COMPANY LAW REFORM[1]

Throughout the world there is at the moment a quite exceptional wave of activity in the field of company law reform. The United Kingdom, Northern Ireland, the Irish Republic, the Australian States, Ghana, Nigeria, Israel, the Federation of Rhodesia and Nyasaland, France and Western Germany are at the moment all in process of reforming their company law. India, after a root and branch reform as recently as 1957, is revising all over again. Kenya, Uganda and Tanganyika adopted new Companies Ordinances in 1959.

My concern in this paper is primarily with the countries of the Commonwealth, and in particular with the Afro-Asian countries which have either recently attained independence or will shortly do so. Most of these have Acts based upon the United Kingdom Act; indeed there was a time when the English Act was so widely copied or re-enacted that it was virtually a Commonwealth Act of Parliament. This had one obvious advantage — uniformity; it meant that the company lawyer wherever he went in the Commonwealth could move with some assurance. But unfortunately, that uniformity is beginning to break down, for two reasons. In the first place, various countries have adopted the last English Act only very belatedly. We in England are at the moment operating under an Act passed in 1948. You in Singapore and Malaya are still operating on Ordinances based on the English Act of 1929. But you are comparatively well off: in West Africa, for example, Ghana at the moment has an Ordinance based on the English Act of 1862, Nigeria has an Ordinance based on the English Act of 1908 with sundry amendments since, Sierra Leone has one based on the English Act of 1929, and only Gambia, which is probably the least economically developed of the four, has one based on the English Act of 1948. Secondly, a number of Commonwealth countries have recently begun to diverge quite radically from the English model. Some of the Canadian Provinces have done so under American influence. South Africa revised her Companies Act after the English Act of 1948 and went considerably further in a number of directions. India now has a most elaborate Act, which diverges quite substantially from the English model. And recently Victoria and Tasmania have adopted Acts in similar terms which are totally different in layout and substantially different in matter from the English Act.

1. The substance of this paper was delivered as a lecture at the University of Malaya in Singapore and in Kuala Lumpur in December 1960.

Hence complete uniformity of Commonwealth company law has broken down. Fortunately, there are signs that regional uniformity may take its place. In Australia, where hitherto the States have had their own Acts each of which is different from the others, a Uniform Companies Bill, based upon the Victoria and Tasmania Acts, has recently been drafted and is likely to be adopted by all. Similarly Kenya, Uganda, and Tanganyika have recently adopted identical Companies Ordinances. It seems to me that this points the way for desirable future development. Obviously those Commonwealth countries which are closely inter-related regionally and economically should strive to have uniform Companies legislation. Unfortunately, there are rivalries and jealousies in certain parts of the Commonwealth that make this difficult of attainment. But at least Malaya and Singapore should be able to remain in step, and ultimately perhaps so will the West African, the East African and the Central African countries, and India and Pakistan. And perhaps ultimately we will go full circle and come back to Commonwealth unity again. If that occurs it may well be that the United Kingdom will adopt an Act of one of her former dependencies instead of *vice versa.*

What then should be the basic nature of a reformed Companies Act in the Afro-Asian countries of the Commonwealth? Should it still preserve the basic principles of English law and equity, or should it look elsewhere for inspiration?

I hope it is not just prejudice, patriotism and imperialism that makes me answer unhesitatingly that basic English principles should be preserved. The arguments for this seem to me to be overwhelming. There is no such thing as a peculiarly Afro-Asian type of business corporation. The joint stock company is essentially a product of Western industrial civilisation and its legal regulation has to be based on one of the Western models. All these Afro-Asian countries of the Commonwealth have for many years had Acts based upon the English model. Their lawyers, their accountants and their businessmen, have become familiar with this model. To try now to uproot the past and start from an entirely different source would cause endless trouble and would discourage economic development rather than encourage it. And besides, the English model is a pretty good one to follow, forming as it does, the basis of the company law of a very large part of the Non-Communist World — not only the Commonwealth but also the U.S.A. It is a system, in other words, familiar to some of the most important sources of foreign investment which most Afro-Asian countries need.

