

The Fallacy of Property Rights' Rhetoric in the Company Law Context: From Shareholder Exclusivity to the Erosion of Shareholders' Rights

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Introduction

This article argues that shareholder supremacy is based on a false concept that the shareholders own the company. It will refute the dominant view in both the academic and corporate worlds that the shareholders have a property right over the company. It will argue that the whole edifice of shareholder supremacy is based on shaky foundations; property rights do not apply within the company law context in the same manner as in other areas of law. It argues that the recognition of the shareholders as owners of the company was justified in the context of the early corporate forms such as partnerships, but that its transplant into the modern public company is not only deeply problematic but wrong. The structure, nature and functions of the modern public company and the role of shareholders within its context have changed to such a degree that the previous status of shareholders as owners of the company is obsolete. The evolution from partnership to the modern company has resulted in a new landscape in company law. It is therefore astonishing that this is not reflected in theory, where shareholders are dogmatically accepted as the owners of the company. At least at a theoretical level, they enjoy complete supremacy at the expense of actors who are vital for the operation and the success of the corporation, namely the creditors, the employees, the suppliers and through them, in a way, society as a whole.

This article will define the traditional notion of property rights and it will argue that they are not applicable in the modern corporate context. It will argue that shareholder

ownership nowadays flows mostly from ideological dogmatism. Presently, in practice, shareholders can only legitimately use the rights inherent in their shares, such as the right to vote. However, the existence of shares with multiple or no voting rights proves that establishing a link between shareholding and ownership of the company is a challenging task. Their role in monitoring the management is nowadays widely recognised as very difficult to perform. This article will focus on shareholder protection and, more specifically, on the derivative action of ss.260–263 of the Companies Act 2006 (CA 2006). The derivative action was introduced so as to empower aggrieved shareholders against mismanagement of the company. However, it will be argued that holding the management to account will prove to be difficult. If shareholders were the owners of the company, they would enjoy a protection similar to that of the owner of any other tangible or intangible good. This article will argue that the judicial stance on the matter proves that it is now increasingly embedded in jurisprudence that the status of shareholders as owners of the company is more of a fallacy than a reality. The judiciary has now abandoned the attachment to property rights when examining the position of shareholders, especially in relation to management. The fact that the courts refuse to grant to shareholders a level of protection suitable to a proprietor testifies to the deeply problematic nature of shareholder primacy and the invalidity of the property rights rhetoric on the corporation.

Can the traditional concepts of “ownership” and “property rights” apply in companies?

Property rights are defined as consisting primarily of a “bundle of rights”.¹ The definition of the traditional concept of ownership and property rights entails the right of exclusion, the right of use, the right of possession and the right to alienate.² This is a characteristic of the Western liberal property concept, which emphasises the power to exclude others

“as the central indicia of ownership, and the right of the owner to the beneficial use and enjoyment of the land and personal property over which ownership is claimed”.³

The owner of property has the right to exclude other individuals from his property, to refuse the use of his property for unauthorised purposes and to refuse its possession by others. If any individual attempts to disobey these restrictions, they may be found accused of criminal conduct such as theft or of a civil offence such as trespassing. Owners traditionally have “an unassailable legal entitlement to immediate possession of property occupied by ab initio trespassers”,⁴ which the

¹ P. Birks, “The Concept of Civil Wrong” in D.G. Owen (ed.), *Philosophical Foundations of Tort Law* (Oxford: Oxford University Press, 1997), p.48.

² N.S. Glackin, “Back to Bundles: Deflating Property Rights, Again” (2014) 29(1) *Legal Theory* 3.

³ C. Rodgers, “Nature’s Place? Property Rights, Property Rules and Environmental Stewardship” (2009) 68(3) *Cambridge Law Journal* 553.

⁴ R. Walsh, “Stability and Predictability in English Property Law: The Impact of Article 8 of the European Convention on Human Rights Reassessed” (2015) 131 *Law Quarterly Review* 586.

circumstances and needs of the trespassers could not displace or postpone. Thus, an element of power rests at the very core of the traditional notion of ownership: the power to determine the relationship between the property itself and third parties. Therefore, a distinctive characteristic of

“a property relationship between one person and a thing, at any point along the property spectrum, is to negate the liberty of the rest of mankind to use the thing without the licence of the ‘owner’.”⁵

Property law is “replete with legal doctrines that specify control powers rather than liability rules”.⁶ The concept of property as an expression of power follows inexorably from the understanding of property rights not as rights over things but as rights against persons. In *Southwark*,⁷ the court ruled that necessity in the form of a deprived homeless family moving into an empty council house at a time of an extreme housing crisis without permission is a “mask for anarchy ... squatters committed a criminal offence in forcibly entering into property, as well as the civil offence of trespass”.⁸ In addition to that, property owners are free to use and dispose of their property as they see fit.⁹ Nothing can curb the power of the owner to allow access to any unauthorised individual.

In sharp contrast to that, in the corporate context, shareholders will find that they do not possess this power. Not only do they lack the right or the capacity to allow or prevent access to the company's premises but, more importantly, they will find it quite difficult even to protect their investment from mismanagement. If ownership is understood as governing power relationships between the different actors who are related to the property, it is even more important in a company context to look at the management who have the real power to deploy the assets of the company. Corporate governance reflects these arrangements at corporate level and assigns these powers not to shareholders but to management. Many shareholders—especially the minority ones—do not even get a say on the choice of the managers of the company. This is due to either lack of information or even to a lack of interest in corporate affairs. The latter is a clear indication that many shareholders do not view themselves as owners of the company in the first place. Even at a psychological level, the owner of an item is interested in determining its use; this does not appear to be the case with shareholders, who are content to confine themselves to the modest role of getting some profit from the

company in the form of dividends rather than exercising any ownership-like right or carrying out the responsibilities inherent in such a role, such as keeping themselves informed about corporate developments at all times.

Therefore, companies do not fit into the property rights discourse.¹⁰ In contrast to the traditional legal theory of property rights, the shareholders are not in a position to exercise the traditional rights inherent in the concept of property; no shareholder is permitted to “use a listed company's assets for his own purpose or restrict management's access to corporate resources”.¹¹ Thus, in *Automatic Self Cleansing Filter Syndicate*,¹² the court held that a resolution passed by a simple majority of shareholders was not effective. The resolution purported to order the directors to go ahead with an agreement to sell the whole of the assets of the company. The directors believed that this was unwise. The court clarified that the “control of the company is to be vested in the directors”.¹³ The corporate concept therefore clearly slices the bundle of rights inherent in property rights into various pieces: the stockholder

“gets the right to receive some of the fruits of the use of property, a fractional residual right in corporate property, and a very limited right of control. The rights to possess, use, and control the property go to the managers of the corporation”.¹⁴

According to the court, “a sole shareholder has no independent right which is violated by trespass upon or conversion of the corporation's property”¹⁵; this demonstrates the difficulty in using traditional notions of property in the corporate context.

To that end, in *Foss*,¹⁶ the court stated that

“it was not, nor could it successfully be, argued that it was a matter of course for any individual members of a corporation thus to assume to themselves the right of suing [the management] in the name of the corporation. In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this”.

This ruling forms, notably, one of the foundations of the English company law as it has clearly formulated one of its basic rules. It underlines not only the nature of the company as the only bearer of the right to sue the directors for mismanagement, but it also highlights, in a rather vivid manner, the particularly disadvantageous position,

⁵ J.W. Harris, *Property and Justice* (Oxford: Clarendon Press, 1996), p.264.

⁶ L.M. Austin, “Property and the Rule of Law” (2014) 20(2) *Legal Theory* 88.

⁷ *Southwark LBC v Williams* [1971] Ch. 734; [1971] 2 W.L.R. 467; 69 L.G.R. 145 CA (Civ Div).

⁸ See *Southwark* [1971] Ch. 734; and *McPhail v Persons, Names Unknown* [1973] Ch. 447 at 460; [1973] 3 W.L.R. 71; 72 L.G.R. 93 CA (Civ Div).

⁹ T. Allen, “Liberalism, Social Democracy and the Value of Property under the European Convention on Human Rights” (2010) 59(4) *International and Comparative Law Quarterly* 1055, 1056.

¹⁰ P. Ireland, “Company Law and the Myth of Shareholder Ownership” (1999) 62 M.L.R. 62. See also J. Hill, “Visions and Revisions of the Shareholder” (2000) 48 *American Journal of Comparative Law* 39.

¹¹ C. Rose, “Stakeholder Orientation versus Shareholder Value: A Matter of Contractual Failures” (2004) 18 *European Journal of Law and Economics* 77, 82.

¹² *Automatic Self Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch. 34 CA.

¹³ *Automatic Self Cleansing Filter Syndicate* [1906] 2 Ch. 34.

¹⁴ D. Votaw, *Modern Corporations* (Englewood Cliffs: Prentice-Hall, 1965) quoted in M.M. Blair, *Ownership and Control* (Washington, D.C.: Brooking Institute, 1995), p.224.

¹⁵ *W. Clay Jackson Enterprises Inc v Greyhound Leasing and Financial Corp* 463 F. Supp. 666, 670 (D.P.R. 1979).

¹⁶ *Foss v Harbottle* 67 E.R. 189; (1843) 2 Hare 461 Ch.

especially of minority shareholders who are literally stuck in the company without a particularly effective means to react to mismanagement and the loss of their investment and capital. Minority shareholders are thought to be motivated to be “rationally ignorant in the sense that their ownership stake does not afford them much influence with management”.¹⁷ Their lack of influence on corporate decision-making encourages their lack of engagement within corporate affairs, which facilitates their lack of information about the corporate agenda. Therefore, they are trapped in a company with a set of dire choices in their hands. They can either sell their shares at a severe loss—and therefore fail to retrieve even their initial investment—or stay in a company where their influence is indeed minimal, if any. Their disadvantageous position within the company, which is explained in detail in the final part of this article, basically leaves them with a theoretical entitlement of ownership without the capacity to control the management and safeguard their investment. In this case, minority shareholders will see their actual property—their shares and capital—suffer heavy losses, and yet, they will be in no position to react to a violation which in property law would have been sanctioned. This is a clear indicator of the difficulty in using “property rights” rhetoric in the company law context. Their “*de jure* ownership claim of an equity capital share is ‘autonomous’, completely separated from the *de facto* operational control” of the company.¹⁸ The theoretical façade of the relationship between the shareholders and the company is one marked by the existence of a property right on the company; however, in practice, the shareholders—especially the minority ones—are left without the means to effectively safeguard their investment.

