JUDICIAL REFORM OF COMPANY LAW IN THE UNITED KINGDOM

THE FUNCTION OF JUDICIAL REFORM IN COMPANY LAW

The development of company law in the United Kingdom has proceeded spectacularly from one company law reform to another. In the 20th century, the milestones of progress are the names of the great judges who presided over the successive company law reform committees, Lord Loreburn, Lord Greene, Lord Cohen[1] and at present Lord Jenkins.[2]

Important as the statutory reform of company law is, it is not the only — and perhaps not even the most important — source of law reform. What matters most in a subject such as company law which, in essence, is the law of business organization and management, is the spirit in which the existing law is administered. If the decisions of the courts are formal and sophisticated, businessmen and their professional advisers tend to indulge in subterfuge and abuse of legal facilities. If, on the other hand, the courts make it clear that in the interpretation of the existing law they will not tolerate legalistic formalism and rate fairness and sense of responsibility higher, they will create a favourable climate of company administration which will remain tolerably clean. It is now generally accepted that the doctrine of the common law that the courts merely interpret the law but do not create it is a pious myth rather than a realistic appreciation of facts. Statutes are the tools which the legislature entrusts to the courts; by interpreting them the courts give them life and perform a law-making function, and by interpreting a statute in a progressive spirit they engage in law reform, within the limits imposed by the words and intent of the statute. In that sense it is justified to talk of judicial law reform.

It is intended in this paper to indicate the climate of company administration created in the United Kingdom by the leading cases decided since 1948. That the House of Lords, when interpreting the provisions of the Companies Act, 1948, adopted a modern and progressive attitude which is in contrast with the traditional conservatism characterising many of its decisions on other current issues, is, to no

1. Who presided over the Committees which initiated the reforms of 1907-1908, 1928-1929 and 1947-1948 respectively.

2. The Report of the Jenkins Committee is due to be published in 1962.

small degree, due to the influence of Viscount Simonds who, as Mr. Gavin Simonds, was one of the most celebrated company counsel of his time. The general aim of the judicial law reform carried out in the United Kingdom since 1948 is to reduce the gap between the legal way of thinking and the best opinion accepted in business and finance on matters of company administration. The extent and success of this judicial law reform will be appreciated if it is realized that many of the cases which came before the courts raised issues of legal policy and that company law and practice in the United Kingdom would look very different to-day if these issues had been decided differently.

PROTECTION AGAINST OPPRESSION

The most valuable contribution which the House of Lords made to the judicial reform of company law is that in *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer*[3] it gave unqualified effect to the intention of the legislator to prevent oppression of shareholders within the limits of section 210. The relief which that section provides is available if the following conditions are satisfied: first, it must be proved that the affairs of the company are conducted "in a manner oppressive to some part of the members" (including the petitioner) ; secondly, oppression must be practised upon the person concerned in his capacity as member and not in any other capacity, e.g., that of director; and thirdly, the judge, if asked for it, will be prepared to make a winding up order under the "just and equitable" provision of section 222 (f).

The facts of *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer* are too well known to require detailed recounting here. Suffice it to state that it was the first of the three requirements which, perhaps, is not worded too happily in section 210, which was in issue in that case. That requirement is capable of a restrictive or a liberal interpretation. There was little doubt that the Scottish Co-operative Wholesale Society had acted oppressively but it was argued on its behalf that its behaviour did not qualify as oppressive conduct in the affairs of the relevant company, the Scottish Textile and Manufacturing Co. Ltd., a subsidiary of the Scottish Co-operative, in which that company held the majority of shares and Dr. Meyer and Mr. Lucas were minority shareholders. It was argued on behalf of the Scottish Co-operative that if the majority shareholders acted oppressively, that could only be regarded as conduct in its own affairs, by using methods of economic warfare against the relevant company which was its competitor in the rayon market. It was further contended that all that could be said of the Scottish Co-operative's behaviour was that it remained inactive and failed to come to the help of its subsidiary and that such sins of omission did not amount to "conduct" which implied an active interference on the part of the

3. [1959] A.C. 324.

majority shareholders. That these arguments were weighty can be seen from Lord Morton of Henryton's speech.[4] The *Scottish Co-operative* case, although a clear attempt at a "squeeze-out" of the minority by the majority, was not easy to bring within the four corners of section 210, and there was ample opportunity for the House of Lords to adopt the restrictive interpretation of that section on narrow, legalistic grounds. The House of Lords did nothing of that kind but unanimously adopted a liberal interpretation of section 210. It held that "conduct" includes "negative conduct," *i.e.,* an omission, and adopted[5] the statement of Lord President Cooper in the Court of Session that "whenever a subsidiary is formed as in this case with an independent minority of shareholders, the parent company must, if it is engaged in the same class of business, accept as a result of having formed such a subsidiary an obligation so to conduct what are in a sense its own affairs as to deal fairly with its subsidiary." Moreover, the House of Lords adopted this wide interpretation as a matter of deliberate legal policy. Viscount Simonds observed : —[6]

> If this section is inept to cover such a case, it will be a dead letter indeed. I have expressed myself strongly in this case because, on the contrary, it appears to me to be a glaring example of precisely the evil which Parliament intended to remedy.