Am I saying, then, that these countries should continue, albeit a little more speedily, to copy the latest English Act? Certainly not. To my mind the English Act has grave defects in its domestic setting. These defects become almost fatal when the Act is transported into an Afro-Asian setting. The major defects, as I see it, are these:

1. GENERAL ARRANGEMENT

Since 1862 we in England had never produced a new Companies Act starting from scratch. What has happened is that at intervals of about 20 years an expert committee has reviewed the existing law and has made recommendations for reform. An Act has then been passed embodying most of these reforms. This draws the attention of the profession to what those reforms are. But this amending Act has never been brought in to actual operation. It is immediately repealed, the principal Act which it amends is also repealed, and a new consolidating Act, embodying the old Act and the new, is brought into operation. But if the consolidating Act is to pass through Parliament under the special speedy procedure for consolidating measures, it must not include any more amendments. This has meant that the draftsman has never had an opportunity of giving a real spring-cleaning to the English Act. If you compare the arrangement and the length of our 1948 Act with the new Model Bill in Australia you will see how much stream-lining and pruning is possible. Moreover, I am rather dubious whether a revision based upon the report of a largish committee is really the best way of producing an Act of Parliament with a consistent philosophy. The report will almost inevitably represent to some extent a compromise between conflicting views, and consequently the resulting legislation is likely to be something of a patchwork.

2. ABSENCE OF CODIFICATION

My second objection is more important. The English type Companies Act has never attempted to codify company law. It has merely consolidated the statutory rules which are superimposed upon a body of common law and equity embodied in decided cases (mainly English) extending back a century or more. No one who reads the Act can really understand it unless he is reasonably familiar with those decided cases. Many of the most vital principles are never embodied in the Act at all, though often exceptions from them and corollaries to them are stated. It presupposes the existence of the basic principles which it never states. For example, nowhere you will find a statement of the *ultra vires* doctrine; of the rules relating to the raising and maintaining of capital; of the famous rule in *Royal British Bank* v. *Turquand;* of the rule in *Foss* v. *Harbottle*; or of the duties of directors. These are based solely on case law and they have to be extracted from a study of innumerable decided cases, some of them virtually irreconcilable, and the true position emerges, if at all, only when the Act is studied against the background of these decisions. This makes for difficulty in England where there are plenty of trained lawyers and accountants and plenty of law libraries. It makes for still greater difficulty in Afro-Asian countries where these facilities may be lacking. In Malaya and Singapore you are

unusually well-equipped in this respect. But even here, I imagine that you must find it a nuisance at the very least.

3. INAPPROPRIATE TO SMALL BUSINESSES

My third major objection is that the United Kingdom Act and the Ordinances based on it seem to me to be defective in that they do not sufficiently distinguish between the needs of a small family concern and a large public or private company. Both are encouraged to incorporate, and to incorporate with limited liability and with a separation, or a possibility of a separation, between ownership and management. If commerce and industry are to develop, I think it vital that businessmen should be encouraged to personify their businesses however small and give them a distinct legal existence. This enables the business assets and liabilities to be distinguished from personal assets and liabilities. It gives the business a far better chance to expand, and a far better chance of surviving on the death of the founder.

But incorporation is one thing, and limited liability and the separation of ownership and management are different things altogether. In practice under our system, private companies, however small, are incorporated with limited liability because it is as easy and cheap (or at least it is as easy and nearly as cheap) to form a company with limited liability as it is to form one with unlimited liability. But I doubt if the founders are really concerned about limited liability, and if they are that may be a very good reason for denying it to them. Normally what they want are the other advantages of incorporation — a separate business entity, perpetual succession, easier borrowing by way of floating charge and, especially, tax advantages. It is only when the business grows beyond the scope of the family capital that limited liability becomes important: then outside risk capital cannot be enlisted unless there is limited liability. But until then limited liability is not really important — and indeed is a sham. The small family concern will not be able to get any sizable credit facilities unless the members or directors give personal guarantees. What really happens is that business concerns of this sort trade with unlimited liability towards the bigger creditors and limited liability towards the smaller trade creditors. When the business fails the big creditors who have personal guarantees get paid if the members of the company are worth powder and shot; the small trade creditors get nothing or virtually nothing because the business was grossly under-capitalised from the beginning and nothing is left. This seems to me to be profoundly unsatisfactory.

