which shows that 80% of FTSE 350 companies put all directors up for re-election in 2011, in contrast to only 10% in 2010. It is expected that the figure will continue to rise given the remaining companies' willingness to review their practice ahead of 2012.

Gender diversity

In recent years, there has been heightened concern for a more diverse board culture, with current attention focused on increasing the representation of women on boards. In 2010, Lord Davies of Abersoch was commissioned to review the current situation. His report, published in February 2011,[12] presents the business case for gender diversity on boards: namely, improving performance; accessing the widest talent pool; being more responsive to the market; and achieving better corporate governance. Davies urges that it is in the interests of businesses (and shareholders) to encourage gender diversity, and, although he rejects the use of 'quotas' for the time being, he sets out recommendations designed to achieve 25% female representation on boards by 2015.

Two of these recommendations have already been incorporated in the UK Corporate Governance Code and apply to financial years beginning on or after 1 October 2012. The first requires the board to describe the board's policy, objectives and progress on developing gender diversity (Principle B.2.4). The second requires board evaluation to include consideration of the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit and other factors relevant to its effectiveness (Principle B.6).[13]

The full impact of these, and other, changes on board culture and board effectiveness remains to be seen. However, a progress report[14] published in 2012 points to the 'biggest-ever reported increase in the percentage of women on boards' and concludes that there has been a 'culture change' in how women are seen within the workforce. If the rate of increase in representation persists, then it is suggested that a record 26.7% female board representation will be achieved by 2015.

The European Commission is on the bandwagon, and has launched its own consultation and investigation on gender imbalance as a cross-EU issue. A House of Lords Sub-Committee has now launched an inquiry into the subject matter, in aid of the European Commission's consultation.[15] This may result in the introduction of further measures, on an EU level, including the possibility of imposing 'quotas' for corporate entities.

(p. 267) ➢ Questions

1. In *Equitable Life Assurance Society v Bowley* [2003] EWHC 2263 (Comm) at [41], Langley J suggested that 'a company may reasonably, at the least, look to NEDs for independence of judgment *and supervision of the executive management*' (emphasis added). Companies do not appoint NEDs without good reason; they are usually chosen for their specific expertise, experience or business connections. NEDs who provide these services can expect to be paid reasonably well for their contributions, but of course this means that they may become financially dependent on the company to a greater or lesser extent. Is it realistic to expect NEDs to be 'independent', and to supervise executive management? Equally, is it realistic to expect companies to appoint and pay fees to individuals who have little to offer apart from independence and a policing role?

2. How is a line to be drawn between achieving gender diversity and avoiding positive discrimination?

Regulation of institutional investors by the UK Stewardship Code

One phenomenon which had remained largely overlooked until recently was the rise in the number of shares—particularly shares in listed public companies—held by 'institutional' shareholders such as pension funds, insurance companies, unit trusts and mutual funds.[16] The percentage of their holdings overall has grown from about a quarter in the 1960s to about two-thirds in more recent years, and in some companies may be as high as 80% or more, although in some spheres it is now declining.

These bodies hold the long-term savings of millions of citizens, and are managed by specialist professionals who, on the one hand, are in competition with each other but, on the other, are bound by the very nature of their function not to take unwarranted risks with the funds for which they are responsible. Views differ on the extent to which these institutions and their professionals should be expected, or even required, to monitor the performance of those charged with the management of the companies held in their portfolios. Plainly, these large members are in a position to wield considerable influence both in the affairs of a particular company (most notably in a takeover situation) and in the development of general standards of corporate governance.

The UK Corporate Governance Code states that institutional shareholders 'have a responsibility to make considered use of their votes', and that they 'should enter into a dialogue with companies based on the mutual understanding of objectives'.[17] But this is not a panacea. Early on, the Company Law Review drew attention to the likely risk of conflicts of interest inherent in the position of a fund manager: suppose, for instance, that the same institution is both an investor in a company and trustee of its pension fund, or involved with both bidder and target in a takeover bid.

These concerns therefore provided the context in which the Institutional Shareholders' Committee (ISC), the representative forum of the institutional shareholding community in the UK, published its 'Code on the Responsibilities of Institutional Investors' in 2009. These good practice principles were geared at 'enhancing the quality of engagement' between institutional investors with their investee companies, thus providing better stewardship services for investors. This Code became the 2010 UK Stewardship Code on its adoption by the FRC.

