

JUDGES IN THEIR OWN CAUSE: THE RATIFICATION OF DIRECTORS' BREACHES OF DUTY

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The recent decision of the New South Wales Supreme Court in *Winthrop Investments Limited v. Winns Limited*¹ has once again raised for very serious consideration the question of just how far the doctrine of ratification of directors' "misdeeds" or breaches of duty should be permitted to go. The doctrine contemplates the company relieving a director of breaches of duty that may have been committed, or as contemplated in that case, that might be committed in the future. It is clear that the doctrine of ratification is not only recognized by the courts, but is necessary in the context of modern commercial life. Lord Justice Harman put the matter nicely, although I disagree with the final thrust of his comments, in *Bamford v. Bamford*.² In considering there whether the company could ratify an issue of shares by directors for what, in the context of that case, was assumed to be an improper purpose, he noted³

"It is trite law, I had thought, that if directors do acts, as they do every day, especially in private companies, which, perhaps because there is no quorum, or because their appointment was defective, or because sometimes there are no directors properly appointed at all, or because they are actuated by improper motives, they go on doing for years, carrying on the business of the company in the way in which, if properly constituted, they should carry it on, and then they find that everything has been so to speak wrongly done because it was not done by a proper board, such directors can, by making a full and frank disclosure and calling together the general body of the shareholders, obtain absolution and forgiveness of their sins; and provided the acts are not ultra vires the company as a whole everything will go on as if it had been all right from the beginning. I cannot believe that is not a commonplace of company law. It is done every day. Of course, if the majority of the general meeting will not forgive and approve, then the directors must pay for it."

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¹ [1975] 2 N.S.W.L.R. 666, noted (1978) 51 *A.L.J.* 89; (1976) 4 *A.B.L.R.* 315; D. D. Prentice, "Jurisdiction of Shareholders' Meetings" (1977) 40 *M.L.R.* 587; and see H. Mason, "Ratification of the Directors' Acts: An Anglo-Australian Comparison" (1978) 41 *M.L.R.* 161. (Mason's critique is restricted to the more specific issue of a ratification of an issue of shares.) See also Finn, *Fiduciary Obligations* (Sydney Law Book Co., 1977) para. 151-2.

² [1970] Ch. 212.

³ *Ibid.* 237-8.

This particular statement has been the subject of concern, comment and challenge by writers⁴ and courts, but not specifically in the wider context of ratification by those who participate in the relevant breach of duty.⁵ The context in which that statement was made, of course, was a limited one.⁶ Nevertheless, in the light of earlier statements by the courts, ranging from the Privy Council to courts at first instance, it merits analysis again, especially now that it has been "adopted" in Australia.

An analysis of the decision was made for the first time in the Australian context by the New South Wales Court of Appeal in the *Winthrop Investments* case. But in this case the court went even further to consider the situation of ratification in anticipation of breach. It would appear that this is the first time that this matter has been considered directly in relation to an improper issue of shares,⁷ although there are statements in the law reports which suggest that ratification, in anticipation of a breach of duty, is possible.⁸ In this article I will consider whether ratification is possible for certain breaches of duty, and the possibility of "sinning" directors voting their own shares in ratifying their conduct and the issue of whether ratification should be possible for all such breaches of duty. It is then necessary to consider the implications of such a principle insofar as the rights of dissenting minority shareholders are concerned.

There are, in my view, inherent dangers in allowing ratification along the lines suggested by the New South Wales Court of Appeal in *Winthrop*

⁴ The literature in this area is quite voluminous but much of it covers the collateral question of the issue of shares for an improper purpose. On ratification itself relatively little has been written. A select list of articles and notes is set out: On ratification in the context of improper issue of shares—viz. *Hogg v. Cramphorn Ltd* [1967] Ch. 254 see K. W. Wedderburn, "Shareholders' Control of Directors' Powers: A Judicial Innovation?" (1967) 30 *M.L.R.* 77; *Bamford v. Bamford* see K. W. Wedderburn, "Unreformed Company Law" (1969) 32 *M.L.R.* 563; on *Winthrops* case see fn. 1, *supra*. On the issue more specifically see S. M. Beck, "The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered" (1971) 49 *Can. Bar Rev.* 80, 114-9; S. M. Beck, "The Quickening of the Fiduciary Obligation" (1975) 53 *Can. Bar Rev.* 771; F. H. Buckley, "Ratification and the Derivative Action under the Ontario Business Corporations Act" (1976) 22 *McGill L.J.* 167; C. J. H. Thomson, "Share Issues and the Rule in *Foss v. Harbottle*" (1975) 49 *A.L.J.* 134; J. Birds, "The Permissible Scope of Articles Excluding the Duties of Company Directors" (1976) 39 *M.L.R.* 394; G. Jones, "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84 *L.Q.R.* 472; C. D. Baker, "Disclosure of Directors' Interests in Contract" (1975) *Journal of Bus. L.* 181. In addition there is of course a wealth of literature on the major cases discussed here which is noted in appropriate places in the footnotes.

⁵ See in particular articles by Buckley and Beck referred to in footnote 4. Wedderburn dealing with the narrow issue raised in *Bamford* has also been critical (see fn. 4). But in addition issues raised in this article have not been canvassed in Australia in the context of "self-forgiveness" and in the implications for minority shareholding. In any event the decision in *Winthrop* raises some new issues not previously considered in the literature.

⁶ Apart from the cases discussed in this article, see also *Teck Corporation Ltd v. Millar* (1973) 33 *D.L.R.* (3d) 288 and F. Iacobucci, "The Exercise of Directors' Powers:—The Battle of Afton Mines" (1973) *Osgoode Hall L.J.* 353.

⁷ But cf. comments of Buckley J. in *Hogg v. Cramphorn Ltd* [1967] Ch. 254, 169.

⁸ See in particular *Furs Ltd v. Tomkies* (1936) 54 *C.L.R.* 583, and *Regal (Hastings) Ltd v. Gulliver* [1942] 1 *All E.R.* 378; [1967] *A.C.* 134n.

Investments. Certain members of the court tantalizingly suggested that directors by making full disclosure may obtain relief for any breaches of duty, but often courts in recent times have been applying a strict line⁹ especially with respect to conflict of duty and interest, and more particularly in cases dealing with the usurpation of corporate opportunities. The business community expects a degree of certainty in the law, and the stricter interpretation adopted by the courts in this area has led, no matter how critical one might be of the strictness of the rule, to a greater certainty. Directors and officers in a fiduciary position should know, as a result of recent cases, that if they err on the side of allowing a conflict to occur, they must disgorge profits earned by them, to the company.¹⁰ To permit them to go back to the company and seek ratification of their conduct, so as to lessen this obligation, raises further questions of whether the company in general meeting has acted properly in ratifying the proposed conduct and what remedies are available, in these circumstances, to the minority shareholder. This in turn raises the issue of whether the majority of shareholders in ratifying a breach of duty owe fiduciary duties to the minority of a different kind to those enunciated in such classic cases as *Peters' American Delicacy*.¹¹

A remedy for oppression (that is under section 186 of the Uniform *Companies Act*) would seem to be inappropriate.¹² But there are other problems in relation to this question. We have the problem of disclosure.¹³ The courts continually suggest that if frank and full disclosure is made the directors need not be concerned once their conduct has been approved. How can frank and full disclosure be made in the context of this situation?

⁹ See e.g. *Queensland Mining Ltd v. Hudson* (1977) C.C.H. A.C.L.C. 28558; reversed by Privy Council on the facts (1978) 18 A.L.R. 1. Cf. *Daniels v. Daniels* [1978] 2 W.L.R. 73.

¹⁰ As in *Industrial Development Consultants Ltd v. Cooley* [1972] 2 All E.R. 162, and as is implied in *Daniels v. Daniels*, *supra* fn. 9.

¹¹ *Peters' American Delicacy Co. Ltd v. Heath* (1938-39) 61 C.L.R. 457. Here we touch on a huge subject—i.e. the question of fraud on the minority and the rule in *Foss v. Harbottle* (1843) 2 Hare 461. It is beyond the scope of this article to explore fully the interrelation between that rule and ratification but clearly the matter is of direct concern. For a fuller treatment of that rule and its exceptions (including fraud on the minority) see K. W. Wedderburn, "Shareholders' Rights and the Rule in *Foss v. Harbottle*" [1957] *Camb. L.J.* 194 and [1958] *Camb. L.J.* 93; see also Thomson, *supra*, fn. 4.

¹² This remedy has proved inadequate—it has only been used successfully in the most extreme cases. See generally R. Baxt, "Oppression of Shareholders—The Australian Remedy" (1971) 8 *M.U.L.R.* 91; H. Rajak, "The Oppression of Minority Shareholders" (1972) 35 *M.L.R.* 156.

¹³ A nightmare area, it is suggested, in so far as minority shareholders are concerned. They usually lack the expertise to assess the material distributed. They generally lack the funds to challenge directors' circulars; directors may use the corporate machinery effectively to suffocate the minority with material. See the classic comment of Maugham J. in *Re Dorman Long & Co. Ltd* [1934] Ch. 635, and note Gower, *Principles of Modern Company Law* (3rd ed. London, Stevens 1969) 482-7. However, the courts will interevne if the information is misleading or tricky, or if it is not a clear enough explanation. For a recent example of such an intervention see *Re Marra Developments Ltd* (1976) 1 A.C.L.R. 470.

Is it sufficient to reveal or alert the shareholders to a potential breach but nevertheless allow the directors to seek proxies from the shareholders to vote in favour of their proposed conduct?¹⁴ The directors control the proxy machinery;¹⁵ the apathy of the average investor coupled with the absence of any adequately equipped body to supervise the conduct of proxy contest¹⁶ makes the utilization of this procedure suspicious. Whether the information being given to the shareholder is accurate and fair is of course something that the courts can analyse in due course.¹⁷ But then again, we are reminded of the cost of litigation and the fact that failure will result not only in the directors being allowed to pursue their course of conduct but also that the shareholders may have to foot a substantial bill.¹⁸

Above and beyond these considerations we must not forget the general power of the court to forgive in the context of section 365.¹⁹ Perhaps forgiveness of breaches of duty (or certain classes of breach) should be left to the court in this general situation—especially if we are confronted with potential conflict arising between the directors as officers of the company, and the directors as shareholders. These are matters that I will examine in passing below.

WHAT BREACHES OF DUTY CAN BE RATIFIED?

Introduction

Directors of companies are fiduciary agents.²⁰ In most cases they are given the general management and control of the company's affairs.²¹ They are expected to exercise due care and skill in the carrying out of their duties.²² The nature of the skill and care that is expected has never been placed at a very high level;²³ but at the same time the courts will

¹⁴ Note comments on this in *Winthrop, supra*, fn. 1, at p. 16.

¹⁵ See e.g. ss. 141 and 143 of the *Uniform Companies Act* (referred to as *U.C.A.*).

¹⁶ The various Australian Corporate Affairs Commissions do not have machinery to regulate proxy contests as is the case in the U.S.A. where one of the major tasks of the Securities Exchange Commission is to regulate such material. See E. R. Aranow and H. A. Einhorn, *Proxy Contests for Corporate Control* (2nd ed. New York, Columbia Press 1968).

¹⁷ See the cases discussed in *Re Marra Developments Ltd, supra*, fn. 13.

¹⁸ Legal aid is not generally available but perhaps we may see some form of contingent fee or comparable solution in due course. Cf. *Wallersteiner v. Moir* (No. 2) [1975] 1 All E.R. 849, especially Lord Denning at pp. 860-2.

¹⁹ This power is equivalent to the power to forgive breaches of duty etc. by trustees. The directors must have acted reasonably. There are numerous cases on s. 365 and its equivalent. See Gower, *op. cit.* 558-9; H. A. J. Ford, *Principles of Company Law* (Sydney: Butterworths 1974) 354-5; Afterman, *Company Directors and Controllers* (Law Book Co., Sydney 1970) 132-4.

²⁰ See e.g. *Peters' American Delicacy Co. Ltd v. Heath* (1938-39) 61 C.L.R. 457, 504.

²¹ As per Article 71 of Table A of the Fourth Schedule of *U.C.A.*

²² See s. 124(1) of *U.C.A.* and *Re City Equitable Fire Insurance Co. Ltd* [1925] Ch. 407. The following brief overview is meant by way of background to the comments made by Harman L.J. in *Bamford v. Bamford*. For a detailed overview see Gower, *op. cit.*, Ch. 23; see also Afterman, *op. cit.*, Ch. 2; Ford, *op. cit.*, Ch. 15.

²³ Cf. *Re City Equitable Fire Insurance Co. Ltd, supra*, fn. 22; note Gower, *op. cit.* 549-52.

intervene and grant relief,²⁴ not only during the company's lifetime, but in the context of section 367B of the Uniform *Companies Act*,²⁵ once the company has gone into liquidation, or faces similar financial or related misfortune.²⁶

At the same time as they are fiduciary agents, they must act honestly and in the best interests of the company,²⁷ (whatever the latter expression may mean).²⁸ In the context of this general fiduciary duty the courts impose very high standards²⁹—directors must not compete with their company,³⁰ they must not use their powers for an improper purpose,³¹ they must not usurp corporate opportunities,³² they must not use inside information for their personal benefit³³ (now more specifically controlled by statute),³⁴ and generally should not place themselves in a position where their loyalties may be divided.³⁵ They should not secretly enter into contracts with their company,³⁶ but within certain limitations they may take the advantage of contracts with the company providing full disclosure is made.³⁷ There are other specific duties which have been elucidated by

²⁴ Either at common law where the duty is breached (e.g. *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch. 425; *Selangor United Rubber Estates Ltd v. Craddock* (No. 3) [1968] 1 W.L.R. 1555) or under statute (see *Byrne v. Baker* [1964] V.R. 443).

