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FROM BALANCED ENTERPRISE TO HOSTILE TAKEOVER: HOW THE LAW FORGOT ABOUT MANAGEMENT*

Andrew Johnston, Blanche Segrestin and Armand Hatchuel[1]

Abstract

We show that professional management began to emerge in UK companies during the first half of the twentieth century, a development which was widely theorised and accepted. However, the managerially-led enterprise was accommodated rather than protected by company law, making it vulnerable to changes in the law. The Cohen Report of 1945 paid no attention to these developments, and led to the introduction, in the Companies Act 1948, of important, but previously little appreciated, changes in the name of enhancing the accountability of directors to shareholders. The shareholders' statutory right to remove the directors by simple majority overturned existing structures overnight and was an important driver of the hostile takeover, which emerged shortly afterwards. This deprived management of the necessary autonomy to balance the competing interests at stake in the enterprise and to foster innovation. The emergence of the current system of shareholder primacy can be traced back to these developments.

Key Words

Company Law, Corporate Governance, Enterprise, Management, Hostile Takeover, Legal History

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FROM BALANCED ENTERPRISE TO HOSTILE TAKEOVER: HOW THE LAW FORGOT ABOUT MANAGEMENT

1. INTRODUCTION

> 'Here is the most urgent challenge to political invention ever offered to the jurist and the statesman. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise – the association of shareholders, creditors and directors – is incapable of production or distribution and is not expected by the law to perform these functions. We have to give law to the real association and to withdraw meaningless privilege from the imaginary one.'[2]

In this article we offer a new account of the implications of the Companies Act 1948 for corporate governance in the UK, focusing on its effects on the autonomy that professional managers had gained during the first half of the twentieth century, and claimed to be using to balance the competing claims of the various contributors to the corporate enterprise. This autonomy was accommodated but not explicitly protected by the law. We argue that the introduction of a mandatory power for shareholders to remove directors by simple majority in the Companies Act 1948 was an important driver of the emergence of the hostile takeover, which is characterised by wholesale replacement of directors. This allowed the shareholder primacy model of corporate governance to become established and supersede the emergent managerially-led enterprise that had evolved after 1900. In doing so, we show that, rather than a pure market outcome, shareholder control over companies was a policy choice

[2] Lord Eustace Percy, *The Unknown State,* 16th Riddell Memorial Lectures (Oxford: OUP, 1944).

imposed by legislation, which disrupted the 'natural development' of professional management and the enterprise.

The article draws on a historically-grounded account of the function of management, as well as archival research on the genesis of the Cohen Report that led to the Companies Act 1948, to make two contributions. First, it contributes to the theoretical debate about the role of company law in shaping corporate governance outcomes. We show that the 1948 reforms were a regulatory intervention which disrupted the pre-1948 governance arrangements in which directors (and, below them, managers) were strongly entrenched and to which shareholders had consented. Our analysis provides support for those who contend that company law 'plays a crucial role in the *constitution* of financial property forms such as shares… and a more modest one in seeking to ensure their continued integrity.'[3] However, it goes further and shows that the law actually enhanced the value of shareholders' property rights by rewriting the bargains struck between shareholders and companies. In doing so, company law was operating in a manner more akin to 'regulatory paternalism', in which the state substitutes its view of a desirable corporate governance framework for the outcome of 'privately-driven, market-based rule selections'.[4] As such, it is closer to the fears expressed by contractarians about 'politically-motivated regulatory interventions that will inevitably reflect the partisan preferences of dominant social interest groups'.[5]

Second, it contributes to the historical debate about the causes and effects of the emergence of the hostile takeover. Previous contributions have suggested that the 1948 Act facilitated this by furnishing bidders with more reliable information, and have also highlighted the

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[3] P Ireland, 'Property and Contract in Contemporary Corporate Theory' (2003) 23 *Legal Studies* 453, 501, emphasis in original.
[4] M Moore, *Corporate Governance in the Shadow of the State* (Oxford: Hart, 2013) p 256.
[5] ibid at 92; Easterbrook and Fischel say that 'Unless there is a strong reason to believe that regulation has a comparative advantage over competition in markets in evaluating the effects of corporate contracts… there is no basis for displacing actual arrangements as "mistakes", "exploitation," and the like.' F Easterbrook and D Fischel, The Economic Structure of Corporate Law (Cambridge, MA: Harvard University Press, 1991) p 32.

importance of the emergence of institutional investors in the post-war period. We add to this debate by arguing that the contribution of the shareholder removal power to the hostile takeover has not, to date, been adequately explored. The new powers given to shareholders made control of many companies suddenly contestable, as the threshold for director removal was reduced overnight to a simple majority. The effect was to transform managerial practices, sidelining the dominant managerial ideology of balancing competing interests, and ultimately acting as one of the key drivers of the emergence of financialised corporate governance and the social norm of shareholder primacy.[6] Scholars have identified many of the costs of this shift, such as its impact on employee willingness to make contractually unprotected investments in firm-specific human capital, and reduced investment in R&D.[7] This paper suggests that these effects were, in considerable part, driven by the legal changes of 1948 and the subsequent emergence of the hostile takeover, which disrupted the management-led enterprises that had developed during the first half of the twentieth century.

The paper is structured as follows. In Part 2, we explore the historical emergence of modern professional management in the UK from the end of the nineteenth century. While the UK may have lagged behind the US and Germany in this regard, we show that this development was widely accepted, and was legitimated on the grounds that these scientific managers would seek to innovate and to balance the competing interests at stake in the enterprise. In part 3, we show that these radical changes in the management of companies occurred in an unchanged legal context and that the law never developed a positive conception of the role of management. Various familiar features of company law allowed the development of relatively autonomous hierarchies which could operate in this way, but the law did not provide positive support for them, refusing, for example, to allow boards of directors to give managers

[6] S Deakin, 'The Coming Transformation of Shareholder Value' (2005) 13 *Corporate Governance: An International Review* 11.
[7] M Blair, *Ownership and Control* (Washington, DC: Brookings, 1995); W Lazonick, 'Profits without Prosperity' (2014) *Harvard Business Review* 46 (September)

full autonomy. The dependence of managers' positions on boards of directors made managerial structures vulnerable to the later move to empower shareholders. In Part 4, we show that the company law reforms of 1947-8 represent a deliberate regulatory intervention into the control of companies which sought to put shareholders in control. The reformers ignored the emerging role of management within the enterprise and focused exclusively on the relationship between shareowners and directors. We examine in particular the origins of, and rationale for, the shareholders' new mandatory power to remove the directors by simple majority. Part 5 shows how these reforms contributed to creating the conditions for the emergence of the hostile takeover, characterised by the removal of directors and a reorientation of managerial objectives, from the 1950s onwards. We conclude with a plea for scholars to address the role and status of management in law, which is essential if post-crisis economies are to become sustainable and responsible.

2. THE EMERGENCE OF PROFESSIONAL MANAGEMENT IN THE UK

The timing of the separation of 'ownership' and control in the UK remains controversial. The conventional account, based on Chandler, is that family control of companies persisted in the UK during the first half of the twentieth century.[8] Hannah has challenged this, arguing on the basis of London Stock Exchange data that the separation occurred much earlier in listed companies, so that, by the early twentieth century, a substantial majority of large quoted British industrials had widely dispersed shareholdings, but with the directors (and other founders) owning up to 33% of the shares.[9]

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[8] AD Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge, MA: Belknap Press, 1990) pp 288-9; B Cheffins, 'History and the Global Corporate Governance Revolution: The UK Perspective' (2001) 43(4) *Business History* 87, 91; B Cheffins, *Corporate Ownership and Control: British Business Transformed* (Oxford: OUP, 2008), Chapter 9.

[9] L Hannah, 'The "Divorce" of ownership from control from 1900 onwards: Re-calibrating imagined global trends' (2007) 49 *Business History* 404, 417. See also GG Acheson, G Campbell, JD Turner, and

The extent to which management of UK companies was in the hands of professionals in the first half of the twentieth century is similarly contested. Based on an analysis of companies listed in the UK in 1911, Foreman-Peck and Hannah argue that the 'evolution of managerial control in the UK was substantially complete before 1914' with directors holding office 'by virtue of their skills, knowledge, and networks, and promotion or recruitment to the board, not because they held preponderant ownership stakes.'[10] Similarly, Sargant Florence reports significant growth in the ratio of staff to operatives in the UK between 1924 and 1948, noting that management had become 'more specialized and more graded into ranks from general manager to foreman and charge-hand'.[11] Against this, Chandler emphasises the persistence of founder control, so that 'commitment to personal ways of management was therefore perpetuated'.[12] Likewise, Lazonick argues that 'British proprietary capitalists left substantial control over the organization of production and the acquisition of skills on the shop floor' and did not make 'investments in the technical specialists who are integrated into the managerial structure.'[13]

Whilst UK companies did not have had the formal divisional structure so lauded by Chandler as the source of US competitive advantage, it is clear that, even where they were owner-dominated, British companies were appointing technical general managers from the late 1800s, and that craft workers on the shop floor were not doing all the operational management. These structures were certainly more ad hoc than those put in place by US companies,[14] but to deny their existence is surely wrong. In 1896, Slater Lewis published what

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N Vanteeva, 'Corporate Ownership and Control in Victorian Britain.' (2015) 68 *Economic History Review* 911. For a critique of Hannah's account, see Cheffins (2008) above n 7, p 197.

[10] J Foreman-Peck and L Hannah, 'Extreme Divorce: The Managerial Revolution in UK Companies before 1914' (2012) 65 *Economic History Review* 1217.

[11] P Sargant Florence, *The Logic of British and American Industry* (London: Routledge, 1953) p 140.

[12] Chandler (1990) above n 7 p 240

[13] W Lazonick, *Business Organization and the Myth of the Market Economy* (Cambridge: CUP, 2000), p 269.

[14] Webb, for example, referred to 'a hierarchy culminating in some form of General Manager or Managing Director, and reaching, in some cases, a high degree of complexity': S Webb, *The Works Manager Today* (London: Longmans, 1918) pp 4-5.

