SOME ASPECTS OF MODERN COMPANY STRUCTURE: A COMMENT.*

In evidence given before the English Company Law Committee in 1960[1] a spokesman of the Trades Union Congress said that "modern conditions require Companies to accept social responsibility".

An American author has written "the modern Corporation is an institution in search of a philosophy".[2]

Mr. Murray in his paper has quoted Lord Denning's suggestion that Directors should no longer be regarded as managing on behalf of shareholders only but that they should be regarded as representatives of "all vital interests".

I am grateful to Mr. Murray for his paper for two reasons: Firstly, for the most interesting views which he has expressed, particularly on investigations under Part VI of the Act, about which I don't feel competent to comment. The second reason why I welcome Mr. Murray's paper is that I hope it gives me an excuse, Mr. Chairman, for mounting my hobby horse. I think that the legal status of a Company as conceived in the original Joint Stock Company's legislation, and still largely preserved in the modern Companies Acts, should not be undermined.

In a study undertaken in America entitled "the Corporation and the Economy" the conservative view was put thus:—[3]

> "We treat the Corporation, to some extent, as having the rights and responsibilities of an individual. Particularly, there is an overtone of moral responsibility. I don't understand, in theory, how a Corporation which does not have a soul or conscience can be said to have certain responsibilities and how you can attach responsibilities to such a zombie?"

This view echoes Lord Lindley's judgment in *Citizens Life Assurance Co. Ltd. v. Brown*[4]:— "To talk about imputing malice to a Corporation appears to their Lordships to introduce metaphysical subtleties which are needless and fallacious."

* A paper read at the 1966 Law Summer School held at the University of Western Australia.

1 CMD. No. 1749 (1960).

2 R. EELS, THE MEANING OF MODERN BUSINESS, (New York, 1960) 1.

3 See RUBNER, THE ENSNARED SHAREHOLDER, 24.

4 [1904] A.C. 423, at 426.

We have heard this morning of the case of *Parke v. Daily News Limited.*[5] In his judgment in that case Mr. Justice Plowman quoted with approval the judgment of Lord Justice Bowen in *Hutton v. West Cork Railway Co.*;[6] that case turned on the powers of the Directors of a Company to make gratuities.

The Learned Lord Justice said:—[7]

> "A railway company might send down all the porters at a railway station to have tea in the country at the expense of the company. Why should they not? It is for the directors to judge provided it is a matter which is reasonably incidental to the carrying on of the business of the company . . . the law does not say that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company."

He then referred to a case in which it was held lawful for a Company to expend a weeks wages as gratuities as this eased friction between master and servant and so benefitted the Company, Lord Justice Bowen commented:—[8]

> "It is not charity sitting at the board of directors, because as it seems to me charity has no business to sit at boards of directors *qua* charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose."

Section 19(a) and (b) of the Companies Act enlarges Directors' charitable powers, in my view, unfortunately, so that I conceive that a charitable or patriotic gift by the Company need no longer be in the best interests of the Company. You will note that the powers conferred by this section cannot be excluded by the Memorandum. It is not unknown for a Company Chairman, by means of donations from Company funds to attain high office in some respected charitable or patriotic institution and thereby to gain a knighthood for himself.

Mr. Murray referred to Goyder's theory that Companies owe their responsibilities not only to their shareholders but also to their workers, consumers and the community. Although I do not deny that

5 [1961] 1 W.L.R. 493.
6 (1883) 23 Ch.D. 654.
7 *Ibid.*, at 672.
8 *Ibid.*, at 673.

they owe their existence, in a sense, to all these four, I think that their relations with the last three should be regulated by the operations of the market and the intervention of the legislature and not by the social conscience of their Boards. Otherwise, Directors are placed in a position of acute conflict of responsibility. They are, after all, elected by their shareholders and answerable only to their shareholders. Shareholders elect their Directors because of their ability to manage their Company and not because of their patriotic or charitable instincts. When, in 1963, it was discovered that Fisons Limited had, for years, been making surreptitious donations to the English Conservative party, Fisons' Chairman, Lord Netherthorpe, defended his actions on the grounds that "it was in the best interests of the Company". I recall that some Trade Unions whose funds were invested in this Company took exception to this view.