The immediate effect of this interpretation of section 210 was to dispel the view widely held by company lawyers in the United Kingdom that the section had failed to achieve its main objective, owing to its defective wording. It is now realized that the section provides, in fact, a highly effective means of preventing oppression which was defined by Viscount Simonds in the *Scottish Co-operative* case[7] as conduct which was "burdensome, harsh and wrongful." The ratio of that case was at once applied by the Court of Appeal in *Re H. R. Harmer Ltd.*[8] where Jenkins L.J. defined the scope of section 210 as follows :[9] first, "the oppression complained of must be ... oppression in ... his capacity as a member ... of the company as such;" secondly, the section does not "apply to every case in which the facts would justify the making of a winding up order under the 'just and equitable' rule, but only to those cases of that character which have in them the requisite element of oppression;" thirdly, "the phrase 'the affairs of the company are being conducted' suggests *prima facie* a continuing process and is wide enough to cover oppression by anyone who is taking part in the conduct of the affairs

4. *Ibid.,* pp. 346-347.
5. *Ibid.,* p. 343 (Viscount Simonds); p. 362 (Lord Keith of Avonbohu).
6. *Ibid.,* p. 342.
7. *Ibid.,* p. 342.
8. [1959] 1 W.L.R. 62.
9. *Ibid.,* p. 75.

of the company whether *de facto* or *de jure;*" and fourthly, "*prima facie* . . . the word 'oppressive' must be given its ordinary sense."

The strongest argument against the application of section 210 in the *Harmer case* was the contention that the father had acted oppressively in his capacity as member of the board of directors, and not as shareholder. Here again, a wide interpretation was given to the section. Romer L.J. observed[10]:—

> If the Board is browbeaten and either ignored or over-ruled by one of its members, in this case the father, in reliance on his superior voting power, the proprietary interests of the minority shareholders cannot fail to be affected, and a case of oppression within section 210 is, in my judgment, made out.

The protection which the minority shareholder enjoys in the United Kingdom under section 210 should be contrasted with the position in the United States which forms the subject matter of a recent profound study by Professor F. Hodge O'Neal and Mr. Jordan Derwin, entitled *Expulsion or Oppression of Business Associates: "Squeeze-Outs" in Small Enterprises.*[11] Professor O'Neal writes : —[12]

> The minority shareholder in the United States receives considerably less protection against oppression than his British counterpart enjoys; in particular, no State in the United States has legislation similar to section 210 of the United Kingdom Companies Act, 1948. At the same time, American businessmen and their legal advisers have been exceedingly resourceful in developing techniques for oppressing minority owners.

Valuable as the safeguards of section 210 are, they are not the last word in the protection of minority shareholders. It is to be hoped that the Jenkins Report on Company Law Reform will extend the ambit of the provision. In particular, it is to be hoped that the well-known exception to the rule in *Foss* v. *Harbottle*[13] in the case of acts which constitute a fraud against the minority[14] will be included into the ambit of the provision and that the provision will be extended to cover cases such as *Pavlides* v. *Jensen.*[15] This can be done by making the relief of the section available in cases of unfair treatment of shareholders, in addition to oppressive conduct.

10. *Ibid.,* p. 87.
11. Duke University Press, Durham N.C., U.S.A.; and Cambridge University Press, U.K.
12. In "Squeeze-Outs in American Corporations," [1962] *Journal of Business Law,* 210.
13. (1843), 2 Hare 461.
14. See Palmer's *Company Law,* 20th ed., pp. 498-501.
15. [1956] Ch. 565.

