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Critical Analysis of Corporate Group Structure

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Abstract: **The paper will capture the fundamental essence of governance of Corporate Group Structure and focus on the meaning of separate legal persons as provided by ss. 15 and 16 of the companies Act 2006 and judicially demonstrated in the landmark decision in Salomon v Salomon (1897) A.C. 22. The consequence of separate legal personality will be conceptualised. In other words, the dual nature of a company as an association of its incorporators and a person different from its shareholders will be pointed out.**

This paper will strive to examine various theories that justify the lifting of the corporate veil. Theories like sham or fraud exception to the veil of incorporation as in Gilford Motors Co. V Horrne (1933) Ch.935 will be reviewed.

Indeed, a critical analysis will be made on why there is no generally accepted principle for the lifting of the corporate veil. More so, the controversy surrounding the lifting the veil in a group of companies where there are a parent and subsidiary relationships as in Adams V Cape Industries P.L.C.: (1990) Ch. 433; D.H.N. Food Distributors Ltd V Tower Hamlets Borough Council will be critically examined.

The ad hoc approach by the parliament in the enacting more dynamic legislation in this area of law as if Salomon V Salomon is sacrosanct will be discussed. The courts have equally adopted a relaxed attitude towards determining the validity of the conduct of corporate managers who evade liabilities under the guise of separate legal person- Marc Moore (2006), 180-203.

As far as the company in a group is concerned, a strong argument will be put forward on the need for the U.K. to toe the line of other E.U. countries like Germany and Portugal. They are now tilting towards joint economic enterprise, which makes it mandatory for parent companies to guarantee the liabilities of the subsidiary. Likewise, the E.C. Ninth Draft Directive proposed reform in the company broadly on the same lines - Birds. J. et al. (2007), page 81.

Equally, a critical analysis will be made on the duties of directors as provided in Companies Act 2006 ss. 171-177 to examine how effective these duties are, especially in respect of the relationship between the parent company and subsidiaries.

Again the effectiveness of the power of the shareholders to check the excess of directors will be given a critique. For example, how the Foss V Harbottle (1843) 2 Hare 461 rule affects a minority shareholder with particular emphasis on the relationship with the parent company and its subsidiaries. Also, the effectiveness of the minority shareholders remedy as provided by companies Act 2006, ss.260-264 (statutory derivative claims by members), and companies Act 2006, s.994 (protection of members from unfair prejudice), will be critically examined.

Finally, relevant questions will be asked on the way forward, and suggestions will be made to that effect.

Keywords: **Corporate group structure; Companies Act; Corporate veil; Separate legal person and Corporate Managers.**

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I. INTRODUCTION

Corporate Group Structure

A company is a business organisation that is registered or incorporated under the Companies Act, 2006, or its predecessor legislation. Operationally a small company may be run in precisely the same fashion as a partnership. Legally the organization created is subject to entirely different rules.

The primary statute governing companies in the U.K. is the Companies Act 2006. The incorporation of a company has two legal effects: firstly, it creates a legal person. Secondly, that legal person has perpetual succession; that is, it lasts until liquidated by order of court[1]. The law treats the persons who own and control the company as separate from the company itself. A company is an artificial person, independent from the company itself, as opposed to a human who is a natural person.[2] Most of the advantages of companies stem from their separate legal personality. Since a company is a person in its own right, the company is able to perform all the functions of an incorporated company, is able to sue and be sued, has a perpetual succession, has a common seal and has power to acquire, maintain and dispose of the property.[3]

The two primary corporate organs of control are the general meeting of shareholders (Shareholders have a limited role as an organ of power). Shareholders, in turn, appoint the second principal organ: the board of directors – the collective term for directors sitting together as a group. The board manages the strategic and often day to day operational affairs of the company[4]

In most other industrialised countries, these two organs form the core of the company in terms of its management and control. However, they may differ in terms of status and relationship to each other in other countries. In Germany, for example, there are what is termed two-tier boards of directors. Also, supervisory boards and work councils can be found in other European Union countries, who monitor board room performance and have a role in general decision making.[5] Other countries like Italy and Spain have company law, which views the company more like an organ of the state, being there for the benefit of all, not just shareholders and employees.

In the United Kingdom and the United States, there is a so-called single-level board of directors, in which an employee or other representation is not required at board meetings, and the company is seen primarily as a wealth creation mechanism for shareholders[6]

In the U.K., the two principal organs of control within companies are directors and shareholders[7.] Basically, in the U.K., there are two types of companies limited by shares; that is; the private limited company (Ltd) and the public limited company (P.L.C.). The main difference between the two is like the shareholding; for the individual company share may not be traded with the public but must be bought and sold privately, but the public limited company, if it is registered on the Stock Exchange, trade-in its share is with the public. This allows for the limitless potential to raise capital through the sale of new (initial public offer) or existing shares.[8]

The function of the companies can be said that "*the company constitutes an association of several persons for a common object, that object normally being the economic gain of its members*". [9]

There are three distinct types of the company if the functional approach is adopted;

Firstly, companies formed for purposes other than the profit of their members that is those created for social or charitable purposes.

Secondly, companies formed to enable a single trader or small body of partners to carry on a business. In these companies, incorporation is a device for personifying the business and normally, divorcing its liability from that of its members even though the member retains control and share the profits.

