporate histories we outline above suggest a different view. Many of the bad decisions described were supported or even encouraged by a majority of the company’s shareholders (emphasis added).*”

⁴ Company Law Review, *Modern Company Law for a Competitive Economy: The Strategic Framework* (The Stationery Office, 1999) at [5.1.10].

⁵ The Companies Act 1985 s. 303; now the Companies Act 2006 s. 168 (by ordinary resolution to remove a director).

⁶ n 4 at [5.1.17].

⁷ L.E. Strine Jr (Chief Justice of Delaware Supreme Court, writing extrajudicially), “One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?” (2010) 66 *Business Lawyer* 1-2.

⁸ Incentives include giving enhanced voting rights, more dividends, cash payment, or tax reduction to shareholders who hold their shares for a certain length of time. See, for example, T. Belinfanti, “Shareholder Cultivation and New Governance” (2014) 38 *Delaware Journal of Corporate Law* 789, at 845 and D. Arsalidou, “Shareholders and Corporate Scrutiny: The Role of the UK Stewardship Code” (2012) 9 *European Company and Financial Law Review* 342, at 376-77.

engage with the company;⁹ and limiting shareholder pressure on directors (by eliminating quarterly earnings reports). However, these measures do not address a deeper, underlying doctrinal problem, namely, the longstanding, fundamental rule in English common law that shareholders can generally vote as they please, even if their intent, or the effect of which, is entirely antithetical to the company's interests.¹⁰ Granted, this rule is subject to limitations: shareholders cannot exercise their voting powers to either misappropriate corporate property¹¹ or to commit fraud on the minority.¹² Further, restrictions are imposed on them when altering the articles¹³, varying class rights¹⁴ and ratifying transactions.¹⁵ However, these narrow and at times ill-defined restrictions are the exceptions to the rule.

This article seeks to challenge this common law rule. Part II contends that the first rationale for the rule – namely, votes are property rights – is erroneous. Part III argues that the second rationale – that shareholders are allowed to contractually bind themselves to vote in whatever way they wish – is unpersuasive. It then advances three justifications as to why the rule is questionable. The first reason, examined in Part IV, is that the general meeting is arguably an agent of the company and thus, it owes fiduciary duties to the company. Part V analyses the second reason:

⁹ See for example, The UK Stewardship Code (Financial Reporting Council, 2012).

¹⁰ See, for example, *Pender v Lushington* (1877) 6 Ch. D. 70 at 75 where Jessel M.R. observed: "...I have always considered the law to be that those who have the rights of property are entitled to exercise them, whatever their motives may be for such exercise ... a man may be actuated in giving his vote by interests entirely adverse to the interests of the company as a whole"; and *North-West Transportation Co Ltd v Beatty* (1887) 12 App Cas 589 PC at 593 where Sir Richard Baggallay noted "every shareholder has a perfect right to vote ... although he may have a personal interest in the subject-matter opposed to, or different from, the general or particular interests of the company". *Burland v Earle* [1902] A.C. 83 at 94; *Goodfellow v Nelson Line* [1912] 2 Ch. 324; and *Re Astec (BSR) Plc* [1999] B.C.C. 59 at 83.

¹¹ *Cook v Deeks* [1916] 1 A.C. 554; *Menier v Hooper's Telegraph Works* (1874) 9 Ch. App. 350.

¹² *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] 1 All ER 354.

¹³ *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch. 656.

¹⁴ *British America Nickel Corp Ltd v O'Brien* [1927] A.C. 369.

¹⁵ *Boscheok Pty Ltd v Fuke* [1906] 1 Ch 408. For unratifiable wrongs, see *Franbar Holdings Ltd v Patel* [2008] EWHC 1534; *Cook v Deeks* [1916] 1 A.C. 554.

because, save for certain exceptional situations, shareholders in a limited liability company are free from personal liability for any adverse consequences following the exercise of their voting powers (insofar as they are not liable to pay damages or make restitution to other shareholders or third parties), the general rule ought to be that their exercise of voting powers is restricted, rather than this being an exception. Part VI advances the third reason: because exercises of contractual discretionary powers are subject to the implied requirement of *Wednesbury* unreasonableness, the exercise of voting powers, which is a power conferred by the articles of association, the so-called statutory contract between the company and shareholders, should not be exempted from this requirement. Accordingly, the rule ought to be that shareholders must exercise their voting powers responsibly. Part VII draws together the central elements of our analysis and concludes that if shareholders are to be effectively controlled in the exercise of their voting powers, this can be best achieved through the imposition of fiduciary duties together with the importation of the *Wednesbury* reasonableness requirement.

II SHAREHOLDER VOTES ARE PROPERTY RIGHTS?¹⁶

There are numerous obiter remarks in the cases, endorsed by leading commentators,¹⁷ that state that a shareholder's right to vote is a property right and can be freely exercised, regardless of motive, and even if personal interests' conflict with those of the company. Such obiter remarks are nothing but mere assertions because no argument was given in the cases to support the notion. Not all classes of shares necessarily confer voting rights. But if they do, those rights are found in the articles of association and, where applicable, subscription contracts. Such rights are therefore contractual rights. Although contract rights can of course also amount to property rights, justifications ought to be given as to why voting rights constitute property rights. Looking to the

¹⁶ E. Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (CUP, 2019) at Ch 4A.

¹⁷ *North-West Transportation Co Ltd v Beatty* (1887) 12 App Cas 589 PC; *Burland v Earle* [1902] A.C. 83; *Goodfellow v Nelson Line* [1912] 2 Ch. 324. See, for example, P.L. Davies and S. Worthington, *Gower & Davies Principles of Modern Company Law* 10th edn (Sweet & Maxwell, 2016) at [19-9]. Cf R. Flannigan, "Shareholder Fiduciary Accountability" [2014] J.B.L. 1.

authorities where this proposition has been asserted we find that the judges have failed to reason closely in support of the proposition before then going on to find that shareholders can vote as they please.

Importantly, the fact that property consists of a bundle of rights, this does not mean that the individual rights which go to make up that bundle are necessarily property rights.¹⁸ The fact that one gets a bundle of rights, including the right to vote,¹⁹ pursuant to owning shares does not inevitably lead to the conclusion that those rights are property rights. After all, Lord Templeman in *Government of Mauritius v Union Flacq Sugar Estates Co Ltd* held that when voting rights have been taken away, the right to vote is not a property right in itself; it is merely an incident of one's ownership of shares.²⁰ It is questionable why the label of property rights is applied to voting rights but not to other rights such as those governing participation also found in the articles.²¹ The latter have been labeled by the courts either as personal rights of members or as a matter of internal regularity. Both voting rights and the other types of participatory rights are based on and conferred by the articles of association. Yet, curiously, only voting rights have been characterised as property rights; and no explanation appears to have been given, or, indeed, could sensibly be given, as to why this is the case.

¹⁸ *Belfast Corporation v OD Cars Ltd* [1960] A.C. 490 at 517 (HL) (Viscount Simonds).

¹⁹ A property right is a right which “the rest of the world is under a prima facie duty to A not to deliberately or carelessly interfere with a *physical* thing”, and given that shares are not physical things, they are not property rights: S. Douglas and B. McFarlane, “Defining Property Rights” in J. Penner and H. Smith (ed), *Philosophical Foundations of Property Law* (OUP, 2013) at 220, 237-243; B. Swadling, “Property: General Principles” in A. Burrows (ed), *English Private Law* (OUP, 2007, 2nd ed) at [4.17]-[4.18]. However, shares are not corporeal or physical things because they cannot be equated with the company's assets given the doctrines of separate legal personality and reflective loss; nor are shares interests in the company's assets. See A. Pretto-Sakmann, *Boundaries of Personal Property: Shares and Sub-Shares* (Hart, 2005) at 82-93.

²⁰ [1992] 1 W.L.R. 903 (PC) at 909H to 910A and 911B - 911H.