ABUSE OF TAKEOVER PROCEDURE

An important provision of the Companies Act, 1948, is section 209 which, in the case of a successful takeover bid, enables the bidding company compulsorily to acquire the shares of a dissenting minority of one-tenth or less of the shares in the company which is to be taken over, subject to certain safeguards. The provision is exceptional in so far as an expropriation of a shareholder is normally not admitted unless an expropriating clause is contained in the articles.[16]

In *Re Bugle Press Ltd.*[17] an ingenious attempt was made to use the expropriation provision of section 209 for a purpose for which it was not designed. If that attempt had been successful it would have opened up the prospects of a new squeeze-out technique in English law. The facts of the case were, in essence, that two shareholders in the Bugle Press Ltd., a prosperous company, held 90 per cent. of all shares, the remaining 10 per cent. being held by a third shareholder. The two majority shareholders who wished to compel the minority shareholder to sell out formed a new company which made a takeover bid for the shares of Bugle Press. The two majority shareholders approved the proposal of the new company. That appeared to bring the scheme within section 209 and the new company now purported to acquire compulsorily the shares of the dissenting minority shareholder. The attempt failed. Harman L.J. said bluntly : —[18]

> This is a barefaced attempt to evade the fundamental rule of company law which forbids the majority of shareholders, unless the articles so provide, to expropriate a minority.

Here again the Court adopted a broad view and rejected a purely technical approach. Buckley J. had held in the court of first instance that, in the exceptional circumstances of the case, the onus of proving that the proposed scheme was fair was on the transferee company while normally the opposing minority shareholder has to prove that the proposed scheme was unfair. The Court of Appeal preferred to found its decision on the wider ground that if the offeror and the assenting majority shareholders in the company to be taken over are the same, section 209 was used not for the purpose of any scheme or contract properly so called or contemplated by the section but for the quite different purpose of enabling majority shareholders to expropriate or evict the minority

16. *Cf. Brown* v. *British Abrasive Wheel Co.* [1919] 1 Ch. 290 and *Sidebottom* v. *Kershaw, Leese & Co. Ltd.* [1920] 1 Ch. 154; Palmer's *Company Law,* 20th ed., p. 499.

17. [1961] Ch. 270.

18. *Ibid.,* pp. 287-288.

and that that was *prima facie* a purpose for which the court ought not to allow the section to be invoked unless, as Lord Evershed M.R. added : —[19]

> At any rate it was shown that there was some good reason in the interests of the company for so doing, for example, that the minority shareholder was in some way acting in a manner destructive or highly damaging to the interests of the company from some motive entirely of his own.

Harman L.J.[20] even went as far as to state that the squeeze-out scheme of the majority shareholder "never came within [section 209] . . . the minority shareholder might have ignored this notice altogether, but he had no courage to do that."

It should be noted that the *Bugle Press* case has various features in common with the *Scottish Co-operative* case. Not only took the Court of Appeal in the *Bugle Press* case the same broad view as the House of Lords in the other case, as a matter of legal policy, but it resolutely lifted the veil of corporateness where the concept of legal personality was employed as an instrument of oppression and abuse. In the *Scottish Co-operative* case the court established the rule that a holding company which had a subsidiary with an independent minority had a duty to deal fairly with such subsidiary, and in the *Bugle Press* case the majority shareholders and the new company which they had formed for the purpose of making the takeover bid, were treated as the same economic unit. This attitude is the more remarkable as the courts have rightly emphasised their adherence to the fundamental principle of *Salomon* v. *Salomon & Co.*[21] in several recent decisions.[22]

Although in the *Bugle Press* case the attempt to use section 209 as a cover for a squeeze-out of a minority shareholder was defeated, it should not be thought that the provisions of the 1948 Act dealing with takeover bids are satisfactory. They had to be supplemented in the United Kingdom by the code on takeover bids published by the Executive Committee of the Issuing Houses Association under the title *Notes on Amalgamation of British Businesses*[23] and by regulations approved by the Board of Trade under the Prevention of Fraud (Investments) Act, 1958.[24] These measures inspired the Australian Model Companies Bill

19. *Ibid.*, p. 287.

20. *Ibid.*, p. 288.

21. [1897] A.C. 22.

22. *Lee* v. *Lee's Air Farming Ltd.* [1961] A.C. 12; *Tunstall* v. *Steigman* (1962), *The Times,* March 24.

23. Published by the Issuing Houses Association in 1959.

24. Licensed Dealers (Conduct of Business) Rules, 1960, (S.I. 1960 N.O. 1216).

which is the basis for the forthcoming unification of Australian company law to provide, in a schedule to the Model Bill, a code to govern takeover bids.[25] It is to be hoped that the Jenkins Committee will recommend a reform of takeover law on the lines of the Australian Model Bill.

