SECTION 209 OF THE COMPANIES ACT 1955: A STEP TOWARDS SHAREHOLDER PROTECTION

Among the submissions received by the Cohen Committee[1] were several which were concerned about the position of minority shareholders in a private company. The submissions considered particular problems[2] but the committee recognised that these were only aspects of a more general problem. They proposed[3] that the courts be empowered to impose a just and equitable settlement on the parties where oppression of the minority was proven. Their recommendation[4] restates the proposal in a somewhat altered form—at once both more general and more limited—that:

> there be a new section under which, on a shareholders petition, the Court, if satisfied that a winding up order would not do justice to the minority, should be empowered, instead of making a winding up order, to make such other order, including an order for the purchase by the majority of the shares of the minority at a price to be fixed by the Court, as to the Court may seem just.

This recommendation was accepted and became section 210 of the Companies Act 1948 (U.K.). The section, slightly amended, was adopted by the New Zealand Parliament, when it reviewed its companies legislation, and is now section 209 of the Companies Act 1955 (hereinafter referred to as "section 209"). — Empire Bilg

There are no reported New Zealand cases on section 209. References in this paper to the New Zealand position, or similar statements, are premised on the assumption that a New Zealand court would adopt case law developed in other jurisdictions to the whole extent to which it is applicable in the New Zealand context.[5]

I SECTION 209 — OPPRESSION

The stated purpose of section 209 is to provide a remedy in cases of oppression. But what does "oppression" mean in the context of the words "that the affairs of the company are being conducted in a manner oppressive to some part of the members?[6] Oppression, in this sense, is a novelty, although the word has been used occasionally in "fraud on the minority"[7] and winding up cases.[8] The word is usually found in

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1. Committee on Company Law Amendment (U.K.) 1945; Cmd 6659.
2. E.g. Restriction on the transfer of shares and excessive remuneration of directors.
3. Para. 60 of the Report Cmd 6659 (1945).
4. Para. 95.
5. Provisions similar to s.209 appear as s.210 Companies Act 1948 (U.K.), s.186 uniform companies legislation (Australia), s.111 bis Companies Act 1926 (South Africa), s.185 Companies Act 1960 (British Columbia).
6. S.209 (1).
7. *North-West Transportation Company* v. *Beatty* (1887) 12 App. Cas. 589; *Castello* v. *London General Omnibus Co. Ltd.* (1912) 107 L.T. 575 (C.A.) *Rights and Issues Investment Trust Ltd.* v. *Stylo Shoes Ltd* [1965] Ch. 250.
8. *Thompson* v. *Drysdale* 1925 S.C. 311, 315.

juxtaposition with illegal, fraudulent and ultra vires, being used in this situation to convey an idea of harshness in dealings.

Judges faced with the problem of definition have either relied on their dictionary or else attempted a descriptive definition. While the need for a definition becomes less important as a body of case law develops to demarcate the limits of the section, it is noteworthy that, even now, there is no judicial consensus on the definition.

In *Marshall* v. *Marshall (Pty.) Ltd*[9] Broome J.P. considered that "to amount to oppression the conduct complained of must be found to be unjust, harsh or tyrannical".[10]

The matter of definition was not a major issue in the leading case on section 209, *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer.*[11] However Viscount Simonds, in what was almost an aside, introduced a further dictionary definition:

> it appears to me incontrovertible that the society have behaved in a manner which can justly be described as "oppressive". They had the majority power and they exercised their authority in a manner "burdensome, harsh and wrongful"— I take the dictionary definition of the word.[12]

Lord Simonds does not appear to have placed much weight on his definition, but statements *ex cathedra,* even if only obiter, by a member of the House of Lords are treated with respect by judges in lower courts. This definition has been accepted or, at least, quoted in most subsequent cases, notwithstanding that a literal adherence to the cumulative effect of the phrase is restrictive.

The use of the word "wrongful" was unfortunate. It might mean "morally bad" but courts appeared to read it as "unlawful".[13] Professor Wedderburn noted this trend with concern:

> in the English decisions where an oppression remedy has been granted an independent element of unlawfulness has been present—in the *Meyer* case a breach of fiduciary duty by the nominee directors, in the *Harmer* case[14] the breach of the articles by an autocratic father. The question arises, how far does "oppression" reach when there is *no independent element*[15] of legal impropriety?[16]

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9. 1954 (3) S.A. 571.
10. (1954) Annual Survey of South African Law p. 204, hereinafter referred to as "S.A. Survey".
11. [1959] A.C. 324; [1958] 3 All E.R. 66.
12. Ibid., at 342 (71).
13. An exception was *Re Bright Pine Mills Pty Ltd.* (1963) reported in [1969] V.R. 1002.
14. *Re H. R. Harmer Ltd.* [1959] 1 W.L.R. 59, [1958] 3 All E.R. 689.
15. Wedderburn's italics.
16. (1966) 29 M.L.R. 324.

Re Five Minute Car Wash Limited[17] indicates how such an interpretation restricts judicial discretion. Haynes, the petitioner, a holder of 62 of the 3101 shares and an ousted director, made numerous allegations against Evison the manager and two holding companies which had permitted Evison to remain as manager. The majority of the allegations related to defects in management—non-payment of accounts, sale of car wash vouchers at below cost, and failure to remove inefficient staff—which had contributed to the company's continuing losses.

Mr Justice Buckley's judgment, increased the Professor's concern:

> These allegations suggest that Mr Evison is unwise, inefficient and careless in the performance of his duties as managing director and chairman of the board of the company. I can find in them no suggestion that he has acted unscrupulously, unfairly or with any lack of probity towards the petitioner or any other member of the company or that he has overborne or disregarded the wishes of the board of directors, or that his conduct could be characterised as harsh or burdensome or wrongful towards any member of the company[18]

and earlier:

> The mere fact that a member has lost confidence in the manner in which the company's affairs are conducted does not lead to the conclusion that he is oppressed; nor can resentment at being outvoted; nor mere dissatisfaction with or disapproval of the conduct of the company's affairs, whether on grounds relating to policy or to efficiency, however well founded.[19]

If *Five Minute Car Wash* gave a true indication of the development of section 209, one would share Professor Wedderburn's apprehensions. Buckley J. accepts two dangerous ideas about oppression:

1. there is no oppression unless the wrongdoer intends to injure the complainant.
2. wrongful means unlawful.

