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# The Enforcement of Private Actions for Breaches of EC Competition Law - The Role of the Shareholder under English Law

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EU law requires that individuals who have suffered loss or damage as a result of breaches of EU law should have an effective legal remedy. This article considers whether English shareholders have an effective legal remedy for harm caused to the companies in which they have invested where this loss has arisen from clear breaches of Article 81 or 82 EC Treaty in the light of the *Factortame* litigation and *Courage v Crehan*. The article focuses on the European Commission's Green and Staff Working Papers on private actions and concludes that corporate, rather than consumer, actions are the most likely source of damages claims for breaches of European competition law. It examines the position of directors' duties under both US and English law, having regard to both the Walt Disney litigation and the English law changes introduced by the Companies Bill. It reviews the issue of shareholder standing in US antitrust actions under the Sherman Act and the regulation of corporate actions under English law. Consideration is given to the issue of derivative actions for antitrust harm both in the US and in English courts. It is concluded that the English law rules which prevent direct standing for shareholders and which severely limit the possibility of bringing a shareholder derivative action mean that a shareholder does not have an effective national remedy for harm caused by breaches of Articles 81 or 82 EC.

## 1. INTRODUCTION

Antitrust harm may have a chilling effect on equity investment in sectors where there is, for instance, a dominant player which has the capacity to deter new entry or inhibit the expansion of competitors' activities through the abuse of its market power or where undertakings seek to exclude a new entrant from an existing market.[1] Equity investment can take a variety of forms, with venture capitalists and private equity

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[1] Literature on business and competitive strategy frequently refers to the importance of conditions of entry for new entrants to a market. In ME Porter, *Competitive Strategy*, Free Press, 1980, at p 7, Michael Porter refers to the possibility of new entry as being dependent on both existing barriers such as economies of scale and the degree of anticipated retaliation from incumbent firms. In Lowes, Pass and Sanderson, Companies and Markets, London, Blackwells, 1994, at pp 141-146, reference is made to entry forestalling behaviour such as output increases and concomitant price reductions to unprofitable levels in order to deter new entry. The EC Commission Discussion Paper of December 2005: (http://ec.europa.eu/comm/competition/antitrust/others/discpaper2005.pdf accessed on 4th May 2006) relating to the application of Article 82 to exclusionary abuses focuses heavily on the entry forestalling aspects of rebate schemes as a means of determining their legality. Deterrence of new entry has, for instance, been at the heart of the price cutting in Article 82 cases such as Case T-228/97 *Irish Sugar plc v Commission* [1999] ECR II-2969. See also Case T-65/98 *Van den Bergh Foods Ltd v Commission* [2003] II-4653 where the practice of imposing freezer exclusivity obligations, when fully enforced, resulted in Mars' impulse ice cream market share in Ireland falling from 42% to less than 20% (at paragraph 93) and was held to be a breach of both Articles 81 and 81 by Van den Bergh Foods (part of the Unilever Group).

investors making significant investments in companies on a cross-border basis within the European single market.[2] They frequently have finely calculated rates of return, particularly where the company in which they are investing is highly geared. These rates of return and any exit strategy for the investor could be easily disrupted if the anticipated income streams or profit levels of the company are harmed by anti-competitive practices taking place in the market in which it operates.

Venture capitalists typically take a minority shareholding and adopt a 'hands off' approach to management issues. However, such an investor clearly has an obligation to protect its equity participation where the directors of the company in which it has invested fail to do so. Whilst some investors will ensure that contractual mechanisms protect their position, this article will consider whether English law adequately protects the position of a minority shareholder in a situation where harm has been caused to the company in which it has invested due to breaches of EC competition law by a third party. It will consider the ability of a minority shareholder to bring either a direct action in relation to the loss it has suffered or a derivative action under English law on behalf of the company itself. It will examine the reforms being introduced by the Company Law Reform Bill[3] and how these affect the right to bring a derivative action. The legal position of the shareholder will also be assessed having regard to the well established requirement that there must be an effective remedy in respect of directly effective rights arising under EC law.

The existing and proposed position under English law will be compared with minority shareholders' rights to bring suits for antitrust injury in the US and will evaluate how the rights of investors and directors are balanced under US law.

Some consideration will also be given to the EC Commission proposals contained in its Green and Staff Working Papers on private enforcement[4] and the individual's right to damages. However, this article will primarily focus on the existing jurisprudence of the European Court of Justice, since this promises to offer the most immediate and effective support for corporate antitrust actions.

This article concludes that, under English law, minority shareholders do not currently have an effective remedy to make good their losses where their company has been

[2] In its research paper of June 2002 the European Private Equity & Venture Capital Association concluded that capital investment in European companies that are in their start up or expansion stages has grown dramatically, from €2.6 billion in 1995 to €12.2 billion in 2001. The Internal Market Directorate General of the EC Commission recognises the need to improve the rights of shareholders of companies operating across the single market. In its Consultation Document (MARKT/16.09.2004 accessed 4th May 2006) it stresses that its focus is on empowering shareholders through the possession of voting rights and participation at company general meetings. In its Final Report of 4th November 2002 the High Level Group of Company Law Experts identified shareholder protection as a key element in ensuring good corporate governance and shareholder decision making as a factor that would help eliminate cross border obstacles to investment.

[3] Published on 1st November 2005. The Bill received its second reading in the House of Lords on 11th January 2006 and then entered the Parliamentary committee stage

[4] COM(2005)672 Final and SEC(2005)1732, both dated 19/12/05.

clearly harmed by breaches of Articles 81 or 82 EC and the directors do not pursue these claims. Should the Company Law Reform Bill be enacted,[5] the availability of an effective remedy will depend on how directors' duties are interpreted by the courts (and the derivative action developed) in the future.

## 2. ARTICLES 81 AND 82 – THE RIGHT OF ACTION FOR DAMAGES

Whilst Articles 81 and 82 EC create directly enforceable rights in favour of individuals affected by anti-competitive practices, it is for the national courts to determine the third parties harmed by such practices and the remedies available to them in the light of any breaches of EC competition law.[6] In the United Kingdom it has been accepted since the decision of the House of Lords in *Garden Cottage Foods Ltd v Milk Marketing Board*[7] that a remedy in damages is available to compensate those individuals who have suffered losses by virtue of a breach of EC competition law.

The European Court has confirmed in its judgment in *Courage Limited v Crehan*[8] (at paragraphs 26 and 27) that damages must be available for breaches of EC competition Law:

> The full effectiveness of Article [81] of the Treaty and, in particular, the practical effect of the prohibition laid down in Article [81(1)] would be put at risk if it were not open to *any individual* to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition.[9]

The European Court, at paragraph 29 of its judgment in *Crehan*, noted that in the absence of Community rules, it is for the legal system of each Member State:

> to lay down the detailed procedural rules governing actions or safeguarding rights which individuals derive directly from Community law, provided that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and that they do not render practically impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness)

The Court held that it must be open to a party to an agreement which was in breach of Article 81 EC to obtain relief from the other party. EC competition law precluded national laws that barred a party from having a right to claim damages, save where they only affected a party which bore a significant responsibility for the distortion of competition.

