The Undermining of UK Corporate Governance (?)

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Keywords: Corporate Governance, Corporate Ownership and Control, Minority Shareholder Protection, FTSE 100, Listing Rules

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Abstract

Over the past dozen years numerous overseas based businesses with dominant shareholders have become quoted on the London Stock Exchange, prominent examples of which have joined the 'blue chip' FTSE 100 stock market index. While this trend has generated concerns about the 'undermining' of UK corporate governance and has fostered reform proposals by the Financial Services Authority it has thus far escaped academic attention. This paper explains why companies with dominant shareholders have been migrating to London and discusses the policy implications. In so doing it shows that the Financial Services Authority's proposals mostly cover familiar ground rather than being innovative but maintains that the case for radical reform has in fact not yet been made out.

Keywords: corporate governance; corporate ownership and control; minority shareholder protection; FTSE 100; listing rules

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1. Introduction

For decades, a hallmark of British corporate governance has been a separation of ownership and control.[1] Most publicly traded companies, especially larger ones, have lacked a dominant shareholder, and investors have typically taken a ‘hands off’ approach to corporate affairs. This arrangement has created risks that corporate executives will exploit the discretion they have and impose what are referred to as ‘agency costs’ on shareholders. Corporate governance reform in the UK has therefore focused primarily on enhancing managerial accountability.

The emergence of various high-profile exceptions to conventional ownership and control arrangements is now posing challenges for the UK system of corporate governance. A cohort of overseas-based businesses, typically operating in mining and metals, have sought over the past dozen years to expand their investor base and burnish their corporate reputations by listing on the London Stock Exchange, with the most prominent joining the blue-chip FTSE 100 stock market index. A prevalent feature among these additions to the London Stock Exchange has been the presence of ‘blockholders’, namely a single shareholder or a cohesive alliance of shareholders owning a sufficiently sizeable percentage of voting shares to exercise considerable influence over corporate affairs.

Publicly traded companies with dominant shareholders pose different corporate governance challenges than their widely held counterparts. Managerial accountability is unlikely to be a source of serious concern because the blockholders should have both the means and the motive to discipline wayward executives. There is a danger, however, that the dominant shareholders will use their influence to secure private benefits at the expense of

[1] B.R. Cheffins, *Corporate Ownership and Control: British Business Transformed* (OUP 2008), 1, 19.

outside investors. As the *Financial Times* said of the migration of mining and metals groups to the London Stock Exchange in 2011, 'It (has) led to the creation of a class of companies where a tiny number of powerful shareholders could in theory ride roughshod over the rights of minority shareholders.'[2] Due to blockholders typically being the exception to the rule in Britain's publicly traded companies, the UK's corporate governance regime has generally not been tailored to be responsive to the challenges they pose. The influx of overseas-based businesses with blockholders implies a rethink is in order.

What has been characterized as the 'undermining'[3] of UK corporate governance has generated substantial media coverage and has elicited responses from regulators. The topic, however, has not yet attracted the attention of academics. Correspondingly, this paper describes how market trends have been altering the corporate governance terrain in the UK and analyzes the policy implications, with particular reference to the position of minority shareholders.

The paper begins by describing how the quotation of companies on the London Stock Exchange with strong roots outside Britain has begun to reshape patterns of ownership and control and may well continue to do so. Next, the corporate governance implications of this trend will be identified, with particular reference to the possible extraction of private benefits of control by dominant shareholders. This will be followed by an analysis of the legal rules and corporate governance arrangements that offer protection for minority shareholders

2 W. MacNamara and A. Smith, 'The Eurasian Equation' *Financial Times* (London, 24 June 2011).

3 'Undermining the UK Stock Market' *Financial Times* (London, 18 October 2011); R. Sunderland, 'Hoist British Standard Over the FTSE 100' *Daily Mail* (London, 5 November 2011).

against overreach by blockholders. Particular emphasis will be placed on proposals to revise the Listing Rules, which regulate the affairs of companies with shares listed for trading in the UK as a chapter in the FSA Handbook that governs the UK financial services industry.[4] The proposed changes, which are oriented around ensuring companies with dominant shareholders can operate independently from those shareholders, do not constitute a marked departure from former regulatory arrangements and current market practice. This likely is a good thing. Though the possibility of dominant shareholders undermining UK corporate governance is a real one, at this point the case for radical reform has not yet been made out.

2. The Blockholder Influx

Britain, unlike most other industrialized countries, has an 'outsider/arm's-length' system of ownership and control, in the sense that most large business enterprises are traded on the stock market and lack a 'core' shareholder capable of exercising 'inside' influence.[5] Over the past decade, this ownership and control pattern has been disrupted at least partially by an influx of overseas-based businesses with dominant shareholders. The foreign migration to London and the FTSE 100 can be traced back to 1997 when Gencor, a South African mining giant, spun off its base minerals operations to a newly incorporated UK subsidiary, Billiton plc. Billiton went public on the London Stock Exchange with Gencor retaining a majority stake and soon thereafter joined the FTSE 100.[6]

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4 Financial Services Authority, 'FSA Handbook', http://fsahandbook.info/FSA/html/handbook/, accessed 6 February 2013.

5 Cheffins (n 1) 5-6.

6 M. Woolf, 'Gencor Plans £1 Billion London Flotation' *Observer* (London, 1 June 1997); K. Gooding, 'Billiton Ensured of FTSE 100 Place' *Financial Times* (London, 23 July 1997).

When in 1999 two additional major South African companies re-domiciled in the UK and moved their primary stock market listings to London, one journalist observed 'There has surely never been another occasion when three emerging market companies have barnstormed the top echelons of an index as influential as the FTSE 100....'[7] This 'foreign invasion'[8] would soon accelerate. Between 2002 and 2011 a dozen overseas-based businesses with major blockholders became quoted on the London Stock Exchange and became constituents of the FTSE 100 or the FTSE 250 (Table 1).

Table 1: Major London Stock Exchange IPOs with Major Blockholders, 2002 Onwards

Company	**Year of UK Initial Primary or Premium Listing**	**Industry**	**Country where business activities are primarily conducted and country of incorporation**	**Dominant Shareholder(s) (percentage of shares owned at time Primary or Premium Listing Obtained)**	**Years in FTSE 100**	**Landmark features**
Xstrata plc	2002	Mining	Switzerland/UK	Glencore (40 per cent, subsequently 34 per cent)	2003-onwards	
Vedanta Resources plc	2003	Metals	India/UK	Anil Agrarwal (founder, CEO, 57 per cent)	2006 onwards	First Indian business to have its primary listing on the London Stock Exchange
Kazakhyms plc	2005	Copper miner	Kazakhstan/UK	Vladimir Kim, two other executives (collectively more than 70 per cent)	2005 onwards	First business from the former Soviet Union to have its primary stock market listing in London
Hochschild	2006	Silver and	Peru/UK	Eduardo	N/A;	The first

7 C. Wright, 'After the Trek to London, the Toughest Part Begins' *Corporate Finance*, April 1999.

8 F. Guerrera, 'London is Braced for Foreign Invasion' *Independent*, (London, 1 March 1999).

Mining plc		gold miner		Hochschild (controlling shareholder)	FTSE 250, 2006 onwards	Latin American business to go public on the London Stock Exchange for a century.
Eurasian Natural Resources Corporation plc	2007	Metals	Kazakhstan/UK	Kazakh government (19 per cent), Kazakhyms and ENRC's three founders (nearly 15 per cent each)	2008 onwards	
Ferrexpo plc	2007	Iron ore producer	Ukraine/ Switzerland/UK	Kostyantin Zhevago (73 per cent, 51 per cent by 2008)	2008 (FTSE 250, 2008 onwards)	First Ukrainian business to list on the London Stock Exchange
Fresnillo plc	2008	Silver mining	Mexico/UK	Peñoles, controlled by Mexican billionaire Alberto Bailleres controls (over70 per cent)	2008 onwards	First Mexican business ever to list on the London Stock Exchange.
Essar Energy plc	2010	Energy company	India/UK	Raviv family via the Essar Group (77 per cent)	2010-12	
Glencore International plc	2011	Commodities trader	Switzerland/ Jersey	485 senior employees (82 per cent), including the CEO (nearly 16 per cent)	2011 onwards	Largest initial public offering ever carried out in London
Polymetal International plc	2011	Gold and silver miner	Russia/Jersey	Three investors, two Russian and one Czech (48 per cent)	2011 onwards	
Evraz plc	2011	Steelmaker	Russia/UK	Roman Abramovich (35 per cent), Evraz chairman (24 per cent), CEO (12 per cent)	2011 onwards	
Bumi plc	2011	Coal mining	Indonesia/UK	Bakrie family (47 per cent), Rosan Roeslani (13 per cent), Nat Rothschild (11 per cent)	N/A; FTSE 250, 2011 onwards	

Sources: IPO prospectuses, Daily Mail, Economist, Financial Times, Independent, Observer, Times

Data compiled by the FTSE Group, the stock market index provider responsible for administering the FTSE 100, the FTSE 250 and numerous other stock market indices, illustrates the impact of the influx of overseas-based businesses on ownership structure. Since 2001 the FTSE Group has weighted its stock market indices to take into account the 'free float' of the companies involved, attributing a reduced weighting to companies where a substantial proportion of shares are held by investors unlikely to exit purely as a matter of investment strategy, such as founders, directors, other companies, employee share schemes and government shareholders.[9] While the FTSE Group is moving now to actual free float percentages, it has traditionally accounted for free floats by way of weighting bands.[10] Hence, if a company had a free float of more than 75 per cent there would be no free float discount, whereas a company with a free float of between 50 per cent and 75 per cent would be weighted on the basis that its free float was 75 per cent.[11]

Most FTSE 100 companies, lacking dominant shareholders, have a free float exceeding 75 per cent and thus have not had a free float discount applied. However, due in substantial measure to the influx of overseas-based mining and metals businesses, the proportion of FTSE 100 companies with a smaller free float grew considerably between 2005

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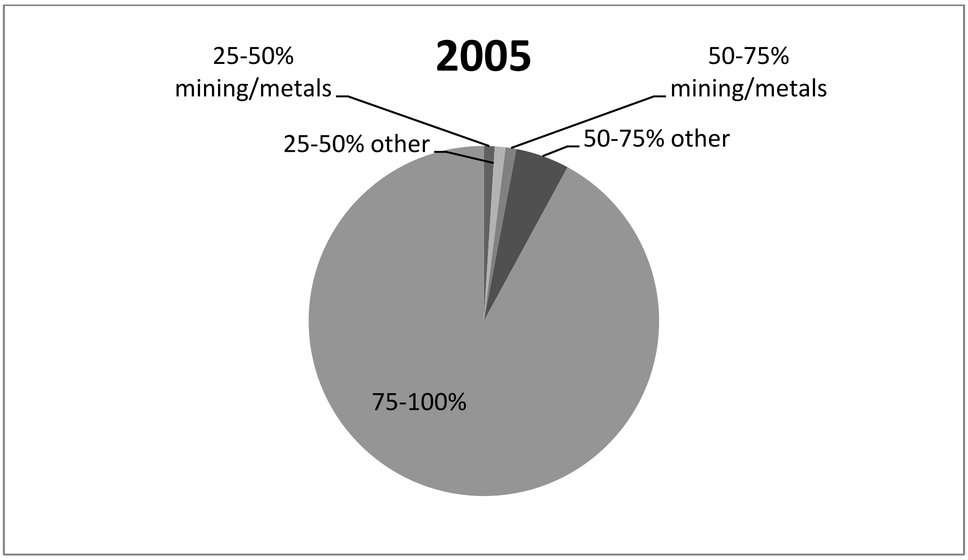
[9] P. Atherton, 'Why Your Tracker is Changing' *Telegraph* (London, 17 June 2001).