The first point is easily disposed of: the Court of Appeal found oppression in *Harmer,* although Harmer Senior was attending to his own interests and was not consciously trying to oppress his sons.

The second is more complex. There would be no grounds for complaint unless there were wrongful acts, in a moral sense, and such acts will normally involve breach of a legal or fiduciary duty, but subsequent cases have shown that wrongful does not have to be read as unlawful.

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17. [1966] 1 All E.R. 242.
18. Ibid., 247.
19. Ibid., 246-247.

Joske J. in *Re Associated Tool Industries Ltd.*[20] found that the directors' refusal to sell their shares in an associated company to the holding company was oppressive. Their refusal may have amounted to the breach of fiduciary duty but the point was not argued and was clearly not regarded as relevant.

This case follows the broader interpretation of *Meyer*. If that is the proper approach, then the main support of the "wrongful means unlawful" argument is removed. In *Meyer* the Law Lords split on the question whether the affairs of the company should be construed narrowly as the subsidiary alone or broadly as the Society, the majority shareholder in the company. If viewed narrowly the nominee shareholders had failed in their fiduciary duty to the subsidiary, but on the broader view the Society's lapse was moral not legal insofar as it was exercising its proprietary rights for its own purposes without regard to the interests of the minority shareholders.

The result of the *Aspek* case[21] should allay the Professor's fears. Apart from a possible breach of the articles in the ousting of Spektor, the petitioner, as a director, which the Judge declared "was not necessary for me to decide this issue",[22] the decision, that there was a prima facie case of oppression, is based on a series of acts in themselves inconclusive but as a whole showing:

> it is in my view possible to say that it may be that the affairs of the company are being conducted with a lack of probity and fair dealing towards the minority shareholders and that there may have been and possibly still is a violation of the conditions of fair play on which Spektor is entitled to rely. Each matter complained of is capable of an explanation which is innocent (for lack of a better word) but may also be part and parcel of conduct designed to react on the rights of members such as to further a scheme whereby the rights of a section of members may be prejudiced.[23]

It is not surprising, in view of the limitations imposed by the cumulative effect of the "authoritative" dictionary definition and difficulties in interpreting that definition, that some judges have preferred the less restrictive descriptive definitions proposed in the early Scottish decisions.

In *Elder* v. *Elder and Watson Ltd.*[24] the first reported decision on this section, the Court of Session rejected the petition but two of the judges proposed descriptive definitions which though differing slightly in emphasis are remarkably similar and have been quoted with approval in other jurisdictions. Lord Cooper's definition:

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20. [1964] A.L.R. 73.
21. *Aspek Pipe Co. Ltd.* v. *Mauerberger* 1968 (1) S.A. 517.
22. Ibid., 529-530.
23. Ibid., 533.
24. 1952 S.C. 49.

> the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely,[25]

is clear, readily understandable and inclusive of a wide area of company practice. Perhaps this last aspect is one reason why it has not been universally adopted; even now the courts shy away from the arena of business policy and practice and some judges echo Lord Eldon's dictum: "This Court is not to be required on every occasion to take the management of every playhouse and brewhouse in the kingdom".[26] Lord Keith's statement in *Elder* that oppression implied "a lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members"[27] was given enhanced status by his reiteration of it in *Meyer.*[28]

These more liberal pronouncements have been referred to in many subsequent cases but appear to have borne fruit only in the latest reported decision, *Aspek.* The applicant "would be entitled to relief, in my view, if he establishes that the majority shareholders are using their greater voting power unfairly in order to prejudice him or are acting in a manner which does not enable him to enjoy a fair participation in the affairs of the company".[29] This restatement, though not particularly authoritative, is a positive move towards the revised definition suggested by the Jenkins Committee viz. any act which is unfairly prejudicial to the minority.[30]

Section 209—Recognised Oppression

The law recognises four categories of oppression. The reason for the small number of recognised classes may be that the section has not yet been fully litigated, many petitions have been rejected on procedural grounds, but it seems likely that the term, as presently defined, is not capable of extension to include other categories. The four categories discussed are not mutually exclusive; in many cases two or more categories may be represented though not always the subject of judicial attention.

(a) *Deadlock*

Benjamin v. *Elysium Investments (Pty) Ltd.*[31] is the only reported case of deadlock where an order under this section has been made instead of the more usual winding up order. The judge was concerned

25. Ibid., 55.
26. *Carlen* v. *Drury* (1812) 1 V. and B. 154, 158; witness *Bright Pine* supra n. 13 at 1011.
27. Supra n. 24 at 60.
28. Supra n. 11 at 364.
29. Supra n. 21 at 527.
30. *Report of the Company Law Committee* Cmnd 1749 (1962) Para. 212 (c).
31. 1960 (3) S.A. 467.

about the availability of the remedy where an equality and not a minority was involved but does not appear to have discussed the aspect of oppression in detail. H. and B. had equal shareholdings in the company and were the only directors. B refused to permit the company to defend an action brought against it by a construction company, of which B was beneficial owner. McPherson suggests that H could rely on B's breach of fiduciary duty but this matter does not appear to have been discussed in the case.[32]

(b) *abuse of procedures*

A company is an artificial personality. While legislatures have imposed few limitations on the range of its activities, they have required companies to set down and abide by their constitutional structures. Membership of a company is conditional upon acceptance of the objects, organisation and practice of the company. The company owes a reciprocal duty to individual members to operate substantially within its constitutional limits. Trouble may arise where either the members or directors embark on *ultra vires* activities.

While it may be possible for one group of members to oppress some other part of the members, the cases so far have dealt with directors' activities. The leading case is *Harmer,* where Harmer Senior, who had voting control but was only one member of the board of directors, treated the company as his own property—acting without the board's authority, directing staff members not to implement board resolutions or, on occasions, acting in a manner completely opposed to the board's resolutions.

The Court of Appeal in a series of strong judgments recognised that this arbitrary exercise of power endangered the company and oppressed shareholders:

> the most dangerous and most oppressive form of conduct is that the father had of going behind properly constituted decisions of the board and taking it upon himself to countermand them . . . such conduct cuts at the very root of proper company procedure and makes it virtually impossible for the business of a company to be carried on.[33]

The problem has arisen in a less acute form in other cases. McFadden's objections in *Associated Tool* included failure of the directors to deliver a full frank and fair notice of meeting to shareholders and an allegation that directors had tampered with the share register to improve their voting position at a general meeting. Both were treated by Joske J. as matters cognisable in support of the petition.