Urwick and Brech describe as 'the first example of a modern "organisation chart" in British business literature',[15] showing a hierarchy from shareholders to directors to chairman or managing director, with the latter above a general manager. The general manager sat at the top of a large hierarchy, with the works manager and chief engineer below and reporting directly to him. Urwick and Brech argue that by 1916, 'no writer on industrial management would have given a works manager any descriptions that left doubts about his inclusion among the ranks of the responsible executives.'[16] Even in companies that still had a dominant shareholder from the founding family who controlled the board, there was considerable delegation to professional managers, and the dominant shareholder normally ensured that those managers had the resources necessary to make the investments to carry out the strategic plans developed by the board.[17]

This is not, however, to claim that the practices which emerged in the UK were ideal. Far from it. The UK did not train anywhere near as many engineers as the US or Germany, and also lagged far behind them in offering university training in management.[18] With less formal hierarchy and structure, British firms carried out less industrial research, tending to rely on consulting engineers rather than in-house staff, a less effective method than carrying out research in-house, which combines 'skills and information from a wide range of functions

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[15] L Urwick and EFL Brech, *The Making of Scientific Management Volume II: Management in British Industry* (London: Management Publications Trust, 1949) p 81.
[16] Ibid p 85. For further examples of early organizational diagrams, see O. Sheldon, *Philosophy of Management* (London: Pitman, 1923) pp 118 and 121.
[17] See for example the case studies contained in MJ Lewis, R Lloyd-Jones, J Maltby and MD Matthews, *Personal Capitalism and Corporate Governance: British Manufacturing in the First Half of the Twentieth Century* (Basingstoke: Ashgate, 2011); M Richardson, 'Rapprochement and Retribution: The Divergent Experiences of Workers in Two Large Paper and Print Companies in the 1926 General Strike' in M Richardson and P Nicholls (eds) *A Business and Labour History of Britain: Case studies of Britain in the Nineteenth and Twentieth Centuries* (London: Palgrave Macmillan, 2011) p 94.
[18] SP Keeble, *The Ability to Manage: A Study of British Management 1890-1990* (Manchester: Manchester University Press, 1992), Chapter Four; Chandler (1990) above n 7, p 293; R Khurana, *From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession* (Princeton: Princeton University Press, 2007) p 138; RP Amdam, 'Business Education' in G Jones and J Zeitlin (eds), *The Oxford Handbook of Business History* (Oxford: OUP, 2008) pp 583-5.

within the firm, and often exploits firm-specific knowledge emerging from the production process.'[19] Accordingly, UK management clearly lagged behind their counterparts in other jurisdictions in fostering innovation through research and innovation programmes,[20] with some scholars explaining this on the basis that British boards did not delegate enough authority to their managers.[21] We will see in section 3 below that the law imposed limitations on the extent to which directors could do this.

The professional manager was a new figure on the industrial scene, and his role had to be explained and legitimated. This process began in the UK around the turn of the twentieth century in the management literature,[22] which explained that professional managers furthered the public good by applying specialised skills, following an ethics of professionalism which required them to balance competing interests, and fostering the development of innovative capabilities.[23]

First, as regards specialized skills, for example, Burton describes the general manager as an 'autocrat, controlling and directing everyone connected with the concern excepting the secretary and auditor, and himself subject only to his directors.'[24] He 'should be a highly qualified engineer' with 'a sufficient grasp of all the departments' using 'his general technical

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[19] DC Mowery, 'Industrial Research 1900-1950' in B Elbaum and W Lazonick (eds), *The Decline of the British Economy* (Oxford: Clarendon, 1986) pp 194-9. However, Sheldon (1923) above n 15, p 44 reported that, even in the UK, 'Many large firms have now instituted research departments, for both applied and pure research.'
[20] DC Coleman, 'Failings and Achievements: Some British Businesses, 1910–80' (1987) 29 *Business History* 1 pp 5-6.
[21] DR Shiman, 'Managerial Inefficiency and Technological Decline in Britain, 1860-1914' (1991) 20 *Business and Economic History* 89, 92-4; J Quail, 'The Proprietorial Theory of the Firm and its Consequences' (2000) 3 *Journal of Industrial History* 1, 8.
[22] For an essential overview, see J Child, *British Management Thought: A Critical Analysis* (London: Allen and Unwin, 1969), Chapter Three.
[23] See for example Sheldon (1923) above n 15, p 26.
[24] FG Burton, *The Commercial Management of Engineering Works* (Manchester: Scientific Publishing Co, 1899), pp iv and 20.

knowledge and common sense' to 'reconcile their conflicting claims, and direct them all to the making of a profitable revenue account.'[25]

Second, as for the professionalism of these new managers, Webb described works managers as belonging to 'a brain-working profession… arranging and directing the activities of a band of producers, including both brain-workers and manual workers, as to create among them the most effective co-operation of their energies in achieving the common purpose'.[26] Other writers around this time were also linking professionalization to striking a workable balance between the interests of capital and labour. Elbourne referred to 'the co-ordination of labour with capital' as 'the outstanding problem of management today' requiring the manager to nurture 'a spirit of goodwill coupled with an adequate sense of discipline.'[27] Similarly, Taylor explained that that 'the fundamental interests of employés and employers… are one and the same',[28] an idea which was gaining currency in management circles in the UK.[29] These emerging approaches were endorsed by government, with a 1919 Ministry of Reconstruction publication, *Scientific Business Management,* stating that:

> 'In the past management has often been somewhat mechanical in its tendency, ignoring the human element in production and distribution. Today, more than ever, it is realised that the welfare of the worker is not only a vital matter for the community, but also from the point of view of the employer a matter of expediency. There is thus the double stimulus – the good employer profits by his "goodness".'[30]

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[25] ibid at 24. Armstrong notes the widespread use in Victorian England of salaried managers who 'were often engineers by the standards of the day': P Armstrong, 'Changing Management Control Strategies: The Role of Competition between Accountancy and other Organisational Professions' (1985) 10 *Accounting, Organizations and Society* 129, 138.
[26] Webb (1918) above n 13, pp 3-4. For the parallel debate in the US, see for example, L Brandeis, 'Business – A Profession' (1912 speech reprinted in *Business – A Profession* (Boston: Small, Maynard & Co, 1912)).
[27] ET Elbourne, *The Management Problem* (London: Library Press, 1919).
[28] FW Taylor, *The Principles of Scientific Management* (New York: Harper and Brothers, 1919) p 10.
[29] Urwick and Brech (1949) above n 14, pp 99-102.
[30] Ministry of Reconstruction, *Scientific Business Management*, Reconstruction Problems 28, (London: HMSO, 1919).

This balancing of interests gradually became more widely accepted as a public service ethos was claimed for management,[31] reaching its zenith in Tawney's argument that industry 'should cease to be conducted by the agents of property-owners for the advantage of property-owners, and should be carried on, instead, for the service of the public'.[32]

The final aspect of the legitimation of management was that it would develop the necessary innovative capabilities for the enterprise to be successful. Whilst we acknowledge that, compared to their competitors, UK manufacturers relatively neglected science, Burton noted as early at 1899 that 'It is chiefly in the manufacturer's appreciation of the scientific branches of his establishment, and of research work that the need lies'.[33] The emerging 'science-based' industry was transforming the enterprise from a productive to an innovative organisation, driving organizations into the unknown, which demanded radical new competencies to devise innovative but sustainable strategies. For example, Sheldon emphasised the contribution of the 'continued growth of inventions for both manual and clerical operations' in adding to the 'complexity and responsibility of management'.[34] Managers required broad autonomy and authority because they were pursuing innovation in a context of 'radical uncertainty', where the consequences of decisions cannot be known in advance, making collective decision-making impossible. Modern managerial authority thus derives from, and is a response to, this radical uncertainty:

> 'Uncertainty leads to the tendency of the groups themselves to specialize, finding the individuals with the greatest managerial capacity of the requisite kinds and placing

[31] Child (1969) above n 21, p 46; for a discussion of the parallel debates in the US, see A Kaufman, L Zacharias and M Karson, *Managers vs. Owners: The Struggle for Corporate Control in American Democracy* (Oxford: OUP, 1995) pp 114-7; M O'Sullivan, *Contests for Corporate Control* (Oxford: OUP, 2000) pp 100-2.
[32] RH Tawney, *The Acquisitive Society* (London: G Bell and Sons, 1921) p 111. See also R Marens, 'Recovering the past: reviving the legacy of the early scholars of corporate social responsibility' (2008) 14 *Journal of Management History* 55.
[33] Burton (1899) above n 23, p 28.
[34] Sheldon (1923) above n 15, p 46.

> them in charge of the work of the group, submitting the activities of the other members to their direction and control.'[35]

Hence, when Berle and Means concluded that 'the "control" of the great corporations' might 'develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community',[36] they were simply reflecting the previous forty years of debate about the role of management in productive enterprise. This conception of management became widely accepted, and as late as 1955, Gower commented that 'it has become almost an accepted dogma that management owed duties to "the four parties to industry" (labor, capital, management, and the community) – a dogma which is repeated indiscriminately in the speeches of right-wing company chairmen and left-wing politicians.'[37] Although Quail has noted that the 'extent to which such thoughts found expression let alone influence within large UK businesses is unknown',[38] Nichols, in interviews conducted with managers between 1961-2, found evidence that this was done implicitly, with managers focusing on promoting the success of the company through economic growth, believing that this would produce fair outcomes for all contributors, and promoting social welfare through economic growth, rather than through an explicit focus on social responsibility in the form of a calculus of social costs and benefits.[39]

3. THE ACCOMMODATION OF THE MANAGERIAL ENTERPRISE IN LAW

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[35] F Knight, *Risk, Uncertainty, and Profit* (Boston: Houghton Mifflin, 1921) at 269.
[36] A Berle and G Means, *The Modern Corporation and Private Property* (Piscataway, NJ: Transaction Publishers, 1991 edition) pp 312-3.
[37] LCB Gower, 'Corporate Control: The Battle for the Berkeley' (1955) 68 *Harvard Law Review* 1176, 1190.
[38] J Quail, 'Visible Hands and Visible Handles: Understanding the Managerial Revolution in the UK' (2002) 5 *Journal of Industrial History* 1, 5.
[39] See T Nichols, *Ownership, Control, and Ideology* (London: George Allen & Unwin, 1969) pp 238-9.

These developments in managerial theory and practice occurred after the establishment of the legal framework governing the allocation of power in companies. In this section, we show that the growth of professional management was accommodated within existing and developing company law doctrines and practices, rather than positively supported by law. As company law gave considerable leeway to directors and prevented shareholders from interfering directly in business decisions, boards were able to shield professional managers from shareholder pressure, giving them sufficient autonomy to balance competing interests and to innovate. However, the law paid no attention to management, recognising the position of 'managing director', but ignoring managers below board level. This meant that managerial autonomy was never guaranteed by law, a fragile state of affairs which was disrupted by subsequent changes to the law which empowered shareholders and contributed to the emergence of the hostile takeover (discussed in parts 4 and 5 below).

(a) The legal conditions allowing the emergence of professional management

There was adequate space within company law at the beginning of the twentieth century for professional management to develop. Contemporaneous accounts indicate that most shareholders did not participate in meetings, did not hold the directors and management to account, and were 'satisfied by conventionally adequate dividends'.[40] More importantly, it was extremely difficult for the shareholders to change the directors, which meant that, as long as management retained the confidence of the directors, they would remain in place and had considerable autonomy in terms of implementing the company's strategy.[41] The right of

[40] JM Keynes, 'The End of Laissez-Faire' (London: Hogarth Press, 1926). For further discussion of the reasons for shareholder passivity during this period, see Cheffins (2008) above n 7, pp 123-30.
[41] As Marris pointed out, shareholders could only remove a senior manager below board level by threatening to replace a majority of the directors with their nominees. R Marris, *The Economic Theory of 'Managerial' Capitalism* (London: Palgrave Macmillan, 1964) p 16. This was practically impossible before 1948.

shareholders to remove a director of a particular company was governed by the company's articles (and so reflected the terms on which the shareholders had joined the company). The default rule provided by Table A was that directors could only be removed by special resolution,[42] or extraordinary resolution,[43] both types of resolution requiring the support of 75% of those entitled to vote and actually voting in person or by proxy.[44] Nor were shareholders in listed companies in a better position: even by 1932, the London Stock Exchange only required that all directors of listed companies be removable by special resolution,[45] so that only a shareholder with a 75% shareholding could definitely 'get rid of management'.[46] Recent research has found that 76.2% of companies incorporated in 1892, regardless of size, adopted the Table A default rule, requiring a 75% majority to remove directors.[47] Companies such as ICI, Rolls Royce and Vickers Armstrong set the threshold as high as was legally permitted.[48] Even if shareholders tried to bring about a change, Hannah's 2007 research shows that the directors and their associates normally kept between a quarter and a third of the shares upon flotation,[49] which would have made their removal impossible, and gave them freedom to put in place credible, long-term management structures.

