INTERNATIONAL JOURNAL OF LEGAL SCIENCE AND INNOVATION

[ISSN 2581-9453]

Volume 2 | Issue 3

2020

English Internal Management Model and its Impact on 21st Century Company Law

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ABSTRACT

Company law across the globe is a result of centuries of evolution. From times of the East India Company to the contemporary world, the laws and mechanisms pertaining to corporate law are a direct consequence of the Industrial Revolution in Britain. Given the entire history of corporations in Britain, this paper lays down the reason behind the emergence of the concept of a separate and stringent internal management model of companies in the first place. In view of the same, this paper shall focus on the aspect as to how the British model of minimum judicial intervention into internal matters of a company has been affecting the rights of shareholders largely, globally. This has been a common occurrence since Britain has been one of the most influential countries in the era of amped up privatization and following the similar road, many developing countries like India also have fallen prey to loopholes of the current corporate law. This paper shall also discuss the rights of minority shareholders of a company and their concerns due to minimal interference by courts at times of violation due to internal management of the company. Finally, the paper shall also shed light as to how the past cases concerning this tussle of intervention between the courts and companies has shaped many current trends of the corporate sector. The paper is essentially a study to comprehend the latest trends of company law and their impact on corporates around the world.

Keywords: *internal management, corporate, judicial intervention, minority shareholders.*

I. INTRODUCTION

The legal system of a country is one of the most essential lynchpins of a considerate nation. These institutions are substantially responsible for creating an atmosphere of belief in a country's quest for fairness.[2] However, in terms of regulating the corporate world all around, sometimes the Courts seem to fall short on power. This is largely because, since times of the Industrial Revolution in Britain, industries were extremely self-reliant and framed regulations

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for themselves, all by their own, with the help of their shareholders.[3] This was perceived to be a boon on these industries since the Bubbles Act of 1720 weighed down the progress of these companies for almost a century. This led to minimum interference of the legal institutions into the matters which were personal to these industries. Later, even after the establishment of a constitutional monarchy in the United Kingdom, the practice of such minimum interference of Courts in internal matters of companies continued and led to the establishment of an extraordinarily strong internal management in companies.

One of the earliest cases ever to emerge around the issue of violation of rights of minority shareholders in a company and the Court's reluctance to meddle into this issue was *Carlen v. Drury*[4]. The company's "internal model" of managing affairs limited the interference of the Court of law until and unless some grave violation of pre-existing terms occurred. This marks the beginning of the exclusion policy of legal intervention into a company's internal matters which continues to sting the affected parties within the company since centuries.[5] Following this landmark judgment in the UK, comes one of the most crucial decisions –*Foss v. Harbottle*[6], which laid down very intricately, the duty of Courts to only interfere into the "company contracts" unless all procedures of internal dispute resolution were exhausted by the companies. This was referred by a series of cases that backed the idea of legal intrusion into matters of the company only under exceptional circumstances.[7] At the onset of this judicial exclusion, this pattern was observed to be one of the most far-reaching rules of the British corporate law since it gave the companies an exclusive right to manage their affairs without bothering about the intrusion by the judicial system. It was only later that concerns regarding such predominant independence were raised when it was realized as to how much of a problem it had started creating for member lying on the minority side of the corporation. Once such demands were put forth, very late in trend, it was even considered that rights of these shareholders were being infringed due to such secrecy in the internal matters of the company. Now, with this freedom amplified due to past actions of the Crown in the UK, the corporate sector was inclusive of the judiciary only in terms of the process of incorporation, matters of criminal nature or unconstitutionality, by large. Freedom in internal affairs meant creating a lot of room private violations. Thus, this freedom of company directors in internal affairs was questioned, but remained very much in practice, as it does even now.

[3] Julian Hoppit, *Counting the Industrial Revolution*, 43 THE ECONOMIC HISTORY REVIEW 173–193 (1990).
[4] *Carlen v. Drury*, 35 ER 61 (1812).
[5] Josephine Bisacre and Claire McFadzean, *Company Law Essentials* (Edinburgh University Press, 2011).
[6] *Foss v. Harbottle*, 67 ER 189 (1843).
[7] *Mozley v. Alston*, 41 ER 833 (1847).