32. Facts and inferences drawn are based on case notes in [1960] S.A. Survey 258 and (1961) 24 M.L.R. 368 (B. H. McPherson).
33. Supra n. 14, Willmer L.J. at 90; see also Jenkins L.J. at 83, and Romer L.J. at 87.

An extraordinary instance of this general category arose in *Re British Columbia Electric Co. Ltd.*[34] The Provincial Government of British Columbia wished to acquire the company and merge it with the State Hydro Authority. Under the statutory scheme, common shareholders were to receive cash and preferred shareholders were to exchange their shares for bonds. Vanstone, the petitioner, a preferred shareholder, signed the transmittal form under protest. Later the statute was declared *ultra vires* but the directors acted as though the statute was valid. Vanstone asserted his rights as a preferred shareholder. When the matter was litigated the judge ordered the company to buy him out for cash in terms of the articles. This meant that he received the par value of the shares, unpaid dividends and a premium, instead of twenty five year 6% bonds.

(c) *abuse of powers*

In the Articles of Association directors are given certain powers. Courts have required them to exercise these powers bona fide for what they consider is in the interests of the company. This nebulous subjective test does not afford much protection to shareholders; inefficiency[35] or negligence[36] will escape but, at least, the more blatant forms of abuse are remediable.

Shareholder complaints in this area have been restricted to allegations of excessive payments to directors. In *Marsh* v. *Odendaalsrus Cold Storages Ltd*[37] a petitioner sought an order that *inter alia* directors should not receive remuneration in excess of 25% of the profits for the year. The petition failed but a dictum of Vierya A.J. that:

> if it were demonstrated that the emoluments which the controlling interests permitted to be paid to the directors were of such a nature that they bore no relation to what ordinarily in commercial practice could be considered a fair remuneration for the work done and so depleted the profits available for distribution, a small shareholder would be entitled to say there was a violation of the fair play he was entitled to expect[38]

was favourably considered in *Aspek*. Spektor alleged that the removal of the property letting contract from his established real estate business to Mauerberger's newly established department and a subsequent raising of the commission rate from $2\frac{1}{2}$% to 5% was oppressive. At the preliminary hearing Tebbutt A.J. noted:

> the employment of an inefficient rent collection and supervision agent may be prejudicial to the interests of shareholders in a company whose real asset is a multi storey building of

34. (1964) 47 D.L.R. (2d) 754.
35. *Re Five Minute Car Wash* supra n. 17.
36. *Pavlides* v. *Jensen* [1956] Ch. 565.
37. 1963 (2) S.A. 263, noted in [1963] S.A. Survey 356.
38. Ibid., 268.

> shops and offices . . . it cannot be said that the substitution of Mauerberger's property department as the rent collection or supervision agent, is without substance or relevance.[39]

Because the exercise of directors' powers is a matter of subjective good faith and company policy, this category is likely to remain narrow in scope but, in a limited number of cases of the more blatant type, it will afford a remedy.

(d) *bona fides in group relationships*

Section 209 states *inter alia* that a remedy may be given where "the affairs of the company are being conducted in a manner oppressive to some part of the members". In this aspect, one must recognise that judges have, as a whole, looked to the spirit of the legislation rather than strictly at the words of the section. One of the more important uses of this section has been to prevent management from using the entity concept and the corporate group structure to oppress members of a company forming some part of the group.

The three cases where group relationships have been important reflect separate facets of the category. Scottish Textiles Ltd., formed in 1946, was in reality an incorporated partnership of two German rayon spinners, who had the skill, experience and qualifications to obtain a rayon production licence from the wartime control board, and the Scottish Co-operative Wholesale Society (S.C.W.S.). When controls were removed in 1952, the S.C.W.S. decided to commence rayon production on its own behalf and liquidate the subsidiary. However S.C.W.S. was not prepared to buy out the minority at market value. When their inadequate offer was refused, they applied economic pressure. The minority tried to maintain Scottish Textiles as a going concern but the S.C.W.S.'s three nominee directors adopted a policy of non-disclosure and inactivity. In the Court of Session, Lord Cooper recognised a duty of good faith for holding companies:

> Whenever a subsidiary is formed . . . with an independent minority of shareholders, the parent company must, if it is engaged in the same class of business, accept as a result of having formed such a subsidiary an obligation so to conduct what are in a sense its own affairs as to deal fairly with its subsidiaries.[40]

As a matter of strict analysis, this broad statement did not receive the imprimatur of the House of Lords. While all agreed that oppression had been proved, the four Law Lords reached their decisions in divergent ways. Viscount Simonds adopted the broad approach, Lords Morton and Denning took a narrower view—oppression based on the inactivity of the nominee directors—while Lord Keith recognised both

39. Supra n. 21 at 531.
40. *Meyer* v. *Scottish Textiles* 1954 S.C. 381, 391.

views. The divergence is important but not critical. The opinions of Lords Morton and Denning may appear restrictive, but Lord Denning's recognition of the invidious position of directors in such situations means that, in fact, holders of both broad and narrow views will be able to satisfy themselves of the presence of oppression in relevant group situations:

> Lord Blanesburgh said (in *Bell* v. *Lever Bros*)[41] that a director of one company was at liberty to become a director also of a rival company. That may have been so at that time. But it is at the risk now of an application under section 210 if he subordinates the interests of the one company to those of the other.[42]

Re Bright Pine Mills Pty. Ltd.[43] illustrates another facet of the parent/subsidiary relationship. Swallow, the majority shareholder and controlling force of Bright Pine, decided to extend the operations of the company. Though using the company's assets, the newer operations were run as separate partnerships. Later partnerships did not include all the shareholders in Bright Pine. In the course of finding for an excluded and oppressed shareholder, O'Bryan J. delivering the judgment of the Full Court stated:

> a director of a company is obliged at all times to . . . refrain from making decisions about the company's affairs without regard to its interests,but in order to divert, what might otherwise be a profitable enterprise to another concern, particularly to one in which he himself has a proprietary interest, the real purpose of his action being to prevent a minority shareholder participating in that profit.[44]

The broader view in *Meyer* was accepted, without discussion, and extended in *Re Associated Tool Industries,* which held that between parent, associated and subsidiary companies there was a reciprocal duty of utmost good faith. The need for reciprocity was made evident by the unusual facts of this case which almost amounted to the tail wagging the dog. Three directors of A.T.I. were "milking" the group through an associated distributing company, which they controlled.