In addition to that, the right of possession which is integral to the notion of property rights is inapplicable in the case of shareholders. They can only validly claim that they have a right to possess their shares but the company is legally recognised as being a person separate from the humans behind it. It has a lifespan of its own and it determines its own affairs. The managers of the company are under a legal duty to promote the success of the company, even when that comes into conflict with the interests of parts of its shareholders. The shareholders are legally allowed to pursue their own interests even when the latter do not coincide with the interests of the company.¹⁹ In fact they are even allowed to become parties to shareholders’ agreements which bind them into voting en bloc in general meetings aimed at pursuing the distinctive individual interests of the parties to the agreement rather than the interests of the company as a whole.²⁰ Therefore, it is judicially accepted that the interests of the company and the interests of the

shareholders may indeed diverge; and, if so, the directors are legally obliged to pursue the interests of the company to the detriment of the interests of—at least—parts of the shareholding. These are distinctive features of company law that cannot be traced in the traditional relationship of ownership, where owner and property are integrally linked and the latter is used with the exclusive aim of serving the needs and interests of its owner.

Even the possession of their shares does not entail a traditional ownership-like relationship. Section 541 of the CA 2006 states that “the shares or other interest of a member in a company are personal property ... and are not in the nature of real estate”. It is therefore recognised that a share does not confer on its owner a right to the “physical possession of anything”.²¹ It is nowadays judicially accepted that a share confers a right²²—albeit with limitations—to invoke the provisions of the articles of association. Furthermore, the existence of shares with no voting rights, as well as the existence of non-transferable shares, challenges the very core of the traditional right to property which, as explained above, is founded upon the rights to use and alienate. The shareholder may be lacking any influence on important aspects of the decision-making of the company if he owns shares that do not grant any right to vote and, therefore, no right to have a say in the corporate context. Similarly, he may possess non-transferable shares that entail the loss of yet another aspect of traditional property rights: the right to alienate.

Within the context of the traditional concept of ownership, the owner could enjoy judicially enforced property insurance. The latter provides financial reimbursement to the owner of property in the event of damage or theft. One cannot detect any analogy to that in the corporate context. The only potential analogy could be the remedies available to shareholders in cases of directorial abuse which may lead to damage and financial losses for shareholders. However, as it is thoroughly explained in the final part of this article, the judicial stance on this matter is at best ambivalent. The courts refrain from interfering with the internal affairs of the company and the shareholders face a set of obstacles in their attempt to invoke the remedies in question. In any case, as the analysis of ss.260–263 of the CA 2006 in the final part of this article demonstrates, even when they are successful in their bid to address directorial mismanagement, any compensation is not granted to them but to the legal person that is the company. This is a clear judicial recognition of the lack of any ownership right on the part of shareholders. When a tenant causes damage to the property of the owner, the latter is granted compensation to cover the costs of repair. He/she can even demand a guarantee when renting his property to

¹⁷ K. Sikavica and A.J. Hillman, “Combining Financial and Psychological Insights for a New Typology of Ownership” in M. Goranova and L.V. Ryan (eds), *Shareholder Empowerment* (New York: Palgrave Macmillan, 2015), p.44.

¹⁸ G. Poitras, *Equity Capital: From Ancient Partnerships to Exchange Traded Funds* (New York: Routledge, 2016), p.447.

¹⁹ *Fulham Football Club Ltd v Cabra Estates Plc* [1992] B.C.C. 863; [1994] 1 B.C.L.C 363; (1993) 65 P. & C.R. 284 CA (Civ Div).

²⁰ *Fulham Football Club* [1992] B.C.C. 863.

²¹ See J. Dine and M. Koutsias, *Company Law* (Basingstoke: Palgrave Macmillan, 2014), p.67.

²² *Eley v Positive Government Security Life Assurance Co Ltd* (1876) 1 Ex. D. 88 CA.

the tenant. In the corporate context, the shareholders may not get to choose who will manage the company; and if management is deeply ineffective, leading to serious losses and financial damage, the shareholders may succeed in getting some compensation which, however, is not granted to them but to the legal person. Section 260 of the CA 2006 is absolutely clear in stating that the shareholders are enforcing a right which does not belong to them but to the company and, therefore, they cannot have a legal claim on the relevant compensation. Their main benefit is that they may now be in a company which is managed in a more effective manner. This is clearly a status which has nothing in common with the owner of property in its mainstream sense.

In the most extreme scenario of expropriation, where the owner is deprived of his property for a superior public good, a liberal legal order will involve the compensation of the owner at a level comparable to the market value of his property, aiming at leaving the owner no worse off than he would have been under “an ordinary consensual transaction with other private parties”.²³ On the other hand, in a social democratic legal order, “economic efficiency is furthered by denying compensation to property owners who are able to self-insure against the risk of expropriation”.²⁴ Compensation is not viewed as restitution to the prior condition but as one of the parameters of the general management of the economy. If one attempts a parallel to the company, one may argue that, in the case of insolvency, which entails the total loss of shareholder investment and the coming to an end of the company, depriving the shareholders of their property—that being their shares and capital invested in the company—the shareholders do not enjoy such protection. At this critical point where the company ceases to exist, the state treats creditors as the owners of the company, placing them at the top of the list of actors who are to be compensated for the demise of the company. Property law sees the relationship between “owners of private property and the state as one of opposition. Their interests must be “balanced against each other”²⁵ and that balance can only be struck if the owner receives market value compensation for being deprived of his property. This is certainly not the case in the corporate context.

One of the most distinctive features of insolvency is that there is a list of actors who should be satisfied at the end of the process in priority from others. A preferential creditor is a creditor receiving a preferential right to payment upon the debtor's insolvency. That means that certain creditors are given priority over others, usually for the whole amount of their claims but potentially also for a certain value of their claims against the company. In the UK, creditors with fixed security are prioritised

over the preferential creditors generally. The preferences list will be drafted on the basis of the existence of fixed and floating charges. The shareholders are at the bottom of the list and they are compensated only if the demands of all other actors are satisfied. It seems that, in the corporate context, the risk inherent in the role of shareholders, which is often combined with lax supervision of the management of the company, is much higher than the risk assumed by the owner of property in its traditional sense.

Therefore, when the core of the traditional concept of property is unenforceable within the company law context, it is evident that the employment of property rights rhetoric is based solely on ideological grounds rather than any solid legal basis. It is a remnant of early corporate forms where the relationship between the company and its shareholders was recognised as one marked by the existence of property rights. However, that relationship presented characteristics that do not survive nowadays. Furthermore, while the corporate realities underpinning the notion of ownership within the company changed radically, theory still interprets the concept of property rights within the corporate context in a deeply flawed manner.

The historical and ideological roots of shareholder primacy—property, liberty and individual rights

The roots of the English corporate model were chiefly inspired by the legal thinking of medieval England. England was an agricultural society:

“[T]rades ancillary to agriculture and village life were practised locally by individual traders and their families. The bulk of medieval trade and industry was professionalized and largely confined to communal towns.”²⁶

In the 12th and 13th centuries, the development of the Flemish commercial society led to the export of English wool and the growth of foreign trade across the shores.²⁷ In the commercial towns, both the manufacturers and the merchants “traded under the aegis of the craft guilds”.²⁸ Guilds were organisations that controlled the local market, which operated as a monopoly. The guilds would set the regulatory requirements to enter the market, the conditions that local craftsmen had to fulfil or the standards for the production of local goods. This is important, as one can detect the roots of one of the most fundamental aspects of English company law at that exact point. The country's tendency to self-regulate and avoid state legislative intervention was evident in the organisation of the guilds. When guilds were at the peak of their power, the

²³ Allen, “Liberalism, Social Democracy and the Value of Property under the European Convention on Human Rights” (2010) 59(4) *International and Comparative Law Quarterly* 1055, 1056.

²⁴ L. Blume and D. Rubinfeld, “Compensation for Takings: An Economic Analysis” (1984) 72 *California Law Review* 569.

²⁵ Allen, “Liberalism, Social Democracy and the Value of Property under the European Convention on Human Rights (2010) 59(4) *International and Comparative Law Quarterly* 1055, 1057.

²⁶ M.M. Postan, *The Medieval Economy and Society* (London: Weidenfeld & Nicolson, 1972; London: Pelican, 1975).

²⁷ R.I. Tricker, *Corporate Governance: Practices, Procedures and Powers in British Companies and their Boards of Directors* (Aldershot: Gower, 1984), p.26.

²⁸ Tricker, *Corporate Governance* (1984), p.26.

restrictive illiberal regulation did not flow from the state but from the guilds themselves. Their regulations perpetuated the existence of monopolies at that time, betraying yet another expression of individualism that seeks to limit the role of the state in what are perceived as personal affairs. Personal freedom became “universal” at an early date in this country as “self help and self government” were for centuries taught to the English in the “school of town life ... there were no rights without duties”.²⁹ Therefore, when Jefferson wrote that

“we hold those truths to be sacred and undeniable: that all men are created equal and independent, that from that equal creation they demand rights inherent and inalienable”,

he was putting into words a view of the individual and society which had its roots in 13th-century England or earlier.³⁰ Individuality and self-regulation enjoy deep roots in English history, having left their clear imprint on all aspects of regulation. Company law could not be an exception to that rule, nor could corporate governance. Every nation constructs the structure of its companies in a manner reflective of its dominant ideological principles and beliefs. It was only natural that English companies would be based on the very same principles that shaped the predominant ideological identity of the nation.

The common law became strongly associated with the idea of economic freedom and, more generally, the subject’s liberty from arbitrary action by the Crown.³¹ The philosophical foundations of such a debate can be traced before that. Magna Carta, a landmark development in the evolution of English constitutional law and traditions, included a variety of rights with a special emphasis evidently attributed to the rights of the individual. The inclusion of the right to property in the list of fundamental rights, and the importance ascribed to personal ownership as an expression of liberty, provided England with the theoretical basis on which its future corporate law was to be determinately influenced. Therefore, English law was keen from an early stage to protect aspects of the private life of individuals against intrusions from everyone, including the king, and has a rich tradition³² in the protection of personal autonomy. As early as 1604, in *Semayne’s Case*, it was stated that “the house of everyone is to him as his castle and fortress”.³³

Magna Carta placed “individual liberties above all others except communal rights”,³⁴ a concept adopted by English common law in the 13th century. In 1361, the English Justices of the Peace Act 1361 provided for the

arrest of peeping toms and eavesdroppers. From the beginning, the intent to protect an individual from the Government was clear:

“[T]he poorest man may in his cottage bid defiance to all force of the Crown. It may be frail ... the rain may enter; but the King of England cannot enter.”³⁵

This position vividly highlights the prominent position that liberty assumed in the English legal order from a very early point of history. It is translated into the right of any individual to define a space that should be respected by anyone, including the highest authority. The underlining concept of liberty was the right to personal property. The phrase “an Englishman’s home is his castle” embodies the profoundness of the right in question in the nation’s mind; the home is the castle of its owner and no one can enter unless permitted by the owner. Liberty is a sacrosanct right which allows an individual to exercise his activities, without any intervention, within a space where he can exercise his authority.