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[42] Companies Act 1862, Table A, Art 65.

[43] Companies Act 1906, Table A, Art 86; Companies Act 1929, Table A, Art 80.

[44] Companies Act 1862, s 55 and Companies Act 1908, ss 69(1) and (2). A special resolution also required a second meeting to confirm the decision by simple majority until 1929: see Companies Act 1862, s 51 and Companies Act 1908, s 69(2). The Companies Act 1929 dispensed with the requirement of a second meeting for a special resolution. As Mr Justice Cohen observed, the directors tended to hold all the proxies for the general meeting: see *Minutes of Evidence Taken Before the Company Law Amendment Committee* (London: HMSO 1943-1944), para 7071.

[45] Cheffins (2008) above n 7, pp 130 and 278. This had not been a listing requirement in 1906: see *Rules and regulations of the London Stock Exchange* (London: The Stock Exchange, 1906) set out in L Davis, L Neal, EN White, 'How it all began: the rise of listing requirements on the London, Berlin, Paris, and New York stock exchanges' (2003) 38 *The International Journal of Accounting* 117, Appendix A.

[46] Evidence of Samuel Cash, partner in Vizards, *Minutes of Evidence* (1943-1944) above n 43, para 10191.

[47] TW Guinnane, R Harris, NR Lamoreaux, 'Contractual Freedom and the Evolution of Corporate Control in Britain, 1862 to 1929' (2014) *NBER Working Paper* No 20481 pp 20 and 27.

[48] E McGaughey, *Participation in Corporate Governance*, Unpublished LSE PhD Thesis, 4th November 2014 p 84.

[49] Hannah (2007) above n 8, pp 415-7.

Directors were also commonly entrenched through provisions in the articles. By default, boards were 'staggered' with one third of the directors required to retire each year but available for re-election by the general meeting by simple majority.[50] However, this offered little help to restive shareholders because, as a default rule, it was avoided in a number of ways. Some companies made no provision for removal of directors whatsoever, which meant that the shareholders had to pass a special resolution to change the articles before they could vote on removal of directors.[51] Before 1906, most companies made bespoke provision to designate one or more managing directors who were exempt from retirement by rotation.[52] In 1906, Table A was amended to reflect this practice and provided a default rule allowing companies to appoint managing directors, who were exempt from retirement by rotation, and this was rarely displaced.[53] Finally, it was a common practice for the founders of the company to provide that they would remain directors for life or for a certain number of years provided they satisfied a shareholding requirement.[54] These strategies, which were adopted by a significant minority of companies in Guinnane et al's 1892 sample,[55] meant that a special resolution to change the articles was required, followed by a vote to remove the director.

[50] Companies Act 1862, Table A, Arts 58, 60 and 61; Companies Act 1906, Table A, Arts 78, 80 and 81; Companies Act 1929, Table A, Arts 73, 75 and 76 (providing for re-election by default). Guinnane et al (2014) above n 46, p 10 suggest that this was perhaps to ensure continuity in management of the enterprise.

[51] *Imperial Hydropathic Hotel Co v Hampson* (1882) 23 C.D. 1; see also *Report of the Committee on Company Law Amendment* (Cm 6659, 1945) (Cohen Report), paragraph 130.

[52] In Guinnane et al's samples, 64 percent of their sample of companies registered in 1892 and 92 percent of their sample from *Burdett's Stock Exchange Official Intelligence* (1892) made provision along these lines: TW Guinnane, R Harris and NR Lamoreaux, 'Contractual Freedom and Corporate Governance in Britain in the Late Nineteenth and Early Twentieth Centuries' (2017) 91 *Business History Review* 227, 244.

[53] Companies Act 1906, Table A, Art 72; Companies Act 1929, Table A, Art 68. In Guinnane et al's (ibid) 1912 and 1927 samples virtually all companies adopted this provision. By default, the general meeting could remove a managing director or manager from his position by simple majority, with 44.9% and 62% of companies in Guinnane et al's 1912 and 1927 samples adopting this provision. Presumably the directors could simply reappoint the managing director or manager in the unlikely event of removal by the general meeting.

[54] This was common where a business was incorporated for the first time: see FB Palmer*, Company Precedents for Use in Relation to Companies Subject to the Companies (Consolidation) Act, 1908 (Volume 1)* (London: Stevens, 1912) pp 981-2.

[55] Guinnane at al (2014) above n 46, p 20.

Nor did amalgamations and mergers during the first half of the twentieth century generally result in changes to the directors and managers.[56] These operations proceeded consensually, with directors only departing by consent, and managerial hierarchies frequently remaining intact, particularly in the early, largely anti-competitive amalgamations in which individual companies remained separately managed under a holding company.[57] This was a far cry from the hostile takeovers of the second half of the twentieth century in which a bidder explicitly sought to change the incumbent directors as soon as they gained control.

These practices meant that shareholder removal of directors was, as an 1894 book aimed investors put it, 'in practice… almost an impossibility.'[58] However, the effective entrenchment of directors and managers, with shareholders becoming increasingly peripheral, did not give rise to controversy, and was endorsed by the company law literature during this period.[59]

Looking beyond removal of directors, shareholders had few other options open to them. The law did not allow them to interfere with the decisions of the directors. In a number of cases at the beginning of the twentieth century, the courts ruled that a simple majority of shareholders could not give binding instructions to the directors. These rulings were justified either by reference to the bargain made between the shareholders,[60] or to the need to protect minority shareholders,[61] or to the company as a separate legal entity.[62] It is at least arguable

[56] J Franks, C Mayer and S Rossi, 'Spending Less Time with the Family: The Decline of Family Ownership in the United Kingdom' in R Morck (ed), *A History of Corporate Governance around the World: Family Business Groups to Professional Managers* (Chicago: University of Chicago Press, 2005) pp 595-7 showing that, between 1919 and 1939, 'on average, two thirds of the target directors remained on the target's board after the acquisition'.
[57] See for example L Hannah, *The Rise of the Corporate Economy* (London: Methuen, 1976) pp 86-7; Franks et al (2005) above n 55, p 584.
[58] JD Walker & Watson, *Investor's and Shareholder's Guide* (Edinburgh: E&S Livingstone, 1894) pp 142-3.
[59] Stiebel's 1920 book simply stated that the articles 'should empower the company to remove directors by extraordinary or special resolution': See A Stiebel, *Company Law and Precedents* (London: Sweet & Maxwell Ltd, 2nd edn, 1920) pp 396 and 423.
[60] *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34; *Quin & Axtens Ltd v Salmon* [1909] A.C. 442 pp 443-4.
[61] See the decisions of the Court of Appeal in both *Cuninghame* [1906] 2 Ch 34 and *Quin & Axtens Ltd* [1909] 1 Ch 311 .
[62] *The Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89.

that, whilst the judges were justifying their decisions on the basis of conventional company law concerns, they were in fact reflecting the emerging – and widely accepted – ideology that, in order for businesses to be successful, management had to be free from interference. Further support for this argument comes from the United States, which saw similar legal developments around the same time, but justified on entirely different bases. There the courts prevented shareholder interference with management on the basis that the power to manage was given to the directors by the law of the state of incorporation,[63] or on basis that it would not be appropriate to hold the directors responsible to the corporation if they could be forced to act with others who could control their acts.[64] Reviewing these developments, Hurst identified a minority shareholder logic, but also suggested that 'the peculiar hostility of the courts' to attempts by shareholders to control the directors 'perhaps reflected the high value which prevailing opinion put on the entrepreneurial function in the growth decades from about 1870 to the 1930s depression.'[65]

Likewise, it was very difficult for shareholders to challenge directors' decisions before the courts. The law required that directors' decisions be oriented towards the 'benefit of the company',[66] a concept widely interpreted as referring to the commercial interests of the shareholders rather than the interests of the separate legal entity.[67] However, it was clear that the law allowed the directors to take account of and spend money on interests other than those of shareholders, provided this was 'reasonably incidental to the carrying on of the

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[63] *Hoyt* v. *Thompson's Executors,* (1859) 19 N.Y. 207 p 216, ruling that the directors' powers are 'original and undelegated'.
[64] *Charlestown Boot & Shoe Co v Dunsmore* (1880) 60 NH 85; *Manice v Powell* (1911) 201 NY 194 pp 200-1.
[65] JW Hurst, *The legitimacy of the business corporation in the law of the United States, 1780-1970* (Charlottesville, VA: University of Virginia Press, 1970) pp 79-80.
[66] *Hutton v West Cork Railway Co* (1883) 23 Ch D 654, per Bowen LJ in the Court of Appeal. See also *Parke v Daily News* [1962] Ch 927. Both these cases concerned the payment of gratuities to directors or employees after the company had ceased to be a going concern.
[67] See e.g. J Parkinson, *Corporate Power and Responsibility* (Oxford: OUP, 1993) p 77.

business of the company'.[68] Recently, a number of scholars have challenged the conventional understanding of this line of case law, arguing that the 'interests of the company' was never defined by the courts, and that all these decisions turned on the narrow point that gratuitous payments were void for ultra vires because they were not reasonably incidental to the business objectives specified in the company's memorandum.[69] Marc Moore argues that the correct interpretation of these cases is that 'corporate funds could legitimately be devoted to shareholders and/or employees as the directors reasonably deemed fit for the furtherance of the company's constitutionally specified line(s) of business, so long as the interests of *the business* as such were genuinely being promoted in some way.'[70]

As well as according with the emergent theory of management as balancing the competing interests at stake in the enterprise and seeking to innovate, this new interpretation of the case law fits with contemporaneous theoretical developments in the legal literature. 'Real entity' theory was the subject of considerable academic discussion throughout the early twentieth century following its importation from Germany by Maitland in 1900, and its adoption by political pluralists such as Laski.[71] That theory emphasised the social existence of the corporate entity as a result of cooperative activity towards a common goal, with a strong

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[68] The directors had very broad discretion to make expenditures aimed at conducting 'the business to the most advantage' where the company was a going concern: see *Hampson v Price's Patent Candle Co* (1876) 45 L. J. Ch. 437. In *Evans v Brunner, Mond & Co* [1921] Ch 359, this extended to funding scientific education in universities, considered by the directors to be essential for the business which 'depended increasingly upon the advance of pure science. The company's greatest difficulty was to find men sufficiently equipped by their previous studies to undertake research work.' The limits of the principle were only reached in *Tomkinson v South-Eastern Railway Company* (1887) 35 Ch.D. 675, where the court ruled *ultra vires* a spending decision, rejecting as 'extravagant' the argument that 'any expenditure which may indirectly conduce to the benefit of the company is *intra vires*'.