²⁵ Now that it is drafted in terms of negligence and not misfeasance (s. 367B being based on s. 333 of The English *Companies Act* 1948) the scope of the provision may have been considerably widened. Cf. *Walker v. Wimborne* (1976) 50 A.L.J.R. 446, and see M. J. Trebilcock, "The Liability of Company Directors for Negligence" (1969) 32 *M.L.R.* 499; but contra *Kimberley Mineral Holdings Ltd v. Triguboff* (1978) C.C.H. A.C.L.C. 29973.

²⁶ The section (s. 367B) applies also when the company is in receivership, under investigation pursuant to Part VIA of *U.C.A.* or suffering from similarly embarrassing situations.

²⁷ Cf. *Re Smith & Fawcett Ltd* [1942] Ch. 304; *Greenhalgh v. Arderne Cinemas Ltd* [1951] Ch. 286, 291; see Gower, *op. cit.* 521-4; see Afterman, *op. cit.* 40-50.

²⁸ It means more than the individual hypothetical shareholder (the test enunciated by Evershed M.R. in *Greenhalgh, supra*, fn. 27) in so far as businessmen are concerned and in so far as certain decisions of the courts indicate. See *Walker v. Wimborne, supra*, fn. 25, where the court recognized that interests of creditors might also be relevant. See *infra*, pp. 28-29 and note a discussion of this case in R. Baxt, "The Duties of Directors of Public Companies—The Realities of Commercial Life, the Contradictions of the Law, and the Need for Reform" (1976) 4 *A.B.L.R.* 289 and cases discussed there.

²⁹ Cf. Gower, *op. cit.* 526 ff.; Afterman, *op. cit.* 66-100; Ford, *op. cit.* 310-27.

³⁰ See e.g. *Aberdeen Railway Co. v. Blaikie Bros* (1854) 1 Macq. 461.

³¹ See *Mills v. Mills* (1938) 60 C.L.R. 150.

³² See *Regal (Hastings) Ltd v. Gulliver, supra*, fn. 8.

³³ Query whether there has always been such a rule—see *Percival v. Wright* [1902] 2 Ch. 421 and compare *Allen v. Hyatt* (1914) 30 T.L.R. 444; see unreported decision of Mahon J. in *Coleman v. Myers* (1976) N.Z. Sup. Ct. (discussed by M. Hetherington, "Financing an Insider Takeover" (1976) 4 *A.B.L.R.* 220); cf. Gower, *op. cit.* 517-20; Afterman, *op. cit.* 101-5; Ford, *op. cit.* 322-34.

³⁴ See s. 124(2) of *U.C.A.* and s. 112 of *Securities Industry Act*; see R. Baxt, H. A. J. Ford and G. J. Samuels, *An Introduction to the Securities Industry Acts* (Sydney, Butterworths 1977) Ch. 14.

³⁵ Contrast Lord Denning's famous *dicta* in *Scottish Co-operative Wholesale Society Ltd v. Meyer* [1959] A.C. 324, 366-8 with that of Lord Blanesburgh in *Bell v. Lever Bros Ltd* [1932] A.C. 161, 195.

³⁶ *Transvaal Lands Company v. New Belgium (Transvaal) Land & Development Co.* [1914] 2 Ch. 488.

³⁷ See s. 123 of *U.C.A.* and note *North-West Transportation Co. Ltd v. Beatty* (1887) 12 App. Cas. 589; see Gower, *op. cit.* 526-35; and Baker, *supra*, fn. 4.

the courts, but these generally flow from the more recognized duties mentioned above.³⁸

In respect of which of the above duties, specifically, can the directors seek forgiveness from the company in general meeting? Will the machinery for ratification be the same in each case, or are there limitations to the general power vested in general meeting? To what extent can the directors use their own votes in seeking ratification of breaches of duty? And finally, to what extent will ratification relieve them of liability at the behest of a shareholder dissatisfied with the decision to forgive? I shall examine these questions in the context of specific individual duties.

I shall deal with the issues by looking at four major areas (or duties) in respect of which ratification for breach has been the subject of judicial comment. These are (1) the duty of care and skill (or negligence); and (2) the fiduciary duties of (a) using powers for an improper purpose, (b) contracting with the company, and (c) usurping corporate property and opportunity.

Needless to say, the question of ratification may involve breaches of other duties. Indeed it is an essential element of the rule in *Foss v. Harbottle*³⁹—i.e. the ratification of irregularities. As noted earlier, I shall not be looking at the rule itself except in passing and commenting on where ratification leaves the disgruntled minority shareholder.

I commenced this article by quoting from the now famous dicta in *Bamford v. Bamford*.⁴⁰ It is appropriate to remember that whilst the court may be prepared to accept this as a general principle it will also wish to ensure that the majority of shareholders do not oppress or hurt the minority.⁴¹ As Buckley J. noted in *Hogg v. Cramphorn Ltd.*⁴²

“... 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. Nor will this court permit directors to exercise powers, which have been delegated to them by the company in circumstances which put the directors in a fiduciary position when

³⁸ For a discussion of these in general, see Gower, *op. cit.* Ch. 23; Afterman, *op. cit.* Ch. 2; Ford, *op. cit.* Ch. 15.

³⁹ (1843) 2 Hare 461 and refer to articles cited in fn. 11, *supra*.

⁴⁰ *Supra*, fn. 1.

⁴¹ The “duty” owed by the majority of shareholders (or the company) is said to be to act bona fide in the best interests of the company (cf. *Greenhalgh v. Ardenne Cinemas Ltd*, *supra*, fn. 27) but clearly this obligation can not be equated to that of directors. The courts have recognized the property rights of shareholders. (See *Pender v. Lushington* (1877) 6 Ch. D. 70 and comments on this individual right in the context of *Foss v. Harbottle* in Wedderburn, *supra*, fn. 11). Whilst there has been a tendency to look more closely at situations where a contractual right of a minority shareholder is being affected there is little comfort by and large for minority shareholders unless there is an *abuse of power* or *oppression* (cf. *Peters' American Delicacy*, *supra*, fn. 11, per Dixon J. at 506-7) whatever those expressions may mean (contrast comments of Foster J. in *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268, 280-2, a recent decision on this “duty”).

⁴² [1967] Ch. 254, 268.

exercising those powers, in such a way as to interfere with the exercise by the majority of its constitutional rights; and in a case of this kind also, in my judgment, the court should not investigate the rival merits of the views or policies of the parties. . . .

A majority of shareholders in general meeting is entitled to pursue what course it chooses without the company's powers, however wrong-headed it may appear to others, provided the majority do not unfairly oppress other members of the company. . . ."

If the constraints recognized here are observed, the actions on the part of the majority will seldom be challengeable. In examining when and whether they should be, I will not be discussing a variety of complex issues that are related to the question of ratification. The ability of companies to include indemnification clauses, despite section 133⁴³ of the Uniform *Companies Act* is an important issue which has been discussed elsewhere;⁴⁴ the question of whether ratification involves an usurpation by the general meeting of the powers of directors was directly raised in *Winthrop Investments*,⁴⁵ but we will not be discussing it fully here.⁴⁶ The power of the court to relieve directors of breaches will be mentioned in passing, but the scope of this discretion must remain outside the scope of this article.⁴⁷ Finally, an issue which is central to ratification—the content of the disclosure provided—must also find another forum for fuller exploration, although the relevance of this matter will certainly be discussed in the body of this article.⁴⁸

Duty of Care and Skill

The duty of care and skill expected of a company director is not of a standard that could be described as being high. The classic exposition of the position of a company director, in the case of *Re City Equitable*⁴⁹ has

⁴³ Included to overcome the use of such clauses in cases such as *Re City Equitable Fire Insurance Co. Ltd*, *supra*, fn. 22.

⁴⁴ See Birds, *supra*, fn. 4; Baker, *supra*, fn. 4.

⁴⁵ Cf. Samuels J.A. [1975] 2 N.S.W.L.R. 666, 682-3; Mahoney J.A., *ibid.*, 706-7.

⁴⁶ The issue was clearly raised by Plowman J. at first instance in *Bamford v. Bamford* [1969] 1 All E.R. 969. He viewed the power of the general meeting to be residual in areas involving the issue of shares because it was not burdened by the same constraints (i.e. duty to use power for proper purpose) that confronted directors. The Court of Appeal refused to follow this line of reasoning. Samuels J.A. in *Winthrop Investments* felt that the shareholders had no such power and that it was only in the most obvious and clearly defined case that the general meeting would be given this wider power ([1975] 2 N.S.W.L.R. 683). See G. D. Goldberg, "Article 80 of Table A of The Companies Act 1948" (1970) 33 *M.L.R.* 177; Gower, *op. cit.* 136-8; see *infra*.

⁴⁷ I.e. the caution to be applied by the court in exercising its powers under s.365 of *U.C.A.*, but we will be commenting on the possible function of the court as an alternative to ratification.

⁴⁸ Cf. the materials cited fn. 13, *supra*.

⁴⁹ *Supra*, fn. 22; see discussion of this duty in Trebilcock, *supra*, fn. 25 and cf. Gower, *op. cit.* 549-52; Afterman, *op. cit.* 126-32. The courts have never been keen to impose high standards on directors. Cf. comments of Buckley J. in *Re Five Minute Car Wash Service Ltd* [1966] 1 All E.R. 242, in which the failure on the part of the director to ensure leases were renewed whilst showing lack of competence was

been endorsed in the Victorian Supreme Court in its decision of *Byrne v. Baker*.⁵⁰ That case was concerned with section 124(1) which requires a director of a company to act honestly and use reasonable diligence in the discharge of his duties⁵¹ (inter alia).

"[A] comparison of the language [used in *Re City Equitable*] with the language of [Section 124(1)] would suggest that the latter was inspired by the former. . . . What the legislature by the sub-section is demanding of honest directors is diligence only; and the degree of diligence demanded is what is reasonable in the circumstances and no more. It is clear from what Romer J. said that his conception of the diligence required of a director was something quite different from the diligence of a man who might aptly be described as a diligent person, in the sense that he could always be relied upon to give close attention to all business affairs in his hands."

The fact that the word skill was missing from the subsection did not in any way lower the standard expected by Romer J. It is interesting to note that the court did not suggest that the statutory language raised the standard expected and enunciated by the decision in *Re City Equitable*.⁵²

It is disappointing, from the writer's point of view, that the courts have taken such a negative view of the section⁵³ and its "equivalent" in other jurisdictions.⁵⁴ This disappointment is heightened when one is confronted by the proposition that a director may seek forgiveness of his negligence from the company in general meeting, which forgiveness may well bar any complaint that the company or minority shareholders may have against

not regarded as overly unusual; also *Re Tropic Isle Ltd (In Liq.) Rees v. King* [1967] Qd.R. 193 where the failure on the part of directors to obtain independent valuations of real estate was again not regarded as "unusual" in the context of the expected skill of directors.

⁵⁰ [1964] V.R. 443. See also *Re Co-operative Travel Society Ltd & Ors* (1978) *Aust. Co. Law Cases* 29,813, 29,830-1.

⁵¹ *Ibid.* 450.

⁵² [1925] Ch. 407.

⁵³ Another illustration of such a negative view although in a different context, is *Marchesi v. Barnes* [1970] V.R. 434, which concerned the related duty imposed on the directors to act *honestly*. The statute (s. 124(1) of U.C.A.) is in addition to and not in derogation of the common law (see s. 124(4)) but despite this position a conservative interpretation has so far been adopted; cf. Afterman, *op. cit.* 131; Ford, *op. cit.* 351-2.

⁵⁴ See e.g. the interpretation of a similar statute in Pennsylvania which requires directors to discharge their duties "with that diligence, care and skill which ordinarily prudent men should exercise under similar circumstances in their personal business affairs" (s. 408 of *Business Corporation Law* 1933)—in *Selheimer v. Manganese Corp. of America*, 224 A. 2d 634 (1966) (Penn. S.C.). As a result of criticism of the statute in *Selheimer* the words in emphasis were dropped in 1968; cf. *Smith v. Brown-Borhek Company*, 200 A. 2d 398 (1964); see A. V. Wray, Note (1967) 45 *Nth. Car. L.R.* 748 for a comment on *Selheimer*. In Canada similar statutes have been introduced in s. 117(1)(b) of the *Canada Business Corporations Act* and s. 144 of the *Ontario Business Corporations Act*—see comment by J. S. Ziegel, "New Look in Canadian Corporation Law", *Studies in Canadian Company Law* (Ziegel 2d ed. Toronto, Butterworths 1973), at 44-6 and F. Iacobucci, "The Business Corporations Act, 1970: Management and Control of a Corporation" (1971) 21 *U.T.L.J.* 543.

him. Certainly that is the thrust of the proposition put forward by Danckwerts J. in *Paylides v. Jensen*.⁵⁵ In that case, the decision turned on standing; the complaining shareholder alleged that the directors of the company had negligently and in breach of their duty arranged for the sale of a valuable asset belonging to the company to another company in which they were indirectly interested. The shareholders' suit was dismissed; they had not alleged *ultra vires* or fraud. In so far as negligence may have been relevant Danckwerts J. noted⁵⁶

"It was open to the company, on the resolution of the majority of the shareholders, to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of the majority to decide that, if the directors by their negligence or error or judgment had sold the company's mine at an undervalue, proceedings should not be taken by the company against the directors."

He denied the claim of the minority shareholders. Forgiveness, which would have been possible on the vote that could have been cast by the directors and their supporters in the case, would mean that no action by a minority shareholder could have been maintained.