Equally unsatisfactory is the fact that with every incorporated company under our system, it is envisaged that a distinction will be drawn between membership and management. Now with a small family concern, in the first instance this is not so. There is no separation: the

members and the directors are the same people and they will not clearly distinguish what they do in one capacity from what they do in another. And whatever they take out of the business will be in the form of directors' remuneration and not in the form of dividends. This is advantageous tax-wise and at this stage it does no harm. But then what happens? One of the founders dies and his share passes, let us say, to his widow. Now there is a separation between ownership and management. But the surviving directors go on just as before, and continue to take out all the profits in the form of remuneration. What was formerly a legitimate piece of tax avoidance now becomes a shocking fraud on the widow.

The fact that incorporation as a company carries with it these two consequences — limited liability and separation of ownership and management — means that the legal rules relating to private companies have to be almost as complicated as those relating to public ones. Creditors have to be protected against the dangers of limited liability; members have to be protected against the misdeeds or possible misdeeds of the directors. Indeed the safeguards needed are probably greater than with public companies. Large public companies on the whole are efficiently and honestly run and they function in the fierce blaze of newspaper publicity. It is with small private companies that people get their fingers burnt — little people who can ill afford it. These small companies constantly fail. Because they are small the failure excites no publicity and is rarely reflected in the liquidation figures because nobody bothers to wind them up. There is not enough left to make it worthwhile. They just go out with a whimper leaving a number of small creditors crying for their money.

Probably the elaborate precautions which we already have are inadequate. On the other hand, they are too elaborate for the small family concern. How many private companies in fact comply with all the rules in the Companies Act? Not all in England. Precious few in Africa. In Malaya and Singapore? You know the answer better than I do.

These being the three major defects of our present legislation, how should they be eradicated?

1. Streamlined Arrangement

First, I would suggest that an Afro-Asian country wishing to adopt a new Companies Act should not just take the United Kingdom Act and add to and subtract from it. There should, in my view, be a new approach; a new approach both in form and substance. As I have said, preserve the present basic principles by all means, but do not slavishly follow either English law or the English Act. A new streamlined

arrangement should be adopted. And the draftsmen should not be afraid to borrow from other systems — from France, from Germany, from Scandinavia, from America. He should not be afraid to adopt completely novel ideas if he thinks they are appropriate to the local conditions. And certainly he should not be afraid of pruning ruthlessly. There are many sections of the English Act which are virtually obsolete in England, and there are others that are totally inappropriate except in England: both should be eradicated.

2. Codification

Secondly, I suggest that the company law should be codified. This is a suggestion which will shock the orthodox, for codification is out of fashion in the common law world to-day. But after all, here we have a branch of commercial law which should be reasonably intelligible not only to the lawyer but also to the accountant, to the company secretary, and to the company director. At present it is a jungle through which he certainly cannot find his way. And even the lawyer cannot find the answer except by delving into a mass of alien case-law. It seems to me quite lamentable that countries which attain independence should remain saddled with Companies Acts which are only intelligible in the light of foreign decisions extending over the last two centuries.

Some will say that it would not be possible to codify without producing an Act which would be enormously long. This I do not believe. The new Australian Model Bill is very much shorter than the English Act. It is by no means a complete code; on the other hand, it does enact a number of rules which hitherto have been left to judge-made law. It sets out briefly the fiduciary duties of the directors, for example. In Israel (another country which at the moment has an Act based on the English Act of 1929) there has been prepared a very interesting and comprehensive draft code which is considerably shorter than any English-type Act. The draftsman has achieved this by adopting a civil law technique of draftsmanship — stating broad general principles in short pithy sentences. Frankly I am somewhat, doubtful myself whether this would work in a country where the judges and lawyers have been brought up in the English legal tradition and expect statutes to spell out the law in some detail. Accordingly in the draft code which I prepared for Ghana I have spelt matters out in more detail. Even so, in length (if in no other way) it compares favourably with the English Companies Act. In other words, it can be done and I think it should be done.