²¹ *Macdougall v Gardiner* (1875) 1 Ch. D. 13: The articles stated that if requested by five members, a vote by poll on the adjournment of the general meeting would be required; *Pender v Lushington* (1877) 6 Ch. D. 70: here the articles contained a voting cap that precluded members from voting more than 100 shares regardless of the number of shares owned by the members.

Not only are votes not property rights, but a close analysis of the cases reveals that the real reason underlying decisions where the courts have held that they are, thus permitting members to vote as they please, is this: either the interests of the company were not in issue (because other interests such as the personal rights of members were at stake) or the outcome did not harm the interests of the company (because the outcome of those cases, where the votes or transactions were challenged, was found to be fair and reasonable). An example of the former can be found in *Pender v Lushington*²². Examples of the latter can be found in *North-East Transportation Co Ltd v Beatty*²³ and *Burland v Earle*.²⁴

In *Pender v Lushington*, the court found that the failure of the chairman of a general meeting of shareholders to record some of the votes cast by nominee shareholders was a violation of a member's personal right qua member to have his votes counted and recorded. The chairman discriminated against some of the members by denying them the right to have their votes recorded. Jessel M.R.'s obiter assertions regarding the freedom of shareholders to vote as they please, regardless of motive, on the basis that votes are property rights, are beside the point. The issue here was the breach of the personal rights of the shareholders, as conferred by the articles, to have their votes recorded. That aside, Jessel M.R.'s bald assertion of property, without argument, is question-begging. It did not and could not transform voting rights, which are conferred by the constitution and subscription contract, into property rights. And even if votes are property rights, there are substantial restrictions on those rights. It is a trite observation that property rights do not give untrammelled powers to the owner to do anything with his property if the consequence of doing so will cause harm the interests of others. This was recognised in *Menier v Hooper's Telegraph Works*,²⁵ cited with approval by Jessel M.R., where the Court of Appeal held that shareholders cannot vote in such a way as to "sell the assets of the company and keep the

²² (1877) 6 Ch. D. 70.

²³ (1887) 12 App. Cas. 589.

²⁴ [1902] A.C. 83.

²⁵ (1874) 9 Ch. App. 350.

consideration”²⁶. Further, shareholders cannot vote to “appropriate to themselves money, property or advantages which belong to the company, or in which other shareholders are entitled to participate.”²⁷ Nor are they permitted to vote in transactions that are of a “fraudulent character or beyond the powers of the company.”²⁸ Fraud refers not to dishonesty or immorality but “[i]t merely means [that] the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power.”²⁹ Accordingly, Jessel M.R.’s stark assertion that members are permitted to vote even if their motives are “entirely adverse to the interests of the company as a whole,”³⁰ must be open to question.

In *North-West Transportation*, Beatty who was the director and shareholder sold a steamship to the company. Because there was a conflict of interest, the shareholders were required to ratify the sale transaction. In addition to asserting that shareholders can vote as they please even if doing so was contrary to the company’s interests, the court found the following: the price was fair, the company needed the steamer, there was no other steamer available, there was no fraud, and the minority was not oppressed. Thus, the interests of the company were not prejudiced by the ratification. The assertion that votes are property rights was again beside the point.

In *Burland v Earle*, Burland who was one of the directors and a majority shareholder, made a profit by selling certain property and plant to the company. The claimants sought an order against Burland for disgorgement of the profits. Apart from affirming *North-West Transportation* and holding that shareholders can vote on transactions in which they are interested,³¹ the court

²⁶ Ibid at 354.

²⁷ *Burland v Earle* [1902] A.C. 83 at 93.

²⁸ Ibid.

²⁹ *Vatcher v Paull* [1915] A.C. 372 at 378 (Lord Parker) (PC).

³⁰ *Pender v Lushington* (1877) 6 Ch. D. 70 at 75.

³¹ n 27 at 94.

endorsed (but did not elaborate on) the evidence that (a) the sale price was not unfair to the company,³² and (b) the next largest shareholder “was present at the sale and knew all about the transaction,”³³ including the price that Burland paid for the property and plant. As was the case in *North-West Transportation*, there was no evidence that the company’s interests were adversely affected by the transaction between the shareholder and the company.

The cases examined above demonstrate that when the court invoked the notion that shareholders can vote as they please, the company’s interests were either not prejudiced or not in issue. Had the outcome been harmful to the company’s interests, it is suggested that the shareholders’ exercise of voting powers would be restricted. The proposition that shareholders can vote as they please did not provide the critical justification for the result reached in these cases. It seems to amount to little more than window dressing.³⁴

One case, however, that requires some explanation is the first instance decision of *Northern Counties Securities Ltd v Jackson & Steeple Ltd*.³⁵ There, Walton L.J. noted that an injunction in another proceeding had been issued against the defendant company ordering it to comply with the contract which it had entered into with the claimants to issue shares to them and to list the shares on a Stock Exchange. The defendant company gave an undertaking to the court to issue the shares and obtain a Stock Exchange quotation. However, the defendant failed to comply with the court order and did not discharge its undertaking. The claimants applied to the court to order the defendant company to: (a) convene a general meeting to approve the share issue; (b) send a circular to all members to induce them to vote in favour of the shares and warn them that the failure to do so would amount to a contempt of court; and (c) restrain the directors, in their capacities as shareholders, to vote against the issue of shares. Walton L.J. rejected the contents of the circular.

³² Ibid at 98.

³³ Ibid.

³⁴ E. Sneed, “The Stockholder May Vote as He Pleases: Theory and Fact” (1960) 22 Univ. Pitts. L Rev 23.

³⁵ [1974] 1 W.L.R. 1133.

He held that the members, as well as the directors voting as members, can vote against the company's contractual obligations and undertaking to the court. The judge said that shareholders in a general meeting are not agents of the company, although their acts can bind the company.³⁶ Also, because they are exercising their own rights of property, they can vote as they please and their acts cannot be regarded as those of the company.³⁷ Walton L.J. is able to arrive at the remarkable conclusion that shareholders in a general meeting can vote as they please and will not be liable for the exercise of their votes, even if they intended to cause the company to violate its undertaking to the court and its contractual obligations.³⁸ Further, he rejected the claimant's contention that the shareholders' vote would expose the company to proceedings for contempt of court.³⁹ The effect of his judgment is that the company could circumvent the court order through the acts of general meeting. The judge's analysis is objectionable. First, it is questionable that shareholders in a general meeting can deliberately cause, direct or authorise the company to violate a court order and breach a contract, and yet not be held liable at all. It is even more questionable that the board of directors can bind the company by entering into a contract; and yet, the shareholders acting in a general meeting are permitted to simply disregard the company's contractual obligations and court order. To escape this problem, Walton L.J. drew the problematic distinction between the acts of the shareholders in a general meeting and the acts of the company.⁴⁰ He further relied on the notion that shareholders can vote as they please. It is true that shareholders who voted against complying with the court order may not be held personally liable for contempt of court because the liability for contempt rests with the company (their decision is attributed to the company). However, the possibility cannot be dismissed, as Walton L.J. did, that either the shareholders or directors might be liable for: abetting the company for contempt of court or for inducing the breach of contract, insofar as they have been personally involved in the abetment and

³⁶ Ibid at 1144-1145.

³⁷ Ibid.

³⁸ Ibid at 1144-1146.

³⁹ Ibid.

⁴⁰ Walton LJ endorsed the defendant's counsel argument: [1974] 1 W.L.R. 1133 at 1144.

inducement to the extent sufficient to attract liability.⁴¹ For example, the directors who were also the shareholders sent out notices to the members in order to induce them to vote against complying with the undertaking and the issue of shares by alleging that the company would save substantial sums of money if the resolutions were not passed. Further, as acknowledged by Lord Maugham in *Southern Foundries (1926) Ltd v Shirlaw*, if a company was liable for breaching a contract, its shareholders would be liable for inducing the breach if they had authorised or procured such breach by exercising their powers under the articles.⁴² If directors can be personally liable for inducing breach of contract or abetting the company for contempt of court,⁴³ then shareholders who are aware of the contract and the court order should not be immune from liability for deliberately preventing the company from discharging those enforceable obligations by voting against the issue and listing of shares.

