RECENT CASES

HOGG v. CRAMPHORN LTD.

Can a general meeting ratify the exercise of powers by directors for an improper purpose?

One thing about which judges and company directors seem often to agree is that the courts are not really the appropriate place to review the acts of directors unless they are actually misappropriating the property of the company. There is, of course, an elaborate body of law dealing with directors' duties, but there has been a tendency to invite the board to side-step this by obtaining a resolution of a general meeting confirming any act about which the directors may have doubts. It is this aspect of the decision in *Hogg v. Cramphorn Ltd.*[1] that is of particular interest.

I

Cramphorn Ltd. was incorporated in England over seventy years ago to carry on the business of corn and seed merchants and the business prospered. At the time of the action, the company was a public company with an authorized capital of £136,000 divided into 96,000 five per cent cumulative preference shares of £1 each, of which 90,293 were issued, and 40,000 ordinary shares of £1 each, of which 35,888 were issued. The shares were not quoted on a stock exchange. Colonel Cramphorn was chairman and managing director, and the directors, their relatives and friends held about 37,000 shares.

Whilst the business of the company was very solid, it was not particularly profitable having regard to the assets employed, and it eventually attracted the interest of a Mr Baxter who made an offer for the whole of the issued capital. Colonel Cramphorn does not seem to have formed a favourable impression of Baxter, and the board took steps to defend itself from the threatened take-over. The company entered into a trust deed for the benefit of the employees of the company with Colonel Cramphorn, a partner in the firm of accountants who were the company's auditors, and an employee of the com-

[1] [1966] 3 All E.R. 420.

pany, as trustees. The unissued preference shares were allotted to the trustees with the right to cast ten votes per share on a poll and, with these votes, the board could expect the support of over half the votes at general meetings. To enable the trustees to take up the shares, an interest free loan was made by the company from a reserve known as the Employees' Benevolent and Pension Fund; this fund was the absolute property of the company. Subsequently, the balance of this reserve was advanced to the trustees to enable them to buy up preference shares to be held on the trusts of the deed. In a letter to members, the board stated that the possibility that an offer might be made had led them 'to consider in particular the position of the company's staff, upon whose loyalty and enterprise the company is very dependant for its success and development'. They concluded that 'an offer such as that to which reference has been made would have an unsettling effect on the staff, and accordingly it was thought they should have a sizeable voice in the affairs of the company'.

Samuel Rolleston Hogg held fifty ordinary shares in the company and he commenced proceedings on behalf of himself and all other members of the company except the defendants against the company and the trustees of the deed for a declaration that the deed and issue of preference shares were void and that the moneys advanced to the trustees were held in trust for the company. Buckley J. took the view that the articles of the company did not in fact empower the directors to attach the special voting rights to the preference shares, but held nevertheless that the trustees could elect to retain the shares without such rights. On the other hand, although he accepted 'that the board acted in good faith and that they believed that the establishment of a trust would benefit the company and that avoidance of the acquisition of control by Mr. Baxter would also benefit the company',[2] he held that the power to issue shares had been exercised for an improper purpose, namely, to ensure control of the company by the directors, and that the deed and loan were tainted with the same vice. However, the action was then stood over to enable a general meeting to be called to consider whether the action of the directors should be ratified. A meeting was in fact held and the action of the directors duly approved by ordinary resolution.

If one accepts the view that company directors ought to be immune from the law unless they have been dishonest, in the sense of pocketing the company's funds, this result will be acceptable. On the other

[2] Id. at 427.

hand, if one takes the view that the legal duties of company directors are not unduly burdensome and ought to be enforced even where the irregularity involved is the improper exercise of powers for a purpose with which one may, on occasion, sympathize, one may be inclined to look closer at the decision. How could a simple majority in general meeting ratify this abuse of power by the directors?

II

The plaintiff could not have complained if the articles of Cramphorn Ltd. expressly empowered a majority in general meeting to implement such a scheme; but the court did not examine the articles to see if they did. On the face of it, they did not. Article 10 provided that 'the shares shall be under the control of the directors, who may allot or otherwise dispose of the same to such persons, on such terms and conditions, and at such times as the directors think fit', and Buckley J. remarked that 'the plaintiff says, no doubt rightly, that the company in general meeting could not by ordinary resolution control the directors in the exercise of the powers under article 10'.[3] No doubt he had in mind such well-known cases as *Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cuninghame*[4] in which the resolution of a general meeting for the sale of the company's assets was held to be ineffective where general powers of management had been vested in the directors. The fact is that it would not have made much sense for the court to search the articles for a power to implement the scheme. It could not have been expected that the articles would contain a provision empowering a majority in general meeting to do all things necessary to resist a take-over. Presumably, an article empowering a majority to condone a breach of duty on the part of the directors would be void having regard to section 205 of the Companies Act 1948.[5] Even if the articles gave a majority in general meeting a concurrent power with the directors to issue shares, execute trust deeds, etc., the question would arise whether these powers were not also given for the purpose of carrying on the company's business and not for the purpose of resisting a take-over bid.[6] Why, then, did the general meeting have power to ratify?

