

So what does a “shareholder”, “member” and “holder” of shares really mean?

Many English law governed agreements invoke Companies Act 2006 (“CA06”) definitions for standard terms such as “shareholder”. A recent decision confirms that only those persons whose names appear in a company’s share register qualify as a “shareholder”, “member” or “holder” of shares (the terms are interchangeable) for CA06 purposes.

English law distinguishes between legal and beneficial title to shares. Share registers only record persons who hold legal title to shares. Ultimate owners of the economic interest in shares will not appear on the share register. In many cases, the underlying owner is not disadvantaged as they have de-facto dividend, voting and information rights through contracts with the registered member. But, as the decision confirms, they cannot exercise CA06 minority shareholder protections (e.g. an application to overturn a resolution to re-register a public company as private) in person.

The case also reiterates that, if a registered shareholder holding shares on behalf of a number of persons votes (through the appointment of proxies) both for and against a resolution, they are still a person who has voted in favour of the resolution so exempting them (and the underlying owners) from various minority protections in CA06.

Background

The case involved a public limited company incorporated in England which was managed and operated from Germany. Its shares were only listed for trading on German exchanges (regulated by the Deutsche Börse). Under the rules of those exchanges, its shares had to be held in dematerialised form (i.e. title to shares is evidenced electronically and not by paper certificates). The company’s share register recorded only two registered shareholders: an individual and also Bank of

New York Depositary (Nominees) Ltd (“BNY”) which held the remaining issued shares as depositary agent on trust for the holders of accounts with Clearstream. Clearstream is the clearing and settlement division of Deutsche Börse through which trades on the relevant exchanges between Clearstream account holders are transacted electronically. The Clearstream account holders must themselves be banks or financial institutions and cannot be individuals. So, what are actually traded on Deutsche Börse are not shares in the company but “Clearstream Interests” or “CIs”. CIs in turn represent the underlying ownership rights in the company’s shares.

The company had passed a special resolution to be re-registered as a private limited company. Under CA06, “holders” of not less than 5% in nominal value of the company’s issued share capital (or not less than 50 of the company’s members) may apply to court for the cancellation of the re-registration resolution. The court may cancel or confirm the resolution and may also require compulsory purchase of the dissentient shareholders’ interests. This affords minority shareholders some protection against the inevitable adverse impact on marketability of their shares resulting from the re-registration particularly where the shares were previously listed.

Three individuals claimed they were minority shareholders (holding between them some 6% of the company’s shares). They began proceedings alleging that their aggregate holding of the company’s shares gave them standing to apply for cancellation of the re-registration resolution. The defendants (who included the company) argued that the claimants were not “holders” of shares as their names did not appear on the company’s share register and so they did not have standing to apply.

Meaning of “shareholder”, “member” and “holder” of shares

A “shareholder”, “member” or “holder” of a share (the terms are interchangeable) is only the person whose name is registered in the company’s register of members i.e. the person with legal title to the shares. This is confirmed, among other things, by the definition of “member” in the CA06 which refers to persons whose names are entered in the company’s register of members. For example, these phrases do not include a person who only has a:

- (a) beneficial interest in a share (e.g. beneficiary under a trust or persons holding shares through nominees); or
- (b) purely economic interest in a share (e.g. through dividend payment rights contractually agreed between that person and the legal registered owner).

In this case, the private individuals each had an account with a bank or other financial institution which itself had a Clearstream account and held CIs in the company. The Clearstream account holders were able to trade CIs representing shares. The shares themselves were in turn registered in the name of BNY as depositary agent. Only BNY was capable of qualifying as a “holder” or “member” for the purposes of deciding who could apply to overturn the re-registration resolution. The company’s articles did not themselves confer any rights on the Clearstream account holders’ customers (i.e. the claimants). So, the only rights the claimants had were derived from the terms of their contracts with the Clearstream account holders. This was the case even though the company had from time to time blurred the distinction between the registered holders, the Clearstream account holders and the individuals concerned, such as by allowing those individuals to vote at some annual general meetings on producing a statement from one of the Clearstream account holders.

How does this compare to shares held in CREST?

CREST is the electronic settlement system for shares traded on the London Stock Exchange’s Main Market and AIM. Corporate shareholders can join CREST while still remaining the legal owner of the shares (either as direct or sponsored CREST members). This applies whether or not they are banks or financial institutions. Individuals holding shares in CREST can choose to open a CREST account:

- (a) in their own name, in which case they remain the legal and beneficial owner of the shares (and the “holder” of the shares for CA06 purposes). This tends to apply to fairly active shareholders with large numbers of shares; or
- (b) through a nominee, in which case the nominee becomes the legal owner of the shares (and so is the “holder” of the shares for CA06 purposes) while the individual remains the beneficial owner and will have contractual rights to receive, via the nominee, dividend payments and information from the company. This is a cheaper option and tends to apply to smaller investors. In this case, the individual does not appear on the share register and is not a “holder” for CA06 purposes.

Could BNY as registered holder be joined into the application?

The court went on to consider whether BNY could have been joined into the overturning application (perhaps at the direction of the banks and financial institutions who were Clearstream account holders or even on the instructions of the claimants). In practice, this course was not open as an application to overturn a re-registration resolution is not available to “*a person who has consented to or voted in favour of the resolution*”. It is well established that, if a registered shareholder holding shares on behalf of a number of persons votes (through the appointment of proxies) both for and against a resolution, they are still a person who has voted in favour of the resolution for the purposes of this carve out and equivalent provisions in CA06.

Enjoyment or exercise of members' rights by third parties

The judge admitted that this reading of CA06 deprived the claimants (as indirect investors) of the sort of protection which those who formulated CA06 thought ought to be extended to minority shareholders (e.g. the ability to challenge a re-registration resolution). But he felt that there would need to be an extremely strong reason to override the orthodox understanding of company law.

In drafting CA06, the legislators did go some way towards enabling registered members to pass direct rights to holders of the ultimate economic interests in shares. Under CA06, a company's articles may include a mechanism for a member to nominate any third party (not just the beneficial owner of that member's shares) to enjoy or exercise all or any of its specified rights in relation to the company e.g. voting rights. CA06 clearly states that this does not confer rights enforceable against the company by anyone other than a member. But what does this mean in practice?

In the current case, the court had to look at the distinction between the transfer by a member to a third party of *contractual* rights arising under the articles (e.g. voting rights) and any *statutory* rights which are closely linked to, and are required to give effect to, the contractual rights. For example, if a member transfers to a third party a contractual right under the articles to vote shares, that is automatically accompanied by a transfer of the member's statutory right to appoint a

proxy to vote on its behalf at the relevant meeting. While the transferee cannot enforce any contractual rights against the company (other than through the registered member), the court said any accompanying statutory rights *could* be directly enforced against the company by a third party transferee. Crucially, this does not extend to all the transferring member's statutory rights under CA06; only its statutory rights which are required to give direct effect to any contractual rights being transferred.

Eckerle and Others v (1) Wickedder Westfalenstahl GmbH and (2) DNick Holding plc [2013] EWHC 68 (Ch)

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