The second and final objection is that, as a general rule, shareholders ought to exercise their voting powers responsibly, otherwise they can deliberately harm the interests of company. Such harm may be manifested by, for example, bringing the company into disrepute and causing it to sustain damage because, as on the facts of *Northern Counties Securities Ltd*, its breach of contract and the consequent court order. The extraordinary effect of Walton L.J.'s reasoning is that the company's contractual obligation and undertaking to the court are rendered unenforceable by injunction where shareholders vote against the relevant resolutions, which he held that they are absolutely permitted to do so, "whatever its effect may be."⁴⁴ However, if all powers have to be exercised bona fide and for proper purposes,⁴⁵ then no exception should be made for the exercise of voting powers by shareholders unless a compelling justification can be given. Accordingly, the

⁴¹ By analogy with directorial liability in *In MCA Records Inc v Charly Records Ltd* [2003] 1 B.C.L.C. 93 (CA).

⁴² *Southern Foundries (1926) Ltd v Shirlaw* [1940] A.C. 701 at 711.

⁴³ B. Hannigan, *Company Law* 4th edn (OUP, 2016) at 75-76.

⁴⁴ *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 W.L.R. 1133 at 1144 (Walton L.J. endorsed the submissions of the defendant directors' counsel).

⁴⁵ *Vatcher v Paull* [1915] A.C. 372 (HL) at 378 (Lord Parker); *Equitable Life Assurance Society v Hyman* [2002] 1 A.C. 408 (HL) at 451-62.

reasoning and result in this case seem to be fundamentally flawed. The decision in *Northern Counties Securities Ltd* also serves to underscore the central problem with the rule that shareholders can generally vote as they please.

III SHAREHOLDERS' AGREEMENTS⁴⁶

A further argument that ostensibly supports the notion that shareholders can vote as they please is that they are permitted to enter into contracts to vote in certain ways, or not to vote at all, and such contracts are enforceable by injunction. The authority that is typically cited to support this proposition is *Puddephatt v Leith*.⁴⁷ There, the claimant borrowed money from the defendant and under the loan agreement he mortgaged his shares to the defendant and transferred them to his name. The defendant promised the claimant to vote the shares according to his instructions, but he reneged on his undertaking. The court ordered him to comply with the promise.

A close examination of the decision shows that it is simply a matter of contract law. It is authority only for a simple proposition: undertakings or promises given by one party to another to vote in certain ways (or not to vote at all) are enforceable. But it does not follow from this proposition that shareholders can vote in whichever way they want to, even if they are antithetical to the company's interests. It may be objected, however, that implicit in the proposition that a shareholder's contractual undertaking to vote in any way required by the promisee includes voting against the company's interests if it is pursuant to the promisee's instructions. But the problem with this argument is that the issue — whether or not a (mandatory) injunction will be granted to compel the shareholder to vote as instructed by the promisee if doing so is opposed to the company's interests — was not raised, let alone decided, in the case. Similarly, although there is nothing in the decision concerning the duties or restrictions that could or should be imposed on

⁴⁶ n 16.

⁴⁷ [1916] 1 Ch. 200 (Ch).

shareholders when they exercise their voting powers, it is a logical fallacy to infer from the silence that there are or should be no such duty or restriction.

There is another first instance decision, however, which might be taken to lend support to the notion that shareholders can vote as they please, even if their intent, or the effect of which, is to harm the company's interests. But again, the judge's reasoning is flawed. In *Wilkinson v West Coast Capital*,⁴⁸ Clause 5 of the shareholders' agreement provided that unless the consent from more than 65% of the shareholders was obtained, shareholders were required to ensure that the company did not enter into certain transactions. Clause 7 provided that each shareholder had to use all reasonable and proper means to promote the company's interests. In order to allow the directors, who were also the controlling shareholders, to personally make an acquisition, the controlling shareholders deliberately blocked the acquisition by not voting to permit the pursuit of those opportunities. This had the effect of precluding the company having an interest in the acquisition. Warren J upheld the acts of the controlling shareholders and the acquisition by directors, holding there was no conflict of interest. The judge took the view that Clause 7 had to be read subject to Clause 5.⁴⁹ In a remarkable statement, Warren J said that even if the board of directors had held the view that the acquisition was in the company's interests, the directors could still acquire it for themselves because they, acting as shareholders, were entitled to refuse to consent to the acquisition that was required by Clause 5.⁵⁰ The minority shareholder's unfair prejudice petition therefore failed.

Warren J's reasoning leads to problematic consequences. Not only can shareholders vote as they please, but they can do so in order to deprive the company of valuable opportunities, thereby deliberately harming its interests. Further, directors can be insulated from liability when they acquire certain corporate opportunities, so long as they, acting as shareholders, refuse to

⁴⁸ [2007] B.C.C. 717 (Ch).

⁴⁹ *Ibid* at [225].

⁵⁰ *Ibid* at [299].

consent to the company's acquisition. This exemption from liability for placing themselves in a conflict situation will operate even where the board has determined that it is in the company's interest to pursue the acquisition. And yet, the directors are permitted to exploit the opportunity. Warren J sought to explain away the conflict by asserting that the shareholders, who are also directors, are under no duty to vote to approve the acquisition, even if it is in the company's interests to do so.⁵¹ The effect of his reasoning is that the company is prejudiced twice. First, the company is not able to undertake the acquisition. Secondly, it cannot sue the directors for breaching their fiduciary duties when they made the acquisition. Admittedly, shareholders can legitimately take a different view on business decisions from directors, and they can express this disagreement through their votes. But there ought to be limits to manifestly self-serving and prejudicial exercise of shareholder voting rights, particularly where, as on the facts of the case, the interests of the company were clearly harmed. Nevertheless, no such limits appeared to be countenanced by Warren J.

Let us assume that there was no such shareholders' agreement. If the directors, who are also the controlling shareholders, wish to exploit certain opportunities, they may, in their capacity as shareholders, alter the company's articles to include a provision to the effect that consent from certain percentage of shareholders is required for entering into certain transactions. The aim is for the shareholders to withhold consent so that they as directors can exploit the opportunities. But such alteration to the articles will be subject to the requirement to act bona fide for the benefit of the company as whole.⁵² However, it is highly questionable why such a requirement should not apply to shareholders exercising their voting rights under the shareholders' agreement to decide whether or not to consent to the acquisition, in particular provisions which directly impact on the company's interests, such as Clause 5 in *Wilkinson*. It is no answer to assert that to impose such a requirement would conflict with the proposition that shareholders can vote as they please and can do so without regard to the adverse effect it would have on the company. This is because if this

⁵¹ Ibid at [299-300].

⁵² n 13.

answer was correct, then shareholders would be able to alter the articles of association without any restriction. But this is not the case.

Accordingly, it seems clear that the rule that shareholders can vote as they please notwithstanding any harm that may ensue to the company is objectionable. Further, the proposition that directors are under a duty to vote in the company's interests, but the very same directors, in their capacity as shareholders, can vote in opposition to the company's interests, thereby undermining or negating the actions of directors and prejudicing the company, is problematic. We now turn to explore this argument further.

IV THE GENERAL MEETING AS AN AGENT OF THE COMPANY⁵³

Given that a company is an artificial entity, it can, of course, only act through its agents. The question that arises is which acts of which agents count as the company's acts so that the company can be said to be empowered to take certain actions, or be contractually, criminally, tortiously or statutorily liable for certain acts. In the context of a company, it has been held that "[u]nder the law of agency the physical acts and state of mind of the agent are in law ascribed to the principal, and if the agent is a natural person it matters not whether the principal is also a natural person or a mere legal abstraction."⁵⁴ Professors Watts and Reynolds argue that just as the board of directors is the company's co-agent when it acts to bind the company, likewise when shareholders in general meeting act on the company's behalf to alter its legal position, and the source of their authority is the companies statute and the company's constitution."⁵⁵ They clarify that although Lord Hoffmann distinguished between the primary rules of attribution (i.e. board and shareholder

⁵³ n 16 at Ch 3B.