Lastly, companies formed to enable the investing public to share in the profits of an enterprise without taking any part in its management. [10]. Here the company is again a device similar to the trust. However, this term is designed to facilitate the raising and to put to use capital by enabling a large number of owners to entrust it to a small number of expert managers.

As a company it has a dual nature as an association of its members, but also as a separate person from its members. As soon as necessary formalities of incorporation are satisfied, a new entity comes into existence, which is separate and distinct from its directors and shareholders.

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The paper will now examine the key features of a group of companies. There are many reasons why a business might wish to expand or operate through subsidiary companies. It may be administratively convenient, economically more efficient, and geographically more convenient, allows for intercompany loans and transfers, and makes it easier to raise capital and separate liability and risk.[11]

Whatever the reasons, there is no doubt that the corporate group structure allows for potentially massive wealth creation.

It is pertinent to examine in detail the separate legal entity. This fundamental principle was first put to the test in 1897 in the famous case of;

SALOMON V SALOMON (1897) AC 22 HL

" Salomon had incorporated his boot and shoe repair business. He transferred the business to a company own by him. He acquired all the shares in the company, except six, and were held by his wife, daughter, and the four male children got remaining".

Part of the payment was used for the transfer of the business and made in the form of debentures (a secured loan). This was issued by the company to Salomon.

Salomon transferred the debenture to Broderib in exchange for a loan. Salomon defaulted on payment of interest on the loan, and Broderib sought to enforce the security against the company. Unsecured creditors try to put the company into liquidation". The issue here is, Is Broderib or the unsecured creditors Salomon (himself) had priority concerning payment of the debts?

It was argued for the unsecured creditors that Salomon's security was void as the company was a sham and was, in reality, the agent of Salomon.

But in **the House of Lords** it was held; "*That the company had been properly incorporated and that therefore security was valid and could be applied*. A company and its members are separate people." Here the court could find no evidence of any fraud or trickery carried out by Salomon.

A further illustration of separate legal entity principle was found in **Gramaphone and Typewriter V. Stanley (1908) 2 K.B. 89CA.**

"*An English company held all the shares in a German company. The Revenue was seeking to tax the U.K. company on monies held by its German company in depreciation account there, alleging that in reality, the business was "carried on" by the U.K. parent in the U.K. and that the monies held in Germany were taxable as U.K. profits. The argument is that there was no "true" separate German entity; it was a 'mere department' of the U.K. parent for tax purposes".*

To succeed in this argument, the Revenue had to show, either that the German company is a fiction, a sham, a simulacrum and that in reality, the English company and not the German company was carrying on the business, or, that the German company if it was a real thing, was the agent of the U.K. company.

As to the former, the court could find no evidence that the German company was a sham. As to the latter, the mere holding of all the shares in a company did not make that company at one with its principle or sole shareholder; they were separate entities.[12]

Also, it is essential to examine '*The Veil Doctrine in Company Law*'. One of the primary motivations for forming a company or corporation is the limited liability it offers its shareholders.

Under this doctrine, a shareholder's limited liability can lose only what contributed as actions to the corporate entity and nothing else, however there is a significant exception to the general concept of limited liability.. There are certain circumstances in which courts will have to examine through the company that raises the incorporation veil, also known as piercing the veil and holding the company's shareholders directly and personally responsible for the obligations.

The veil doctrine is invoked when shareholders confuse the distinction between the company and the shareholders. It is important to note that although a separate legal entity, a company can only act through its constituent human agents.[13].

Consequently, there are two main ways in which a company is held accountable in corporate or corporate law through direct liability and secondary liability, the corporate veil piercing doctrine varies from country to country.

There are three existing theories for the lifting of the corporate veil. The first is the *fictional /contractual theories*, which hold that the existence of the company is a concession of the state - it is a creature of the country. It is formed based on contract theory between individuals – a foundation contract-which may change during the company's lifetime subsequently.

This holds freedom of association through the contract, an entrepreneurial approach which in the absence of any fraud or wrongdoing the state will not interfere, and the courts will uphold the separate existence of the company.[14] This model limits social responsibility; it creates an entity remote from regulatory interference. Attempts to deny the use of contract in this way, companies must function as a community in association with all stakeholders.

The *communitaire theories* see companies as a concession of the state and thereby an instrument of the state that can be utilised by the state to pursue its objectives. This approach can be found in old communist countries such as Italy and Spain and in modern China and Russia.

The *concession theory*, on the other hand, examines the existence and operation of the company as a concession by the state, which grants the ability to trade using the corporate tool, mainly where it operates with limited liability. These theories accept that the country has a role to play in ensuring that organisational group structures are fair and democratic; but that said, it marks the limits of state interference, the company is not a tool of the state to use to achieve its objectives, it is limited interference.[15] The concession theories are generally agreed to be the broad approach of the U.K. Courts and legislature with the European Union borrowing from the communitaire theories.

