VOLUME - 12, ISSUE - 10, OCTOBER - 2023 • PRINT ISSN No. 2277 - 8160 • DOI : 10.36106/gjra

Original Research Paper

Law

CORPORATE GOVERNANCE -THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE – A STUDY

Mr . Palepogu Chanakya

III/III LLB (HONS), Viswa Bharathi College Of Law

ABSTRACT

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. Protection of Creditors or Investors or Share Holders and immunity to the Board of Directors under Corporate Governance has finally evolved through different interpretations and judgments. **Salomon v A Salomon & Co Ltd:** Salomon v A Salomon & Co Ltd [1896] UKHL 1, [1897] AC 22 is a landmark UK company law case. The effect of the House of Lords' unanimous ruling was to uphold firmly the doctrine of corporate personality, as set out in the Companies Act 1862, so that creditors of an insolvent company could not sue the company's shareholders for payment of outstanding debts. **Facts of the Case:** Mr. Aron Salomon made leather boots or shoes as a sole proprietor. His sons wanted to become business partners, so he turned the business into a limited liability company. This company purchased Salomon's business at an excessive price for its value. His wife and five elder children became subscribers and the two elder sons became directors. Mr. Salomon took 20,001 of the company's 20,007 shares which was payment from A Salomon & Co Limited for his old business (each share was valued at £1). Transfer of the business took place on 1 June 1892. The company also issued to Mr. Salomon £10,000 in debentures. On the security of his debentures, Mr. Salomon received an advance of £5,000 from Edmund Broderip. Soon after Mr. Salomon incorporated his business there was a decline in boot sales. The company failed, defaulting on its interest payments on its debentures (half held by Broderip). Broderip sued to enforce his security. The company was put into liquidation. Broderip was repaid his £5,000. This left £1,055 company assets remaining, of which Salomon claimed under the retained debentures he retained. If Salomon's claim was successful this would leave nothing for the unsecured creditors. When the company failed, the company's liquidator contended that the floating charge should not be honoured, and Salomon should be made responsible for the company's debts. Salomon sued. It has become the fashion to call companies of this class "one-man companies". That is a taking nickname, but it does not help one much in the way of argument. If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the Act of 1862 may have been complied with, it is inaccurate and misleading: if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that I can see contrary to the true intention of the Act of 1862, or against public policy, or detrimental to the interests of creditors. If the shares are fully paid up, it cannot matter whether they are in the hands of one or many. If the shares are not fully paid, it is as easy to gauge the solvency of an individual as to estimate the financial ability of a crowd. It was argued that the agreement for the transfer of the business to the company ought to be set aside, because there was no independent board of directors, and the property was transferred at an overvalue. There are, it seems to me, two answers to that argument. In the first place, the directors did just what they were authorized to do by the memorandum of association. There was no fraud or misrepresentation, and there was nobody deceived. In the second place, the company have put it out of their power to restore the property which was transferred to them. It was said that the assets were sold by an order made in the presence of Mr. Salomon though not with his consent, which declared that the sale was to be without prejudice to the rights claimed by the company by their counter-claim. Salomon's case still represents the orthodox view of separate legal personality under English law, although a number of exceptions have since evolved. In Williams & Humbert v W & H Trade Marks [1986] AC 368 at 429B Lord Templeman described as "heretical" the suggestion that this principle should be ignored. In E.B.M. Co Limited v Dominion Bank [1937] 3 All ER 555 at 564 Lord Russell of Killowen stated the principle was one of "supreme importance". In Adams v Cape Industries plc [1990] Ch 433 Slade LJ said "the court is not free to disregard the principle of Salomon v A Salomon & Co Ltd [1897] AC 22 merely because it considers that justice so requires. Our law, for better or worse, recognizes the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities." In Prest v Petrodel Resources Ltd [2013] UKSC 34, [2013] 2 AC 415 at paragraph 66 Lord Neuberger called Salomon: "a clear and principled decision, which has stood unimpeached for over a century". In the decades since Salomon's case, various exceptional circumstances have been delineated, both by legislatures and the judiciary, in England and elsewhere (including Ireland) when courts can legitimately disregard a company's separate legal personality, such as where crime or fraud has been committed. There is therefore much debate as to whether the same decision would be reached if the same facts were considered in the modern legal environment, given the House of Lords' decisions in Pepper v Hart and Re Spectrum Plus Ltd and the Privy Council in Attorney General of Belize v Belize Telecom Ltd that require a purposive approach to interpreting legislation. In 2013 there was a systemic review of these authorities in Prest v Petrodel Resources Ltd and Lord Sumption distinguished between cases of truly "piercing the corporate veil" and situations where it was held that the company was essentially an agent for a wrongdoer or held property on trust.