⁵⁴ *Tesco Supermarkets Ltd v Natrass* [1972] A.C. 153 at 198-199 (Lord Diplock).

⁵⁵ P. Watts and F.M.B. Reynolds, *Bowstead and Reynolds on Agency* 21st edn (Sweet & Maxwell, 2017) at [1-028].

resolutions) and general rules of attribution (i.e. principles of agency)⁵⁶, he did not say that the board or the general meeting are not agents; the preponderance of authority shows that they are; and that the primary rules of attribution should be viewed as sources of actual authority.⁵⁷

The authors affirm the fact that board and the general meeting are co-agents of the company. Undoubtedly, under both the Companies Act 2006 and the company's constitution, the general meeting is empowered to make decisions on behalf of the company and such decisions of the general meeting will bind the company. In other words, the company is the principal and the general meeting its agent, as is the case with the board of directors. Just as the acts of the board bind the company and affect the latter's legal position, so do those of the general meeting.

One may question from where or from whom the general meeting obtains the power to alter the principal's legal position. In short, how is the agency relationship created? The answer lies in the "unilateral manifestation by the principal of willingness to have his [or its] legal position changed by the agent."⁵⁸ From the time a company is legally incorporated, power, as a matter of construction or necessary implication, is conferred on the general meeting to act on its behalf. How else can the decisions or actions of the general meeting bind the company if the company, a real and separate and distinct legal entity, has not been legally treated as having assented to the general meeting to act on its behalf?

Further, while the Companies Act does not state that the general meeting is an agent of the company, resolutions passed at a general meeting are treated as if they alter the legal position of the company. Because the company is a separate legal entity distinct from its members, the assent given by the company to the general meeting to affect its legal rights and obligations has to be necessarily implied and imputed to the company. No contract is necessary to show that the

⁵⁶ *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 A.C. 500 at 506.

⁵⁷ n 55 at [1.028].

⁵⁸ *Ibid* at [1-006].

principal has conferred the power on the agent to alter its legal position. It suffices if “the principal manifests to the agent that he is willing for the agent to act, and the agent does so in circumstances indicating that his acts arise from the principal’s manifestation”⁵⁹, “even though the first person [i.e. the person conferring the power] cannot be shown to have had, any may indeed not have had, a specific intention of conferring authority.”⁶⁰ This manifestation of assent by the principal has to be viewed objectively. Thus, when a company is incorporated, it becomes a real and separate legal entity, and it is legally treated as having manifested its willingness for the general meeting to act on its behalf. Once authority is conferred by the principal on the agent, and the agent purports to act on the principal’s behalf (such as when a general meeting makes a decision in meeting or through written resolutions), it cannot deny that it acted on the principal’s behalf.⁶¹

It might be objected that the board and the general meeting are *organs*, not *agents*, of the company. As an organ of the company, the general meeting acts as, and not on behalf of, the company.⁶² Six rebuttals are warranted. First, the proposition that the company, an artificial legal entity, can only act through its agents (primarily but not exclusively through the board and the general meeting) is based on many well-established authorities.⁶³

Second, the doctrine of separate legal personality and the rules of attribution call into question the assertion that the general meeting is an organ of the company and acts as the company. To say that the general meeting is an organ of the company implies that it is an intrinsic and internal part of the entity. This is inconsistent with the doctrine of separate legal personality which clearly

⁵⁹ Ibid.

⁶⁰ Ibid at [1-008].

⁶¹ Ibid at [2-032].

⁶² See, for example, *Gower and Davies*, n 17 at ch. 7.

⁶³ See, for example, *Aberdeen Railway Company v Blaikie Brothers* (1854) 1 Macq. 461 at 471 (Lord Cranworth L.C.); *Ferguson v Wilson* (1866) LR 2 Ch. App. 77 at 89 (Cairns L.J.); *Citizen's Life Assurance Company Limited v Brown* [1904] A.C. 423 at 426 (Lord Lindley); *Tesco Supermarkets Ltd v Nattrass* [1972] A.C. 153 at 198-199 (Lord Diplock); and *VTB Capital Plc v Nutritek International Corp* [2013] 2 W.L.R. 398 at [138] (Lord Neuberger).

establishes that the company is distinct and separate from its shareholders and directors. To say that the general meeting, as an organ, acts *as* the company, as opposed to on its behalf, seems to be an incorrect way of expressing the legal principle that the acts of the general meeting (or the acts of the board of directors) are attributed or attributable to the company under certain circumstances and for certain purposes. To say that the decisions of a majority vote of shareholders, or decisions of the board, “shall be” or “are” decisions of the company, is merely an abbreviated and imprecise way of expressing the legal principle that the decisions of the general meeting (or the directors) are attributed to the company under certain circumstances. To put it in another way, if the general meeting (or the board) is indeed an organ of the company that acts *as* the company, or if the acts of the general meeting (or the board) *are* those of the company, then the rules of attribution would be redundant. The attribution rules fundamentally presuppose that the general meeting is distinct and separate from the company, i.e. it is not an organ of the company, and therefore, rules are required to attribute the acts of the former to the latter.

Third, commentators who have endorsed the idea that the board or the general meeting is an organ of the company and reject the proposition that it is an agent, have derived support for their position in part from German law.⁶⁴ However, this is inconsistent with the English authorities stated above and contrary to our second rebuttal point. Under German law, the board and the general meeting (“Aktiengesellschaft”) are treated as “integrated parts of the corporation organism itself”⁶⁵ and thus, the acts of these organs are “... *automatically* the act of the juristic person [i.e. the company],”⁶⁶ which “... leads *necessarily* to the exclusion of the rules of agency as far as “organ-acts” are concerned.”⁶⁷

⁶⁴ S. Watson, "Conceptual Confusion: Organs, Agents and Identity in the English Courts" (2011) 23 S.Ac. L.J. 762 at [32].

⁶⁵ D. Eckert, “Shareholder and Management: A Comparative View on Some Corporate Problems in the United States and Germany” (1960) 46 Iowa L.R. 12 at n 5.

⁶⁶ *Ibid.*

⁶⁷ *Ibid* at 18 (emphasis added).

Fourth, German law which rejects the agency view and endorses the organic view has been said to have formed the basis of Viscount Haldane LC's directing mind and will approach,⁶⁸ adopted in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd*.⁶⁹ This position has been shown to be fraught with policy problems and, when applied in subsequent cases, such decisions have attracted trenchant criticism by leading commentators.⁷⁰

Fifth, the concept of organ is doubtful in its analytic value. It has been asserted that "whether a person is an organ or not depends upon the extent of the powers which in law he has express or implied authority to exercise on behalf of the company."⁷¹ On this view, a general meeting, like the board of directors, is an organ of the company because it has been conferred authority to exercise significant powers on the company's behalf. In short, in order to be an organ, it must first be an agent.⁷² If that is the case, what is the distinctive analytic value of having the concept of organ? If it is merely used to underscore the importance of certain kinds of agents in company law (i.e. the board and the general meeting), it is unnecessary to introduce the concept of organ. Unsurprisingly, the concept of organ does not have doctrinal status under English company law, unlike agency. More importantly, it seems incoherent to claim that on the one hand, the concept of organ necessarily precludes the application of agency law (as noted in point three above), and on the other, the concept of organ depends on agency law.

⁶⁸ *El Ajou v Dollar Land Holdings Ltd* [1994] B.C.C. 143 at 159 (Lord Hoffmann).

⁶⁹ [1915] A.C. 705.

⁷⁰ See for example, E. Ferran, "Corporate Attribution and the Directing Mind and Will" (2011) 127 L.Q.R. 239.

⁷¹ n 68.

⁷² In *Northside Developments Pty Ltd v Registrar-General* (1990) 170 C.L.R. 146, at [64] (Dawson J.).