At first, Buckley J. seems to imply that there is no difficulty with the idea of a majority in general meeting ratifying acts that it did not,

3 Id. at 429.
4 [1906] 2 Ch. 34.
5 s. 133 of the Uniform Companies Acts.
6 See generally Part III of this note.

excepting in this sense, have power to do.[7] But ratification of an act normally requires a principal with legal capacity to do the act himself.[8] The judgment continues:

> Had the majority of the company in general meeting approved the issue of the 5,707 shares before it was made, even with the purported special voting rights attached (assuming that such rights could have been so attached conformably with the articles), I do not think any member could have complained of the issue being made; for in these circumstances, the criticism that the directors were, by the issue of the shares, attempting to deprive the majority of their constitutional rights would have ceased to have any force. It follows, in my opinion, that a majority in a general meeting of the company at which no votes were cast in respect of the 5,707 shares could ratify the issue of those shares.[9]

Of course, if the only objection to the exercise by the directors of a power for an improper purpose was that it might deprive the majority of their constitutional rights, it may well be accepted that a majority could "ratify" the exercise of the power although one might have thought that this could do no more than in some way estop those members who "ratified" the act from afterwards complaining of it.[10] But what of the constitutional rights of the minority? It may be that Buckley J. took rather too narrow a view of *Piercy v. S. Mills & Co. Ltd.*,[11] upon which he relied. It is certainly true that in that case an issue of shares by the directors for the sole purpose of turning a hostile majority into a minority was declared invalid and that Peterson J. stated that 'it was not . . . open to the directors for the purpose of converting a minority into a majority, and solely for the purpose of defeating the wishes of the existing majority, to issue the shares which are in dispute in the present action'.[12] There does not seem to be any reason to believe that his view of the issue would have been any different if it had been made, as in *Hogg v. Cramphorn Ltd.*, in order to prevent the conversion of a minority into a majority and thus for the purpose of defeating the expectations of a potential

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7 '[Counsel] goes on to say, I think with less justification, that what they could not ordain a majority could not ratify': per Buckley J., [1966] 3 All E.R. 420, 429.

8 See, for example, Wright J. in Firth v. Staines, [1897] 2 Q.B. 70, 75.

9 [1966] 3 All E.R. 420, 429.

10 In any event, there is really no such thing as "the majority" but only a majority on a particular issue, and the members constituting the majority will change from time to time.

11 [1920] 1 Ch. 77.

12 Id. at 84.

majority. After referring to *Fraser v. Whalley*[13] and *Punt v. Symons,*[14] he said:

> The basis of the decisions in these two cases I have referred to is that directors are not entitled to use their powers of issuing shares merely for the purpose of maintaining their control or the control of themselves and their friends over the affairs of the company or merely for the purpose of defeating the wishes of the existing majority of shareholders.[15]

Piercy v. S. Mills & Co. Ltd., then, does not support the view that an issue of shares for the purpose of maintaining the directors in control will cease to be objectionable if the directors use their control to secure a resolution of a general meeting "ratifying" their act.

III

The continuing confusion over the question of the relative powers of the general meeting and the board of directors seems to be caused by the reluctance of the courts to accept the implications of *Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cuninghame.*[16] Before and since that decision, the assumption has been made that the powers of a company are vested in the general meeting though they are usually delegated to the directors. On this view, it follows that a general meeting may ratify an act of the directors in excess of the powers conferred on them. In *Grant v. United Kingdom Switchback Railways Company,*[17] for example, Lindley L.J. stated that 'the shareholders can ratify any contract which comes within the powers of the company . . . .'[18] However, in the *Cuninghame* case it was pointed out that in dealing with the members of a company you are dealing 'with parties having individual rights as to which there are mutual stipulations for their common benefit' and, if that is the case, 'there is no ground for saying that the mere majority can put an end to the express stipulations contained in the bargain which they have made.'[19]

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13 (1864) 2 Hem. & M. 10.
14 [1903] 2 Ch. 506.
15 [1920] 1 Ch. 77, 84.
16 [1906] 2 Ch. 34.
17 (1888) 40 Ch. D. 135.
18 Id. at 139. The result, on the particular facts, may readily be accepted inasmuch as the case involved a contract entered into by directors who, being interested, had no right to vote; a general meeting could not, of course, validate contracts if fraud was involved. It is quite another thing to suggest that a majority in general meeting can ratify acts in excess of the power of the directors in the strict sense.
19 [1906] 2 Ch. 34, 45, per Cozens Hardy L.J.