Here it is of paramount importance to further identify and examine occasions when veil lifting/ piercing will be permitted; where statute so declares or where it is permissible for statutory interpretation or at common law or in equity where some fraud, dishonesty or improper use is found to exist or where principles of the agency are said to apply. And where relatively new development is said to live in an economic or enterprise entity which may embrace one or more 'separate' legal entity companies and circumstances exist indicating that a particular corporate form is being used as a mere 'device, 'sham' or 'façade' to avoid some consequences. For example, **sections 213 and 214 of the Insolvency Act 1986** make a director personally liable for fraudulent or wrongful trading.

The Companies Act of 2006, section 1159 *"defines a company as a subsidiary of another company, its holding company, if that other company; it is that other company: it has the majority of the voting rights in it or is a member that has the right to appoint or take away the higher number of its board of directors, or one of the owners of the company and controls by itself. Following an agreement reached jointly with other shareholders, most of the voting rights contained therein or is a subsidiary of a company that is itself a subsidiary of that other company.* "

Furthermore, **Companies Act 2006 section 1162** defines another corporate group relationship, that of parent-subsidiary as *"the parent-subsidiary will be a parent if it has the right to exercise a dominant influence over a company by provisions contained in the articles of the subsidiary; or under a control contract." "Dominance influence is found where the controlling company has a right to give directions concerning the operating and financial policies of the company controlled which its directors are obliged to comply with whether or not they are for the benefit of the company controlled".*

In **Adams V Cape Industries Plc. 1990**.[16] Cape Industries, a U.K. - based company, operated as a U.S. subsidiary, NAAC, trading in asbestos. A group of workers who became ill after working with asbestos had successfully brought an action against NAAC and been awarded damages of US$5.2 million. NAAC then went into liquidation without paying the costs, and its operations were taken over by a new company C.P.C., which was funded by Cape though not a subsidiary. C.P.C. was run from the same premises as NAAC with the same Managing Director but controlled by a Liechtenstein registered company, A.M.C., which acted as an agent for Cape.

Following the liquidation of the NAAC, the workers tried to bring an action against Cape in the U.K. on the basis that it was responsible for the actions of its subsidiary and had liquidated NAAC to avoid paying the damages.

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The court found that Cape was not responsible and said that "*if a company decides to organize the business of its group in such a way that the activity carried out in a particular foreign company is the activity of its subsidiary and not of its own, it's ours judgment, entitled to do so."* The judgment went on to say, in effect, that the legal precedents were more important than justice. *"Neither in this class of case nor any other class of case is it open to the court to disregard the principle of Salomon V A. Salomon and Co. Ltd. merely because it considers it just to do so."* [17]

The paper will now focus on the critical analysis of corporate manslaughter. If we agree that the company is not a human being, the question arises, what is it? From a political point of view, the corporation is a dictatorship, or at best an oligarchy, run as a centrally planned economy with an extensive bureaucracy. But where is the core of the system? Here lies the real power and real vulnerability of the corporation, because at its centre is a power vacuum, the shareholders own and supposed have to control, but they do not manage; the board and chief executive control, but theoretically owe their power to the shareholders.

As a result, the buck does not stop- no one has the ultimate duty to think about what the corporation should do and be; the only imperative is the directors' duty to act in the best interests of the company, which means the best interests of the shareholders, which means profit. If this leads the directors or managers to have to act against their conscience, well, that's their duty to shareholders. Because of the above and the reason for the fact that very large, often multinational companies were seen as literally *'getting away with murder'* **Corporate Manslaughter Act 2007** introduces a new offence of corporate manslaughter. **Section 1 of the 2007 Act** provides that;

"A company is culpable of an offence if the way in which its actions are managed or organized; (a) resulted to a person's death and (b) accounts to a gross breach of a important duty of care owed by a company to the deceased" [18]

Section 2 of the 2007 Act defines activities likely to be covered and includes: *"employees working for the company, supply of goods or services or carrying on of any construction or maintenance."*

The Act is not restricted to a particular level of management, for example, a director, but concentrates on how a specific activity that caused death was managed.

As far as corporate group structure is concerned, the issue of agency is very significant and worth detailed analysis; for example, in **Smith, Stone, and Knight Ltd. V Birmingham Corporation** (1939)**. All ER 116**, Atkinson J, have raised the veil to allow a subsidiary that carries on business on land owned by the holding company to request compensation for being an agent.

Also from **Firestone tyre and rubber Co. Ltd. V. Lewellin (1957) 1 WLR 352,** agency was formerly the cause for lifting the veil where a British company manufacturing tyres for an American holding company and it was held to be its agent. In **Re F.G. (Films) Ltd. (1953) 1 WLR 483,** where fraud and acute practice were also a factor, the American holding company founded a British subsidiary to produce the film "Monsoon," which was believed to be an agency, and the film was American, where fraud and acute practice were also a factor. The American holding company founded a British subsidiary to produce the film "Monsoon," which was believed to be an agency, and the film was American.

Again in the same **Smith, Stone & knight Ltd .V Birmingham corporation (1908) 2 KB 89.** The court allowed the agency argument finding that the subsidiary was not operating on its behalf, but on behalf of the parent company – it was also an agent acting for its principal; the degree of close control exercised by the parent was evidence of this. There is no problem where an express agreement exists. For example, in Salomon case, if a contract existed appointing the company the agent of Salomon, then he would have been liable. The difficulties occur where the agency is sought through the nature of the control relationship exercised, that is where the two parties; agent and principal consent and hold themselves out through their actions to be a principal or agent and that some outside party knows of that relationship and relies upon this for purposes of contracting or under tort, the agency is said to arise through apparent or ostensible authority to act.