(p. 268) At the outset, and unlike the UK Corporate Governance Code, it should be noticed that the Stewardship Code is optional, in the sense that institutional shareholders are free to choose whether or not to sign up and engage. However, once they do sign up, their fund managers or agents are responsible for ensuring compliance and, like the UK Corporate Governance Code, the Stewardship Code operates on a 'comply or explain' basis. The FSA introduced in December 2010 under Conduct of Business Rule 22.3 the requirement that stakeholder firms are to disclose the extent of their commitment to the Code; and where they do not commit to the Code, they are requires to outline their 'alternative investment strategy'. This requirement does not deny the Code's voluntary nature.

Client and beneficiary-primacy

Depending on the chosen investor structure, institutional shareholders/investors act for or represent 'clients' or 'beneficiaries'. The Stewardship Code puts the interests of these clients and beneficiaries centre stage. Principle 2 reiterates the institutional investor's duty to act in the interests of all clients and/or beneficiaries when they exercise their powers. This duty is analogous to that imposed on directors (see Chapter 6), who are required by Companies Act 2006 (CA 2006) s 172 to act to promote the success of the company. In both cases, the requirement seeks to ensure that the agents in question do not seek to further their own interests and, in the process, sacrifice the interests of those they are supposed to protect. Principle 2 therefore requires institutional investors to formulate and disclose publicly a clear 'robust' policy to manage any potential conflicts of interest.

To the same ends, Principle 5 requires institutional shareholders to act collectively with other investors where appropriate. Put this way, shareholder value (for the clients/beneficiaries) is to be promoted, even if its achievement comes at the price of commercially sensitive collaboration with actual of potential competitors.

Enhanced interaction with investee companies

Principle 1 requires institutional shareholders to disclose their policy on discharging their stewardship responsibilities. The Guidance indicates that such disclosure should include information as to how investee companies will be monitored by the institutions, and suggests that active dialogue with the board of an investee company may be necessary.

Principle 3 strengthens this idea of monitoring, including appraising investee board and committee structures (especially in the light of any departures from the UK Corporate Governance Code), and elaborates on the need for and nature of any regular and active dialogue with the boards.

Enhanced publicity

A consistent feature of the Code is that institutional investors are not only expected to formulate clear policies for discharging their duties, but are also obliged to disclose these policies and report publicly on their implementation.

Review and amendment

In April 2012, the FRC published a consultation document[18] on proposed revisions to the Stewardship Code (the '2012 Revision'). Critics have complained that the concept of 'steward-ship' is too vague, and that the Code provides a 'one-size-fits-all' solution which is inappropriate for all types of institutional investors. The 2012 Revision is designed to address these fundamental issues, as well as more specific or technical issues which have emerged. As the consultation document puts it, the aim is to:

- clarify the aim and definition of stewardship;
- (p. 269) delineate more clearly the varying responsibilities of different types of institutional investors;
- address issues identified in the FRC's December 2011 report;
- address a small number of other issues fundamental to stewardship that previously had not been dealt with in the Code;
- edit the previous text where needed to create greater consistency across the Code; and
- provide more information, where needed, on how the Code is expected to be implemented.

Narrative reporting reforms

In addition to changes made to the Corporate Governance Code and the Stewardship Code, the Department for Business, Innovation and Skills has responded to its earlier consultation on narrative reporting and produced draft regulations introducing a series of changes aimed at facilitating shareholders' access to information.[19]

As proposed, the new format annual reports will be made up of two key documents: a concise 'high level' Strategic Report, replacing the business review and containing 'strategic, headline information', with some extra content for quoted companies concerning the business model, human rights and diversity; and a more detailed Annual Directors' Statement to be made available on company websites.

Role of the company secretary

Before turning to directors, the role of company secretaries should be noted. A public company must have a company secretary (CA 2006 s 271); a private company need not, although the functions must then be carried out by the directors (s 270). The role of company secretary has evolved into one of increasing responsibility and influence within the management structure: for an early recognition of this evolution, see *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* **[3.15]**.