The board of directors is not merely an agent. The relative powers of the general meeting and the board of directors depend on the articles, although it is certainly within the power of the former to alter the articles by special resolution and, thus, to alter the distribution of power for the future. It would seem to follow from this that a general meeting cannot ratify an act of the directors in excess of the powers conferred on them.

In Australia, the question has also caused difficulties. In *Miles v. Sydney Meat-Preserving Co. Ltd.*,[20] the High Court refused an injunction to restrain the directors of a company from carrying on the business of the company with a view to benefiting the pastoral industry rather than with a view to the earning of profits for distribution as dividends. A majority of the shareholders were graziers and approved the policy of the board. Griffith C.J. took the view that members did not occupy a fiduciary relation to one another and that 'the nature and quality of the acts done by the members, or by the directors with their approval, are not affected by the motives actuating the members or directors, and the Court can only take cognizance of the concrete and overt acts of the company'.[21] On the other hand, Isaacs J., dissenting, thought that the question before the court was not the right of a member to exercise the powers he had as he pleases but 'it concerns the limits and extent of those powers; no decision has ever been given that shareholders can for their own reasons knowingly authorize the exercise of what I may call the working incidents of a corporation's objects given for one purpose, to carry out a purpose alio intuitu'.[22] Isaacs J. was in the majority (Griffith C.J. dissenting) a few years later in *Dutton v. Garton*,[23] and there is other Australian authority for the view that a majority in general meeting cannot ratify the exercise by directors of a power for an improper purpose, at least where the articles are in usual terms.[24]

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20 (1912) 16 C.L.R. 50.

21 Id. at 65.

22 Id. at 91.

23 (1917) 23 C.L.R. 362. Although the case involved the question whether the majority were not making a present to themselves or, at least, attempting to prevent the minority from obtaining a decision of the court on this question, it does not seem to have turned on the question of fraud.

24 Ngurli Ltd. v. McCann, (1953) 90 C.L.R. 425. See, also, Lee v. Robertson, (1863) 1 W. & W.(E.) 374, (Vic. Sup. Ct.); Davis v. The Commercial Publishing Co. of Sydney Ltd., (1901) 1 S.R. (N.S.W.) Eq. 37; Dowse v. Marks, (1913) 13 S.R. (N.S.W.) 332, 341.

IV

One of the difficulties that may face a minority anxious to contest the exercise by directors of a power for an improper purpose is the rule in *Foss v. Harbottle*.[25] That rule is often said to prevent action by a minority unless there has been fraud or the acts concerned are ultra vires the company or require a special majority in general meeting.[26] The rationale of the rule is that an abuse of power by the directors is a wrong done to the company and the company is, therefore, the proper plaintiff. In this context, "the company" means a simple majority in general meeting as it is they who can decide whether to institute proceedings. If the majority decline to institute proceedings, exceptions to the rule are recognized in order to meet the complaint that a wrong may go without a remedy. There would be little point in allowing a minority to sue in respect of an act that was, in any event, within the power of a majority. The exceptions to the rule ought then to be limited to acts which are not within the power of a majority. On this view, the categories of fraud, ultra vires and acts requiring a special majority are not necessarily exhaustive if there are other acts that are not within the power of a simple majority.

Discussing this aspect of the rule, the Judicial Committee in *Burland v. Earle*[27] said:

> The cases in which the minority can maintain such an action are, therefore, confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company . . . . It should be added that no mere informality or irregularity *which can be remedied by the majority* will entitle the minority to sue, if the act when done regularly would be within the powers of the company and the intention of the majority of the shareholders is clear. This may be illustrated by the judgment of Mellish L.J. in *MacDougall v. Gardiner,* (1875) 1 Ch.D. 13, 25.[28]

It seems clear that it was not intended to limit the exceptions to the rule to fraud and acts ultra vires the company in the strict sense in which the words ultra vires are commonly used. A distinction was drawn between irregularities beyond the power of a majority to

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25 (1843) 2 Hare 461; 67 E.R. 189.