The principle that the company acts as agents for its shareholder or about another parent company was also mentioned in **Smith, Stone & Knight V Birmingham Corporation (1939) 4 All ER 116.** In which it was decided that the subsidiary company was an agent of the parent company, and therefore, compensation was payable.

Furthermore, in **D.H.N. Food Distributor Limited V London Borough of Tower Hamlets (1976) 1 WLR 852**, "*it was held that a parent company could sue the subsidiary and was entitled to compensation for the disturbance of a business* *and was not precluded from this by the fact that the structures in which the activity was carried out belonged to the same group of companies "*

The '*agency*' principle was adopted in revenue cases, such as **Firestone Tyre and Rubber Company Limited V Lewellin (1956) 1 All ER 693** in which it was held *"that an American company was carrying on business in England through its English subsidiary and therefore liable to pay English income tax." However, in **Adams V Cape Industries Plc (1990) BCC 786**, it was held "that an agency cannot be implied just because a parent company owns all or most of a subsidiary's shares."*

Also, in **Apthorpe V Peter Schoenhofen Brewing Company Ltd. (1899) 4 T.C. 41, C.A**., a company was formed in the U.K. to acquire an American brewery company. All the shares in the American company, except three, were bought by the English company. Management of the American company was facilitated through a committee which the U.K. Company had dominant control over. There was a close day to day connection with the American company on matters of management of its affairs. The Revenue was claiming that the brewery business was being carried on partly in the U.K. through the close degree of control being exercised by the U.K. parent and was therefore liable to U.K. tax. The parent claimed that the Salomon principle applied and that there were two separate companies, only liable to a tax on dividends received.

The court found that; "*the head and seat and directing power was in England, and though technically business profits belonged to the American company, it carried on business as an 'agent' for its U.K. principal (Wright J P46), the U.K. parent was liable."* [19] The *'agency'* relationship was primarily found to exist through the nature and degree of control being exercised by the parent company.

Once again, the general principle for lifting the corporate veil of the concept of façade will be examined. Whether it is possible or not streamline the confused state of the law with regards to the application of idea like façade as used by Lord Keith in **Woolfson V Strathclyde Regional Council (1978) S.C. (H.L.) 90**, which in Adams the court believed that guideline for its application to determine whether or not a company exists as façade within the meaning of the word in Woolfson is sparse [20]

Here in **Woolfson V Strathclyde Regional Council (1978) SLT 159**, House of Lords, Lord Keith stated the view that; *"in the first instance the Salomon principle must be observed, each person being a separate legal entity even within wholly-owned group structures".*

He went on to say, *"it is appropriate to pierce the corporate veil only where special circumstances exist, indicating that it is a mere façade concealing the facts*." There was no legal definition given of the precise meaning of a façade but in **Snook V London and West Riding Investments Ltd. (1967) 1 All ER 518** a '*sham/ façade'* was taken to mean; *"An intention to give third parties or the court the appearance of creating between the parties' legal rights and obligations different from the actual legal rights and obligations which the parties intend to create."* Concerning a group of companies, the developments in other European jurisdictions like: Germany and Portugal, as well as the European Commission, where the laws are skewed in favour of a single economic entity. This is to enhance the problem of liabilities to third parties in a group of companies. A balance has to be struck to ensure that flexibility in a business organisation is not stifled as a result of over-regulation and that justice is done in an individual case.

The argument for corporate group enterprise is to the effect that some instances, some companies that act as a corporate group, may operate in a way that the parent entity is not distinguishable from the subsidiaries. The set of reasons given in favour of piercing the corporate veil in these situation is to ensure that a corporate group that seeks the advantages of limited liability must also be prepared to accept the corresponding responsibilities. It was the view of **Doyle CJ. In the 1998 case of Taylor V Santos Ltd**.[21], The most notable instance, however, where Anglo – Saxon courts would most probably pierce/lift the corporate veil on the ground of group enterprises is where there exists a sufficient degree of shared ownership and collective enterprise. In the case of **Bluecorp Pty Ltd. V A.N.Z. Executors and Trustee Co Ltd. (1995) 18 ACSR 566,** [22]

Lord Justice acknowledged the main basis under which Anglo – Saxon courts would be timely to pierce the corporate veil as a result of group enterprises. The court stated thus: *"the interrelationship of the corporate entities here, the obvious influence of the control extending from the top of the corporate structure and the extent to which the companies were*

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thought to be participating in a common enterprise with the mutual benefits perceived in the various steps and plans implemented, everything influences the general picture ".

The above hints, notwithstanding the ordinary law courts, may hesitate to pierce the corporate veil where the outcome would produce a different result.

