OPINION OF COUNSEL

for

DULWICH STORAGE COMPANY LIMITED

in the matter of

NOMINET UK

Introduction

Dulwich Storage Company Ltd. ("Dulwich Storage") is a member of Nominet UK, a private company limited by guarantee and not having a share capital. It became a member in around 2020.

The articles of association of Nominet UK (as amended) make provision by article 19 for unequal voting rights amongst the members, as follows:

> "The Board will establish the subscriptions and poll voting rights of Members for the period to 31 August 1997. Thereafter, the subscriptions and poll voting rights will be related to the Member's relative commercial involvement in the .UK domain name service, and will be set by means of bye-laws established in accordance with Article 52.1."[1]

Article 52.1 provides:

> "52. In consultation with the Members, the Board will establish bye-laws for the following purposes:
>
> 52.1 To determine the subscriptions payable by Members (after 31 August 1997) and the voting rights to which they will be entitled;"

In furtherance of those provisions, bye-laws have been made, the current version of which was attached to the Brief with which I have been provided. The bye-laws set out a formula for the determination of voting rights, the application of which leads to a situation where, to echo George Orwell, some members are more equal than others.

Against that background, Dulwich Storage wishes to be advised whether the provisions of Article 19, and the voting formula set out in the Bye-laws is lawful, both in terms of section 285A of the Companies and otherwise.

1 This excerpt is taken from the 2020 version of the Articles as they appear on the Companies House website, though this provision has, in fact, remained unaltered since the original incorporation of the Company.

For the full details, I refer to the Brief.

The Principal Question

A company limited by guarantee, is, nonetheless, a company which is incorporated under the Companies Act and regulated by that Act, as are companies limited by shares. It is merely that, since there is no share capital, certain additional provisions are applied to companies limited by guarantee, and other provisions, which make sense only in the context of companies limited by shares are disapplied. There are, in essence, two types of company: companies limited by shares and companies limited by guarantee.

It was not always this way. Until 1980, there could be incorporated a third type of company (although in practice it was not common), namely a company limited by guarantee yet also having a share capital.

However, Section 5 of the Companies Act 2006 provides:

> "5 *Companies limited by guarantee and having share capital*
>
> (1) A company cannot be formed as, or become, a company limited by guarantee with a share capital.
>
> (2) Provision to this effect has been in force—
>
> (a) in Great Britain since 22nd December 1980, and
>
> (b) in Northern Ireland since 1st July 1983.
>
> (3) Any provision in the constitution of a company limited by guarantee that purports to divide the company's undertaking into shares or interests is a provision for a share capital.
>
> This applies whether or not the nominal value or number of the shares or interests is specified by the provision"

It was the intent of section 5 (and its predecessor provisions) to prevent this third type of company being set up *in futur*e, though there may well be such companies, formed before 22nd December, 1980 still in existence.

To understand the rationale more fully, one has to appreciate the nuanced difference between members of a company as members and members as shareholders. The issuing of shares is the mechanism for giving members of a company a stake in the undertaking of the company (ultimately, its net assets in the event of dissolution) as

well also as creating a concomitant liability, up to the nominal value of the shares, in the event of a deficiency upon dissolution. The members take or contribute based upon the number of shares which they have. Where there are no shares (as in a company limited by guarantee, not having a share capital) this mechanism cannot be used; but the members of the company are nonetheless members and in the event of dissolution would be entitled to share in the company's undertaking as members, though any individual liabilities would be capped at the level of their guarantees, because, absent shares, there is no mechanism to divide up the undertaking any way other than equally.[2]

Where there is a company limited by share capital, there is a tendency to refer to the members as "shareholders", and that is not inaccurate, for the mechanism by which they become members is to acquire shares, but the words are not synonymous, for their rights *as members* may be set out in the articles, and different members may have different rights. Sometimes that is done by creating different classes of shares, but sometimes there is only one class of shares with an individual shareholder or shareholders being given a disproportionate voting power in certain particular, specified situations. The paradigm example is found in the House of Lords case of *Bushell v Faith [1970] AC 1099* where the articles provided that a company director's shares should count triple in voting on an Ordinary Resolution for his removal. In dealing with a submission that certain statutory provisions effectively prevented such an uneven weighting of votes, Lord Donovan stated (at page 1110-1):

> "When, therefore, it is said that a decision in favour of the respondent in this case would defeat the purpose of the section and make a mockery of it, it is being assumed that Parliament intended to cover every possible case and block up every loophole. I see no warrant for any such assumption. A very large part of the relevant field is in fact covered and covered effectively. And there may be good reasons why Parliament should leave some companies with freedom of manoeuvre in this particular matter. There are many small companies which are conducted in practice as though they were little more than partnerships, particularly family companies running a family business; and it is, unfortunately, sometimes necessary to provide some safeguard against family quarrels having their repercussions in the boardroom. I am not, of course, saying that this is such a case: I merely seek to repel the argument that unless the section is construed in the way the appellant wants, it has become 'inept' and 'frustrated'."