Danckwerts J. did not comment on whether the directors who had committed the breach could exercise votes; he did not comment on whether the vote necessary was by simple majority. But by his direct reference to the Privy Council decision in *Burland v. Earle*⁵⁷ prior to his mention of ratification, it is implicit that he was not contemplating denial to the shareholders of their "voting power to carry a resolution by the circumstances of [their] having a particular interest in the subject matter of the vote".⁵⁸

If Danckwerts J. is correct, and there has been no case which have discussed the concept of ratification that suggest that he is not, the shareholders have little recourse. The only "exception", a case on the question of *standing*, is the recent decision of Templeman J. in *Daniels v. Daniels & Ors.*⁵⁹ The courts will generally not intervene to permit standing; unless oppression or fraud or some other "exception"⁶⁰ to the rule in *Foss v. Harbottle* can be shown to exist in the exercise by the majority of their vote, there will be no possibility of the minority shareholder getting to court at all.

In *Daniels v. Daniels*, the plaintiffs were minority shareholders in a

⁵⁵ [1956] Ch. 565.

⁵⁶ *Ibid.* 576.

⁵⁷ [1902] A.C. 83.

⁵⁸ [1956] Ch. 576.

⁵⁹ [1978] 2 W.L.R. 73.

⁶⁰ The best "bet" is on the basis of the exception which is described by Gower as "where justice so requires"—see Gower, *op. cit.* 585. Note also the discussion of this exception by Street C.J. in *Hawkesbury Development Co. Ltd v. Landmark Finance Pty Ltd* [1969] N.S.W.R. 782. The "principle" has not yet been "applied"; cf. *infra* p. 52.

company who brought an action alleging breach of duty on the part of the directors in selling certain assets at an undervalue. The action was challenged on the basis that the Statement of Claim disclosed no cause of action, the directors relying in part on *Pavlides v. Jensen* and in part on the broader scope of *Foss v. Harbottle*. The defendants argued that fraud would have to be pleaded before the action could proceed. Templeman J. rejected this view. He reviewed many of the authorities,⁶¹ but felt that none of them denied standing to the plaintiffs.⁶²

“The authorities which deal with simple fraud on the one hand and gross negligence on the other do not cover the situation which arises where, without fraud, the directors and majority shareholders are guilty of a breach of duty which they owe to the company, and that breach of duty not only harms the company but benefits the directors. In that case it seems to me that different considerations apply. If minority shareholders can sue if there is fraud, I see no reason why they cannot sue where the action of the majority and the directors, though without fraud, confers some benefit on those directors and majority shareholders themselves. It would seem to me quite monstrous—particularly as fraud is so hard to plead and difficult to prove—if the confines of the exception to *Foss v. Harbottle*, 2 Hare 461, were drawn so narrowly that directors could make a profit out of their negligence. Lord Hatherly L.C. in *Turquand v. Marshall*, L.R. 4 Ch. App. 376, 386, opined that shareholders must put up with foolish or unwise directors. Danckwerts J. in *Pavlides v. Jensen* [1956] 1 Ch. 565 accepted that the forbearance of shareholders extends to directors who are ‘an amiable set of lunatics’. Examples, ancient and modern, abound. To put up with foolish directors is one thing; to put up with directors who are so foolish that they make a profit of £115,000 odd at the expense of the company is something entirely different.”

The question of ratification was not considered by him, but by implication he was denying ratification in a case where the directors benefited themselves. In this sense the case fits more in line with *Cooke v. Deeks*.⁶³ It should be noted that he did not distinguish *Pavlides v. Jensen*; rather he relied on it to support his holding. I find this unacceptable, for in the earlier case the directors were gaining an “advantage” as well (through the company they controlled).⁶⁴

If the shareholders were to find a way into court, a further difficulty they would then face is the fact that the court does not normally inquire

⁶¹ The main decisions other than those mentioned here were *Birch v. Sullivan* [1957] 1 W.L.R. 1247; *Heyting v. Dupont* [1963] 1 W.L.R. 1192; *MacDougall v. Gardiner* (1875) L.R. 20 Eq. 383.

⁶² [1978] 2 W.L.R. 73, 79-80.

⁶³ [1916] 1 A.C. 554; see *infra* pp. 46-7.

⁶⁴ In *Pavlides v. Jensen* the “defendant” company (D) was a subsidiary of H and the directors of D were also directors of H and constituted the majority of H’s board. D also held 25% of the share capital of the purchaser company. The company was thus “sharing” in the benefit of the cheap price and it could be argued by analogy its directors would benefit from this sale.

into the business judgment of the directors.⁶⁵ The case would normally have to amount to gross negligence for the court to delve into the merits of the decision by the directors.

Until the important recent decision in *Daniels v. Daniels & Ors.*, the minority shareholder appeared to have had no remedy in most of these cases. How far we can take *Daniels* remains to be seen. There is still the reluctance on the part of the court to find negligence on the part of the directors.

Will the result be different if we are concerned not merely with a breach of common law duty to act with care and skill but also with a potential breach of section 124(1)?⁶⁶ This might be the result, however unintended it may have been, following the decision of the Victorian Supreme Court (Full Court) in *Lawson v. Mitchell*,⁶⁷ decided in 1975.

In that case an information under section 161(1)⁶⁸ of the Uniform Companies Act (U.C.A.) had been brought in a Magistrates Court against certain company directors. In the course of the action, the defendants submitted that the court had power and ought to have relieved the defendants from liability under s. 365 of the U.C.A.⁶⁹ The Magistrate accepted the submission; he assumed that as the directors would have been relieved of liability under the terms of the section, he should dismiss the information. An order nisi to review his decision was brought to the Full Supreme Court.

It is unnecessary at this point, to deal with the wide powers given to the court under section 365 of the U.C.A. The Supreme Court examined the history of the section and concluded that when it was viewed in its form and context and "even without regard to its history", the section had "no application to criminal liability, and is confined to relief from civil liability".⁷⁰ The examination of the history of the section suggested to the court that it applied to a wider series of events, including the ability to deal with the situations covered by indemnity clauses which were common⁷¹ prior to the inclusion of s. 133 of the U.C.A.—a section which prevents the inclusion in the articles of association of a general indemnification to directors for breaches of duty and breaches of the trust, etc.⁷² The Full

⁶⁵ This is the classic reason thrown up by the courts in refusing to go behind directors' decisions—for a recent illustration see *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 42 A.L.J.R. 123, 125; cf. Gower, *op. cit.* 520-1; Afterman, *op. cit.* 44-5.

⁶⁶ The section imposes a duty which is in addition to the common law duty (s. 124(4)) but as noted above the court in *Byrne v. Baker* (*supra*, fn. 50) seemed to imply no "raising" of the standard.

⁶⁷ [1975] V.R. 579.

⁶⁸ The directors were charged with a failure to keep proper books and records for the purpose of preparing annual accounts.

⁶⁹ In that they were acting honestly and it was reasonable to excuse them of such a "minor" offence.

⁷⁰ See the detailed discussion of the history of the provisions—[1975] V.R. 584-92.

⁷¹ E.g. *Re City Equitable Fire Insurance Co. Ltd*, *supra*, fn. 22.

⁷² See discussion of this section in article by Birds, *supra*, fn. 4.

Court held that no court could relieve a director for failing to comply with the requirement that accounts be prepared and filed under s. 161(1); it is arguable that if directors breached section 124(1) of the U.C.A. the court likewise could not relieve them.

If the court cannot relieve for a statutory liability which had now been made coextensive with the civil liability—as was said to be the effect of the section in *Byrne v. Baker*⁷³—can the general meeting relieve the directors of liability? Section 124(3) provides that an officer of the corporation who is in breach of either s. 124(1) or s. 124(2) (the improper use of information) is not only liable to the corporation but also guilty of an offence.⁷⁴ Even if the corporation could excuse the director for a breach of duty in respect of any damage suffered by the corporation he would still on the face of things be guilty of an offence.

It would be interesting to see what attitude the courts would have to a situation where a director who had committed what amounted to a breach of section 124(1) and then obtained forgiveness (by using his own votes) of his breach of duty from the company in general meeting, was sued on the basis of the breach.⁷⁵

One would hope that, if ratification were possible, the courts would require ratification by at least an independent majority of shareholders, although I would suggest in these circumstances that a majority larger than a simple majority of independent shareholders be obtained.⁷⁶ If the director were found guilty of an offence and there was later ratification, the court might be more inclined to listen to the complaint of a minority shareholder who had voted against the attempted ratification.

One final comment on the case—the Court in analysing section 365 said it was a provision that only related to relief for civil liability. Now that a breach of duty in respect of care and skill has been made a criminal offence, as well, it would seem that the court could *not* relieve a director for breach of duty amounting to failure to comply with section 124(1); it would indeed be a strange result if the company, by a simple majority, with the “guilty” directors exercising their own vote, could have the power to grant relief. It might be argued that the damage caused by the breach is caused to the company and not to the public at large in this context, and such power of ratification might arguably still be available. The legislature has not differentiated in the drafting of the statute between those

⁷³ [1964] V.R. 443.

⁷⁴ The penalty is \$2,000.

⁷⁵ A first question would be the standing of the shareholder who wished to sue. Unless there was a fraud on the minority or “justice so required” an act of negligence would hardly be regarded as a basis for standing in the current state of authorities. Templeman J. did not dissent from *Pavlidis v. Daniels v. Daniels* (*supra*, fn. 59). The directors in his view were gaining an advantage but the company was not “damaged”.

⁷⁶ Simply to clarify the position for the court in the case of a later challenge although in essence even a 99% approval should not deprive the complaining shareholder from mounting an action. The onus would be a heavy one.

breaches which are concerned with possible damage to the public and those which are concerned with damage to the incorporators and shareholders flowing from a breach by the directors. It is the writer's view that in the context of section 124 and the decision in *Lawson v. Mitchell*, ratification by shareholders is no longer possible where the conduct amounts to a breach of section 124(1).

We are assuming here that the scope of the duty under review is narrow. If it is equivalent to a concept of negligence/misfeasance in the context of the High Court decision in *Walker v. Wimborne*,⁷⁷ further grave questions arise. The Court in that case held the directors liable under the forerunner to the present s. 367B⁷⁸ because, *inter alia*, they had failed to direct their attention to the interests of the company. One had assumed that this means the interests of the shareholders,⁷⁹ but Mason J. cautioned against this narrow view⁸⁰

"The fundamental [principle is] that each of the companies was a separate and independent legal entity, and that it was the duty of the directors . . . to consult its interests and its interests alone in deciding whether payments should be made to other companies. In this respect it should be emphasized that the directors of a company in discharging their duty to the company must take account of the interest of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of a company, whether it be a member of a 'group' of companies in the accepted sense of that term or not, must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent."

If a duty is said to be owed to creditors as well, no ratification by shareholders alone may be possible, but this view is yet to be tested.

My considered view is that the shareholders should be able to ratify in only a limited number of situations—i.e. where only their interests are clearly involved, where there is an independent vote with full disclosure and where it is clear that no minority shareholders will thereby be deprived of stating a case to the appropriate court. This is the consensus in some U.S. jurisdictions,⁸¹ whilst in other jurisdictions ratification by smaller majorities is permitted. If this is not acceptable (as being too liberal) then we can always permit the courts to "forgive" under s. 365 of the U.C.A.

⁷⁷ (1976) 50 A.L.J.R. 446; for a more detailed comment on this case see article by Baxt, *supra*, fn. 28.

⁷⁸ The section was based on misfeasance which has now been replaced by negligence.

⁷⁹ Cf. discussion of this topic, *supra* p. 20 and footnotes.

⁸⁰ 50 A.L.J.R. 446, 449.

⁸¹ See H. G. Henn, *Corporations* (2nd Ed., St Paul, West Publishing 1970) p. 380, and note *Smith v. Brown-Bohrek Co.* 200 A. 2d 398 (1964) (Sup. Ct. Penn.); cf. *Alcott v. Hyman* 208 A. 2d 501 (1965) (Sup. Ct. U.S.A.).

BREACH OF FIDUCIARY DUTIES

In dealing with the fiduciary duties of directors, we are not only limiting discussion to three basic duties (even though they are broad), but to specific situations covered by these where more difficult questions have been raised. Furthermore, we are assuming here that in speaking of these duties we are dealing with duties owed to the company—i.e. the shareholders.⁸² To extend this obligation to others⁸³ would be both unwise⁸⁴ if we wish to have meaningful law in this area and, in the context of the cases, inappropriate.

1. Use of Power for Improper Purposes⁸⁵

The area in which the issue of ratification has been most actively discussed recently is where the directors have abused their position of control for their own advantage or have misused their powers, i.e. where they have used their powers for an improper purpose. Until the decision in *Hogg v. Cramphorn Ltd*,⁸⁶ it was the view that in such a case the acts of the directors were void and therefore not ratifiable.⁸⁷ The about-face caused by that decision, and in particular *Bamford v. Bamford*,⁸⁸ has led to a complete reassessment of this question.⁸⁹

In discussing the scope of ratification it should be recalled that the courts recognize that directors as shareholders in the company have certain rights as possessors of property.⁹⁰ As Dixon J. put it in *Peters American Delicacy v. Heath*⁹¹

⁸² In line with the traditional views expressed in a long line of cases (cf. Gower, *op. cit.* 520-2).

⁸³ For example employees or creditors as may be implied from cases such as *Parke v. Daily News Ltd* [1962] Ch. 927, where any duty to employees was rejected; cf. Baxt, *supra*, fn. 28.

⁸⁴ There are situations in which the views of creditors are required to be obtained but these are limited to situations involving capital restructuring or reduction. The implications of the High Court's *dicta* in *Walker v. Wimborne* (*supra*, fn. 80), would make the task of any director seeking ratification of say an issue of shares to defeat a takeover almost impossible. I doubt if the courts would entertain any extension of the *dicta* and will probably limit it in the context of the duties we are discussing here to matters of business judgment.

⁸⁵ This covers not simply the issue of shares for an improper purpose but also such powers as the refusal to register transfer of shares, making calls on unpaid capital, etc. (See Gower, *op. cit.* 524-5 and footnotes.) We are however limiting our discussion to cases involving the issue of shares but the criteria should be no different in relation to the other examples.