The Act of piercing the corporate veil until now remains one of the most controversial subjects in corporate law, and it would continue to remain so, even for the years to come. On the whole, and as discussed, the doctrine of piercing the corporate veil continues to be only an exceptional act tht produced the desired effect by courts of law. Courts are better equipped to comply with the corporate personality rule that a company is a separate legal entity from its shareholders who have their rights and obligations and can sue and be sued on their behalf.[23]

As we move from jurisdiction to jurisdiction across the world, its application narrows down to how that system of the law appreciates the subject. Common law jurisdictions are examples par excellence where the piercing of the corporate veil has gained notoriety, and as the various cases indicate, courts under this system of the law generally appreciate every fact by its merits.[24]

The above notwithstanding, there are general categories such as fraud, agency, sham or façade, unfairness, and group enterprises, which used to be the most peculiar basis under which the ordinary law courts would pierce the corporate veil. But these categories are just a guideline and by no means far from being exhaustive.

II. MANAGEMENT

The location of managerial power resides with the board of director (Table A article 70).[25]

Table A (SI 1985/805) is a set of standard form articles of association. The materials are a formal document required to be registered by all companies which set out the internal working of the company, for example, shareholder rights, appointment and removal of directors, etc. [26] Table A is a model which companies are free to adopt or not and to modify. If a company does not take

Table A or has a modified version, in the event of a dispute, the court will refer to Table A for clarification. Fully customised articles, in which Table A is excluded in its entirety, are often adopted for the first time when a company becomes a public company to raise capital from the investing public. Whatever form of articles used, most companies provide that the management of the business will be by the board. [27]

The **companies Act 2006 section 20** confirms the position above but also provides for new simpler Table A to be drafted by Secretary of state, one for the private limited and another one for the public limited company and re entrenchment S22 a company's articles may contain a provision to the effect that specific rules of the sections may be altered or removed only if certain conditions are met, or particular procedures complied with that are more restrictive than the usual process of alteration – a special resolution (75% majority).[28] These may be the requirement for approval by a parent company or a particular shareholder. This is acceptable provided; entrenchment is contained in original articles or after incorporation where all members agree to an amendment to existing sections to bring in an entrenchment clause. Such clauses cannot stop the future unanimous decision to remove any entrenchment clause and alter a requirement or an alteration ordered by the court.[29]

Managerial power is given to boards by the shareholders may not reflect reality. In large companies, for example, the board will be a formal body that meets at periodic intervals; an organisation such as this can set and refine the strategic direction of the company and can supervise its management, but it cannot itself perform the function of managing the company daily. That task has to be devolved to the individual senior managers of the company, some of whom may be, but none of whom need be directors of the company.[30]

Director's duties fall on all directors, both executive and non- Executive. An executive director is one who is actively engaged, usually full-time, in the affairs of the company.

Also, the parent company can be an executive and non-executive director but cannot do so by the shadow director route [31] **as per section 251 of Companies Act 2006.**

There is a possibility that a parent company might find itself a shadow director of a subsidiary when the level of control, which is exercises is such that the directors of the subsidiary are accustomed to act following its directions or instructions. It will be a question of fact in each case as to whether this level of control exists. For the parent/ holding company, there is an exemption for the general fiduciary duties. A parent/ holding company cannot become a shadow director for purposes of the general fiduciary duties.[32] (**Section 251 (3) companies Act 2006).**

Legally, a corporation is owned by its shareholders and controlled by directors. In running the company, directors are bound by the common law *"fiduciary duties, the most important of which is to act in good faith in the best interests of the company as a whole."* This duty has generally been interpreted by the courts to mean acting in the interest of the shareholders; in the short term a company may aim at, for example, increasing market share or developing new products in the anticipation that this will eventually lead to higher profits.[33]

In a larger corporate size organisation, no one shareholder is in a position to exercise effective control through the formal process of the general meeting. Further, shareholders in public companies have little incentive to monitor the management closely since they have limited liability, and they can protect themselves against the company-specific risks by portfolio diversification. The cost to an individual shareholder of monitoring management would generally exceed the benefit to that person, and any interest attained would benefit all shareholders the- free-rider problem.[34] If investors are unhappy with the performance of the management, the capital markets provide an "*exit*" since they can simply sell their shares and invest elsewhere. Managerial autonomy in the larger company leads to a structure which gives scope for the managers to use the sum invested more for their benefit than for the benefit of the shareholders (conflict of interest) or they may not give the care and attention to the management of it that they would go to their own money (managerial shirking).[35]

It is essential to mention and examine the "*Statutory Derivative Action"* under **section 260 of Companies Act 2006**. Derivative credits are procedures brought by a member of the company regarding a lawsuit brought against the company and seeking compensation on behalf of the company.

Rivative claims are actions brought by a member of the company in respect of a cause of action vested in the company and looking for relief on behalf of the company. The complaint can only be made in relation to an action derived from a real or proposed act or omission which implies negligence and violation of the director's obligations. Claim against directors for breach of their obligations owed to the company fall within **section 260 of the companies Act 2006**, which is wider than the standard law action it replaces.[36] It permits a derivative work for breach of duty to exercise reasonable care, skills, and diligence.[37] There is no longer a need to demonstrate *"fraud on the minority"* and "*wrongdoer control"*. So that even where the defendant director has acted in good faith and has not gained personally, a claim can be brought under section 260.