There is no good reason why the same logic ought not to apply to the rights of members in a company limited by guarantee, but without a share capital.

That this is so is confirmed by the recent UK Supreme Court case of *Children's*

2 This may be subject to such limitations upon dividing up the undertaking amongst the members at all as may appear in the articles – for example, in the case of a charitable company, the members are prevented by the articles from taking any part of the undertaking on dissolution – this has to be transferred to another charity.

Investment Fund (UK) v Attorney General [2022] AC 155. Although concerning a rather different issue (the fiduciary duties of a member of a charitable company limited by guarantee), attention should be drawn to the comments of Lady Arden JSC at §160:

> "Moreover, the legislature has not sought to interfere with or restrict the special voting rights a company may confer on any member, and so the articles could provide that only one member should effectively be able to vote on a resolution. The House of Lords considered in *Bushell v Faith [1970] AC 1099* that the mandatory rule in section 184 of the Companies Act 1948 (now section 168 of the 2006 Act), whose purpose was to prevent companies from making removal of a director subject to an extraordinary resolution, did not prevent special voting rights being attached to a particular share on any ordinary resolution for the removal of a director. In that case, the House of Lords by a majority held that the article attaching special voting rights was valid despite the provisions of section 184(1), since Parliament was only seeking to make an ordinary resolution sufficient to remove a director and had not sought to fetter a company's right to issue a share with such rights or restrictions as it thought fit."

Although the reference to *Bushell* brings with it a reference to shares, it is clear in the context of *Children's Investment Fund UK* that lady Arden was relating this explanation of the rights of members *as members (*as set out in a company's articles), to companies generally, including (as in that case) a company limited by guarantee.

However, it is not necessary to engage in a process of exegesis, as the Companies Act itself makes matters clear in section 284, which provides as follows [*emphasis supplied*]:

> 284 *Votes: general rules*
>
> (1) On a vote on a *written resolution*—
>
> (a) in the case of a company having a share capital, every member has one vote in respect of each share or each £10 of stock held by him, and
>
> (b) **in any other case, every member has one vote.**
>
> (2) On a vote on a resolution on a *show of hands* at a meeting, each member present in person has one vote.
>
> (3) On a vote on a resolution on a *poll* taken at a meeting—
>
> (a) in the case of a company having a share capital, every member has one vote in respect of each share or each £10 of stock held by him, and

(b) **in any other case, every member has one vote.**

(4) **The provisions of this section have effect subject to any provision of the company's articles.**"

There is a subsidiary argument, suggested in the Brief, to the effect that the weighted voting is a provision that "purports to divide the company's undertaking into shares or interests" and is therefore an unlawful provision for share capital, contrary to section 5(3). However, the flaw in this argument is that the weighted voting provisions apply to *membership rights* and have nothing to do with trying to divide the *undertaking* of the company, as should be obvious from my analysis above. In short, this is an argument which cannot succeed.

In summary, therefore, there is nothing *in principle* unlawful in the insertion of provisions in Nominet UK's Articles giving different members different voting rights.

<u>The Effect of Section 285A:</u>

However, section 285A (and its statutory predecessor) limits the freedom given by section 284 (4) as follows:

> "285A In relation to a resolution required or authorised by an enactment, if a private company's articles provide that a member has a different number of votes in relation to a resolution when it is passed as a written resolution and when it is passed on a poll taken at a meeting—
>
> (a) the provision about how many votes a member has in relation to the resolution passed on a poll is void, and
>
> (b) a member has the same number of votes in relation to the resolution when it is passed on a poll as the member has when it is passed as a written resolution."

Article 19 specifically refers to *poll* voting rights which will be set by bye-laws made under article 52.1. Paragraph 4 of the bye-laws does, indeed, set out a formula for determining poll voting rights.

If that is all that had been done, there would certainly have been a difference between voting rights on a written resolution (one member one vote, in terms of section 284(1)(b)) and votes on a poll (as per the formula). The result would have been that the provisions of the bye-laws regarding weighted voting would, in terms of section 285A have been void, and, consequently, any votes taken on a poll using that formula (at any rate in relation to resolutions "required or authorised by an enactment") would likewise be open to being set aside.

The matter, however, is not quite that simple. Paragraph 5 of the bye-laws purports to provide for the same weighting of votes on both a vote by written resolution and on a show of hands. That provision would clearly be *ultra vires* if treated as having been made under the authority of article 19 (which relates to poll voting rights only) and would therefore be ineffective.