[10] FTSE Group, 'FTSE Indices - Free Float Methodology Change' (18 June 2012), available at http://www.ftse.com/tech_notices/2012/Q2/35710_20120618_Global_FF_methodology.jsp, accessed 7 February 2013

[11] FTSE Group, 'FTSE Free Float Methodology Change FAQ', October 2012, 3-4, available at http://www.ftse.com/Indices/FTSE_Index_Standards/FTSE_Free_Float_Methodology_Change_FAQ311012_FINAL1.pdf, accessed 7 February 2013.

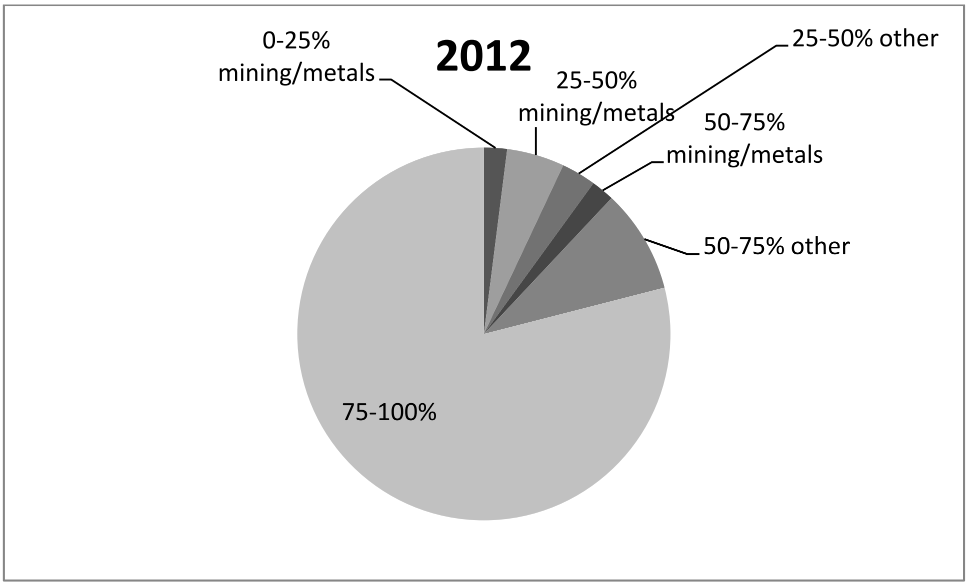
and 2012 (Figures 1, 2). The surge in the number of mining and metals businesses with a free float of less than 75 per cent was driven primarily by companies where the proportion of shares held by 'arm's-length' investors was in fact below 50 per cent.

Figure 1: Free Float, FTSE 100 Constituents, June 2005



Source: Data provided by FTSE Group

Figure 2: Free Float, FTSE 100 Constituents, July 2012



Source: Data provided by FTSE Group

Why have overseas-based blockholder-dominated businesses migrated to London? Typical objectives include raising the profile of the company, broadening the investor base and increasing liquidity in the dealing of shares.[12] Other leading stock exchanges can offer similar benefits, but for companies in metals and mining London's flourishing community of investment bankers, brokers and analysts specializing in mining and commodities is a strong draw.[13] The possibility of a FTSE 100 listing is as well. Major national stock market indices, such as the Dow Jones Industrial Average, France's CAC index and Germany's Dax, tend to be closely tied to their respective home markets.[14] Matters are somewhat different with the FTSE 100. It is not intended to be a barometer of the UK economy but rather functions as a list of the biggest companies which treat the London Stock Exchange as the primary stock market on which trading of their shares occurs.[15] Correspondingly, for large overseas-based businesses that list in London becoming a FTSE 100 constituent is a realistic objective.

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12 'Sterling Silver' *Economist* (London, 17 May 2008); M. Kavanagh, 'Polymetal Placing Paves Way to Debut' *Financial Times* (London, 29 October 2011); M. Atherton, 'London Calling: Why a Listing in the UK is Proving so Attractive' *Times* (London, 17 November 2012).

13 R. Wigglesworth, 'Listings: Gold Standards' *Financial Times* (London, 6 December 2011).

14 R. Sutherland, 'FTSE in Crisis' *Observer* (London, 6 June 2010).

15 S. Watkins, 'Footsie Serves as a Barometer for the World' *Mail on Sunday* (London, 6 June 2010).

Prestige is part of the FTSE 100's attraction, with being a member of a globally-known index of blue chip companies being a badge of honour.[16] As a *Financial Times* columnist observed in 2011, 'Right now nothing says you have arrived as an international entrepreneur quite so much as owning a big stake in a FTSE 100 company.'[17] More prosaically, there will be something of a captive market for a FTSE 100 company's shares because of 'trackers', collective investment vehicles promising to mimic at low cost the performance of stock market indices. Numerous tracking funds market themselves on the basis they replicate the performance of the FTSE 100 and thus are under an onus to buy and hold shares in the companies that comprise the index.[18]

The reorientation of the London Stock Exchange and the FTSE 100 does not appear to a mere fad. The Financial Services Authority (FSA), which is ceding its role as the regulator with responsibility for UK financial markets to two successor bodies in 2013,[19] acknowledged the point in a 2012 consultation paper on amendments to the Listing Rules it oversees in its capacity as the UK Listing Authority, saying that companies with a majority

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16 A. Jones, 'Re-Drawing the Blue Chip Index Map' *Financial Times* (London, 1 June 2010); K. Burgess, 'Investor Unease at London's Foreign Influx' *Financial Times* (London, 29 October 2011).

17 J. Guthrie, 'Abramovich Switch Tests Mettle of FTSE 100 Index' *Financial Times* (London, 18 October 2011).

18 Atherton (n 12); 'The Tories' Beloved City is More Fond of Filthy Lucre than Pristine Corporate Values' *Observer* (London: 11 December 2011); J. Moore, 'ENRC is a Blue Chip Company – But Just for Gamblers' *Independent* (London: 12 June 2012).

19 Financial Services Authority, 'CP 12/24: Regulatory Reform: PRA and FCA Regimes Relating to Aspects of Authorisation and Supervision,' (2012), 7, available at http://www.fsa.gov.uk/static/pubs/cp/cp12-24.pdf, accessed 28 January 2013.

shareholder represented ‘a sizeable proportion of the companies coming to conduct an IPO (initial public offering) in London, and we have no reason to believe this trend will be reversed in the near future.’[20] For instance, in 2012 MegaFon, a Russian telecoms company 50 per cent owned by Russia’s richest person (Alisher Usmanov), raised £1.7 billion by making available for dealing on the London Stock Exchange 15 per cent of its shares, perhaps setting the stage for a repeat of the 2011 move into the FTSE 100 by fellow Russian-oriented firms Evraz plc and Polymetal International plc.[21] Similarly, Alico Dangote, Africa’s richest person, has indicated that Dangote Cement, an industrial conglomerate he controls, would like to list on the London Stock Exchange and sell a minority stake to public investors to finance expansion.[22]

3. Corporate Governance Implications

The fact that the ownership structure of overseas based businesses migrating to the London Stock Exchange and the FTSE 100 is a departure from the norm for Britain poses challenges for the UK system of corporate governance. When, as has typically been the case

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20 Financial Services Authority, ‘CP 12/25: Enhancing the Effectiveness of the Listing Regime and Feedback on CP 12/2’ (2012), 90, available at http://www.fsa.gov.uk/static/pubs/cp/cp12-25.pdf, accessed 25 January 2013.

21 G. Spanier, ‘Megafon’s Not so Mega Start’ *Independent* (London, 29 November 2012); J. Quinn, ‘Myners Defends MegaFon’ *Sunday Telegraph* (London, 2 December 2012); D. Hamilton, ‘Russian Metals Groups Apply for London Listing’ *Herald* (Glasgow, 24 October 2011).

22 X. Rice, ‘Dangote Plans London Listing for Stake in Cement Business’ *Financial Times* (London, 2 April 2012); A. Hirsch, ‘Africa's Richest Man is Cementing his Place in History’ *Guardian* (London, 4 April 2012).

with larger publicly traded companies in the UK, a company has widely dispersed share ownership there is a substantial risk shareholder apathy will create for the executives in charge substantial latitude to act in an ill-advised or self-serving manner and impose managerial 'agency costs' on investors. Correspondingly, corporate governance reform in the UK has largely focused on the enhancement of managerial accountability.[23]

'The UK governance regime', to quote the *Financial Times*, 'is less equipped to cope when the controversial behaviour comes from large investors themselves.'[24] Enforcement of the UK Corporate Governance Code, which provides corporate governance benchmarks for listed companies,[25] illustrates the point. The Listing Rules require companies with what is referred to as a 'premium listing' to discuss and justify any failures to comply with Code provisions.[26] The logic underlying the 'comply or explain' approach the Code employs is that companies retain flexibility with respect to corporate governance while shareholders can,

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23 Cheffins (n 1) 1-3.

24 MacNamara and Smith (n 2).

25 See Financial Reporting Council, 'The UK Corporate Governance Code' (Financial Reporting Council, 2012) (hereinafter UK Corporate Governance Code), available at http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.aspx, accessed 6 February 2013.