A recent report by the All Party Parliamentary Corporate Governance Group (APPCGG) at the House of Commons, entitled 'Elevating the Role of the Company Secretary', presented the findings from a study of company secretaries of 'FTSE All Share' companies. These findings show that the scope of the company secretary's role varies considerably between companies, but none of the profiles seem adequately described by the term 'secretary', which is consistently seen as problematic. The most commonly suggested alternative is 'Corporate Governance Director', which goes some way towards reflecting the growing importance of the role in the realm of corporate governance.

➢ Question

Compare the approach in *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* **[3.15]** with the *dicta* of Lord Macnaghten from more than 100 years ago, in *Ruben v Great Fingall Consolidated* **[11.13]**, in which his lordship described the role of the secretary as a 'mere servant'. What factors may have contributed to this drastic change of attitude?

(p. 270) ➣ Note

See the APPCGG's report on engagement between the board and the non-board management, available at:www.appcgg.co.uk/documents/reconnecting_the_board_report.pdf.

Directors' service contracts

In practical terms, directors could be made virtually irremovable by negotiating for service contracts with very long terms, so that companies could then only get rid of the directors by paying prohibitive sums as compensation. A board of directors acting in collusion could see to it that every member of the board was protected in this way.

To avoid this risk, the legislation now provides that no service contract may be made to run for more than two years without the prior authorisation of the members (CA 2006 ss 188–189).[20] Without this approval, the relevant terms are void and a term is deemed to be included in the contract allowing the company to terminate the contract at any time on reasonable notice. The rule applies to both contracts of service and contracts for services (s 227), and also to engagements with shadow directors (s 223(1)(a)).

In addition, all directors' service contracts must be open for inspection by the members (ss 227–230), and every company must give, in a note to its annual accounts, information about aggregate directors' remuneration (s 412). (A small company can omit this information from the accounts it files at Companies House.) All unquoted/unlisted companies must give statistical information, but are not required to identify payments to each director by name.

Remuneration of directors

Directors have no prima facie entitlement to remuneration.[21] Provision for payment is therefore usually made in the articles, and the appropriate decision-making process is as determined there. CA 2006 ss 188 and 189 (noted earlier) limit the company's power to determine its own procedures, and ss 227–230 impose disclosure obligations. Beyond these restrictions, the company is free to determine its own practices.

It is crucial for directors that there *is* clear constitutional authority for any agreements that are made, and that the proper procedures have been followed. Without these, the purported arrangements are void (see *Guinness plc v Saunders* **[5.01]**) and directors are not entitled as of right to any remuneration, whether upon a *quantum meruit*, 'equitable allowance', or otherwise. Indeed, if a person is not a director, he or she will fare better in obtaining payment for any services rendered (see *Craven-Ellis v Canons Ltd* **[5.02]**).

The power to pay directors' remuneration must be strictly observed.

[5.01] Guinness plc v Saunders [1990] 2 AC 663 (House of Lords)

In January 1986, the board of Guinness appointed a committee of three directors, Saunders, Roux and Ward, to handle the day-to-day decisions in connection with a takeover bid which Guinness had made for another company, Distillers. The bid was ultimately successful. Ward had been paid a fee of £5.2 million for his part in the bid, which he said had been agreed by **(p. 271)** the committee. The company's articles empowered the board of Guinness to fix the remuneration of individual directors, and contained several provisions allowing it to delegate various of its functions. The House of Lords declined to construe the articles in a way that invested the committee with power to pay remuneration to one of its own members, and ordered Ward to repay the £5.2 million.

LORD TEMPLEMAN: … Mr Ward admits receipt of £5.2m from Guinness and pleads an agreement by Guinness that he should be paid this sum for his advice and services in connection with the bid. Mr Ward admits that payment was not authorised by the board of directors of Guinness.

The articles of association of Guinness provide:

Remuneration of directors.

> 90. The board shall fix the annual remuneration of the directors provided that without the consent of the company in general meeting such remuneration (excluding any special remuneration payable under article 91 and article 92) shall not exceed the sum of £100,000 per annum …
>
> 91. The board may, in addition to the remuneration authorised in article 90, grant special remuneration to any director who serves on any committee or who devotes special attention to the business of the company or who otherwise performs services which in the opinion of the board are outside the scope of the ordinary duties of a director. Such special remuneration may be made payable to such director in addition to or in substitution for his ordinary remuneration as a director, and may be made payable by a lump sum or by way of salary, or commission or participation in profits, or by any or all of those modes or otherwise as the board may determine.