The complication comes in the wording of article 52.1 which provides that the bye-laws should regulate "voting rights", without limitation or qualification as to what sort of voting rights. Article 52.1 cannot be dismissed as *ultra vires*, because it is not a subsidiary power. Rather articles 19 and 52.1 have to be read together, as a whole. It is a canon of construction that where two provisions in the same deed conflict with one another, the latter should be preferred, and, on that basis, paragraph 5 of the bye-laws would not be invalidated. However, it is reasonably arguable that there is no conflict between article 52.1 and article 19 – article 52.1 should be read as referring back to article 19, and, therefore, the reference in article 52.1 should be read as referring back to the particular voting powers that were specified in article 19.

I think that the latter argument is more robust, but, that argument is an essentially semantic one. If it came to litigation the Court would be likely to apply a contextual interpretation as envisaged in *Kookmin Bank SA v Rainy Sky [2011] 1 WLR 2900,* namely that the court has to have regard to all the relevant surrounding circumstances, and if there should be two possible constructions the court is entitled to prefer the construction which is consistent with business common sense and to reject the other construction.

The argument which would then be deployed is that, since the "article 19 alone governs" argument would lead to a result whereby the bye-laws are unlawful, the drafters of the articles could not have intended such a result, and the "give primacy to article 52.1 (which does not produce such a result)" argument is to be preferred.

I am deeply sceptical of such an argument as it seems to be an exercise in allowing the tail to wag the dog (the bye-laws are subordinate to the articles), but, in any event, at the time that the bye-laws were originally made, the differentiation between poll voting rights and other voting rights was entirely lawful: the predecessor of section 285A was not enacted until 2009, pursuant to the Companies (Shareholders Rights) Regulations 2009.

In these circumstances the argument that the "business common sense" interpretation would require to be such as to avoid the articles falling foul of section 285A simply does not get off the ground. The articles speak from the time that they were made, and the creation at that time of a differentiation of voting rights on a poll vote with voting on other forms of voting would have been perfectly lawful.

In these circumstances, there is a robust argument that the provision in the bye-laws

equiparating voting rights in respect of votes cast other than on a poll with poll voting rights is *ultra vires*. If that provision is invalid, then the bye-laws fall foul of section 285A and, insofar as they create weighted voting on a poll, that provision is itself invalid.

Lack of Certainty

The weighting of the voting rights is not stipulated in the Articles themselves, beyond the vague and uncertain aspiration in Article 19 that the rights "rights will be related to the Member's relative commercial involvement in the .UK domain name service". Thus far, this lacks certainty. However, article 19 continues: "and will be set by means of bye-laws established in accordance with article 52.1".

The bye-laws (at any rate at first sight) appear to set out a reasonably clear formula by which the weighted voting rights can be calculated. Applying the principle *certum est quod certum reddi potest* (that is certain which can be rendered certain), therefore, I do not, as at present advised, see such a lack of certainty as would make the provision ineffective. This, of course, proceeds upon the assumption that the provision is not ineffective in the first place (as to which, see above).

However, I am informed that the formula is of such complexity that there may have been occasions when it had not been applied properly. This would potentially invalidate any vote where such an error had been made – it would, however, depend on whether the outcome would have been different had the formula been correctly applied.

Unfair Prejudice

I am asked whether the weighted voting provisions might permit a member to petition the Court under section 994 of the Companies Act on the ground "that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least [the Applicant])"

However, this is an argument which will not fly. If the weighted voting provisions are lawful, (as to which see above) then the mere existence of weighted voting would not, of itself, amount to prejudice. In order to bring a petition under section 994, a member would have to point to some manner in which the weighted voting was actually being abused by the majority in order to (or with the effect of) oppressing the minority.

Conclusion

As the foregoing analysis discloses, it is lawful for the articles of a company limited by guarantee to provide for weighted voting, and this principle would clearly apply to

the articles of Nominet UK.

However, the manner of the wording of article 19 appears to allow for different voting systems for polls as opposed to written resolutions. That is clearly unlawful in terms of section 285A, with the consequence that the provision about how many votes a member has in relation to a resolution passed on a poll is void, with the further consequence that decisions previously made by that method might potentially be attacked. I say "potentially" as there may be issues of estoppel etc. arising on a case by case basis - for example, a particular member might be taken to have acquiesced in the making of the bye-laws and be prevented from now trying to argue that the bye-laws were not authorised in terms of the articles. This is, however, likely to be a lesser concern in the case of Dulwich Storage Ltd. which has only recently become a member.

There is a possible competing argument (discussed above) that article 19 read along with article 52.1 falls to be construed as, in fact, allowing the bye laws also to make provision for weighted voting in forms of voting other than on a poll. However, as also explained above, I do not believe that to be a tenable argument.

If the principals of Dulwich Storage Limited along with Mr. Davies would wish to explore these matters with me further, I should be happy to consult with them.

THE OPINION OF

Iain G. Mitchell QC (Scotland)

Tanfield Chambers,
2-5 Warwick Court,
London WC1R 5DJ.

24th August, 2022.