[69] See for example, M Moore, 'Shareholder Primacy, Labour and the Historic Ambivalence of UK Company Law' (2016) *University of Cambridge Legal Studies Research Paper Series No 40/2016*; J Mukwiri, 'Myth of Shareholder Primacy in English Law' (2013) 24(2) *European Business Law Review* 217.

[70] Moore (2016) ibid at 18.

[71] FW Maitland 'Moral Personality and Legal Personality' (1905) 6 *Journal of the Society of Comparative Legislation* 192; H Laski, 'The Basis of Vicarious Liability' (1916) 26 *Yale LJ* 105 p 134; H Laski, 'The Personality of Associations' (1916) 29 *Harvard Law Review* 404. For discussion see R Harris, 'The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business' (2006) 63 *Wash. & Lee L. Rev.* 1421.

implication that the shareholders were no longer 'owners'. Indeed, whilst not being in favour of the emergence of 'semi-socialism', Keynes referred to these developments as 'natural tendencies' that were resulting in 'semi-autonomous corporations'.[72]

These rules and practices did not mean that the directors were entirely unresponsive to the shareholders.[73] It was common to include a shareholding 'qualification' for directors,[74] and there is evidence that directors paid dividends steadily to shareholders during this period.[75] Hidden reserves were commonly relied upon to allow regular and acceptable dividends to be paid, so that dispersed shareholders of large companies, who had little access to reliable accounting information, remained passive.[76] However, the practical effect of the law was that shareholders had little choice but to accept the directors and managers of the companies in which they held shares, and decisions were oriented to the interests of the organisation, and towards fairness to the various contributors to the corporate enterprise.[77]

Compared with the current position, it is striking that directors and managers were central and entrenched, whilst shareholders had become peripheral.[78] Entrenchment, consensual mergers, rules about shareholder instructions and the lack of judicial review of business

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[72] Keynes (1926) above n 39.
[73] Nichols (1969) above n 38 pp 78-9; P. Ireland, 'The Corporation and the New Aristocracy of Finance' in J-P Robé, A Lyon-Caen, S Vernac (eds), *Multinationals and the Constitutionalization of the World Power System* (Oxford: Routledge 2016) p 80.
[74] See FB Palmer, *Company law: a practical handbook for lawyers and business men* (London: Stevens, 1902) p 151. In 1906, the London Stock Exchange required listed companies to have a director shareholding qualification in their articles. Whilst no minimum level was specified, in practice it was set at a level representing 'a substantial proportion of an individual director's wealth': G Campbell and J Turner, 'Substitutes for Legal Protection: Corporate Governance and Dividends in Victorian Britain' (2011) 64 *Economic History Review* 571, 582-3. Mandatory rules in this area were rejected by the Greene Committee (see Report of the Company Law Amendment Committee (Cmnd 2657, 1926) para 53).
[75] Cheffins (2008) above n 7, p255.
[76] Ibid at 295
[77] Nichols (1969) above n 38, pp 53-4; Keynes (1926) above n 39.
[78] For a rare example in which a managing director with a ten year contract was ousted from his position by a holding company which had acquired all the shares in the company and altered the articles, allowing it to remove any director by notice, terminating his contract and giving him a right to damages: see *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701. For further discussion see McGaughey (2014) above n 47, pp 83-4.

decisions created board autonomy, and allowed for the emergence of professional management who – in the language of today's economics – could specialise their skills to those of the firm and make credible commitments to those they managed.

(b) The missing concept of the manager in company law

The last section shows that the autonomy of directors in relation to shareholders was established by law and practice. However, the law had less to say about professional managers, being content simply to leave them under the control of the directors, and never developing a positive conception of the managerial function. In company law, managers were simply viewed as employees,[79] with a limited duty of good faith implied into their contract of employment,[80] whilst in labour law they were treated as representatives of the employer.[81] The law allowed directors to delegate functions to managers, provided there was a power to do so in the articles, as there was by default,[82] and its scope increased over time. As discussed above, the practice evolved of the directors appointing one or more of their number as managing directors to act as the head of management, and the courts recognised the validity of these contractual arrangements.[83] Table A of 1906 caught up with this practice, giving companies power by default to 'from time to time appoint one or more of their body to the office of managing director or manager'.[84] Responsibility for the actions of the managing

[79] Quail comments that 'A sharp line was drawn between the directors (seen as partial owners representative of the owners as a whole) and managers (seen as employees). Firms were viewed as sets of operations carried out by employees but initiated and supervised by directors in a manner analogous to the separate roles of politicians and civil servants.' Quail (2002) above n 37, p 7.
[80] *Robb v Green* [1895] 2 Q.B. 315, 317.
[81] PL Davies and M Freedland, 'The Complexities of the Employing Enterprise' in G Davidov & B Langille (eds), *Boundaries and Frontiers of Labour Law* (Oxford: Hart, 2006) p 278.
[82] For example, Companies Act 1862, Table A, Art 68 allowed the directors to delegate to individual directors or committees, who would remain subject 'to any regulations that may be imposed on them by the directors', paving the way for a distinction in practice between executive and non-executive directors.
[83] See for example Scrutton J in *Nelson v James Nelson & Sons Limited* [1913] 2 KB 471 describing the power given to the directors to appoint a managing director as 'a very ordinary one in articles'.
[84] Companies Act 1906, Table A, Art 72; Companies Act 1929, Table A, Art 68.

director remained with him (as a fiduciary) and with the rest of the board, although the requirements of diligence on the other (non-managing) directors were not stringent.[85] The common thread running through all these changes was that the managing director or manager had to also be a director, and so a connection was maintained between the board and the management through the person of the managing director or manager.[86] Whilst there may have been considerable separation between directors and management in practice, it was viewed as essential for a representative of management to appear before the directors.[87]

Faced with these changes in practice, the courts had to identify the legal implications of appointing a managing director, gradually moving from viewing him as 'only an ordinary director entrusted with some special powers'[88] to treating him as both a manager and a director,[89] with his managerial functions determined by contract.[90] In *Horn v Henry Faulder & Co*,[91] the court moved beyond managing directors and considered the outer limits of what could be delegated to managers. It concluded that, on the grounds of ultra vires, neither the company nor the board could, under standard articles vesting management in the board, delegate to a manager on terms that he would have full power to conduct the business (with the exception of capital expenditures and litigation) of the department without interference from the directors. Hence directors had to retain a residual power to intervene, consistent with the current idea that the directors bear some residual responsibility, via their fiduciary and common law duties, for the acts of the person to whom power is delegated. Likewise, in

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[85] Directors would only be liable for 'gross' negligence, essentially a lack of good faith: *Lagunas Nitrate Company v Lagunas Syndicate* [1899] 2 Ch. 392 per Lindley LJ.
[86] In *Craven-Ellis v Canons Ltd* [1936] 2 K.B. 403 at 413-4, Greene LJ took the view that 'A managing director is in a very different position to that of a mere manager since he is able to attend and vote at meetings of the board, and from the point of view of the company it was of importance that the person managing its affairs should be in a position to do this.'
[87] See for example Burton (1899) above n 23, p 5, noting that sometimes the roles of managing director and manager were combined, and that it was essential for full reporting to the board to occur.
[88] *In re Newspaper Proprietary Syndicate Ltd* [1900] 2 Ch 349.
[89] *Southern Foundries (1926) Ltd v Shirlaw* [1940] A.C. 701; *Goodwin v Brewster* (1951) 32 TC 80.
[90] Per Lord Reid in *Harold Holdsworth & Co (Wakefield) Ltd v Caddies* [1955] 1 All ER 725, 738.
[91] (1908) 99 LT 524.

another case, the court ruled that, where management was delegated to a general manager, ‘the only duties which [the board] could delegate to the general manager are those which belong to the management of the ordinary commercial business of such a company.’[92] Hence there was a separation between the management function, which could be delegated by the board, and the control function, which could not. While these cases provided legal support for delegation of business decision-making and management to managers below board level, the management function was never positively defined.

By interpreting the default articles as making appointment of management a matter for the directors alone, the law created scope for the emergence of the managerially-led enterprise. As we have seen, there was no positive conception of the role of management, and managerial autonomy was achieved indirectly, through a combination of entrenched boards, bespoke articles, and the non-interventionist approach taken by the courts. There was no significant opposition to director and management control in the legal and management literatures of the first half of the twentieth century, but equally, managerial autonomy rested on weak legal foundations. This, then, was the context in which the Cohen Committee was appointed in 1943 to conduct a review of company law.

4. THE COHEN COMMITTEE AND THE COMPANIES ACT 1948

> ‘Finding the shareholder a passing investor, we have insisted that he is an owner and a member of an electorate. Finding managements to be hirers of capital, we have tried to bury this disquieting fact by calling them hired hands of the shareholder-owners. Finding "control" to have slid away from "ownership," we have sought to put the control back with the ownership where it "belongs." Pressed by the evident

[92] *In re County Palatine Loan and Discount Company. Cartmell’s Case* (1874) L.R. 9 Ch.App. 691, per Sir G. Mellish, L.J.

economic need for flexible centralized management, we have sought to decentralize decision-making and offer it to the multitude.'[93]

The report of the Cohen Committee sought to put control of companies back into the hands of shareholders, paying no regard to the emergence of professional management described in sections 2 and 3 above. It recommended a number of regulatory interventions into the internal governance of companies in order to achieve this goal, including, most importantly, a mandatory right for the shareholders to remove the directors by simple majority. Its recommendations were implemented in the Companies Act of 1947, which was consolidated into the Companies Act 1948.[94] These legal changes, along with the growth of institutional shareholders in the post war period,[95] radically reoriented the UK's system of corporate governance in the second half of the twentieth century. Together, they created the conditions for the emergence of the hostile takeover, which undermined the fragile autonomy of managers and sidelined the balancing approach.

Driven by concerns about the quality of financial reporting following the financial crash of 1929, as well as other corporate scandals,[96] the Cohen Committee was asked to consider amendments to company law, focusing on 'the safeguards afforded for investors and for the public interest.'[97] Bircher notes that the decision to set up the Cohen Committee was motivated by a perceived need for 'greater publicity… and… better safeguards for investors and shareholders' and the 'growing claim that the interests of the community, as distinct from

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[93] B. Manning, 'The American Stockholder' (1958) 67 *The Yale Law Journal* 1477, 1490.
[94] *Report of the Committee on Company Law Amendment* (Cm 6659, 1945) (Cohen Report).
[95] Cheffins (2008) above n 7, pp 344-5, noting that by 1969, retail investors no longer owned a majority of the shares of UK public companies. High tax rates encouraged individuals to sell their shares and invest in other, more tax-efficient assets, including pensions and life insurance: see ibid, pp 81-2 and 341-9.
[96] P Bircher, *From the Companies Act of 1929 to the Companies Act of 1948: A Study of Change in the Law and Practice of Accounting* (Oxford: Routledge, 1991) pp 80-90; J Maltby, 'Was the Companies Act 1947 A Response to a National Crisis?' (2000) 5 *Accounting History* 31, 38 and 47
[97] Cohen Report (1945) above n 93, p 7.

those of the shareholders, should have more recognition in the formation and conduct of a corporation'.[98]

Both investor protection and public interest concerns could be met, at least in part, through reform of disclosure and accounting.[99] The Cohen Committee modernised financial accounting. It proposed that companies should be required to disclose an audited balance sheet which gives 'a true and fair view of the state of affairs of the company', and a profit and loss account, drawn up on the basis of defined accounting standards,[100] whilst parent companies should produce consolidated accounts for the group as a whole.[101] The Committee recommended prohibition of the practice of creating secret reserves, which directors used to smooth dividend payments and keep shareholders happy, in particular because it distorted the pricing of shares.[102] The Committee confidently rejected claims that 'if fully informed, shareholders would press for excessive dividends'.[103]

Beyond enhancing accounting requirements, however, the Cohen Committee gave almost no attention to other ways in which company law might protect the public interest as distinct from the interests of shareholders.[104] Nor was the position of professional management

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[98] P. Bircher, 'Company Law Reform and the Board of Trade, 1929–1943' (1988) 18 *Accounting and Business Research* 107 at 116-7. References to the community and public interests in the mandate were considerably 'watered down': B. Clift, 'The Labour Movement and Company Law Reform 1918-1945' (1999) *Sheffield Political Economy Research Centre Research Paper No.1* pp 34-7.