Therefore, the links between the right to property and liberty in the sense of safeguarding a place against intrusion from any authority highlight the importance of the former within the English legal culture. The “house of everyone” was defined as a fully autonomous area which should be left intact from external intervention, even by as superior an authority as the king. This is very similar to the dominant perception of the company in the UK today. The company is an exclusively private affair which should be left intact by governmental or judicial intervention unless the latter is indeed imperative. The main problem emerges when actors who do not have any ownership claim on the company, such as the management, and administer the company in such a way that strips the shareholders of any rights that resemble the rights of ownership. The right to control the company is the principal right of this type. Nowadays, it seems that someone has invaded the “house”, assumed more power than its owner or legal resident and stripped the latter of the protection that he/she was supposed to enjoy. Therefore, shareholders are left with an entitlement to ownership of the company in law but, in fact, with just a few tools against the invasion by foreign actors—the management—of what used to be considered as their autonomous space. The state and the judiciary remain faithful to their adherence to a hands-off approach to the corporate phenomenon. They avoid interfering in corporate affairs even in cases where shareholders’ rights are at risk. While the English legal order offers a solid protection of ownership rights across all fields of law, the approach taken within the context of company law is a notable departure from that principle. Also, it reveals a

²⁹ G.M. Trevelyan, *English Social History* (London: Penguin, 1944).

³⁰ A. Macfarlane, *The Origins of English Individualism* (Oxford: Basil Blackwell, 1978), p.202.

³¹ P.G. Mahoney, “The Common Law and Economic Growth: Hayek Might Be Right” (2001) 30 *Journal of Legal Studies* 508.

³² See Lord G. Slynn, “The Development of Human Rights in the United Kingdom” (2005) 28 *Fordham International Law Journal* 477.

³³ *Semayne’s Case* 77 E.R. 194 at [91a] No.1; (1604) 5 Co. Rep. 91 QB. See R. Singh, “Privacy and the Media after the Human Rights Act” (1998) 6 *European Human Rights Law Review* 712.

³⁴ B.R. Bale, “Informed Lending Decision v Privacy Interests in Great Britain” (1997) 10 *Transnational Lawyer* 77.

³⁵ B.L. Cardonsky, “Towards a Meaningful Right to Privacy in the United Kingdom” (2002) 20 *Boston University International Law Journal* 396.

judicial departure from the principle that the shareholders are the owners of the company, a principle whose dominance in theory is almost absolute.

Therefore, there is a fundamental understanding of individual liberty as inextricably linked with ownership of property. This is the ideological context which defined company law too. The status enjoyed by personal liberty and property in the English legal order distinguished the country from its continental European neighbours and led historians to claim that "England in the thirteenth century was a far more sophisticated market than Marx recognised".³⁶ In the corporate governance context, "ownership" entails the legal allocation of property rights among stakeholders such as shareholders, creditors and employees, and "controls" the ways legal rules shape the balance of power among them.³⁷ Therefore, there is a clear conflict of the essence of property rights between UK and continental European thought on the matter. This is despite that fact that the early teachings of the Christian Church were hostile to individual ownership of property; these teachings against ownership failed to assume prominence in the West, where a cultural trend traced back to Aristotle viewed ownership of property as the basis of a durable society.³⁸

In the UK, the understanding of property rights is very much related to the allocation of risk within the context of a commercial relationship as well as within the corporate context.³⁹ This is particularly evident in commercial as well as contractual relationships, where the question of how risk is allocated relates to the question of which market participant bears the risk of market transactions. Whilst a contractual agreement between two parties appears to be neutral at first sight, the truth is that the disparity of bargaining power between the individuals involved will fall more heavily on the weakest party to the transaction. While the state has put in place a procedure on the basis of which a breach of contractual obligations is to be sanctioned, in reality, the weakest party does not have equal access to that procedure with its strongest contractual party.

A good example of that is the company in the UK. The latter is viewed as a contractual entity—a nexus of contract—which is built upon the articles of association. The articles are the company's constitution and they are viewed as a contract. Parties to the contract are the company as well as every shareholder who joins the company. It is argued in this article that the contract is not of neutral value; despite the existence of enforcement mechanisms provided by law, its implementation by the weakest contractual party—the shareholders—is indeed quite difficult. Therefore, there is a great divergence between the reality and the rhetoric where the shareholders are recognised as the owners of the company

and their supremacy is theoretically unchallenged. In practice, they are a weak party to a contract; they fail to enforce rights stemming from that contract because their access to the state enforcement procedure is problematic. Therefore, the property rights rhetoric in the context of company law leads to very uncomfortable conclusions. The shareholders are the owners of the company while enjoying an eroded protection of the rights which flow from their shares. Stakeholders who have no property rights claim on the corporation are exorcised as mere externalities when they are crucial for corporate success, especially in the long term. That paves the way only to directorial primacy which negates the whole property rights rhetoric as it places the individuals with no property right claim whatsoever at the corporate throne. As Berle puts it, "the peculiarity of the corporate form is that it subjects ... property rights [of the shareholders] to such exigencies in a peculiar and drastic degree and for far more limited ends".⁴⁰

The property right of the company is vested in the legal person that is the company. The latter has assumed ownership of both its business activities and its property. That means using the corporate vehicle exclusively for the purposes of private profit devoid of any social responsibility; the latter is likely to contravene the property rights of the company. That is not to suggest that the company should not aim at profitability. Profitability should be achieved in a sustainable manner based on long-term planning that would serve all stakeholders involved and, principally, the shareholders. In reality, property rights are normally accompanied by a responsibility of the owner to fulfil certain standards, i.e. the owner of the flat has to sustain it at an acceptable level for tenants. In company law, it seems that property rights are granted theoretically at least to the shareholders with no responsibilities attached. In addition to that, the management of the company can abuse the provisions of the contract—the articles of association—but the other party to the transaction can find it very hard to sanction the abuse.

Therefore, it seems that, within company law, we have the introduction of a set of property rights which operate on a very different basis from those in the outside world,⁴¹ and this is the result of an ideological dogma which fails to admit that this rhetoric has evolved into the source of major problems within the company. The ideological underpinnings of property rights in the corporate context result in a clearly distortive allocation of risk to the part of stakeholders—including the shareholders—and therefore end up by allocating the actual power to management. Property rights are defined as "rights against other people"⁴² and they were aimed at being exercised by shareholders against anyone who infringes them.

³⁶ Macfarlane, *The Origins of English Individualism* (1978), p.201.

³⁷ S. Wen, *Shareholder Primacy and Corporate Governance* (Abingdon: Routledge, 2013), p.13.

³⁸ R.A.G. Monks and N. Minow, *Corporate Governance* (Chichester: John Wiley and Sons Ltd, 2010), p.96.

³⁹ J. Dine, M. Koutsias and M. Blecher, *Company Law in the New Europe* (Cheltenham: Edward Elgar, 2007), p.118.

⁴⁰ A. Berle and G. Means, *The Modern Corporation and Private Property*, Library of Congress (New Jersey: Transaction Publishers, 1991), p.245.

⁴¹ Harris, *Property and Justice* (2002), p.140.

⁴² Dine, Koutsias and Blecher, *Company Law in the New Europe* (2007), p.118.

However, now they are in fact exercised by the company through its management against all stakeholders, including the shareholders. This is a serious failure of the dominant theory of property rights within the context of company law and, unless it is radically reformed, the problems to which it gave birth are not going to be dealt with effectively.

The birth of shareholder primacy and ownership in company law—partnerships

The notion of ownership that is dominant in the English company law today stems from partnership. This article argues that the recognition of shareholders as owners of the partnership was justified on the basis of the nature of risk they assumed when becoming partners. However, the emergence of the limited liability public company has introduced a considerable shift in the relationship between the shareholders on the one hand and the company on the other, which renders necessary a reconsideration and a redefinition of the term “ownership”. Defining ownership within the context of the modern corporate forms in the same manner as with partnerships is not only obsolete but, most importantly, wrong as it fails to take into account a set of factors that have significantly altered the nature of the shareholders’ relationship with the company. By the early 18th century, small partnerships were the preferred tool to conduct business and trade in England. These companies were not incorporated, and a mere collection of individuals constituted and owned the entity.⁴³ The owners of the partnerships were also providing the funding for the enterprise. Rapid technological developments necessitated increased funding for the expansion of the existing enterprises if they were to embrace novel methods of production. These developments led to the unincorporated company, a form of partnership where some members would run the company and others, usually landowners or successful traders, would provide the capital. The partnerships were marked by absolute shareholder primacy; the shareholders were the “owners” of the entity. While that sounds similar to the dominant approach nowadays too, the premise on which shareholder primacy was based was very different from the contemporary corporate reality. At that point, shareholder primacy was reflected at all levels of corporate activities and shareholders clearly enjoyed rights which were normally attributed to the owners of an object, in complete contrast to now. At that point, every shareholder could block collective decisions. Partnerships reached decisions through the unanimity rule based on the one partner, one vote system.⁴⁴ This is a point of crucial importance as it serves as a clear demonstration of the fact that the early partners were heavily involved in the administration and the management of the company.

They formed an integral part of the management and they exercised full control of the company. Their ownership was a notion of control of what was supposedly owned. These links have now been smashed, rendering imperative a redefinition of the supposed “property right” that shareholders hold on the company.

The members’ involvement in the company was underlined by the one partner, one vote system, which rendered each member of the company instrumental in its decision-making. This has to be contrasted with shareholders now; they can hold shares which may or may not have voting rights attached to them. If the shareholder is the owner of the company, then why are there non-voting shares? How can the institutionalisation of the lack of control on the company on the part of the supposed “owner” be justified? It is astonishing that the dominant trend within company law views a shareholder as an owner of the company when he may have no control over the management of the company, especially when his share may carry either no voting rights, which renders the application of the principle of “ownership” a mere farce, or a single voting right, which weighs more lightly than the respective shares of other members that may carry multiple voting rights. This is not only problematic for the application of the concepts of “ownership” and “property rights” to shareholders, but it betrays a state of affairs that is redolent of a lack of democratic accountability within modern companies. Therefore, it is clearly argued that, since the nature of the relationship of shareholders with the company has changed so much, it is surprising that the law has avoided recognising this reality and still recognises a form of shareholder dominance within the company that, in reality, is gradually resembling an empty shell. The case of the derivative action analysed at a later point in this article is indicative of the contrast between dominant ideology as reflected by the law and contemporary corporate reality.