26 See, for example, Campbell v. Australian Mutual Provident Society, (1908) 99 L.T. 3.

27 [1902] A.C. 83.

28 Id. at 93 (author's italics). Cf. Paulides v. Jensen, [1956] Ch. 565.

remedy and those which were not. Thus, the rule would not prevent a minority from proceeding in respect of the exercise by directors of a power for an improper purpose if it is correct that it is not within the power of a majority to remedy the defective exercise of the power.[29]

Even if the exceptions to the rule are now thought to be limited to fraud, ultra vires, and acts requiring a special majority, there is nevertheless authority that minority action in respect of the exercise of a power for an improper purpose is not caught by the rule. It is generally recognized that the word "fraud" in this context is not to be given the strict meaning that it may have in other areas of the law. In *Ngurli Ltd. v. McCann*,[30] it was said that

> the powers conferred on shareholders in general meeting and on directors by the articles of association of companies can be exceeded although there is a literal compliance with their terms. These powers must not be used for an ulterior purpose. 'The term fraud in connection with frauds on a power does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power', per Lord Parker in *Vatcher v. Paull*, [1915] A.C. 372, 378.[31]

On the question of ultra vires, once one accepts that a majority in general meeting cannot ratify the exercise by directors of a power for an improper purpose, it is difficult to see why such an exercise of power is not in fact ultra vires the company and so within that exception to the rule. An act is ultra vires if it is not done for the purpose of pursuing the company's objects.[32] The view that directors have exercised their powers for an improper purpose rests on the assumption that the purpose for which they were exercised was not the

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29 In Peninsula & Oriental Steam Navigation Co. v. Johnson, (1937-1938) 60 C.L.R. 189, 207, Latham C.J. said: 'If, however, it were shown that the directors had not acted in good faith in the interests of the company, but had acted for the purpose of protecting Johnson or of stifling the litigants or for some other improper reason, their act could be challenged and could be set aside by the court.'

Even though Buckley J. in Hogg v. Cramphorn Ltd. held that the scheme could be ratified by a general meeting, the action was not misconceived inasmuch as the rule in *Foss v. Harbottle* must be subject to the proviso that it does not prevent action in respect of acts that involve voting rights.

30 (1953) 90 C.L.R. 425.

31 Id. at 438.

32 Re Jon Beauforte (London) Ltd., [1953] 1 All E.R. 634.

pursuit, or reasonably incidental to the pursuit, of the company's objects.[33]

J. K. WALSH

MACKENDER, HILL and WHITE v. FELDIA A.G.; HOPKINS v. DIFREX S.A.; LEWIS CONSTRUCTION CO. PTY. LTD. v. M. TICHAUER S.A.

The effect of foreign jurisdiction clauses in common law forums.

In *Mackender, Hill and White v. Feldia A.G.*[1] the respondents (English underwriters) issued a writ for a declaration that an insurance policy which they had issued to the appellants (Belgian diamond merchants) was void for illegality and voidable for non-disclosure. A foreign jurisdiction clause subjected the policy to Belgian law and Belgian jurisdiction. Leave to serve the writ out of jurisdiction was granted to the respondent by Roskill J. and confirmed by McNair J. The Court of Appeal reversed their decision. The reason was that a dispute about non-disclosure and illegality (the allegation was that the appellants regularly smuggled diamonds into Italy) could not avoid the contract ab initio, but could merely render it voidable or unenforceable. Such a dispute was within the foreign jurisdiction clause and should be tried in Belgium. Leave to serve the writ out of jurisdiction was refused.

In *Hopkins v. Difrex S.A.*[2] a contract of employment between Hopkins and the defendant (a French company) contained a foreign jurisdiction clause in favour of French courts. Hopkins' employment as managing director of the defendant's N.S.W. subsidiary was terminated because of alleged misconduct. The contract permitted the defendant to dismiss Hopkins for "serious default", and "Australian workers' legislation" was to govern the interpretation of that phrase. Hopkins sued in N.S.W. for wrongful dismissal and the defendant applied for an order of stay of proceedings by reason of the foreign jurisdiction clause.

Maguire J. held that the clause could not oust the jurisdiction of the court; that prima facie both parties were bound by the clause;

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33 A court could not properly adopt any other test unless the articles expressly state the purpose for which the power was given and this would not be usual.

1 [1966] 2 Ll.L. Rep. 449.

2 [1966] 84 W.N. (N.S.W.) 297.