Finally, Lord Hoffmann implied in *Meridian Global Funds Management Ltd v Securities Commission*,⁷³ that the decisions of the board or the general meeting constitute decisions *on behalf of the company*. This implication is clear from his holding that “[n]ot every act on behalf of the company could be expected to be the subject of a resolution of the board or a unanimous decision of the shareholders.”⁷⁴ As some commentators have pointed out, organs act as the company whereas agents act on behalf of the company.⁷⁵ If the board or general meeting are organs of the company, then its decisions could not be made on the company’s behalf, which is contrary to Lord Hoffmann’s dictum. Further, it has been remarked that the board as an organ of the company is the basis of the primary rule of attribution expounded by Lord Hoffmann in *Meridian*.⁷⁶ If this is correct, it follows that an organ acts as, but not on behalf of, the company. But Lord Hoffmann said precisely the opposite. An agent acts on the company’s behalf.

1. The duties owed by the general meeting (agent) to the company (principal)

The above analysis addresses the questions of why the general meeting is an agent of the company and how the relationship of agency arises. The next question is what is the nature of the duties that are owed by the agent to the principal. Agents are by definition fiduciaries as agency is “the fiduciary relationship which exists between two persons [the agent and the principal].”⁷⁷ In addressing the view that whether or not agents owe fiduciary duties should depend upon whether the particular circumstances of each case warrant such an imposition, they argue that while a person can be subject to fiduciary duties though not an agent, the converse should not be true

⁷³ [1995] 2 A.C. 500 (PC).

⁷⁴ Ibid at 506.

⁷⁵ See, for example, the discussion in B. Hannigan *Company Law* 4th edn. (OUP, 2016) at ch. 4.

⁷⁶ *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* [2014] H.K.E.C. 419 at [64] (Lord Walker N.P.J).

⁷⁷ n 55 at [1-001].

because an agent has the power to alter the principal's legal position.⁷⁸ Accordingly, "[i]t is appropriate and salutary to regard the fiduciary duty as a typical feature of the paradigm agency relationship,"⁷⁹ but the precise content of the duties will vary with the circumstances. Importantly, courts have held that fiduciary relationships include that of agent and principal and a "critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense."⁸⁰ Shareholders in general meeting undertake (or are treated under the law by virtue of incorporation and the companies legislation as having undertaken) to act on the company's behalf; the general meeting has scope for the exercise of discretionary powers⁸¹; and it can unilaterally exercise that power or influence, thereby affecting the principal's interests.

2. The content of the general meeting's fiduciary duties

If the general meeting is a co-agent of the company and hence owes fiduciary duties to it, the next question that arises is what is the content of those duties?⁸² The short answer is that they should

⁷⁸ Ibid at [6-036]-[6-037].

⁷⁹ Ibid at [6-036].

⁸⁰ *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 C.L.R. 41 at [68] (Mason J) (emphasis added); *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18 (Millet L.J.).

⁸¹ For examples of discretionary powers, see n 1. These powers are discretionary because shareholders can choose whether or not to attend the general meeting and whether or not to vote. And in the case of requiring directors to call a general meeting, whether or not to do so in the first place.

⁸² Needless to say, [n]ot every breach of duty by a fiduciary is a breach of fiduciary duty": P. Millett, "Equity's Place in the Law of Commerce" (1998) 114 L.Q.R. 214 at 218, and a fiduciary may in appropriate circumstances also owe and breach non-fiduciary duties.

include the duty to act in good faith in the best interests of the company together with the no-conflict and no-profit rules.⁸³

Regarding the duty to act in the best interests of the company, it may be argued that this becomes circular as it would amount to the general meeting being required to act in its own interests, which would, in effect, imply that the general meeting owes duties to itself. The response to this argument lies in how we understand the notion of the interests of the company. Under the common law, it refers to the interests of the shareholders as a whole, present and future, not to those of a particular shareholder or a particular group of shareholders.⁸⁴ However, the interests of the company should not necessarily be equated with those of the shareholders as the interests of the latter, compendiously put, lies with share price maximisation. But share price in itself does not reflect the true value of a company,⁸⁵ and “represents a poor basis for either regulation or investment.”⁸⁶ Crucially, the maximisation of share price has been demonstrated to result in pervasive short-termism which has caused serious harm to the company, stakeholders such as employees and creditors, as well as the broader economy.⁸⁷ Further, empirical evidence has shown that a substantial number of companies do not regard maximising share price as their sole or critical goal.⁸⁸ It is one of their many goals. It is neither overriding nor predominant.

⁸³ *Bristol and West Building Society v Mothew* [1998] Ch. 1 at 18 (Millet L.J.).

⁸⁴ *Brady v Brady* (1987) 3 B.C.C. 535 at 552 (Nourse L.J.).

⁸⁵ See, for example, L.A. Stout, “The Mechanisms of Market Inefficiency: An Introduction to the New Finance” (2003) 28 J. Corp. L. 635 at 653-54.

⁸⁶ n 2 at 10.

⁸⁷ See eg, L.A. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett-Koehler, 2012); E. Ferran, “Corporate Mobility and Company Law” (2016) 79 M.L.R. 813 at 836.

⁸⁸ A. Keay and R. Adamopoulou, “Shareholder Value and UK Companies: A Positivist Inquiry”, (2012) 13 E.B.O.R. 1 at 17, 22: based on a survey of the top 50 largest companies listed on the FTSE 100 Index of the London Stock Exchange, it was found that (i) around 44% have neither maximizing shareholder value nor increasing stakeholders’ benefits as their ultimate aim but instead have multiple goals such as “achieving growth, leadership, development, or profit” and (ii) nearly 67% of the sample companies did not have a clear shareholder-value maximisation objective.

The best interests of the company should therefore extend beyond increasing share price to include the impact of the general meeting's decisions on the overall, long term value of the company.⁸⁹ The latter consists of whether proper and adequate investments have been made in both tangibles, such as physical assets, and intangibles, such as attracting and retaining top managerial talent, enhancing employee skills and compensation, establishing good reputation with customers, and augmenting the research and development capability of the company.⁹⁰ Further, the investments and contributions of other constituencies such as employees, creditors or suppliers have to be considered, although not equated with the long term value of the company. The overall, long term value of the company therefore requires a holistic, contextual assessment of its fundamental goals. It is the antithesis of excessive risk-taking and short-termism.⁹¹

The interests of the company should not be synonymous with those of the shareholders because their interests conflict: the paradigmatic case of which involves the short-term interests of shareholders and the long-term interests of the company.⁹² For example, the global financial crisis brought into sharp relief the interests of certain influential shareholders who pursued the goals of short-term profit maximisation that resulted in the collapse of companies and financial institutions with widespread, adverse consequences for other companies and the economy generally. But as the Kay Review noted, even before the onset of the 2008 crisis, there were many instances of shareholders taking actions detrimental to the company's long-term interests.⁹³ Hence, it is important not only to distinguish corporate interest and shareholders' interests, but also to understand the former in terms of its long-term value and viability.

⁸⁹ A. Keay, "Ascertaining the Corporate Objective" "Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model" (2008) 71 M.L.R. 663 at 685.

⁹⁰ Ibid.

⁹¹ See for example, n 2.

⁹² Ibid.

⁹³ n 3.

If we understand the notion of the company's interests as encompassing the long-term value of the company as a separate and distinct commercial entity whose interests extend beyond those of shareholders, the latter of which is often narrowly and unjustifiably construed to mean the share price maximisation, then we can address the problem mentioned earlier, i.e. the claim that the general meeting owes fiduciary duties to the company to act in good faith in its best interests in effect amounts to saying that the general meeting owes duties to itself because corporate interest is necessarily equated with shareholders' interests.

Regarding the no-conflict and no-profit rules, it is suggested that what they should mean in the context of the general meeting is that where shareholders' personal interests conflict with their duties to the company, fiduciary law ought to require the conflicted shareholders not to act, i.e. not to vote in general meeting. It does not follow from the no-conflict or no-profit rules that shareholders cannot make a profit from buying and selling shares. They are of course perfectly entitled to do so. But they are subject to fiduciary duties only when they act in a general meeting. If at that time, their interests conflict with their duty to act in good faith in the company's interests, it is suggested that fiduciary law should preclude them from voting or, if allowed to vote, then their votes should be disregarded. But fiduciary law only precludes unauthorised conflicts and unauthorised receipt of profits. It is thus suggested that where there is prior authorisation in the form of fully-informed advance consent from a majority of disinterested shareholders, the conflicted shareholder may be permitted to vote and his votes may be counted.