[99] The Cohen Report (1945) above n 93, para 5, stated that its proposals for information disclosure would 'ensure that as much information as is reasonably required shall be made available both to the shareholders and creditors of the companies concerned and to the general public.'

[100] ibid, paras 96 and 103.

[101] ibid, para 119. This recommendation was specifically targeted at protecting shareholders, who were lacking 'information as to the financial position and results of the undertakings in which they are interested.'

[102] ibid, para 101. This was a particularly controversial topic, and much time was spent discussing it.

[103] Ibid.

[104] It did propose giving the courts power to require, and making it easier for shareholders to demand, a Board of Trade investigation into the management of the company where this was 'in the public interest'. (Cohen Report (1945) above n 93, para 156) However, there was no proposal to allow any group other than the shareholders to demand an investigation, and discussions about the introduction of public shareholders (see for example, *Minutes of evidence (1943-44)* above n 43, Appendix M at 169) or company commissioners (see for example ibid, para 8134) during the hearings made no impact on the final report.

within companies ever discussed during the Committee's hearings, and it was rarely raised in any of the memoranda that it considered. Instead, influential members of the committee simply proceeded on the a priori basis that re-establishing shareholder control over directors was fundamental. During the Committee's hearings, Mr Justice Cohen commented that 'The view upon which company law is based, I think, is that the shareholders elect the directors to conduct their business' and that directors' remuneration comes out of the shareholders' money.[105] Similarly, Professor Goodhart stated that 'the most important point in company law' is 'the question of shareholders' control'.[106] Other members assumed that the shareholders were the 'proprietors' of the business, leading them to assume that control should be reconnected to ownership in order to ensure efficient use of corporate resources.[107] Finally, the trade unions, which might have pushed for changes in a more pluralist direction, had little meaningful input into the work of the Committee. Their representative frequently failed to attend meetings;[108] their memorandum and representations focussed on the role of disclosure in assisting with wage negotiations;[109] and they did not make any submissions on more fundamental questions of internal control or worker representation, perhaps because these ran contrary to their adversarial approach to industrial relations.

Given these assumptions, and in the absence of any articulation of the argument for protecting the wider public through company law, the Committee focused from its first questionnaire on whether reforms were 'necessary to safeguard the interests of shareholders or minorities of shareholders'.[110] Its final report sought 'means of making it easier for

[105] *Minutes of evidence (1943-44)* above n 43, para 7038
[106] ibid, para 9479
[107] See for example Mr Wilmot's description of shareholders as 'proprietors of the business' (ibid, para 1743) and his reference to the 'original conception of control of the company by its proprietors' (ibid, para 3682).
[108] Clift (1991) above n 97, p 44.
[109] See Memorandum by the General Federation of Trade Unions, *Minutes of evidence (1943-44)* above n 43, Appendix SS, and, for example, ibid, para 11274.
[110] Company Law Amendment, Draft Questionnaire for Discussion, Cohen Committee Archive, CL3, BT 146/5

shareholders to exercise a more effective general control over the management of *their* companies'.[111] The justification for this was the 'illusory nature of the control theoretically exercised by shareholders over directors' which 'has been accentuated by the dispersion of capital'.[112] While the Committee recognised that 'Executive power must inevitably be vested in the directors and is generally used to the advantage of the shareholders',[113] it concluded that it was 'desirable to give shareholders greater powers to remove directors with whom they are dissatisfied, than they have at present'.[114]

The Committee therefore recommended a number of changes which sought to empower the shareholders as a means of countering the separation of 'ownership' and control. First, it addressed shareholder meetings, which were viewed as a crucial means of control by shareholders over directors,[115] proposing mandatory minimum notice periods which would override the company's articles.[116] Second, the Committee recommended the introduction of mandatory rules relating to proxies which would override the articles and reduce the likelihood of the directors controlling all the proxies.[117] Third, the Committee sought to make it easier for shareholders to propose resolutions at the general meeting,[118] recommending that 100 members holding on average not less than £100 of paid up capital per member, or a member or members holding not less than 5 per cent of the voting shares, should be entitled

[111] Cohen Report (1945) above n 93, para 5, emphasis added
[112] Ibid, para 7. The Committee's figures showed that, in a sample of large companies, 87.7% of the shareholders owned less than 300 shares (ibid, para 124).
[113] Ibid, para 124.
[114] Ibid, para 130.
[115] Ibid, para 125.
[116] Ibid, para 126, implemented by s133 CA 1948.
[117] Ibid, paras 132-4, implemented by s136 CA 1948.
[118] Under Companies Act 1929, s114, shareholders owning not less than one tenth of paid up capital carrying the right to vote were allowed to requisition an extraordinary general meeting, and the requisition had to state objects of meeting. Directors had to comply within 21 days, failing which the requisitionists could convene it themselves, with the company repaying their costs. This allowed shareholders to propose resolutions, including special resolutions. However, the Committee concluded that this power had become 'largely illusory because with the great increase in the number of shareholders it has become difficult for any single shareholder, or even for a group of shareholders, to seek the support of their fellow members': see Cohen Report (1945) above n 93, para 128.

to require the company to send out, albeit at the shareholders' expense, any proposed resolution or statement.[119]

However, the most important recommendation was that 'there should be a provision, overriding anything to the contrary in the articles of a company, that any director, whether under a service contract or not, should be removable by an ordinary resolution, without prejudice to any contractual right for compensation.'[120] Whilst the Committee was aware that the default articles and contemporary practice made it very difficult for the shareholders to remove the directors, there is virtually no discussion of this fundamental change in the minutes of the evidence given to the committee. In its memorandum, the London Stock Exchange recommended that the Companies Act should follow the Stock Exchange Listing Rules and give the general meeting 'power by Extraordinary Resolution to remove any Director (including Life Directors or Managing Director with long-term contracts) before the expiration of his period of his office'.[121] Cohen simply responded that 'the company should have that power undoubtedly'.[122] There is no other discussion in the reported proceedings of the shareholders removing the directors by simple majority. An examination of the Cohen Committee archive reveals that a solicitor called Stephen Gordon suggested at an early stage that

> 'Managements in this country, at all events have a very strong sense of service to the entity which they manage and they tend to put the Company before the shareholders. The interests are not necessarily identical… It is worth considering whether it is not possible to bring the shareholders into closer relation with the Company's affairs, and

[119] Cohen Report (1945) above n 93, para 128, implemented by s140 CA 1948 with slight changes to the time periods.
[120] Ibid, para 130
[121] See *Minutes of evidence (1943-44)* above n 43, Appendix X at 350.
[122] Ibid, para 6038.

> the following suggestions are made…Shareholders should be entitled, subject to any contract, to remove any Director by a bare majority (on a poll).'[123]

This suggestion does not appear to have made an immediate impact on the Committee.[124] Instead, it was resurrected at a relatively late stage of the Committee's proceedings. The Association of British Chambers of Commerce opposed any 'general alteration of the existing rights of shareholders, since shareholders could ascertain their rights at the time when they subscribed or bought their shares'. A number of their suggestions intended to prevent abuses of majority control[125] were included in a memorandum summarising principal suggestions made to the Committee,[126] and in a memorandum for consideration at meetings in early August 1944, which referred to a suggestion that 'all directors should be subject to annual re-election'.[127] It is unclear where the suggestion of annual re-election of directors came from, as it is not marked as a new suggestion, and there is no mention of it in any intervening memoranda. There was no mention at this stage of Stephen Gordon's suggestion. In the event, at its 32nd meeting, the Committee agreed that 'all directors should be subject to annual re-election… except as regards directors under service contracts which stipulated that they must remain directors as long as their service contracts remained in force'.[128] The minutes of the next meeting record the abandonment of annual re-election, and an agreement 'to recommend instead that shareholders should be given the power to remove directors, including directors under service contracts, by ordinary resolution.'[129] The provision then remained in all further drafts of the report, supplemented by an annotation to the second

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[123] Cohen Committee Archive, CL 11A BT 146/5 (submission of by Stephen Gordon of Lawrence, Messer and Co).
[124] Unfortunately, the minutes of the first thirteen meetings of the Committee, BT 146/3 are missing from the National Archives.
[125] Cohen Committee Archive, CL 72, BT 146/5
[126] Ibid, CL 102
[127] Ibid, CL 142 (memorandum circulated for consideration at meetings to be held on Tuesday 1st August and Wednesday August 2nd, dated 14th July 1944, para 11(6)).
[128] Ibid, BT 146/4 (Minutes of 32nd meeting 6/9/44).
[129] Ibid, (Minutes of 33rd meeting 19/9/44, para 1).

draft report by Cohen himself that this would be 'without prejudice to any contractual right for compensation' and making an exception for a permanent director of a private company appointed before the Act came into force on the basis that 'this right arose in substance as an agreed matter of contract'.[130]

Apart from the statement in the final report that shareholders should have greater powers to remove directors, there is nothing in the Minutes of Evidence or the archive to shed light on how the Committee thought this rule would impact on the governance and management of companies. It is clear that the Committee was concerned about the impact of mergers and amalgamations on shareholders. As noted in section 3(a) above, before 1945, mergers tended to proceed consensually. The proposer negotiated with the incumbent directors to reach a settlement for their loss of office, in the form of either a seat on the board of the merged company or a compensation payment. In the case of a seat on the merged board, this was often a long-term appointment to allow the director 'to retain some control',[131] whilst payments for giving up directorships could amount to a considerable sum,[132] which the Cohen Committee viewed as a diversion of part of the purchase price of the business from the shareholders to the directors.[133] The Committee therefore recommended that these payments should be approved by the shareholders in general meeting, failing which the director would be obliged to distribute the funds to the shareholders.[134]

[130] Ibid, CL187C [B], BT 146/11.
[131] *Minutes of evidence (1943-44)* above n 43, paragraph 10190 (Evidence of Samuel Cash, partner in Vizards)
[132] Hannah notes that this could amount to as much as one tenth of the purchase price: L Hannah, 'Takeover Bids in Britain Before 1950: An Exercise in Business "Pre-History"' (1974) 16 *Business History* 65, 72.
[133] Cohen Report (1945) above n 93, para 92.
[134] Ibid. Ultimately s193 CA 1948 introduced a rule requiring directors to disclose to, and obtain approval from, the general meeting for any payment made to them 'by way of compensation for loss of office, or as consideration for or in connection with his retirement from office'. Failure to comply would result in the director holding the payment on trust for shareholders who sold their shares.