The law is at present unfortunately vague as to how to judge "the best interests of the Company". This vagueness is well illustrated by the *Savoy Hotel Case* to which Mr. Murray referred. The Directors improperly froze the assets of that Company to frustrate two attractive take-over bids because they thought it a shame that the famous Berkeley Hotel should be pulled down to make way for an office block. The Directors pleaded in their defence, in the subsequent investigation, that they had taken Counsel's opinion and that Counsel had advised that if the freezing scheme was in the view of the Directors "in the best interests of the Company" it was legal. He also advised that the best interests of the Company did not mean even the best interests of *all* its members, but meant the best interests of its present and *future* members!

I do not want to leave you with the impression that I do not care about the community, the consumers or the workers. On the contrary, I am rather cynical about most Directors having a really disinterested regard for them. I think that if there was a little less humbug about the social responsibilities of Companies, Parliament might be more vigilant in imposing generous standards of employment, strict consumer protection laws and so on. Directors, meanwhile, should stick to their last, run their Companies profitably and distribute handsome dividends to their shareholders. This is not an anti-social policy. Remember that every pound gratuitously expended by the Directors is not only withheld from the shareholders but is also denied to the tax gatherer who, after all, finances most of the welfare schemes in which Companies are now trying to dabble.

I must take Mr. Murray up on his apparent disapproval of Chief

Justice Ostrander's decision in *Dodge v. Ford.*[9] He speaks of a dividend of US$1,200,000 on "the capital" of US$2,000,000 and infers that this is generous enough. The actual profits of the year in question amounted to US$60,000,000 out of which Ford proposed to pay a dividend of US$1,200,000. The capital of US$2,000,000 bore no relation, after some years of astonishing development, to the asset value of the Company; the surplus above the capital stock in 1916 amounted to US$112,000,000. The US$1,200,000 dividend proposed was therefore only about 2% of that years earned profit and about 1% of the value of the assets used to earn it. Incidentally, Dodge did not ask for any great hand-out, the Counsel asked only that a dividend be declared based on the prevailing interst rate for money loans in the State of Michigan, the dividend amounted to about one third of the year's profits.

Perhaps at this stage I might also refer to the dilemna of the Editor of a newspaper maintaining journalistic standards to which Mr. Murray referred. He mentioned in particular the London Times. It is interesting that 90% of the shares in the London Times are, I believe under the control of Lord Astor and that there is a provision in its Articles of Association prohibiting the transfer of shares without the approval of a Committee consisting of the Lord Chief Justice of England, the President of the Royal Society, the Governor of the Bank of England, the Warden of All Souls College, Oxford, and, I believe, the President of the Institute of Chartered Accountants. This Committee is supposed to ensure that no shares fall into the hands of people who would use the paper to make a commercial profit or who might compel it to depart from its customary "Establishment" line. Many other English 'quality papers', in one way or another, protect themselves from commercial exploitation by provisions in their Memoranda or Articles of Association, they include the Economist, Guardian, Yorkshire Post, Liverpool Daily Post and Birmingham Post. Surely, the proper course for the founders of a newspaper intended to maintain journalistic standards at the expense of profits to shareholders is to so provide in its Memorandum and Articles of Association so that the investing public may know what kind of investment is being offered.

Alex Rubner in his entertaining book *The Ensnared Shareholder,* to which I am indebted for some of the wilder comments I am making this morning, divides the history of English Companies into two periods: "the first, during which many Directors deliberately

[9] (1919) 3 A.L.R. 413, 204 Mich. 459.

fleeced investors and creditors for their own enrichment; the second, during which Directors, without transgressing the law, oppressed their shareholders for the greater glory which they hoped to derive from an arbitrary control of a growing Corporation."[10]

In America the situation seems as bad. According to an article in the Harvard Law Review quoted by our own Ex-President in his new book on Company Directors—"the management holds its powers in trust, yet it enjoys the perquisites of property . . . at law the directors are trustees for the stockholders, and the management are agents of the directors. But as the Trustee becomes independent and the agent usurps the office of the principal the law lags far behind."[11]