3. Enforcement

It is suggested that an aggrieved shareholder through a derivative claim or the company through the board of directors should have standing to petition the court to set aside the decision of the general meeting if it breaches its fiduciary duties. Note that the general meeting, and not an individual shareholder, is an agent of the company. This is because only the decisions of the general meeting can bind the company and alter its legal position. In other words, only the general

meeting can act on the company's behalf. But an individual shareholder does not have the authority to act on the company's behalf, except in the case of a "one-man company" or unless the general meeting delegates authority to an individual shareholder to act on the company's behalf. The implication is that an individual shareholder does not owe fiduciary duties to the company. Accordingly, only the general meeting, and not an individual shareholder, can be sued for breaching fiduciary duties as an agent, the judicial remedy of which is to invalidate the decision of the general meeting or to issue an appropriate injunction to prevent the resolutions from being passed at the general meeting or acted upon. As individual shareholders will not be held personally liable for breach of fiduciary duties, the limited liability principle is not undermined, and thus, they will not be deterred from investing in the company. Nevertheless, the limited liability principle provides a reason for calling into question the rule that shareholders can generally vote as they please, as discussed below.

V. FREEDOM FROM LIABILITY

It is settled that modern company law originated from joint stock company law, which was itself based on partnership law.⁹⁴ The most significant and enduring influence of partnership law on company law is the contractual principle, which treats companies, like partnerships, as created and governed by agreements among shareholders, subject to applicable law. Shareholders, like partners, are permitted to choose the terms that regulate the arrangements among themselves and with the company, and the law gives effect to those contractual arrangements (subject to any applicable mandatory law). It has been said that this contractual principle "lies at the very heart of UK corporate law"⁹⁵ and is "the most fundamental legal principle of UK corporate governance law."⁹⁶ There are several crucial implications arising from this contractual principle that can be best seen in the context of partnership law. One is that partners can make any partnership decision they

⁹⁴ R. Harris, "The Private Origins of the Private Company: Britain 1862-1907 (2013) 33 O.J.L.S. 339 at 370-374.

⁹⁵ M. Moore, *Corporate Governance in the Shadow of the State* (Hart, 2013) at 137.

⁹⁶ *Ibid* at 139.

please, even if their intent or the effect of which jeopardises the interests of other partners, as long as they are liable for the consequences of their decisions. Thus, partners could breach the partnership agreement, or act contrary to the interests of other partners, but they will have to bear the consequences of their actions. Such consequences include paying damages or making restitution to the other partners; a third party suing the delinquent partner; or the innocent partners being jointly and/or severally liable to the third party for the actions of the delinquent partner.⁹⁷ In short, freedom of action on the part of the partners is accompanied by liability for the consequences of their actions.

The rule that shareholders can vote as they please was transposed from partnership law. However, as a general rule, shareholders in a limited liability company, as opposed to partners, are not liable for the consequences of the exercise of their votes, even if their intent, or effect of which, is to harm the interests of the company. They are not liable in so far as they, unlike partners, are not personally liable to pay damages or make restitution to the company, shareholders or third parties who have been adversely affected by their exercise of voting powers. Shareholders may be personally liable where their exercise of voting powers have breached a shareholders' agreement or the articles of association; or where their voting decisions have unfairly prejudiced a minority shareholder, they may be required to purchase the shares of that shareholder,⁹⁸ or prohibited from altering the articles.⁹⁹ However, these are exceptions to the general rule that shareholders in a limited liability company are free from personal liability for the consequences of the exercise of their voting powers, and these exceptions are narrow and limited. This is because shareholders are not personally liable for all breaches of the articles; only those provisions that specifically confer

⁹⁷ G. Morse, *Partnership Law* 7th edn. (OUP, 2010) at [5.05].

⁹⁸ Companies Act 2006, s. 996(2)(e).

⁹⁹ Companies Act 2006 s. 996(2)(d).

enforceable personal rights on shareholders qua shareholders¹⁰⁰ and those which are not mere irregularities.¹⁰¹

Further, the ambit of unfair prejudice has been narrowed because the petitioner is required to prove that there was either a breach of the articles or statute or an informal, non-legally enforceable understanding between the company and its members, which the court should recognize as being enforceable in the particular circumstances of a quasi-partnership company.¹⁰² Thus, it is unlikely that minority shareholders of public companies can avail themselves of this protection.¹⁰³ The practical result is that in public companies, particularly if there is a majority shareholder or a shareholder who has de facto control of the general meeting, a shareholder will not be subject to personal liability for the consequences of the exercise of his voting powers. In sum, although shareholders like partners have the freedom to make any decision as they please, shareholders, particularly those in public companies, differ legally from the position of partners because they are not personally liable for the consequences of their actions, save for certain narrow exceptions.

Given that shareholders' freedom from personal liability for the exercise of their voting powers in a limited liability company is generally unfettered, this freedom should be accompanied by responsibilities or obligations. In short, the freedom shareholders enjoy from liability when exercising their voting powers should be a basis upon which to fetter that freedom, particularly if their intent, or the effect of which, is likely to result in harm to the interests of the company. By contrast, in an unlimited liability company, shareholders' freedom to vote as they please should not be curbed as they will be personally liable for the consequences of their voting decision. In

¹⁰⁰ *Hickman v Kent or Romney Marsh Sheepbreeders' Association* [1915] 1 Ch. 881.

¹⁰¹ *MacDougall v Gardiner* (1875) 1 Ch. D. 13.

¹⁰² *O'Neill v Phillips* [1999] 1 W.L.R. 1092 at 10-11.

¹⁰³ One alternative is that the aggrieved shareholders in public companies can sell their shares, but this seems inadequate because the value of their shares would have already been diminished.

other words, power has to be constrained when the usual constraint – being personally liable for the consequence of the exercise of powers (i.e. liable to pay damages or to make restitution etc) – is ineffective.

We have argued that the rule which permits shareholders to vote as they please is unjustified both in principle and policy. The third and final reason why the rule permitting unfettered voting powers is questionable is that the power to vote, which, as we have seen, is a contractual power, should be subject to the implied requirements of *Wednesbury* unreasonableness.

VI WEDNESBURY UNREASONABLENESS

As we have sought to demonstrate, the right to vote is a contractual right that usually comes with the purchase of shares. Indeed, “the scope of rights conferred by the share that is purchased is a function of the terms of the contract setting out those rights and not a function of any inherent rights associated with the ownership of ‘a share’, whether preferred or ordinary. Accordingly, to determine the rights granted to the shareholder one has to interpret this contract.”¹⁰⁴ The right to vote that comes with the share is therefore determined by the contract between the company and the purchaser. This contract takes the form of the company’s constitution and, if applicable, the subscription contract.

Further, it is worth noting that the right to vote does not necessarily come with the purchase of a share. Shares can be issued and purchased without any voting rights and for those shares that come with voting rights, some may be given more than one vote per share. Whether or not a share comes with the right to vote, and if so, the number of votes per share, is dependent on the terms of the contract. The contractual primacy governing the right or power to vote is further supported by the Companies Act 2006, s.284. Although this provision sets out the default rules relating to the

¹⁰⁴ D. Kershaw, *Company Law in Context: Text and Materials* 2nd edn. (OUP, 2012) at 711.

number of votes a member has in different contexts,¹⁰⁵ it specifically states that these rules are “subject to any provision of the company’s articles.”