The impact of section 260 will be limited because of time and huge financial costs that will be involved to bring the action. However, it is doubtful whether the article will achieve its desire result, especially in a group of companies. It is widely accepted that there is a particular problem in respect of acting in the interests of the company where a company is part of a group or wholly-owned subsidiary. Although, much in practical terms, the various companies within a corporate group are run as one enterprise, as a matter of law, the directors of each company within the group are required to act in the interests of the company to which they are appointed rather than in the importance of the group as a whole - (**Lindgreen V L & P Estates (1968) 1 Ch. 572).** Yet, if the interests of the company are treated as being synonymous with the benefits of its shareholders, then at least in wholly-owned subsidiaries, the duty of the directors of the subsidiaries should translate simply into a duty to act in the interests of the parent company. This is not the position under English company Law case law.

The only concession to the group structure is that although, strictly, directors should specifically direct their minds to their company's interests (**Charterbridge Corporation V. Lloyds Bank (1970) 1 Ch 62,74)** refers. This concession is a fallback that may have some use in limited cases but properly advised directors should direct their minds specifically to the subsidiary's interests rather than risk being judged to have failed in their duty based on an objective test of what the intelligent and honest director could reasonably have believed. Director of subsidiary companies can also seek to protect themselves by having the parent company authorise or ratify their action or conduct.[38]

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The substantial risk for directors of a wholly-owned subsidiary is that actions that are taken for the prosperity of the group as a whole but which are loss-making for the acting subsidiary may jeopardise its solvency and prejudice its creditors. Shareholders' ratification will not protect the directors when the company's safety is in doubt because creditors' interests intrude at that point.[39] The rule which obliges subsidiary company directors to consider the benefits of the company as distinct from the group becomes, in substance, part of the broader principle which treats the company's interests as being synonymous with those of its creditors in an occasion where the company becomes bankruptcy.

In **Facia Footwear Ltd v Hinchcliffe (1998) 1 BCLC 218,** where a cash-rich subsidiary guaranteed the debts of other companies in the group, massive payments were made by the directors of the subsidiary to other companies in the group two months before the subsidiary went into liquidation. The claim by the liquidator was that the directors made these payments in disregard of the subsidiary's creditors' interests. The directors argued "*that the payments were in the normal course of implementation of group treasury arrangements and there was no suggestion that the payments were for private purposes or in breach of any statutory or other obligation or otherwise than for the trading purposes of the recipient companies"* .[40] Most importantly if the group of companies collapsed, the subsidiary would also collapse under the weight of the cross- guarantees; moreover, the directors were intent on keeping the group afloat as they believed a refinancing scheme was a serious possibility.

There must be a law in the U.K. like the German law, *"where parents companies in return for making decisions which benefit the group as a whole can make those decisions provided they guarantee the debts of the subsidiary company."*

It is evident in the Companies Act 2006 that directors must also make their own decisions. Here nominee directors can prove a problematic instance in this respect.[41] Nominee directors are directors elected onto a board at the behest of a major creditor, majority shareholder, and parent company, etc. In reality, they are there to look after the interests of those who got them elected, but under company law, they must act in the company's attention even if this goes against their appointor. The rule is also an obstacle to the development of employee representation at board level; employee appointees would naturally incline to represent and promote employee interests but the law, as it currently stands, would not permit them to do so.[42] In **Kuwait Asia Bank E.C. V National Mutual Life Nominees Ltd (1991) 1 AC 187, P.C.** where nominee directors appointed by their employer bank, Lord Lowry stated*; "in the performance of their duties as directors .... they were bound to ignore the interests and wishes of their employer, the bank. They could not plead any instruction from the bank as an excuse for breach of their duties*." Therefore directors must not be shackled to their sponsor or appointor, for example, a parent or holding company.

The other important factor here is the issue of the stakeholder model. The economic success of a company will bring about social benefits to many stakeholder constituencies. It will not happen if the company is a financial failure.

The issue of obliging directors to act primarily for the benefit of shareholders alone is questioned. Corporate Governance reform was undertaken in many parts of the world in the late 1980s and early 1990s. This reform process wondered whether the interests of the company should be managed for the shareholders alone or the other corporate stakeholders as well. Numerous opinions strongly support the idea that corporate governance should be viewed as a system whereby companies should be governed for the benefit of all stakeholders, including shareholders, employees, creditors, suppliers and communities. By this manner, companies should be operated as communities in partnerships with all their owners. Thus, the authors propose that the success of a company is inextricably intertwined with a consideration of the rights and interests of its employees and other stakeholders.[43]

The prevention of the abuse of powers, directors are subject to specific duties imposed by law. The responsibilities of a director are now principally set out in a statutory statement of directors' duties introduced by the **Companies Act of 2006**. It is important to note that this statement is still not an exhaustive list of the responsibilities of directors. Consequently, the total of seven statutory obligations was codified under the Act, relating to listed companies in the UK.[44]

The first duty is the duty **to act within powers** [45;] this means a director must *"act by the company's constitution" and must only "use powers for their main purpose."* It is noted that the term "*constitution"* goes beyond the article. It said to include resolutions and agreements. The other part of this duty requires that the director must not misuse their powers. [46]

Howard **Smith Ltd. V. Ampol Petroleum Ltd. (1974) AC 821** was a case law reviewed by the Privy council. It concerned the power of directors to issue new shares. Lord Wilberforce said here that a decision of directors to issue shares could be set aside based on improper purpose even though there was no element of self-interest involved, and that while it might in some situations be proper to issue shares for purposes other than raising capital for the company, it also must be unconditional for directors to use their fiduciary powers over the shares in the company purely to destroy an existing majority or create a new majority which did not previously exist. [47]

The second duty is **to promote the success of the company** 48. It requires that a director act in a way he considers in good faith. It would likely develop the company's success for the benefit of its members as a whole.