⁸⁶ [1967] Ch. 254.

⁸⁷ See e.g. *Punt v. Symons & Co. Ltd* [1903] 2 Ch. 506; *Piercy v. S. Mills & Co. Ltd* [1920] 1 Ch. 77; see Gower, *op. cit.* 524; K. W. Wedderburn, "Ultra Vires or Directors' Bona Fides?" (1967) 30 *M.L.R.* 566.

⁸⁸ [1970] Ch. 212.

⁸⁹ See e.g. K. W. Wedderburn, "Shareholders' Control of Directors' Powers: A Judicial Innovation?" (1967) 30 *M.L.R.* 77; Buckley, *supra*, fn. 4; and the *Winthrop Investments* case [1975] 2 *N.S.W.L.R.* 666.

⁹⁰ We are assuming that they are shareholders which of course need not be the case, although in each of the cases in this area they have been shareholders.

⁹¹ (1938-39) 61 *C.L.R.* 457, 503-4 cf. *Pender v. Lushington* (1877) 6 *Ch.D.* 70.

"Primarily a share in a company is a piece of property conferring rights in relation to distributions of income and of capital. In many respects the proprietary rights are defined by the articles of association and it is easy to see that a power of alteration might be used for the aggrandisement of a majority at the expense of a minority. . . . The shareholders are not trustees for one another, and, unlike directors, they occupy no fiduciary position and are under no fiduciary duties. They 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. No doubt the exercise of the right affects the interests of others too. . . ."

Latham C.J., in *Mills v. Mills*,⁹² recognized the conflict that might face a director who is not only a shareholder, thus possessing property which he could use in certain ways, but also a fiduciary agent. This dilemma would not, however, in his view prevent the director from considering his own interests in exercising his discretion. His famous description of the dilemma is worthy of repetition.⁹³

"I do not read the general phrases which are to be found in the authorities with reference to the obligations of directors to act solely in the interests of the company as meaning that they are prohibited from acting in any matter where their own interests are affected by what they do in their capacity as directors. Very many actions of directors who are shareholders, perhaps all of them, have a direct or indirect relation to their own interests. It would be ignoring realities and creating impossibilities in the administration of companies to require that directors should not advert to or consider in any way the effect of a particular decision upon their own interests as shareholders. . . . A director . . . is not, in my opinion, required by the law to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be present to the mind of any honest and intelligent man when he exercises his powers as a director."

As a result of the recent but long line of cases culminating in the *Ampol* case,⁹⁴ it was the position that so long as the directors in their capacity as shareholders were not abusing their position, the court would not intervene so as to overturn the exercise of power by the majority.⁹⁵ The court, of course, will intervene if the shareholders have acted fraudulently or

⁹² (1938) 60 C.L.R. 150.

⁹³ *Ibid.* 163-4; cf. Dixon J. *ibid.* 185-6.

⁹⁴ *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 1 All E.R. 1126.

⁹⁵ There is a long line of cases in which this issue has been considered at length. See K. E. Lindgren, "The Fiduciary Nature of a Company Board's Power to Issue Shares" (1971-72) 10 *U.W.A.L.R.* 364; (see also (1972-73) 11 *U.W.A.L.R.* 68 and 384); and C. J. H. Thomson, "Share Issues and the Rule in *Foss v. Harbottle*" (1975) 49 *A.L.J.* 134 for two articles in which the issues and the cases are reviewed. Cf. Mason, *supra*, fn. 1 and see also references cited p. 51, fn. 231, *infra*.

oppressively.⁹⁶ Similarly, if there is a breach of contract the court may intervene to grant relief.⁹⁷

Putting on one side these rather "easier" situations, we are then faced with more complex scenarios in which the directors act in what they believe to be the best interests of the company (and with all honesty), yet nevertheless further their own interests at the expense of other shareholders. The courts had always regarded a misuse of power as improper which could and would be enjoined where requested. The decision in *Punt v. Symons*⁹⁸ and *Piercy v. Mills*^{98a} (*inter alia*) were confirmed by Buckley J. in *Hogg v. Cramphorn Limited*.⁹⁹

The directors in that case were concerned at the pending takeover of the company by Baxter, a corporate raider. They honestly believed the takeover would damage the company and unsettle the employees; they proceeded to place a large new issue of shares with persons acting as trustees on behalf of the employees through trust companies. As a result of this issue, Baxter's takeover plans were foiled. Hogg, a minority shareholder in the company, challenged the issue of shares. Buckley J. held that the issue was improper because no matter how honest the directors were, and notwithstanding the fact that they were acting in what they believed to be the best interest of the company, they were misusing their powers. This statement of principle has been reproduced earlier.¹⁰⁰

Buckley J. indicated that the company in general meeting could ratify the course of conduct taken by the directors, and indeed this actually occurred.¹⁰¹

The question of ratification in this instance did not pass unnoticed in the context of his judgment;¹⁰² but it was not until *Bamford v. Bamford*¹⁰³ that the question was considered directly. It is unnecessary to trace the history of that case in the lower court.¹⁰⁴ The Court of Appeal held that where there had been an issue of shares which was purportedly to defeat a takeover, this was clearly an improper exercise of the directors powers. It also held that the majority of shareholders (including the directors

⁹⁶ See comments of Buckley J. in *Hogg v. Cramphorn Ltd* [1967] Ch. 254. The decisions in other cases in which the courts have intervened to enjoin issues include *Winthrop Investments* and *Clemens v. Clemens and Others* [1976] 2 All E.R. 268.

⁹⁷ The decision of Street C.J. in *Equity* in the lower court in the *Ampol* case is a good illustration of this, see [1972] 2 N.S.W.L.R. 850.

⁹⁸ *Supra*, fn. 87.

^{98a} *Supra*, fn. 87.

⁹⁹ [1967] Ch. 254.

¹⁰⁰ *Ibid.* 268.

¹⁰¹ *Ibid.* 272(n).

¹⁰² *Ibid.* 269.

¹⁰³ [1970] Ch. 212.

¹⁰⁴ The directors in order to forestall a takeover of their company decided to issue shares to a third company. The allotment was ratified by the company and the question put to Plowman J. was that assuming the directors were exceeding their powers (or acting *mala fides*) could the issue be ratified? He held that the resolution was effective but on the basis of residual powers—see *infra*, p. 33, fn. 115. His decision was affirmed, but not his reasons.

exercising their own votes but not in respect of the shares that had been issued) could ratify the conduct at a meeting which was convened for this purpose. It is not necessary to quote again the famous statement of Harman L.J. in approving ratification.¹⁰⁵ Whilst Russell L.J. approached the matter on slightly different ground,¹⁰⁶ he effectively agreed with the view that the company could put a stamp of approval on the conduct of the directors. The result of this case makes the comment of Wedderburn following *Hogg v. Cramphorn* even more appropriate.¹⁰⁷

“Where any new issue could possibly affect voting control, only an unwise management will now fail to have it approved by the shareholders. This in turn is likely to make directors act at an even earlier stage, at the stage of rumours rather than knowledge of a bidder’s interest in the shares, in order to ensure that there is no possible risk of not getting their majority at the meeting.”

The question of whether the directors have acted for an improper purpose in regard to the misuse of their power is not of direct concern here. It has been examined in detail elsewhere.¹⁰⁸ The decision in *Bamford v. Bamford* was commented on favourably by the Privy Council in the *Ampol Petroleum* case,¹⁰⁹ although the Court did not have to deal with the question of ratification in that case. It was not until¹¹⁰ the decision in *Winthrop Investments* that the matter came up for direct consideration in a reported case in Australia.

It was assumed in arguing this case, that the directors were acting improperly in negotiating with a friendly party for a transfer of certain assets of the target company in exchange for the issue of shares to defeat the takeover offer being maneuvered by the appellant. The directors, in an ingenious variation of the procedure followed in the earlier cases,¹¹¹ sought ratification in advance of the sale and issue of shares, on the basis that if this action was ratified no future challenges could be brought. An interim

¹⁰⁵ *Supra*, p. 16, fn. 3.

¹⁰⁶ He relied *inter alia* on the fact that the directors owed a duty to the company and it was a decision of the company whether to litigate in the present circumstances. The company chose not to do so, by ratifying the issue, and no remedy lay at the behest of the shareholders. On this issue of standing see C. J. H. Thomson, “Share Issues and the Rule in *Foss v. Harbottle*” (1975) 49 *A.L.J.* 134.

¹⁰⁷ (1967) 30 *M.L.R.* 76, 83.

¹⁰⁸ See K. E. Lindgren, “The Fiduciary Nature of a Company Board’s Power to Issue Shares” (1971-72) 10 *U.W.A.L.R.* 364; Thomson, fn. 106, *supra*; J. H. Farrar, “Abuse of Powers by Directors” [1974] *Camb. L.J.* 221; J. R. Birds, “Proper Purposes as a Head of Directors’ Duties” (1974) 37 *M.L.R.* 580; M. E. Bennun, “Directors’ Powers to Issue Shares: Two Contrasting Decisions” (1975) 24 *Int. Comp. L.Q.* 359; N. C. A. Franzi, “The Subjective and Objective Elements of Company Board’s Power to Issue Shares” (1976) 10 *M.U.L.R.* 392.

¹⁰⁹ *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 1 *All E.R.* 1126.

¹¹⁰ There are suggestions of this approach in some cases—e.g. *Ashburton Oil N.L. v. Alpha Minerals N.L.* (1971) 123 *C.L.R.* 614 per Gibbs J. at 643.

¹¹¹ In the earlier cases (e.g. *Hogg, Bamford*) meetings were held following the issue of shares to gain support for the directors’ actions, and in order to avoid any litigation.

injunction was obtained to prevent the issue of shares;¹¹² it was discontinued by Bowen C.J. in *Equity* and Winthrop appealed this decision to the New South Wales Court of Appeal.

The court was unanimous in its view that *Bamford v. Bamford* should be followed.¹¹³ There were variations, however, in the support given to *Bamford v. Bamford*; it is clear that all three judges felt that ratification of an abuse of power in this context was possible, and that provided full and meaningful disclosure of relevant facts was made to the shareholders, the general meeting could proceed to ratify in accordance with the principles laid down in *Bamford v. Bamford*. Glass J.A. was of the opinion that if ratification was necessary it could be, and had been, effected;¹¹⁴ in his view the shareholders were carrying out an accepted function within power in approving the scheme put to them;¹¹⁵ and there was no oppression or other tainting factor in their conduct to leave the resolutions open to attack. Samuels J.A. held that he did not have to decide the question of whether ratification had been effected, because in his view of the facts

¹¹² An injunction was granted initially by Wootten J. (5/8/1975) but this was dissolved by Bowen C.J. in *Equity* (1975) C.C.H. Aust. Company Law Cases 28,327.

¹¹³ See Glass J.A. [1975] 2 N.S.W.L.R. at 671; Samuels J.A., *ibid.* 681 (although he felt that in the context of the case he was not required to consider the issue); Mahoney J.A., *ibid.* 700, 702.

¹¹⁴ *Ibid.* 674:

"[T]he general meeting could validly authorize the board to implement the proposal, notwithstanding that those present were predominantly inspired by the purpose of defeating the takeover. In executing the authority conferred on it, the motivation of the board would be equally immaterial, whether it coincided with that of the shareholders or not. Once the shareholders, consulting their own interests, have decided what the company should do, I do not see that the board is any longer restrained by a fiduciary duty to have regard to those interests."

¹¹⁵ See Glass J.A., *ibid.* His views on the matter were clearly disputed by Samuels J.A., *ibid.* 682-3

"[T]he allotment of shares and the making of contracts are matters for the directors, and not for the shareholders. But there are, no doubt, circumstances in which the shareholders in general meeting may exercise powers vested in the directors."

and

"All these instances are remote from the present situation, and the cases which establish them do not authorize the resolutions in suit as the product of some general supervisory power in the general meeting. No such power exists. The shareholders may have ultimate control, because they can alter the articles or remove the directors; but they cannot interfere in the conduct of the company's business where management, as here, is vested in the board. The general meeting has power to intervene to resolve a deadlock, other than one produced by the application of power secured by the articles . . . which prevents the company's business from being carried on at all; and it has power to ratify an act of the directors done in breach of their duty, or to authorize the doing of an act which would be in breach of duty. In each of the last two cases the shareholders are waiving their right to object or avoid. . . . But they have no general power to transact the company's business, or to give effective directions about its management. As Jordan C.J. said in *Clijfton v. Mount Morgan Ltd* ((1940) 40 S.R. (N.S.W.) 31, at p. 44; 57 W.N. 35): 'But there is no universal rule that shareholders in general meeting may by ordinary resolution bind or represent the company with respect to anything and everything.'"

Cf. Mahoney J.A., *ibid.* 706-7.

no breach of duty had occurred.¹¹⁶ He was of the view that ratification as enunciated by *Bamford v. Bamford* was possible,¹¹⁷ but did not have to decide that issue in this case. Recognizing the need for full and meaningful disclosure in such a context, he felt that the directors had not provided same in this instance.¹¹⁸ Samuels J.A. left the reader tantalizingly up in the air on the issue of ratification on the hypothetical issues.¹¹⁹ However, in reading between the lines, I suggest that he would support the proposition that with full disclosure prospective ratification was possible.¹²⁰

Mahoney J.A. was not so reluctant to express an opinion, although again his statements were by way of dicta. He agreed with the proposition that the power to affirm voidable transactions of the kind in question was vested in the company (i.e. the shareholders) and that any restrictions placed on that power would have to be clearly shown.¹²¹ He further noted that because the shareholders in general meeting had the power, and could be shown to be willing to exercise such a power to ratify breaches of duty once they had occurred, he was of the view that, in anticipation of a breach they could approve a proposed course of conduct which on its face would amount to a breach of duty. His comments are worthy of note.¹²²

"It was argued for the defendants that what occurred in the present case was that the directors, having the exclusive power under the articles of Winns to cause the company to enter into the proposed transaction, had transferred the exercise of that power to the shareholders in general meeting; . . . [b]ut, whether it would be open to the directors so to do, this is not what, in form, the resolutions suggest: they do not purport to be the exercise by the shareholders of the particular power, but the approval by the shareholders of the company entering into the transaction, presumably by its proper organ, the directors. . . .