Articles 90 and 91 of the articles of association of Guinness depart from the Table A articles recommended by statute, which reserve to a company in general meeting the right to determine the remuneration of the directors of the company.[[22]] But by article 90 the annual remuneration which the directors may award themselves is limited and by article 91 special remuneration for an individual director can only be authorised by the board. A committee, which may consist of only two or, as in the present case, three members, however honest and conscientious, cannot assess impartially the value of its work or the value of the contribution of its individual members. A director may, as a condition of accepting appointment to a committee, or after he has accepted appointment, seek the agreement of the board to authorise payment for special work envisaged or carried out. The shareholders of Guinness run the risk that the board may be too generous to an individual director at the expense of the shareholders but the shareholders have, by article 91, chosen to run this risk and can protect themselves by the number, quality and impartiality of the members of the board who will consider whether an individual director deserves special reward. Under article 91 the shareholders of Guinness do not run the risk that a committee may value its own work and the contribution of its own members. Article 91 authorises the board, and only the board, to grant special remuneration to a director who serves on a committee.

It was submitted that article 2 alters the plain meaning of article 91. In article 2 there are a number of definitions each of which is expressed to apply 'if not inconsistent with the subject or context'. The expression 'the board' is defined as 'The directors of the company for the time being (or a quorum of such directors assembled at a meeting of directors duly convened) or any committee authorised by the board to act on its behalf.'

The result of applying the article 2 definition to article 91, it is said, is that a committee may grant special remuneration to any director who serves on a committee or devotes special attention to the **(p. 272)** business of the company or who otherwise performs services which in the opinion of the committee are outside the scope of the ordinary duties of a director. In my opinion the subject and context of article 91 are inconsistent with the expression 'the board' in article 91 meaning anything except the board. Article 91 draws a contrast between the board and a committee of the board. The board is expressly authorised to grant special remuneration to*any* director who serves on *any* committee. It cannot have been intended that any committee should be able to grant special remuneration to any director, whether a member of the committee or not. The board must compare the work of an individual director with the ordinary duties of a director. The board must decide whether special remuneration shall be paid in addition to or in substitution for the annual remuneration determined by the board under article 90. These decisions could only be made by the board surveying the work and remuneration of each and every director. Article 91 also provides for the board to decide whether special remuneration should take the form of participation in profits; the article could not intend that a committee should be able to determine whether profits should accrue to the shareholders' fund or be paid out to an individual director. The remuneration of directors concerns all the members of the board and all the shareholders of Guinness. Article 2 does not operate to produce a result which is inconsistent with the language, the subject and the context of article 91. Only the board possessed power to award £5.2m to Mr Ward …

[Lord Templeman ruled further that: (i) none of Guinness's other articles conferred a power on the committee to pay Ward remuneration; (ii) Ward was not entitled to sue Guinness for professional services rendered as a solicitor; (iii) Saunders, as chairman, had no actual or ostensible authority to agree that Ward should be paid the sum; and (iv) that since the articles made express provision for the way in which directors should be remunerated, Ward had no claim by way of *quantum meruit*.]

LORD GOFF OF CHIEVELEY delivered a concurring opinion.

LORDS KEITH OF KINKEL, BRANDON OF OAKBROOK and GRIFFITHS concurred.

If the director's appointment is void, remuneration on a* quantum meruit *basis may be possible.

[5.02] Craven-Ellis v Canons Ltd [1936] 2 KB 403 (Court of Appeal)

The facts appear from the judgment.

GREER LJ: The signatories to the memorandum and articles, being entitled to elect the first directors, nominated Mr Phillip du Cros, the plaintiff, and Mr A W Wheeler as the first directors on 15 August 1928, and on 23 August the directors co-opted Sir Arthur de Cros as a director. Under the articles these directors could act without qualification for two months, but after that time they became incapable of acting as directors as none of them had acquired the necessary qualification. The only issued shares of the company were in the two signatories to the memorandum, but there is little room for doubt that these gentlemen were nominees of the du Cros'. Be this as it may it is clear that on the expiration of the two months, the directors having no qualification ceased to be directors, and were unable to bind the company except as de facto directors by agreements with outsiders or with shareholders … On 14 April 1931 an agreement was executed under the seal of the company, purporting to be between the company and the plaintiff, stating the terms on which he was to act by resolution of the unqualified directors. The plaintiff in this action sought to recover from the defendant company the remuneration set out in the agreement, and as an alternative, sought to recover for his services on a quantum meruit. Until the company purported to put an end to his engagement he continued to perform all the services mentioned in the agreement.