More generally, the Committee was clearly concerned that it was very difficult to remove long-term or life directors who were no longer competent, but who had entrenched themselves through provisions in the articles, either upon foundation or during an amalgamation process,[135] an area in which Cohen had practised.[136] The recommendation to make all directors removable by ordinary resolution certainly made it futile for directors to negotiate long-term seats on the board following a merger. However, the decision to give the shareholders such a strong power to remove the directors went far beyond what was required to counter the problems of incompetence and value extraction during amalgamations, and beyond what even the Stock Exchange considered was required to give adequate protection to shareholders. Whilst the Committee probably did not intend to facilitate changes in the control of companies or hostile takeovers, its repeated expressions of concern for the position of small shareholders, focus on the importance of the share price and emphasis on the importance of shareholder control strongly suggests that it intended to bring about a wider shift in power from directors to shareholders.[137] At no point did the Committee ever discuss the impact of this regulatory change on the professional managers who were increasingly dominating operational decision-making within companies.

Nor did the provision implementing the recommendation generate significant controversy in Parliament. In the second reading of the Companies Bill in the House of Lords, Sir Richard Stafford Cripps, President of the Board of Trade and a Labour politician stated that it was a 'large and rather complicated-looking piece of legislation' which was 'non-contentious…

[135] See for example the observation of Professor Goodhart that 'it is possible… for directors to continue in office longer than may be desirable' (*Minutes of evidence (1943-44)* above n 43, paras 5257 and 9481). Cohen pointed out that removal of life directors would require at the very least an extraordinary resolution (ibid, para 5148). See also the representations from the London Stock Exchange (ibid, para 6185) and Cohen Committee Archive, CL108A, BT 146/5.

[136] *Minutes of evidence (1943-44)* above n 43, para 10194.

[137] As Horace Samuel, who gave evidence to the Committee but did not discuss removal of directors, put it in his 1933 book, 'Directorates thus tend to constitute the vested interest of a group, and being a vested interest, are almost as difficult to dislodge as the pocket-boroughs of the eighteenth century.' H Samuel, *Shareholders' Money* (London: Pitman, 1933) p 120.

certainly from the party point of view.' He emphasised that amendment was 'urgently necessary' because 'the relationship between management and ownership in limited liability companies has tended progressively to be more and more shadowy'.[138] He emphasised the role of the accounting reforms in assisting shareholders to understand their position, and a number of other measures enabling 'shareholders to play a real part as owners', although he did not refer to the mandatory power of removal.[139] In debates, one speaker appears to have confused ordinary and extraordinary resolutions,[140] whilst another erroneously thought that the 1929 Act provided for removal by extraordinary resolution.[141] There was some concern that minorities might use the power to 'interfere too much with the proper conduct of the companies' business by threatening arbitrary resolutions', [142] but the most vehement opposition came from Viscount Maugham, who argued that this was a change 'of a most revolutionary kind, and that its effect would be likely to cause a great deal, of harm in the ordinary day-to-day work of companies.'[143] However, his main concern was the 'obloquy' which would be suffered by a director who was proposed to be removed, whereas 'the whole point about the three-quarters majority is that so large a majority as that will never be obtained unless there is some real reason for the removal of a director.'[144] He also questioned the logic of overruling companies' articles rather than allowing a company 'to make up its own mind on the subject',[145] and noting the Law Society's opposition to the amendment on the basis that it would 'have a most injurious effect on the shareholders who form a minority.'[146] In the end, the recommendation was embodied in s184 CA 1948, with a longer notice period

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[138] *Hansard*, HC Deb, vol 438, col 585-6, 6 June 1947.
[139] ibid, col 588.
[140] ibid, col 642 (Eric Fletcher, MP)
[141] *Hansard*, HL Deb, vol 146, col 969, 1 April 1947 (Viscount Maugham)
[142] *Hansard*, HC Deb, vol 438, col 619, 6 June 1947 (Sir Hugh Lucas-Tooth, MP)
[143] *Hansard*, HL Deb, vol 145, col 862, 24 February 1947
[144] Ibid, col 872
[145] Ibid col 863
[146] Ibid col 865

of 28 days to ensure that there was 'no snap question about this' and an opportunity for the director to make representations.[147]

It is perhaps surprising that this rule was introduced by a Labour government. Maltby explains that Labour was committed to 'the creation of a new institutional framework to increase social control rather than investors' control of companies' and, being focused on nationalisation of quasi-monopolies, did not engage with the process of companies legislation.[148] In addition, the development of the welfare state may have prevented the Labour Party from worrying about the social implications of changes in shareholder rights and, subsequently, the emergence of the hostile takeover.[149]

Perhaps because it was included in a couple of lines buried in the middle of paragraph 130, entitled 'Election of Directors', the proposal was barely noted in contemporary academic commentary. Kahn-Freund, for example, saw the 'divorce between financial interest and power of management' as 'a fact… which is inherent in the technical and organization evolution of capitalist society' against which an Act of Parliament was 'useless'.[150] Dodd's review of the Report did not even refer to it,[151] whilst a 1951 analysis simply noted that 'the report is conservative' and that the Committee 'refrained from recommending fundamental alterations of the law'.[152] Gower wrote approvingly of the change in 1956 in dealing with one

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[147] *Hansard*, HL Deb, vol 146, col 727-8, 25 March 1947; HC Deb, vol 441, col 194-5, 28 July 1947; HL Deb, vol 151 col 955-75, 5 August 1947.

[148] Maltby (2000) above n 95, pp 47 and 54.

[149] As Bruner puts it, 'stronger social welfare protection… permitted the UK corporate governance system to focus more intently on shareholders without precipitating social backlash' (C Bruner, *Corporate Governance in the Common Law World* (Cambridge: CUP, 2013) p 143). For detailed discussion of the Labour Party's evolving approach to takeovers and mergers during the 1960s and 1970s, see ibid at 151-60. It was only during the 1980s, with the rolling back of many of those reforms, as well as the weakening of trade unions, that those social consequences became clearer. We are grateful to an anonymous referee for suggesting this point.

[150] O Kahn-Freund, 'Company Law Reform: A Review of The Report of The Committee on Company Law Amendment' (1946) 9 *Modern Law Review* 235, 245

[151] EM Dodd, 'Review: Report of the Committee on Company Law Amendment' (1945) 58 *Harvard Law Review* 1258

[152] AB Levy, *Private Corporations and Their Control Vol I* (Oxford: Routledge and Kegan Paul, 1950) p 167.

of the 'vital corporate problems of the century', that is, 'the control of stockholders over management', and contrasting it favourably with the position in many US states.[153] However, like the Committee, none of these commentators appears to have anticipated the full implications of this change.

This provision, which represented a deliberate policy decision to interfere in contractual allocations of rights, transformed the balance of power within companies. It gave the majority in general meeting full control of the composition of the board for the first time, and so shifted ultimate control of the direction of the company from the board (and, often, the management) to the general meeting, which came to be viewed as the ultimate controller of the company's assets because of its power to 'hire and fire' the directors.[154] It strengthened the position of those who argued that the board of directors was the representative of the shareholders, and weakened advocates of the real entity approach, who emphasised the company as a separate legal entity, and its long-term interests as the touchstone for good management.[155]

However, its most important effect was that it contributed to the emergence of the hostile takeover, because it allowed outsiders, for the first time, to make offers 'over the heads of the Boards concerned',[156] with a considerable degree of confidence that they would be successful and certain that, having acquired control of the general meeting, they would be able to replace the directors (and with them, the senior management). From the 1950s

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[153] LCB Gower, 'Some Contrasts Between British and American Corporation Law' (1956) 69 *Harvard Law Review* 1369, 1381, 1389-90 and 1396. However, he did not explicitly link the emergence of takeovers to s184 CA 1948. As Bruner (2013, above n 148, p 148) notes, Cohen himself, in a 1957 lecture, appears to have recognised that his committee's reforms 'contributed to the rise of hostile takeovers', although he did not explicitly refer to the contribution of the removal power.

[154] LCB Gower, 'Corporate Control: the Battle for the Berkeley' (1955) *Harvard Law Review* 1176, 1185-6.

[155] However, this approach to management appears to have persisted among those managers in a Northern City interviewed by Nichols in 1961-2: see Nichols (1969) above n 38, Chapter 17.

[156] This was the Bank of England's working definition of a takeover from 1959, included in 'Take-over Bids, Note of meeting at Bank of England on Friday 10 July 1959', cited in R Roberts, 'Regulatory Responses to the Market for Corporate Control in Britain in the 1950s' (1992) 34 *Business History* 183, 184.

onwards, the argument that management should balance competing interests at stake in the company was rarely heard, as the focus shifted to prioritising the interests of shareholders.

5. THE EMERGENCE OF THE HOSTILE TAKEOVER IN THE 1950s

In the early 1950s, shortly after the implementation of the Cohen Committee's reforms, the first wave of hostile takeovers struck British companies.[157] Indeed, between 1948 and 1961, 25 per cent of companies quoted on the London Stock Exchange were taken over by other quoted companies.[158] However, the takeover did not just operate as a viable alternative to the consensual merger after 1948. It also operated as a transaction aimed at gaining a purely financial advantage for the bidder. Although some takeovers were carried out for industrial reasons, many takeovers during the 1950s and 1960s were financially motivated, as bidders sought to gain control of companies and remove the board in order to access reserves, liquidate undervalued assets or gain tax advantages. It is no exaggeration to state that the Companies Act 1948 ushered in the modern era of financialised, shareholder value corporate governance.

What effect did the Companies Act 1948 have? Before its introduction, there were significant obstacles to takeover bids which bypassed the board of directors and were addressed directly to the shareholders. The bidder had to offer a very high price so that the directors could not say that the bid was inadequate. Shareholders, who had little reliable information about the company's financial position, tended to follow the recommendation of the directors as to whether to accept a bid from an outsider.[159] More significantly, there was a fundamental

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[157] Charles Clore launched the first hostile takeover bids in 1953 for the Savoy Hotel and Sears: see D Chambers, 'The City and the Corporate Economy since 1970' in R Floud, J Humphries and P Johnson (eds), *The Cambridge Economic History of Modern Britain, Volume 2* (Cambridge: CUP, 2014) p 267.
[158] Hannah (1974) above n 131, p 67.
[159] See JB Tabb, *Accountancy Aspects of the Takeover Bids in Britain 1945-1965* (Unpublished PhD Thesis, University of Sheffield, 1968) p 10; Hannah (1974) above n 131, p 71

asymmetry between incumbent directors, who only had to control – directly or through other supportive shareholders – 25% of the shares in order to prevent a bid which would make changes of which they did not approve, and bidders, who had to acquire 75% of the shares to take control of the general meeting and change the board. As a result, consensual mergers were the norm, and hostile takeovers were virtually unheard of. Where they did occur, they were motivated by an industrial, and generally anticompetitive, logic.[160]

Before 1948, it would technically have been possible for a takeover bidder who had merely acquired a majority of the shares to gain control of the board by refusing to re-elect the incumbents during two rounds of annual retirements.[161] This, however, would have been unacceptable to a hypothetical bidder, as the incumbents would remain in control of the company's decision-making during that period, potentially taking decisions adverse to the interests of the new controlling shareholder, and any challenge would require long, expensive and uncertain litigation. Any bidder relying on leverage would have faced even greater difficulty. Whilst directors might have stood down 'voluntarily' in the event of a change of control of the general meeting, there is simply no evidence of this type of change of control occurring before 1948. Instead, changes of control tended to result in directors retaining their positions,[162] or being paid to give up their positions, an issue about which the Cohen Committee expressed concern.[163] Similarly, a new controlling shareholder might have relied on the articles, which provided a default power for the general meeting to increase the number of directors by ordinary resolution, to appoint a number of new directors to take control of the board.[164] However, bespoke provisions would normally have made this fruitless.