Voting is a discretionary power conferred by the contract on a member who has purchased a share because a member can choose not to vote even if shareholders’ resolutions are required for certain decisions to be taken. Given that the right, or more accurately, discretionary power, to vote is governed and regulated by contracts, the question is whether, absent any express restrictions, there should be any implied obligation on shareholders acting in general meeting? It is suggested that the answer lies with *Wednesbury* unreasonableness. It is trite law that contractual discretionary powers, even if they appear unfettered, have to be exercised in good faith and without arbitrariness, capriciousness, and unreasonableness. These restrictions are imposed on many different types of contracts including those involving corporate parties,¹⁰⁶ commercial entities,¹⁰⁷ consumers,¹⁰⁸ employment parties,¹⁰⁹ and unincorporated associations.¹¹⁰ A leading authority on the restrictions imposed on the exercise of contractual discretionary powers with respect to the doctrine of unreasonableness is *Braganza v BP Shipping Ltd.*¹¹¹ Here, the issue concerned the exercise of powers by an employer to determine whether its employee was entitled to benefits upon death. The Supreme Court noted five key points as being relevant to the determination.

First, it reiterated that contractual discretionary powers are not unfettered and cannot be exercised irrationally, perversely, arbitrarily, capriciously or in bad faith.¹¹² This is uncontroversial.

¹⁰⁵ Written resolution, show of hands or poll.

¹⁰⁶ *Watson v Watchfinder.co.uk Ltd* [2017] EWHC 1275 (Comm).

¹⁰⁷ *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] Bus. L.R. 1304 at [66].

¹⁰⁸ *Paragon Finance Plc v Staunton* [2002] 1 W.L.R. 685 at [37]-[42].

¹⁰⁹ *Mallone v BPB Industries plc* [2003] B.C.C. 113 at [36]-[37].

¹¹⁰ *The Vainqueur José* [1979] 1 Lloyd's Rep. 557 at 574.

¹¹¹ [2015] 1 W.L.R. 1661.

¹¹² *Ibid* at [26].

Second, in determining what unreasonableness means, the court approved and applied the public law principle of *Wednesbury* unreasonableness,¹¹³ holding that *Wednesbury* comprises two limbs: process and outcome.¹¹⁴ The first refers to the decision-making process: whether the power-holder has taken into account all relevant considerations and excluded all irrelevant considerations. The second refers to the decision itself, that is, the outcome – whether it is so unreasonable that no reasonable decision-maker could have come to it. The court recognised that the even if the first element is satisfied, the decision can nevertheless be invalidated on the basis of the second element. The converse situation should hold true as well: even if the second element is satisfied, the decision can be invalidated on the basis of the first element if the outcome would have been different had the right matters been taken into account. Both limbs, therefore, have to be satisfied.

Third, while *Braganza* was concerned with the exercise of contractual powers in an employment context, the court did not confine the use of *Wednesbury* unreasonableness to that context only,¹¹⁵ although the court did recognise that employment contracts may attract more intense scrutiny.¹¹⁶ Further, the fact that the court recognised that the basis of *Wednesbury* is to control the abuse of contractual discretionary powers, it did not confine the principle to situations where there is significant imbalance of powers, and so it has a wider application which goes beyond employment contracts. Indeed, cases subsequent to *Braganza* have applied *Wednesbury* to arms-length contractual situations to control the power of a company to give consent to exercise share options,¹¹⁷ and to the power of a bank to charge fees for collecting receivables.¹¹⁸ There is

¹¹³ *Associated Provincial Picture Houses Ltd v Wednesbury Corpn* [1948] 1 K.B. 223 at 233-234 (Lord Greene M.R.) (CA).

¹¹⁴ n 111 at [24], [29]-[30], [53] and [103].

¹¹⁵ *Ibid* at [29]-[30], [53], [102]-[103].

¹¹⁶ *Ibid* at [32], [36] and [54]-[55].

¹¹⁷ *Watson v Watchfinder.co.uk Ltd* [2017] Bus. L.R. 1309.

¹¹⁸ *BHL v Leumi ABL Ltd* [2017] 2 Lloyd's Rep. 237.

thus no reason in principle to bar the application of *Wednesbury* to the context of voting powers, although what is exactly required by *Wednesbury* may vary with the precise context.

Fourth, the court recognised that the intensity of a *Wednesbury* review will depend upon the competence of the courts, which in turn depends on two things. The first is the nature of the decision, an example of which is the distinction drawn by Lord Hodge between an employer's exercise of powers to award bonuses based on an open-ended discretion in the contract as opposed to the grant of death benefits based on findings of fact: for the latter, courts have more expertise.¹¹⁹ The second is the nature of the context: such as the distinction drawn between commercial and employment/consumer contracts. In the case of the latter, the courts have traditionally been more solicitous.

Finally, while *Braganza* has recognized that “it is not for the court to rewrite the parties' bargain for them, still less to substitute themselves for the contractually agreed decision-maker,”¹²⁰ “the party who is charged with making decisions which affect the rights of both parties to the contract has a clear conflict of interest.”¹²¹ Therefore, on that basis, a party's exercise of powers should be subject to the requirement of *Wednesbury* unreasonableness. Accordingly, in addition to the well-established basis for controlling discretion, namely preventing abuse of powers, regulating conflicts of interest, particularly where there is significant power imbalance, provides another significant justification.

The question then is why and how should we apply the above insights to the regulation of the exercise of discretion by shareholders? Regarding the question of why, the basis for subjecting shareholders to the *Wednesbury* unreasonableness requirement is to prevent abuse of voting

¹¹⁹ n 111 at [56].

¹²⁰ Ibid at [18].

¹²¹ Ibid.

powers,¹²² and to control the potential adverse impact such exercise of power would have on other shareholders where there is a conflict of interest. Thus, the basis is not agency, unlike the case of the general meeting. Controlling abuse of powers and, in particular, conflicts of interest is important not only because the general meeting together with the board of directors, is responsible for making decisions that affect the interests of the company, but also where there is information asymmetry or inequality of power. In light of the conflicts of interest between different types of shareholders and the company such as extractions of private benefits of control by controlling shareholders, and institutional shareholders who pursue short-term gains, imposing the *Wednesbury* requirement is appropriate. For example, as noted above, the 2008 global financial crisis brought into sharp relief the adverse consequences that result from permitting the pursuit by certain influential shareholders of short-term profit maximisation.¹²³

Regarding the question of how the *Wednesbury* requirement could be applied, an example can be drawn from the unanimous House of Lords decision in *Equitable Life Assurance Society v Hyman*.¹²⁴ While the court did not use the term “unreasonableness” or “irrationality”, its reasoning is substantially along similar lines. Article 65(1) of the company’s constitution provided that the amount of any bonus was “within the absolute discretion of the directors, whose decision thereon shall be final and conclusive.”¹²⁵ Under Equitable Life’s retirement annuity policies, policyholders were given the choice to opt for either the current annuity rate or the guaranteed annuity rate (“GAR”). The latter turned out to be far more generous than the former. As the policyholders were likely to opt for the GAR, the directors invoked Article 65, rejected GAR, and decided to pay the bonus based on the then current annuity rate.

¹²² Ibid.

¹²³ See, for example, D. Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations* (26 November 2009).

¹²⁴ [2002] 1 A.C. 408.

¹²⁵ Ibid at 453 (emphasis added).

The House of Lords rejected the directors' contention that they had unfettered discretion under Article 65 to determine the amount of bonus and implied a requirement that they could not override GAR. It held, in effect, that the directors had exercised their powers unreasonably, contrary to the purpose and the policy of the articles. Lord Steyn said that "the self-evident commercial object of the inclusion of guaranteed rates in the policy is to protect the policyholder against a fall in market annuity rates by ensuring that if the fall occurs he will be better off than he would have been with market rates. The choice is given to the GAR policyholder and not to the Society."¹²⁶

While *Hyman* is concerned with the exercise of discretionary powers by directors not shareholders, two lessons can be drawn that are applicable to the context of the general meeting. First, although the terms clearly and unequivocally conferred unfettered and unqualified discretion on the directors ("absolute", "final and conclusive"), the court implied a restriction into those terms. This suggests that the court's jurisdiction to review the exercise of discretionary powers will rarely be ousted absent clear and express terms that effect. Second, interpreting this case in light of *Wednesbury*, the court invalidated the directors' exercise of powers because it was contrary both to the first limb of the *Wednesbury* test because the directors had failed to take into account a highly relevant consideration, the reasonable expectations of the policyholders, and the second limb because the decision was one that no reasonable authority would have made given that it flouted the purpose of the policy. This decision demonstrates one factor of an unreasonable outcome: the failure to give effect to, or acting contrary to, the purpose of the instrument.