Due to such freedom granted to companies in the UK for almost 200 years in order to design their rules and to formulate their internal committees, there has been a perilous effect on the role of company law at present, in the 21st century.[8] In spite of the existence of significant laws in order to manage and regulate corporate matters like that of the Companies Act, 2006, and the UK Corporate Governance Code, there still seems to be extreme skepticism for letting in Courts to take up the entire issue in their own hands.[9] Though superficially it all seems to be undoubtedly working well for the corporate sector, in reality, the dissatisfaction amongst shareholders has been off charts. Even though there has been no concrete precedent to declare Court's absolute reluctance to intervene into internal corporate matters, during the course of centuries due to historic autonomy of these companies, it has seemed to become a matter of controversy which threatens the corporate law and its legal directives not only in the UK but also all across the globe.

II. FINDINGS

The United Kingdom has been the pioneer of almost everything "law" since the inception of modern era. Due to this, any reform that transpires in the English Law has a mammoth effect at a global level.[10] On the same lines, the influence of the model of internal management under the English Law, which elucidates a company's power to regulate its own internal affairs without the interference of the judiciary has been massive in the global setting. For the purpose of comprehending the same, the following needs to be understood in context of the topic of internal maintenance model of the British corporate law and its effect on the 21st century:

MEANING OF INTERNAL MANAGEMENT UNDER COMPANY LAW

In common terminology, the basic definition of Internal Maintenance or Management can be laid down as, "*the power of a company to avoid the interjection of the Courts in the discourse of business or corporate governance, unless a severe violation occurs on their side"*[11].

These violations are mostly taken under the purview of legal proceedings only if found be fraudulent in nature or found to be *ultra vires.* For venturing into the legal prospects of internal maintenance model, it is pertinent to gain a common understanding of this idea.

[8] George Gluck, *Standard Form Contracts: The Contract Theory Reconsidered*, 28 THE INTERNATIONAL AND COMPARATIVE LAW QUARTERLY 72 (1979).
[9] Jean Du Plessis, *Revisiting the Judge-Made Rule of Non-Interference in Internal Company Matters*, 127 SOUTH. AFRICAN LAW JOURNAL 304 (2010).
[10] G. H. Lawson, *Recent and Future Changes in English Company Law*, 9 MANAGEMENT INTERNATIONAL REVIEW 21 (1969).
[11] Michael Blackman, *'Members' Rights against the Company and Matters of Internal Management'* 110 SOUTH AFRICAN LAW JOURNAL 473 (1993).

However, in order to gain a rather legal perspective of this concept, it is pertinent to understand the legal meaning attached to it with the help of formal definitions of the same. These have been laid with the help of precedents and legal literature, which the following shall elucidate.

Legal Definition of Internal Maintenance Model

In the language of corporate law, a company's constitution, which includes it Memorandum and Articles of Association empower its directors to discharge certain duties and perform certain acts. The manner in which these acts are performed form the "*internal management*" of the company according to what has been laid down in *Griindling v. Beyers*[12], after almost a century of changes and amendments to the concept.

The above definitions have been arrived at after several centuries of evolution of the English Law. Setting boundaries in the discourse of a company's business is extremely critical.[13] As observed, the UK has been a preacher of the fact given its infamous history with the Bubbles Act, of a company designing its own internal rules until the minimum mandatory standard of shareholders and investors is complied with.[14] This includes the idea of the internal affairs of a company being subject to interference only by the committees within the ambit of the organization. Primarily, this is indicative of the fact that the Courts shall not intervene into the decisions and activities of the company unless a grave violation occurs which is unresolvable by the dispute resolution mechanism within such company, which the *Carlen's* case[15] initially laid down, which further substantiates the same. This showcased the degree of exclusivity which the companies want to maintain in context of the legal settings.[16] The same concept was furthermore expounded by judgments like that of *Foss's case*[17], which emphasized on the importance of company contracts and their sanctity in the legal forum.

ENGLISH COURTS AND COMPANY AFFAIRS

Though history of Britain has a major role to play in the exclusive nature of companies in the UK, the question as to why Courts are even now hesitant to intervene in internal affairs of a company still raises brows. Over the years, the companies have gotten a hold of enough authority which can cause a clash between the powers of the judiciary and them. Such events have transpired in the light of the development of company law in Britain during the days of

[12] *Griindling v. Beyers*, SA 131 (1967).
[13] *R v. Dodd*, 9 East 516 (1808).
[14] Hoppit, *supra* note 2, at 174.
[15] *Drury*, 35 ER 61 (1812).
[16] Brenda Hannigan, *Company Law* (5th ed. 2003).
[17] *Harbottle*, 67 ER 189 (1843).