The significance of the resolutions . . . was, in my opinion, this. The shareholders in general meeting had expressed an approval of the proposed transaction which would (let it be assumed) have, as such, no operative effect in respect of the transaction when it was carried into effect by the making of specific contracts. From the expression of the wishes of the shareholders in general meeting, a judge would be entitled to infer, for the purposes of such an interlocutory application, that it was probable or, perhaps, a practical certainty, that, once the contracts had been entered into, the shareholders in general meeting would pass such resolutions as would be necessary to render such

¹¹⁶ *Ibid.* 681

"But in the present case the directors had merely decided to act in the future; at the time of the general meeting they had not done the act upon which they had determined. They had not, therefore, committed any act in breach of their duty. So, in the strict sense, there was nothing to ratify. If the power of the shareholders was confined to ratification of an act already done, that power was not exercisable for want of appropriate subject-matter."

¹¹⁷ *Ibid.*

¹¹⁸ *Ibid.* 684-5.

¹¹⁹ *Ibid.* 685.

¹²⁰ There are scattered suggestions to this effect e.g. *ibid.* 680, 681, 685.

¹²¹ *Ibid.* 699.

¹²² *Ibid.* 703-4.

contracts valid and not voidable. If, after the contracts had been entered into, they had done so, then the contracts would be unassailable by Winthrop upon the grounds here relevant."

He argued, however, that there had not been proper disclosure in this case.¹²³

On balance, it seems that at least a majority of the Court was prepared to accept the view that ratification in advance was possible, whilst Samuels J.A. was probably of that view as well. In doing so, they clearly accepted the proposition put forward by Lord Russell in *Regal Hastings v. Gulliver*,¹²⁴ and by the High Court in *Furs Ltd v. Tomkies*.¹²⁵ Speaking in an area of the law that has caused more difficulty—i.e. the taking by corporate directors of an opportunity that was available to the company but could not be taken up by the company—Lord Russell noted in the English case that the directors could in anticipation of their conduct approach the company in general meeting and obtain approval.¹²⁶ If that is the correct position with respect to the more stringent duty of directors not to compete, or to allow a conflict of their interest and duty, then such an approach would almost certainly be applicable in the area of the improper use of power. Buckley J. had anticipated that such a view was tenable.¹²⁷ Even earlier than *Regal Hastings*, the High Court had clearly envisaged that a director, acting in good faith, could be given the green light to take a share of corporate property in a situation where the company would not be seriously disadvantaged.¹²⁸

AN INDEPENDENT VOTE?

Assuming that ratification in advance is feasible, the next question is whether the directors who have participated in the improper use of power may vote their own shares at the general meeting. It seems clear in cases such as *Northwest Transportation Company v. Beatty*,¹²⁹ dealing with the sale of a director's asset to the company, that this is a right available to the directors as shareholders, and there appears to be nothing in any of the other cases in this area to negate this approach. Because the directors are shareholders, they hold property which Dixon J. described as giving them significant rights,¹³⁰ and they may exercise their votes in respect of

¹²³ *Ibid.* 705-6.

¹²⁴ [1942] 1 All E.R. 378; [1967] 2 A.C. 134(n).

¹²⁵ (1936) 54 C.L.R. 583.

¹²⁶ "They could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the Regal shareholders in general meeting" [1942] 1 All E.R. 378, 389. Cf. *infra*, p. 45, fn. 195.

¹²⁷ In *Hogg v. Cramphorn Ltd* [1967] Ch. 254, 269

"Had the majority of the company in general meeting approved of the issue of the [relevant] shares before it was made . . . I do not think that any member could have complaints of the issue being made. . . ."

¹²⁸ See *Furs Ltd v. Tomkies* (1936) 54 C.L.R. 583, 599.

¹²⁹ (1887) 12 App. Cas. 589.

¹³⁰ In the *Peters' American Delicacy* case (1938-39), 61 C.L.R. 457, 503-4.

this property in whatever way they feel justified, subject to the general constraints applying to the exercise by the shareholder in general meeting of his right to vote.¹³¹ The only restrictions that have been imposed is where the directors are acting fraudulently or usurping corporate property.¹³² The extent of this qualification with respect to more rigorous duties of the directors not to compete and not to take corporate property are discussed below.

Mahoney J.A. in *Winthrop* did however express some reservations on the validity of the votes cast by the directors in general meeting. He queried whether an exercise by a general meeting of a vote in favour of a course of conduct which amounts to an improper use of power, would be regarded as valid if the resolution by the general meeting could be shown to have been motivated by the same vitiating purpose as held by the directors. In other words, if the shareholders (including the directors exercising their votes) were concerned to defeat a takeover and voted with this purpose in mind, he expressed doubts as to the validity of the resolution.

"It is established that resolutions of shareholders in general meeting would not be effective . . . if the purpose of the majority of the meeting was otherwise than for the purposes of the company as a whole [(see *Ngurli Ltd v. McCann*)].¹³³ It has not yet been settled whether, if the purpose of that majority be that which the directors are here assumed to have, viz. the defeating of the *Winthrop* takeover, that will be an improper purpose of that majority within the principles adverted to in *Ngurli Ltd v. McCann*. *Bamford v. Bamford* decides that, in an exercise by the shareholders of the power of the company to avoid a transaction voidable on that ground, a resolution may be valid to affirm the transaction; it decides, as I have previously pointed out, nothing as to whether the resolution may be ineffective, because the majority have the same purpose."¹³⁴

The other judgments are unfortunately less helpful. Samuels J.A. did not express a view on this issue, saying that the matter was yet to be

¹³¹ Cf. Gower, *op. cit.* 562-4.

¹³² As e.g. in *Menier v. Hooper's Telegraph Works* (1874) L.R. 9 Ch. App. 350 (a clear case of fraud); e.g. *Cook v. Deeks* [1916] 1 A.C. 554; cf. *Daniels v. Daniels* [1978] 2 W.L.R. 73, and *Canada Safeway Ltd v. Thompson* [1951] 3 D.L.R. 295 (taking corporate property).

¹³³ [1975] 2 N.S.W.L.R. 666, 707.

¹³⁴ (1953) 90 C.L.R. 425. In this case the High Court affirmed the right of a minority shareholder to challenge an issue of shares in a situation in which it appeared that the issue would have been ratified by the majority. The company was a small family company. See 90 C.L.R. 438-9 where the Court noted

"Voting powers conferred on shareholders and powers conferred on directors by the articles of association of companies must be used bona fide for the benefit of the company as a whole. . . . The court is more ready to interfere in the second [the case of directors] than it is in the first instance [the case of the company in general meeting]. Shareholders even where they are also directors are not trustees of their votes and as individuals in general meetings can usually exercise their votes for their own benefit. But there is a limit even in general meetings to the extent to which the majority may exercise their votes

argued.¹³⁵ Glass J.A. appeared to have little doubt that the resolution would have been effective.¹³⁶

The doubts expressed by Mahoney J.A. raised directly the possibility of the operation of the rule in *Foss v. Harbottle*¹³⁷ in this context. If the company in general meeting could vote to ratify a course of conduct that amounted to a breach of duty by the directors, and that resolution was also tainted because it was in breach of the obligation owed by the majority to the company as a whole, would there be a remedy for minority shareholders? If the case came within the principles enunciated in *Ngurli Ltd v. McCann*,¹³⁸ there could be little doubt that there would be; but the great difficulty arises in trying to pin the acts of the shareholders down with some certainty so as to give rise to the operation of this rule.

I welcome the doubts expressed by Mahoney J.A. because in my view, as is clearly expressed in *Ngurli Ltd v. McCann*, the minority shareholder in such a case should still have standing.^{138a} But let us look briefly at the difficulties that arise in employing his "test". Can it be assumed that directors who voted at that meeting have been motivated by the same purposes as motivated their actions as directors? There are many statements in the cases which indicate the "sacredness" of the shareholder's right to exercise his vote unfettered by his directorial garments. Latham C.J. was most unequivocal in his comments;¹³⁹ Dixon J. is clearly of the same view¹⁴⁰ and statements in *Hogg*,¹⁴¹ *Bamford*¹⁴² and *Ampol*¹⁴³ support such an approach. In the *N.C. Steeple* case¹⁴⁴ there was an interesting illustration of this theory, even though it does not deal directly with the subject matter under discussion.

for their own benefit. That limit is expressed in the classic passage from the judgment of Lindley M.R. in *Allen v. Gold Reefs of West Africa* ([1900] 1 Ch. 656, at p. 671). The power of a three-fourths majority to alter the articles of association must, Lord Lindley said, 'like all other 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.' . . . Nor can the majority of shareholders exercise their voting power in general meeting so as to commit a fraud on the minority. They must not exercise their votes so as to appropriate to themselves or some of themselves property, advantages or rights which belong to the company."

Cf. *Millers (Invercargill) Ltd v. Maddams* [1938] N.Z.L.R. 490.

¹³⁵ [1975] 2 N.S.W.L.R. 666, 685.

¹³⁶ *Ibid.* 673-4.

¹³⁷ (1843) 2 Hare 461; see Thomson, *supra*, fn. 106.

¹³⁸ See the quotation set out *supra*, fn. 34, and note also *Nash v. Lancegaye Safety Glass Ltd* (1956) 92 Ir. L.T.R. 11.

^{138a} This question is discussed further in Thomson, *supra*, fn. 106.

¹³⁹ Both in *Peters' American Delicacy Co. Ltd v. Heath* (1938-39) 61 C.L.R. 457, 481-2 and in *Mills v. Mills* (1938) 60 C.L.R. 150 (*supra*, p. 30).

¹⁴⁰ *Supra* pp. 29-30.

¹⁴¹ [1967] Ch. 254, 268.

¹⁴² [1970] Ch. 212, 238.

¹⁴³ [1974] 1 All E.R. 1126, 1136.

¹⁴⁴ *Northern Counties Securities Ltd v. Jackson & Steeple Ltd* [1974] 2 All E.R. 625.

The plaintiffs agreed with the defendant company that they would deliver to the defendant executed transfers of certain shares, in return for which the company would make an issue of shares in favour of the plaintiff and take steps to have these shares listed for quotation on the London Stock Exchange. The directors of the defendant company failed to "complete" their (or rather the company's) part of the bargain. A meeting of shareholders was called to pass certain resolutions to ensure listing of the relevant securities; the directors did not recommend the motions which would have helped implement the agreement referred to earlier; they did not solicit proxies in favour of the motions and advised shareholders they were free to vote as they wished, using counsel's opinion to support this stand. The meeting was enjoined at the application of the plaintiff because of breaches of court undertakings given earlier by the company, but an order seeking a declaration that the directors must vote their shares in favour of the resolutions was rejected, Walton J. noting¹⁴⁵

"[A] shareholder in a company may have more than one capacity, and . . . in each capacity he is entitled to act as necessitated by such capacity, [and this] appears to me to be fully consistent with my view that in relation to the matters here in question, a director who is, as a director, bound to take one course, may as an individual shareholder take quite another."

One of the reasons for the failure of the resolutions in *Winthrop* was the fact that there had been inadequate disclosure to the shareholders with respect to the motives of the directors. The majority held that it had not been made clear to the shareholders that the directors in recommending the sale/exchange were acting for an improper purpose, and that this was a matter that they were to consider in deciding whether to validate their conduct.¹⁴⁶ But assuming that such a disclosure had been made, would this

¹⁴⁵ *Ibid.* 637-8. He also made the following comments which are in line with the statement of Latham C.J. quoted *supra* p. 30.

"When a director votes as a director for or against any particular resolution in a directors' meeting, he is voting as a person under a fiduciary duty to the company. . . . When a shareholder is voting for or against a particular resolution he is voting as a person owing no fiduciary duty to the company who is exercising his own right of property to vote as he thinks fit."

[1974] 2 All E.R. 625, 635.

¹⁴⁶ There was no duty on the part of Winthrops (the appellants) to rectify the non-disclosure. The directors had simply failed to emphasize the nature of their "duty" and its potential breach in the context of the case. Note the following comments by Samuels J.A. [1975] 2 N.S.W.L.R. 666, 684

"As I have endeavoured to show, there was no question of the shareholders merely offering advice to the directors, or of their simply weighing up whether the proposed transaction was or was not in the commercial interests of the company. If the resolutions go no further than this, then the competing assertions of the adversaries may well have put the shareholders in possession of the material facts. . . . But, if the directors are to get the protection which they seek, the resolutions must reach well beyond any question of commercial interest. They are ineffective, unless they can be regarded as having authorized a breach of duty, or as having waived its consequences. I would myself have thought it clear beyond argument that, the purpose of the meeting being to

not immediately colour the actions taken by the shareholders (including the directors) in approving the resolution? After all, if they were aware that the directors were using their powers to defeat a takeover, what are the possible reasons which might have been considered by the shareholders in approving the directors' course of action? One reason may have been to ensure that the takeover was defeated and to support their directors; another to retain the status quo. Others may have involved financial considerations. They may have been other personal reasons as well. How is the court to evaluate which of the reasons were predominant in the minds of individual shareholders when we are considering the vote of the body at large? Unless the court had irrefutable evidence that the shareholders comprised only the directors concerned, e.g. as in *Cook v. Deeks*,¹⁴⁷ or that it was quite clear that they were exercising their vote for the purpose of defeating the takeover, the questions raised by Mahoney J.A. are extremely difficult ones.