The English rule in question precluded a party from seeking damages or restitution where it was obliged to rely on its own illegality to do so, a rule developed over 200

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[5] Op cit, n 3.

[6] Case 127/73 *Belgische Radio en Televisie SV SABAM* [1974] 1 ECR 51.

[7] [1983] 3 WLR 143.

[8] Case C-453/99 [2001] ECR I-6297.

[9] Emphasis added.

years by the judiciary.[10] This rule had been extended into the field of competition law by the Court of Appeal in *Gibbs Mew v Gemmel*[11] when Peter Gibson LJ held that Article 81 EC not only made an infringing agreement automatically void, but also made such an agreement illegal. He cited the opinion of Advocate General Jacobs in *van Schijndel v Stichting Pensioenfonds*[12] in which he stated that an English judicial rule which equated a breach of Article 81 EC with illegality (thus rendering it unenforceable and denying a party any right of damages) did not infringe the requirement that such national rules should be non-discriminatory in their effects. Unfortunately whilst such a rule was non-discriminatory and equivalent in its effect, it did not meet the requirement that it should also provide an effective remedy for those affected by an anti-competitive agreement.

## 3. THE APPLICATION OF NATIONAL RULES AND THE PRINCIPLE OF EFFECTIVENESS

The ability of national courts to choose procedures and remedies autonomously has been subject to the principle of effectiveness for many years in fields outside that of EC competition law. In *Von Colson and Kamann v Land Nordrhein-Westfalen*[13] a national law limiting compensation for discrimination to travel expenses was held not to provide an effective remedy. The European Court held in *MH Marshall v Southampton and South West Hampshire Area Health Authority*[14] that any national remedy for discrimination 'must be such as to guarantee real and effective judicial protection and have a real deterrent effect on the employer.' Compensation for non-discrimination must not be less than the amount necessary to make good the loss and damage actually suffered.

## 4. THE LOCUS STANDI OF SHAREHOLDERS UNDER EU LAW

In the *Queen v Secretary of State for Transport, ex parte Factortame Limited* (*'Factortame no. 2'*)[15] the European Court of Justice had considered the legality of the Merchant Shipping Act 1988 having regard to the EC Treaty provisions relating to freedom of establishment.[16] The Act amended the regime for the registration of fishing vessels entitled to participate in the British fishing quota, imposing a British nationality requirement on owners, managers and operators if vessels were to remain on the register of British vessels. One of the nationality requirements was that 75% of the shareholders in any company owning a vessel wishing to remain on the register must be British citizens, resident and domiciled in the United Kingdom. Where existing shareholders did not meet this requirement, the company in question would have lost

[10] *Holman v Johnson* (1775) 1 Cowp. 341 and upheld more recently by the House of Lords in *Boissevain v Weil* [1950] AC 327; *Kiriri Cotton Co. Ltd v Dewani* [1960] AC 192; *Tinsley v Milligan* [1994] 1 AC 340.

[11] [1998] Eu LR 588.

[12] Joined Cases C-430/93 and C-431/93 ECR, [1995] I-4705 at para 49 (the Advocate-General had dwelt at some length in earlier passages for the need for an effective remedy in other contexts).

[13] Case C-14/83 [1984] ECR 1891.

[14] Case C-271/91 [1993] ECR I-4367.

[15] Case C-221/89 [1991] ECR I-3905.

[16] Article 52 EC (now Article 43).

the benefit of its fishing licence. The European Court held that national legislation which prohibited Spanish nationals from holding shares in English companies which both owned fishing vessels and enjoyed United Kingdom fishing rights was in breach of the European Treaty provisions regarding freedom of establishment.

In *Brasserie du Pecheur SA v Bundesrepublik Deutschland* and the *Queen v Secretary of State for Transport, ex parte: Factortame Limited*[17] an English Divisional Court, faced with a damages claim by the companies affected by the United Kingdom legislation, referred to the European Court of Justice the question, '*are those persons who were owners or managers of such vessels, or directors and/or shareholders* in vessel-owning and managing companies, entitled as a matter of Community law to compensation by [the United Kingdom] for losses which they have suffered as a result of all or any of'[18] the infringements of the directly effective rights to freedom of establishment arising under the European Treaty which the Court had adjudged to have occurred in *Factortame No 2*. In its judgment the European Court held that, the United Kingdom government having exceeded its discretion in introducing the legislation:

> (20) … the full effectiveness of Community law would be impaired *if individuals* were unable to obtain redress when their rights were infringed by a breach of Community law
>
> (67) … the State must make reparation for the consequences of the loss and damage caused in accordance with the domestic rules on liability, provided that the conditions for reparation of loss and damage laid down by national law must not be less favourable than those relating to similar domestic claims and must not be such as in practice to make it impossible or excessively difficult to obtain reparation …
>
> (82) Reparation for loss or damage caused *to individuals* as a result of breaches of community law must be commensurate with the loss or damage sustained so as to ensure the effective protection for their rights.[19]

The European Court held that there should be a causal link between the breaches of European law and the losses sustained, but subject to this, appears to accept that individual shareholders may claim for losses they have incurred as a result of those breaches. Here, either the non-British shareholder would be obliged to sell his shares or, if he chose to retain them, the vessel-owning company would lose valuable fishing rights. The breaches of EC law could be regarded as causing direct or indirect loss to the shareholder, however, the fact that the shareholder was capable of being harmed by the legislation is not in doubt.[20]

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[17] Joined Cases C-46/93 and C-48/93 [1996] ECR I-1029.

[18] Emphasis added.

[19] Emphasis added.

[20] The fact that harm caused to a company can result in losses to shareholders has been acknowledged under English law. See, for instance, *George Fischer (Great Britain) Ltd v Multi Construction Ltd* [1995] 1 BCLC 260.

Under English law any violation of Articles 81 or 82 EC will be regarded as a statutory tort,[21] with causation being determined according to the 'but for' test applied in tortious cases. In *Arkin v Borchard Lines (No. 4)*[22] the High Court considered allegations that a liner conference had operated a price fixing cartel in breach of Article 81 EC, thereby eliminating a competitor. On the issue of causation the Court concluded that, had the plaintiff been able to demonstrate that the liner conference was in breach of Article 81 EC, the issue of causation must be approached:

> on the basis of commonsense, there being … an overarching concept that the chain of causation can be broken only if it is concluded that the claimant's own conduct displaced that of the defendant as the predominant cause of the claimant's loss.[23]

Taken together the judgments in *Brasserie du Pecheur SA v Bundesrepublik Deutschland* and the *Queen v Secretary of State for Transport, ex parte: Factortame Limited* and *Arkin v Borchard Lines (No. 4)* would indicate that a shareholder must have standing for breaches of directly effective rights under the EC Treaty which have caused harm to that shareholder and that, where this has occurred, the issue of causation under English law facilitates the pursuit of such a right.