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[160] See Tabb (1968) above n 158, p 11. In 1906, Lever exceptionally launched hostile bids for a number of his competitors who had refused to form a cartel with him, and another hostile bid was launched by John Knight Ltd in 1920.
[161] In Guinnane et al's 1892 sample only one company required all directors to stand for re-election at each annual meeting: see Guinnane et al (2017) above n 57, p 243.
[162] Franks et al (2005), above n 55.
[163] Cohen Report (1945) above n 93, para 92.
[164] See e.g. Companies Act 1929, Table A, Art 77; Companies Act 1906, Table A, Art 83; Companies Act 1862, Table A, Art 63.

For example, many companies provided for the appointment of a managing director who did not have to stand for re-election by rotation, either for a fixed term or indefinitely.[165] The courts enforced articles giving broad powers to managing directors, even where this effectively gave them a veto over board decisions, and so increasing the size of the board in accordance with the articles would not have allowed a new majority controller to take control of management from a managing director without altering the articles (which would have required 75%).[166] Hence, being appointed as a managing director would allow a director to 'perpetuate their power indefinitely',[167] and the courts were content to allow this to happen in the name of managerial continuity.[168]

Proxy contests akin to those by which transfers of corporate control occur in Delaware never emerged in the UK either, [169] probably because this approach would have entailed considerable risk for the would-be controller. First, before 1948, the directors tended to control all the proxies, with shareholders very passive, making any attempt to identify and lobby the shareholders at the very least time-consuming and expensive, and perhaps even impossible, given widespread use of nominees and no requirement to disclose beneficial ownership. Second, any attempt to remove directors entrenched by the articles would have required a 75% majority, and would potentially have resulted in litigation. The inevitable delay and uncertainty surrounding any attempt to take control of the board, as well as the cost and

[165] Guinnane et al (2017) above n 57, p 244. Similarly, many companies provided that anyone seeking the office of director, except retiring directors or those chosen by the board, had to provide advance notice, potentially giving the directors 'time to line up the votes to block anyone whom they did not favour from securing a seat on the board': see ibid.

[166] Clauses in the articles requiring consent of managing directors to particular decisions were enforced at the instance of a shareholder-director in *Quin & Axtens, Ltd v Salmon* [1909] AC 442. This effectively limited the powers of the board, because as Lord Loreburn put it, 'the directors cannot manage it in a particular way – that is to say, they cannot do certain things if Mr. Salmon or Mr. Axtens objects' (ibid, 443).

[167] Guinnane et al (2017) above n 57, p 244.

[168] In the Court of Appeal decision in *Quin & Axtens*, Farwell LJ considered the provision in the articles to be 'a most usual and proper requirement, because a business does require a head to look after it, and a head that shall not be interfered with unnecessarily'. The effect was that 'to oust the directors, a special resolution would be required': see [1909] 1 Ch 311, 319.

[169] For discussion, see Bruner (2013) above n 148, pp 39-40 and 208-9.

uncertainty of litigation to challenge managerial decisions taken in the interim, would have been sufficient to deter most would-be bidders. Even if banks had been willing to lend, this would, in most cases, have ruled out using borrowed money to fund the acquisition of shares.

By levelling the playing field between incumbents and outsiders, the 1948 changes radically altered the prospects of hostile takeovers, making it much more difficult for company directors to resist, and opened up a wider range of companies to hostile takeover. In the period from 1948 until the introduction of the City Code in 1968, the ability to take control of a company by obtaining a simple majority of the shares was a fundamental driver of the emergence of the hostile takeover. Whilst shareholders generally may have been dispersing, Hannah's research in relation to listed companies, noted above, shows that directors and other founders normally controlled around one third of the shares, with the directors themselves often controlling around 25%.[170] This, of course, was sufficient to maintain control under the default – and normally adopted – rules of Table A. Once the law was changed, the incumbents had to win around sufficient additional shareholders to create an absolute majority. The new institutional shareholders, presented with the prospect of a capital gain, would be unlikely to side with the incumbents. Effectively, contests for corporate control became a race to 50%.

Bidders could build up significant shareholdings through on-market acquisitions via a nominee, and it was very difficult for the directors to find out about this.[171] In a number of cases, bidders built up positions of 20-25%, giving them a significant chance of acquiring a majority of the shares when they eventually launched a bid.[172] Bidders could also use various coercive tactics

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[170] Hannah (2007) above n 8.

[171] ss95 and 98 CA 1929 required companies to maintain and make public a register of members. However, s101 provided that trusts of shares did not have to be entered on the register, making it difficult to identify beneficial ownership. The Cohen Committee made proposals to require nominee shareholdings to be indicated and beneficial interests of more than 1% to be disclosed (above n 93, paras 78 to 81), but these recommendations did not become law.

[172] As in the bids by Daily Mirror for Amalgamated Press in 1958 and Viyella International for Jersey Kapwood in 1966: see Tabb (1968) above n 158, p 191.

to put pressure on shareholders to tender. These included making partial bids or bids for limited quantities of shares,[173] offering bonuses for early acceptance,[174] and declaring offers unconditional without disclosing the number of acceptances.[175] These tactics played on the fear of shareholders that if they did not tender, they would be locked in as minority shareholders, vulnerable to opportunistic value extraction by the new controllers,[176] or forced to accept a lower price for their shares when they eventually sold. Bidders amplified those fears by threatening to implement a 'conservative' or 'prudent' dividend policy once they acquired control,[177] whilst media reports of successful bidders reducing the dividend following acquisition served as a further warning to shareholders who were considering not tendering their shares.[178]

The emergence of these practices presented incumbent directors, who normally had a large amount of personal wealth tied up in shares, with a dilemma, as the advent of a hostile bid threatened to turn them into minority shareholders, and also created a significant risk that they would be removed from their positions as directors (otherwise the bid would not have been hostile).[179] They knew that, if the bid was successful and they had refused to tender,

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[173] ibid, at 188, identifying at least 13 partial bids between 1948 and 1965. For example, in its bid for Drake & Mount, Longman only offered to buy the first 10,000 shares tendered. There was no regulation of partial bids until the introduction of the City Code in 1968.

[174] As in the bid of Westminster Bank for Diners' Club Ltd in 1965: see ibid at 189

[175] As in the 1961 bid by City Centre Properties Ltd for Manchester Royal Exchange: see ibid at 192. The Revised Notes of 1963 required the bidder to disclose the level of acceptances, but this rule was subsequently broken by British Oxygen which declared its bid for Murex unconditional but delayed disclosure of the level of acceptances by six hours: ibid at 262.

[176] Bull and Vice show how, provided they acted in good faith, a majority shareholder could then use their control to withdraw surplus cash from the company by selling assets to it: G Bull & A Vice, *Bid for Power* (London, Elek, 3rd ed, 1961) p 227. The shareholder's 'sell out' right was not introduced until 1986.

[177] See for example the bid by Broadmead for Murdoch & Co in 1957 or the 1958 bid by Reynolds for British Aluminium, in which Reynolds warned shareholders publicly that it was close to gaining control, and that once it had control of the company, it would instate a 'prudent' dividend policy (Tabb (1968) above n 158, p 60).

[178] In 1963, Courtaulds took control of Bairns-Wear Ltd and cut the dividend from 10% to 5%: see ibid at 246.

[179] From a sample of forty-five takeovers between 1947 and 1960 (which did not distinguish between voluntary and involuntary takeovers), Singh found that 'around half' of the directors of the acquired company were dismissed within two years of the takeover, but that 'the incidence of dismissal seems on the whole to have little relationship either to the size or the profitability of the acquired firm'. A.

they would be forced to accept whatever price the new controller offered them, or to remain as a potentially oppressed minority shareholder.[180] Beyond this, incumbents who were not willing to sell their shares had three courses of action open to them, none of them simple. They could try and take defensive measures,[181] but these were circumscribed, first, to a considerable degree, by the courts and, later, completely, by the City Code on Takeovers.[182] Second, they could try to persuade the shareholders not to sell their shares by increasing the dividend, which increased the share price, but reduced the funds available for reinvestment in the business, and therefore also managerial autonomy, or by taking actions similar to that

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Singh, *Takeovers: their Relevance to the Stock Market and the Theory of the Firm* (Cambridge: CUP, 1971) p 149. These figures form a marked contrast to the findings of Franks et al (2005, above n 55) in relation to takeovers between 1919 and 1939.We are unaware of any quantitative study of director removal during the UK 1960s takeover wave, but indirect support for the development of a new threat to the position of directors and management can be found in the growth of structural defensive measures between 1950 and 1965, a dynamic which came to an end as institutional investors mounted opposition to this (ibid p 603, Table 10.8), as well as the post-bid defensive measures in companies such as the Savoy Hotel, and those which came before the courts in *Hogg v Cramphorn Ltd* [1967] Ch 254. By the 1980s, board removal appears to have been routine following a hostile takeover: in a study of hostile takeovers in the UK from 1985-6, Franks and Mayer found that 90 percent of directors were replaced within two years of the bid, whilst for accepted bids the figure was 50 percent: J Franks and C Mayer, 'Hostile Takeovers and the Correction of Managerial Failure' (1996) 40 *Journal of Financial Economics* 163, 167-8.

[180] This appears to have happened for the first time in the takeover by Fraser of Binns in 1953. The directors held 29% of the shares, preventing Fraser from using the squeeze out rules (s209 CA 1948 required the bidder to have acquired 90% of the shares), but they capitulated once Fraser acquired a majority of the shares, and sold their shares to him at the lower price of his first bid: see Bull and Vice (1961) above n 175, pp 109-110.

[181] The directors of the Savoy Hotel Ltd appear to have been the first to have tried this: see ibid, pp 29-46.