II THE COMMON LAW—REMEDIABLE SITUATIONS

Section 209 was developed because it was considered that the common law did not offer sufficient protection to minority shareholders. Apart from winding up, only two categories are recognised. Without section 209, there would be no direct action for lack of bona fides in

41. [1932] A.C. 161, 195.
42. *S.C.W.S.* v. *Meyer,* supra n. 11 at 368.
43. [1969] V.R. 1002.
44. Ibid., 1013.

group relations, although indirect action would be available in some circumstances.[45] However because the common law remedy is available for single oppressive acts, whether of continuing effect or not, it is able to provide a more comprehensive range of actions within its limits.

The difference in available remedies is to a large extent accounted for by differing procedural requirements, but the later development of the statutory remedy and the consequent changes in company development and social attitudes are also factors.

(a) *Abuse of procedures*

(i) *notice of meeting*

In all but the smallest companies, an ordinary shareholder's opportunity to engage in the business of the company is limited to annual or special general meetings. Proportionately, few shareholders take advantage of their opportunities. However, as the resolutions passed at company meetings may have a significant impact on membership rights and privileges, courts have usually insisted that a member receives adequate notice of the meeting.[46]

Adequacy of notice comprehends two separate elements—adequacy in point of time which is partly statutory and has not caused litigation and adequate information of the business of the meeting. The question to be asked by the court is: "Was there a full, frank and fair disclosure to the shareholders?"[47] "Notice of the business to be transacted is to enable a member to determine in his own interest whether he will attend or stay away".[48] Apart from *Ind Coope,* the generally accepted proposition is that persons calling a meeting (usually the directors) must make adequate disclosure of the purpose of the meeting and bring to the attention of the shareholders any unusual features associated with the resolution which would influence the reasonable man of business e.g. the special interests of directors.[49]

(ii) *right to have articles observed by the company*

"The articles of association constitute a contract not merely between the shareholders and the company but between each individual shareholder and each other".[50] On analogy with general contract principles there would seem to be no reason why a shareholder should not enforce this contract. Wedderburn argues in "The Rule in Foss v. Harbottle"[51] that this is what was done in *Salmon* v. *Quin and Axtens*

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45. *Baillie* v. *Oriental Telephone Co.* [1915] Ch. 503.
46. The notorious exception is *Normandy* v. *Ind Coope* [1908] 1 Ch. 84 where a notice of meeting to approve new Articles did not specify that the new Articles provided for a substantial increase in directors' remuneration.
47. Swinfen Eady L.J. in *Baillie* supra n. 45 at 518.
48. *Gould* v. *Wellington Waterside Union* [1924] N.Z.L.R. 1025, 1031.
49. *Kaye* v. *Croydon Tramways* [1898] 1 Ch. 358; *Tiessen* v. *Henderson* [1899] 1 Ch. 861.
50. Stirling J. in *Wood* v. *Odessa Waterworks* (1889) 42 Ch.D. 636, 642, see also s.34 Companies Act 1955 (N.Z.).
51. [1957] C.L.J. 194 at 212-215.

Ltd.[52] However this is a limited right; courts have refused in intervene where the breach complained of can be remedied by ordinary resolution. Finlay J., in *Humphries* v. *Auckland Tailoresses,*[53] after reviewing many cases, reached the conclusion that a member has a personal right of action, where the majority could condone or ratify an irregularity or informality of procedure, if private injustice results or the irregularity has not been condoned by a clear majority. This criterion may not be particularly helpful but is probably the most definite that can be reached on the present state of the authorities.[54]

(iii) *right to prevent articles being altered in such a way as to constitute a fraud on the minority or to prevent a company acting in reliance on such articles if they are altered.*

Shareholders are aware that their contract with the company and other members is capable of alteration by the majority. Accordingly not every alteration which adversely affects a shareholder will be remediable, but on the other hand the majority may not alter the articles capriciously. Lord Lindley M.R. introduced the test: "is the alteration bona fide for the benefit of the company as a whole?"[55] This test is schizophrenic in nature, being more rigorously applied where directors' actions are being scrutinised than where shareholder resolutions are considered. *Greenhalgh* v. *Arderne Cinemas*[56] has established that this test requires a shareholder to proceed upon what is in his honest opinion for the benefit of the corporators as a general body. In reaching his position the shareholder is entitled to consider his own position as an individual.

In practice, the court has abrogated its right to intervene except in patent cases of discrimination between majority and minority[57] or where the alteration is not for a company purpose.[58] The Greenhalgh saga chronicled by Gower[59] clearly illustrates the narrowness of the judicial outlook, the self imposed limitations on court scrutiny and the ease with which a fraudulent majority could draft their way around the limitations.[60] The courts in their reluctance to intervene in matters of company policy have developed a formula which enables them to remain aloof from most situations involving policy or internal management.

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52. [1903] 1 Ch. 311 (C.A.) affirmed on appeal *sub nom. Quin and Axtens* v. *Salmon* [1903] A.C. 442.
53. [1950] N.Z.L.R. 380.
54. E.g. a dubious distinction between private rights and company rights enables a member to demand that his vote be recorded: *Pender* v. *Lushington* (1877) 6 Ch.D. 70 but not to insist that a poll be taken to gauge the feeling of the meeting: *McDougall* v. *Gardiner.* (1875) 1 Ch.D. 13.
55. *Allen* v. *Gold Reefs of West Africa* [1900] 1 Ch. 656, 671.
56. [1951] Ch. 286, (C.A.).
57. *Kerry* v. *Maori Dream Gold Mines* (1898) 14 T.L.R. 402; *Brown* v. *British Abrasive Wheel Co.* [1919] 1 Ch. 290.
58. *Australia Fixed Trusts* v. *Clyde Industries* [1959] S.R. (N.S.W.) 33.
59. Modern Company Law (3rd ed. 1969) pp. 571-573.
60. *Dafen Tinplate* v. *Llanelly Steel* [1920] 2 Ch. 124 cf. *Sidebottom* v. *Kershaw Leese and Co.* [1920] 1 Ch. 154.