It would be better, in my view, to require an independent group of shareholders to ratify the transaction. We would reduce to a minimum questions of motives of the shareholders, and consider whether there has been a fraud on the minority or some form of oppression.¹⁴⁸ Whilst this in itself is an extremely difficult matter to ascertain under any circumstances in cases involving public companies with a wide range of shareholders (as witness the decided cases), to require proof of motive on the part of a "mixed" group of shareholders when a takeover is involved with so many issues that may be relevant to the minds of individual shareholders, is to impose a greater burden on the complainant and the court. The approach taken in some jurisdictions in the U.S.A., is to require not only an independent vote but to prohibit (in certain circumstances) the solicitation of proxies by directors.¹⁴⁹ This approach, even if it appears to cut back the constitutional rights of shareholders, does so only marginally.¹⁵⁰

Where there are different classes of shareholders involved and one group is to benefit more from a particular course of action than another, this would be a case in which the courts would have some guidance as to how

excuse the directors, that purpose must have been clearly stated, and the nature of the contemplated breach of duty clearly disclosed by the directors seeking to be absolved."

Cf. *Re Marra Developments Ltd* (1976) 1 A.C.L.R. 470.

¹⁴⁷ [1916] 1 A.C. 554; *infra* pp. 46-7.

¹⁴⁸ As enunciated for example, in *Peters' American Delicacy Co. Ltd v. Heath* (1938-39) 61 C.L.R. 457 although even here motives can come up in varying degrees of difficulty—e.g. *Clemens v. Clemens & Ors* [1976] 1 All E.R. 268.

¹⁴⁹ See e.g. *Claman v. Robertson* 128 N.E. 2d 429 (1955) (Ohio Sup. Ct.).

¹⁵⁰ In the Australian context where proxy solicitation is very much in the control of directors—see p. 19, fns. 16, 17, *supra*. In the U.S.A. the courts would be more reluctant to impose such restrictions because of the policing of proxy solicitation material. Cf. *Henn, op. cit.* 380.

to treat the matter.¹⁵¹ The controllers may be enjoined if it seems clear that they are obtaining a better deal or if they act in a way which clearly discriminates in their favour.¹⁵² In U.S. cases¹⁵³ it has been suggested that actions on the part of the directors which are voidable—for example a contract in which the directors are personally interested and which has not been fully disclosed to the company—may be affirmed by the company in general meeting providing there is a disinterested majority and there is no fraud committed on the minority.¹⁵⁴ Full disclosure would be required.

Our courts could require independent ratification of breaches of duty involving improper use of power as they do with other duties discussed below, by requiring an independent majority to be present when the particular vote is to be taken. In this regard, we would support the principle that underlies the cases dealing with variation of class rights¹⁵⁵ and approval of schemes of arrangement.¹⁵⁶ Here the courts require separate classes of shareholders or creditors respectively to be convened for the purposes of determining the appropriate resolution. The courts have recognized the difficulty of permitting larger meetings to be held where shareholders or creditors may have interests which affect them in different capacities.¹⁵⁷

Megarry J. outlined the difficulty and the dilemma in these cases in *Re Holders Investment Trust Ltd.*¹⁵⁸ A scheme for the reduction of capital had to be confirmed by shareholders pursuant to the *Companies Act*.¹⁵⁹ Separate meetings of different classes of shareholders were required. The holder of the largest parcel of ordinary shares also held a substantial portion of preference shares, and was able to influence the vote of preference shareholders whose interests were different from those of the

¹⁵¹ See e.g. *Peters' American Delicacy Co. Ltd v. Heath*, *supra* fn. 46, where there were fully paid and partly paid shareholders involved in a restructuring of corporate capital and *Mills v. Mills* (1938) 60 C.L.R. 150, where the court had to balance the interests of preference and ordinary shareholders (*inter alia*).

¹⁵² See e.g. *In Re Fowlers Vacola Manufacturing Co. Ltd* [1966] V.R. 97 where the court rejected a reduction of capital because the preference shareholders had not been independently canvassed; but by and large the rights of such shareholders are usually regarded as subservient to ordinary shareholders—e.g. *Mills v. Mills*, *supra* fn. 151, and see R. Baxt, "The Rights of Preference Shareholders—Reality or Mirage" (1969-70) 9 *U.W.A.L.R.* 146; M. A. Pickering, "The Problem of the Preference Share" (1963) 26 *M.L.R.* 499.

¹⁵³ The list of cases is large—see Henn, *op. cit.* pp. 379-81.

¹⁵⁴ One good example of this is *Brownstein v. Devine* 337 Mass. 408 (1958) (Mass. Sup. Ct.)—see also *Alcott v. Hyman* 208 A. 2d 501 (1965) (U.S.A. Supreme Court) although the issues were not clearly on point in the latter case.

¹⁵⁵ Pursuant to section 65 of *U.C.A.* i.e. that a separate meeting of shareholders of different classes be called for the purposes of determining issues affecting their rights and other aspects. See e.g. R. Baxt, "The Variation of Class Rights" (1968) 41 *A.L.J.* 490; Gower, *op. cit.* 506-14; Ford, *op. cit.* 177-83.

¹⁵⁶ See ss. 181-3 of *U.C.A.* See e.g. comment of Adam J. *In The Matter of Chevron (Sydney) Ltd* [1963] V.R. 249.

¹⁵⁷ See in particular comments of Street J. in *Re Landmark Corporation Ltd* [1968] 1 N.S.W.R. 759, 765, 767. Here the interests of the creditors were conflicting and the scheme was disapproved.

¹⁵⁸ [1971] 2 All E.R. 289.

¹⁵⁹ Cf. s. 64 of *U.C.A.*

ordinary shareholders. Megarry J. recognized that the beneficial owners of shares may concentrate on their own personal interests, and the shareholders may be under a duty to do the best for all those belonging to the relevant group—e.g. a trustee acting for his beneficiaries. But at the same time those interests may be very different from those of other members in the class. In the circumstances, it was important that separate meetings or at least separate considerations be taken into account by the relevant shareholders of the company when acting in different capacities or where considering different classes of shares. Megarry J. held that the reduction of capital could not be confirmed in this particular instance.¹⁶⁰

Let me add a final note on the possibility of ratification of the breach of the statutory duty imposed on directors. Section 124(1) requires directors to act honestly in addition to acting with care and skill. In *Marchesi v. Barnes and Keogh*,¹⁶¹ Gowans J. assumed that the section covered the general duty of a director to act in good faith in the best interests of the company. If a charge was brought under section 124(1) where directors were issuing shares for an improper purpose, then the common law interpretation of that duty as enunciated in cases such as *Hogg v. Cramphorn Ltd*¹⁶² and *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Company N.L.*¹⁶³ would be applied. Does this mean that we now have a situation, as with the duty to act with due care and skill,¹⁶⁴ where there is a breach which could not be relieved by the courts under s. 365 of the U.C.A.¹⁶⁵ and yet breach of that duty may be relieved by the company in general meeting? Even if the company in general meeting did ratify the course of conduct of the directors, would not a prosecution under section 124(1) still be available? And if that is so, we are faced with the strange situation of the court not being able to excuse a course of conduct which has already been excused by the company in general meeting! The fact that no prosecution may be brought would seem to be irrelevant to the overall questions. Some clarification of this issue is required.

2. Contracting with the Company

The duty of a director not to allow a conflict between his personal interest and his duties to act in good faith have clearly been enunciated many times. The classic exposition is in the case of *Aberdeen Railway Co. v. Blaikie*¹⁶⁶ in which Lord Cranworth stated¹⁶⁷

¹⁶⁰ [1971] 2 All E.R. 289.

¹⁶¹ [1970] V.R. 434; a charge was brought against directors for issuing shares for an improper purpose.

¹⁶² [1967] Ch. 254.

¹⁶³ (1968) 42 A.L.J.R. 123.

¹⁶⁴ *Supra* pp. 23-6.

¹⁶⁵ Cf. *Lawson v. Mitchell* [1975] V.R. 579 discussed *supra* pp. 26-8.

¹⁶⁶ (1854) 1 Macq. 461.

¹⁶⁷ *Ibid.* 471.

"A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect.

So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. . . .

It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee have been as good as could have been obtained from any other person—they may even at the time have been better. But still so inflexible is the rule that no inquiry on that subject is permitted."

Statutory intervention has led to a modification of this rule. Section 123 and the articles of association¹⁶⁸ permit directors to contract with the company provided disclosure is made. However, section 123 and the articles would appear to be in addition to and not in derogation of the common law¹⁶⁹ and should disclosure by the director of his interest in the contract be unsatisfactory, even if not fraudulent, the shareholders still have the option of avoiding the contract.¹⁷⁰ The section merely requires directors to disclose information by declaring their interest in material contracts; and as noted in the case of *Castlereagh Motels Ltd v. Davies-Roe*,¹⁷¹ the action available to the company for a breach of this general duty not to allow conflict is a common law one. Section 123 creates an additional duty punishable by law.¹⁷²

Any contract entered into in such a case is voidable.¹⁷³ Being a voidable contract, it is clear that the company in general meeting could vote to ratify the relevant transaction.¹⁷⁴ The clearest example of this is the classic decision in *N.W. Transportation Company Ltd v. Beatty*¹⁷⁵ where it was noted¹⁷⁶

¹⁶⁸ E.g. Article 81 of Table A of Fourth Schedule and note *Transvaal Lands Co. v. New Belgium (Transvaal) Land and Development Co.* [1914] 2 Ch. 488.

¹⁶⁹ See *Castlereagh Motels Ltd v. Davies—Roe Motel Narrandera Pty Ltd* [1966] 2 N.S.W.R. 79.

¹⁷⁰ The contract is voidable at common law see *Hely Hutchinson Ltd v. Brayhead Ltd* [1967] 3 All E.R. 98, and whilst section 123 may not be used to avoid the contract (*Castlereagh Motels, supra* fn. 169) the shareholders no doubt still can challenge the contract (e.g. *Transvaal*, fn. 168, *supra*).

¹⁷¹ *Supra* fn. 169.

¹⁷² See s. 123(5).

¹⁷³ Not void as has been suggested in argument before the Court of Appeal for example in *Hely Hutchinson, supra* fn. 170.

¹⁷⁴ Cf. Gower, *op. cit.* 566-7.

¹⁷⁵ (1887) 12 App. Cas. 589.

¹⁷⁶ *Ibid.* 593-4. In this case the ratification was by a vote of 306 to 289 but of the 306 affirmative votes, 291 were cast by the director whose contract was being affirmed. But contrast the language of Ritchie C.J. in the Supreme Court of Canada

"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 other 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 any such 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 of a company is precluded from dealing, on 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. . . ."

Most articles of association prevent the director from voting at a board meeting at which the board of directors is given power to ratify contracts on behalf of the company.¹⁷⁷ Would the director in the appropriate case have power to vote his shares where ratification is sought in the general meeting?¹⁷⁸ In such a case it would appear strange to disallow his vote in one capacity and permit it in another, yet the director is acting in a different capacity which has been recognized by the courts as giving this freedom.

The questions of disclosure both at the directors' level and at the level of the general meeting would seem to be vital. However, until there is a direct rejection by statute or by a court of suitable jurisdiction of the principle in *Northwest Transportation Company v. Beatty*, it would seem clear that provided the interested director acts honestly and makes disclosure to the company he may exercise his vote in seeking ratification of the relevant contract. In such a case, unless it can be shown that there is fraud or oppression, the minority shareholder will have no cause to complain and no standing in the courts.¹⁷⁹ In the U.S.A., an independent majority is required at the general meeting where ratification is sought.¹⁸⁰

"[F]air play and commonsense alike dictate that if the transaction and act of the director are to be confirmed it should be by the impartial, independent and intelligent judgment of the disinterested shareholders." (1887) 12 S.C.R. 598, 604.

¹⁷⁷ See Article 81 of Table A of Fourth Schedule. Contrast e.g. the article in *Hely Hutchinson*, *supra* fn. 170.

¹⁷⁸ If *Beatty's* case, *supra* fn. 175, is any authority, they certainly do have this power.

¹⁷⁹ Fraud was originally suggested as a basis of the faction in *Beatty's* case but this was not pleaded in the case. Cf. F. H. Buckley, "Ratification and the Derivative Action under the Ontario Business Corporations Act" (1976) 22 *McGill L.J.* 167, 195-6.

¹⁸⁰ See *Henn*, *op. cit.* 469-70 and note *Remillard Bri-k Co. v. Remillard Dandini Co.* 241 P. 2d 66 (1952) where fairness in the price of the item sold to the company was still required.

3. Usurpation of Corporate Property and Opportunity¹⁸¹

An area which has created concern on this issue of ratification, because of certain statements made, in passing, by the House of Lords,¹⁸² and also by the High Court of Australia,¹⁸³ is the question of whether directors may seek ratification or confirmation where there is expropriation of corporate assets. The cases appear to divide themselves into two groups. First, ones in which the directors have either fraudulently or oppressively diverted to themselves property which in law or in equity belonged to the company. Remedies have been available to minority shareholders in these cases at common law¹⁸⁴ or pursuant to statute.¹⁸⁵

The other, more difficult, group involve situations in which directors take up an opportunity which the corporation either cannot or will not take up itself. It is in this latter group that much of the difficulty on the issue of ratification arises.¹⁸⁶

The law regards attempts by directors to expropriate corporate assets as being a breach of their duty to the company and a situation of where a minority shareholder can bring an action on behalf of the company as an exception to the rule in *Foss v. Harbottle*.¹⁸⁷ This was the situation in *Menier v. Hooper's Telegraph Works*¹⁸⁸ in which the European South American Telegraph Company had been formed to lay a transatlantic line. A licence was necessary, but one of the company's directors obtained it in his own name and organized a second company to exploit it for which services he received a payment. An action was brought by the company against the director; an appeal against the failure to obtain an injunction was considered, but the company passed a resolution with the aid of the majority votes of the defendant (in cahoots with the relevant director) to abandon his appeal. Later, the company was wound up. The court held that the diversion of the licence and side payment amounted to a sale of corporate assets for the benefit of the defendant and that the abandonment of the action was unfair; and the minority shareholder would have the standing to complain of the conduct. If this right was disallowed on the basis of *Foss v. Harbottle*,¹⁸⁹ "the majority might divide the whole of the assets" among themselves. This principle has been followed in recent cases

¹⁸¹ I have "lumped" these two together although it will be seen that there have been attempts by the courts to differentiate the two duties on the scope of ratification. In my view such a classification is not justified, and whilst supported by cases such as *Regal (Hastings) Ltd v. Gulliver* [1942] 1 All E.R. 378, the distinction is in my view unreasonable. I shall attempt to show why in the context of the cases.