In the case of insolvency, all members of the partnership were liable for the accumulated debt; therefore, the level of risk assumed by shareholders at that point was indeed paramount. The fortunes and fate of the company coincided with their personal fortune and fate. In 1854, the Royal Commission on the reform of mercantile law stated that:

“[T]he law of partnership which renders every person who ... [is] liable to the whole of the debts is unsatisfactory and should be amended to permit such persons to contribute to the capital of such concerns ... without incurring liability beyond a limited amount.”⁴⁵

The Limited Liability Act 1855 was passed, granting, for the first time, the privilege of limited liability to the members of joint stock companies that comprised more

⁴³ F.B. Palmer, *Company Law* (London: Sweet and Maxwell, 1968), p.134.

⁴⁴ A. Rahmani, “Shareholder Control and its Nemesis” [2012] I.C.C.L.R. 13.

⁴⁵ Royal Commission on the Reform of Mercantile Law, *Report* (1854).

than 25 members; the companies assumed the responsibility to include the word "limited" in their name but this principle was denied to general partners.⁴⁶

The evolution of shareholder primacy and ownership—the joint stock companies

The introduction of the notion of the corporate entity in the UK's Joint Stock Companies Act 1844 saw "the entity displace the shareholders as owner of the enterprise".⁴⁷ The companies were made separate from their shareholders. Parliament then passed the Joint Stock Companies Act in 1856 (JSCA 1856), which formed a consolidating statute. The divorce between the corporation and the human element behind it was not fully absorbed, and s.3 of the JSCA 1856 read "seven or more persons ... may ... form themselves into an incorporated company".⁴⁸ This suggested that the company and its founders were inseparable. The new Companies Act 1862 (CA 1862) deleted the words "themselves into"; at that point it was clear that private individuals could no longer assume the corporate form.⁴⁹ It was clear that a company consisted of them but it was certainly not them.⁵⁰ This statement embodies the essence of one of the fundamental principles of company law, which recognises the company as a separate legal person. Even in pure linguistic terms, today, a company is referred to as "it", reflecting precisely its depersonalised status, while before the CA 1862, companies were referred to as "they", indicating their unbreakable links with the humans who comprised them.⁵¹ From that point, the "company was everything that the shareholders did not own".⁵² It was its assets, human, tangible and intangible, contracts and agreements. Therefore, the company was basically what was left from the legal divorce between the productive assets of the company and the private individuals who initially founded it.

The Vice-President of the Board of Trade⁵³ would explain that

"it is not as important to urge the adoption of limited liability ... (but to) argue in favour of human liberty that people may be permitted to deal how and with whom they choose without the officious interference of the state ... it is ill advised legislation which steps in between him and the exercise of that right".⁵⁴

This statement, made at the passing of the Bill, reveals the parameters of its philosophical and ideological background that also formed the theoretical basis upon which modern English company law is founded. The granting of the privilege of limited liability to the company by the state, in practice, minimised the risk taken by potential shareholders. It provided solid safeguards to the latter that the extent of their involvement in a given company was a purely personal decision. The granting of limited liability was founded on the basis of the respect of personal liberty. English company law would be based on two pillars: on personal liberty and on the limitation of the role of the state. Joint stock companies were instituted through a concession by the king to his subjects,⁵⁵ rather than the corporation being a "contractually, voluntarily devised aggregate person".⁵⁶ The recognition of the shareholders as the owners of the company was viewed as a step towards limiting the role of the state and consolidating personal liberty.

However, the joint stock company did not enjoy a separate personality from its "members" as, legally speaking, it was nothing more than a large partnership.⁵⁷ The members as partners clearly owned the assets, and they were jointly liable for the debts incurred by the business and had all the rights and powers which ownership implied. Their entitlement to control was a byproduct of their established legal ownership of the company.⁵⁸ Therefore, the affairs of the company would be conducted on the basis of one vote for every shareholder, irrespective of the size of their investment, while collective decisions had to be taken unanimously.⁵⁹ These provisions were a clear indication of the fact that at that point shareholders were viewed as the members who co-owned the company and exercised powers which were consistent with this status, such as continuous participation in the management of the company and unanimous approval of its plans. This practice aimed at safeguarding individual shareholders as members of a corporation "rather than as owners of a portion of the corporate capital".⁶⁰ Nowadays, however, the shareholders are the owners of the capital reflected by the value of their shares rather than of the assets of the company. Therefore, it is clear that joint stock holders of that time were the owners of the stock comprised in the company.⁶¹

⁴⁶ Partnership Act 1890 s.9.

⁴⁷ A. Keay, *Board Accountability in Corporate Governance* (Abingdon: Routledge, 2015), p.113.

⁴⁸ P. Ireland, I. Grigg-Spall and D. Kelly, "The Conceptual Foundations of Modern Company Law" (1987) 14 *Journal of Law and Society* 149, 150.

⁴⁹ Keay, *Board Accountability in Corporate Governance* (2015), p.114.

⁵⁰ Ireland, Grigg-Spall and Kelly, "The Conceptual Foundations of Modern Company Law" (1987) 14 *Journal of Law and Society* 149, 150.

⁵¹ Keay, *Board Accountability in Corporate Governance* (2015), p.114.

⁵² L. Talbot, *Critical Company Law* (Abingdon: Routledge, 2008), p.154.

⁵³ *Hansard*, HC Vol.140, col.131 (1 February 1856).

⁵⁴ *Hansard*, HC Vol.140, col.131 (1 February 1856).

⁵⁵ S. Watson, "The Significance of the Source of the Powers of Boards of Directors in UK Company Law" [2011] J.B.L. 600.

⁵⁶ R. Harris, *Industrialising English Law: Entrepreneurship and Business Organisation 1720–1844* (Cambridge: Cambridge University Press, 2000), p.18.

⁵⁷ R.B. Grantham, "The doctrinal basis of the rights of company shareholders" (1998) 57 *Cambridge Law Journal* 554, 557.

⁵⁸ Grantham, "The doctrinal basis of the rights of company shareholders" (1998) 57 *Cambridge Law Journal* 554, 558.

⁵⁹ Rahmani, "Shareholder Control and its Nemesis" [2012] I.C.C.L.R. 13.

⁶⁰ Rahmani, "Shareholder Control and its Nemesis" [2012] I.C.C.L.R. 13.

⁶¹ J.E.O. Abugu, "Primacy of Shareholders' Interests and the Relevance of Stakeholder Economic Theories" (2013) 34 *Company Lawyer* 202.

Clearly, at that point, the principal corporate aim was to generate profits for their stockholders: the notion of shareholder primacy.⁶²

As a starting point, company law conceived of shareholders as the owners of the company, although nowadays they do not own “the properties” of the company.⁶³ The early English companies were run by their owners and those owners were also their controllers. Ownership and control in these corporations were merged into a common concept.⁶⁴ A limited number of partners acted as a board of directors to manage the business, subject to the tight control of all the partners in general meeting.⁶⁵ The control of the company was integral to the shareholders’ rights and duties, rendering a claim that they “owned the company” as absolutely valid. They exercised the management of the company and assumed the risks involved in that management. They performed the duties that an owner performs and they controlled what they owned. Therefore, at that point, “owners managed and managers owned”.⁶⁶ Companies were regarded as something more than limited partnerships with each member exercising control over the management.⁶⁷ In the *York* case, the court stated that directors were to exercise their “judgement as they may consider best for the interest of the company; that is, for the interest of the shareholders of the company”.⁶⁸ Therefore, it is clear that when shareholders were in control of the company, the courts viewed the two concepts—company and shareholder—as synonymous. The owners of the company were the company. In complete contrast to that, it is nowadays accepted that directors owe their duty to the company and only to it. The granting of a separate legal personality to the company radically altered the nature of the role of shareholders within the company.⁶⁹ The owner of the company is now the company itself.

The modern company—the separation of ownership and control

The separation of ownership and control was the landmark event which radically altered the position of shareholders within the company. It significantly limited their capacity to exercise control on the company. The separation of ownership and control came as a result of the increasing need for capital on the part of American and English companies in order finance their investments in the newly invented technologies of that time. They resorted to the stock market and invited millions of people to buy their shares and provide them with the capital they were in need of. Therefore, the companies in those jurisdictions

gradually acquired a dispersed shareholding basis that comprised potentially millions of shareholders. Also, while the shareholders were still viewed by law as the owners and controllers of the company, their number did not allow them either to control the company or to participate in its decision-making. This phenomenon emerged in the US but it applies to English companies too, which also resort to the stock market to attract capital for their investments. This is why both systems are defined as the “outsider systems of corporate governance”, in contrast to the “insider systems of corporate governance”. The former—as in the US and the UK—seek their financing from “outside” the company, namely the stock markets, while the latter—as in Germany—seek financing from the “inside” of the company, namely the existing shareholders, or by banks in the form of a loan.

Both the English but also the American companies were on a course of change from the family-run businesses of the past to the large public companies with a widely diffused shareholder basis of the present. Questions in relation to the balance of power within the corporation were brought from the background to the centre of the relevant debates that are ongoing up to this day. David Halberstam argued that, at that point, ordinary citizens believed that buying stock—owning part of a giant company—was a real possibility in their lives. By purchasing stocks, they became

“participants in capitalism ... junior partners of Henry Ford II ... the Ford family had been joined by some 300,000 new co-owners of their company ... It also marked the beginning of a historic shift in American capitalism, a major increase in the influence of Wall Street in companies like Ford. The Street was a partner now and the family had to respond to its norms ... Before the war only a small number of Americans held stocks and they were to a large degree of the same class as the owners of the old line companies. The market was a kind of gentlemen’s club, virtually off limits to the rest of the society”.⁷⁰

A new era emerged, centred on the Stock Exchange and aimed at making every citizen a stockholder.⁷¹ Politics appeared to play a significant role, which triggered the further dispersion of shares to a wider number of actors, further consolidating a model of dispersed shareholders’ basis. According to Roe, the reason for the development and maintenance of fragmented ownership in the US was that politicians did not feel comfortable with Wall Street

⁶² W.W. Bratton, “Berle and Means Reconsidered at the Century’s Turn” (2001) 26 *Journal of Corporate Law* 737, 761.

⁶³ Abugu, “Primacy of shareholders’ interests and the relevance of stakeholder economic theories” (2013) 34 *Company Lawyer* 202.