26 Financial Services Authority, FSA Handbook (n 4), Listing Rules (hereinafter Listing Rules), para. 9.8.6(5), (6), (7); London Stock Exchange, 'A Comparison of the Eligibility Criteria and Continuing Obligations for the Main Market (Premium and Standard) and AIM' (2010), available at http://www.londonstockexchange.com/companies-and-advisors/main-market/companies/primary-and-secondary-listing/premiumstandardandaimcomparison.pdf, accessed 6 February 2013.

with the information at hand, press for change in appropriate circumstances.[27] Implicitly the shareholders the UK Corporate Governance Code is targeting are 'arm's-length' investors. The disclosures the scheme generates should be irrelevant to a dominant shareholder because that sort of investor should already be aware of a company's corporate governance arrangements and thus will not treat what is divulged as a departure point for taking corrective action.[28]

More broadly, the primary challenge the UK corporate governance system is designed to address – imposing checks on otherwise potentially unaccountable executives – is typically going to be an after-thought in companies with major blockholders.[29] Investors owning a large percentage of the shares in a publicly traded company will have a strong financial incentive to keep a careful watch on what is going on. Also, these 'core' investors should have sufficient influence to gain access to high-quality information to detect problems early and to orchestrate the removal of disloyal or ineffective managers if things are going awry. Managerial fidelity therefore is much less likely to pose a problem in companies with dominant shareholders than it is in companies with dispersed share ownership.

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[27] See UK Corporate Governance Code, 'Comply or Explain', 4.

[28] A. Smith and K. Burgess, 'Governance Concerns Rise After Spate of London IPOs' *Financial Times* (London, 17 June 2011).

[29] See generally B.R. Cheffins, 'Corporate Law and Ownership Structure: A Darwinian Link?' (2002) 25 University of New South Wales Law Journal 346, 360; R.J. Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 Harvard Law Review 1641, 1650-51; R. Kraakman *et al.*, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, (2nd edn., OUP 2009), 51-52.

While the managerial agency cost problem will be less pressing in companies with a major blockholder than it is in companies characterized by a separation of ownership and control, corporate governance may be far from ideal. The primary danger is that dominant shareholders will take advantage of their position to secure disproportionate returns known as private benefits of control.[30] Blockholders may, for instance, bestow upon themselves lucrative corporate perks unavailable to other shareholders or seek to ensconce a family member in a senior managerial position to provide a head start in life.[31]

Dominant shareholders in a publicly traded company can also potentially use related party transactions to orchestrate the non-proportional flow of corporate assets in their favour.[32] What is referred to as 'tunnelling' can be achieved by one-sided 'sweetheart' intercompany deals between a publicly traded company in which its dominant shareholder has relatively low cash flow rights and firms that shareholder wholly controls.[33] Another possibility will be for a dominant shareholder to 'squeeze out' minority shareholders with a

30 Kraakman *et al.* (n 29) 89-90; A. Dyck and L. Zingales, 'Private Benefits of Control: An International Comparison' (2004) 59 Journal of Finance 537, 541.

31 Cheffins (n 1) 62-63.

32 European Commission, 'Green Paper: The EU Corporate Governance Framework' COM 2011 164 final, 17.

33 Gilson (n 29) 1663; M. Bertrand, P. Mehta and S. Mullainathan, 'Ferreting Out Tunneling: An Application to Indian Business Groups' (2002) 117 Quarterly Journal of Economics 121, 121-22.

'going private' transaction that takes the publicly traded company off the stock market at an opportunistic price.[34]

Events concerning Bumi plc, an Indonesian-focused coal miner, illustrate the risks that related party transactions can pose. In 2010, financier Nat Rothschild raised £707 million to create a London-listed 'cash shell' (special purpose acquisition vehicle) called Vallar plc.[35] Vallar used the cash to buy a sizeable minority stake in PT Bumi Resources, a publicly traded firm controlled by Indonesia's Bakrie family that was Indonesia's largest coal producer, and a majority stake in Indonesian entrepreneur Rosan Roeslani's Berau Coal Energy, Indonesia's fifth largest coal producer.[36] In 2011 Vallar was renamed Bumi plc, with the Bakrie family owning 47 per cent of the shares, Roeslani owning 13 per cent and Rothschild 11 per cent.[37] The Bakrie family subsequently sold to Samin Tan, an Indonesian

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[34] R.J. Gilson and J.N. Gordon, 'Controlling Controlling Shareholders' (2003) 152 University of Pennsylvania Law Review 785, 787.

[35] K. Burgess and P.J. Davies, 'The Heavy Hitters', *Financial Times*, (London, 28 September 2010); C. Thompson and A. Deutsch, 'King Nat's Coal', *Telegraph* (London, 15 January 2011).

[36] T. Bawden, 'The Coal Mining Giant That's Hot to Handle', *Independent* (London, 2 November 2011); A. Deutsch and W. MacNamara, 'Timeline: Props Crack in Rothschild's Mine Venture', *Financial Times*, (London, 12 November 2011); 'Bad Blood Spills as Bumi Blame Game Turns to Open Warfare', *Financial Times* (London, 18 October 2012).

[37] Deutsch and MacNamara (n 36) 'Family's Route to Financial Difficulty', *Financial Times*, (London, 2 November 2011).

coal mining tycoon, half of their 47 per cent stake in Bumi plc to help to repay a sizable loan.[38]

Rothschild's plan was to combine high standards of corporate governance and undervalued Indonesian mining assets to create a coal mining powerhouse that would quickly join the FTSE 100.[39] Bumi plc's market capitalization failed to reach the required levels, resulting in it joining the less glamorous FTSE 250.[40] Investor concerns with related party transactions would soon contribute to Bumi's share price falling 70 per cent in 2012 and result in the company becoming 'a symbol of the pitfalls facing investors in emerging market companies, even when they have the aura of respectability that a London listing confers.'[41]

A letter Rothschild wrote in 2011 to PT Bumi Resources' chief executive officer calling for a review of the company's corporate culture was the 'opening shot' in what would become a protracted saga,[42] with one of Rothschild's complaints being that the company had

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[38] A. Deutsch, 'Bakries Offload Half of Bumi Stake to Pay Down Loan,' *Financial Times*, (London, 2 November 2011).

[39] Thompson and Deutsch (n 35); 'Bumi/Glencore', *Financial Times*, (London, 13 October 2011).

[40] J. Guthrie, 'Ousting Nat Would be Bad for Bumi and the Bakries', *Financial Times* (London, 7 February 2012).

[41] G. Chazan, 'Bakrie Resigns as Co-Chairman of London-listed Miner Bumi,' *Financial Times* (London, 8 December 2012); see also H. Thomas and J. Guthrie, 'Boost for Rothschild in Tussle Over Bumi,' *Financial Times* (New York, 8 January 2013) (Bumi share price).

[42] K. Burgess and G. Chazan, 'Investors Seek Bumi Talks with Bakries,' *Financial Times* (London, 7 February 2012).

lent hundreds of millions of dollars to parties affiliated with the Bakries.[43] The Bakrie family and Tan retaliated by threatening to use their voting power to pass a shareholder resolution dismissing Rothschild as a Bumi plc director and Rothschild subsequently quit the board while accusing Tan of being complicit in the oppression of minority shareholders.[44] A Bumi plc initiated investigation of irregularities at PT Bumi Resources, including allegations of undeclared related party transactions where the Bakries reputedly acquired two mining infrastructure companies from PT Bumi at a substantial discount to actual value, would later prompt the Bumi plc board to contemplate suing to recover lost funds.[45]

While related party transactions are an obvious source of potential concern in blockholder-dominated quoted companies, a 2011 boardroom bust-up at Eurasian Natural Resources Corporation plc (ENRC), a Kazakhstan-focused metals group, illustrates that dominant shareholders can raise corporate governance eyebrows in other ways. When ENRC reincorporated in the UK and moved to the London Stock Exchange in 2007, the three Kazakh metals magnates who founded the company each entered into a 'relationship agreement' with the company designed to ensure ENRC would operate independently from the founders and pursuant to which each promised to use his voting rights to ensure there was

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43 J. Guthrie, 'Nat's Rep at Risk as Bumi Spat Spills Into Open,' *Independent* (London, 10 November 2011); D. Fortson, 'Rothschild Immature Say Partners,' *Sunday Times* (London, 13 November 2011).

44 G. Chazan, 'Bakries Move to Oust Rothschild', *Financial Times* (London, 4 February 2012); J. Aglionby, 'Bumi Governance Dispute "Put to Bed", Says Chairman,' *Financial Times* (London, 28 March 2012).

45 A. Osborne, 'Law Firm Investigates Dealings at Miner Bumi,' *Telegraph* (London, 11 December 2012); H. Thomas and B. Bland, 'Bumi to Take Legal Action for Lost Funds,' *Financial Times* (London, 23 January 2013).

a majority of independent non-executive directors on the board.[46] Sir Richard Sykes, former chief executive of pharmaceutical giant GlaxoSmithKline, and Kenneth Olisa, a leading figure in the UK's high technology sector, were among the eight individuals designated as independent directors.[47]

In 2011 ENRC's chief executive, an ally of the three founders, resigned due to board pressure. Despite the assurances in the relationship agreement about ENRC's independence, the founders responded by using their votes as shareholders to veto the re-appointment of Sykes and Olisa as directors, the first time during the 27 year history of the FTSE 100 that shareholders of a FTSE 100 company had vetoed the re-election of incumbent directors.[48] While ENRC's three founders characterized the affair as 'no big deal', reasoning 'there is no shortage of English lords to go on boards,'[49] Olisa branded the dismissals 'more Soviet than City.'[50] The *Financial Times* essentially concurred with Olisa, arguing that the clash showed

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46 Eurasian Natural Resources Corporation plc, 'Prospectus' (2007), 190, available at http://www.enrc.com/Documents/IPO/ENRC_Prospectus_FINAL_Cover.pdf, accessed 6 July 2012.

47 ibid, 185-86, 188.

48 MacNamara and Smith, (n 2); T. Bawden, 'Fiery Grandee is Out But Not Down' *Guardian* (London, 10 June 2011).

49 L. Armistead, 'Owners Say Storm Over ENRC Vote "No Big Deal"' *Telegraph* (London, 10 June 2011).

50 D. Robertson, 'More Soviet than City: the Oligarchs' Boardroom Coup' *Times* (London, 9 June 2011); R. Mason, 'In the Line of Fire' *Telegraph* (London, 12 June 2011).

'Britain's vaunted governance code can only work in controlled companies if the majority shareholders are inclined to follow its spirit.'[51]

4. Floating Into the FTSE 100

Investors concerned about the extraction of private benefits of control in companies with dominant shareholders can theoretically rely on a pure market-oriented response: do not buy the shares.[52] Putting caveat emptor into practice, however, with companies that have dominant shareholders is not entirely straightforward when a company obtains a premium listing and is large enough to merit inclusion in the FTSE 100.[53] Fund managers find themselves under pressure to buy shares in all companies in the index as a risk reduction device because the FTSE 100 is a key benchmark they are measured against.[54] Moreover, tracker funds that are marketed on the basis that they mimic the performance of the FTSE 100 typically undertake to buy and hold shares in all companies in the index.[55]

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51 'ENRC Digs Deeper' *Financial Times* (London, 13 June 2011).

52 D. Reece, 'It's Not Just Regulators Proving Complacent – So Too are Investors' *Telegraph* (London, 29 June 2011); J. Warner, 'Caveat Emptor is the First Rule of Investment, So Ignore at Your Peril' *Telegraph* (London, 14 June 2011). .