British monarchy and continued till the time Britain became a constitutional monarchy. This can be the result of years of tug of war between both and the damage to the company structure due to policies of the Crown in the early days.[18]

Reluctance of English Courts to Interfere in Company's Internal Affairs

The companies form a management of their own. The moment a company is incorporated as per the methods prescribed under Section 7 of the Companies Act, 2006, it runs on a Constitution of its own. The legislation clarifies as to the validity of companies and their actions in the very beginning. This means that a company, in the first instance will not be incorporated if it has an unlawful object and ill intentions out of such incorporation.[19] The entire legislation has been drafted in such a manner that the role of the legal system is *prima facie* critical until the company has been put into functioning. Due to such extreme involvement during incorporation of the company, the notion of minimal interference of Courts post such legal procedures has been a well-accepted reality. The reason for this is the separate legal entity of a company.[20] In addition to the same, since the memorandums and articles are completely under the control of the company directors, the Courts do not seem have much role in the same unless an issue of criminality of invalidity occurs. This issue has caused multiple challenges in taking the corporate law forward, along with brining bad name for companies, at large.

Violation of Rights of Minority Shareholders

Superficially seeming to be a wonderous thought, internal management model is not as white as it may seem. No doubt, the interests of the company are safeguarded, and their separate legal entity nature is respected; this model has been infamous for violating rights of the shareholders of the company a lot many times.[21] This is due to the fact that at times this internal maintenance model is so tight that there remains no room for the Courts to intervene and act as a protector of the rights of minority shareholders.[22]

In the legislation, the members do seem to have a right to complain against of an irregularity against the company. This creates the "contractual relationship" between the company and these members.[23] But, there always remains a dilemma regarding the extent of usage of this provision of the legislation. By the trends of corporate law in the recent times, it is very

[18] Oonagh E. Fitzgerald, *Corporate Citizen: New Perspectives on the Globalized Rule of Law* (McGill-Queen's University Press 2020).
[19] Companies Act, s 7(2) (2006).
[20] Murray A Pickering, *'The Company as a Separate Legal Entity'* 31 Modern Law Review 481 (1968).
[21] Du Plessis, *supra* note 8.
[22] *Bainbridge v. Smith*, 41 Ch D 462 (1889).
[23] Companies Act, s 65(2) (2006).

 [ISSN 2581-9453]

evident that this right of the members is extremely limited. The only solution to resort to is for the member to convince the company from abstaining to pass a resolution which may be violative of the shareholders' rights as observed in *Cooper v. Garratt*.[24] The moment the company chooses to forgo such a request made by the shareholder, the member is left with no actual further remedy but to approach the Court; yet again the internal maintenance model takes the stage and the Courts seem hesitant of interceding the decisions taken by the company's management.[25]

The last resort is also called to be a derivative claim. This claim is where an action is brought by shareholder of the company against a third party, which usually is another party within the company, like that of a director or an officer. However, in order to proceed with the same action brought, the minority shareholder must show *prima facie* reason to the Court as to why such suit has be put forth against the insider member.[26] Though this concept of derivative claim goes against the norms of traditional company law, they do have made a position for themselves in the view of rights of minority shareholders.

In the UK, such derivative claim is not usually entertained as per the 1843, *Foss v. Harbottle* doctrine of internal management unless on claims of fraud or *ultra vires*.[27] Though it is observed that the 2006 legislation has been inclusive of rights of minority shareholders, the *Foss* doctrine is still very much in function and has not been reformulated or abandoned. At times, the entire thought behind even introducing such claim is said to have ulterior motive of not protecting the minority shareholder but, the company.[28] The shareholders anyway find themselves in a dilemma due to the contracts they sign with the company and ultimately suffer losses irrespective of the situation.[29]

THE IMPACT OF AGED COMPANY LAWS ON THE 21ST CENTURY COMPANY LAW

It is the duty of the law to keep up with changing times. If law does not seem to evolve over time, it seems to become rather unlawful and loses its purpose. Over centuries of development, company law has gone from being primitive and novice to a law that everyone looks up to. There are areas of it which have undergone enormous growth, and this is an undisputed fact. Anyhow, certain facets of it, important ones, have not received their fair

[24] *Cooper v. Garratt*, 137 WLD 1945.
[25] *Houldsworth v. City of Glasgow Bank*, 5 App Cas 317 (1880).
[26] Companies Act, s 261 (2006).
[27] *Harbottle* 67 ER 189 (1843).
[28] Margaret M Blair and Lynn A Stout, *'A Team Production Theory of Corporate Law*' 2 Virginia Law Review 85 (1992).
[29] *Dougall v. Gardine*, 1 Ch D 13 (1875).

share of consideration yet.[30] An example of the same is the internal maintenance model under corporate law.