The company, having had the full benefit of these activities, decline to pay either under the agreement or on the basis of a quantum meruit. Their defence to the action is a purely technical defence, and if it succeeds the Messrs du Cros as the principal shareholders in the company, and the company, would be in the position of having accepted valuable services and refusing, for purely technical reasons, to pay for them.

(p. 273) As regards the services rendered between 31 December 1930 and 14 April 1931, there is, in my judgment, no defence to the claim. These services were rendered by the plaintiff not as managing director or as a director, but as an estate agent, and there was no contract in existence which could present any obstacle to a claim based on a quantum meruit for services rendered and accepted.

As regards the plaintiff's services after the date of the contract, I think the plaintiff is also entitled to succeed. The contract, having been made by directors who had no authority to make it with one of themselves who had notice of their want of authority, was not binding on either party. It was, in fact, a nullity, and presents no obstacle to the implied promise to pay on a quantum meruit basis which arises from the performance of the services and the implied acceptance of the same by the company. …

I accordingly think that the defendants must pay on the basis of a quantum meruit not only for the services rendered after 31 December 1930, and before the date of the invalid agreement, but also for the services after that date. I think the appeal should be allowed, and judgment given for such a sum as shall be found to be due on the basis of a quantum meruit in respect of all services rendered by the plaintiff to the company until he was dismissed. …

GREENE LJ delivered a concurring judgment.

TALBOT J concurred.

➢ Questions

1. On the purported contract with the company the plaintiff, as an 'insider', was deemed to have constructive notice both of the supposed directors' want of competence and of his own ineligibility for appointment as the managing director, because he was not a director. In the light of *Hely-Hutchinson v Brayhead Ltd* **[3.09]**, would he now be considered an 'insider'? In any event, would the protections available to third parties contracting with the company (see 'Statutory provisions protecting third parties (outsiders) from the consequences of constitutional limitations on corporate capacity', pp 85ff and CA 2006 s 161) provide any assistance where the company has no board of directors?

2. On the *quantum meruit* claim, the judgment rests in part upon the assumption that 'the company' accepted the plaintiff's services. Which organ or agent of the company could in the circumstances be deemed to have done so? (There were some outside members.)

3. Why was this reasoning not acceptable in the context of a validly appointed director in *Guinness plc v Saunders* ?

4. In *Re Richmond Gate Property Co Ltd* [1965] 1 WLR 335, Plowman J held that a managing director was not entitled to remuneration on a *quantum meruit* basis, because the articles of the company provided that a managing director was to receive 'such remuneration … as the directors may determine', and the company had gone into liquidation without any consideration of the matter by the directors. The existence of an express arrangement about remuneration, the judge held, ruled out any possibility of an alternative claim based on a *quantum meruit*. The case depends in part on a misunderstanding of *Craven Ellis v Canons Ltd*, and may be open to criticism on other grounds also, so that its authority is questionable. After *Guinness plc v Saunders*, how would a court decide this case?

Setting the amount to be received by a director by way of remuneration

It is permissible to pay directors remuneration when the company has made no profits, and even when the company is not solvent (subject to any other misfeasance this may involve). The amount of remuneration is for the members (or other authorised body) to fix, and need not necessarily be determined by the market value of those services. But an award of remuneration must be 'genuine' and not a 'disguised gift' or an unlawful return of capital to a member, as illustrated by the next case.

(p. 274) ***An award of remuneration must be 'genuine'.***

[5.03] Re Halt Garage (1964) Ltd [1982] 3 All ER 1016 (Chancery Division)

Mr and Mrs Charlesworth were the only directors and members of the company, and initially they had both worked in the business, drawing sums as directors' remuneration under express powers in the memorandum and articles. In 1967 Mrs Charlesworth became ill and ceased to take an active part in the business, but she remained a director and continued to draw remuneration at a reduced rate. From 1968 onwards, the company became unprofitable, and in 1971 it went into insolvent liquidation. The liquidator claimed that Mrs Charlesworth had no right to be paid after she had given up work, and also that Mr Charlesworth had been paid more than the market value of his services, and sought restitution of the sums allegedly overpaid. The payments to Mr Charlesworth were upheld, even those made after the company had ceased to be profitable. But Mrs Charlesworth was obliged to refund that part of the money paid to her which the judge held was not a 'genuine award of remuneration' but a 'disguised gift out of capital'.