⁶⁴ Abugu, “Primacy of shareholders’ interests and the relevance of stakeholder economic theories” (2013) 34 *Company Lawyer* 202, 204.

⁶⁵ R. Flannigan, “Shareholder Fiduciary Accountability” [2014] J.B.L. 3.

⁶⁶ A.D. Chandler, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, MA: Harvard University Press, 1997), p.9.

⁶⁷ W.T. Allen, “Our Schizophrenic Conception of the Business Corporation” (1992) 14(2) *Cardozo Law Review* 261.

⁶⁸ *York & North Midland Railway v Hudson* 51 E.R. 866; (1845) 16 Beav. 485 at 496.

⁶⁹ Flannigan, “Shareholder Fiduciary Accountability” [2014] J.B.L. 189.

⁷⁰ D. Halberstam, *The Reckoning* (New York: William Morrow, 1986), p.227.

⁷¹ Monks and Minow, *Corporate Governance* (2010), p.103.

having the power to control large corporations whose activities and now shareholder basis involved a large part of the electorate.⁷² This therefore “led to legal constraints which prohibited or raised the costs of banks and other institutions holding large blocks of shares”.⁷³ The prohibition of bank ownership of equity promoted by the Glass-Steagall Act 1933 was indicative of an ideological and political climate that viewed the absence of institutional investors as a prerequisite of corporate democratisation. In any case, Roe suggested that the early structures of American corporations created a path dependency⁷⁴; on the basis of the latter, this very initial ownership structure had a significant influence on legal rules, which also determined subsequent structures. The law can contribute to the maintenance of a dispersed shareholding basis by introducing high standards of minority shareholder protection. Coffee argued⁷⁵ that the latter enjoy such a high level of protection that they lack the incentive to advance their position within the company, assuming additional risks. The advanced level of legal protection they enjoy functions as a motivation to sustain their current status and, hence, perpetuates the fragmented shareholding of the corporation in question. The corporate reality changed for good; ownership and control were two concepts in a state of divorce.

Nowadays shareholders are not the owners of the company

This article argues that the widely accepted and vigorously supported view in the UK that the shareholders are the exclusive owners of the corporation is simply incorrect. An individual holding a property right on an object is in a position to control it. The ability to control what you own forms the core of property rights. The owner of an object or property is in a position to control its possession and define its use. The owner of property can allow or prohibit access to it and can exercise the full rights of ownership on his possession. The sole right possessed by the owner of an asset is his ability to exclude others from the use of that asset. That is, the owner of a machine can decide who can and who cannot work on that machine; the owner of a building can decide who can and who cannot enter the building; the owner of the car can decide who can drive it and who cannot enter it.⁷⁶ Ownership emphasises physical possession; therefore, it is a right which presents a certain degree of challenge

when attempting to apply it at corporate level.⁷⁷ No property right is absolute: as Parkinson points out, ownership rights are not absolute.⁷⁸ One explicit and particularly important role which ownership of private property plays is protecting owners against arbitrary interference by allowing them to control and prevent interference external to their property.⁷⁹ Shareholders are clearly not in a position to do that, especially since interference with what supposedly constitutes their property is institutionalised in the shape of management, which they cannot usually control. The term “primacy” entails supremacy or some sort of priority control over a certain variable⁸⁰; theoretically at least, shareholders should enjoy that over the decision-making process. However, that control is effectively granted to management, with the shareholders lacking the willingness, the information and the means to control it to a degree that an owner would. The notion of ownership may have been justified in the context of partnerships as analysed above, where partners had equitable ownership of the assets, acted as the management of the entity and became insolvent with it. However, with the evolution of the company into its current form, the nature of the role of the shareholder has significantly changed. It is truly astonishing that this is “seemingly forgotten by most advocates of the finance model”.⁸¹ A major issue that Berle and Means originally raised was whether shareholders in widely held companies should be given the same legal rights and protections as other owners of property. Their answer was negative. It was clear that ownership in this context is a very different concept from the mainstream one we are all accustomed to. Therefore, it is clear that the separation of equity ownership from control radically altered the nature of the whole legal concept of property in respect of corporations.⁸² The separation of ownership and control left shareholders with nothing more than a symbolic sense of ownership,⁸³ rather than ownership itself. In the *Kaufman*⁸⁴ case, the court stated that a shareholder

“has no present interest in the physical property of an unliquidated corporation; the corporation is responsible for the acts of the corporation but the stockholder normally is not ... shareholders' claims have nothing to do with corporate assets [since] corporate assets grow or diminish because of corporate not shareholder conduct”.

⁷² See Roe, “A Political Theory of American Corporate Finance” (1991) 91 *Columbia Law Review* 10.

⁷³ *Pettet's Company Law: Company Law and Corporate Finance*, edited by J. Lowry and A. Reisberg (Harlow: Pearson, 2012), p.66.

⁷⁴ M.J. Roe, “Chaos and Evolution in Law and Economics” (1996) 109 *Harvard Law Review* 641.

⁷⁵ J.C. Coffee Jr, “The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications” (1999) 93 *Northwestern University Law Review* 654.

⁷⁶ O. Hart and J. Moore, “Property Rights and the Nature of the Firm” (1990) 98(6) *Journal of Political Economy* 1119, 1121.

⁷⁷ K. John and A. Silberston, “Corporate Governance” (1995) 153 *National Institute Economic Review* 84, 87.

⁷⁸ For a detailed analysis refuting the justifications for unlimited property rights, see Harris, *Property and Justice* (1996).

⁷⁹ L. Miles, “A philosophical basis for the ‘enlightened shareholder value’ approach” (2012) 308 *Company Law Newsletter* 1, 2.

⁸⁰ C. Nyombi, T. Mortimer and R. Lewis, “Shareholder Primacy and Stakeholders' Interests in the Aftermath of a Takeover: A Review of Empirical Evidence” (2015) 2 *International Business Law Journal* 161, 162.

⁸¹ T. Clarke, *Theories of Corporate Governance* (Abingdon: Routledge, 2004), p.175.

⁸² Votaw, *Modern Corporations* (1965), pp.96–97.

⁸³ B. Clarke, “Corporate Responsibility in Light of the Separation of Ownership and Control” (1997) 19 *Dublin University Law Journal* 50.

⁸⁴ *Kaufman v Société Internationale* 343 U.S.156 (1952).

This makes it clear that any claim of ownership of the company is simply impossible to sustain on legal principles. In *Short*,⁸⁵ the court stated that “shareholders are not in the eyes of the law part owners of the undertaking. The undertaking is something different from the totality of its shareholding”.

In the company context, the shareholder does not own specific assets of the corporation but rather a proportional slice of the entirety of assets reflected in his stock certificate. Shareholders hold no right over the tangible and intangible assets of the company, otherwise the personal creditors of the shareholders would be able to seize the company’s assets in the case of default on their debts.⁸⁶ From a legal point of view, it is clear that the shareholders do not own the company as none of the requirements of ownership is met at this point.⁸⁷ The shareholders own shares, which are, in any case, items of property per se.⁸⁸ This does not in itself provide them with a claim on the company’s assets, let alone entail the ownership of the company as an entity.⁸⁹ The rights in the company arise as a result of the ownership of the share and they are limited to those rights inherent in their shares; there is no “residual claim to the company itself ... because the shareholders’ entitlement is then exhausted”.⁹⁰ Therefore, shareholders have evolved from owners of the partnership into the bearers of rights flowing directly from their shares. Rights embodied in their shares are indicative of their ownership of the shares; however, their status within the company is no longer that of its owner. They own the capital reflected by the value of their share. Our

“daily references to property tend to be a mutual conspiracy of unsophisticated semantic allusions and confusions ... because our linguistic shorthand has a certain low level communicative efficiency”.⁹¹

We use the term “owner” as “a convenient way of referring to all kinds of claims to a resource without thereby intending to delve into the precise nature of those claims”.⁹² In company law, this problem emerges when employing the term “ownership” in a rather imprecise manner, referring to the company and not simply to the share capital, as is correct.⁹³ Therefore, the main point is that the ownership of capital and of the actual shares should not be confused with ownership of the firm.⁹⁴ This is the main mistake that has been carried on from the past

and into an era whose realities have rendered the previous axioms obsolete. This is reflected by the fact that, in public companies, most owners of the capital are almost entirely dissociated from the management, with the result that the agenda of the latter diverges from that of the shareholders.⁹⁵ In any case, it is clear and universally accepted that when a shareholder invests money in a company, the money becomes the equity of the company⁹⁶: “[p]roperty, power and entitlement can be seen as the three central aspects of a share”,⁹⁷ and the share offers a bundle of rights that include neither the ownership of the company’s assets nor the ownership of the company as an entity. The rights that shareholders have are simply the rights to receive a dividend, the right to vote and the right to bring derivative proceedings *on behalf of* the company; the latter is analysed in the final part of this article. These rights flow from their ownership of the share and not from owning the company.⁹⁸

However, even this assumption is no longer adequate in the current economic and financial reality. Developments in capital markets have facilitated the decoupling of the ownership of shares from voting rights, and have consequently fundamentally undermined the understanding that underlines the position of shareholders in the company. We can now have shareholders with no voting rights or shareholders with limited voting rights, which sheds light on the democratic deficit⁹⁹ within the corporate context. From the erosion of the one share, one vote system we passed to the removal of voting rights altogether in certain cases, which is an astonishing downgrading of the position of shareholders within the corporate context. In such a context, it is clear that the shareholders face mounting challenges to enforce rights that stem from their ownership of the shares, let alone sustain any legally unfounded notion of ownership of the company as an entity.

This is of paramount importance because shareholder control of the company in the UK or in the US as a component of the alleged ownership works through the mechanism of voting. Nowadays, the one share, one vote rule may be a default rule of company law but it can be removed by private contract, so ownership control by shareholders can be eroded to non-existence.¹⁰⁰ The companies issue shares of various classes, which means

⁸⁵ *Short v Treasury Commissioners* [1948] 1 K.B. 116 at 122; 63 T.L.R. 472; [1947] L.J.R. 1463 CA.

⁸⁶ C. Clerc, “Questioning the legitimacy of shareholder power” in J.-P. Touffut (ed.), *Does Company Ownership Matter?* (Cheltenham: Edward Elgar, 2009), p.96.

⁸⁷ A. Keay, *The Corporate Objective* (Cheltenham: Edward Elgar, 2011), p.101.

⁸⁸ S. Worthington, “Shares and Shareholders: Property, Power and Entitlement (Part 1)” (2001) 22 *Company Lawyer* 258, 259.