[182] For discussion of the scope of defensive measures under common law and under the City Code, see A Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 *Cambridge Law Journal* 422. One further possibility was to give the directors weighted voting rights on a resolution to remove them, as permitted by the case of *Bushell v Faith* (1970) 1 All ER 53. However, there is no evidence that this mechanism was used in the UK as a pre-emptive defence against hostile takeovers. If adopted on incorporation, this would reflect the agreement between the founders (and indeed such clauses are widely understood as a means of protecting agreements within quasi-partnership companies), but it would be difficult to introduce such a clause after listing, as this would require a special resolution to alter the articles, and institutional shareholders would be strongly opposed to a measure that would entrench board members. This hostility can be seen from their opposition to the use of non-voting shares, which were used for a brief period as a defensive measure during the 1950s and 1960s, but were gradually eliminated by strong opposition from institutional investors and disapproval from the stock exchange (Franks et al (2005) above n 55, p 604). This hostility presumably explains why multiple voting rights are legally permissible but rarely seen in practice in UK listed companies (see J Armour, S Deakin, V Mollica and M Siems, 'Law and Financial Development: What we are Learning from Time-Series Evidence' (2009) 6 *BYU L Review* 1435, 1459 fn 87, noting that there was 'no legal or regulatory prohibition of multiple voting rights' between 1970 and 2005).

of a bidder, such as selling off the company's freeholds to an insurance company and leasing them back.[183] Third, they could launch their own bid for control of the majority of the shares if they had, or could obtain, sufficient funds,[184] or they could persuade a friendlier company (which might let them retain their place on the board) to bid for the company. Fourth, they could 'render themselves irremovable without their own consent' by issuing non-voting shares, a practice which was 'designed to frustrate takeovers', and, by 1962, had recently 'become a major issue'.[185] As directors focused on the threat of takeover and increasing the share price, the idea that the role of management was to balance competing interests and to foster innovation largely disappeared from public debate after 1948.

Beyond s184, a number of other drivers of the emergence of the hostile takeover in the early 1950s have been identified. Hannah's 'tentative explanation' for the failure of the hostile bid to emerge sooner was the poor quality of accounting information before 1948, and it was only following the accounting reforms that bidders could gain access to reliable accounting information without the cooperation of the target.[186] Those changes also made shareholders less dependent on the advice given to them by the directors, who had less of an informational advantage than previously.[187] Taxation played a role too, with company directors, in the face of rising taxes on profits, dramatically reducing distributions to shareholders in order to 'maintain an adequate flow of funds for their businesses', depressing share prices and making companies with large quantities of liquid assets more attractive to bidders. At the same time, bids were attractive to shareholders because, by selling their shares, they could obtain a tax-

[183] In 1960, British Drug Houses responded to a bid by doubling its dividend, whilst in 1962, Waterlow & Sons Ltd responded by selling off its head office and distributing the proceeds to shareholders: see Tabb (1968) above n 158, pp 61-2.
[184] The first example of this appears to be the contested takeover in 1955 of Millspaugh by Hadfields. The rival bidder was defeated once Hadfields obtained a majority of the shares. See Bull and Vice (1961) above n 175, pp 166-183.
[185] *Report of the Company Law Committee (Cmnd 1749, June 1962),* Note of Dissent, paras 6 and 9 (Jenkins Committee).
[186] Hannah (1974) above n 131, pp 69-71 and 75.
[187] Ibid at 70-1

free capital gain rather than dividends which were subject to income tax at very high levels.[188] Similarly, as private individuals sold their shares during the 1950s and 1960s to institutions, dispersal of shares increased, creating a necessary condition for the emergence of the hostile bidder who sought to buy control on the market rather than through a private acquisition of a controlling stake. Moreover, the rapid growth in institutional investment from the 1950s onwards ensured that bidders were increasingly approaching fund managers who were not aligned with management, but who tended to be passive in matters of corporate governance,[189] and would be likely to sell out their holdings in return for a premium.[190] Indeed, the possibility of hostile takeovers was probably one of the main reasons why institutional investors were willing and able to remain passive throughout the period from the 1960s to the 1980s.

Whilst all these factors contributed to the emergence of the hostile takeover after 1948, the contribution of s184 has not received sufficient attention. Hannah rejected the argument that the new power of the majority to remove the directors facilitated the emergence of the hostile takeover on the basis that the Stock Exchange already required listed companies to have a term equivalent to Art 80 of Table A 1929 in their articles.[191] However, that provision only required that directors be removable by extraordinary resolution, that is, by a 75% majority. The dissenting minority of the Jenkins Committee, led by Gower, implicitly identified its importance, noting that, following the introduction of s184, 'the ultimate sanction vested in

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[188] Bull and Vice (1961) above n 175, pp 16-18. For details of marginal tax rates of top rate taxpayers during this period, see Cheffins (2008) above n 7, p 342.

[189] The Wilson Report concluded that the extent of direct contact between institutions and companies 'varies greatly' (see *Committee to Review the Functioning of Financial Institutions* (Cmnd 7937, 1980), para 900). In 1989, in a Bank of England discussion paper, Charkham concluded that while dialogue did occur 'on occasion', most shareholders had 'all but abdicated' their responsibilities under the system of 'shareholder supremacy'. J Charkham, 'Corporate Governance and the Market for Companies: Aspects of the Shareholders' Role' *Bank of England Discussion Paper No 44*, November 1989, 4.

[190] We are grateful to John Quail for suggesting this point. Franks et al (2005, above n 55, p 586) highlight the importance of 'the growing influence of institutional investors… in establishing the United Kingdom's unusually active market in corporate control'.

[191] Hannah (1974) above n 131, p 5 fn 69.

the shareholders… was greatly strengthened by enabling them to dismiss any director at any time by majority vote', and that 'the possibility that a take-over bidder will obtain control by acquiring these votes has caused directors to pay greater heed to the interests of shareholders'.[192] More recent commentary has begun to focus on the significance of this legal change. In his 2008 historical account of the separation of ownership and control, Cheffins noted that this provision of the Companies Act 1948 'imposed constraints on those controlling companies' and 'increased the leverage bidders possessed'.[193] Bruner notes that the new rule 'permitted would-be acquirers to achieve substantial governance power through open-market share purchases'.[194] Moore has gone the furthest in recognising the importance of this right, describing the shareholders' 'shotgun right' as the 'most significant legal-institutional factor underlying the centrality of the so-called "shareholder wealth-maximisation norm"'.[195]

By changing the thresholds for control of the board, and with it, the management, s184 played a critical role in allowing the hostile takeover to become an established practice, the legitimacy of which was no longer questioned by policy-makers after the mid-1950s. It gradually gained approval, first from commentators,[196] then from the City of London and the Bank of England,[197] and, finally, in 1962, from the Jenkins Company Law Review Committee, which endorsed takeovers as a 'convenient method of amalgamation'.[198] The dissenting

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[192] Jenkins Committee, Note of Dissent, (1962) above n 184, paras 4 and 7.
[193] Cheffins (2008) above n 7, pp 76 and 363. At p 332, Cheffins notes that the new right of the majority to dismiss directors before the end of their term was stricter than the stock exchange requirements.
[194] Bruner (2013) above n 148, p 147.
[195] Moore (2013) above n 3, p 212.
[196] In 1954, *The Economist* argued that if companies have financed themselves through retained earnings, but those 'resources are successfully employed to yield their best economic return, the companies never will be will be, or need not be, "victims" at all, for the bidder will defeated. But if the assets are not yielding a proper return, then even the bidder who "merely" wishes to take possession of them will generally be performing an economic service to the community.' (*The Economist*, 23rd January 1954, p254). In 1961, Bull and Vice approved of the argument that 'the bidder makes the most efficient use of a company's assets', whilst 'many boards in the past have tended to adopt excessively long-term schedules'. Bull and Vice (1961) above n 175, pp 25-6.
[197] In 1953, the Bank of England had expressed opposition to the emerging hostile takeover, but by 1958 had given its approval: see Roberts (1992) above n 155, pp 187 and 191.
[198] Jenkins Committee (1962) above n 184, para 265.

minority of that Committee added the further gloss that takeovers were a spur to managerial efficiency.[199] By 1963, the efficiency-enhancing effects of takeovers were beginning to be theorised by economists,[200] and in 1965, Manne introduced the theory of the market for corporate control to the United States.[201] In 1968, the City Code on Takeovers and Mergers was introduced, normalising the hostile takeover by precluding directors from taking any action to frustrate bids and removing the uncertainty that surrounded the common law approach to defensive measures.[202] The autonomy of directors and managers had been truncated, and from then on, their primary focus was, of necessity, the interest of shareholders as expressed by the share price.

6. CONCLUSION

In this article, we have argued that, during the first half of the century, companies were moving towards an enterprise model, with professional managers balancing the competing interests of the various groups and fostering innovation in pursuit of the public good. In this new enterprise, the shareholders had become peripheral and passive, temporary holders of claims on the company, whilst hierarchies of directors and managers were virtually permanent, protected by the company's articles, their own shareholdings and the courts' refusal to interfere in the way companies were run. In other words, this evolution of the enterprise occurred within the existing legal context. Company law granted great leeway to directors, allowing them to nominate managers to run the company in their place, subject only to

[199] Ibid, Note of Dissent, para 9: 'Efficient directors who have treated their shareholders fairly and frankly should have little to fear from a raider' and should not be allowed to protect themselves against this 'remote risk' by issuing non-voting shares and 'converting themselves into a self-perpetuating oligarchy'.
[200] R Marris, 'A Model of the "Managerial" Enterprise' (1963) 77 *Quarterly Journal of Economics* 185, 190.
[201] HG Manne, 'Mergers and the Market for Corporate Control' (1965) 73 *Journal of Political Economy* 110.
[202] Johnston (2008) above n 181.

residual control. However, the role of management was never really considered by the law, and managers were never given legal guarantees of the autonomy which was required if they were to fulfil the functions claimed for them in the burgeoning management literature.

The 1948 reforms contributed significantly to a reduction of the fragile autonomy of management, and with it, the potential of the enterprise to balance competing interests and to innovate. They disrupted these hierarchical structures (to which the shareholders had impliedly consented) with the introduction of a mandatory statutory rule (highly unusual in the company law context) which allowed the removal of the directors by simple majority, overriding anything in the company's articles. This article has shown that shareholder control represents a regulatory and policy choice rather than a market outcome. This choice was little debated in Parliament, and its instigators fell back on unjustified assumptions that shareholder control was essential. Efficiency-based justifications of company law only came later, attempting, as Ireland puts it, 'to defend and legitimate the rights and privileges of rentier shareholders'.[203]

This article has begun the task of showing what was lost in this change. Companies became single purpose, financial entities, having control over, but providing little positive support for, the business enterprise. The capacity of management to take account of the impacts of their decisions on a range of interests was greatly reduced as they were forced by the threat of takeover to prioritise the immediate financial interests of shareholders. This 'bracketing'[204] of company law in the name of greater director accountability to shareholders produced a number of adverse side-effects in the second half of the twentieth century, including short-termism and a lack of investment in R&D and innovation, side-effects which continue to the present day. Yet there is little or no appetite for fundamental reform to the scope of company

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[203] P Ireland, 'Defending the Rentier: Corporate Theory and Reprivatization of the Public Company' in A Gamble, G Kelly and J Parkinson (eds) *The Political Economy of the Company* (Oxford: Hart, 2001) pp 144-5

[204] L Johnson, 'New Approaches to Corporate Law' (1993) 50 *Wash. & Lee. L. Rev.* 1713, 1715.

law. Policy-makers are discussing restoring trust in companies through indirect measures such as country-by-country tax reporting, or through stakeholder advisory panels. We would suggest that more fruitful avenues may be found by revisiting the management literature of the first half of the twentieth century, and finding new ways to guarantee autonomy within a framework of accountability.