> OLIVER J: Now there is no presumption that directors' remuneration is payable only out of divisible profits …
>
> Counsel for the liquidator does not go to the extent, in fact, of suggesting that when a company has fallen on bad times the directors must either close the business down immediately or go on trying to pull it round for nothing … What I think counsel's submission comes to is this, that while the company has divisible profits remuneration may be paid on any scale which the shareholders are prepared to sanction within the limits of available profits, but that, as soon as there cease to be divisible profits, it can only lawfully be paid on a scale which the court, applying some objective standard of benefit to the company, considers to be reasonable. But assuming that the sum is bona fide voted to be paid as remuneration, it seems to me that the amount, whether it be mean or generous, must be a matter of management for the company to determine in accordance with its constitution which expressly authorises payment for directors' services. Shareholders are required to be honest but, as counsel for the respondent suggests, there is no requirement that they must be wise and it is not for the court to manage the company.
>
> Counsel for the liquidator submits, however, that if this is right it leads to the bizarre result that a meeting of stupid or deranged but perfectly honest shareholders can, like Bowen LJ's lunatic director,[23] vote to themselves, qua directors, some perfectly outlandish sum by way of remuneration and that in a subsequent winding up the liquidator can do nothing to recover it. It seems to me that the answer to this lies in the objective test which the court necessarily applies. It assumes human beings to be rational and to apply ordinary standards. In the postulated circumstances of a wholly unreasonable payment, that might, no doubt, be prima facie evidence of fraud, but it might also be evidence that what purported to be remuneration was not remuneration at all but a dressed-up gift to a shareholder out of capital …
>
> This, as it seems to me, is the real question in a case such as the present. The real test must, I think, be whether the transaction in question was a genuine exercise of the power. The motive is more important than the label. Those who deal with a limited company do so on the basis that its affairs will be conducted in accordance with its constitution, one of the express incidents of which is that the directors may be paid remuneration. Subject to that, they are entitled to have the capital kept intact. They have to accept the shareholders' assessment of the scale of the remuneration, but they are entitled to assume that, whether liberal or illiberal, what is paid is genuinely remuneration and that the power is not used as a cloak for making payments out of capital to the shareholders as such …
>
> **(p. 275)** [His Lordship referred to Mrs Charlesworth's illness, and continued:] The fact is that, however valuable and exacting may have been the services which Mrs Charlesworth had rendered in the past, her continued directorship contributed nothing to the company's future, beyond the fact that she was and remained responsible as a director and was able to make up the necessary quorum for directors' meetings (of which remarkably few took place if the minutes are any accurate guide).
>
> On the other hand, it is said that the Companies Act 1948 imposes on every company incorporated under its provisions an obligation to have a director and it contemplates that those who assume the responsibilities of office, whether they carry them out well or ill, may be paid for that service in such way and in such measure as the company's regulations prescribe or permit. Here the company's constitution conferred on it in express terms a power to award to a director a reward or remuneration for the bare fact of holding office, and that power the company purported to exercise. If it be legitimate for the company to award some remuneration, however nominal, to Mrs Charlesworth for acting as a director and taking on herself, for good or ill, the responsibilities which that office entails, at what point, counsel for the respondents asks, does it become beyond the company's power to do that which its constitution permits it to do and how can the court take on itself the discretion as to quantum which is vested in the shareholders,

there being, ex concessis, no mala fides? I have not found the point an easy one, but on the view that I take of the law the argument of counsel for the respondents is very difficult to meet *if* the payments made really were within the express power conferred by the company's constitution.

But of course what the company's articles authorise is the fixing of 'remuneration', which I take to mean a reward for services rendered or to be rendered; and, whatever the terms of the resolutions passed and however described in the accounts of the company's books, the real question seems to me to be whether the payments really were 'directors' remuneration' or whether they were gratuitous distributions to a shareholder out of capital dressed up as remuneration.