(b) *Abuse of powers*

Fraud on a power "does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term or any conduct which could properly be termed dishonest or immoral. It merely means that the power has been exercised for a purpose or with an intention beyond the scope of or not justified by the instrument creating the power".[61] This proposition is taken from a trust case but its application to company law was recognised in *Ngurli Ltd.* v. *McCann.*[62] Both shareholders and directors are given power to act for the company in certain circumstances. They must exercise these powers bona fide for the purpose for which they were conferred. While courts will supervise the exercise of powers by both, as in other areas of company law, they are more ready to intervene where directors are involved.[63]

Fraud on a power could be alleged in numerous situations but only three situations have been litigated:

(i) *issuing shares*

Shares should be issued for the purpose of raising capital or capitalising existing reserves, they "must not be issued under the cloak of such a purpose for the real purpose of benefiting some shareholders or their friends at the expense of other shareholders or so that some shareholders or their friends will wrest control of the company from the other shareholders".[64] This abuse will be remediable even where the acquisition of voting power is not the sole purpose but is a substantial object.[65]

These Australian decisions do not appear to have been considered in the United Kingdom, where this abuse, in the form of transferring property or shares to the Staff Benevolent Fund trustees, has been adopted by several boards of directors to make their companies less attractive to take over bidders. The Savoy Hotel case in 1953-4 attracted considerable publicity and was the subject of a Board of Trade investigation.[66] Notwithstanding the investigator's opinion that the Savoy scheme was legally improper as an abuse of directors powers, similar schemes have subsequently been approved by English courts.[67]

The Australian decisions are theoretically distinguishable. In these cases the directors were benefitting themselves or some part of the

61. Lord Parker in *Vatcher* v. *Paull* [1915] A.C. 372, 378.
62. (1953) 90 C.L.R. 425, 438.
63. Ibid., at 439.
64. Ibid., at 439-440.
65. *Mills* v. *Mills Ltd.* (1938) 60 C.L.R. 150.
66. *The Savoy Hotel Ltd. and the Berkeley Hotel Ltd: Investigation under Section 165 (b) of the Companies Act 1948: Report of E. Milner-Holland, Q.C.* H.M.S.O. 1954; see also Gower (1955) 68 Harvard L.R. 1176.
67. *Hogg* v. *Cramphorn* [1967] Ch. 254; *Bamford* v. *Bamford* [1969] 2 W.L.R. 1107 (C.A.).

shareholders at the expense of other existing shareholders, whereas in the English cases the directors purported to protect themselves and the company against future shareholders. However, the tenor of the English cases, which militate in favour of established majorities and entrenched directorates, suggests that the judges hearing these actions were not fully aware of the implications of their decisions. Thus Buckley J.[68] reemphasised the traditional judicial attitude to company affairs:

> Unless a majority in a company is acting oppressively towards the minority, this court should not and will not itself interfere with the exercise by the majority of its constitutional rights or embark upon an inquiry into the respective merits of the views held or policies favoured by the majority and the minority.

He did not apparently recognise that the action was brought to determine the constitutional rights of the majority. Likewise Harman L.J., when delivering the leading judgment in *Bamford* referred to the long and "curiously inept process" which the trial judge, Plowman J., had adopted when considering this "tolerably plain case", but does not seem to have realised that the "trite law" was in fact a recent development and represented a significant change from the accepted position prior to *Hogg* v. *Cramphorn.* Professor Wedderburn, who has chronicled the changes[69], believes that the latest decision is evidence of "the conceptual muddle which has overcome company law in the courts".[70]

This major breach of duty, like the sale or long term lease of company assets[71] can be ratified, in the United Kingdom, at least, by a mere majority of shareholders in general meeting. No rules of precedent require New Zealand courts to prefer English to Australian decisions and it is submitted that the Australian cases, which create a reasonable regimen for shareholder/director/company relationships should be preferred.

(ii) *Overpayment of directors:*

Article 76 Table A Companies Act 1955 provides that the remuneration of directors shall be determined by the company in general meeting. The Article is often amended to permit directors to determine their own remuneration. Unless this determination is made in good faith, it is obvious, particularly in a small company, that they could divert a major portion of the profits into their own pockets at the expense of unrepresented shareholders. It is surprising that in only two cases have the courts remedied such abuse. Neither case provides a satisfactory basis for this sub-category.

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68. *Hogg* v. *Cramphorn* supra n. 67 at 268.
69. (1967) 30 M.L.R. 77; (1968) 31 M.L.R. 688; (1969) 32 M.L.R. 563.
70. (1969) 32 M.L.R. 563, and further discussion in (1970) 33 M.L.R. 350-352.
71. See sub-category (iii) below.

Millers (Invercargill) Ltd. v. *Maddams*[72] appears to be right on point; the Court of Appeal asked whether "there was an abuse of power on the part of the majority shareholders or that the course adopted in respect of the remuneration of the appellant James Thomas Sharp as managing director was of a fraudulent character *quoad* the respondent as the minority shareholder"[73] and answered:

> he has taken more of the company's money by way of remuneration than was . . . reasonable and proper. In the result I think he has used his power to obtain a certain amount of the company's money which should have been available to the shareholders as a whole.[74]

While one may support the principle for which this case is authority, the tenor of the judgment clearly indicates that the Chief Justice was more concerned about the way in which the appropriation was achieved than any objective standard of "what is excess remuneration?" Like *Brown* v *Can Erin Mines,*[75] the case indicates that over-payments are more likely to be remedied where factors, other than internal management, are involved.

Both cases recognise that if directors or any section of the company are over-compensated, shareholders or some part of them are deprived of benefits, but neither case is necessarily a precedent where directors in good faith unrealistically overvalue the worth of their services.

A different but legally similar situation arose in *Alexander* v. *Automatic Telephone Co.*[76] where the directors of a newly formed company made calls on the shares of other shareholders but did not make calls on their own shares. The differential treatment was not disclosed to or ratified by the ordinary shareholders. The breach of duty was recognised, but, once again, it is possible that the non-disclosure motivated the Court of Appeal more than the substance of the breach.