However, under English law a shareholder's standing in an action to recover damages where the company in which he holds shares has been harmed by a breach of Article 81 or 82 EC is far less certain. Whilst a right of action for damages is a matter for national courts, such a remedy must be available to anyone affected by breaches of Community law, even if the relevant national law denies the availability of such a remedy. Thus a company or its shareholders, must have an effective remedy where, for instance, Articles 81 or 82 EC have been breached and that corporate entity or shareholder has suffered loss. This article will consider the issue of shareholder direct standing and the right to a derivative action under US law in sections 5 and 12 and English law in sections 9 and 10.

## 5. ANTITRUST ACTIONS IN THE US – SHAREHOLDER LOCUS STANDI IN DIRECT ACTIONS

Section 1 of the Sherman Act 1890[24] provides that:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce … is declared illegal. *Every person* who shall make any contract or engage in any combination or conspiracy declared by sections 1 to 7 of this title to be illegal shall be guilty of a felony[25]

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21 *Garden Cottage Foods Ltd v Milk Marketing Board,* op cit, n 7.

22 [2003] EWHC 687 (Comm)

23 *Ibid*, at para 536.

24 15 USC § 1.

25 Emphasis added in each case.

In addition to the fines which can be imposed on corporations or individuals and the prison sentences which the latter may face, such an infringement of the Sherman Act can be the subject of a private action in the US Federal Courts under Section 26 of the Act.

Section 4 of the Clayton Act 1914[26] provides for treble damages actions in civil courts for antitrust harm:

> *Any person* who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore … and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.[27]

Despite the references to 'every person' and 'any person' in each of the two statutes, it is not every person who can bring an action for harm caused by infringements of US antitrust law. In the US standing is determined by reference to the underlying goals of the antitrust laws. In *Brunswick Corporation v Pueblo Bowl-O-Mat Inc*[28] the US Supreme Court held that a plaintiff must have suffered 'antitrust injury'. A plaintiff must therefore demonstrate individual harm which is linked to an adverse effect on competition. As Jacobson and Greer have pointed out:[29]

> Brunswick has substantially improved antitrust analysis. It has helped to ensure that the antitrust laws remain true to their essential pro-consumer underpinnings.

The civil right to treble damages conferred by Section 4 of the Clayton Act has also had a major impact on the issue of standing in the US courts. Berger and Bernstein[30] have remarked that although the language of Section 4 of the Clayton Act is expansive the courts have adopted a relatively narrow approach to standing:

> On its face this language [Section 4 of the Clayton Act] seems to grant a private right of action to anyone who can prove an injury to his 'business or property' was caused by an antitrust violation. Yet the lower federal courts have created an antitrust standing requirement by interpreting the phrase 'by reason of' to imply not only the *fact* of causation but also the presence of *legal* causation. In Section 4 case law this legal causation requirement, like the proximate cause requirement in the law of torts, restricts the scope of the defendant's liability and a plaintiff's right to recovery. Although antitrust standing is analytically distinct from the statutory requirement of 'injury' to 'business or property' … its precise definition remains elusive because of the inherent ambiguity of the concept of legal causation.

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[26] 15 USC § 15.

[27] Emphasis added.

[28] 429 US 477 (1977).

[29] JM Jacobson & T Greer, 'Twenty-one years of antitrust injury: Down the alley with Brunswick v Pueblo Bowl-O-Mat' (1998) 66(2) Antitrust Journal 273.

[30] D Berger & R Bernstein, 'An analytical framework for antitrust standing' (1977) 86(5) The Yale Law Journal 809.

> The sparse legislative history of Section 4 hardly suggests a Congressional mandate for the legal causation that the courts have imposed on the seemingly all inclusive language of Section 4 … [the] courts have created this limitation primarily out of concern about the excessive penalties that may be incurred because of the mandatory treble damages feature of the section. Despite the potential conflict with the compensatory and deterrent purposes of private antitrust litigation, many courts have denied standing on the grounds that treble damage recoveries by every person affected by an antitrust violation could exact duplicative or even ruinous recoveries from antitrust defendants[31]

It has been held in a number of US cases[32] that where antitrust injury has occurred to a company no shareholder can bring an action directly but may only do so by derivative action.[33] Any shareholder affected by antitrust harm which gives rise to an action for damages by the company in which he holds his investment has suffered merely an indirect loss and the proper plaintiff is the company. Any wrongful injury caused by breaches of the Federal antitrust laws must be recovered by the company and the shareholder will not be able to recover for any diminution of the value of the company's shares, no matter how extensive the resultant shareholder losses.

## 6. The Commission's View of Private Actions and Possible Claimants

The Commission has adopted its Green and Staff Working Papers[34] in the light of the *Crehan* judgment and the empowerment of national regulatory authorities and courts under the Commission's modernisation programme.[35] The Green Paper's goal is to shift some of the burden of enforcement onto the shoulders of private litigators in national courts. Many obstacles stand in the way of a successful private action and both Commission Papers consider these problems and their possible solutions in some depth. This article does not aim to discuss these issues in any detail, but will only consider the Papers in order to assess the Commission policy goals from the perspective of a shareholder in a company affected by an agreement or a practice which is in breach of either Article 81 or 82 EC.

In its Green Paper[36] the Commission states that damages actions for an infringement of EC competition law serve several purposes, one of which is to compensate those who have suffered a loss as a result of anti-competitive behaviour (paragraph 1.1). In its

[31] *Ibid*, at pp 811 & 812.

[32] For instance: *Loeb v Eastman Kodak Co.* (1910, CA3d Pa) 183 F 704; *Roseland v Phister Mfg. Co* (1942, CA 7th Ill) 125 F2d 417, 139 ALR 1013; *Peter v Western Newspaper Union* (1953, CA 5th Fla) 200 F2d 867; and, *Vermilion Foam Products Co. v General Electric Co.* (ED Mich) 386 F Supp 255.

[33] See particularly *Fanchon & Marco, Inc v Paramount Picture Inc* (1952, DC NY) 107 F Supp 532, and on appeal (CA2d) 202 F2d 731, 36 ALR2d 1336.

[34] Op cit, n 4.

[35] Council Regulation 1/2003/EC, OJ 2003, L1/1 which empowers courts to apply all the EC Treaty provisions relating to competition law, including Article 81(3), but does not harmonise procedures or remedies, the latter remaining a matter for the courts of each Member State.

[36] Op cit, n 4.

introductory paragraph to the Green Paper the Commission identifies consumers and firms who have suffered losses as a consequence of an infringement of the antitrust rules as those to whom damages should be payable. Whilst acknowledging at paragraph 2.5 that, '[i]t will be very unlikely for practical reasons, if not impossible, that consumers and purchasers with small claims will bring an action for damages for breach of antitrust law', the Green Paper considers the possibility of collective actions by consumers.

However, in the immediate future it is likely to be corporate entities with a trading or competitive relationship with the infringer which are the parties most likely to bring a claim. The experience of consumer claims in England under the Competition Act 1998 and the Enterprise Act 2002[37] would suggest that even with favourable procedural conditions, consumers are only likely to 'piggy back' or follow on from existing regulatory decisions, rather than initiate stand alone actions themselves. Consumer bodies have a wide remit whilst being inadequately resourced.