KEYWORDS :

BACKGROUND

Sir Adrian Cadbury chaired a committee whose aims were to investigate the British corporate governance system and to suggest improvements to restore investor confidence in the system. The Committee was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession. The 'Cadbury Report', titled Financial Aspects of Corporate Governance, is a report issued by "The Committee on the Financial Aspects of Corporate Governance" chaired by Sir Adrian Cadbury, Chairman of Cadbury, that sets out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures. The report embodied recommendations based on practical experiences and with an eye on the USA experience, further elaborated after a process of consultation and widely accepted. The final report

was released in December 1992 and then applied to listed companies reporting their accounts after 30th June 1993.The report's recommendations have been used to varying degrees to establish other codes such as those of the Organization for Economic Cooperation and Development (OECD), the European Union, the United States, the World Bank.

Report

The Board

1. Every public company should be headed by an effective board which can both lead and control the business. Within the context of the UK unitary board system, this means a board made up of a combination of executive directors, with their intimate knowledge of the business, and of outside, non-executive directors, who can bring a broader view to the company's activities, under a chairman who accepts the duties and responsibilities which the post entails.
2. Tests of board effectiveness include the way in which the members of the board as a whole work, the Chairman, whose role in corporate governance is fundamental, and their collective ability to provide both the leadership and the checks and balances which effective governance demands. Shareholders are responsible for electing board members and it is in their interests to see that the boards of their companies are properly constituted and not dominated by any one individual.
3. All directors are equally responsible in law for the board's actions and decisions. Certain directors may have particular responsibilities, as executive or non-executive directors, for which they are accountable to the board. Regardless of specific duties undertaken by individual directors, however, it is for the board collectively to ensure that it is meeting its obligations.
4. Whilst it is the board as a whole which is the final authority, executive and non-executive directors are likely to contribute in different ways to its work. Non-executive directors have two particularly important contributions to make to the governance process as a consequence of their independence from executive responsibility. Neither is in conflict with the unitary nature of the board.
5. The first is in reviewing the performance of the board and of the executive. Non-executive directors should address this aspect of their responsibilities carefully and should ensure that the chairman is aware of their views. If the chairman is also the chief executive, board members should look to a senior non-executive director, who might be the deputy chairman, as the person to whom they should address any concerns about the combined office of chairman/chief executive and its consequences for the effectiveness of the board.
6. The second is in taking the lead where potential conflicts of interest arise. An important aspect of effective corporate governance is the recognition that the specific interests of the executive management and the wider interests of the company may at times diverge, for example over takeovers, boardroom succession, or directors' pay.

The Chairman

1. The chairman's role in securing good corporate governance is crucial. Chairmen are primarily responsible for the working of the board, for its balance of membership subject to board and shareholders' approval, for ensuring that all relevant issues are on the agenda, and for ensuring that all directors, executive and non-executive alike, are enabled and encouraged to play their full part in its activities. Chairmen should be able to stand sufficiently back from the day-to-day running of the business to ensure that their boards are in full control of the company's affairs and alert to their obligations to their shareholders.
2. It is for chairmen to make certain decisions that their non-executive directors receive timely, relevant information tailored to their needs, that they are properly briefed on the issues arising at board meetings, and that they make an effective contribution as board members in practice. It is equally for chairmen to ensure that executive directors look beyond their executive duties and accept their full share of the responsibilities of governance.
3. Given the importance and particular nature of the chairman's role, it should in principle be separate from that of the chief executive. If the two roles are combined in one person, it represents a considerable concentration of power. We recommend, therefore, that there should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board.

