PROTECTION OF MINORITY SHAREHOLDERS

A feature of twentieth century company law has been the increased attention paid to the protection of minority shareholders. Fundamentally, two developments have taken place in this area. The first is the increased equitable limitations placed upon the powers conferred on the majority in general meeting. Coupled with this has been the relaxation of previously very rigid rules relating to standing. The second phenomenon has been the growth of statutory intervention to supplement and replace the general law in relation to protection of minority shareholders.

In regard to the first mentioned development the foundation of these equitable limitations is expressed to be that the majority must act for the benefit of the company as a whole. Although this language is reminiscent to that of directors' duties no fiduciary obligation is owed by the majority shareholders. Conduct which violates the majority's duty constitutes "fraud on the minority". The doctrine of fraud on the minority is intertwined with the topic of locus standi for actions regarding minority protection.

In relation to the equitable limitations on the voting power of the majorities two conflicting principles have sought supremacy The first principle permits the complete utilization of the powers attached to the chose in action; the share. As Mellish L. J. in Menier v Hoopers Telegraph Works (1984) LR 9 ch app 350 at page 354 stated:

"shareholders of a company may vote as they please."

This notion is the consequence of the emphasis being focused on the share, devoid of considering its surrounding circumstances. The leading Australian statement supporting this view is to be found in Peters' American Delicacy Co Ltd v Heath (1939) 61 CLR 457 at page 504. There Dixon J, as he was then, held:-

> "[the shareholders] vote in respect of their shares, which are property and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage."

The earliest English authority for this contention is contained in Pender v Lushington (1877) 6 Ch. D. 70 at pages 75-76.

The principle that collides with this unfettered freedom is contained in the statement of doctrine by Lindley MR in Allen v Gold Reefs of Wester Africa Ltd [1900] 1CH 656 at page 671. The Master of the Rolls held:

> "[the power of the majority must] like all powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded".

The focus of this principle is wider than the first as it takes account of more factors, such as the effects of using the property rights on other shareholders.

The resulting friction generated by the competing principles has been the evidence for this century's struggle for protecting minority shareholders. The ascendary of the second principle over the first has been reflected in the expansion of the doctrine of fraud on the minority. To take the analysis further the cases on this equitable limitation require

categorization. Various groupings have been suggested by various authors. The plethora of nominated sub-divisions is indicative of the ad hoc and uncertain nature of this area. The grouping utilized by Redmond in Companies and Securities Law, which is very similar to that suggested by Gower, is the one that is referred to here.

One category of cases dealing with equitable limitations applies to resolutions of the general meeting which expropriate corporate property or rights. The case of Menier v Hooper's Telegraph Works (1874) LR 9 CH App 350 illustrates this grouping. In that case the company directors decided to abandon proceedings which sought to regain valuable rights. In addition, the members in general meeting voted for the company to pass into voluntary liquidation. Arguing that the two decisions had been obtained by the majority shareholder pursuant to his own best interests a minority shareholder sued. James L.J. held at page 353:

> "The minority of the shareholders say in effect that the majority has divided the assets of the company more or less between themselves to the exclusion of the minority. I think it would be a shocking thing if that could be done, because if so the majority might divide the whole assets of the company, and pass a resolution that everything must be given to them, and that the minority should have nothing to do with it."

The Privy Council decision in Cook v Deeks [1916] 1AC 554 supports the protection of minority shareholders on the basis of expropriation of corporate property. The High Court did likewise in Ngurli Ltd v McCann (1953) 90 CLR 425 at page 447. The difficulty with this grouping of cases is to ascertain

what the court will treat as an expropriation of corporate property. Both Regal (Hastings) Ltd v Gulliver [1967] 2AC 134 and Furs Limited v Tomkies (1936) 54 CLR 583 highlight this difficulty. Gower at pages 617 - 618 suggests that a reconciliation and understanding can be found in the cases by the distinction between misappropriating the company's property and merely making an incidental profit. The incidental profit, unless it flowed from a use of the company's property, is not itself company property, and thus no expropriation of company property can logically occur.