⁸⁹ Worthington, “Shares and Shareholders” (2001) 22 *Company Lawyer* 258, 258.

⁹⁰ Grantham, “The doctrinal basis of the rights of company shareholders” (1998) 57 *Cambridge Law Journal* 554, 565.

⁹¹ K. Gray and S. Gray, *Land Law* (London: Butterworths, 2003), p.34.

⁹² W. Njoya, “Employee Ownership and Efficiency: An Evolutionary Perspective” (2004) 33(3) *Industrial Law Journal* 211, 222.

⁹³ R. Pennington, “Can Shares in the Company be Defined?” (1989) 10 *Company Lawyer* 140.

⁹⁴ E. Fama, “Agency Problems and the Theory of the Firm” (1980) 88 *Journal of Political Economy* 288.

⁹⁵ J.M. Keynes, “The End of the Laissez Faire” (1926) in J.M. Keynes, *Essays in Persuasion* (New York: W.W. Norton, 1951).

⁹⁶ D. Li, “The Nature of Corporate Residual Equity under the Equity Concept” (1960) 35 *Accounting Review* 258, 261.

⁹⁷ Worthington, “Shares and Shareholders” (2001) 22 *Company Lawyer* 258, 258.

⁹⁸ Keay, *The Corporate Objective* (2011), p.102.

⁹⁹ K. Vanneste, “Decoupling economic rights from voting rights: a threat to the traditional corporate governance paradigm” (2015) 15(1) *European Business Organisation Law Review* 59, 61.

¹⁰⁰ Rahmani, “Shareholder Control and its Nemesis” [2012] I.C.C.L.R. 13, 14.

that the multi-voting rights shares entail a multi-speed share ownership too. When Google went public in 2014, it

“issued class A shares with one vote each and class B shares with ten votes each. The class B shares were only available to founders the current management team ... their 33 per cent shareholding gave the founders ... 80 per cent of the votes”¹⁰¹.

Some shareholders are more privileged and equal than others. Joint stock companies issued only one class of shares, hence providing a basis for the justification of shareholder primacy that entailed control of the corporation and participation to its management. Nowadays, the “owners” of the company may not participate in the management, have limited information about corporate affairs and have limited voting rights which are inferior to their shareholding.

Modern investing techniques have further eroded the relationship between the shareholder and the company. It is now possible to acquire voting rights in the company without owning stock.¹⁰² This is the practice of “stock borrowing”, which is a system in which traders borrow shares that they do not already own. It means that a hedge fund can use the share’s voting rights without indeed being its owner. This indicates not just how far this is from the original concept of the joint stock companies, but also the complete break from the reality of that era, which, however, is dominant at a theoretical level even today.¹⁰³ This is particularly crucial because it underlines how outdated are the principles which form the core of the property rights rhetoric within the context of company law. Modern financial practices have rendered obsolete the argument that shareholders are the owners of the company because, crucially, enough non-members can use the voting rights that a share entails even though they do not own the share. We have a massive antithesis at the foundation of the argument in question: on the one hand, the members of the company cannot exercise any voting rights because they may possess shares with no voting rights, but they are guaranteed compete supremacy within the corporate context. At the same time, non-members can exercise voting rights flowing from shares that they do not even own. The latter can exercise one among the basic bundle of rights which is not available even to some of the shareholders. This demonstrates the fallacy of adopting a dogmatic view on shareholders’ exclusivity based on an alleged ownership of the company. Also, whilst company law is usually quick to adapt to the new realities at both an economic and a societal level, it is turning a blind eye to this misconception standing at its foundations. This creates challenges to the agency rhetoric

too. The supporters of the nexus of contacts theory uphold the view that the directors are the agents of the shareholders, while they are clearly the agents of the company. In the aforementioned case, are they also agents of the hedge funds who borrowed the stocks while not owning them or not? Do they form part of the body of shareholders as, typically, they do not hold any shares, although they do exercise the rights flowing from the borrowed stocks, in sharp contrast to that part of the shareholders who are not in a position to do so?

There is no dictionary in which this state of affairs could be defined as “ownership” exercised by a holder of a “property right”. This is why this article argues that the contemporary corporate realities render a redefinition of those terms in the company law context imperative. It also argues that the current state of affairs is the byproduct of a dominant ideology rather than the effect of law. However, corporate practice is irreconcilable with ideology¹⁰⁴ as shareholders do not own anything in the company other than shares, with the rights to vote and to receive a dividend facing challenges when enforcement is attempted. When they vote on corporate matters, they vote in the shareholders’ meetings with an agenda fixed by directors and on resolutions proposed by the management. It is the board that decides what choices are available for shareholders. The law of shareholder voting is so weak that shareholders “scarcely qualify as part of corporate governance ... the list of items about which shareholders have voting rights is remarkably short”¹⁰⁵. The list includes, principally, the right to elect and remove directors; they cannot vote to sell the company’s assets or the company itself, although they may in some cases vote to veto a sale or a merger proposed by the board.¹⁰⁶ In addition to that, in contrast to the traditional legal theory of property rights, the shareholders are not in a position to exercise the traditional rights inherent in the concept of property; no shareholder is permitted to use a listed company’s assets for his own purpose or to restrict management’s access to corporate resources.¹⁰⁷ Instead, the shareholder only acquires the right to dividends which, in any case, fall within the absolute discretion of the management and a very limited right of control.¹⁰⁸ The concrete definition of the rights of a proprietary nature stemming from the ownership of shares is indeed problematic, considering that the shareholders do not have a right to receive a fixed dividend or to have their capital returned to them at a specified date. The difficulty in defining the exact scope of the proprietary rights stemming from stockholding is reflective of the challenges in defining shareholding in a traditional “property right” sense. The corporate concept slices the bundle of rights inherent in property into various

¹⁰¹ C. Padgett, *Corporate Governance* (Basingstoke: Palgrave Macmillan, 2012), p.19.

¹⁰² B. Tricker, *Corporate Governance* (New York: Oxford University Press, 2012), p.59.

¹⁰³ Tricker, *Corporate Governance* (2012), p.59.

¹⁰⁴ J. Kerekebuna, “Shareholders as Owners of the Corporation: Why Should We Care?” (2013) 18(2) *Coventry Law Journal* 19, 21.

¹⁰⁵ J.R. Macey, *Corporate Governance* (Princeton, NJ: Princeton University Press, 2008), p.201.

¹⁰⁶ L. Stout, “New Thinking on Shareholder Primacy” in P.M. Vasudev and Susan Watson (eds), *Corporate Governance after the Financial Crisis* (Cheltenham: Edward Elgar 2012), p.28.

¹⁰⁷ Rose, “Stakeholder Orientation versus Shareholder Value” (2004) 18 *European Journal of Law and Economics* 77, 82.

¹⁰⁸ Votaw, *Modern Corporations* (1965), pp.96–97.

pieces; however, the rights to possess, use and control the property are clearly attributed to the management of the corporation.¹⁰⁹ Thus, only the right to transfer the interest, which has also been the overriding aim in the securities markets, is undoubtedly exercised by the shareholders.¹¹⁰ According to the court, “a sole shareholder has no independent right which is violated by trespass upon or conversion of the corporation’s property”.¹¹¹ This is an astonishing ruling that demonstrates the difficulty of using traditional notions of property in the corporate context. Therefore, when property rights have been deprived of all their essential elements, attempting to identify one party as the “owner” in the traditional sense is neither meaningful nor right.¹¹²

Especially the latter two items involve the management of property, which is the core right inherent in ownership. The fact that shareholders do not have a say on that is clearly indicative of the non-existence of any sort of property rights over the company. When the lack of control is accompanied by apathy towards the company and abstinence from its decision-making, then the involvement of shareholders within the decision-making of the company becomes purely ceremonial, if not a mere farce. It is therefore clear that shareholder primacy is based on a deeply outmoded conception of the company.¹¹³ It appears that the exercise of control on the part of the shareholders over the management would mostly depend on the size of their shareholding; majority shareholders may assume initiatives that would be similar to that of an owner. However, minority shareholders are most likely to fail to exercise any of the powers that would normally be exercised by an “owner”. The notion of shareholder primacy, based on a hollow concept of ownership, is undermined by the very realities that shareholders face when attempting to participate in corporate life. It is therefore imperative that the existing legal framework sets aside its dominant ideological perceptions and embraces an approach that would reflect the current state of affairs more accurately. The concept of ownership is no longer the “key doctrinal construct in explaining the position and the rights of shareholders”.¹¹⁴

The judges, too, seemed to have moved away from protecting the shareholders’ property rights in the company to a focus on protecting their ownership of their shares.¹¹⁵ There are “three elements to the concept of private property, namely having an interest in an enterprise, having power over it and acting with respect to it”.¹¹⁶ Shareholders do have an interest in the enterprise

and so too do other stakeholders. The separation of ownership and control has eroded the foundations of the property right that the shareholders clearly held in partnerships and joint stock companies. In this context, sustaining a company model marked by absolute shareholder supremacy is hard to justify, and so is its dominance in theory and law.

Institutional investors who will normally hold a greater piece of shareholding than ordinary shareholders do not appear to be particularly empowered either. Despite the concentration of shares in the hands of institutions, shareholder accountability has not increased to the degree predicted or hoped for at the beginning. Hence, the main question is: why are institutional investors not using their voting power to curb directors’ excessive pay?¹¹⁷ The lack of motivation of institutional investors to play a crucial role in the monitoring of management in many cases can be explained by the fact that sometimes the investors in question are located in jurisdictions different from the domicile of the company whose shareholding they acquired. They also take into account the transaction costs involved in monitoring the management, which most often exceed the gain from monitoring or are of equal value.¹¹⁸ Therefore, they may not want to incur that cost. The effect is that, although institutional investors are, by definition, in a better position to control management, they choose apathy, aligning their position with individual shareholders. When interviewed about shareholders exercising their rights, one institutional investor noted:

“[T]here is a weakness ... in that responsibility for ownership rests with people who don’t want it and are not seeking it. We are investing in shares because they give us a good return and it is coincidental really that they bring with them this responsibility. I am not saying we don’t want this responsibility. I am saying it is difficult to handle that sort of thing.”¹¹⁹

The body of shareholders is likely to remain rationally apathetic.¹²⁰ It is therefore clear that shareholder democracy as a concept is now “fallacious”¹²¹ because any idea of shareholder control as a counter to managerial power has proved to be more wishful thinking rather than reality. As Attenborough puts it, the traditional

¹⁰⁹ See Blair, *Ownership and Control* (1995), p.224.