(iii) *expropriation of or improper dealing with company property or opportunities*

This is an area where the courts have been relatively active in protecting minorities. Three principles distill the essence of this subcategory, but fine distinctions need to be made if all the leading cases are to be included therein:

If property or rights accrue to a company in law or equity, directors or a majority may not divest the company of them in an inequitable manner.

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72. [1938] N.Z.L.R. 490.
73. Ibid., 491 per Myers C.J.
74. Ibid., 494-495.
75. (1961) 25 D.L.R. (2d) 250.
76. [1900] 2 Ch. 56.

A company may sell or lease all or a substantial part of its assets to another company, in which some part of the members of the first company are interested, provided it is done bona fide for value and without discriminating against minority shareholders.

The conflict of interest which arises where a director sells assets to a company or trades in assets which may have been company property is a breach of fiduciary duty ratifiable by an informed majority in general meeting.

The first principle is well illustrated by *Menier* v. *Hoopers Telegraph*[77] and *Cook* v. *Deeks*.[78] European Telegraph was formed to exploit a licence which Baron agreed to assign to them. Hoopers, a major shareholder, believed it could make a larger profit if they had the licence. They arranged for Baron to assign the licence to them and used their voting strength to prevent European from pursuing remedies against Baron. In *Cook* v. *Deeks,* three members of a railway construction company performed a contract which the company had won through a newly formed company which did not include Cook, a member of the original company. In both cases the court reached similar conclusions:

> shareholders may vote as they please, and for the purpose of their own interests, yet the majority of shareholders cannot sell the assets of the company and keep the consideration, but must allow the minority to have their share of any consideration which may come to them.[79]

However a majority may appropriate long term advantages provided that it is prepared to treat other shareholders equitably in the short term. Thus Castello was deprived of all future benefits of association with London Transport when the majority resolved to wind up the company and sell its assets to the Underground Company, which they owned. Full payment in cash was sufficient, he had no right to insist on membership of the new company.[80] Similarly, in *Dominion Cotton Mills* v.*Amyot,*[81] the Privy Council held that a shareholder had no cause for complaint where directors representing the majority shareholder, Dominion Textiles, had leased the company's mills to the Textile company for 21 years at a rent reasonable in the circumstances. In both cases the majority had effectively deprived the minority of the advantages of membership but this was not recognised as discrimination.[82]

Directors are in a fiduciary relationship with their companies and are under a duty not to permit their personal interests to conflict with the company's interest. They may contract with the company. Such

77. (1874) 9 Ch. App. 350.
78. [1916] 1 A.C. 554 (J.C.).
79. Mellish L.J. in *Menier* supra n. 77 at 354.
80. *Castello* v. *London General Omnibus Co.* (1912) 107 L.T. 575.
81. [1912] A.C. 546.
82. Para 212 (e) of the Jenkins Report recommends that such acts require approval in advance by the general meeting.

contracts are voidable but may be ratified by the general meeting[83] unless the subject matter of the contract belongs in equity to the company. However the courts are unwilling to impute equitable ownership to the company: vide Lord Cairns in *Erlanger* v. *New Sombrero Phosphate Co.*:[84]

> It may well be that the prevailing idea in their mind was not to retain or work the island but to sell it again at an increase in price . . . and very possibly to promote or get up a company to purchase the island from the them, but they were . . . perfectly free to do with the island whatever they liked.

This statement was quoted with approval in *Burland* v. *Earle*[85] when the Board found that the president of a bank note company who bought a lithographic machine and later sold it to his company at an enhanced price was not accountable as trustee for the difference.[86]

To succeed a shareholder must show that the wrongdoer had a mandate or authority from the company to purchase the goods[87] or that the matter was so related to the affairs of the company that it can be said to have been done in the course of management.[88] However, in view of *Burland's* case[89] and *Percival* v. *Wright*,[90] this second line of attack will not be lightly countenanced.

III COMPARISON OF PROCEDURES

Differentiating between the areas of relief available under the statute and at common law, is an investigation of only part of their differences. Procedure plays an important part in both remedies. The restrictions imposed by procedural rules have been responsible for much of the criticism which has been levelled at both actions.

Section 209 appears to be a procedural morass. An applicant must show that:

1. he is a shareholder of the company;
2. that the affairs of the company are being conducted in an oppressive manner;
3. that the oppression affects him in his character as a member; and

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83. *North-west Transportation* v. *Beatty* (1887) 12 App. Cas. 589.
84. (1878) 3 App. Cas. 1218, 1235.
85. [1902] A.C. 83, 99 (J.C.).
86. Discussed in "Directors Powers and Duties" (E. E. Palmer) in *Studies in Canadian Company Law* (ed. Ziegel) p. 393.
87. *Canada Safeway* v. *Thompson* [1951] 3 D.L.R. 295.
88. *Regal (Hastings)* v. *Gulliver* [1942] 1 All E.R. 378 (H.L.) esp. Lord Macmillan at 391-392.
89. Supra n. 85.
90. [1902] 2 Ch. 402.

4. that it would be just and equitable for an order to be made under this section,

before a judge has any discretion whether or not to make the order asked for.

The list is long and the petitioner will need to exercise care if he is to overcome the procedural obstacles but at least the requirements are well settled.[91]

The proper interpretation of (4) is matter of particular importance in New Zealand. Section 209 differs from the United Kingdom section in permitting a petitioner to claim either (a) that to wind up the company would unfairly prejudice that part of the members but otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up, or

(b) that in any other case it is just and equitable to make an order under this section.

Prima facie, the (b) alternative should free the section from the technicalities of the winding up jurisdiction which were encountered in *Re Bellador Silk Ltd.*[92] and *Bader* v. *Weston*[93] and extensively criticised.[94] In view of the similarity in wording between it and section 217 (f), it is probable that a court would exercise jurisdiction in similar circumstances. *Re Bright Pine Mills*[95] indicates that (b) will be used in situations which can be justified under section 217 (f) with all reference to winding up rules deleted.