53 'Not King Coal' *Economist* (London, 11 February 2012).

54 Wigglesworth (n 13).

55 See n 18 and related discussion. Those who establish and operate index tracking funds can, however, devise 'carve-outs' that mean their funds are not forced to buy shares in particular types of companies, such as mining enterprises. See Guthrie, "Abramovich" (n 17); N. Rothschild, 'Rothschild Model Brings Listings to London' (letter to the editor), *Financial Times* (London, 19 October 2011).

The 2011 ENRC boardroom bust-up, in addition to illustrating controversies dominant shareholders can spark, cast a spotlight on the means by which the company had achieved prominence in UK investor circles as a member of the FTSE 100.[56] Inclusion in the FTSE 100 is contingent upon the market value of the shares eligible for trading being larger than the equivalent figure for at least ten index incumbent companies.[57] A company also must have a premium listing, the eligibility for which the Financial Services Authority, acting as the UK Listing Authority, determines.[58]

When ENRC applied in 2007 for a 'primary' listing, the pre-2010 equivalent of a premium listing, the FSA's Listing Rules said a company was only eligible for a primary listing if it had distributed 25 per cent or more of its shares to the public.[59] ENRC's free float in fact was only 18 per cent of the shares but the FSA relied on its ability to grant a waiver.[60] ENRC, as a UK-incorporated company, did not have to satisfy a FTSE Group rule stipulating that an overseas company could only qualify for inclusion in a UK stock market index such as the FTSE 100 if it had a free float of greater than 50 per cent; ENRC fulfilled the 15 per cent threshold then applicable to UK companies.[61] Hence, with the market value of ENRC's shares eligible for trading being large enough, it became a FTSE 100 constituent despite its 18 per cent free float.

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56 MacNamara and Smith (n 2); 'ENRC Digs' (n 51).

57 http://www.ftse.com/Indices/UK_Indices/Index_Rules/Review_Process/index.jsp, accessed 7 February 2013.

58 ibid

59 Listing Rules, para. 6.1.19(3).

60 MacNamara and Smith (n 2); Listing Rules, para. 6.1.20.

61 FTSE Group, 'Ground Rules for the Management of the UK Series of FTSE Actuaries Share Indices', Version 11.1, September 2011, paras. 4.2.3, 4.5.3, 4.5.4.

At much the same time as the ENRC boardroom fracas was sending shockwaves through London's financial district ('the City') additional companies announced their intention to engage in ENRC-style 'slalom(ing) through the UK rule book towards a FTSE 100 listing.'[62] With Russian focused steel-maker Evraz plc the UK Listing Authority followed the precedent set with ENRC and waived the 25 per cent free float requirement so as to grant the premium listing Evraz needed to qualify for the FTSE 100 after its 2011 IPO.[63] Russian miner Polyus Gold indicated at the time that it had plans, subsequently abandoned due to stumbling blocks created by Russian regulators, to follow the same path to the FTSE 100.[64]

In response to lobbying by various institutional investors concerned about dominant shareholders the FTSE Group raised in 2011 the minimum free float it required for a UK incorporated company to be included in a UK stock market index from 15 per cent to 25 per cent.[65] Most investment managers supported the change.[66] Some, however, thought a more

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62 J. Guthrie, 'Kremlin Gremlins Stall FTSE Flight of Polyus Gold' *Financial Times* (London, 26 October 2011).

63 J. Bowker, 'Russian Steel Giant Moves Closer to Blue-Chip Ranking' *Independent* (London, 8 November 2011).

64 Guthrie (n 62).

65 FTSE Group, 'FTSE Announces the Results of the Market Consultation on Minimum Free Float Requirement for the FTSE UK Index Series' 14 December 2011, available at http://www.ftse.com/2011Consultation/, accessed 7 February 2013. On the lobbying effort, see K. Burgess, 'FTSE Considers Tougher Listing Rules' *Financial Times* (London, 2 November 2011); M. Leroux and G. Parkinson, 'FTSE Emphasises Quantity to Preserve the Quality of "Free Floats"' *Times* (London: 2 November 2011).

radical approach was needed. The head of corporate governance at the National Association of Pension Funds (NAPF), which represents pension schemes with collective assets of roughly £800 billion, remarked 'This is a step in the right direction, but it doesn't go far enough. The 25 per cent minimum does not provide the protection for minority investors which is derived from being able to block a majority shareholder resolution.'[67] The NAPF urged the FTSE Group to require that a UK-incorporated company's free float be 50 per cent or more before it could be included in FTSE indices, a call which was backed by the Universities Superannuation Scheme, the UK's second largest pension fund, and various City fund managers.[68]

Following the FTSE Group's 2011 adjustments to its stock market index eligibility rules, debate concerning free float requirements shifted to the Financial Services Authority. In a January 2012 consultation paper on possible amendments to the Listing Rules the FSA identified protection of minority investors as an issue worth of consideration and asked for feedback on various safeguards that could be provided, including introducing possible changes to the minimum free float required for listing.[69] Nevertheless, when the FSA issued

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[66] D. Robertson, 'Oligarchs are Ordered to Open Their Companies to Ordinary Investors,' *Times* (London, 15 December 2011).

[67] ibid

[68] K. Burgess, 'FTSE Pushed on Investor Rights' *Financial Times* (London, 15 December 2011); S. Johnson, 'Pensions Lobby on Index Rules', *Financial Times* (London, 19 December 2011).

[69] Financial Services Authority, 'CP 12/2: Amendments to the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules' (2012), 10-11, available at http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/cp/cp12_02.pdf, accessed 9 February 2013.

a follow up consultation paper on Listing Rules amendments in October 2012 it did not recommend changing for companies seeking a premium listing the current free float requirement of 25 per cent or more of the shares listed.[70] Instead, it merely proposed that additional guidance be provided on when the free float requirement would be waived and even recommended for companies seeking a less prestigious 'standard' listing that it should be possible to proceed without meeting free float requirements if enough shares were issued to ensure sufficient liquidity.[71]

The FSA's preferred approach to reform was to make changes to the Listing Rules that would ensure that companies with a 'controlling shareholder', defined as a shareholder who together with associates held at least 30 per cent of the shares or voting power, would be able to operate independently of that controlling shareholder.[72] The FSA justified its approach in two ways.[73] First, free float requirements were said to constitute a 'blunt tool' with which to address concerns about dominant shareholders. The FSA reasoned that the free float requirement would need to be at least 70 per cent to address fully concerns about dominant shareholders, citing the fact that the UK Takeover Code deems a shareholder, or "concert party" of shareholders, owning 30 per cent or more of the shares of a quoted company to have effective control. According to the FSA, free float rules this draconian would foreclose a large number of companies from obtaining a premium listing 'where there has been no suggestion that a problem exists.'

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70 Listing Rules, para. 6.1.19(3).

71 Financial Services Authority (n 20) 105-6.

72 ibid, 91-92.

73 ibid, 88.

Second, the FSA expressed concern that strict free float requirements would compromise the London Stock Exchange's attractiveness as a venue for companies to launch initial public offerings. The FSA, citing the fact that maintaining the competitiveness of UK markets for listing securities is one of the UK Listing Authority's objectives, indicated that for companies contemplating whether to go public on a stock exchange the level of the free float required was a critical factor. On this count the FSA was in synch with government thinking, in that in September 2012 government ministers proposed addressing a perceived loss of technology IPOs to non-UK stock markets by permitting technology companies to list on the London Stock Exchange while making available to the public as little as 10 per cent of the issued shares.[74] US stock markets, the most likely destination for such firms, require that companies issue shares of a minimum prescribed value to the public (at least 1 million shares with a value of $100 million in the case of the New York Stock Exchange) rather than rely on free float rules.[75]

Ken Olisa, one of the two ENRC directors dismissed in 2011, said that the lessons arising from that boardroom rift were 'to do with behaviour not bans' and correspondingly argued that concerns about dominant shareholders could be addressed much better by positioning outside investors to use effectively the powers available to them rather than by precluding listing through tough free float requirements.[76] The FSA largely concurred in its

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[74] C. Arthur, 'Startups Offered Fast-Track London Listings' *Guardian* (London: 21 September 2012); M. Palmer, 'City Not Up to Speed for Tech Flotations' *Financial Times* (London: 21 September 2012).

[75] R. Sullivan, '"Watered Down" Free Float Rules Cause Concern' *Financial Times* (London, 15 October 2012).

[76] K. Olisa, 'Listing Authority Should Focus on Behaviour not Bans' (letter to the editor), *Financial Times* (London, 24 October 2011).

October 2012 consultation paper, saying that the vast majority of premium listed companies were committed to the standards associated with a premium listing and that where problems had arisen 'the pattern (was) one of misaligned behaviour.'[77] Correspondingly, the FSA's suggestions for reform focused on 'individual measures which (were) designed to correct in a proportionate way specific points of this misaligned behaviour.'[78] We consider in the next Part of the paper the extent to which implementation of the FSA's proposals would address concerns about dominant shareholders.

5. Key FSA Proposals Concerning Dominant Shareholders – An Assessment

While corporate governance reform in the UK has largely focused on the enhancement of managerial accountability a combination of company law, the FSA Handbook (primarily the Listing Rules), the UK Corporate Governance Code and market mechanisms offer minority shareholders in publicly traded companies protection against the risk that a dominant shareholder will take advantage of their position to secure potentially excessive private benefits of control. The FSA's proposals for reforming the Listing Rules would, if implemented, upgrade to some extent various types of minority shareholder protection and have a negligible direct impact on others. We will consider here the changes that would occur and turn in the next Part of the article to key types of minority shareholder protection the FSA's proposals do not affect directly.

To anticipate, the overall verdict that will be offered on the FSA's proposals is a mixed one. On one hand, the Listing Rule amendments would not bolster minority shareholder protection to the extent that might be anticipated. On the other hand, in areas

77 Financial Services Authority (n 20) 12-13, 90.

78 ibid, 82.

where the status quo will largely prevail minority shareholder protection is already substantial and might be improved, albeit indirectly, if the FSA's proposals are implemented.

A simplifying assumption here is that the Companies Act 2006 applies,[79] which is justifiable given that among major overseas-based businesses with dominant shareholders that have moved into the FTSE 100 or FTSE 250 most have become incorporated under UK law (Figure 1). Even an exhaustive assessment of the position with a UK-incorporated company is beyond the scope of this paper. The analysis presented here nevertheless indicates that sufficient constraints are imposed on dominant shareholders to mean that, absent additional Bumi-style sagas, radical reform is not merited.