This model started off on a rather positive note, that is to assure that the sheer interference of the Crown in the matters of a company does not hamper the progress of a whole new emerging corporate world. The initiative of limiting such interference was to provide companies with enough room to create their own mechanism as per the prescribed manners of company legislation and proceed for boosting the economy. In the midst of such dynamic ideas and thoughts, it was difficult to imagine as to what would transpire if the internal equation of a company in itself is hit hard by interior politics.

History is proof of how UK has been a trendsetter since colonial times. The impact it has had on the life, law and mannerism on its colonies and worldwide is remarkable. The scenario in the UK is quite astonishing for a country so advanced in almost every facet of law and life. Since it is a nation so inherently followed and looked up to, the lack of attention to rights of members within the corporation poses a threat to development of company law globally.[31] The rigid laws of the corporate seem to curtain the mechanisms of the company and the violations that have been taking place within the rooms. The people who have their rights violated are desperate to claim damages and seek relief but do not seem to have an option of the same in a country so sophisticated.

Thus, the decisions like that of *Re City Equitable Fire Insurance Co.*[32] and *Dovey v. Cory*[33] which adopted a rather timid approach for dealing with company law and internal business affairs need to be forgone and judiciary should be rather active and vigilant towards the rights of all parties in a company equally since this is what the essence of law and rule of law is. It would not be wrong to adapt to a more American formula of corporate law as the English Courts did in the case of *Daniels v. Anderson*[34] for stricter interpretation of rights and labilities of minority shareholders.

III. CONCLUSION AND SUGGESTIONS

Company Law in the UK has had a remarkable historical evolution, undoubtedly. Taking cognizance of many flaws, it has emerged as a legislation which is applauded by many across

[30] Steven Davidoff Solomon & Randall Stuart Thomas, *The Corporate Contract in Changing Times: Is the Law Keeping Up?* (University of Chicago Press 2019).
[31] *John Warren Head, Global Business Law: Principles and Practice of International Commerce and Investment* (Carolina Academic Press, 2007).
[32] *Re City Equitable Fire Insurance Co*., 407 [1925] Ch.
[33] *Dovey v. Cory*, 477 [1901] AC.
[34] *Daniels v. Anderson*, 13 ACLC 614 (1995).

the world. Many of Britain's colonies have also adopted a similar approach towards their corporate legislations, showcasing the standing and influence of the UK corporate laws worldwide. Given the bitter past of company law, along with the very lenient approach towards the same in the 21st century, it can be concluded that the **rigid internal management model of companies is affecting the application of Company Law in the 21st century.**

Amid such amplified standards of corporate legislation, the lack of Court's supervisory power on companies has definitely raised concerns which needs to be revised. The whole object of having a regulatory body to overlook the activities of a company is failed due to such absence of judicial control over the internal dynamics of these corporations. The Courts have been infamous in turning a blind eye on the activities of internal affairs of a company due to their rigid internal maintenance model. This model which has been active for almost two centuries, is widely invading the 21st century corporate legal system and hampering prospective development. In order to pave way for a more modified version of company legislation, the legal system of the UK, which acts a role model for many nations globally, requires to:

- Reformulate the *Carlen* and *Foss* rule of internal management and establish a balanced view in respect of judicial intervention when required.
- Emphasize on the power of Courts in a modern nation and work towards the judiciary's equal involvement in all spheres, including the corporate world.
- Ensure that the power to intervene into the internal affairs of the companies is regulated by a body of control.
- Certify that the provisions of Companies Act, 2006, which protect the rights of members of a company against insiders are revised and given a stricter interpretation.

By pouring in these much-required efforts into the judicial framework, the independency and dependency of a company on the judiciary can be balanced and amicably ensured. Thus, by doing so, 21st century can assure in bringing in a more successful company law.

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 [ISSN 2581-9453]