I do not think that it can be said that a director of a company cannot be rewarded as such merely because he is not active in the company's business. The mere holding of office involves responsibility even in the absence of any substantial activity, and it is indeed in part to the mere holding of office that Mrs Charlesworth owes her position as a respondent in these proceedings. I can see nothing as a matter of construction of the article to disentitle the company, if the shareholders so resolve, from paying a reward attributable to the mere holding of the office of director, for being, as it were, a name on the notepaper and attending such meetings or signing such documents as are from time to time required. The director assumes the responsibility on the footing that he will receive whatever recompense the company in general meeting may think appropriate. In this case, however, counsel for the liquidator is entitled to submit that the sums paid to Mrs Charlesworth were so out of proportion to any possible value attributable to her holding of office that the court is entitled to treat them as not being genuine payments of remuneration at all but as dressed-up dividends out of capital …

[His Lordship considered the evidence, and ruled that only £10 out of the £30 per week which had been paid to Mrs Charlesworth while she was ill was genuinely 'remuneration'. He ordered her to repay the balance.]

➤ Questions

1. Mrs Charlesworth was a member. Could Oliver J have reached the same conclusion if she had not held shares?

2. Earlier in his judgment, Oliver J said:

> It is commonplace in private family companies, where there are substantial profits available for distribution by way of dividend, for the shareholder directors to distribute those profits by way of directors' remuneration rather than by way of dividend, because the latter course has certain fiscal disadvantages. But such a distribution may, and frequently does, bear very little relation to the **(p. 276)** true market value of the services rendered by the directors … Yet it is very difficult to see why the payment of directors' remuneration, on whatever scale the company in general meeting chooses, out of funds which could perfectly well be distributed by way of dividend, should be open to attack merely because the shareholders, in their own interests, choose to attach to it the label of directors' remuneration …

Does this mean that different rules apply if a company has undistributed profits?

3. Could Mrs Charlesworth have kept the payments if:

(i) the company had been solvent at the time they were made?

(ii) the members had believed that the company was solvent, when in fact it was not?

4. This case indicates there are limits to the power of shareholders to decide freely on matters of remuneration. Does the decision, in effect, suggest that shareholders must act 'bona fide and for proper purposes' in exercising their powers? (See 'Summary of limitations on members' voting', pp 243ff). Could this common law approach

impact on the shareholders' vote proposed under the new legislative reforms in relation to directors' remuneration (see later)?

5. If the power to decide remuneration lies with the directors (see the Model Articles art 19 (private companies) and art 23 (public companies)), are the constraints on decision-making the same, or greater? Who *should* the power be given to?

6. Could a failure to ensure that the board fixes salaries that are affordable by the company show a director's unfitness and be a ground for a disqualification order under the Company Directors Disqualification Act 1986?

7. Could a directors' (or majority members') decision to award 'excessive' remuneration be open to challenge as a 'fraud on the minority' (see 'Exceptions to the rule in *Foss v Harbottle*', pp 640ff and consider whether it now has a statutory equivalent) or 'unfair prejudice' (see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff)?

➢ Notes

1. In *Barclays Bank plc v British & Commonwealth Holdings plc* [1996] 1 BCLC at 9 Harman J said that he found the decision in *Halt Garage* difficult to accept because, in his view, it is not possible for a resolution to be held valid in part and unlawful as to the rest: the irregularity should have led to a finding that it was void *in toto*. (The Court of Appeal ([1996] 1 BCLC 1 at 26ff) did not refer to this point.) What would this have meant for the liquidator's claim?

2. The payments to Mrs Charlesworth might now be caught by Insolvency Act 1986 (IA 1986) s 238 (as a 'transaction at an undervalue', subject to the time limits fixed by that section). In an appropriate case, IA 1986 s 423 might also be applicable (this has no time limits but requires proof of an intention to put assets beyond the reach of the company's creditors). See 'The conduct of the liquidation', pp 805ff.

3. The reasoning of Oliver J was followed by Hoffmann J in *Aveling Barford Ltd v Perion Ltd* **[10.14]** to strike down as not 'genuine' and as an unauthorised return of capital a sale of land made at an undervalue by a company to another company controlled by its principal member. Can these cases be seen as part of an emerging new doctrine which may be invoked where corporate assets are wrongfully depleted for the benefit of insiders? Is the doctrine, if there is one, even wider than this? Does this support an 'arm's length approach' as emerging from *Progress Property Co Ltd v Moore and another* [2010] UKSC 55 (Supreme Court) **[10.15]**.