In contrast to the apparent complexity of the statutory procedure, the requirements of the common law, superficially, appear to be simple. To commence an action the applicant must bring himself within one of the exceptions to the Rule in *Foss* v. *Harbottle*.[96] Four exceptions have been recognised[97], and a fifth has been suggested.[98] The two "exceptions"

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91. The procedural requirements and some of the finer points concerning them are discussed by B. H. McPherson in (1962-3) 36 A.L.J. 427 and P.C. Heerey in (1962-3) 36 A.L.J. 187.
92. [1965] 1 All E.R. 667, where the plaintiff had a good case under section 209, but the company was insolvent. Because he had no *locus standi* under section 217 (f) his claim was denied.
93. 1967 (1) S.A. 134 where the petitioner's claim was defeated because he could not meet the shareholding requirements which would have enabled him to commence winding up proceedings.
94. (1966) 29 M.L.R. 321 (Wedderburn); (1965) Journal Bus. Law 259 (Schmittoff); (1967) 84 S.A.L.J. 405 (Beuthin).
95. [1969] V.R. 1002, 1011.
96. (1843) 2 Hare 461, 67 E.R. 189.
97. *Edwards* v. *Halliwell* [1950] 2 All E.R. 1064, 1066-1067 contains a current exposition of the Rule and exceptions.
98. Gower op. cit. 585; Wedderburn [1957] C.L.J. 194, 203-4; supported by Harman L.J. in *Heyting* v. *Dupont* [1964] 1 W.L.R. 843, 853, but not favourably received by Russell L.J. in *Heyting* at 854 or Danckwerts J. in *Pavlides* v. *Jensen* supra n. 36, 575.

which have proved most useful in oppression situations have been fraud on the minority and a personal cause of action.

The personal action is procedurally uncomplicated. Like a petitioner under section 209, the plaintiff is suing to protect his own rights and not merely attempting to evade the procedural requirements of a representative fraud on the minority action.

By his contract with the company the shareholder undertakes with respect to most rights which membership carries to accept as binding on him decisions of the majority arrived at in accordance with the law and the articles. Other rights of the shareholders cannot be taken from him unless he consents. The personal right of action is available only to protect these individual membership rights.[99] Among the protected attributes of membership are: the right to receive full and fair notice of meetings,[1] the right to have a vote recorded,[2] and the right to insist on a company following proper procedures, subject to the internal management exception.[3] However, the distinction between personal and corporate rights is dubious. Subject to acceptance of the new attitude appearing in *Hogg* v. *Cramphorn*,[4] a judge is likely to dismiss an action if, in his view, a member is seeking to protect a corporate right.

The exception most often invoked by shareholders seeking common law protection against company oppression is "fraud on the minority". The name is a misnomer; the exception operates to prevent fraud on the company. Procedurally two elements need to be established: fraud and control. The simplicity is more apparent than real. The case law, particularly with regard to fraud, is rent with difficult-to-reconcile decisions.

Fraud means equitable fraud, which is a more extensive category that common law fraud as enunciated in *Derry* v. *Peek*.[5] It incorporates fraud on a power or misuse of fiduciary position and includes bona fide actions which are fraudulent in nature[6] as well as mala fide actions. "Fraud lies rather in the nature of the transaction than in the motives of the majority."[7]

The wide ranging control which could be exercised by this device is limited by the court's acceptance that the company in general meeting is able to ratify most frauds. This limitation was introduced because courts recognised that directors are in fiduciary relationship with their company but shareholders exercise their votes as property rights.

This restriction creates problems. Only non-ratifiable frauds may be the subject of a fraud on the minority action. A ratifiable fraud will

99. Taken from *Palmer's Company Law* (5th ed) 498.
1. See p. 488 ante.
2. *Pender* v. *Lushington* (1877) 6 Ch.D. 70.
3. See p. 488 ante.
4. [1967] Ch. 254, and discussion by Wedderburn in (1967) 30 M.L.R. 77.
5. (1889) 14 App. Cas. 337 (H.L.).
6. E.g. *Alexander* v. *Automatic Telephone* supra n. 76.
7. Wedderburn [1958] C.L.J. 93, 96.

either have been ratified, in which case there is no cause of action, or not ratified in which case the company will presumably bring an action in its own name. What are non-ratifiable frauds? Where the majority receive company money or money's worth which is denied to the minority;[8] this is clearly within the category, but the cases do not establish how much further, if at all, it extends.

The matter of "control" has also caused problems. The applicant is only justified in bringing an action if he can show good reason why the company will not protect its own interest.[9] The best answer is that the wrongdoers are in control. In some of the earlier cases the courts adopted a simplistic approach—do the wrongdoers hold a majority of shares? Later, the fact that a majority in general meeting condoned the fraud was sufficient. Jessel M.R.[10] recognised a third category: "where the corporation has shown that it is not willing to sue", which has not received much support.

Generally fraud by persons having *de jure* control has been required, but the task has been lightened by recent cases where judges have stated that they will look behind nominee holdings[11] or recognise the *de facto* control of directors.[12]

In summary the common law procedures may seem to be less of an obstacle than the statutory requirements. However, the statute provides firm steps toward the goal of relief, whereas the apparently simple common law procedures require the applicant to overcome a mass of ill defined and sometimes conflicting case law before a remedy is available. It is notable that in jurisdictions where section 209 has been introduced the older common law actions are suffering a decline. Complainants, or their legal advisers, prefer to seek statutory relief.

IV THE POSSIBILITY OF REFORM

The foregoing survey has demonstrated that the statutory and common law remedies are not strictly comparable. But, while procedural requirements differ, the remedies are available in much the same circumstances. The statute empowers courts to grant a wider range of relief than the common law,[13] but both remedies suffer from their limited scope. The statutory remedy is not clearly superior to the common law position. The Jenkins Committee recognised that section 209 was inadequate:

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8. *Menier* supra n. 77 *Cook* v. *Deeks* supra n. 78.
9. Wedderburn [1958] C.L.J. 93, 95.
10. *Russell* v. *Wakefield Waterworks* (1876) 20 Eq. 474, 482.
11. *Pavlides* v. *Jensen* supra n. 36.
12. *Brown* v. *Can Erin* supra n. 75.
13. E.g. *Harmer,* supra n. 11, where executive power was transferred from the father to his sons; cf. common law which could have awarded damages or granted injunctions.