Resolutions to release directors from the consequences of their breach of duty to the company form the second category of cases in this area. Bamford v Bamford [1969] 1 All ER, 969 held that the general meeting has a wide power to ratify the actions of the directors who are in breach of their duties and to exonerate them from liability arising from such a breach. However, to understand where the protection of the court will be extended to the minority the various duties of the directors must be stated. These include the duty to avoid conflicts of interest and to act for proper purposes. The directors must also exercise a reasonable degree of care and diligence.

As a generalisation the general meeting is capable of ratifying a director's breach of his duty to avoid conflicts of interest. However, North West Transportation Co. v Beatty (1887) 12 App (as 589 does indicate limitations on this ability. The Privy Council stated:

> "The general principles applicable to cases of this kind are well established. Unless some provision to

> the contrary is to be found in the charter or instrument by which the company is incorporated, the resolution of a majority of the shareholders duly convened, upon any question with which the company is legally competent to deal, is binding upon the minority, and consequently upon the company, and every shareholder has a perfect right to vote upon such a question, although he may have a personal interest in the subject matter opposed to, or different from, the general or particular interests of the company. On the other hand, a director is precluded from dealing, on the behalf of the company with himself, and from entering into engagements in which he has a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound by fiduciary duty to protect; and this rule is as applicable to the case of one of several directors as to a managing or sole director. Any such dealing or engagement may, however, be affirmed or adopted by the company, provided such affirmance or adoption is not brought about by unfair or improper means, and is not illegal or fraudulent or oppressive towards those shareholders who oppose it."

On the question of whether the general meeting can ratify a breach of the duty to exercise the powers for a proper purpose Ngurli Ltd v McCann (1953) 90 CLR 425 held that where the directors have acted in their own interests rather than in the interests of the company ratification is open to challenge by the minority. Bamford v Bamford (supra) should be noted on this point. It held that the majority can ratify an improper exercise of powers by the directors where the directors honestly believed their actions were in the best interests of the company. The case of Winthrop Investments Limited v Winns Limited [1975] 2NSWLR 666 held that the majority is capable of prospectively ratifying a breach of directors' duties unless it can be shown that the majority in ratifying failed in their duty to act bona fide for the benefit of the company. Once again the test is vague and so leaves the court with much discretion.

The possibility of ratification of a director's breach

of the duty to exercise reasonable care and diligence was considered in Pavlides v Jensen [1956] Ch 565. In that case the court found that the majority could release the directors after they had acted negligently. However, this should be contrasted with Daniels v Daniels [1978] 2 WLR 73 where no release was allowed as the directors negligence resulted in a benefit to themselves. Thus a distinction must be drawn between where a benefit is a consequence of this breach.

The third grouping of case law recognised as constituting fraud on the minority is the power of the majority to vote for alteration of the articles. Ford, at page 467, considers whether or not this grouping now, as S.73 allows the memorandum to be altered, applies to alterations to the memorandum. As S73(8)(10) only allows the Supreme Court to cancel such an alteration to the memorandum on the application of persons with an interest of not less than 10 percent, it would appear logical that this grouping could be appropriate to any attempts to alter the memorandum.

In Brown v British Abrasive Wheel Co. Ltd [1919] 1 Ch 290 an attempt was made to alter the articles so that the majority could acquire the shares of the minority. Ashbury J. held that the proposed alteration would be invalid, and an injunction to prevent the alteration was granted. Jacobs J. in Crumpton v Morrine Hall Pty. Ltd [1965] NSWR 240 allowed relief where alterations were proposed in a home unit company to restrict sub-letting of a shareholder's unit as it was fraud on the minority. However, when the High Court considered this

matter in Peters' American Delicacy it upheld an alteration which had the effect of depriving holders of partly-paid shares to the advantage of holders of fully-paid shares. Therefore, Fort at page 472, suggests that discrimination is not a sufficient test in this area, but because of lack of consistency shown in the cases no suitable test of a concrete nature can be supplied.

At this point the case of Phillips v Manufacturers' Securities Ltd (1971) 116 LT 290 should be noted. It held that a company may, from its inception, have valid articles capable of discriminating against the minority. It would be interesting to speculate what would the result be if this was litigated today. It could be argued that the minority shareholder knows of the unfavourable articles and it is their responsibility if they should purchase the shares. This is analogous to the notion of freedom of contract. The reference to contract law is also instructive in the likely outcome of such litigation. As the scope of freedom of contract has been narrowed and the court been exercising an increasing remedial role, likewise it might be presumed with original discriminatory articles.