The Commission therefore takes a broad view of potential claimants. Nevertheless for the reasons noted above, this policy goal of expanding competition law enforcement through private action is likely to depend on the appetite (or lack of it) which those with deeper pockets have for this role. This will in turn depend on the way in which the behaviour of the officers of a company[38] is regulated by the laws of the Member State in which it is incorporated or has its seat[39] and as to whether the investment community is likely to play a role in competition law enforcement.

[37] Certain statutory provisions facilitate adopting the follow on approach, Section 47A of the Competition Act 1998 (inserted by section 18 of the Enterprise Act 2002) allows those who have suffered loss or damage as a result of the infringement of UK or EC competition law to bring a claim before the Competition Appeal Tribunal where the Office of Fair Trading or the EC Commission has ruled that an infringement has occurred. Section 47B (introduced by Section 19 of the Enterprise Act 2002) allows specified consumer bodies to bring such a claim.

[38] The corporate governance debate has intensified following the collapse of Enron and WorldCom. As Professor Coffee notes in JC Coffee, *Gatekeepers - The Role of the Professions in Corporate Governance*, Oxford, OUP, 2006, at p 17, ' … the boards of Enron and WorldCom did strange and reckless things: the Enron board waived its conflict of interest policy so that Andrew Fastow, its chief financial officer, could run special purpose entities with Enron, reaping secret profits running into millions of dollars in the process, and the WorldCom board extended loans and guarantees to its financially strained chief executive totalling $250 million … '. He further notes at p 24, ' … Enron's fervent desire to show immediate earnings growth and to hide problems, liabilities and money-losing transactions seem a direct consequence of how its management was compensated. They were incentivized to manage for the short-term, and not surprisingly they did.'

[39] In R Smith & J O'Brien, Conflict of Laws, London, Cavendish Publishing, 2nd Ed, 1999, at p 85, citing *Janson v Dreifontein Consolidated Mines Ltd* [1902] AC 484, John O'Brien states: 'In general, English law takes the view that the nationality of the company is the country of its incorporation. It is sensible to distinguish this common law approach from those in civil law countries where the nationality of the company will be determined by the real seat of the corporation. The concept of the real seat is a technical one but normally means where the board of directors meet and where the general meeting takes place and the administrative centre is located.'

## 7. THE REGULATION OF ENGLISH COMPANIES

English company law is founded on the principle that the company is a separate legal entity, distinct from its shareholders.[40] Its affairs are managed by its directors, acting as a board.[41] The directors are obliged to act in the interests of the company.[42] The directors owe their duties to the company, not to individual shareholders: *Percival v Wright*[43] and more recently *Peskin v Anderson.*[44]

Historically the board has had a wide discretion as to whether or not to bring legal proceedings.[45] Since the directors owe a duty to the company 'an action complaining of breach of duty must be brought by the company (i.e. by the directors whose conduct is being challenged).'[46]

Whilst directors can be removed by a majority of the shareholders passing a resolution to this effect, control of general meetings is largely in the hands of the directors who convene and set the agenda for such meetings with one of their number chairing the proceedings.[47] Shareholdings are often held by a diverse number of minority shareholders (especially in the case of public companies), rather than by one shareholder with a majority of the votes. Achieving a decision of the majority of the shareholders, particularly to change the management or to commence litigation, can be difficult to achieve.[48]

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[40] *Salomon v Salomon* [1897] AC 22

[41] See for instance the Companies (Tables A to F) Regulations SI 1985/805, which are typically adopted by a newly formed private company as part of its Articles of Association. Article 70 provides that "the business of the company shall be managed by the directors". Articles 88-98 regulate board proceedings.

[42] *Re Smith v Fawcett* [1942] Ch 304

[43] [1902] 2 Ch 421

[44] [2001] BCC 874

[45] *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1989] BCLC100.

[46] JE Parkinson, *Corporate Power and Responsibility*, Oxford, Clarendon Press, 1993 at p 83. See also the observations of Janet Dine in J Dine, *Company Law*, London, Palgrave MacMillan, 5th Ed, 2005, at p 202, 'One aspect of company law that always influences the standard imposed on directors in practice is the means of enforcing the duties that are owed. There is no point in imposing a duty on someone if there are no effective means of enforcing that duty.'

[47] See for instance Article 37 (directors' power to convene general meetings of shareholders) and 42 (chairman of the board of directors to chair such general meetings) of Table A of the Companies (Tables A to F) Regulations SI 1985/805.

[48] Based on research relating to 250 randomly selected companies listed on the London Stock Exchange over a 5 year period commencing in 1988, Barca and Becht note in F Barca & B Becht (eds), *The Control of Corporate Europe,* Oxford, OUP, 2001, at p 270 ' … the top shareholder owns an average ultimate voting block of 14.4% (with a median of 9.9%); the second and third shareholders have average share stakes of 7.3 and 6.0% … in the typical British company absolute control would require a coalition. On average a coalition of the top three shareholders would own 27.7%; all large shareholdings combined would come to about 40% … lack of ownership concentration and control in British (and American) companies necessitates codes that prevent management from acting to the detriment of the shareholders.'

## 8. THE CORPORATE DECISION TO SUE

Decisions to commence legal proceedings must therefore usually be taken by the board of directors. At this point it is necessary to consider which party might cause a company antitrust harm, whether directors may wish to bring an action for damages and if not, whether a shareholder could compel the reluctant directors to bring such an antitrust action.

Assuming that the company is not itself in breach of EC competition law, there are a number of different scenarios in which a company may be the subject of antitrust harm. A dominant supplier may engage in a commercial practice that constitutes an abuse of that dominance under Article 82 EC, for instance by tying unwanted products. Alternatively, a company may face harm from the activities of a cartel which constitutes an obvious violation of Article 81(1) EC. Finally, the company could be subject to an anti-competitive practice or agreement which neither constitutes an abuse of a dominant position nor a clear cut violation, such as a cartel, but which requires subtler analysis under Article 81(1) and (3) EC.

Any of these scenarios may involve dominant enterprises, cartelists or enterprises operating at the same or a different level in the value chain (a competitor, supplier, or customer). A company may clearly have been harmed by a price fixing cartel, for instance as a direct customer of a cartelist supplier. If the Commission's policy of encouraging enforcement by private action is to be effective, it is critical for companies in such circumstances to be subject to strong internal pressure to bring such an action. There are a number of factors which may influence the board's view of the infringement. Long drawn out and costly litigation with a competitor is one thing, destroying relationships with valuable trading partners is another. The relatively frequent and wide ranging reforms introduced by the Commission in the field of motor vehicle distribution are strongly indicative of the impressive deterrents to any complaint (let alone legal action) facing a distributor which has been treated in an anti-competitive manner by a motor vehicle manufacturer.[49] Certain sectors prone to cartelisation or other forms of antitrust violation often evince a culture of non-compliance with the competition laws. This may affect the attitude of board members who have developed their careers within the relevant industry. A shareholder who faces a diminution in his investment, should the directors not take action to repair the damage caused, may bring welcome objectivity and additional pressure to the board's deliberations.