A. Requiring Companies to be Independent From Their Controlling Shareholders

One change to the Listing Rules the FSA proposed in its October 2012 consultation paper was the adoption of a provision stipulating expressly that a listed company with a dominant shareholder be capable of acting independently.[80] A change of this nature would reverse the deletion in 2004 of Listing Rules 3.12 and 9.34, which in combination required companies with a 'controlling' shareholder (a shareholder owning 30 per cent or more of a quoted company's shares) to be able to function independently of that shareholder.[81] The

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79 Chapter 46.

80 Financial Services Authority (n 20) 93-94.

81 ibid, 92; Financial Services Authority, 'Listing Review: Table of Destinations' (2004), 7, available at http://web.archive.org/web/20050529125817/http://www.fsa.gov.uk/pubs/cp/04_16/table_destinations.pdf, accessed 28 January 2013. On the versions of paras. 3.12 and 9.34 that were deleted, see 'The UKLA Sourcebook: December 2003 amendment', Conditions for listing –

rationale for de-regulation in 2004 was that the relationship between a controlling shareholder and other shareholders could function suitably by way of disclosure and the judgment of investors.[82] A rethink was prompted by the influx of companies with dominant shareholders combined with lobbying by concerned investors.[83]

It is doubtful whether the restoration of a provision in the Listing Rules requiring that publicly traded companies with dominant shareholders be able to operate independently will make a major difference in practice. A 1998 corporate bust up involving Emerson Electric, 'a heavyweight of the US electronics industry,'[84] and Astec (BSR) plc, a UK-based quoted company in which Emerson Electric owned 51 per cent of the shares, illustrates the point. Emerson Electric's would ultimately take Astec private by acquiring all shares publicly traded but this was preceded by 'one of the most extraordinary City dogfights anyone can remember.'[85] Emerson Electric Co. approached Astec's independent directors to see if they would recommend that shareholders accept its offer to buy the remaining shares at the price at which the shares had recently been trading. Emerson shelved its offer when the

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Chapter 3, available at http://www.fsa.gov.uk/pubs/other/listing_rules_amendment.pdf, accessed 28 January 2013.

82 Financial Services Authority (n 20) 92.

83 ibid, 89, 92.

84 'Emerson/Astec', *Independent* (London, 26 November 1998).

85 C. Gresser, 'Thunder and Lightning in an Electric Storm' *Financial Times* (London: 11 February 1998); see also M. Barrow, 'Astec Succumbs to £265m Takeover' *Times* (London: 26 November 1998).

independent directors held out for better terms and subsequent discussions failed to result in an agreement as to a fair price per share.[86]

When Astec's board declined to endorse Emerson Electric's bid to take Astec private Emerson Electric used its voting power to isolate the independent directors, as it removed three Astec executives from the board and replaced them with Emerson Electric nominees.[87] Emerson Electric also put pressure on Astec to cut off dividend payments to shareholders, though it in fact did subsequently support a dividend the board declared.[88] Emerson Electric ultimately prevailed despite offering a considerably lower price than it had done when Astec's independent directors initially balked. Astec's independent directors endorsed the new proposal partly because the company's share price had fallen well below what Emerson Electric was offering due to a sharp deterioration in trading conditions.[89] The independent directors had also been largely marginalized from corporate affairs and knew a revised offer would probably not be forthcoming if they said no.[90]

Institutional shareholders accused Emerson Electric of engaging in 'bullying tactics'[91] and media reports suggested Emerson Electric 'rubb(ed) minority shareholders' noses in the

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86 *Re Astec (BSR) plc* [1998] 2 BCLC 556, 564-65, 567; P.T. Larsen, 'Emerson Changes Tactics in Battle with Astec Investors' *Independent* (London, 17 March 1998).

87 *Astec (BSR)* (n 86) 566-67.

88 ibid., 567, 571.

89 'Emerson/Astec' (n 84); C. Jones, 'Emerson in the Driving Seat' *Investors' Chronicle* (London, 4 December 1998).

90 Jones (n 89).

91 A. Edgecliffe-Johnson, 'Investors Lose Case against Emerson' *Financial Times*, (London, 8 May 1998).

dirt.''[92] Nevertheless, the London Stock Exchange, which at that point promulgated and enforced the Listing Rules, did not invoke the provision requiring a listed company to act independently of a controlling shareholder.[93] A judicial ruling following on from litigation implicitly endorsed the failure to intervene.

Eleven Astec (BSR) institutional shareholders responded to Emerson Electric's high-handed tactics by launching a petition alleging that they had been 'unfairly prejudiced' under what is now s. 994 of the Companies Act 2006.[94] In dismissing the petition Jonathan Parker J. referred to the provision in the Listing Rules requiring companies to be able to function independently of controlling shareholders. He indicated there had not been a failure to observe this provision, reasoning that that there was no conflict of interest between Emerson and Astec (BSR) because their respective businesses were complementary.[95] If Listing Rules 3.12 and 9.34 were, in effect, restored to the Listing Rules as a result of changes the FSA has proposed the impact would be minimal if the new provisions are interpreted as narrowly as they were in the late 1990s.

B. Relationship Agreements

A second change the FSA proposed in its October 2012 consultation paper to respond to concerns about dominant shareholders was amending the Listing Rules to require a company seeking to obtain and retain a premium listing to have in place a relationship

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[92] Jones (n 89).

[93] At the time, the relevant provision was Listing Rule 3.13 rather than 3.12: *Astec (BSR) plc* (n 86) 563-64. The key elements were transferred to Listing Rule 3.12 in 2000: Financial Services Authority, 'The Listing Rules' (2000), para. 3.12.

[94] *Astec (BSR)* (n 86) 559.

[95] ibid, 579.

agreement with its controlling shareholder structured to preserve the company's autonomy.[96] This proposal harkens back to the Listing Rules' past in the same way as the FSA's proposal to re-introduce a provision requiring companies to be able to operate independently of their dominant shareholder(s). In 1997 the London Stock Exchange added a Listing Rules provision requiring a listed company with a controlling shareholder to show that contractual arrangements were in force that would avoid detriment to the company's general body of shareholders.[97] The assumption was that these contractual arrangements would take the form of a relationship agreement.[98]

The London Stock Exchange found when it in effect required companies with controlling shareholders to have a relationship agreement in place firms affected that were already listed resisted complying.[99] There also was uncertainty whether amendments to relationship agreements should be treated as related party transactions for which the approval

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96 Financial Services Authority (n 20) 93.

97 'Changes to SE Listing Rules' *Accountancy* (London, 15 October 1997), 96.

98 ibid

99 Norton Rose, 'London Stock Exchange Rules Updated: Amendment 13' *Mondaq Business Briefing* (London, 4 March 1999), available at http://www.mondaq.com/x/6488/Antitrust+Competition/London+Stock+Exchange+Listing+Rules+Updated+Amendment+13, accessed 29 January 2013.

of independent shareholders was required.[100] In 1999 the London Stock Exchange retreated and abolished the relationship agreement requirement.[101]

While relationship agreements were only mandated briefly in the late 1990s, they have been commonplace in the years since. The UK Listing Authority, which took over responsibility for promulgating and administering the Listing Rules from the London Stock Exchange in 2000,[102] has consistently encouraged companies with dominant shareholders to use relationship agreements and could use leverage provided by a Listing Rule provision requiring applicants to submit prescribed documentation before it approved a listing to arm-twist companies going public to put a relationship agreement in place.[103] Hence, it has been customary for companies applying for a listing on the London Stock Exchange and destined to have a dominant shareholder to put in place a relationship agreement providing for the company's operational independence.[104] Standard clauses in relationship agreements have included an undertaking to ensure that the listed company would at all times operate independently of the dominant shareholders, guarantees of substantial representation for

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[100] ibid

[101] ibid; 'Listing Rules: Amendment 13', *PLC Legal Update* (London, 1 January 1999), available at http://plc.practicallaw.com/4-100-9521?q=amendment+13+listing+rules, accessed 29 January 2013.

[102] Paul L. Davies, *Gower and Davies' Principles of Modern Company Law* (7th edn, Sweet & Maxwell, 2003), 650.

[103] J. Plender, 'ENRC Fiasco Shows Governance Failure' *Financial Times* (London, 27 June 2011); J. Ford, 'We Must Learn From the Flawed "Rothschild Model"' *Financial Times* (London, 20 February 2012); Listing Rules, para. 3.2.2(2).

[104] London Stock Exchange, 'A Guide to Listing on the London Stock Exchange' (London: London Stock Exchange, 2010), 35.

individuals independent of the dominant shareholders on the board of directors and key board committees, promises that transactions between the company and the dominant shareholders would be at arm's-length and undertakings by a company's dominant shareholders that they would not have privileged voting rights as compared to other shareholders.[105]

The FSA, in its October 2012 consultation paper, did not merely propose going back to the 1997 position. Instead, it recommended that relationship agreements contain certain mandatory terms, that companies be required to disclose annually how their relationship agreement was functioning and that the shareholders at large approve material changes in addition to the parties (i.e. the company and the dominant shareholder(s)).[106] Still, since relationship agreements are already a standard feature of the landscape with companies with dominant shareholders implementation of the FSA's proposals would provide outside investors with relatively little fresh protection.[107] Furthermore, the FSA's proposals do not deal with enforcement, which is a potentially problematic aspect of relationship agreements. If a listed company's dominant shareholder breaches terms of a relationship agreement the

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105 See, for example, Kazakhyms plc prospectus, (2005), 190-91, available at http://www.kase.kz/files/emitters/GB_KZMS/kzmsf9_2006e.pdf, accessed 29 June 2012; Vedanta Resources plc prospectus, (2003), 68-69, available at http://www.vedantaresources.com/uploads/listingparticularsfull.pdf, accessed 25 May 2012; Ferrexpo plc prospectus (2007), 177-78, available at http://www.ferrexpo.com/uploads/ipoprospectus.pdf, accessed 25 May 2012.

106 Financial Services Authority (n 20) 93-96.

107 A. Smith, 'When Public Companies Risk Being Private Fiefdoms' *Financial Times* (London: 3 October 2012) (citing the fact that ENRC's relationship agreement did not preclude its founders from dismissing two independent directors – see n 48 and accompanying text).

company will be the logical party to enforce the terms. The company's board will be charged with deciding whether to launch proceedings and the directors could well be reluctant to antagonize the dominant shareholders by litigating. As we will see in a moment, even directors who are otherwise independent have good reason be mindful of the views of a controlling shareholder.

C. Independent Directors

A third reform suggestion proffered by the FSA in its October 2012 consultation paper in response to concerns about companies with 'controlling' shareholders was that this sort of company should be compelled to have a board of directors comprised of a majority of independent directors.[108] In the UK, with its outsider/arm's-length system of ownership and control, the primary governance role of non-executive directors is to help to alleviate the managerial agency cost problem by keeping potentially wayward executives in check.[109] Given that in publicly traded companies with dominant shareholders those shareholders will usually keep a close eye on management, non-executive directors in such firms are not under the same onus to bolster managerial accountability as they are in companies with fully dispersed share ownership.[110] Non-executive directors in companies with dominant blockholders can, however, serve the interests of shareholders in a different way, namely by

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108 Financial Services Authority (n 20) 99-101.