After an examination of the equitable limitations on the power of the majority and an attempt at categorization it must be stated that the area of general law protection of minorities is unclear. It's lack of clarity is the function of two factors, of which the second is really a consequence of the first. This initial point is that two opposed principles are in direct conflict within this area. The second point is that with

the ascendary of the concept of the protection of the minority that the delineation between the two principles has been, and continues, shifting. Thus, close legal analysis of the case law to determine relatively specific legal tests is less than fruitful. Thus, Jacobs' J. statement in Crumpton v Morrine Hall Pty Ltd [1965] NSWR 240 is relevant. At page 244 His Honour stated that:-

> "It seems to me that the truth is that the courts in each generation or in each decade have set a line up to which shareholders have been allowed to go in affecting the rights of other shareholders by alterations of articles of association and beyond which they have not been allowed to go. It seems to me that no amount of legal analysis or analytical reasoning can conceal the fact that the decision has in the past turned, and must turn ultimately, on a value judgment formed in respect of the conduct of the majority - a judgment formed not by any strict process of reasoning or bare principle of law but upon the view taken of the conduct."

Foster J. in Clemens v Clemens Bros Ltd [1976] 2 All ER 268 at 282 stated it would be:

> "unwise to try to produce a principle, since the circumstances of each case are infinitely varied."

Indeed, Ford at page 465 compares this area of law to that of negligence which relies heavily on the hypothetical reasonable person for the application of a broad formula to diverse factual situations. Uncertainty of result is the outcome of the court's attempt to reflect changing social and business views on the protection to be afforded to minority shareholders.

Logically connected with these equitable limitations is the power to litigate. Standing is an essential element for the minority to obtain the court's protection. An easing of previously strict standing rules has been evident this century, which has allowed for greater minority shareholder protection.

Generally, the directors' duties are owed to the company, and only in exceptional circumstances to individual shareholders. Further, the power to litigate in the company's name resides in the directors. This is clearly the result of Regulation 66 of Table A which gives powers of management to the board. Dicta in Marshall's Value Gear Co. Ltd v Manning Wardle & Co. Ltd [1909] 1 Ch 267 suggests that the general meeting itself may authorise the commencement of proceedings in the company's name. But where neither organ will enforce a duty or sue for the company in cases such as Ngurli v McCann and Mills v Mills (1938) 60 CLR 150 the court has permitted a shareholder to sue for a wrong done to the company. This derivative suit occurs where fraud on the minority has taken place. This action requires two elements, "fraud" and "control". In these cases the cause of action belongs not to the shareholder but rather to the company. The derivative suit operates as an exception to the rule in Foss v Harbottle (1843) 67 ER 189 which stands for the proposition that the company is the proper plaintiff to bring an action if the wrong is done to the company. The Foss v Harbottle rule was, according to Boyle in his article "The Minority Shareholder in the Nineteenth Century" (1965) 28 MLR 317, a major impediment to the nineteenth century minority shareholder seeking redress for a wrong. The derivative suit lessens this problem. In this suit the member sues on behalf of themselves and all other members. The company is joined as a co-defendant, and so any judgment will bind it. Wallersteiner v Moir(No.2) [1975] QB 373 has further assisted

the minority shareholder by finding that if the derivative suit is properly and reasonably brought then usually the company will be ordered to pay the plaintiff's costs.

Another exception to the strict standing rule of Foss v Harbottle was mooted in that case by Wigram V-C at pages 202-203. This possible exception is where justice requires. This notion has received further support in Edwards v Halliwell [1950] 2 ALL ER 1064 and in Hodgson v NALGO [1970] 1 WLR 130. Such an exception must be seen as assisting the minority shareholder. However, the English Court of Appeal in Prudential Assurance Co. Ltd v Newman Industries Ltd (No. 2) cast doubt on this exception by considering it impractical.