However, in performing the duty, the director must have regards to the various factors set out in the Act.-- **Mission Capital Plc V Sinclair (2008) EWH 1339** refers.

The third duty is **to exercise independent judgment**; [49] directors must exercise their powers independently of the third party's instruction. It requires future discretion, not fettered. Directors may still delegate their powers provided they do so following the company's articles and act by agreements that have been duly entered into by the company.

In **Fulham Football club Ltd V. Cabra Estates (1992) BCC 863**, it was explained that directors are obliged not to fetter their decision because the company is entitled to a business judgment for its best interest and based totally on commercial considerations. However, if directors do shackle their decision; it is in the best interest of the company, the directors are allowed to do so because it is a long time policy. **Clause 159 (2b) of the Company Reform Bill**; states that that the director's duty of independent judgment is not infringed *"by acting in a way authorized by the company's constitution."*

The fourth duty is **to exercise reasonable skill, care and diligence** a director owe' a duty to the company to exercise the same standard of care, skills, and diligence, a director owes a duty to the company to exercise the same standard of care, skills, and diligence that would be exercised by a someone who works very hard. One should note, however, that before this duty was codified, 'the common law duty was generally accepted to be the objective and subjective test set out in **section 214 of the Insolvency Ac of 1986 per Hoffman LJ. In Re D' Jan of London Ltd. (1993) BCC 646.**

An objective test would require the general knowledge, skills, and experience that may reasonably be expected of a person carrying out the same functions as the director concerning that company. (**Dorchester Finance Co Ltd V Stebbing (1989) BCLC 498)** case in which Foster J. regarded that blindly accepting the report of the auditors was unacceptable even for non- executive directors. A subjective test requires the general knowledge, skills, and experience that the director has **(Re City Equitable Fire Insurance Co. Ltd (1925) Ch 407**).

This is the only duty not enforceable as a fiduciary duty, and the sole remedy for a breach would be damaged against the director.[51]

Also is the duty **to avoid conflicts of interest**, which requires a director to prevent a situation where he has or could have a direct or indirect interest conflicting with the company's attention. [52] This responsibility is not infringed if the case cannot realistically be regarded as expected to give rise to a conflict of interest or, where endorsed, the directors authorise the matter.

In **Bray V Ford (1896) AC44**, it was further explained that the no-conflict rule of this case was deployed to eliminate the directors from being '*swayed*' from their duties by the considerations of their interests. In **Guinness Plc V Saunders (1990) 2 AC 663**, the director placed himself in a position of conflict of interest when he made excessive remuneration to himself without the informed consent of the company. This approach was also used in **Ball V Eden project Ltd. (2002) 1 BCLC 313.**

Next is the duty **not to accept benefits from the third parties**[53] This duty prohibits the acceptance of benefits, especially bribes. Shareholders will be able to authorise the receipt of benefits, but the board may not. The duty is not infringed by the acceptance of a benefit which could not reasonably be regarded as likely to give rise to a conflict of interest.

Lastly is the duty **to declare interest in the proposed transaction or arrangement** [54.] It will allow directors to disclose their interest in any proposed sale to the board before the company proceeds. There is no need to disclose anything that the other directors already know or ought to be reasonable about. No pronouncement is obligatory if the interest cannot logically be seen as likely to give rise to a variance of interests.

This list is not exhaustive, but highlights areas of particular importance that reflect the fullest expectations of responsible business practices. The verdict as to what will support the victory of the company, and what constitutes '*success*' is for the directors' good faith ruling.

The statutory duties and the standard of care that the current day directors have to display as listed in the **companies Act of 2006 sections 171-177** is reasonable, especially under the current economic climate.

The global economic turmoil where companies which hitherto declared mind-blowing profits, with over the top bonuses to the senior management are suddenly going burst, and yet very little is heard of the responsibilities of those guilty. The companies Act 2006 will instill honesty, discipline, and efficiency into the management of the U.K. listed companies, especially groups of companies. The Act will encourage openness and long-term wealth creation, excellent business arrangements, and practices, while the rogue trader-- companies will be sanctioned/punished accordingly.

III. CORPORATE SHAREHOLDERS

Tricker (1984) states that; four primary sources of corporate power may be identified. These are;

1. Ownership power within the corporation.
2. The balance of power between the shareholders and the board of directors
3. Managerial power, and
4. Institutional power.[55]

As companies grow and increase their share capital, with more shareholders investing in shares, so the proportion of voting stock held by the most significant shareholders decreases. Hence, the power of the shareholders to control large corporations effectively diminished. As a result, the interests of ownership and control have diverged, and the balance of power has shifted from members to managers.[56] Additionally, annual general meeting, in many cases proved to be both inadequate and ineffective for exercising governance where there was a diversity of shareholders, most of whom generally did not attend. Other stakeholders of the company were not invited to participate in the annual general meeting. Any concerns that they had were usually not heard, as there were no corporate governance policies or programs in place to allow for this.[57]