109 UK Corporate Governance Code, A.4, Supporting Principle ('Non-executive directors should scrutinise the performance of management.)'

110 See n 29 and related discussion; K. Hofstetter, "One Size Does Not Fill All: Corporate Governance for 'Controlled Companies'" (2006) 31 North Carolina Journal of International Law and Commercial Regulation 597, 629.

acting as a check on the dominant faction.[111] Emerson Electric Co.'s protracted taking private of Astec (BSR) plc in 1998 provides an illustration of independent directors trying to do this, as they rejected Emerson Electric's initial offer to try to get better terms.[112]

The FSA's independent director proposal seemingly implies a substantial change to corporate governance practice. Code provision B.1.2 of the UK Corporate Governance Code stipulates that with boards of companies in the FTSE 350 stock market index at least half of the directors should be 'independent' in character and judgment. However, a listed company need not structure its board in this manner so long as it discloses what is going on and provides a suitable explanation.[113] The FSA has in essence proposed stripping companies with controlling shareholders of this 'comply or explain' option.[114]

While mandating board structure in companies with controlling shareholders would be a departure from the dominant UK approach to corporate governance, there is precedent. Between 1993 and 1997 the Listing Rules stipulated that in listed companies with a controlling shareholder all significant decisions should be taken by directors a majority of whom were independent of the controlling shareholder.[115] The London Stock Exchange

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[111] J. Dahya, O. Dimitrov and J.C. McConnell, 'Does Board Independence Matter in Companies With a Controlling Shareholder?' (2011) 21 Journal of Applied Corporate Finance 67, 67.

[112] *Supra* n 86 and accompanying text.

[113] UK Corporate Governance Code, 'Comply or Explain', 4.

[114] Financial Services Authority (n 20) 99-100.

[115] London Stock Exchange, 'Listing Rules' (1993), para 3.13. On this being a new provision, see London Stock Exchange, "Commentary on the Listing Rules and Tables of Destination and Derivation", (1993), 6, identifying new provisions in chapter 3.

justified the deletion of this requirement on the basis that it was 'satisfied the legal responsibility of directors to act in the best interest of all shareholders provides a satisfactory safeguard in this regard.'[116] The common law duty to which the London Stock Exchange was referring has been codified in modified form in s. 172(1) of the Companies Act 2006.

The introduction of a Listing Rule that would mandate board composition would no doubt increase to some degree the proportion of independent directors on boards of companies with controlling shareholders. The change, however, would not be a radical one. It is already standard practice for companies that are planning an IPO on the London Stock Exchange and will have a dominant shareholder thereafter to add to the board a number of independent directors likely to be known and respected by potential shareholders.[117] More generally, among larger companies with dominant shareholders listed on the London Stock Exchange independent directors are already prevalent. As of 2011, 70 per cent of FTSE 350 companies with a free float of less than 50 per cent complied with what is now Code provision B.1.2.[118]

The available empirical evidence suggests that for companies with dominant shareholders that would be forced to reconfigure their boards in response to a mandatory listing rule the benefits may be negligible. While according to a 2011 22-country study encompassing 782 publicly traded companies with dominant shareholders there was a

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116 'Notes to Subscribers to the Listing Rules, Amendment No. 11', September 1997, quoted in *Astec (BSR)* (n 86) 579.

117 A. Hill, 'Advice as Old as Trollope: Lords Should Look Before They Leap' *Financial Times* (London, 11 June 2011).

118 Grant Thornton, *Corporate Governance Review 2011: A Changing Climate Fresh Challenges Ahead* (Grant Thornton, 2011), 9.

statistically significant correlation between the number of independent directors and corporate valuations in countries where shareholder protection was weak, in countries like Britain that offered a high degree of shareholder protection the presence of independent directors was irrelevant.[119] A plausible explanation for this outcome is that where minority shareholders were well-protected dominant shareholders operated under meaningful legal constraints and independent directors added little to the mix.

Another reason why in a country such as Britain independent directors may generate few statistically measureable benefits in publicly traded companies with dominant shareholders is that the independent directors may be concerned about losing their directorships if they step too far out of line. Section 168 of the Companies Act 2006 authorizes shareholders to dismiss a director at any time by way of a simple majority vote and dominant shareholders are at liberty to use this power. The fact Nat Rothschild faced in 2011 the threat of removal from the Bumi plc board by the company's dominant shareholders illustrates the point.[120]

The FSA, in making its proposals concerning independent directors, responded to the danger that the voting power of dominant shareholders can pose. Citing 'the importance of independent directors in representing inter alia the interests of the independent shareholders' the FSA recommended that in companies with controlling shareholders both independent shareholders and the shareholders generally should approve the election of independent directors.[121] Even if the Listing Rules are amended to implement this proposal, however, the operation of s. 168 of the Companies Act 2006 should be unaffected. Correspondingly, a

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119 Dahya, Dimitrov and McConnell (n 110).

120 Aglionby (n 44).

121 Financial Services Authority (n 20) 101.

dominant shareholder with sufficient voting power conceivably could dismiss directors elected with the backing of neutral shareholders with little or no regard for the views of those shareholders. Independent directors would therefore have to continue to look over their shoulders in companies with dominant shareholders.

6. Additional Aspects of Minority Shareholder Protection Under the UK System of Corporate Governance

We have now seen that the FSA's October 2012 proposals to amend the Listing Rules to respond to concerns about dominant shareholders are not particularly novel and seem unlikely, if implemented, to provide substantial additional protection for outside investors. Is the conservatism of the FSA a cause for concern? This seems unlikely. The fact that the FSA's proposals are not radical in nature suggests that implementation will do little to diminish the London Stock Exchange's attractiveness as a venue for companies to go public with a controlling shareholder. At the same time, the level of protection afforded to minority shareholders in companies with dominant shareholders should be acceptable despite the lack of dramatic change. This is because, as we will see now, dominant shareholders in premium listed companies already operate under a series of constraints, in addition to relationship agreements and independent directors, that combine to provide a meaningful check on blockholder misbehaviour.

A. Regulation of 'Tunnelling'

For outside investors in a publicly traded company with a dominant shareholder a major source of concern is that the dominant shareholders will use contracts between the company on the one hand and entities the dominant shareholder controls outright on the other to extract private benefits of control.[122] With UK-incorporated companies, however, any

122 See nn 32 to 33 and related discussion.

such potential ‘tunnelling’ is closely regulated. For instance, by virtue of s. 177 of the Companies Act 2006 if a company’s directors fail to declare to the board personal interests they have in transactions the company is proposing to enter into, the contracts in question can be set aside.[123] Moreover, if directors have a personal interest in a proposed ‘substantial property transaction’, which is deemed to include all transactions involving assets with a value exceeding £100,000, the consequences will be the same unless shareholders approval is sought and obtained.[124]

A key limitation with ss. 177 and 190-96 is that they only apply to directors, meaning they are inapplicable if a dominant shareholder of a publicly traded company who is not a director has a personal interest in a contract to which the company is a party.[125] Also, when ss. 190-96 apply dominant shareholders are free to vote on the relevant transaction even if they are also directors. Chapter 11 of the Listing Rules addresses these gaps with its regulation of transactions involving premium listed companies and parties related to them.[126]

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[123] Companies Act 2006 (CA 2006) ss. 177-78; Paul L. Davies and Sarah Worthington, *Gower and Davies’ Principles of Modern Company Law* (9th edn, Sweet & Maxwell, 2012), 568-69.

[124] CA 2006, ss. 190(1), 191(2)(b), 195. A contract can also qualify as a ‘substantial property transaction’ if the assets are worth more than 10 per cent of the asset value of the company (s. 191(2)(a)) but the value of any transaction meeting this threshold with a publicly traded company will greatly exceed £100,000.

[125] The assumption here is that the dominant shareholder is also not a ‘shadow director’, which would bring ss. 190-96 into operation (see CA 2006, s. 223(1)(b)) and might do the same with s. 177 (see s. 170(5)).

[126] Chapter 11 only applies to companies with a premium listing: Listing Rules, para. 11.1.1.

'Related party' is defined for the purposes of Chapter 11 to include a company's substantial shareholders, with substantial shareholders being those who own 10 per cent or more of the shares.[127] So long as a related party has an interest in a transaction and the transaction is sizeable enough to qualify under the Listing Rules as a 'Class 2' transaction,[128] a listed company must put the transaction to a shareholder vote and the listed company must ensure related parties, including any substantial shareholder, abstains from voting.[129] Hence, with a controversial plan ENRC announced in 2011 to buy from its founders shares of a Kazakh thermal oil producer it did not already own, the founders refrained from voting as ENRC's neutral shareholders approved the deal.[130]

The fact that controversies concerning related party transactions were at the centre of for the Bumi plc/Rothschild/Bakries saga illustrates that regulation under UK company law and the Listing Rules does not provide all of the answers for 'tunnelling'.[131] It is important to remember in this context, however, that Bumi plc was not itself a party to the controversial transactions. Instead, PT Bumi Resources, the Indonesian company in which Bumi plc ended

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127 Financial Services Authority, FSA Handbook (n 4), Glossary, 'substantial shareholder', Listing Rules, para. 11.1.4.

128 Listing Rules, para. 10.2.2, Chapter 10, Class Tests (providing a transaction will qualify if the value of the assets exceeds 5 per cent of the gross assets of the company, if the profits attributable to the assets exceed 5 per cent of profits of the company or if the consideration exceeds 5 per cent of the market value of the company's shares).

129 Listing Rules, paras. 10.4, 11.1.7(3), (4).

130 T. Bawden, 'ENRC in New Governance Storm Over $600m Deal' *Independent* (London, 12 October 2011); E. Rowley, 'ENRC Shareholders Back Deal to Buy Coal Firm From Founders' *Telegraph* (London, 3 April 2012).

131 See nn 41 and 45 and related discussion.

up being a substantial minority shareholder, was the focal point, and Bumi plc's inability to exert sufficient pressure on PT Bumi Resources to correct matters was the source of Bumi's problems rather than UK rules governing related party transactions. As an adviser on political and business risk was quoted in the press as saying in 2012, 'From the context of past practices in Indonesia, the decision by Mr. Rothschild to become a minority partner was unconventional and the grim outcome was foreseeable.'[132]

B. Public-to-Private Transactions

The most dramatic type of transaction where a dominant shareholder of a publicly traded company will have a personal agenda that potentially conflicts with the interests of outside investors is where the dominant shareholder wants to buy out the other shareholders and take the company private. With UK-incorporated companies a dominant shareholder seeking to do this will likely rely on one of two procedures, each of which offers significant protection to outside investors. First, a dominant shareholder can carry out a 'squeeze-out' under s. 979 of the Companies Act 2006, which permits the compulsory acquisition of all of a company's shares.[133] To invoke s. 979, however, the dominant shareholder will need to make an offer to acquire all of the shares the dominant shareholder does not already own and owners of not less than 90 per cent in value of the shares to which the offer relates will have

[132] 'Bad Blood' (n 36). See also D. Fortson, 'Come on Nat' *Sunday Times* (London, 4 November 2012) ('As a minority shareholder in faraway mines, however, there was little Bumi's London executives could do. The company's fatal flaw was exposed.')