It is a commonplace noted by most authors that, in Mr. Adams' words, "Shareholding is no longer ownership, but a form of passive absentee profit sharing contract."[12] According to the author of the chapter on companies in *Law Reform Now,* "failure by shareholders to take an active interest in the affairs of their company encourages the contempt in which the management holds them and the lack of information found in the accounts; and accounts which are not informative do not serve to encourage the shareholders to take an intelligent interest in the affairs of their company."[13] At present, for example, most Companies still adhere to the method of accounting based on depreciation from historic cost. Some evidence was given to the Jenkins Committee in favour of compulsory periodic revaluations of assets which is already mandatory in France; but the Committee made no recommendations. The shareholders lack of information was highlighted shortly afterwards during the take-over battle between the Boards of I.C.I. and Courtaulds. The Board of Courtaulds, in response to I.C.I.'s take-over bid *"revealed"* to its shareholders that Courtaulds' accumulated *reserves alone* were enough to cover the price put upon that Company's shares by the Stock Exchange. Its Directors suddenly *"found"* that they could immediately distribute to their shareholders a bonus of ten shillings worth of 7% loan stock for each ordinary share, could promise substantially larger dividends in the future and a capital distribtion to each ordinary shareholder in each of the next three years—all this largesse was to come out of the reserves which had not been apparent from the Compay's earlier published accounts and, I suspect, would never have been become known to the shareholders had not the bid been made!

10 RUBNER, THE ENSNARED SHAREHOLDER, 10.
11 (1942) HARV. L. REV. 551, at 553.
12 ADAMS, COMPANY DIRECTORS IN AUSTRALIA, 40.
13 GARDNER & MARTIN, LAW REFORM NOW, 188.

Gower[14] recognises that whilst a Company must not cook its books to show a profit when there is none, as Lord Kylsant did, it is more likely that a modern management will cook its books to present the Company to the Revenue, its workers and its members as less affluent than it really is. There is a very good reason for this. In the bad old days Companies had to issue fraudulent prospectuses to gull investors into subscribing equity capital. The modern giant corporation aims at becoming self-financing so that its Directors need not maintain a generous dividend record to attract new public investors.

If the law effectively compelled Directors to keep their shareholders well informed in prosperity as well as in adversity, the shareholders would take more interest in their Company. I concede that shareholders must not be permitted to interfere directly with management decisions of the Board and I am opposed to government by general meeting, but I think that Directors should be compelled to have more regard to the interests of their shareholders and pay more respect to their wishes. To this end I favour a reform in the election of Directors of large public companies.

In half of the States of America as well as in Canada and in India cumulative voting is compulsory. It is a kind of proportional representation which should appeal in Australia. Under this system if, for example, five Directors are to be elected, a disciplined minority of 20% of members can ensure the election of one Director of its choice. Under the present system even if all members vote, which is unheard of, 51% of members can elect the whole board. Experience has shown that with cumulative voting and no staggering of elections, members of large corporations have managed to elect one or more Directors who really represent their interests. Mr. Murray pointed to the need for a distinction between the liabilities of full-time and part-time Directors. At present part-time Directors are usually public figures elected by the management to lend it respectability in return for a substantial fee paid for doing little or nothing—in England they are known as 'guinea pigs'. If instead of 'guinea pigs' we could have part-time Directors democratically elected by the shareholders to watch over the executives I would welcome such a distinction.

Finally, I would like to vest in the members of a Company the decisive control over the basic objectives of the Company. The old law of ultra vires was undoubtedly an engine of fraud and caused hardship. It was anyway largely evaded by the vaguest formulation of a Company's objects. Lord Wrenbury noted with distaste in

[14] GOWER, MODERN COMPANY LAW (2nd ed.), 424.

Cotman v. Brougham[15] that "the function of the memorandum is taken to be, not to specify, not to disclose, but to bury beneath a mass of words the real objects of the Company with the intent that every conceivable form of activity shall be included somewhere within its terms".[16] Whilst therefore, I welcome the innovations in section 20(1) of our Act, I doubt if there remain sufficient safeguards for the shareholders. The law should make it compulsory for Directors to obtain the prior consent of shareholders, perhaps by Special Resolution, before important assets are sold, the main activity of the Company is changed or an entirely new field is entered.

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[15] [1914] A.C. 514.
[16] *Ibid.*, at 523.

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