¹⁸² *Regal (Hastings) Ltd v. Gulliver*, *supra* fn. 181.

¹⁸³ *Furs Ltd v. Tomkies* (1936) 54 C.L.R. 583.

¹⁸⁴ See e.g. *Cook v. Deeks* [1916] 1 A.C. 554.

¹⁸⁵ See s. 186 of *U.C.A.* and *Re Bright Pine Mills Pty Ltd* [1969] V.R. 1002.

¹⁸⁶ Cf. Buckley, *supra* fn. 179, pp. 185-8.

¹⁸⁷ (1843) 2 Hare 461; even if the diversion is not really damaging to the company—see *Daniels v. Daniels* [1978] 2 W.L.R. 73, 79.

¹⁸⁸ (1874) L.R. 9 Ch. App. 350; see also *Lister & Co. v. Stubbs* (1890) 45 Ch.D. 1.

¹⁸⁹ (1843) 2 Hare 461.

and confirmed in the classic decision of *Cook v. Deeks*.¹⁹⁰ A different remedy was given, but the same principle was applied in *Re Bright Pine Mills Ltd*.¹⁹¹

In the House of Lords case of *Regal (Hastings) Ltd v. Gulliver*,¹⁹² whilst directors were held to be in breach of duty in circumstances where they benefited personally as a result of the company's financial inability to take up shares in a subsidiary, they were nevertheless advised their conduct was ratifiable either in advance or at a later stage.¹⁹³

Lord Russell's comment that ratification was possible had been a most troublesome statement in corporate jurisprudence; but it is matched by the similar and earlier comments made by the judgments of Rich, Dixon and Evatt JJ. in *Furs Ltd v. Tomkies*.¹⁹⁴

In that case, the defendant was the managing director of the plaintiff company and had particular expertise in dyeing and tanning processes. The company wished to sell that part of its business, and instructed the managing director to obtain the best possible price for it. The board of directors also suggested that the defendant look after his own interests in whatever way he could. Tomkies managed to find a buyer for the business but the purchaser was only prepared to buy that part of the business if Tomkies would come with it. A deal was arranged which resulted in the company receiving less for its assets because Tomkies was also to receive a contract of employment; payment was satisfied by giving him promissory notes and shares.

Furs Ltd sued Tomkies on the basis that he held the shares and the promissory notes in trust for the company. The High Court affirmed Tomkies' liability. It held that it was not possible for the board of directors to give Tomkies the go-ahead to make a contract for himself if this would result in the company receiving less for its assets.^{194a} However, Tomkies could have "looked after himself" if he had obtained ratification, but his first duty was to the company. Rich, Dixon and Evatt JJ. noted¹⁹⁵

"[T]he board could not relieve him of the equitable obligations which arose of [his] conflict of duty and of [private] interest. His one resource [sic], if he was resolved to adopt the unwise course of acting in the transaction on behalf of his company and yet seeking a profit for himself, was complete disclosure to and confirmation by the shareholders."

He did not wish to do so and he was forced to disgorge the shares and promissory notes held by him.

¹⁹⁰ *Supra* fn. 184; see also *Daniels v. Daniels* discussed pp. 24-5, *supra*.

¹⁹¹ *Supra* fn. 185. The action here was based on the oppression remedy. See discussion, *infra* p. 46.

¹⁹² [1942] 1 All E.R. 378.

¹⁹³ *Ibid.* 389.

¹⁹⁴ (1936) 54 C.L.R. 583.

^{194a} Even though Tomkies was unable to arrange a sale at a higher price.

¹⁹⁵ 54 C.L.R. 583, 599.

In this case, the defendant was said to be able to ratify his conduct even though the company would sustain a "loss" on the deal. This is clearly out of line with cases in which there was no finding of fraud (as in *Cook v. Deeks*) in which the possibility of ratification is very limited. For example, in *Canada Safeway Ltd v. Thompson*¹⁹⁶ the court at first instance held that ratification was virtually restricted to an unanimous vote.¹⁹⁷

"Raley could not buy into Empress without full disclosure to his company and to all its shareholders. In my view, nothing less than a unanimous resolution of its shareholders consenting to the buy after such full disclosure would enable Raley to buy Empress shares without rendering himself liable to account for all profits made on their sale."

Similarly in *Daniels v. Daniels*,¹⁹⁸ although only a case on the question of standing, the intimation is that ratification by the directors who obtain the benefits at the corporation's expense will not succeed.¹⁹⁹

As against this "line" of authority it is clear, if one looks at the line of cases including *Menier*²⁰⁰ and *Cook v. Deeks*,²⁰¹ that no matter how much support the perpetrators of a corporate fraud, or even some lesser misdeed, will obtain at the general meeting at which they seek ratification, the minority shareholder will still be able to bring an action if they are seeking to restrain the taking of corporate property. And in *Cook v. Deeks* the property belonged to the company only in "equity".²⁰²

The decision in *Cook v. Deeks* has been applied by the Supreme Court of Victoria, although on a different basis, in *Re Bright Pine Mills Ltd.*²⁰³ This was an action brought under section 186 of the *Companies Act* charging oppression on the part of the controllers of the company. It was alleged that they had channelled to another company, which they controlled, certain property and other rights that could have been obtained for the Bright Pine Mills Company. The Court held that the conduct of the directors amounted to oppression, a finding that applied to the controlling shareholders, who were pursuing a course of conduct designed

¹⁹⁶ [1951] 3 D.L.R. 295, aff'd [1952] 2 D.L.R. 591.

¹⁹⁷ [1951] 3 D.L.R. 295, 321.

¹⁹⁸ [1978] 2 W.L.R. 73.

¹⁹⁹ *Ibid.* 79-80, see p. 25, *supra*.

²⁰⁰ *Supra* fn. 188.

"Assuming the case to be as alleged . . . then the majority have put something into their pockets at the expense of the minority. If so, it appears to me that the minority have a right to have their share of the benefits ascertained for them in the best way in which the court can do it." (*ibid.* p. 353)

²⁰¹ "It would be quite another thing if the director had originally acquired the property which he sold to his company . . . [as in] *North West Transportation Co. v. Beatty*. . . . If . . . the directors could not retain the benefit [of the contract] for themselves, then it belonged in equity to the company. . . . [I]t appears quite certain that directors holding a majority of votes would not be permitted to make a present [of the contract] to themselves." [1916] 1 A.C. 564.

²⁰² Cf. Gower, *op. cit.* 564. I find this distinction less than helpful in contrasting *Cook v. Deeks* [1916] 1 A.C. 554 with *Regal (Hastings)* [1942] 1 All E.R. 378, see *infra* p. 48.

²⁰³ [1969] V.R. 1002.

by them to advance their own interests or the interests of others to the detriment of the company or to the detriment of other shareholders. The court confirmed the view²⁰⁴ that such persons must refrain from making decisions which would in a sense deprive a minority shareholder or the company from sharing in the profit which would otherwise be available to them.

Various authors have highlighted the difficulties in reconciling the views enumerated in *Cook* and *Regal* (and we can add to that *Furs Ltd*). Gower attempted to distinguish the cases on this basis

"The answer, it is submitted, depends first on the distinction between (a) misappropriating the company's property and (b) merely making an incidental profit for which the directors are liable to account to the company. . . . [A]n incidental profit is not treated as the company's property unless it flows from a use of the company's property. *Cook v. Deeks* clearly came within (a) for it was the duty of the directors to acquire the contracts on behalf of the company. Hence the company in general meeting could not ratify, at any rate if the directors' own votes caused the resolution to be passed. 'Even supposing it be not *ultra vires* of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves.' [*Cook v. Deeks* [1916] 1 A.C. at 364.]"

Gower admits that the onus will be on the directors to show that the contract is for the benefit of the company and this will be difficult. He then goes on to look at the other line of cases.

"On the other hand, in *Regal (Hastings) Ltd v. Gulliver* the directors had not misappropriated any property of the company. Prima facie, therefore, the company could ratify what they had done and enable them to retain the profits. The difficulty, however, is that they had used information coming to them as directors, and, as we have seen, it may be that this is to be regarded as the company's property. If so, the shares which they acquired belonged in equity to the company. However, the present to them of the shares would not necessarily have been improper. Since the company was financially unable to acquire the shares there might have been a bona fide decision of its members that it was in the interests of the company to allow the directors to retain the shares and the profits made from them—especially if the directors refrained from voting. In *Cook v. Deeks* the directors had profited at the company's

²⁰⁴ *Ibid.* 1011

"[C]onduct would be oppressive . . . if directors or shareholders holding a controlling power in the direction of the company's affairs were to pursue a course of conduct designed by them to advance their own interests. See, e.g., *Menier v. Hooper's Telegraph Works* . . . *Northwest Transportation v. Beatty*. . ."

and

"[A] director of a company is obliged at all times to act in the company's affairs in . . . the best interests of the company . . . and to refrain from making decisions . . . in order to divert, what might otherwise be a profitable enterprise to another concern [in which he held] a proprietary interest, the real purpose of his action being to prevent a minority shareholder participating in that profit." [1969] V.R. 1013.

expense; in *Regal* they had profited without harming it in any way. To forbid ratification in the former and to allow it in the latter makes some sense. Moreover, in *Cook v. Deeks*, unlike *Regal*, the directors had broken their duty to act bona fide in the interests of the company. . . ."²⁰⁵

I find such a distinction narrow and, with respect, requiring the courts to engage in a gymnastic analysis where a strict rule should be the *rule* with a few exceptions.²⁰⁶ Wootten J. recognized the need for such a strict rule in *Queensland Mines Ltd v. Hudson*²⁰⁷ after reviewing the most recent cases:

"There constantly runs through the later cases the theme that courts will not burden themselves with the difficult and multitudinous enquiries as to whether a person in a fiduciary position has, in all the circumstances, succumbed to temptation. They simply insist that such a person does not act in a way in which he is exposed to temptation."

His decision was reversed on appeal by the Privy Council²⁰⁸ but, it seems, on the facts. The Court also refused to endorse his general warning on the unwillingness of courts to examine the nature of the alleged abuse, choosing a "common sense" approach.²⁰⁹ The result is that we have seen

²⁰⁵ Gower, *op. cit.* 565-6.

²⁰⁶ See e.g. Laskin J., *Canadian Aero Service Ltd v. O'Malley & Others* (1973) 40 D.L.R. (3d) 371. Laskin J. in referring to *Boardman v. Phipps* [1967] 2 A.C. 46 and *Industrial Development Consultants Ltd v. Cooley* [1972] 2 All E.R. 162 noted (40 D.L.R. 384)

"What these decisions indicate is an updating of the equitable principle whose roots lie in the general standards that I have already mentioned, namely, loyalty, good faith and avoidance of a conflict of duty and self-interest. Strict application against directors and senior management officials is simply recognition of the degree of control which their positions give them in corporate operations, a control which rises above day [sic] accountability to owning shareholders and which comes under some scrutiny only at annual general or at special meetings. It is a necessary supplement, in the public interest, of statutory regulation and accountability which themselves are, at one and the same time, an acknowledgement of the importance of the corporation in the life of the community and of the need to compel obedience by it and by its promoters, directors and managers to norms of exemplary behaviour."

It should be noted however that Laskin J. was not prepared to legislate. He was prepared to accept the view that in some cases the duty would not be regarded as having been breached, but in the context, I would suggest, of a court adjudication. He noted at 391

"The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificity and the director's or managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private, the factor of time in the continuation of fiduciary duty where the alleged breach occurs after termination of the relationship with the company, and the circumstances under which the relationship was terminated, that is whether by retirement or resignation or discharge. . . ."

²⁰⁷ (1977) C.C.H. A.C.L.C., 29,658, 29,685; contrast *Peso Silver Mines Ltd v. Cropper* (1966) 58 D.L.R. (2d) 1.

²⁰⁸ (1978) 18 A.L.R. 1.

²⁰⁹ *Ibid.* at pp. 4-5.

a softening of the almost strict approach in *Boardman v. Phipps*,²¹⁰ but the Privy Council was satisfied that approval had been obtained by Hudson in taking up a lapsed corporate opportunity.

I would still suggest that it is self-defeating to permit variations to the approach suggested by Wootten J. depending on the nature of the disclosure to shareholders, the voting that takes place and other matters. For if we allow ratification, we question the very basis of the rule which applies in these cases.²¹¹

“Whatever the merits of this rule, there is no reason why it should be applied to cases where the taking of a corporate opportunity is being sanctioned. The courts should insist that the directors’ acts be approved by a majority of disinterested shareholders. Nor should the directors be allowed to solicit proxies in support of the ratification. Any director who is truly acting bona fide should not object to, and has nothing to fear from, the votes of his fellows disinterested shareholders. The denial of his shareholder vote to a director would be no more than the application to corporate affairs of the commandment that no man should be seen to be a judge in his own cause.”