3. Incorporated Partnerships

Thirdly, I suggest that a new form of business organisation is needed for the small family concern. Here, the legal regulation should be very simple; simple enough for small businesses run by relatively

unsophisticated people. There should be no limited liability and no separation of ownership and management; as I have already argued, if these are present you inevitably get complications. Such a form of organisation already exists in embryo — the partnership. And the law is already codified in the Partnership Act of 1890. But at present the English type of partnership is subject to two fatal defects: (i) it does not incorporate the firm, and (ii) the firm is dissolved on the death or retirement of any partner. Remove these defects and it will do very well.

What is wanted, I suggest, is an Incorporated Partnership Act (separate from the Companies Code) providing that, on the registration of certain very simple particulars, broadly the same as those required under the Registration of Business Names Ordinance, the firm should become a distinct legal entity; a new corporate body which would continue to exist until formally liquidated, irrespective of changes in the partners. On the death or retirement of any partner, the other members should have the option of either buying out his share, or of admitting his successors and assigns into the partnership if they want to come in, or of winding up. In every other respect, or pretty well every other respect, the existing law in the Partnership Act could continue to prevail. It provides what is wanted: there is no limited liability, and there is no separation of management and ownership. On the other hand, all the other advantages of a corporate personality should be afforded. The firm should be allowed to borrow on floating charge and given all the tax advantages of an incorporated company.

If this very simple organisation were available for a small family concern, no harm would be done if the Companies Code were relatively complicated and provided really adequate protection for creditors, shareholders, and investors.

4. Increased Creditor Protection

Accordingly my fourth suggestion is that the Companies Code should go considerably further in creditor protection than either the English Act, or the existing Ordinances. In the first place, it should, in my view, take steps to prevent limited companies from getting under way when they are grossly under-capitalised. English law is, I think, almost unique in providing no minimum paid up capital for limited liability companies. One company in England was formed with a paid up capital of one halfpenny divided into two one farthing shares. We have now abolished the farthing, so in future, presumably, two halfpenny shares and a paid up capital of a penny will be needed; but it does not seem to me that this is really an adequate basis for trading with limited liability. In West Africa I found that there were quite a number of

companies which had nominal capitals of millions of pounds but not a penny of it was paid up. They proudly advertised on their notepaper "nominal capital £10 million"; not a word was said to suggest that the capital was nominal indeed!

It seems to me to be quite self-evident that no one should be allowed to trade with limited liability unless he is prepared to put a reasonable amount of capital into his business. There is no hardship here on the small businessman. Nobody is preventing him from trading. All one is saying is that if he wants to trade without personal liability he must put a reasonable amount of assets into the business, which alone is going to be liable for the business debts. If he is unable or unwilling to do that, let him trade with unlimited liability. The proposed Incorporated Partnership Act can afford him all the advantages of incorporation except limited liability; if he wants that as well he should provide some guarantee of creditworthiness. What the minimum paid up capital should be is a matter of taste, and probably varies from country to country. Even if it were quite small, say the equivalent of 10,000 Straits dollars, of which 2,000 dollars should be paid up in cash, it might prevent a number of present abuses.

Secondly, I suggest that every limited liability company should be made to publish its balance sheet and profit and loss account. Under the existing Ordinances in Malaya and Singapore it is only a balance sheet that has to be published and not even that in the case of every private company (and private companies include a number of companies that are by no means small family concerns). Under the English Act of 1948, both the balance sheet and the profit and loss account have to be published, but there is an exemption for certain private companies. We tried rather unsuccessfully to lay down a legislative definition of what a small family concern is, and we let them off. But why? If a person wants to trade with limited liability surely he ought to make public the accounts of the business so that the people dealing with it can see whether there is a reasonable prospect that the business will be able to meet its obligations?