Ford, at page 479 and following, has an intersection of the common law developments resulting in the protection of minority shareholders and the statutory intervention to the same end. This common ground occurs in the member's personal action. In cases such as Ngurli v McCann (supra) and Howard Smith v Ampol Petroleum [1974] AC 821 the High Court recognised wrongs done to the shareholders personally, and not to the company. As these cases dealt with the capital structure of the companies it may be suggested that Australian actions relating to the capital nature of the company will give rise to a personal action by shareholders. In this way the minority shareholder is not confined or restricted by the Foss v Harbottle rule as it has no ambit of operation.

A further area in which the proper plaintiff rule,

stemming from Foss v Harbottle ceases tobe relevant is in the statutory contract contained in the memorandum and articles. Hickman v Kent or Romney Marsh Sheep Breeders Association [1915] 1 Ch 881 held that the memorandum and articles of association constitute a statutory contract. Section 78 declares that the memorandum and articles have the effect of a contract between the company and each member, between the company and each officer, and between a member and each other member. Ford at page 483 suggests that the language of this new s.78 may mean that a member can enforce an obligation such as that involved in Eley v Positive Life Assurance Company (1874) LR 9 CP503 where the articles required the member to be appointed the company's solicitor.

A fetter upon the minorities reliance upon the statutory contract is, as Ford details from page 483 onwards, is the presumption of ratification by the majority. Thus, another flaw is evident in the protection of minorities. The importance of statutory modifications to the general law protection of minorities becomes increasingly relevant.

The protection offered by the general law to minorities is although it has been extended, haphazard and less than comprehensive in its coverage. The initial point is that the cases in this area articulate no single test, and thus the scope of the protection is uncertain. This imprecision is a function of the application of ever changing views of what behaviour of the majority will and will not be tolerated. Further, a strict application of Foss v Harbottle would often make it impossible

for minorities to seek protection. The severity of this standing rule has been mitigated by the introduction of exceptions and the expansion of the availability of personal actions. The statutory provisions for protecting minorities fulfil two functions; a supplement to the general law and a wide expansion of the protection of the minority shareholder.

The two primary statutory remedies which avail themselves to minority shareholders are the compulsory liquidation remedies and the provisions for oppression. Standing is given to the individual in these cases. The problem associated with Foss v Harbottle is thus avoided.

The oppression remedy was inserted to the English Companies Act following the recommendations of the Cohen Committee [Cmnd 6659 of 1945]. Section 186 was introduced to the Australian Uniform Companies Legislation of 1961. The initial English provision, S.210 of the Companies Act (UK), was comprehensively reformed in 1980 and is now contained in ss 459-461 of the Companies Act 1985 (UK). The Australian section was expanded and became S.320. This was amended in 1983. The overall effect of these changes has been to overcome some of the judicial limitations placed upon the protection of minority shareholders.

Nothing in s.320 prevents it's application to any type of company. The court may make remedial orders if it is of the opinion that the affairs of the company are being conducted in a manner that is "oppressive", "unfairly prejudicial" or "unfairly discriminatory" against a member. The concept of "unfairly" in

the latter two grounds is an essential element as demonstrated by Wayde v NSW Rugby League Committee Ltd (1985) 59 ALJR 798. The notion of "unfairly prejudicial" is a result of the Jenkins Committee's [Report of the Company Law Committee, Cmnd 1749 of 1962 at paragraph 202] desire to lower the threshold of conduct, from "oppression", that must be met for a remedy to be available. Therefore, the new ground for relief makes it easier for minority shareholders to seek redress. "Unfairly discriminatory" is the product of the recommendation of the Macarthur Committee [final report of the Special Committee to Review the Companies Act (1973) (NZ)]. Once again this new ground provides greater scope for relief to the shareholder. Although S.320 has been expanded so as to provide a remedy to members in a wider range of circumstances, the cases appear to suggest that S.320 does not permit a minority shareholder to force a purchase of his shares simply because he is "locked in". Nor does it apply merely because the member is disgruntled with the way the company is being run. The Victorian case of Re G. Jeffrey (Mens Store) Pty Ltd (1984) 9 ACLR 193 and the New Zealand Court of Appeal decision in Thomas v H.W. Thomas Ltd (1984) ACLC 610 support these contentions.