(p. 277) Statutory reforms to deal with directors' remuneration

In the wake of the global financial crisis, the general public has been vocal in expressing concern, and sometimes outrage, that alarmingly high levels of directors' remuneration often bear no relationship to the laggardly performance of their listed companies, and certainly cannot be justified when employee wages are being cut or frozen.

In response to this sentiment, in June 2012 the government announced 'the most comprehensive reform' in relation to directors' remuneration.[24] The proposed measures have now been introduced through the Enterprise and Regulatory Reform Act 2013, with the intention that these reforms will be enacted at a date yet to be determined. In other words, these changes will come in the form of binding law, not merely 'best practice'.

The proposed reforms are geared towards giving shareholders of quoted companies a direct voice on pay policies and on the structure and implementation of exit payments. In conjunction with these objectives, the reforms will also facilitate better access to information related to directors' remuneration.

At the heart of these reform is the proposal for a binding shareholders' vote on directors' pay. Each year (or at a minimum every three years), the shareholders will be given an opportunity to vote on the company's policy on directors' remuneration. Before the vote, shareholders will have access to a policy report compiled by the board which will set out the key elements of pay with supporting information, and will compare these figures with the company's overall strategy or objectives, and will indicate the principles or factors which formed the basis for the pay policy. The policy report will also specify the impact on directors' pay if the company's performance is above, on or below target. A majority vote in favour of the policy is required before the policy is adopted.

Shareholders will also be given an 'advisory vote on implementation', that is, in relation to directors' remuneration actually paid in accordance with the policy adopted by the annual vote. If the vote fails, then the policy will return to the binding vote for re-approval in the subsequent year. This will ensure that the company's remuneration policy does not become a toothless document, but is in fact directly linked to the level of remuneration paid to directors.

Finally, 'exit pay' for any departing directors must also feature in the policy report and the corresponding votes mentioned earlier. This will ensure that directors do not receive substantial exit packages on leaving the company, which (unfortunately) seems to have been the case in recent years despite poor performance of companies and the markets in general.

To add support to these proposed legislative changes, the FRC is considering related changes to the Code. For example, if a vote reveals a significant dissenting minority, then the company should publish a public statement setting out how it will address such shareholder concern, thus holding directors to public account.

These reforms will be further supported by changes to narrative reporting, namely the production of strategic reports by companies (see 'Narrative reporting reforms', p 269). These will encapsulate a section on directors' pay, so that cross-references can be made between the key information contained in the report and the policy document on which the shareholders will vote.[25]

Finally, it is noteworthy that the FCA and PRA have in place a Remuneration Code,[26] which applies to around 2,700 firms within their ambit. The Code (the latest version of which came into force on 1 January 2011) reflects concerns that firms are taking unnecessary and unreasonable **(p. 278)** risk in the hope of increasing remuneration and bonuses. It mandates firms to implement remuneration policies which are in line with the overarching goal of harnessing 'sound and effective risk management'. Mandatory payment deferral and use of shares in lieu of cash payment are also featured in the Code.

➢ Questions

1. Are these changes too interventionist? Is the government placing too many limits on companies' freedom to set their own goals and policies, including how much they pay their directors?

2. What problems may arise when so much emphasis is placed on shareholder control? Is it realistic to expect shareholders, especially those with small shareholdings in many different companies, to play such an active role in monitoring directors? How should shareholder control measures be structured so as not to defeat the purpose of centralised management in the first place?

3. Is it congruent with the idea of 'enlightened shareholder value' that only shareholders get a vote on such matters as directors' remuneration? Should other stakeholders, for example the employees, also receive a vote? What practical disadvantages are likely to emerge if that is the case?

Further Reading

ARSALIDOU, D, 'The Regulation of Executive Pay and Economic Theory' (2011) 5 *Journal of Business Law* 431.
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BAINBRIDGE, SM, 'Why a Board? Group Decisionmaking in Corporate Governance' (2002) 55 (1) *Vanderbilt Law Review* 41.
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