5. INCREASED INVESTOR PROTECTION

Fifthly, the Companies Code should go considerably further in protecting members and investors and in fettering the plenary powers of the directors. Our 1948 Act has gone some way in this direction. In particular we have enacted section 210 which affords the new remedy against oppression alternative to winding up. This has proved distinctively useful, but it does not go far enough. It applies only where there is a course of oppression which would justify a winding up order. It should be extended so that it applies generally to cases where there is a breach of the director's duties so as to enable any shareholder

to bring an action. At the moment the directors' duties are largely unenforceable except in liquidation because of the mysteries of the rule in *Foss* v. *Harbottle.*

The 1948 Act has also extended the powers of the Board of Trade (the relevant Ministry) by enabling them to appoint an inspector on their own motion and to take proceedings on behalf of the company or the members if his report reveals improprieties. This affords some recognition of what I believe to be true, namely that the time has gone when investors can be left to protect themselves. Even, perhaps especially, in a private enterprise economy the State must provide a watch dog to protect them. In the U.S.A. the Securities and Exchange Commission goes quite a long way in this direction.

But no watch dog can protect against incompetence or inefficiency. The only safeguards here are to ensure that the directors are answerable to some body which can dismiss them, and that that body is afforded the fullest possible information by the directors regarding the exercise of their stewardship. We seek to secure this by making the directors answerable to the shareholders and by providing for disclosure through accounts. Here again the 1948 Act has made some advances. Far more details have to be given in the accounts — though here again we still lag far behind the U.S.A. (for example, turnover figures are not compulsory). And whatever the articles of association may say the directors can now be dismissed by ordinary resolution at any time. It used to be said that it was pointless to increase the powers of the members because they were a flock of sheep who would never exercise independently any power they were given. We forgot that among them there might be a wolf in sheep's clothing — the take-over bidder. The spate of take-over bids in the last ten years has, I am sure, caused the directors to keep very much on their toes. If they do not make the best use of the assets entrusted to their stewardship, A Big Bad Wolf may gobble them up. On the whole this seems to me to be very salutary.

Unfortunately many boards of directors have dug themselves in by issuing non-voting ordinary shares to the public while they retain the voting shares which give them absolute control though they are only a minute fraction, sometimes as little as 2% or 3%, of the equity. Such boards are immovable without their own consent, however incompetent they may be, and if they consent to go they can get a handsome premium for their shares because they are transferring control.

This seems thoroughly objectionable. Our new Companies Code should, I am sure, ban non-voting shares. I may say that we are at present in a minority in allowing them. In most of the countries of the European Continent votes must be proportional to shares in capital. Non-voting ordinary shares in public companies are banned by the

Indian and South African Acts. In the U.S.A. the New York Stock Exchange refuses to list them, which has much the same effect.

6. Simplification

But although our new Act should provide additional safeguards, it can and should, introduce many much needed simplifications.

Why have the distinction between the memorandum and articles? Why not merge them into one document — the Regulations ?

Why insist on more than one member of a company? Many companies in fact are one-man companies — why not face the facts? Why preserve the fiction that a company is an association of persons? It is not; it is a personified business. Insisting on several members does no good to anyone — for members *qua* members have no duties or responsibilities. But what we do need is two or more directors, and the Code, I suggest, should so provide.

Clearly something should be done about the *ultra vires* doctrine. Bona fide third parties should not be concerned to see whether companies are acting within their objects; nor should they be saddled with constructive notice of everything in the company's public documents; it defies business practice to lay down rules which presuppose that nobody deals with a company until he has sent a trained lawyer to inspect its file at the Companies' Registry. On the other hand, a stricter limitation should be imposed on the directors so that they cannot change to some totally different business without letting their shareholders know anything about it.

Clearly, too, we should provide that a company can adopt contracts purporting to be made on its behalf prior to its incorporation. How can any lawyer read *Kelner* v. *Baxter* and *Newborne* v. *Sensolid* without blushing?

7. Reforms

Finally let me refer to two other much needed reforms which our Code should contain — there are, of course, many others but time is running out and I regard these as particularly important.