TAKEOVER OF PRIVATE COMPANIES

The trend of judicial law reform which is apparent in the cases discussed so far is likewise discernible in another leading case, decided since the passing of the Companies Act 1948, namely in *Lyle & Scott Ltd.* v. *Scott's Trustees.*[26] Here again an evasive attempt was supported by legalistic arguments which again were rejected by the House of Lords in no uncertain terms. Lyle & Scott Ltd. were a private company carrying on a knitwear and hosiery business in Scotland. The articles of the company provided a pre-emptive right of the ordinary shareholders to acquire shares which were offered for transfer and imposed an obligation on every ordinary shareholder who was "desirous" of transferring his shares to inform the secretary of the company of that fact. A takeover bidder approached the shareholders of the company to purchase their shares and the majority agreed to sell the shares and receive the purchase price for them, but the company contended that the shareholders were bound to comply with provisions of the pre-emption clause and to tender the shares to the minority shareholders who were unwilling to sell their shares to the bidder. In the House of Lords it was contended for the majority shareholders that they were not "desirous" of transferring their shares. Evidently their intention was to constitute themselves nominees for the bidder and to vote the present Board out of office at the next occasion. Viscount Simonds said[27] that "at least one acid test would be the return by them of the price they had received," and as they had not returned the price there was no genuine change of mind on their part and they were still "desirous" of transferring their shares to the bidder. The further argument of the majority shareholders that they were no longer "desirous" of transferring their shares because their task had already been done and their desire satisfied, was rejected by Viscount Simonds, in a masterly understatement, as "almost humorous."[28]

The decision of the House of Lords in the *Lyle & Scott* case is of the highest importance in company law. It preserved the private character of the private company in English law. It made it impossible for an outsider to break into the "close corporation" as the Americans call the

25. See Professor Ross W. Parsons, "Uniform Company Law in Australia," in [1962] *Journal of Business Law* (July) and Professor H. A. J. Ford at p. 48, *supra.*
26. [1959] A.C. 763.
27. *Ibid.*, p. 774.
28. *Ibid.*, p. 774.

private company, contrary to the provisions of the articles. Again the House of Lords paid more attention to substance and legal policy than to subtlety and legal technicality. How different would be the climate of company law in the United Kingdom to-day if the case had been decided differently!

The same strictness can be observed in *Qualter Hall & Co. Ltd.* v. *Board of Trade*[29] and *Re Prenn's Settlement*[30] which deal with the status of the exempt private companies. Although different issues were raised in each of these cases, they have this in common that the courts made it clear that the requirements relating to exempt private companies have to be interpreted strictly and cannot be whittled away or evaded. Lord Evershed M.R. expressed this principle in *Prenn's* case as follows :—[31]

> When an exemption . . . is found in an Act the court must see that anyone claiming the benefit of it does, without reasonable doubt, bring himself within the language conferring the exemption.

PREFERENCE SHARES

The decisions of the House of Lords in *Scottish Insurance Corporation* v. *Wilsons and Clyde Coal* Co.[32] and *Prudential Assurance Co.* v. *Chatterley-Whitfield Collieries Co. Ltd*.[33] constitute a turning point in the legal concept of preference shares. It will be remembered that the House of Lords held in these cases that the preference shares in question which carried preferential rights as to dividend and capital were not entitled to participate in the distribution of surplus assets and the winding up of the companies concerned, contrary to what was thought to be the law before these decisions. The main principle which emerged in these decisions is stated in Palmer's *Company Law* as the following *prima facie* rule : —[34]

> If the rights attached to a class are specified, and in particular the classes given preferential rights as to dividend and capital, the rights set out in the relevant provisions are in each case exhaustive.

29. [1961] Ch. 121.
30. [1961] 1 W.L.R. 569.
31. *Ibid.*, p. 572.
32. [1949] A.C. 462.
33. [1949] A.C. 512.
34. Palmer's *Company Law,* 20th ed., p. 301.

The importance of these decisions is, in the words of Lord Evershed M.R. : —[35]

> The view of the courts may have undergone some change in regard to the relative rights of preference and ordinary shareholders — and to the disadvantage of the preference shareholders, whose position has . . . become somewhat more approximated to the role ... of debenture holders.

In short, by these decisions the House of Lords brought the legal concept of the preference share into line with the financial meaning of that type of investment which is that it forms part of the "loan capital" of the company but not of its "risk" or "equity" capital. This development was unavoidable after the reform of 1947 and 1948 had introduced the concept of "equity share capital", now defined in section 154(5) of the Act of ,1948, a concept unknown to the definition of the subsidiary company in the Companies Act, 1929, section 127. This change in the legal understanding of the preference share had escaped the practice and consequently the decisions of the House of Lords in the *Scottish Insurance* and *Prudential Assurance* cases caused surprise and resulted in a heavy fall in the quotation of preference shares at the Stock Exchange. One can but admire the realism with which Viscount Simonds, "reading these articles as a whole with such familiarity with the topic as the years have brought," said[36] that:—

> The last thing a preference shareholder would expect to get (I do not speak here of the legal rights) would be a share of surplus assets . . . such a share would be a windfall beyond his reasonable expectations.