If ratification is possible, should it be restricted to an independent body of shareholders as is required in some jurisdictions in the U.S.A.?²¹² Further, should any endorsement be unanimous?²¹³ I would favour both these propositions subject to the court being able to excuse by way of section 365. To permit the directors to vote in their capacity as shareholders raises the questions so vividly canvassed by Mahoney J.A. in *Winthrop Investments*²¹⁴ and the distinctions between *Regal (Hastings)* and *Cook v. Deeks* which I believe do not merit the painstaking analysis attempted.

RATIFICATION AND THE REMEDIES OF MINORITY SHAREHOLDERS

The courts have always been reluctant to delve into questions involving the justification of decisions by directors²¹⁵ and the company’s general meetings.²¹⁶ But to ignore the difficulties thrown up by cases involving “self-forgiveness” by the committers of breaches of duty, no matter how bona fide they may have been, in either their acts of commission (or

²¹⁰ See fn. 206 *supra*.

²¹¹ S. M. Beck, “The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered” (1971) 49 *Can. Bar Rev.* 80, 119.

²¹² See *Blaman v. Robertson* 128 N.E. 2d 429 (1955) (Ohio Sup. Ct.); *Mayer v. Adams* 141 A. 2d 458 (1958) (Delaware Supreme Court). See Henn, *op. cit.* 379-81 and Beck, *op. cit.* 119 for a review of U.S. authorities.

²¹³ As is suggested in *Cook v. Deeks*, *supra* fn. 202, *Canada Safeway Ltd v. Thompson* [1951] 3 D.L.R. 295, and by Ritchie C.J. in *Beatty's case* (1887) 12 S.C.R. 598, 604 (compare p. 42, fn. 176).

²¹⁴ [1975] 2 N.S.W.L.R. 666.

²¹⁵ See e.g. Gower, *op. cit.* 524-5.

²¹⁶ *Ibid.* 562-4.

omission) or in their acts of forgiveness, is to place impossible hurdles in the way of the complaining minority shareholder. Rather than deny themselves this exercise of discretion, the courts could impose certain "constraints" on the exercise of the ratification process.

An independent vote could be demanded, as has been the case in the U.S.A.²¹⁷ What is meant by independence in this context may vary from case to case. Whilst recognizing the force of Mahoney J.A.'s comments in *Winthrop Investments*²¹⁸ referred to earlier, I feel the issue of motive which he retains in his text raises immense difficulties as I have pointed out before.²¹⁹ To overcome at least some of these difficulties one could require separate meetings of different "groups" within the class of shareholders involved as suggested above in the context of the *Holders Investment Trust* case.²²⁰ I feel the analogy can be usefully made to cases involving class rights.

Whilst the cases involving schemes and reductions of capital are governed by statutory rules as to the holding of separate meetings,²²¹ the general principles of law that apply in analyzing the manner in which the votes were cast at the relevant meetings are the same as those applying in deciding if there is, for example, a fraud on the minority.²²² It seems clear to the writer that directors who seek to obtain ratification of their own acts may well be considered as representing a separate class of shareholders from those who will otherwise vote in favour of their course of conduct and should perhaps be disqualified from voting in all cases.

Even if we accept such an approach there are other problems involved in requiring an independent vote. We should ensure that solicitation of proxies is either *not* allowed by the "sinners", or that it is carefully supervised. In the absence of any machinery to supervise this exercise in other areas,²²³ perhaps we should simply allow the courts to evaluate the information disseminated with the ability to enjoin any meeting in the corporate case.²²⁴

To deny the directors their right to solicit proxies may be too great a jump to take except in the rarest of cases.²²⁵ When one is suggesting that the directors be disqualified from voting in situations involving ratifiable

²¹⁷ And for example in *Canada Safeway Ltd v. Thompson*, *supra* fn. 213.

²¹⁸ It is clear that these comments, although applying to an improper use of powers, merit consideration in other areas where ratification must be by way of voting by shareholders in general meeting.

²¹⁹ *Supra* p. 37.

²²⁰ [1971] 2 All E.R. 282 see p. 40, *supra*.

²²¹ *Supra* pp. 40-1.

²²² E.g. *Peters' American Delicacy Co. Ltd v. Heath* (1938-39) 61 C.L.R. 457.

²²³ See discussion *supra* p. 40 and footnotes at accompanying text.

²²⁴ As in the *Marra Development* case—see p. 18, fn. 13, *supra*.

²²⁵ The obvious case is the usurpation of corporate property. But it may be asked why not permit the director the right to distribute relevant material and encourage, in the context of the serious nature of the acts being ratified, personal attendance by shareholders or the supervision of the proxy material by the Corporate Affairs Commission, at the company's expense.

acts, one finds regrettably that there is little support for the view that an independent vote be taken.

I can find few pertinent references to the possible disqualification of directors voting in such a context. James L.J., in *Mason v. Harris*,²²⁶ noted

"It has been suggested that the Court has some means of directing a meeting to be called in which the corrupt shareholder shall not be able to vote. If the Court had any such power that mode of proceeding might furnish the best remedy in cases of this nature, but I cannot see how any directions for holding such a meeting could be given."

Manson J. did not have this difficulty in *Canada Safeway*.²²⁷ It is a pity that the variation of rights and scheme of arrangement cases were not argued, for they may have supported such an approach.

An alternative approach is to set down certain percentages which may be required at meetings where ratification is sought, ranging from a simple majority (independent) in cases involving a bona fide breach of duty (such as the improper issue of shares) and negligence, to an unanimous vote of independent shareholders in a situation such as *Cook v. Deeks*,²²⁸ with a special resolution being required in other cases.²²⁹

But even this approach still leaves one basic question unanswered (except in the case of unanimous consent): what if a shareholder still objects and wishes to bring proceedings? And what if a shareholder changes his mind?²³⁰

At the moment the position appears to be as follows in so far as the minority shareholder is concerned. If fraud or oppression is found to exist, or if disclosure has not been meaningful, the court will entertain an action in the appropriate case.²³¹ Mahoney J.A. suggests that even in the absence of fraud or oppression the court should at least hear what the shareholder

²²⁶ (1879) 11 Ch.D. 97, 109.

²²⁷ [1951] 3 D.L.R. 295, 321; see also *Beatty's* case in the Supreme Court of Canada 12 S.C.R. 598, 604.

²²⁸ And of course if we are dealing with worse situations such as *Menier* (1874) L.R. 9 Ch. App. 350, it would be easier to treat the usurpation of corporate opportunity cases as coming within this category in the light of the analysis in *Boardman v. Phipps* and *Queensland Mining*, *supra* fns. 206, 207. Compare the treatment of this area by S. M. Beck, "The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered" (1971) 49 *Can. Bar Rev.* 80, and "The Quickening of Fiduciary Obligation" (1975) 53 *Can. Bar Rev.* 771, with G. Jones, "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84 *L.Q.R.* 472. See also A. J. McClean, "The Theoretical Basis of the Trustee's Duty of Loyalty" (1969) 7 *Alberta L.R.* 218.

²²⁹ A special resolution is required to amend articles of association and I would include cases involving contracts with a company as within this category. Perhaps, as in the case with respect to amendment of articles, in certain Canadian jurisdiction, a two-thirds majority could be introduced for such cases. This would fit in with the operation of certain aspects of the rule in *Foss v. Harbottle* as well.

²³⁰ In the U.S.A. a shareholder who changed his mind would not have standing—see *Henn*, *op. cit.* 469-70.

²³¹ As an exception to the rule in *Foss v. Harbottle*—see *Gower*, *op. cit.* K. W. Wedderburn, "The Rule in *Foss v. Harbottle*" [1957] *Camb. L.J.* 194, [1958] *Camb. L.J.* 93.

has to say about the motives of the ratifying majority (a difficult task even in the best of cases).²³² Fraud on the minority, that classic exception to the rule in *Foss v. Harbottle*,²³³ may be a barren plot from which the minority shareholder can seek some succour; but the rather nebulous exception entitled "where justice requires"²³⁴ may be a fertile area if cases such as *Clements v. Clements & Others*²³⁵ are of any authority.

In that case the majority shareholder (controlling 65% of the votes in a general meeting) was a director and the controller of the company. She wished, *inter alia*, to be able to "restructure" the shareholding so that her niece who held 45% of the shares could not block resolutions requiring a special majority. An issue of shares was proposed which in effect would give Mrs Clements and her friends over 75% of the shares and retain control in her hands. The niece sought to set aside this arrangement.

Foster J. acceded to this complaint, and whilst his reasoning was a little hard to follow, the conclusions appear both right and heartening.²³⁶

Foster J. was recognizing the existence of a remedy in the minority shareholder in the context of an abuse of power²³⁷ by the majority, but one can compare the result in this case with the result in *Mills v. Mills*.²³⁸ In any event, his judgment, coupled with various statements recognizing the importance of this exception "where justice so requires" in recent Australian cases such as the *Hawkesbury Development*²³⁹ and the very important distinction raised by Templeman J. in *Daniels v. Daniels*²⁴⁰ means that courts are prepared, more so now than twenty years ago, to give the shareholder his day in court, even if they do not always classify their decisions in the same way.

It is unnecessary in the context of decisions such as these to develop a line of argument that the directors owe a duty to each individual shareholder and that therefore each shareholder must be asked to forgive the directors in each and every case. The appellants argued this in *Winthrop Investments*²⁴¹ relying on cases such as *Grant's case*²⁴² and dicta

²³² [1975] 2 N.S.W.L.R. 666, 707; see pp. 37-8, *supra* Wedderburn, *op. cit.* 93 ff.

²³³ Enunciated clearly in *Pavlides v. Jensen* [1956] Ch. 565, 574-6. Discussed in *Hawkesbury Development Co. Ltd* [1969] 2 N.S.W.R. 782, 789-90; see also *Heyting v. Dupont* [1964] 1 W.L.R. 843, 854, 855.

²³⁴ [1976] 2 All E.R. 268.

²³⁵ *Ibid.* 280-2.

²³⁶ Equating it to oppression; see V. Joffe, "Majority Rule Undermined?" (1977) 40 *M.L.R.* 71.

²³⁷ (1938) 60 C.L.R. 150.

²³⁸ *Hawkesbury Development Co. Ltd v. Landmark Finance Pty Ltd*, *supra* fn. 233.

²³⁹ *Ibid.*

²⁴⁰ [1978] 2 W.L.R. 73.

²⁴¹ See e.g. discussion by Mahoney J.A. [1975] 2 N.S.W.L.R. 691 ff. See also S. M. Beck, "The Shareholders' Derivative Action" (1974) 52 *Can. Bar Rev.* 159, 169-79; cf. C. J. H. Thomson, "Share Issues and the Rule in *Foss v. Harbottle*" (1975) 49 *A.L.J.* 134, but contrast Wedderburn, *supra* fn. 231, 207-15; cf. H. Mason, "Ratification of the Directors' Acts: An Anglo-Australian Comparison" (1978) 41 *M.L.R.* 161, 167-70.

²⁴² *Grant v. John Grant & Sons Pty Ltd* (1950) 82 C.L.R. 1 and in particular pp. 31-2; cf. *Ngurli Ltd v. McCann* (1953) 90 C.L.R. 425, 444.

in *Richard Brady*.²⁴³ Clearly, the duty is owed primarily to the company.²⁴⁴ If the company forgives but does so in circumstances where there is inadequate disclosure, fraud on the minority, oppression or some similar factor involved, the shareholder will be given standing as is clearly recognized in *Ngurli Ltd v. McCann*.²⁴⁵ It is in the more difficult cases where it is unclear whether any of these elements is present that the issue of whether forgiveness by the majority will preclude any action by a disgruntled shareholder voting against the resolution.

The cases where it is easy to dispose of this difficulty will be fairly obvious, as in *Cook v. Deeks*.²⁴⁶ But what about the marginal case such as *Beatty*,²⁴⁷ *Clements*, even *Daniels* and *Winthrop*? Can it be said that the duty is not discharged here until each shareholder has his day? This will expose the courts to a reanalysis of *Foss v. Harbottle*, and they may choose not to embark on such a task without legislative discretion.

The acid test will come when the questions raised by Mahoney J.A. in *Winthrop Investments*²⁴⁸ with respect to the purpose or motive of the shareholders in ratifying the directors' breach of duty are raised directly in a case; and when there is a modern *N.W. Transportation v. Beatty* fact situation litigated. It is only then that one will find out, I anticipate, that the exceptions to *Foss v. Harbottle* do not have enough flexibility to cope with the very real problems raised when the right hand of the company gives to the directors what they as the left hand of that company could not take. It is then that the need for some real clarification of this issue of independent ratification will become apparent. And it is then that we will see whether certain trends in the recent cases discussed here will be maintained, or whether the minority shareholders must hope for statutory intervention to give them a chance of questioning, before the courts, the biased decision-making which the present rules on ratification clearly allow and, in my view, obviously expect. In the long run, a simple procedure based on court "forgiveness" under s. 365 may be the solution we will opt for—but if the courts allow the flexibility called for above, the effect will be almost the same with the courts the final arbiters or judges, and not those in control.

²⁴³ *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, esp. Dixon J. at 143.

²⁴⁴ I sympathize but disagree with the line pursued by Beck, *supra* fn. 241. His analysis of the Australian cases at 177-9 is in my view incorrect. Whilst a shareholder may clearly in some cases pursue an action in the company's name in cases involving such breaches there is still no authority in Australia which permits us to take the further step he suggests. In my view the answer lies elsewhere as I suggest in this article.

²⁴⁵ *Ngurli Ltd v. McCann*, *supra* fn. 242.

²⁴⁶ [1916] 2 A.C. 554.

²⁴⁷ *North West Transportation Company Ltd v. Beatty* (1887) 12 App. Cas. 589.

²⁴⁸ *Supra* p. 36.