[49] The Motor Vehicle Block Exemption Commission Regulation 1400/2002, OJ 2002, L203/30, Article 3(4) of which requires a motor vehicle manufacturer to give detailed objective and transparent reasons for any dealership termination in order to prevent a manufacturer terminating on grounds not permitted by EC competition law. Article 3(6) of the Regulation requires a number of matters, including any dispute about whether termination is justified, to be referred to an independent expert or arbitrator.

The Confederation of British Industry recently acknowledged[50] that shareholder power can be a major force in promoting corporate good governance. Whilst their observations were made in response to the EC Commission's consultation on its proposal to promote cross-border voting by shareholders,[51] they have a more general resonance:

> CBI members support shareholder engagement, which is not to say that companies and shareholders always share the same views, but rather that the exchange of views is generally seen as positive in the long run. We believe that the UK experience has been that dialogue between companies and shareholders backed up by real powers on the part of the shareholders can bring about cultural change

The difficulties inherent in bringing proceedings for breaches of competition law are highlighted at length in the Commission Green Paper[52] and a director may also be affected by very subjective considerations. EC competition law is often understood inadequately and there is a less litigious culture in the United Kingdom compared with the US. As indicated above, cultural and social factors and a desire not to 'rock the boat' in a particular sector which does not enjoy a tradition of competition law compliance may unduly influence director deliberations. The less prospect there is of shareholders calling directors to account, the less disciplined and rigorous the directors thinking is likely to be and, as the CBI has pointed out, the harder it will be to change the culture of the company. Whilst a shareholder in an English company can generally be assured of a right to vote and participate in matters reserved to a general meeting of shareholders,[53] the principle of majority rule means that disciplining the directors may not be easy.[54]

## 9. SCOPE OF THE SHAREHOLDER DIRECT RIGHT OF ACTION IN ENGLISH LAW

If directors do not enforce company rights then, in the light of the 'reflective loss' rule, the availability of a right to bring a derivative action is crucial. The English courts have established in *Prudential Insurance Co Ltd v Newman Industries Ltd (No.2),*[55] *Johnson v Gore Wood & Co*[56] and in *Gardner v Parker*[57] that any losses suffered by a shareholder by

[50] CBI response to fostering an appropriate regime for shareholders' rights July 2005 (http://forum.europa.eu.int/irc/DownLoad/kmeVAKJ_miGUbpJEH26CRWRYCx3NtriCr_9LXRWYGe1PH1BxGoSt6IZ-cKcdJ_oTyV6OETUp2UxVqIlDnG/cbi_en.pdf accessed on 4th May 2006)

[51] EC Commission Proposal for a directive on the exercise of shareholders' voting rights, COM(2005) 685.

[52] Op cit, n 4.

[53] Article 54 of Table A in the Companies (Tables A to F) Regulations SI 1985/805 provides members of a company with one vote for each ordinary share held on a poll (rather than a show of hands where each member present has one vote). Usually the Chairman of the meeting will demand a poll.

[54] Op cit, n 47.

[55] [1982] 1 Ch 204.

[56] [2001] 1 All ER 481.

[57] [2002] 2 AC 1.

reason of harm to the company cannot be recovered by that shareholder. In the *Prudential* case the Court of Appeal stated that:[58]

> [A shareholder] cannot … recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company, in the diminution of the net assets of the company, in which he has (say) a 3 per cent shareholding.

This 'reflective loss rule' was confirmed by the House of Lords in *Johnson v Gore Wood & Co.*[59] It held that a shareholder may not recover his losses where the company has a right of action and any loss suffered by the shareholder merely reflects the loss caused to the company. The shareholder may sue, either where the company suffers loss but has no right of action, or where the shareholder has an independent right, separate from any right belonging to the company, and where the loss to the shareholder is separate from that caused to the company.[60]

These decisions highlight the perilous position of a minority shareholder. Breaches of Articles 81 or 82 EC may cause the share value of a company to fall due to predatory pricing by a dominant competitor (resulting in lost sales by the company) or additional costs occasioned by a cartel overcharging the company. If the directors fail to act then, in the absence of a right to a derivative action on behalf of the company, the only realistic remedy available to a minority shareholder in English law would be to be bought out under s 459 of the Companies Act 1985 at the then fair (and depressed) share value.[61]

In what circumstances can an individual shareholder currently bring proceedings in derivative form on behalf of the company to ensure such an antitrust enforcement action is initiated? Whilst these rights are very limited at present, proposed reforms to English company law will extend the right to bring a derivative action and will expose directors to greater uncertainty about their discretion in such matters.

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[58] Op cit, n 55 at pp 222 & 223.

[59] Op cit, n 56.

[60] Op cit, n 56, see, for instance, the judgment of Lord Bingham at pp 35E to 37A

[61] It is by no means clear that a minority shareholder would have such a right to be bought out in the circumstances outlined earlier in this paper, namely when the directors have failed to pursue a third party whose anti-competitive acts have caused harm to the company. In *O'Neill v Phillips* [1999] 2 All ER 961, Lord Hoffmann emphasised that unfair prejudice actions will usually need to be based on deviance from the 'legitimate expectations' of the allegedly oppressed shareholder. In *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14, Hoffmann LJ, as he was then, had indicated that a shareholder might in certain circumstances have a legitimate expectation that would effectively restrain the exercising of legitimate corporate powers by directors. The most usual remedy for an oppressed shareholder is the making of an order by the court that his shares be purchased by the company or another shareholder under section 461(2)(d) Companies Act 1985. The date at which the shares will be valued will be that on which the order is made (i.e. after the competition law harm has occurred): *Re London School of Electronics* [1986] Ch 211.

## 10. THE SHAREHOLDER DERIVATIVE ACTION IN ENGLISH LAW – CURRENT POSITION AND REFORMS

### 10.1. The existing common law

The basic rule under English common law is that the proper plaintiff for a wrong done to the company is the company itself and that the interests of the majority shareholder will prevail over those of the minority: *Foss v Harbottle*.[62] It was held in *Burland v Earle*:[63]

> the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again it is clear law that, in order to redress a wrong done to the company or to recover money or damages alleged to be due to the company, the action prima facie should be brought by the company itself.

In *Edwards v Halliwell*[64] Jenkins LJ explained that exceptions to this rule arose where an act was illegal or ultra vires the company, where the matter requires the sanction of a special majority of the shareholders, where the personal and individual rights of the shareholder 'have been invaded' or where there is a fraud on the minority and the wrongdoers are in control of the company. The first of these grounds would appear to allow a derivative action by minority shareholders should the company be proposing to enter into or maintain in force an anti-competitive agreement. The fourth and principal additional exception (fraud on a minority) would seem to present an insuperable hurdle for the shareholder to overcome. If the company has been harmed by a manifest breach of EC competition law but the directors do not act, such a decision is unlikely to constitute wrongdoing which would allow a derivative action to be brought.[65]

### 10.2. The Company Law Reform Bill

The Law Commission Report No. 246[66] had proposed the relaxation of the rule in *Foss v Harbottle* and that a new form of derivative action be established on a statutory basis. This proposal is reflected in the Company Law Reform Bill currently before Parliament.[67] Section 239(3) of the Bill would allow a derivative action to be brought, 'in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company'.