¹¹⁰ Monks and Minow, *Corporate Governance* (2010), p.108.

¹¹¹ *W. Clay Jackson Enterprises* 463 F. Supp. 666, 670 (D.P.R. 1979).

¹¹² See J.W. Singer, “The Reliance Interest in Property” (1988) 40 *Stanford Law Review* 611, 615.

¹¹³ S. Watson, “How the Company Became an Entity: A New Understanding of Corporate Law” [2015] *J.B.L.* 120.

¹¹⁴ Grantham, “The Doctrinal Basis of the Rights of Company Shareholders” (1998) 57 *Cambridge Law Journal* 554, 556.

¹¹⁵ S. Leader, “Private Property and Corporate Governance Part I: Defining the Interests” in F. Patfield (ed.), *Perspectives on Company Law* (London: Kluwer Law International, 1995), p.94.

¹¹⁶ L. May, “Corporate Property Rights” (1986) 5 *Journal of Business Ethics* 225, 226.

¹¹⁷ E. Ndzi, “Directors’ Excessive Pay and Shareholder Derivative Action” (2015) 36 *Company Lawyer* 144, 145–146.

¹¹⁸ Ndzi, “Directors’ Excessive Pay and Shareholder Derivative Action” (2015) 36 *Company Lawyer* 144, 146.

¹¹⁹ J. Solomon, *Corporate Governance and Accountability*, 2nd edn (Chichester: John Wiley & Sons Ltd, 2009), p.19.

¹²⁰ Clarke, “Corporate responsibility in light of the separation of ownership and control” (1997) 19 *Dublin University Law Journal* 50.

¹²¹ Lord Wedderburn, “Control of Corporate Actions” (1989) 52 *Modern Law Review* 401.

“enabling-law philosophy, excessively aggressive efficiency rationales and powerfully focused managerial strategies have combined to weaken an already inarticulate faith in the primacy of owner over manager”.¹²²

Greenfield found the property-based conception of the shareholders' role to be “crude and analytically unsound and a simplistic notion of the sanctity and the indivisibility of property rights”¹²³ since the shareholders lack control over the corporate assets.

The shareholders tend to look at the company as a means to make profit rather than an entity they own which they can use in the manner they see more fit. Tocqueville's central hypothesis was that “democracy constitutes the sole model of acceptable governance in modern society and it will eventually prevail in all spheres of organised activity”¹²⁴; corporations might prove even Tocqueville wrong, at least in the sense of democracy as we know it in the public domain. Despite that, English company law embraces the dominant principle of shareholder primacy, shareholder wealth maximisation or shareholder value.¹²⁵ However, even though shareholders might be seen as the owners of the company by the majority of scholars and legislators, this is not always the case in the courts. In *Kaufman*, the court stated that “a shareholder has no present interest in the property of a company that remained out of liquidation”.¹²⁶ In *Short*,¹²⁷ Lord Justice Evershed of the English Court of Appeal “denied the ownership of the company by shareholders”.¹²⁸ In *Bligh*,¹²⁹ the court provided that “shareholders have no proprietary interest in the corporation”.¹³⁰ In the *Macaura* case,¹³¹ the court stated that

“the incorporator even if he holds all the shares is not the corporation, and that neither he nor any creditor of the company has any property legal or equitable in the assets of the corporation”.

Therefore, the basic principle that was clarified in the landmark *Salomon*¹³² case comes into direct conflict with the notion that shareholders are the owners of the company. It is astonishing how two of the most important features of English company law, the separate legal personality granted to the company and shareholder supremacy based on a notion of ownership, come into conflict with each other in such an abrupt manner. The dominant view, which therefore recognises that shareholders have a property right over the company,

does not only conflict with contemporary reality as analysed above, but is also directly in contrast with one of the pillars of modern company law.

Can the shareholders exercise effective control on management? The case of the derivative action

The duties which a director owes to the company are useful only if they can be enforced effectively. Therefore, the question is: can the supposed owners of the company exercise effective control over management? The analysis embarks on the premise that, if a right has been infringed which is, in law, a right belonging to a company, the only proper claimant is the company itself. This rule was known as the rule in *Foss* after the case in which it was first clearly established. This is one of the most fundamental rules in company law, which demonstrates that the ownership of the company's affairs rests with the company. If one of its rights is infringed then it is for the company as a separate legal entity to act. Individual shareholders are given that right only as an exception to the rule. That comes into contrast with the notion of property rights out of the context of company law. If one's right to one's property is infringed, then the property owner will be in a position to exercise any right to protect the property. The fact that one of the most integral elements of property rights is not available to shareholders, apart from as an exception to the rule, demonstrates the lack of solid foundations for any property rights rhetoric within the ambit of company law.

In *Bamford*, it was stated that it “would be for the company to decide whether to institute proceedings to avoid the voidable allotment”.¹³³ Therefore, as a basic principle of company law, the institution of proceedings against the perpetrator of a wrong against the company rests with the company. That leaves especially the minority shareholders in an incredibly disadvantageous position. This principle was aimed at avoiding the problem of proceedings being commenced simultaneously by all the shareholders who believed themselves to be aggrieved by a particular action of the management. Therefore, it is evident that both the law and the courts strove to protect the company as the entity which bears those rights, and not the shareholders. The legal entity that is the company is the owner of the company, and, therefore, both the legislature and the judiciary created the legislative and judicial framework which prevented shareholders from raising their own claims against the perceived perpetrators of the wrong against the company.

¹²² D. Attenborough, “The Vacuous Concept of Shareholder Voting Rights” (2013) 14(2) *European Business Organisation Law Review* 147, 158.

¹²³ K. Greenfield, *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities* (Chicago: Chicago University Press, 2006), pp.43–47.

¹²⁴ P.-Y. Gomez and H. Korine, “Democracy and the Evolution of Corporate Governance” (2005) 13(6) *Corporate Governance* 739, 742.

¹²⁵ A. Keay, “Company Directors Behaving Poorly: Disciplinary Options for Shareholders” [2007] J.B.L. 656.

¹²⁶ *Kaufman v Societe Internationale* 343 U.S. 156 (1952) at 166.

¹²⁷ *Short* [1948] 1 K.B. 116 at 122.

¹²⁸ Keay, *The Corporate Objective* (2011), p.101.

¹²⁹ *Bligh v Brent* 160 E.R. 397; (1837) 2 Y. & C. Ex. 268 KB.

¹³⁰ Keay, *The Corporate Objective* (2011), p.101.

¹³¹ *Macaura v Northern Assurance Co Ltd* [1925] A.C. 619 HL.

¹³² *Salomon v Salomon & Co Ltd* [1897] A.C. 22 HL.

¹³³ *Bamford v Bamford* [1970] Ch. 212 at 242; [1969] 2 W.L.R. 1107; (1969) 113 S.J. 123 CA (Civ Div).

If there was an ownership right infringed, this clearly belonged to the legal person. The shareholders could put forward any claims that they potentially had only through an exception to the rule—the so-called derivative claim. A shareholder might be permitted to sue *on behalf of the company* if the latter's board is dominated by the perpetrators of the wrong who prevent the company from suing them. Therefore, the aggrieved shareholders are seeking to enforce a right which does not belong to them but to the company; the right derives from the company. The court introduces a set of onerous requirements that the shareholders in question will need to satisfy before their claim is even examined by the court. If the shareholders manage to satisfy these tough requirements, then they receive compensation for their losses which, however, has to be returned to the company since they exercise a right which does not belong to them but to the company. Therefore, it is clear that the company has simply outsourced a right to the aggrieved shareholder which did not belong to him, simply because, owing to the circumstances, the company could not exercise that right at the moment and it would have been *in the interests of the company* that the shareholder should be allowed to exercise that right as an exception to the rule. Therefore, the very nature of the derivative action negates the very essence of the claim that the shareholders have a property right over the company. If they did, they would have been able to exercise all the rights integral to a property right, such as the right to protect their property from abuse.

Minority shareholders

In addition to that, the *Foss* rule consolidated a concept of majority rule¹³⁴ in the company's affairs. This leaves minority shareholders with few chances to safeguard their right, which exposes the judicial reluctance to uphold the right of action of minorities. In the case of individuals who own property, they have the equal capacity to exercise all rights stemming from their ownership against any perpetrator; however, this is not the case with shareholders. The minority ones will find that raising a derivative action is indeed very difficult. So, within the company context, it is indeed very problematic to go down the property rights road without encountering insurmountable obstacles. Section 261 of the CA 2006 lays down the procedure to be followed when raising a derivative claim and sets out the rules for the derivative claim to proceed. The member of the company who is bringing the derivative claim must apply to the court for permission to continue it. This is a reflection of the *Foss* rule and two of its most important principles: the principles of "proper plaintiff" and the principle of "internal management". The latter is clearly reflective of

the majority rule; the courts will refrain from intervening in the internal decision-making of the company unless it is deemed absolutely necessary.¹³⁵

Therefore, the historical position of the country towards the protection of minority shareholders has been criticised as a harsh stance.¹³⁶ Sealy has described the English courts as hostile to minority shareholder litigations.¹³⁷ This highlights the astonishing contradiction between theory and judicial practice, with the former recognising the shareholders as the owners of the company and the latter refraining from granting them the right to uninhibitedly protect their interests over what they allegedly own. The court will not intervene if it is of the opinion that pursuing the perpetrator of the wrong done to the company is not in the company's interests, irrespective of whether the interests of its shareholders were abused or not. While scholars and practitioners debate several aspects of the company, there is a widespread agreement that the derivative action under English law does not constitute an effective controlling mechanism.¹³⁸ This seems to imply that it is "somehow undesirable that companies are exposed to civil litigation by minority shareholders".¹³⁹ Therefore, it seems that the effectiveness of shareholders remedies is inhibited by an implicit need to limit shareholders' access to litigation. The company apparently needs to be protected by a flood of lawsuits from aggrieved shareholders. This is, however, indicative of the status of power within the company too. The principal role rests with the legal person that is the company. To put it simply, it is the legal person which clearly owns the company. The shareholders have a rather problematic access to a set of remedies that do not justify any notion of an alleged ownership. The subject matter of protection is clearly the company, and not them. In the UK, the ability of shareholders to litigate against directors is so reduced that the most effective means of directorial control in public companies is to resort to the market of corporate control, namely to expect a takeover which will result in the removal of the current management. This means that shareholders view an external form of management control as more effective than an internal one, which is an astonishing feature of a jurisdiction based on a notion of shareholder ownership of the company.