[133] CA 2006, ss 979(4), 981(2); Davies and Worthington (n 123) 1091, 1096.

to accept.[134] All acceptors are entitled to the highest price the dominant shareholder offers to any shareholder.[135]

Second, a dominant shareholder can use a scheme of arrangement, a judicially-administered procedure where in this particular context a publicly traded company will propose an arrangement with its shareholders under which the dominant shareholder will acquire all shares on specified terms. Given that the target company's board will apply to court for a scheme with this sort of going private transaction, the dominant shareholder typically must secure initially the support of the directors.[136] If all appears to be in order with the application, the court will order a meeting of the shareholders at which a majority in number representing at least 75 per cent of the shares must vote in favour of the arrangement.[137] Shares held by the dominant shareholder will be excluded from this

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134 CA 2006, ss 974 (2), (3) (defining 'takeover offer' for the purposes of s. 979), 979(2)(a).

135 Davies and Worthington (n 123), 1057 (discussing equal treatment principles under the Takeover Code); G. Yates and M. Hinchcliffe, *A Practical Guide to Private Equity Transactions* (CUP, 2010), 299 (discussing the scope for acceptors to apply for relief under CA 2006, s. 986).

136 CA 2006, s 896(2). There is, however, a theoretical possibility of a 'hostile scheme'. See M. Scott and S. Jackson, 'Practice Note: Schemes of Arrangement: Takeovers', available at http://uk.practicallaw.com/2-107-4013?q=schemes+of+arrangement+takeovers, accessed 24 May 2012.

137 CA 2006, s 899(1).

process.[138] If the neutral shareholders provide the necessary backing, the court can order that the arrangement is binding on all shareholders.[139]

Awareness that a sizeable majority of neutral investors will have to be won over for there to be a squeeze out under s. 979 or a court approved scheme of arrangement puts pressure on a dominant shareholder to offer reasonable terms in a public-to-private transaction. Glencore plc's recent acquisition of Xstrata plc, a mining company, illustrates the point. Xstrata went public on the London Stock Exchange in 2002 with Glencore, then a privately held Swiss headquartered commodity trading firm, retaining a 40 per cent stake.[140] In 2012, Glencore which itself went public in 2011 on the London Stock Exchange with a most of the shares being retained by senior employees,[141] announced its intention to merge with Xstrata, in which Glencore still owned 34 per cent of the shares.[142]

The proposed Glencore/Xstrata merger was to be structured as a scheme of arrangement. Xstrata's chief executive officer said that using the scheme of arrangement procedure was a 'very deliberate strategy by my board...to give disproportionate power to the

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138 *Re Hellenic & General Trust Ltd*. [1975] 3 All ER 382.

139 CA 2006, s 899(3).

140 B. Laurence, 'The Mining Boss who Struck Gold with a Deal that He Mapped Out on a Matchbox' *Mail on Sunday* (London, 17 August 2003); X. Rice, 'A Magic Formula that Keeps Share Price Bubbling' *Times* (London, 19 January 2004).

141 D. Robertson, D. Charter and G. Gupta, 'Dark Side of the City's Secretive New Giant' *Times* (London, 19 May 2011).

142 R. Stovin-Bradford and S. Kirk, 'Glencore' *Financial Times* (London, 15 June 2012).

non-Glencore shareholders in the transaction.'[143] So it proved. Glencore was forced to increase its offer from 2.8 to 3.05 Glencore shares per Xstrata share to win over outside investors, in particular Qatar's sovereign wealth fund and its 12 per cent shareholding in Xstrata.[144] Outside investors were also provided with the opportunity to vote on a plan to give 70 Xstrata executives a collective £144 million bonus to stay in their jobs for three years after the merger and they vetoed this proposal.[145]

C. Minority Shareholder Litigation

If the board of a publicly traded company manages the company in a manner designed to fulfil the wishes of a dominant shareholder the directors will be at risk of breaching their duty to promote the success of the company under s. 172 of the Companies Act 2006.[146] They also might breach a duty s. 173(1) imposes on directors to exercise independent judgment. A dominant shareholder of a listed company who also serves as a director needs to be mindful of the statutory rules governing related party transactions as well as s. 175, which requires directors to avoid conflicts between personal interests and the interests of the

[143] H. Thomas, 'Xstrata Reveals Pre-Nuptial Wrangling' *Financial Times* (London, 22 October 2012).

[144] 'Miner Irritations' *Economist* (London, 15 September 2012); Mark Scott, 'Xstrata's Investors Approve a Takeover by Glencore' *New York Times* (New York, 21 November 2012).

[145] A. Sakoui, H. Thomas, J. Blas and A. Oakley, 'Devil is in Pay Detail for Xstrata-Glencore' *Financial Times* (London, 2 October 2012); J. Samuel, 'Glencore Gets its Merger but Bond is Out After Pay Revolt' *Times* (London, 21 November 2012).

[146] See n 116 and related discussion.

company.[147] Still, while breaches of directors' duties could occur when a publicly traded company is being run at least partly for the personal benefit of a dominant shareholder, enforcement will potentially be problematic. Directors owe their duties to the company and it will fall to a company's board to decide whether the company will launch legal proceedings.[148] If the board of a listed company is under the sway of a dominant shareholder it is unlikely the company will launch a lawsuit alleging breaches of duty to the company.

If a minority shareholder in a listed company suspects favouritism benefitting a dominant shareholder is precluding the company from suing to redress breaches of directors' duties, the minority shareholder could respond by seeking to obtain leave from the court to launch a 'derivative' claim on the company's behalf under ss. 260-64 of the Companies Act 2006.[149] There has yet to be, however, a reported post-Companies Act 2006 case where a minority shareholder of a listed company has sought to obtain leave and various practical deterrents will serve to discourage a change to this pattern.[150] For instance, because English courts typically apply a 'loser pays' costs rule with litigation, if a shareholder's application for leave to bring a derivative action fails the shareholder will likely not only have to pay its

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147 More than one of the duties directors owe may apply in any given case: CA 2006, s 179.

148 *John Shaw & Sons (Salford) Ltd. v. Shaw* [1935] 2 KB 113.

149 CA 2006, ss 260(1) (defining 'derivative claim'); 261(2) (indicating a shareholder must establish a prima facie case that there be a leaving hearing), 263(2), (3) (specifying criteria a court is to take into account when deciding whether leave should be granted).

150 This was verified by searching Lexis' English case law database with the terms 'derivative action' and 'Companies Act'.

own legal fees but also indemnify those who opposed the application.[151] If a leave application is successful, the shareholder may end up underwriting the lawsuit because a judge may well not make an order requiring a company to pay for derivative litigation if the shareholder has the financial wherewithal to pay.[152] Moreover, because with derivative litigation recovery is the right of the company, if a derivative suit succeeds the shareholder who launches the proceedings will only benefit financially to the extent the litigation causes the company's share price to increase and will be no better off than fellow shareholders who made no effort to support the litigation.[153]

Deployment of derivative litigation under the Companies Act 2006 pre-supposes a breach of duty owed to the company by a company's directors.[154] If a company is run in a manner that infringes *personal* rights of minority shareholders this is potentially advantageous procedurally for minority shareholders minded to sue because they will not need to obtain leave from the court to litigate and because any relief granted will be specifically directly toward them rather than the company generally. A dominant shareholder does not owe duties to minority shareholders to act in the best interests of all shareholders or owe any duties of a fiduciary nature.[155] For minority shareholders, however, s. 994 of the

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151 B.R. Cheffins and B.S. Black, 'Outside Director Liability Across Countries' (2006) 84 Texas Law Review 1385, 1406.

152 *Smith v. Croft* [1986] 1 WLR 580.

153 Cheffins and Black (n 151), 1407.

154 CA 2006, s. 260(3).

155 Davies and Worthington (n 123), 691-92; V. Joffe *et al., Minority Shareholders: Law, Practice, and Protection* (4th ed. OUP 2011), 103; D. Kershaw, *Company Law in Context: Text and Materials* (2nd ed. OUP, 2012), 667-68.

Companies Act 2006 provides a potentially valuable personal remedy.[156] This provision empowers a court to grant relief where a company's affairs have been conducted in a manner that is unfairly prejudicial to the petitioning shareholder or the interests of shareholders generally.

Minority shareholders in closely held companies can and often do rely on breaches of expectations derived from informal undertakings and agreements to support a claim for unfair prejudice under s. 994.[157] Case law precedent, however, precludes minority shareholders in publicly traded companies from doing the same.[158] With a publicly traded company theoretically a disgruntled minority shareholder can sue for relief on the basis of other misconduct recognized as qualifying as unfair prejudicial, such as the board abusing its powers or engaging in serious mismanagement.[159] Nevertheless, there does not appear to have been a reported case involving a listed company where an unfair prejudice petition has been successful.[160]

While case law circumscribes the ability of a minority shareholder in a quoted company to rely on s. 994, this provision could help to facilitate the enforcement of a

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156 B. Hannigan, *Company Law* (2nd ed., OUP, 2009), 417.

157 ibid, 428.

158 Joffe *et al.* (n 155) 274-75.

159 J. Payne, 'Sections 459-461 Companies Act 1985 in Flux: The Future of Shareholder Protection' (2005) 64 Cambridge Law Journal 647, 674-75; *Re Saul D Harrison & Sons plc* [1994] BCC 475, 488-89 (abuse of directorial power); *Re Macro (Ipswich) Ltd.* [1994] 2 BCLC 354, 404-7 (mismanagement).

160 Cheffins and Black (n 151) 1410, updated with a search of the Westlaw UK cases database using search terms 'plc' and 'unfair prejudice'.

relationship agreement that is in place. If a dominant shareholder of a listed company has breached the terms of a relationship agreement and the board is reluctant to enforce the terms in court a minority shareholder will not be able to force the issue by seeking leave to bring a derivative action because the statutory procedure is only available when the cause of action is an alleged breach of duty by a director.[161] A petition under s. 994 of the Companies Act 2006 could, however, be a viable option.