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[62] (1843) 2 Hare 461.

[63] [1902] AC 83 (at p 93).

[64] [1950] 2 All ER 106.

[65] Fraud on the minority has been categorised by Janet Dine, op cit, n 45 at pages 258 to 260, as comprising expropriation of the company's property (*Menier v Hooper's Telegraph Works* (1874) LR 9 Ch D350), mala fides breaches of duty (*Atwool v Merryweather* (1867) 5 Eq 464), negligent acts from which the directors benefit (Daniels v Daniels [1978] Ch 406) and use of powers for an improper purpose (*Bamford v Bamford* [1970] Ch 212)

[66] 1997 Cm 3769.

[67] Op cit, n 3.

Moreover, the scope of the director's duties is also being codified. Section 156 of the Bill states that:

> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.
>
> (3) In fulfilling the duty imposed by this section a director must (so far as reasonably practicable) have regard to-
>
> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business interests with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> (f) the need to act fairly as between members of the company.

Sub-section (4) of section 156 preserves existing statutory and common law obligations to consider the interests of the creditors.

The proposals heighten the degree to which directors must take into account environmental matters and trading relationships, without indicating how the various factors set out in sub-section (3) are to be balanced or prioritised in the light of the duty set out in sub-section (1). Nor is it clear how 'success' will be determined in sub-section (1). As with the obligation to have regard to the interests of employees introduced by Section 309(1) of the Companies Act 1985, the duty to discharge the obligation of good faith and to consider these interests is only enforceable by the company itself.

Under Section 157 a director must exercise independent judgment and by virtue of Section 159 is also obliged to avoid conflicts of interest.

Section 158 of the Bill provides that a director is required to exercise reasonable care, skill and diligence, meaning the skill required given the knowledge skill and experience that a director has or that which may reasonably be expected of him given the functions he carries out. Thus whilst there is a high degree of possible subjectivity in the scope of the obligations set out in Section 156, the standard of care will be measured by reference to both an objective and a subjective test. This approach was first adopted by Section 214 of the Insolvency Act 1986 when assessing whether directors should be made liable to contribute to the assets of a company in liquidation for wrongful trading.

The standard was utilised by Hoffmann LJ when deciding the general duty of care applicable to the director of a solvent company.[68]

Under Section 240 of the Bill the court must give permission for the bringing of a derivative claim. This procedural requirement is subject to a number of safeguards set out in Section 242. One of these is that the court will not give permission for the derivative claim to proceed unless the shareholder's claim will facilitate the promotion of the success of the company. The court will also have regard to whether the claimant is acting in good faith and as to the likelihood of a majority of the shareholders approving the directors' actions. Ratification by shareholders will be harder to achieve in future, as under Section 216 of the Bill the votes of those interested in the ratification must be disregarded. This should enhance the prospects of a shareholder being able to mount a derivative action.[69]

In what circumstances will a minority shareholder be able to argue that a director is, or is about to be, negligent or in breach of his duties to the company, thus enabling the shareholder to bring a derivative action on behalf of the company? Whatever the legal position, a shareholder will have to overcome significant practical difficulties, ranging from the informational to the financial,[70] and will still require the consent of the court to proceed. The English Attorney-General, Lord Goldsmith, pointed out in a very full statement[71] during the Parliamentary debate on the Bill, that the new form of derivative action:

> is a fail-safe mechanism rather than a weapon of first resort. It is important to remember … that the damages are paid not to individual shareholders but to the

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[68] *Re D'jan of London Ltd, Copp v D'jan* [1994] 1 BCLC 561; *Norman v Theodore Goddard* [1991] BCLC1028. Janet Dine emphasise in *Company Law* (op cit, n 46 at p 192) the problems which the courts have historically experienced in developing a standard of behaviour for directors: 'The difference in the sizes and complexity of companies and the differences in the degree of involvement of the directors in question, coupled with the unique economic circumstances surrounding each decision, make it difficult for the court to build up a body of precedents. This is unlike judging the performance of other professions where often similarly qualified persons have had similar decisions to make.' However, professionals such as accountants and lawyers often have to deploy their professional skills on matters which range widely in terms of their complexity and financial significance and are still subject to the threat of an action for negligence. The development of directors' duties away from the purely subjective approach adopted in cases such as *Re City Equitable Fire Insurance* [1925] Ch 407 is, however, helpful.

[69] Janet Dine, op cit, n 46 at pp 254 & 255, has suggested that the approach of allowing the majority of shareholders to ratify acts of the directors ' … where shareholders' property rights are being infringed' is inappropriate, since such a vote by the majority would be ' … merely an assertion that their personal interests lie in one course of action not that their derivative interests lie in that course'. This is in the light of her earlier remarks, op cit, n 46, at p 150, citing *Pender v Lushington* (1877) 6 Ch D 70, that ' … a shareholder may exercise his vote as he pleases and does not have any duty to take into account the interests of others or of the company'.

[70] AJ Boyle in AJ Boyle, *Minority Shareholders' Remedies*, Cambridge, CUP, 2002, points out at p 9 ' … that the two most significant barriers to successful shareholders' proceedings (especially in the case of derivative suits) are: (a) the difficulty of obtaining, in advance of litigation, adequate evidence to support alleged wrongdoing (even where this is strongly suspected); and (b) the difficulty posed by the great expense of such civil litigation (without any hope of direct personal benefit)'.

[71] Hansard 27th February 2006 Columns GC5 and 6.

company itself, and yet it is the shareholders, the members who bring the action, who may be required to bear heavy legal costs.

> … a derivative action is not and will not be the same thing as an American-style shareholder class action brought in the name of a group of shareholders. Under the Companies (Audit, Investigations and Community Enterprise) Act 2004 … companies may already indemnify directors against any liability incurred in respect of such actions, even if judgment is given against the director.
>
> What do we expect? … we do not expect there to be a significant increase in the number of derivative claims as a result of putting derivative action on a statutory footing … There will continue to be tight judicial control of such cases …
>
> We also expect the courts to respect commercial judgments; the procedure that we impose will ensure that …
>
> We have to strike a careful balance between protecting directors from vexatious and frivolous claims and protecting the rights of shareholders. It would be dangerous to move to far against either of those interests. Have the Government got the balance right? We believe that we have

The Attorney-General appears to be categorising the reforms as merely clarifying the circumstances in which a claim can be brought. He envisages them as no more than a statutory replacement of the existing cumbersome common law doctrine. However, the right to bring a derivative action is now linked to any breach of a director's duties, including his duty of care.

After lobbying by industry and City law firms,[72] the government has belatedly realised that the prospects for derivative actions have been significantly enhanced by the Bill's provisions. It has apparently decided to reform the procedural aspects of the Bill to inhibit derivative claims. According to a Financial Times report published as this article was being written:[73]

> The government … [has] acted to quell fears the [Company Law Reform Bill[74]] would trigger mass litigation against companies. Lawyers warned that a right in the bill for minority shareholders to sue a director without board approval would unleash a flood of lawsuits.
>
> The courts will be given powers to curb such claims. A two stage process will require judges to dismiss "non-meritorious" claims early on without a company having to mount a detailed procedural defence. The courts will also get an express power to punish undeserving litigants with cost orders.