Accountability of Boards to Shareholders

1. The formal relationship between the shareholders and the board of directors is that the shareholders elect the directors, the directors report on their stewardship to the shareholders and the shareholders appoint the auditors to provide an external check on the directors' financial statements. Thus, the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress. The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.
2. In the Committee's view, both shareholders and boards of directors should consider how the effectiveness of general meeting should be increased and as a result the accountability of boards to all their shareholders strengthened. Possible ways forward include providing forms in annual reports on which shareholders could send in written questions in advance of the meeting, in addition to their opportunity to ask questions at the meeting itself, and the circulation of a brief summary of points raised at the Annual General Meeting to all shareholders after the event. Consideration might also be given to ways of boards keeping in touch with their shareholders, outside the annual and half-yearly reports.
3. The proportion of shares held by individuals and by institutions has broadly reversed over the last thirty years, so that institutional shareholders now own the majority of shares of quoted companies. They are, however, largely holding their shares on behalf of individuals, as members of pension funds, holders of insurance policies and the like.
4. The Institutional Shareholders' Committee's advice to its members to use their voting rights positively is important in the context of corporate governance. Voting rights can be regarded as an asset, and the use or otherwise of those rights by institutional shareholders is a subject of legitimate interest to those on whose behalf they invest.
5. These conclusions on the role of institutional shareholders raise issues over the lines of communication between boards and their shareholders. The first issue is one of parity between shareholders. The institutions are in a position to keep in touch with the boards of the companies in which they have invested, in a way which is not feasible for the. individual shareholder. What boards must do, however, is to ensure that any significant statements concerning their companies are made publicly and so are equally available to all shareholders.
6. A second issue which arises over communications between institutional investors and companies is the danger of imparting inside information. If price-sensitive information is to be given (and it is the company's responsibility to decide what might be price-sensitive), it must only be with the prior consent of the shareholder, who will then be unable to deal in the company's shares until that information has been made public. It is for

shareholders to decide whether their longer-term interests are impaired by becoming insiders, because of the short-term constraints to share dealing which that position imposes.

Both shareholders and directors have to contribute to the building of a sound working relationship between them.

REFERENCES

1. Shailer, Greg. Corporate Governance, in D. C. Poff, A. C. Michalos (eds.), Encyclopedia of Business and Professional Ethics, Springer International Publishing AG, 2018. https://doi.org/10.1007/978-3-319-23514-1_155-1
2. OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264236882-en
3. Sifuna, Anazett Pacy (2012). "Disclose or Abstain: The Prohibition of Insider Trading on Trial". Journal of International Banking Law and Regulation. 27 (9).
4. Luigi Zingales, 2008. "Corporate governance", The New Palgrave Dictionary of Economics, 2nd Edition. Abstract.
5. Williamson, Oliver E (1 August 2002). "The Theory of the Firm as Governance Structure: From Choice to Contract". Journal of Economic Perspectives. 16 (3): 171–195. doi:10.1257/089533002760278776.
6. Williamson, Oliver E. (1996). The Mechanisms of Governance. Oxford University Press.
7. Pagano, Marco; Volpin, Paolo F. (2005). "The Political Economy of Corporate Governance" (PDF). The American Economic Review. 95 (4): 1005–1030. doi:10.1257/0002828054825646. JSTOR 132703.
8. Daines, Robert, and Michael Klausner, 2008 "Corporate law, economic analysis of", The New Palgrave Dictionary of Economics, 2nd Edition. Abstract.
9. Williamson, Oliver E. (July 1988). "Corporate Finance and Corporate Governance". The Journal of Finance. 43 (3): 567–591. doi:10.1111/j.1540-6261.1988.tb04592.x.
10. Schmidt, Reinhard H.; Tyrell, Marcel (November 1997). "Financial Systems, Corporate Finance and Corporate Governance". European Financial Management. 3 (3): 333–361. doi:10.1111/1468-036X.00047.
11. Tirole, Jean (1999).The Theory of Corporate Finance", Princeton. Description and scrollable preview.
12. "OECD Principles of Corporate Governance, 2004, Articles II and III" (PDF). OECD. Retrieved 2011-07-24.
13. Cadbury, Adrian, Report of the Committee on the Financial service Aspects of Corporate Governance, Gee, London, December, 1992, Sections 3.4
14. Sarbanes-Oxley Act of 2002, US Congress, Title VIII
15. "OECD Principles of Corporate Governance, 2004, Preamble and Article IV" (PDF). OECD. Retrieved 2011-07-24.
16. "OECD Principles of Corporate Governance, 2004, Article VI" (PDF). OECD. Retrieved 2011-07-24.