Procedure for bringing a derivative claim

The court will determine whether it is going to allow the derivative claim to proceed in accordance with the criteria laid down in s.263 of the CA 2006. Section 261(2) clarifies that, during the first stage of the application, the court is interested mainly in the evidence provided by the applicant to help it decide whether a prima facie case is established; if it is, the court will grant permission to

¹³⁴ A.O. Nwafor, "Unfair Prejudice Remedy: A Relief for the Minority Shareholder—A Comparative Perspective" [2011] I.C.C.L.R. 285.

¹³⁵ J. Tang, "Shareholder Remedies: Demise of the Derivative Claim?" (2012) 1(2) *UCL Journal of Law and Jurisprudence* 178, 179.

¹³⁶ J. Kirkbride, S. Letza and C. Smallman, "Minority Shareholders and Corporate Governance: Reflections on the Derivative Action in the UK, the USA and in China" (2009) 51(4) *International Journal of Law and Management* 206, 208.

¹³⁷ L.S. Sealy, "Problems of Standing, Pleading and Proof in Corporate Litigation" in B.G. Pettet (ed.), *Company Law in Change* (London: Stevens & Sons, 1987), p.3.

¹³⁸ A. Reisberg, *Derivative Actions and Corporate Governance* (Oxford: Oxford University Press, 2007), p.2.

¹³⁹ A.J. Boyle, *Minority Shareholders' Remedies* (Cambridge: Cambridge University Press, 2002), pp.12–13.

proceed. This is a unique requirement as it does not normally exist in civil cases. Basically, the court will examine, on a prima facie basis, whether the criteria of s.263 are fulfilled so as to allow the case to proceed. During the second stage of the procedure, s.261(3) clarifies that the court can give further directions as to the evidence to be provided, this time by the company. The third stage of the process includes the hearing, provided for by s.261(4). If the court is convinced that the criteria of s.263 are met, it may give permission to continue with the claim. The obligation to establish a prima facie case before the examination of the actual claim was not part of the Law Commission's recommendations; however, it was introduced by the Parliament in order to discourage shareholders from initiating proceedings against their management in big numbers.

Section 263(2) sets out the requirements which, if fulfilled, will grant the permission to continue the derivative claim. Section 263(2)(a) introduces a hurdle for a minority shareholder to clear. The question to be asked here would be: would a—fictional—director acting under his duty to promote the success of the company (s.172) raise a derivative claim? The court must assess whether the derivative claim will contribute to the promotion of the success of the company or not. The actual effect of this provision is to grant to the court management powers¹⁴⁰ as to the determination of whether proceeding may be brought against a wrong. The duty of s.172 applies exclusively to directors who are appointed to the office with the duty to promote the success of the company as a whole. The directors cannot pursue—at least theoretically—their own interests but they have to pursue the interests of the company. In contrast to that, shareholders are indeed in a position to pursue their own selfish interests,¹⁴¹ as well as their personal agenda, since they do not act as the agents of the company's interests. Therefore, basically, here we witness the imposition on the shareholders of a duty that is imposed on directors. This is an emphatic reminder of the fact that the ownership of the company rests with the company. The company is the overwhelming authority against which the court is to determine which action can be pursued and which action should be swallowed by the aggrieved shareholder. The latter may theoretically be the owner of the company but, in practice, both the law and the courts are clearly setting his/her interests aside so as to safeguard the real owner of the company; namely, the legal person that is the company.

In *Franbar Holdings*,¹⁴² the court explained some of the matters that a fictional director may consider, such as the size of the claim, the cost of proceedings, the ability of the company to fund them, the effect on the company's

reputation and the disruption to its normal business activities. In the same case, the deputy judge accepted that, where an unfair prejudice claim under s.994 has been instituted¹⁴³ and the claimant is offered to be bought out of the company, then a hypothetical director acting under the s.172 obligation would be less likely to continue the derivative claim. Despite the fact that both remedies can be exercised for the very same real facts, it seems that, in fact, if that happens, then s.994 will indeed undermine the solidity of the case for the application of s.260. That sends the message that the derivative action is a second-class remedy. In *Iesini*,¹⁴⁴ the court also stated that it should only refuse permission when no director¹⁴⁵ would seek to continue the claim. Although this sounds as if it is extending the ambit of protection granted by the courts, it is not compatible with the letter of the provision, which does not imply such a test. Furthermore, it always remains to be seen whether this test will be complied with in the future by the courts or whether it will suffer changes to the direction of its limitation. In the same case, the court held that, if the claim is for the benefit of the company, it will be allowed even if the claimant will derive other benefits from it. If the dominant purpose of the action is for the benefit of the company, then it will satisfy the good faith requirement. In *Mission Capital*,¹⁴⁶ the court stated that permission to continue with a derivative claim on the basis of s.261 was refused where the fictional director acting on the basis of s.172 was unlikely to attach much importance to the claim in question and the alleged damage was speculative.

In accordance with s.263(2)(b) and (c), if the alleged wrong has been either authorised or ratified by the company, then permission to continue will not be given. This places a considerable burden on the shoulders of minority shareholders. This is a clear expression both of the "appropriate plaintiff" principle as well as the "majority rule". The appropriate plaintiff is always the company and, if it decides to ratify a wrong done to it, then the aggrieved shareholder will not be allowed to proceed with his claim against the perpetrator. This means that the alleged "owner" of the company will be prevented from suing against an abuse of his alleged "property right" because the judicial authorities will no longer recognise such a right as belonging to him. This is because the actual owner of such a right—the company—has indeed decided that pursuing the claim is not in its interests. The only relief that the law offered to minority shareholders is the new s.239 of the CA 2006, which now provides that the votes of the wrongdoing directors and connected members will be disregarded in ratifying the wrongdoing conduct. This may relieve some shareholders and

¹⁴⁰ E.C. Mujih, "The New Statutory Derivative Claim: A Paradox of Minority Shareholder Protection: Part 2" (2012) 33 *Company Lawyer* 99.

¹⁴¹ K. Raja, "Majority Shareholders' Control of Minority Shareholders' Use and Abuse of Power: A Judicial Treatment" [2014] I.C.C.L.R. 162, 181.

¹⁴² *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch); [2008] B.C.C. 885; [2009] 1 B.C.L.C. 1.

¹⁴³ *Franbar Holdings* [2008] EWHC 1534 (Ch) at [37].

¹⁴⁴ *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch); [2010] B.C.C. 420; [2011] 1 B.C.L.C. 498 at [85].

¹⁴⁵ A. Keay, "Applications to Continue Derivative Proceedings on Behalf of Companies and the Hypothetical Director Test" (2015) 34(4) *Civil Justice Quarterly* 346, 362.

¹⁴⁶ *Mission Capital Plc v Sinclair* [2008] EWHC 1339 (Ch); [2008] B.C.C. 866; [2010] 1 B.C.L.C. 304.

somehow help to reverse the trend which witnessed only a few cases of shareholders initiating derivative actions in England.¹⁴⁷

Section 263(4) provides that “particular regard” should be given to the views of those members who have no personal interest in the case. *Smith v Croft* had previously introduced the requirement that, in order for a derivative action to proceed, the minority shareholder in question had to prove that he enjoyed the support of the majority of independent-minded shareholders. That is a reference to the majority of the shareholders independent from the directors; otherwise one might say that, in order for the aggrieved shareholder to have locus standi, he needs to be supported by the majority of the minority shareholders. This is particularly difficult in small or medium-sized private limited companies, where normally the shareholders will share close personal links with each other—sometimes they may even be family—and they are quite probably going to be unwilling to jeopardise those links by supporting a derivative action. This is clearly further undermining the raising of a derivative action. In *Stainer*,¹⁴⁸ the court stated that the applicant commenced the proceedings not only in his own interests but for the benefit of a large number of minority shareholders. He secured letters of support and a financial contribution from 35 other small shareholders. The applicant’s conduct in seeking and obtaining that support was perceived by the court as strong evidence that he was acting in good faith. It is therefore evident that a shareholder who wishes to bring a derivative action has to deal with challenging procedural and substantive obstacles¹⁴⁹ so as to be granted permission to proceed with his action. This is despite the fact that the CA 2006 has actually removed a few of the pre-existing obstacles which were introduced previously by the courts and are no longer in place, such as the obligation to prove that the wrongdoer had profited personally from his own negligence.¹⁵⁰

Conclusion

This article has argued against the dominant view in both academia and practice that shareholders are the owners of the company. It has explained that the concept of

ownership of the company on the part of the shareholders is simply a fallacy; therefore, the edifice of shareholder supremacy is based on shaky foundations and it should be reformed. The nature and the subject matter of property rights as we know them outside company law do not operate on the same basis within company law. The company as a legal person has disassociated itself from the humans behind it, and the complex relationships which have evolved within the corporate framework have led to a corporate landscape where shareholders are in no position to control the company in a variety of important matters inherent in its function. If the purpose of recognising shareholder ownership over the company was to empower shareholders and to attain a greater level of protection of their rights, then this has clearly failed. This is because nowadays, in practice, shareholder supremacy has given way to managerial dominance. The latter has shifted the focus of the company to short-term goals which are not only detrimental for the company as a whole but also for the shareholders more specifically. The courts, which in principle are fervent supporters of shareholder supremacy, have effectively curtailed shareholders’ rights to an unacceptable degree, as the case of the application of shareholders’ remedies demonstrates. It is therefore evident that shareholder supremacy is nowadays purely ideological and a relic of previous corporate forms that are now extinct. A degree of dogmatic adherence to ideologies which were rendered obsolete by reality created a problematic situation within company law, which has the company and its shareholders as one of the main victims. Legislators should set aside any ideological dogmatism and reform the law so as to address these issues and adjust to the realities and the challenges of the 21st century, while playing their societal role effectively. The latter involves a company with a long-term agenda. It involves a company that will effectively safeguard the interests of its shareholders against managerial abuse and be inclusive of the stakeholders who are instrumental in its success, especially the creditors and the employees. In an era of globalisation and increased corporate presence in all aspects of life, this is a goal that needs to be achieved.

¹⁴⁷ A. Reisberg, “Shareholders’ Remedies: In Search of Consistency of Principle in English Law” (2005) 16(5) *European Business Law Review* 1065.

¹⁴⁸ *Stainer v Lee* [2010] EWHC 1539 (Ch); [2011] B.C.C. 134; [2011] 1 B.C.L.C. 537.

¹⁴⁹ J. Poole and P. Roberts, “Shareholder Remedies: Corporate Wrongs and the Derivative Action” [1999] J.B.L. 99.

¹⁵⁰ *Pavlides v Jensen* [1956] Ch. 565; [1956] 3 W.L.R. 224; (1956) 100 S.J. 452 Ch D.