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[72] AJ Boyle remarks at p 13 of *Minority Shareholders' Remedies,* op cit, n 70), 'It is obviously expected that those whose function it is to represent the interests of the large public companies (e.g. the CBI and leading firms of city solicitors) will resist any change in the law which might encourage an "active" market in civil litigation by minority shareholders.'

[73] Financial Times, 4th May 2006, front page article, 'Companies win safer shield from lawsuits'.

[74] Op cit, n 3.

## 11. THE SPECTRE OF US STYLE CLAIMS – EU REACTION TO THE US MODEL

Like the Commission in its Green and Staff Working Papers, the English Attorney-General seems to regard class actions and US attorney style intervention as 'opening the floodgates' and involving 'the horrendous spectacles I have seen mentioned in some places'. But it is not clear that this accurately depicts how derivative actions operate in the US. In addition the changes introduced to the duties of directors result in fiduciary obligations and a duty of care which bear striking similarities to the same obligations and duties imposed on directors in the US. If the English courts adopt the same approach as the Courts of Delaware in interpreting these duties, directors will have little to fear.

Neelie Kroes is the European Commissioner who heads the Directorate General for Competition and is in charge of European Competition Policy. She observed in an opening speech at the recent conference entitled, 'Private enforcement in EC Competition law: the Green Paper on damages actions':

> I should respond to those who allege that we are importing alien American concepts into our pristine European system. First, I can say unashamedly that we have learnt some lessons from the US system.[75]

However, she went on to state that, notwithstanding this very evident influence by the US antitrust laws on EC competition law:

> I do not want to cut-and-paste an American style system here … I have the feeling that we can find our own way on this … for example by enhancing the possibility of collective actions by consumer organisations. I am not naïve about the bear traps we need to avoid. We must avoid excessive levels of litigation. We must avoid speculative law suits prompted by ambulance-chasing lawyers. We must avoid an avalanche of unmeritorious claims.[76]

As Carl Baudenbacher, President of the EFTA Court, pointed out in his presentation 'Green Paper on Private Enforcement – Some Reflections on Damages',[77] the Commission faces the dilemma of 'Fostering "a competition culture" but not "a litigation culture"'. He questions whether this self imposed conflict in regulatory goals represents 'swimming without getting wet'? Since enforcement of the US antitrust laws is undertaken to a very high degree by private action, and it is this culture of private action which the Commission wants to help create, the position adopted by the Commission and Neelie Kroes seems inherently contradictory.[78] The Commission

[75] 9 March 2006, 'More private antitrust enforcement through better access to damages: an invitation for an open debate', p 4. http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/06/158&format=HTML&aged=0&language=EN&guiLanguage=en accessed on 4th May 2006)

[76] Ibid, p 4.

[77] ERA Conference, Brussels, 9 March 2006: http://www.era.int/web/en/resources/5_2341_2397_file_en.3238.pdf accessed on 4th May 2006.

[78] See the observations of the panel chaired by Sir Christopher Bellamy at the British Institute of International and Comparative Law workshop held on 15th October 2004 in which it was observed that, 'In the US, private

seems to want to devolve responsibility for enforcement by encouraging private litigation, but, as a powerful bureaucratic institution, also seems frightened of losing control of competition law enforcement to lawyers in the process.[79]

Whatever the advantages or disadvantages of US antitrust suits, there is certainly a vigorous litigation culture which underpins American antitrust enforcement. Does the role of derivative actions in the US indicate how matters might develop in England once the Company Law Reform Bill becomes law?

## 12. GUIDANCE FROM THE US – THE SHAREHOLDER DERIVATIVE ACTION

### 12.1. The Shareholder Derivative Action

Under Rule 23.1 of the US Federal Rules of Civil Procedure, one or more shareholders may bring a derivative action to enforce the right of a corporation, if that corporation has failed to do so. In order to bring such a claim the shareholders need to specify the efforts they have made to obtain that the requisite action is taken by the directors or, if necessary, the shareholders or that any such demand would be futile. The derivative action may not be maintained if the shareholders seeking to bring the claim cannot demonstrate that they fairly and adequately represent the interests of the shareholders in enforcing the rights of the corporation. Typically the derivative action is brought against directors who have not responded to the shareholders' demand that action be taken. The corporation is joined in as a defendant, but subsequently transformed into a plaintiff on whose behalf the action is being brought.

In *Fanchon & Marco, Inc v Paramount Pictures, Inc*[80] the plaintiff owned 50% of a joint venture company, Paramount Hollywood Theatre Corporation, which it had established with Paramount Pictures Inc. The plaintiff originally sued for individual injury to its property and business, on behalf of the joint venture company (claiming the action had director approval) and as a shareholder bringing a derivative suit on behalf of the joint venture company. All three claims were for the same antitrust injury Paramount Pictures was alleged to have caused to the joint venture company. The trial judge dismissed the plaintiff's actions, finding as regards the second of these that the action was not properly authorised and concluding that the plaintiff lacked standing to bring an action for treble damages under section 4 of the Clayton Act in respect of the individual and derivative claims. On appeal the court held that the lack of corporate authorisation made 'more apparent the need of the remedy of a stockholder's derivative

actions account for 90% of antitrust litigation, the EU the (sic) number is closer to zero.' http://www.biicl.org/admin/book/report_competition_litigation_15_oct_04_final.pdf accessed on 4th May 2006.

[79] It should also be borne in mind that European companies are increasingly participating in US class actions in order to deter corporate fraud and recover losses, see M Willis & R Roseman, 'Getting in on the Action' (2005) 51 European Lawyer 35. They note that European investors have sought appointment as lead plaintiffs (who define the class of plaintiff and hence who may recover under the action) in a number of cases and ' … most notably in the shareholder class action against Parmalat – which is being led exclusively by European investors.'

[80] Op cit, n 33.

action'.[81] It went on to hold that the plaintiff was able to bring a derivative action, citing[82] Mr Justice Jackson in the earlier analogous case of *Koster v (American) Lumbermens Mutual Casualty Co*:[83]

> The stockholder's derivative action … is an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty by corporate managers. Usually the wrongdoing officers also possess the control which enables them to suppress any effort by the corporate entity to remedy such wrongs. Equity therefore traditionally entertains the derivative or secondary action by which a single stockholder may sue in the corporation's right when he shows that the corporation on proper demand has refused to pursue a remedy, or shows facts that demonstrate the futility of such a request.

In *Ash v International Business Machine, Inc*[84] the Third Circuit Court stated that the right to bring a derivative suit under the Clayton Act for antitrust breaches arose in the following circumstances:

> The Supreme Court, and, following it, the Courts of Appeals have repeatedly stated and applied the doctrine that a stockholder's derivative action, whether involving corporate refusal to bring antitrust suits or some other controversial decision concerning the conduct of corporate affairs, can be maintained only if the stockholder shall allege and prove that the directors of the corporation are personally involved or interested in the alleged wrongdoing in a way calculated to impair their exercise of business judgment on behalf of the corporation, or that their refusal to sue reflects bad faith or breach of trust in some other way.

