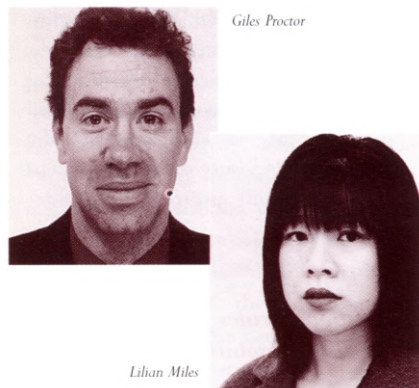


Company Law

Neither use nor ornament: do we really need annual general meetings?

by Giles Proctor & Lilian Miles



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The Department of Trade and Industry's Company Law Review Steering Group has recently published a consultation document on company general meetings and shareholder communication (October 1999). It recognised that, on the whole, company annual general meetings do not achieve their potential in promoting transparency and accountability on the part of directors. The question was raised as to whether annual general meetings should in fact be abolished, and if not, what can be done to improve their effectiveness in monitoring management. The consultation document put forward several issues to be considered and invited feedback from consultees as to what reform could be initiated if general meetings were retained.

WHAT IS WRONG WITH THE CURRENT LAW?

Annual general meetings are important. They provide an opportunity for shareholders to meet together to liaise with management in relation to the affairs of the company. Collective decisions as to the future of the company are taken. Annual general meetings are a vital part of the corporate disclosure process that helps to inform and protect shareholder rights (see J Barnard, 'The three-legged stool of corporate governance reform', *Amicus Curiae*, Issue 13, January 1999, 12–17, for other means of protecting these rights in the UK and the US). Any erosion of these rights can have dire consequences for the company and indeed the markets

themselves; for example, the Report to the OECD delivered by the Business Sector Advisory Group on Corporate Governance, entitled 'Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets' (April 1998), stated that:

'Insufficient shareholder protection may lead to decreased access to capital, increased capital costs and lower investment levels in the economy ... companies, investors and policy makers have a collective interest in promoting adequate protections for domestic and foreign shareholders.'

INACTIVE MAJORITY

We should not discount the possibility that the majority of shareholders are inactive not because they are unable to attend or find it difficult to participate meaningfully in general meetings, but because our culture is such that they are only interested in financial returns at the end of the day.

Unfortunately, the ineffectiveness of annual (as well as extraordinary) general meetings in ensuring proper corporate governance and shareholder protection is well documented (see, e.g. J Charkham & A Simpson, *Fair Shares*, OUP, 1999, Ch. 20; L Miles & G Proctor, 'Unresponsive Shareholders in Public Companies: Dial M for Motivate', forthcoming in *The Company Lawyer*, March/April 2000; L Miles and G Proctor, 'Institutional Shareholders: Sleeping Partners in Corporate Governance?', forthcoming in *The Scottish Law and Practice Quarterly*, April/July 2000). Individual private shareholders do not necessarily hold the necessary voting rights or have access to the resources to influence management. Large institutional shareholders lack the will to do so. The law and practice regulating the holding of general meetings are outdated and clumsy, contributing

to the inability of shareholders to influence management thinking and practice. To quote but a few examples, the present requirement that notice must be despatched 21 days before an AGM is convened (s. 369, *Companies Act 1985* ('CA 1985')) does not take into account weekends and bank holidays, and this could operate to the detriment of those who need more time to think over or consult before casting their votes. Directors must also circulate information relating to resolutions which will be passed at the general meeting. In relation to special or extraordinary resolutions, the notice often sets out in full the text of the resolutions. These are often detailed and complicated and may not be fully understood by the shareholder. As a result, many shareholders are none the wiser! Shareholders who want to table a resolution themselves have to hold the requisite number of shares and bear 'reasonable' costs to have the resolution circulated to other shareholders (at least 5 per cent of the voting rights relating to shares in the company or, alternatively, 100 shareholders who own not less than £100 on average (s. 376, CA 1985)). This is a disincentive to 'caring' shareholders who genuinely feel a particular issue needs to be addressed at the general meeting, but who do not hold the required shareholding or funds to have the resolution circulated. Rules applying to different types of company also disadvantage the shareholder: for example, the rules that proxies cannot vote by show of hands and cannot speak at meetings in public companies (s. 373, CA 1985); indeed this particular set of rules is illogical. Proxies are appointed by shareholders who cannot attend to have their say as well as vote at the general meeting. Why impose limitations on what the proxy can do?

on the Internet

<http://www.dti.gov.uk/dd/review.htm>

Access this site for information about the Department of Trade and Industry's company law review programme.

In response to the consultation paper, we would firstly argue that annual general meetings should be retained. Secondly, we feel that many of the ideas put forward in the paper will only remove practical and procedural difficulties; they will also do little to obligate the larger shareholders to take a more active role at general meetings, as should be the case. We will look briefly at the law and practice in the US in relation to 'shareholder activism' to consider if we could adopt some of its more useful features in the attempt to reform annual general meetings in this country.