The key reason why the judiciary has been reluctant with publicly traded companies to treat breaches of informal undertakings and agreements as the foundation for a successful s. 994 petition is that the market in a listed company's shares will lack credibility unless investors can proceed on the footing that the company's ground rules are as they appear in publicly filed documentation.[162] Extraneous equitable considerations and constraints should therefore not come into play by way of shareholder litigation.

With relationship agreements the situation arguably is different. The terms will in all likelihood be summarized in documentation that has to be filed publicly, namely the prospectus or listing particulars issued in support of the public offering of shares. Correspondingly, contravention of a relationship agreement arguably could qualify, in accordance with the ground rules set down in the leading unfair prejudice case of *O'Neill v. Phillips*,[163] as a breach of the terms on which the shareholders agreed the affairs of the company would be conducted and thus could provide grounds for a successful s. 994 petition. If the Listing Rules are amended, as the FSA has recommended,[164] to make relationship

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161 CA 2006, s 260(3).

162 *Astec (BSR)* (n 86), 588 *Re Blue Arrow plc* [1987] BCLC 585, 590.

163 [1999] 2 BCLC 1, 8.

164 *Supra* nn 96 and 106 and related discussion.

agreements mandatory for premium listed companies with a controlling shareholder, to regulate the content of relationship agreements, to require disclosure of how relationship agreements are functioning and to mandate shareholder approval of material amendments, this would lend credence to an argument that failures to comply with a relationship agreement's provisions could qualify as a breach of a company's ground rules meriting relief under s. 994.

C. Reputational Constraints

Various scholars have theorized that those running a business in a jurisdiction with weak company law and lax institutional safeguards can commit themselves credibly to respect the rights of minority shareholders by listing on a stock exchange in a country which offers high standards of investor protection.[165] To the extent this sort of 'bonding' occurs when businesses with blockholders based outside the UK seek a premium listing on the London Stock Exchange and aim for inclusion in the FTSE 100, meaningful reputational constraints should be in place that will help to improve standards of corporate governance. Developments at ENRC, the Kazakh-based miner afflicted by corporate governance controversy in 2011, arguably illustrate the effects of this sort of bonding.

In 2012, Mehmet Dalman, a veteran UK-based investment banker and hedge fund manager who had been an ENRC non-executive director was appointed chairman of the

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[165] J.C. Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications' (1999) 93 Northwestern University Law Review 641, 657, 673-76; R.M. Stultz, 'Globalization, Corporate Finance, and the Cost of Capital' (1999) 12(3) Journal of Applied Corporate Finance 8, 14-16.

board with a mandate to improve the company's tarnished corporate governance image.[166] Dalman vowed that to the extent corporate governance concerns were depressing ENRC's share price 'that will not be the case going forward.'[167] ENRC, as part of its charm offensive, appointed Richard Burrows, chairman of tobacco giant British American Tobacco, and Mohsen Khalil, a director at the World Bank, as new non-executive directors and organized for stock market analysts following ENRC a largely unprecedented 'corporate governance breakfast.'[168] By the end of 2012 Dalman had 'made some progress in tackling the stigma around ENRC' even though the company was one of the worst-performing in the FTSE 100 during the year.[169]

A way to interpret ENRC's fresh commitment to corporate governance is that it was the product of an implicit but meaningful ongoing bond formulated when the company became quoted on the London Stock Exchange and joined the FTSE 100. As the *Times* said in 2011, 'ENRC's billionaire owners must have understood' that when ENRC became quoted there was a 'surety' ENRC's 'independent directors (would) ensure fair play and an adherence to corporate governance.'[170] ENRC's efforts to improve its corporate governance -- admittedly somewhat belated -- suggests that the company may well have engaged at least to some degree in the sort of bonding discussed in the academic literature.

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166 M. Odell, H. Thomas and A. Sakoui, 'ENRC Explores Ways to Mend its Performance' *Financial Times* (US edition) (New York, 7 May 2012); J. Guthrie, 'Dalman's Great Divide' *Financial Times* (London, 12 June 2012).

167 Odell, Thomas and Sakoui (n 166).

168 H. Thomas, 'Head of ENRC Faces Governance Challenge' *Financial Times* (London, 12 June 2011).

169 'The Year's Worst Performers' *Financial Times* (London, 24 December 2012).

170 D. Robertson, 'What Price a Good Reputation?' *Times* (London, 8 June 2011).

A criticism of the theory that cross-border stock market listings foster bonding is that opting into a regime that is otherwise protective of shareholders may fail to work in the manner intended if the law applicable in the host jurisdiction is only weakly enforced.[171] The point is a potentially telling one in the case of the UK, given that litigation by minority shareholders in publicly traded companies is a rarity.[172] As a 2005 study of Mexican companies cross-listed in the United States illustrates, however, even if law is weakly enforced listing on a stock market where outside investors are otherwise well protected may well generate meaningful market-oriented bonding.[173] US securities law, the study showed, was only patchily enforced with Mexican companies that were cross-listed in the US.[174] Nevertheless, firms of this sort had incentives to adhere to rules they were not otherwise forced to follow because companies that had not been publicly implicated in the improper diversion of corporate assets had ready access to US capital markets denied to companies so implicated.

No equivalent academic test has been carried out for overseas based companies that have become quoted on the London Stock Exchange.[175] Anecdotally, the evidence is mixed.

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171 S.P. Ferris, K.A. Kim and G. Noronha, 'The Effect of Crosslisting on Corporate Governance: A Review of the International Evidence' (2009) 17 Corporate Governance: An International Review 338, 343-44.

172 See nn 150 and 160 and accompanying text.

173 J. Siegel, "Can Foreign Firms Bond Themselves Effectively by Renting US Securities Laws?", (2005) 75 Journal of Financial Economics 319.

174 ibid, 343-48.

175 The results of empirical studies that have been done on the impact of cross-listing on the London Stock Exchange on corporate performance are mixed. See P. Roosenboom and M.A. van Dijk, 'The Market Reaction to Cross-Listings: Does the Destination Matter?',

While events at ENRC suggest that reputational considerations can help to address concerns blockholders generate, the Bumi plc/Bakries/Rothschild saga flags up the limits of bonding. While the feuding, allegations of financial irregularities and a plummeting share price – a 70 per cent drop in 2012 alone – damaged the reputations of many of the individuals involved, as of the time of writing the battle lines remained too deeply drawn to identify an easy way forward.[176] It therefore seems that reputational considerations do impose a check on dominant shareholders but do not offer a guarantee of complete propriety.

7. Conclusion

In 2013 the FSA will be replaced as a single financial services regulator by two new successor bodies.[177] One of these, the Financial Conduct Authority (FCA), will carry out the functions the FSA currently performs as the UK Listing Authority, meaning the FCA will be responsible for determining eligibility for listing and for policing ongoing compliance by listed companies.[178] One of the FCA's first items of business may well be amending the

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(2009) 33 Journal of Banking and Finance 1898 (documenting a positive stock market reaction to announcements of decision to cross-list in London); U. Lel and D.P. Miller, 'International Cross-Listing, Firm Performance, and Top Management Turnover: A Test of the Bonding Hypothesis', (2008) 63 Journal of Finance 1897, 1918-23 (cross-listing in London has no statistically measurable impact on CEO turnover).

176 B. Bland, 'Battle Lines Drawn at Bumi but There is no Easy Way Ahead' *Financial Times* (London, 21 January 2013); Jonathan Guthrie, 'City Gatekeepers Must Make Amends for Bumi Too', *Financial Times* (London, 30 January 2013).

177 See n 19 and related discussion.

178 Financial Services Authority, 'Financial Conduct Authority: Approach to Regulation' (June 2011), 35, available at http://www.fsa.gov.uk/pubs/events/fca_approach.pdf, accessed 7

Listing Rules to introduce tighter control of companies with dominant shareholders. The FSA has indicated that it will publish in the spring of 2013 feedback on responses to its 2012 consultation paper on reform of the Listing Rules that encompassed various proposals designed to address concerns that an influx of overseas based businesses with dominant shareholders has been 'undermining' UK corporate governance. In due course the FCA conceivably could implement verbatim the FSA's October 2012 recommendations.

This paper, in addition to documenting the influx of companies with dominant shareholders that has generated concern, has indicated that implementation of the FSA's 2012 proposals for amending the Listing Rules would not bolster minority shareholder protection to the extent that might be anticipated. Instead, the proposals largely recycle constraints on dominant shareholders present in previous iterations of the Listing Rules. Moreover, the FSA's proposals place considerable emphasis on independent directors and relationship agreements, both of which already feature prominently in companies with dominant shareholders listed on the London Stock Exchange. Should the FCA, if it in fact does amend the Listing Rules to respond to concerns about dominant shareholders, go for a bolder approach? On balance, this would be unwise.

Dominant shareholders do pose risks for outside investors in publicly traded companies. Nevertheless, the fact that among blockholder-dominated, overseas based businesses which have become over the past dozen years part of the FTSE 100 or FTSE 250 stock market indices there has not been -- with the exception of Bumi plc-- a scandal

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February 2013; Financial Services Authority, 'CP 13/3: Regulatory Reform: Handbook Transitional Arrangements, the Appointment of With-Profits Committee Members and Certain Other Handbook Amendments,' (2012), 5, 8, available at http://www.fsa.gov.uk/static/pubs/cp/cp13-03.pdf; accessed 7 February 2013.

involving alleged dishonesty or misuse of corporate assets indicates that dominant shareholders do not have a license to disregard outside investors. Various constraints dominant shareholders face, including regulation of related party transactions, shareholder remedies, reputational concerns, relationship agreements and independent directors have all likely played a role here. Efforts ENRC made to upgrade its corporate governance in the wake of a much-publicized 2011 board bust-up indicates major blockholders in companies with a premium listing in London have incentives to stick to the straight and narrow, even if there is an element of trial and error involved.

Bumi plc's travails show that complacency on the part of investors and regulators is unwise. As a *Financial Times* columnist said in 2013, Bumi's 'muck-slinging governance breakdowns (make) London look like the kind of second-rate bourse that specialises in speculative mining plays because that is all it can attract.'[179] Even those who launched Bumi conceded subsequently that it had been a 'failure' and a 'mess'.[180] Another Bumi-style controversy affecting a blockholder-dominated FTSE 100 or FTSE 250 company would generate considerable momentum in favour of tough action. For instance, even if free float thresholds are a 'blunt tool' and rigid requirements could discourage companies from going public on the London Stock Exchange support could build rapidly for the introduction of the 50 per cent free float threshold the NAPF recommended the FTSE Group adopt for its UK stock market indices.[181] For now, however, whatever undermining of UK corporate governance has occurred due to the influx of blockholder-dominated companies over the past dozen year has not been sufficiently serious to justify radical reform.

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179 Guthrie, (n 176).

180 G. Chazan and J. Guthrie, 'Bumi Float a "Failure" Admits Co-Founder' *Financial Times* (London, 9 February 2013).

181 See n 68 and accompanying text.

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