The first is the introduction of no-par value shares. One of the objects of our Code should be to encourage investment in companies by a wider range of people. The first thing to do is to help them to understand what a share is. And what it is is an aliquot part or share in a business, the value of which fluctuates with the value of the business. All this would be simple enough but for the fact that, for

purely historical reasons, we insist that some fixed value, $1, $10, £1, should be attached to it. This value may not represent its true worth or price even at the date of its issue, for it may be, and often is, issued at a premium. It is highly unlikely to represent its value later on. If the company has done well it will be worth more; if the company has done badly it will be worth less. Its value, and its price on the market, may vary from nothing to infinity. But we go on calling it a ten-dollar or £1 share. Can we wonder that the unsophisticated investor thinks that he has a bargain if he buys a $10 share for $6 and that he has been done if it costs him $15? Moreover, this arbitrary and quite unnecessary par value causes particular confusion in schemes of arrangement and capital reduction. And then it is not only unsophisticated investors who have had the wool pulled over their eyes. Judges have too.

As you may know, over six years ago the Gedge Committee in England recommended the introduction of no-par shares. The Government said that they accepted the report and would act on it when time permitted. We are still waiting and the Jenkins Committee is now considering it again. The Gedge Committee thought that no-par shares should be allowed only in the case of ordinary shares and that they should be optional. Whatever may happen in England I suggest that we should go the whole way in our Afro-Asian Code; that is to say we should provide for compulsory no-par in the case of all classes of shares. I agree that par values are somewhat less misleading in the case of preference shares. But they can be very misleading there too. Recently a company issued what it described as 8½% preference shares with rights of participation up to 12%. They were issued at 6/3d. but given a par value of 5/–. Hence the so-called 8½% produced a yield of less than 7% and the 12% became only 10%. Moreover on a winding up or return of capital all the shareholders got was "the capital paid up thereon". I wonder how many investors knew that this meant only 5/– and that they would lose 1/3d per share.

More controversial, no doubt, is my suggestion that no-par should be compulsory and not optional. But it is only by making them compulsory that simplicity and comprehensibility can be achieved. If both par and no-par exists side-by-side investors will have to learn to understand both and confusion is likely to become worse confounded. The legislation will have to deal with both and will itself become more complicated still. Companies will issue par shares or no-par shares according to what suits *them* best and those who want to mislead will continue to do so. I therefore incline to the view that a legal system should either allow par shares or no-par but not both. And clearly no-par is the more logical and infinitely the more simple.

The second suggested innovation is that companies, subject to proper safeguards, should be allowed to buy back their own shares. Until

towards the end of the last century they used to do so and American companies still can and do. In England, however, the House of Lords in the famous case of *Trevor* v. *Whitworth* held that this was illegal as an unauthorised reduction of capital. That it is possible to provide for a repurchase of shares without reduction of the capital yardstick is shown by the present provisions relating to redeemable preference shares. It would, I suggest, be worthwhile to go further; to take a leaf out of the American book and to permit repurchase by the company of any class of share. If this could be done it could often be helpful on the death of a member of a private company. It would also make employee-share-ownership schemes infinitely easier to operate. And finally it would enable us to use a much simpler organisation for the Unit Trust. In America the equivalent investment medium is almost invariably run as a company — an open end investment trust company or mutual fund. Owing to the inability of our investment trust companies to buy back their share, that is to be open-ended, we have to adopt a much more complicated device with separate managers and trustees. In Australia they have tried to get round this by operating as unlimited companies — for these can reduce capital — but this is an unsatisfactory solution. Why not scrap the rule in *Trevor* v. *Whitworth?* American experience has shown that such dangers as there are can be adequately guarded against.

There then, in broad outline, is my blue-print for a Companies Code suitable for an Afro-Asian member of the Commonwealth. If anyone is interested they will be able to see the outline filled in by reading the Report of the Commission of Inquiry into the Company Law of Ghana. Some of the recommendations in that Report are doubtless inappropriate elsewhere. But I venture to submit that they are more likely to be appropriate to conditions in other Afro-Asian countries than the present English Act.

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