By s.320(2) where an application is made under the section the court has wide powers to make an order it sees as fit. Possible remedies include the winding up of the company (s.320(2)(c)), an order regulating the future conduct of the company's affairs (s.320(2)(d)), an order for the purchase of shares of any member by other members (s.320(2)(e) and an order

that the company institutes or defends legal proceedings or authorise a member to institute or defend legal proceedings in the name of the company (s.320(2)(g)). The width of the court's discretion to make the appropriate order and so protect the minority shareholder is illustrated by two cases. In Re Overton Holdings Pty. Ltd (1984) 2 ACLC 777 The Supreme Court of Western Australia granted an order authorising a member to institute legal proceedings on behalf of the company. In this way the Foss v Harbottle limitation to actions by minority shareholders can be circumvented. The other case is Re R.H. Harmer [1968] 3 All ER 689. In that case a father and two sons were the directors of the family company. The father was chairman and governing director, and with his wife he had control over three quarters of the shares. He ignored the wishes of the sons, the other directors and resolutions of the board. The court found that these actions constituted oppression, and it ordered that the father should not interfere with the valid decisions of the board of directors. Further, the court ordered that the father enter into a contract with the company as a consultant at a specified salary. These two cases give a brief glimpse of how the court can now make very precise orders to remedy any action that is "unfairly prejudicial", "unfairly discriminatory" or "oppression".

The compulsory liquidation remedy available to the members permits the court to make an order for the winding up of a company if the court is of the opinion that it is just and equitable that the company be wound up (s.364(1)(i)), the

directors have acted in the affairs of the company in their own interests rather than in the interests of the members as a whole, or in any other manner whatsoever that appears to be unfair or unjust to other members (S.364(1)(f), affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against a member or in a manner that is contrary to the interests of the members as a whole (S.365(1)(fa)), or an act or omission, by or on behalf of the company, or a resolution or proposed resolution of a class of members of the company, was or would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or was or would be contrary to the interests of the members as a whole (S. 364(1)(fb)). By simply examining the language of this section it is apparent that the legislature has attempt to provide a comprehensive remedy to the shareholder.

Re Tivoli Freeholds [1972] VR 445 is a case involving winding up under the just and equitable ground. Here a company whose main objects were to carry on an entertainment business with associated activities and to acquire land on which theatres were to be erected came under the majority shareholding of a corporate raider. The company sold off its links to the entertainment business, and subsequently lent money to other companies to finance corporate raids. A minority shareholder petitioned for winding up under S.186 UCA (now S.320) or S.222(1)(h) UCA (now S.364(1)(j)). Menhennitt J. ordered winding up as it was just and equitable.

These two primary statutory remedies reflect the desire

to provide protection to members, which includes minority shareholders. The remedies available, especially S.320(2)(j) and (k) which allows the court to order requiring a person to do or not to do a specified act or thing, have given the court much discretion. These remedies are not automatically available. However, the tests that must be satisfied do appear sufficiently elastic to allow changes in what the court will and will not permit the majority shareholders to do. Although these are the primary statutory protective devices extended by the legislation they are not the totality of the statutory remedies available. Under S.574(1) any person whose interests are affected by the conduct of a person which constitutes a contravention of the Code, may apply to the court for an injunction restraining that person from engaging in the conduct. The court may also order that the person acting in contravention of the Code be required to do any act or thing. Section 241 requires the directors to convene a general meeting on the requisition of not less than 200 members is company not having a share capital, not less than 100 members holding shares in a company with a share capital on which there has been paid up an average sum per member of not less than $200, or members holding at least 5 per cent of the paid capital, or who are entitled to at least 5 per cent of the voting rights.

In this brief overview of the protection afforded to minority shareholders three central features have become apparent. The first is that much of the general law has been

confused by the search for highly specific tests relevant to each grouping of cases. It needs to be recognised that such searching is futile, and indeed, irrelevant. A general test of the act being bona fide for the benefit of the company as a whole should be stated, and the individual application of this should be made by the judge in the particular case, utilizing its own facts to a great degree to determine the outcome. (1) The second main feature has been the advent of large scale and important legislation dealing with this area. The final observation has been the noting of the vast increase, by the greater availability of common law remedies, the easing of standing requirements and the extension of statutory remedies, in the protection of minority shareholders.

(1) Legal principle should remain at high abstract level.