There could be four objections to imposing the requirement of *Wednesbury* unreasonableness on the general meeting: it will curtail shareholders' autonomy; courts may substitute their decisions for those of the general meeting; the contents of *Wednesbury* are vague;

¹²⁶ Ibid at 459.

and it is redundant in view of *Allen v Gold Reefs*.¹²⁷ The responses are that first, given that the autonomy of shareholders has not escaped restriction¹²⁸, the key consideration is not whether duties should be imposed on the general meeting, but rather the rationales, purposes and scope of those duties.

Second, it is unlikely that the court will substitute its decision for that of the general meeting. It has been stated that “pursuant to the *Wednesbury* rationality test, the decision remains that of the decision-maker, whereas on entirely objective criteria of reasonableness the decision-maker becomes the court itself.”¹²⁹ When courts evaluate whether the power-holder has exercised the discretion unreasonably, they do not ask whether they themselves think that the decision is unreasonable. Rather, courts will only intervene if the decision falls outside a range of reasonable responses.¹³⁰ Further, the risk of judicial substitution is minimised because courts take a nuanced approach, i.e., the intensity of review varies with the nature of decision and contexts. *Braganza* demonstrated that the courts are cognisant of the limits of their competence. Therefore, courts can still give considerable weight to the decision of the general meeting without kowtowing to it where it is established that the general meeting has devoted sufficient time and resources and given proper consideration to the matter at hand. Moreover, because there is often a range of reasonable responses for most corporate policies, strategies or decisions, the risk of the courts substituting their decisions for those of the general meeting is negligible. Further, it is one thing to say that the courts should not substitute their decisions for those of the general meeting; it is another thing to say that the courts should automatically defer to the general meeting’s decision where it is based on a plausible reason. This, afterall, is the *Allen v Gold Reefs*’ test.

¹²⁷ n 13.

¹²⁸ For example, n 11-15.

¹²⁹ *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116 at [66].

¹³⁰ J. Goodwin, “The Last Defence of *Wednesbury*” (2012) P.L. 445 at 447.

Third, the objection based on vagueness can be addressed by discerning the indicia of unreasonableness, three of which can be found in the case law: failure to give effect to or acting contrary to the purpose of the instrument;¹³¹ failure to give effect to or acting contrary to the terms of the instrument;¹³² and making a factual determination without sufficient or proper evidence.¹³³

Finally, *Braganza's Wednesbury* requirement is distinct from the *Allen v Gold Reefs*' test. When the courts have applied the test in the context of the alteration of articles (i.e. that shareholders must act bona fide for the benefit of the company as a whole), they generally took the view that provided it is not a decision that no reasonable person could have come to, the test is satisfied. In other words, they applied only the second limb of *Braganza's Wednesbury* unreasonableness requirement. The first limb of *Wednesbury* in *Braganza* – the decision-making process – is omitted. Under *the Allen v Gold Reefs*' test, it is only in very extreme situations that an exercise of voting powers will be invalidated. This approach has no bite at all except in the most egregious circumstances. To understand why this is so, we need to understand the meaning and application of the *Allen v Gold Reefs*' test. The test has been applied to mean either that the decision is one that “no reasonable men could consider it for the benefit of the company,”¹³⁴ or “the action of the shareholder is incapable of being considered for the benefit of the company,”¹³⁵ both of which has been treated as synonymous by the court. What this means is that so long as the shareholders can come up with a plausible reason as to why their decision was in the company's interest, the test is satisfied.¹³⁶ Hence in applying the test, courts will not decide whether in their

¹³¹ *Clark v Nomura International plc* [2000] IRLR 766; *Mallone v BPB Industries plc*. [2003] B.C.C. 113.

¹³² *Gan Insurance Co Ltd v Tai Ping Co Ltd* [2001] C.L.C. 1103.

¹³³ *Abu Dhabi National Tanker Co v Product Star Shipping Co Ltd (No 2)* [1993] 1 Lloyd's Rep. 397; n 108.

¹³⁴ *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 K.B. 9 at 18 (Bankes L.J.).

¹³⁵ *Ibid* at 18-19.

¹³⁶ n 13 at 681-682 (Romer L.J.).

view the decision was in fact made in the company’s best interests.¹³⁷ This test has been described a “rationality review,”¹³⁸ which is the second limb of the *Wednesbury* test.

However, as argued above, because of the vital importance of the role of the general meeting, the substantial impact of its decision on the company and other shareholders, and the potential conflicting interests between the shareholders and the company, an attenuated review comprising only the second limb of the *Wednesbury* test is wholly inadequate. In other words, we should adopt *Braganza’s Wednesbury* requirement which has both limbs. Recall that the first limb of the *Wednesbury* test “focuses on the decision-making process—whether the right matters have been taken into account in reaching the decision.”¹³⁹ Applying this to the context of company law, courts would have to evaluate whether the reasoning or decision-making process of the general meeting has included all relevant considerations and excluded all irrelevant considerations.¹⁴⁰

It is contended that all decisions of the general meeting, whether or not they pertain to the alteration of the articles of association, ought to satisfy both limbs of the *Wednesbury* test.¹⁴¹ It is necessary but insufficient that only the second limb of the *Wednesbury* test is to be satisfied and only in the context of alteration of articles or variation of class rights. In other words, under *Braganza’s Wednesbury* requirement, even if the second limb is satisfied, i.e. the decision is one that no reasonable general meeting could have made, the decision may still be set aside if the first limb is not satisfied, i.e. irrelevant considerations have been included in the decision-making process or relevant considerations have been excluded, provided that the outcome would have been

¹³⁷ *Sidebottom v Kershaw, Leese and Company Ltd* [1920] 1 Ch. 154 at 165-166 (Lord Sterndale M.R.).

¹³⁸ See for example, n 104 at 658.

¹³⁹ n 111 at [24].

¹⁴⁰ n 111 at [29].

¹⁴¹ Needless to say, from an evidentiary standpoint, it is far easier to assess whether the first limb of the *Wednesbury* test is satisfied in the general meeting of a quasi-partnership or small, private company as compared to a public company. But this evidentiary issue should not detract from the fact that the general meeting is in principle required to satisfy the first limb.

different if the right matters had been taken into account. The fact that the general meeting's decision is one that is so outrageous in its defiance of logic or evidence that "no reasonable men could have come to it ...",¹⁴² is not the only ground for impugning the decision. Accordingly, the first and second limb of the *Wednesbury* test, to which all decisions of the general meeting ought to be subject, represents an extension of the traditional bona fide requirement that is imposed on shareholders when they alter the articles or seek to vary class rights.

VII CONCLUSION

Not only do shareholders wield significant powers, these powers are augmented by the doctrine of limited liability which grants them immunity against liability for the company's debts. Nor are shareholders personally liable for the adverse consequences which may ensue from the decisions of the general meeting in the sense that they are not liable to make restitution or pay damages to the company, other shareholders or third parties who suffer damage as a result of a decision. Only in extremely rare situations such as when the corporate veil is pierced are shareholders held personally liable, and even then, the grounds on which the veil can be pierced are exceedingly narrow and limited.¹⁴³

In light of the significant powers wielded by shareholders through the ability of the general meeting to act on the company's behalf and the conflicts of interest that can arise between shareholders and the company, it is striking that under the common law, shareholders, subject to certain narrow limitations, can vote as they please without regard for, and even if doing so is antithetical to, the company's interests. This article has sought to challenge this rule. It has argued that the two ostensible reasons traditionally put forward in support of this rule are fundamentally flawed. It provides three legal justifications as to why this rule should be reconsidered with a view

¹⁴² n 134 at 24 (Scrutton L.J.).

¹⁴³ *Prest v Petrodel Resources Ltd* [2013] 2 A.C. 415.

to making the default position one that requires shareholders to exercise their voting powers responsibly so as to ensure that they are accountable.