SHOULD THE AGM BE ABOLISHED?

Should annual general meetings be abolished? We believe not. Annual general meetings are part of UK company culture and tradition. We believe that their abolition will promote more apathy amongst shareholders than already exists. It is necessary to retain annual general meetings (albeit in an amended form) as a focal point for shareholders to remove the AGM altogether would remove the sense of identity shareholders have as shareholders of a particular company. Instead, we should eliminate the factors that stand in the way of annual general meetings being effective, so as to enable shareholders to exercise optimum influence at these meetings.

TRAINING REQUIREMENT

Institutional shareholders in this country have as a priority profit maximisation for their own clients. They seldom concern themselves with affairs in their portfolio company, unless, perhaps, if and when its underperformance threatens the value of their shareholding. By then, it is too late. Training institutional investors and their fund managers on matters of corporate governance should be a requirement under the law, not an option.

We commend the many ideas that the consultation paper has put forward in terms of reforming the annual general meeting. However, we feel that some of the ideas are simplistic (such as holding AGMs at unlimited number of locations, provision of audio-visual communication,

communication through electronic means, inclusion of compulsory matters on the AGM agenda and changing the minimum notice period); they will merely remove the practical difficulties shareholders currently experience rather than address the real problem – that of apathy and de-motivation. We should not discount the possibility that the majority of shareholders are inactive not because they are unable to attend or find it difficult to participate meaningfully in general meetings, but because our culture is such that they are only interested in financial returns at the end of the day. Any law reform in this area should strive to nip this problem in the bud, thereby aiming to revolutionise and reshape what one could call 'UK short-term shareholder culture'. Reform should also not merely attempt a botched repair of the existing structures, with the odd block on the building site being moved to landscape basic deficiencies in company/shareholder relations, but enable a fresh start to be made where necessary.

Obligation to participate

How then do we ensure that shareholders make full use of the annual general meeting to ensure good corporate governance? We feel the following points are crucial.

First, the larger and more powerful shareholders, ie. trustees and institutional investors. These shareholders must receive proper training on corporate governance issues and in some circumstances, depending on their shareholding, be *obligated* to act diligently as responsible shareholders. More than 70 per cent of shares in large public companies are held by such shareholders. If they wake up from their slumber, these giant shareholders can do much to promote transparency and accountability on the part of management in their portfolio companies. Institutional shareholders in this country have as a priority profit maximisation for their own clients. They seldom concern themselves with affairs in their portfolio company, unless, perhaps, if and when its underperformance threatens the value of their shareholding. By then, it is too late. Training institutional investors and their fund managers on matters of corporate governance should be a requirement under the law, not an option. The law can

make better use of existing and able (in terms of resource and influence) shareholders to curb mismanagement.

OPPORTUNITY

Annual general meetings ... provide an opportunity for shareholders to meet together to liaise with management in relation to the affairs of the company. Collective decisions as to the future of the company are taken. Annual general meetings are a vital part of the corporate disclosure process that helps to inform and protect shareholder rights ...

Relaxation of rules for tabling shareholder resolutions

Secondly, we would argue that the stringent requirements in relation to tabling shareholder resolutions must be made more 'shareholder-friendly' so that smaller but no less interested shareholders can play a more active part in corporate governance. We note that the system in the US allows even individual shareholders to table such a resolution. Arguably, the criterion with regard to who can table a resolution should not be the volume of shareholding, but rather how long a shareholder has held shares in a particular company. Genuine concerns must be listened to. Of course there is a risk that if individual or small shareholders can table resolutions, pressure groups and disruptive shareholders will acquire a few shares for this specific purpose. Perhaps a method can be devised whereby resolutions tabled by individual or small shareholders are referred to an independent third party who will decide whether the resolution is 'genuine' (although we recognise that this route may import into the process problems of delay and unnecessary bureaucracy).

DEEP-ROOTED BELIEF

We need to move away from the deep-rooted belief that individual shareholders can do very little to change the way their companies are run and encourage a more 'interventionist' attitude amongst smaller shareholders.

More importantly, however, attitudes in this country amongst smaller

shareholders must change. Along with opening up the way for them to get involved more freely, they must be re-educated, urged to participate in annual general meetings and recognise the potential they have, even as individual shareholders. We need to move away from the deep-rooted belief that individual shareholders can do very little to change the way their companies are run and encourage a more 'interventionist' attitude amongst smaller shareholders. Perhaps one way in which the law can promote wider shareholder activism is by making use of internet technology to provide interested shareholders with the requisite information about their rights and privileges. The media can also help, as can companies themselves.

Role and Contribution of Non-Executive Directors, Director Publications, 1999).