The judicial reform of the concept of preference shares was carried further by Buckley J. (as he then was) in *Dimbula Valley (Ceylon) Tea Co. Ltd.* v. *Laurie.*[37] That case dealt with preference shares which, unlike those in the *Scottish Insurance* and *Prudential Assurance* cases, were expressly given participating rights as to capital in the winding up. The learned Judge held that the ordinary shareholders were entitled to defeat the expectation of the preference shareholders to participate in the distribution of surplus assets and the winding up, by distributing, before the winding up, accumulated profits to the ordinary shareholders or by allotting, before that event, to the ordinary shareholders bonus shares by way of capitalisation of unrealised profits obtained by revaluation of the assets, but that, on the other hand, once the company was in winding up, the preference shares were entitled to participate in the distribution of all surplus assets even though they could have been

35. *In re Isle of Thanet Electric Supply Co. Ltd.* [1949] 2 All E.R. 1060, 1067.

36. [1949] A.C. 462, 487.

37. [1961] Ch. 353.

distributed or made available to the ordinary shareholders before the winding up as profits. Buckley J. rightly saw no logical inconsistency in these propositions :—[38]

> The fact that the ordinary shareholders might be able to defeat the expectations of the preference shareholders to participate in the winding up in undistributed profits is not necessarily inconsistent with the preference shareholders having such a right.

In short, the decisive moment is the commencement of winding up: before that date the ordinary shareholders can approximate assets, which legally qualify as profits, to themselves but after that date all the remaining surplus assets, i.e., assets remaining after payment of the liabilities, costs of winding up, arrears of preference dividend and repayment of capital, are subject to the participating rights of the preference shareholders, irrespective of the nature and origin of these assets before the winding up. It is, however, believed that this result is subject to a qualification which is expressed above in the *First Supplement to Palmer's Company Law* :—[39]

> In *Dimbula Valley (Ceylon) Tea Co. Ltd.* v. *Laurie* no question of oppressive conduct arose; it is thought that if the holders of the participating preference shares can establish that the proposed distribution of assets contravenes section 210, *e.g.*, that the winding up of the company is contemplated and the true purpose of the proposed distribution is to reduce the surplus assets in the winding up an order under that section might be obtained.

CONCLUSION

Judicial reform plays, as has been seen, an important role in company law as it creates the climate in which company affairs are managed and practised. But the function of judicial reform is limited, the great advances in company law have to be carried out by statutory reform. The reason why relatively shortly after the great reform of 1947 and 1948 a further reform of United Kingdom company legislation has already become necessary is not that the courts have been slow to appreciate the contribution they should make to reform; in fact, apart from isolated instances,[40] they have performed the task of judicial

38. *Ibid.*, p. 364.

39. Published in 1962.

40. See, *e.g.*, *Victor Battery Co. Ltd.* v. *Curry's* [1946] Ch. 242, and the observations on this case in Palmer's *Company Law,* 20th ed., p. 443; *Henry Head & Co.* v. *Ropner Holdings Ltd.* [1952] Ch. 124, and the observations on this case in the Gedge Report on No Par Value Shares, H.M.S.O., 1954, Cmd. 9112, p. 16, para. 65; *Davies* v. *Elsby Brothers Ltd.* [1961] 1 W.L.R. 170, which, however, is qualified in its practical effect by *Whittam* v. *W. J. Daniel & Co. Ltd.* [1961] 3 W.L.R. 1123.

reform admirably and at no time have lapsed as significantly as in 1889 in *Derry* v. *Peak*[41] where at once an Act[42] was necessary to overrule an unfortunate decision of the court.

The reason why company law is again being revised is, in the last resort, the great social change which has taken place in the United Kingdom in the post-war period. The rise of the institutional investor, the implications of small shareholding,[43] and, last but not least, the problem of social responsibility in company management, which has stirred the public conscience at the time of the Savoy Hotel dispute,[44] the Jasper Report,[45] the I.C.I. and Courtauld struggle and on other occasions, has raised problems which can only be attempted to be solved by new company legislation.

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41. (1889) 14 App. Cas. 337.

42. The Directors' Liability Act, 1890.

43. Clive M. Schmitthoff, "The Implications of Company Law Reform," in [1960] *Journal of Business Law* 151.

44. See the Report on the Savoy Hotel Investigation, H.M.S.O., 1954.

45. See the Report on the Investigation into the Affairs of H. Jasper & Co. Ltd., H.M.S.O., 1961.

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