> Many witnesses have, however expressed the opinion, with which we agree, that even as interpreted [in *Meyer* and *Harmer*] . . . the section as it stands calls for amendment if it is to afford effective protection to minorities in circumstances such as those with which it is intended to deal.[14]

Their recommendations to overcome the difficulties encountered are of general application to both public and private companies:

(1) *redefinition of oppression:*

"Burdensome, harsh and wrongful", the *Meyer* definition, has been generally regarded as authoritative. As a definition of oppression it is liberal but the committee believed that oppression was not the concept or standard which should be a prerequisite to relief. Instead "unfairly prejudicial" is suggested as the level of conduct which should be remediable. A reduction in standard to permit a court to investigate most genuine company problems instead of being limited to extreme cases is desirable.

(2) *isolated acts*

A shareholder is more likely to be injured by continuing oppression but a solitary major act of oppression can cause injury. Such an act could probably be remedied at common law but can not be remedied by action under section 209. This distinction is one of the few justifications for the retention of the Rule and its exceptions. If the Act was extended to cover "isolated acts" *Foss* v. *Harbottle*[15] could be abrogated and all future actions brought under section 209. This move would create a rational code for shareholder protection and relieve this area of law of the incubus of an outdated philosophy and spurious distinctions between personal and corporate rights, ratifiable and non-ratifiable frauds, investigable matters and matters of internal management.

Such a relaxation may open management to unjustifiable attack from complainants alleging one prejudicial act with limited consequences. However the likelihood of numerous unmeritorious actions is not great; minor, non-continuing, prejudicial acts would be virtually irremediable and the threat of court costs should prevent vexatious litigation over trifles.

(3) *personal representatives:*

This matter concerned both the Cohen and Jenkins Committees. The latter improvised an elaborate scheme to enable an oppressed personal representative to secure redress. Section 85(2), which gives a personal representative the same rights, dividends and advantages as a member solves the matter in New Zealand. However, specific reference

14. Op. cit. n. 30 para. 200.
15. Supra n. 96.

to personal representatives would avoid the possibility that a personal representative would be treated "as if" he were a member but is not a member for the purposes of section 209.

These reforms would encourage greater court involvement in company affairs. This would not be generally appreciated in listed public companies, where a shareholder can usually sell out at no loss to himself. However, reform along these lines is needed in the private, and unlisted public company sector.

Many private and unlisted companies share only their corporate structure with their larger compatriots. In other respects there are great contrasts. Usually, directors exercise strict control over share transfers —members withdraw on the directors' terms The shares may be unmarketable—company activities are too closely controlled by one family for their own purposes to be a good investment. As well, many companies do not declare dividends, profits are paid to directors as wages, bonuses or expenses, and shares become a badge of occupation and, possibly, a capital asset but have no current value. For these reasons, the Jenkins Committee recommendations are particularly relevant to private companies which are much more cloistered and whose activities are not usually subject to scrutiny by auditors or the financial press.

An important suggestion for amendment to suit private company needs comes from a Northern Ireland Committee.[16] The Committee recognised that pitfalls exist for the minority shareholder and recommended amendments which would enable "investors to take a minority interest in a private company with a full assurance that the law would see that they received justice at the hands of their fellow members".[17]

One of their more important recommendations was that section 209 (1) be rephrased to read:

> Any member of a company who complains that the affairs of the company or the powers of the directors are being exercised in a manner oppressive [unfairly prejudicial?] to him or some part of the members (including himself) or in disregard of his or their proper interests as members of the company may make an application to the court for an order under this section.[18]

The addition of the phrases, "or the powers of the directors" and "or in disregard of his or their proper interests as members of the company", which at present have no fixed legal meaning, are presumably meant as a direction to courts to become more involved in private company affairs. The old strategem of remaining aloof from company affairs on the pretext of internal management is no longer acceptable.

16. Report of the Departmental Committee on Company Law Amendment (1959) Cmnd. 393 H.M.S.O. Belfast; noted in (1959) 22 M.L.R. 304.
17. Ibid., at 304.
18. Ibid., at 308.

The amendment would be effective only if the courts interpret "proper interests" in the spirit in which the amendment is offered. Walton and Scott suggest that any person who invests in a company is entitled to expect that:

(a) the company will be managed honestly; and

(b) within the scope of its objects; and

(c) that the management will be efficient; and

(d) that management will be adequately, but not more than adequately remunerated; and

(e) that proper dividends will be paid if the company can afford them.[19]

At present (a), (b) and (d) may be litigated but (c) and (e) are beyond the minority shareholders range. While there could be difficulties —what is a proper dividend? and (c) would require judges to create the standard of a reasonable director, a matter which runs counter to existing decisions on directors[20]—there are no insurmountable obstacles in the way of adopting this five fold test of proper interests.

The Irish recommendations, if implemented, should protect the small investors; I would submit that, given the present structure of company law, it is necessary to afford special protection to the directors of private companies.

In many private companies, a directorship is like a partnership. The director works for the company and his fees are in the nature of a salary. The directorship is a badge of office. Exclusion from board meetings is the equivalent of being "sacked". Unlike a partner, the ousted director is not entitled to withdraw his capital and may not be permitted to sell out.

At present, such a director may get satisfaction, in some instances, by putting the company into liquidation.[21] However, there would appear to be good grounds for extending the section 209 action to oppression (unfairly prejudicing) of the petitioner in his capacity as a director. The need is demonstrated by the numerous cases where a prima facie case of oppression has been made out but relief has been denied because the petitioner was oppressed in his capacity as a director and not as a member.[22]

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19. R. Walton and C. H. Scott: *Modern Problems of Company Law* 11.
20. *Re City Equitable Fire Insurance Co.* [1925] Ch. 407 esp. 428 ff. where the standard though low is higher than in *Overend and Gurney Co.* v. *Gibb* (1872) L.R. 5 H.L. 480 esp. Lord Hatherley at 487.
21. *Re Lundie Bros.* [1965] 2 All E.R. 692.
22. *Elder* v. *Elder (Pty.)* 1952 S.C. 49; *Taylor* v. *Welkom Theatres (Pty.) Ltd.* 1954 (3) S.A. 339; *ex. p. Bates* 1955 (4) S.A. 51, and *Re Lundie Bros* supra n. 21.

Because oppression of a director would differ in type from oppression of a shareholder, it might be thought necessary to afford the oppressed director special remedies. However, judges are given a broad and unfettered discretion to make such orders as they think fit and should have no difficulty in discovering appropriate remedies.

A court would not attempt to force the board to work with an unwanted director, but there is no reason why it should not either order other directors or shareholders to buy out the oppressed director's interest in the company, or award him damages.

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