THE US POSITION

Shareholder resolutions are an integral part of company life in the US. Indeed shareholder activism as a whole charts an interesting path in its corporate history. Corporations in the US are primarily a creation of state law. The federal role is primarily to ensure that there is access for shareholders to information about publicly-traded corporations through the regulatory oversight of the Securities and Exchange Commission (SEC). Shareholder resolutions are circulated at the company's expense, provided the proposer owns at least 1 per cent or \$2,000 of shares entitled to be voted and has held these shares for at least a year.

The requirement as to the volume of shareholding is much less onerous than in the UK. These resolutions may be tabled to address dissatisfaction with directors' performance

or their remuneration, and may even advocate social responsibility on the part of the company (for example, challenging the company on its human rights, fair trade or environmental policies). Of course, the company may challenge the resolution by sending it to the SEC, who may exclude it on one of several grounds. On the whole, however, these resolutions have been boldly used to put shareholders' views across to directors and activity in this area appears to be growing. According to the Report of the Sub Council on Competitiveness USA (J Charkham, at 231:

'Shareholder resolutions involving corporate governance procedures are now amassing an increasingly sizeable percentage – frequently in excess of 30% – of the vote at annual meetings. Thus, shareholder activism as to voting procedures and board organisation is now an established fact.'

It is tempting to perceive the US model of shareholder activism as one which has evolved further than its British counterpart. Concentrated ownership power in the hands of institutional investors can be a force for constructive tendencies (see I Millstein, 'The Evolution of the certifying Board', *The Business Lawyer*, August 1993, Vol 48(4)).

It has been commented that the US system enables shareholders to affect governance outcomes in a variety of ways and such shareholder power (in particular giving broad access to the courts) is uniquely 'US-made'. The fact that such powers are now increasingly accruing to institutional investors in the UK cannot be ignored and the developments in the US should not go unnoticed in this country.

US institutional shareholders (specifically private sector pension funds) are also obliged to vote their shares or at least see that their fund managers do so. The votes must be cast in the interest of the beneficiaries, but, put simply, institutional shareholders in the UK do not pull their weight and seldom get involved so as to ensure good corporate governance in their portfolio companies. The US Department of Labour, however, is committed to ensuring that trustees of private sector pension funds cast their votes on behalf of their beneficiaries and has gone so far as to establish a programme to ensure that this is observed:

'The trustees must be able to demonstrate that when voting they are informed, acting independently of company management and solely in the interest of the beneficiaries. Pension funds are required to keep records of their voting activity which must be open to inspection by beneficiaries, so that they can demonstrate they meet the required standards.'

US PROGRAMME

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As these institutional shareholders have an obligation to cast their votes in the US, there is much more that they must do before they are able to cast their votes on behalf of their beneficiaries. This will at least include questioning management on specific policies, requiring information from management and participating in general meetings. Although it is important to point out that the above-mentioned policy only affects a selected type of institutional shareholder in the US, there is no reason why the UK

on the Internet

<http://www.oecd.org/dstl/sti/industry/indcomp/prod/LETTER.HTM>

The OECD Business Sector Advisory Group's report entitled 'Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets' is available on this website.

Mini-meetings


Thirdly, there is much to recommend holding a series of 'mini' AGMs to supplement one monolithic annual general meeting. These meetings could be timed to coincide with the announcement of interim and final results of the company in question. At these company fora, the chairman, executive and non-executive directors report in person to the meeting on the results and take questions there and then from individual and institutional company shareholders, their analysts and proxies on the results and other aspects of board policy (including aspects of board remuneration, strategy, etc.). Follow-up briefings could be arranged for shareholders who wish to look into issues in more depth. Surely the above arrangement is better (if perhaps a slightly less comfortable one for some boards!) than the laborious and labyrinthine procedures surrounding the annual general meeting in its current form, usually held when the results (the litmus test of company performance for many investors) are some months past or hence (a point made by Michelle Edkins of Hermes Investment Management in her chapter 'View from the Institutional Investor' in *The Independent Director: The*

cannot adopt and apply the same policy more universally in this country.

CONCLUSION

We think it essential that some form of annual general meeting (or however such a meeting is termed) be retained as a focal point for company/shareholder dialogue. We also recognise there is a need to get rid of outdated and illogical rules which block openness and transparency on the part of companies vis-à-vis their shareholders, and for the law to regulate more stringently the voting responsibilities of institutional shareholders.

Most importantly, we need to drive shareholder activism forward so as to benefit both the company and the interests it affects in the wider community. Adopting the willingness of the law in the US to allow small shareholders to table resolutions, at the company's expense, to address what they perceive as important in their companies is one of many ways we can achieve this goal. Only if smaller shareholders are confident that their actions and efforts have as valid a role in corporate governance as those of larger shareholders (and there are signs of this in the US) will they begin to emerge from the woodwork.

Changing and reforming already deeply-embedded traditions and attitudes will not happen overnight. This however must not discourage the investigation of new initiatives and possibilities. If company law is to change for the better, then we must not be afraid to explore new ideas, even though this may initially be met with scepticism and hostility by company management. 

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