### 12.2. The Duties of Directors

Directors' powers and obligations are laid down by State laws, with the most crucial State law being that of Delaware, where most US incorporations occur. As in English law, the board of directors of a US corporation will be the governing body responsible for the company's management and policymaking.[85] Under US State laws, in general terms, those board members have a fiduciary duty to the corporation, including the duties of care, loyalty and good faith. Directors are required to act reasonably, prudently, and in the best interests of the corporation, to avoid negligence and fraud and to avoid conflicts of interest. The general duty of care obligation requires them to exercise such care, including reasonable enquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

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[81] Ibid, at p 733.

[82] Ibid at p 734.

[83] 330 US 518, 522, 523, 67 S.Ct. 828, 91 L.Ed. 1067.

[84] 353 F.2d 491, 493 (3d Cir. 1965) cert. denied, 384 US 927, 86 S.Ct. 1446, 16 L.Ed.2d 531 (1966), and see *United Copper Securities co. v Amalgamated Copper Co.*, 244 US 261, 37 S.Ct. 509, 61 L.Ed. 1119 (1917)

[85] See for instance Title 8 Del.C. 141(a), which provides that the business affairs of a Delaware corporation are to be managed by its board of directors.

The director's duty of care requires commitment, attendance, a need to be informed and to make enquiry.[86] Directors cannot rely on difficult issues being brought to their attention but must maintain adequate information and reporting systems.[87] Directors must act and think independently. They may be guilty of nonfeasance where they show a pattern of inattention and neglect through a failure to supervise and to monitor the activities of the company.[88] They can be liable for misfeasance or faulty decision making, see for instance the critical case of *Smith v Van Gorkom*.[89]

This duty of care is subject to the 'business judgment rule', as set out in the cases of *Van Gorkom* and the derivative litigation relating to *Walt Disney*[90] pursuant to which the courts have shown a reluctance to interfere with informed business decisions. As the court explained at p 872 in the *Van Gorkom* case, the business judgment rule:

> is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.

Thus where the directors act in good faith, take a reasonably informed decision and do not allow a personal conflict of interest to arise, it will be difficult for a shareholder to establish that the director is in breach of his fiduciary duties. In the *Walt Disney* case shareholders brought a derivative action alleging that the board had failed to discharge their responsibilities in agreeing a severance package worth $140 million with Michael Ovitz, who had only served a little under a year as President of Disney. Under Section 102(b)(7) of the Delaware General Corporation Law,[91] corporations can limit or eliminate the personal liability of a director to the corporation for breaches of his duty of care. In these circumstances the plaintiffs were left to try to establish that Mark Ovitz had breached his duty of loyalty and that the remaining directors had breached their duty of good faith. These claims were dismissed by the Chancery Court which held that:

> A failure to act in good faith [would occur] … where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the company, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.

This is a very high threshold for a claimant to overcome. The Delaware Chancery Court's decision has been appealed to the Delaware Supreme Court.

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[86] *Briggs v Spaulding*, 141 US 132 (1891) and in *re Caremark International Inc Derivative Litigation* 698 A.2d 959 (Del. Ch. 1996)

[87] *Graham v Allis-Chalmers Manufacturing* 188 A.2d 125 (Del.1963).

[88] In *re Caremark International Inc.*, op cit, n 86.

[89] 488 A.2d 858 (Del. 1985)

[90] 2005 WL 1875804 (Del. Ch. Aug. 9 504)

[91] Title 8 Del C 102(b)(7).

So, derivative actions in the US are typically brought by shareholders in order to sue directors who are alleged to be in breach of their duties. The directors are usually insured and the Chancery Court of Delaware in the *Walt Disney* derivative litigation has erected an impressive defence for directors confronted by such an action given the width of the business judgment rule.[92]

## 13. CONCLUSIONS

The English Attorney General seems to regard the Company Law Reform Bill as merely codifying and clarifying the existing common law relating to directors' obligations and derivative actions. However, these law reforms appear to be more wide ranging. They impose a greater burden on directors to consider a variety of interests and to be informed and effective in protecting the company's rights. Any failure to respond to these amplified duties is likely to face greater challenge. It would be open to a shareholder to argue that any failure to give proper consideration to the prospects of an antitrust action was a breach of duty entitling the shareholder to bring a derivative action.

Much will depend on how the English courts approach these directors' duties and whether a 'business judgment rule', protecting the directors, is developed by them. English courts are generally reluctant to re-examine business decisions but greater judicial scrutiny is now possible. According to Brenda Hannigan,[93] the Company Law Committee of the Law Society and the Law Reform committee of the Bar Council were concerned about the codification of directors' duties. She describes their concerns as being that:

> the duties are stated in new language which must be interpreted by the courts with consequential costs to business, it will encourage the courts to second-guess business decisions

She comments that:

> to the extent that the duties enact the common law, the existing authorities will be capable of being invoked to explain the nature of the duties which they codify … but given the uncertainty as to the extent to which the statutory statement does reflect the current law, it is more likely that the courts will consider themselves to be starting from a blank sheet[94]

Despite Lord Goldsmith's statement, it remains to be seen what balance the judiciary will strike. It also remains to be seen what use the courts will make of the enhanced procedural powers which the government apparently intends to give them to dismiss 'non-meritorious' claims.

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[92] See the remarks of J Macey, 'Delaware: Home of the world's most expensive raincoat' (2005) 33 Hofstra Law Review 1131 at 1132, 'The deep meaning of the Disney derivative litigation can be easily summarized … directors, in the end, are protected from liability by the slow and steady hand of the Delaware judiciary.'

[93] B Hannigan, *Company Law*, London, LexisNexis Butterworths, 2003, at p 216.

[94] Ibid, at pp 217 & 218.

Accordingly, if enacted, the Company Law Reform Bill proposals relating to directors' duties and derivative actions will need to be tested vigorously in order to assess whether the rights of shareholders are adequately safeguarded.

These reforms and the existing jurisprudence of the European Court put directors under greater pressure to enforce rights to damages under Articles 81 and 82 EC. The European Court of Justice regards shareholders as intended beneficiaries of effective national remedies[95] and any shareholder whose shares have been devalued by, say, a cartel operating in reach of Article 81 EC may well be able to demonstrate that the chain of causation has not been broken under English law in a subsequent civil action.[96] The Commission plainly wants to expand the scope of private of enforcement of competition law in the EU.

Limited standing in the US for shareholders is a direct result of the availability of a treble damages remedy. The absence of direct standing for individual shareholders and the current difficulties in bringing derivative actions under English law mean that, as the law presently stands and without a far more liberal judicial approach following the enactment of the Company Law Reform Bill, any shareholder in a company incorporated in England whose company has been injured by a clear breach of European competition law does not have an effective national remedy.

[95] *Brasserie du Pecheur SA v Bundesrepublik Deutschland* and the *Queen v Secretary of State for Transport, ex parte: Factortame Limited,* op cit, n 17.

[96] *Arkin v Borchard Lines (No. 4),* op cit, n 22.