Furthermore, disgruntled shareholders (other than the institutional shareholders themselves) seeking to change board policies tend to be rare, particularly in countries such as the U.K. Even in the United States of America, where members are generally more active at meetings of public companies, the board may still fail to respond to the wishes of shareholder members.[58] Consequently, *"meetings should zero in on those primary issues of governance, not on issues of executive management. The distinction between governance and management domains is the most misunderstood facet of board conduct"* .[59]

In the U.K. the two main ways in which shareholders can exert control over managers of their company are: through exercising any voting rights attached to their shares at a shareholders meeting: this might be in the form of election of directors or altering the articles or memorandum to take away or modify powers given to directors as to the future; and, if there is a market in the shares, by selling their shares, referred to as control through '*exit*'. "*For the parent company in holding a majority of shares, and /or exerting total control over the subsidiary, often appointing directors to the subsidiary board and or itself as a parent company acting as a director*" [60] **-as per sections 1159 and 1162 of the Companies Act of 2006**.

However, any minority shareholder might seek a statutory remedy under **section 994 of the companies Act 2006** and so through threatening that redress, indirectly exert control over the affairs of the company.[61]

This allows a shareholder to petition the court for relief from *"unfairly prejudicial conduct*" carried out by the board or a majority of shareholders.

To date, **section 994** has been the primary mechanism for resolving disputes between the participants in small, quasi partnership style companies. This is because the section gives broad powers to the court to grant a remedy: one of such solution is to require that remaining shareholder to buy the shares of the claimant at a fair price, a vital solution for the small private company where there is no market shares, least of all any minority shareholdings.[62]

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Within a group of companies, there may well be minority shareholders- individuals or other companies –who object to how the parent company is exerting its influence. This might occur where a subsidiary's required by the parent to act in a way that benefits the group but not necessarily the subsidiary. For example, on the instructions of the parent company, a subsidiary may guarantee another company's loans within the group;. However, this may well benefit the group as a whole, a minority shareholder in the subsidiary may object in seeing no benefit to his company –(subsidiary). Such Act might well lead to a claim that this conduct is unfair and prejudicial to such minority shareholder interest, under **section 994 of companies Act 2006.**[63]

In both corporate and non- profit organisations, Chait (1994) believes that boards, which have sound and workable governance practices in place, generate successful organizations .[64] Thus, to achieve good governance practices, Tricker (1984) believes that the balance of power between the members of a public company and the board of directors needs to be correct.[65]

In a large public company with many subsidiaries operating in various businesses in different parts of the world, power is exercised in a range of roles and at multiple levels. Corporate governance is not simply determining whether the board or the members use power[66] Tricker (1984). It also involves an analysis of the functions and responsibilities of directors of a subsidiary and holding companies, managers of business and its members, employees, creditors, and other interested stakeholders.

Tricker (1984) believes that it is usually only in extreme situations, for example, when the company appears to be on the verge of collapse, that the votes of shareholders begin to count. On a day – to – day basis, however, members are more passive investors than active participants in the governance process. This applies to institutional shareholders where financial institutions would rather incur small losses than allow members to become involved in the processes of corporate governance. Therefore, the actions taken by such institutions are not necessarily in the interests of all shareholders. By circumventing the organisational governance processes, the institutions may well be disenfranchising the legitimate rights of the other members. Hence, questions of accountability have become important issues in this regard.[67]

It is essential to mention that the rights of minority shareholders and members are, in the first instance, controlled by a universal law principle of The Rule in **Foss V Harbottle (1843) 2 Hare 461**. This rule supports the belief that in any company, "*the majority rule is okay*".

"*That is, companies are like mini democracies, if 51% -- the majority of the shareholders and members decide to do something then it is done, and if you happen to be a disgruntled minority shareholder who doesn't agree, then it is tough, you either leave or if you can, sell your shares, this is not an easy option for the small private company" .*[68]

There is a general principle of company law that minority shareholders cannot sue for damages to their company or complain of irregularities in the conduct of their internal affairs. This principle is known as the rule in **Foss V. Harbottle (1843) 2 Hare 461**. Also, it is clear that a mere breach of the fiduciary duties that directors owe to their company is ratifiable and hence cannot be the subject of minority shareholder action- **Burland V Earle (1902) Act 83 (P.C.).** The same is true of an act by directors beyond the authority conferred upon them by the articles, or an irregularity in the appointment of directors – **Grant V U.K. Switchback Railways** (**1888) 40 Ch D 135 (C.A.).**[69]

Although there are occasions when the company may maintain an action, these are when *"where directors use their powers intentionally or unintentionally, fraudulently or negligently in a manner which benefits themselves at the expense of the company, a right to a minority shareholder action will lie."* **Daniels V Daniels (1978) Ch 406.**[70]

IV. CONCLUSION

In conclusion, this paper has been able to explore that shareholders have limited liability. However, banks usually require individuals to sign personal guarantees or to put up their assets as security for loans. It is easier to raise finance because a company can issue shares or create a "floating change" over its assets and ongoing business, and these can be used as security for a loan.

The company pays tax at a flat rate, and losses can be offset against future taxable income. Also, a company structure leads to a clear distinction between the personal affairs of the shareholders and their business affairs.

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