27 If Mr Tobias bona fide considered that the amendment was in the interests of the company as a whole, and there has been no attack on his bona fides, their Lordships do not see why he should not vote. This is only one aspect of the general principle that shareholders are free to exercise their votes in their own interests. As Lord Davey said in *Burland v Earle*,[42] 94:

> 'Unless otherwise provided by the regulations of the company, a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having a particular interest in the subject-matter of the vote.'

28 In any case, it appears to their Lordships that even the test proposed by Mr Todd was satisfied. The only evidence as to the number of shares controlled by Mr Tobias was that of Mr de Vos, who said that it amounted to 28% of the issued share capital. He was cross-examined on this point, with counsel for Citco seeking to establish that Mr Tobias actually controlled very few shares, but stuck to 28%. He did also say that Mr Tobias was indirectly able to exercise the votes of 51% of the share capital, but this was consistent with the additional votes being simply those of supporters who had decided to entrust Mr Tobias with their proxies. Of the 28%, Mr Tobias did not vote the 62,439 shares registered in his own name. If he had not voted the 460,245 shares registered in the names of his **(p. 227)** wife and Piccadilly Properties Ltd, which made up the rest of the 28%, the votes cast in favour of the resolution would have been 665,420 out of a total of 848,420. This would still have been 78%.

29 Their Lordships will therefore humbly advise Her Majesty that the appeal should be dismissed with costs.

➢ Notes

1. The CLR took the view that the principle that a decision to change a company's articles must be taken bona fide for the benefit of the company as a whole was well established and should be retained. This was also the view adopted in *Citco* **[4.24]**.

2. It is rather curious that in both *Allen* **[4.22]** and *Sidebottom* **[4.23]** there are references to the good faith of the *directors*, when it is plain from the rest of the judgments that it is the bona fides of the majority members who pass the special resolution that is crucial. Of course, it would be easy to imagine a situation where the directors have an improper motive in introducing the proposal for change, and simply carry the opinion of the majority along with them. This may be what is being alluded to in the two cases. In fact, the directors in *Sidebottom*'s case held over half of the company's issued shares, and the majority in favour of the resolution was overwhelming.

➢ Question

Lord Hoffmann, at paragraph 18 of the *Citco* judgment, **[4.24]**, took the view that 'some other test' is needed where the proposed alteration concerns the 'rights of shareholders in matters in which the company as a corporate entity has no interest', since there it would be inappropriate 'to ask whether the shareholders had considered the alteration to be in the interests of the company as a whole'. What tests might meet this need? Where the company *has* an interest, the court accepts a*subjective* 'bona fide for the benefit of the company as a whole' test (subject to being persuaded of the bona fides). Where the company has *no* interest, and where there must inevitably be winners and losers as between different groups of shareholders, must the test necessarily be *objective* if the court is not simply to cede all power to the majority voter? See the next case cited.

In the case next cited, Peterson J favoured an objective test of what was 'for the benefit of the company'. This view was disapproved in *Shuttleworth v Cox Bros & Co Ltd***[6.06]** (and in *Citco* **[4.24]**, it seems) but, in the opinion of some writers, this has been to some extent revived by the reformulated test suggested in *Greenhalgh v Arderne Cinemas Ltd* **[4.27]**, which seemed to find favour in *Citco*.

[4.25] Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd [1920] 2 Ch 124 (Chancery Division)

The defendant company altered its articles so as to introduce a power enabling the majority of the shareholders to require any member (with one named exception) to transfer his shares at a fair value to an approved transferee. The plaintiff company had transferred its custom as a purchaser of steel from the defendants to a rival company. It held shares in the defendant company and opposed the alteration. Peterson J upheld its objection, because, in his own view, the alteration was wider than necessary.

> PETERSON J: In *Sidebottom*'s case **[4.23]** the Court of Appeal sanctioned an alteration of the articles of association which enabled the directors to require a shareholder who carried on a competing business, or was a director of a company carrying on a competing business, to transfer his shares, and it did so on the ground that the alteration was for the benefit of the company as a whole. It has been suggested that the only question in such a case as this is whether the shareholders bona fide **(p. 228)** or honestly believed that that alteration was for the benefit of the company. But this is not, in my view, the true meaning of the words of Lindley MR or of the judgment in *Sidebottom*'s case. The question is whether in fact the alteration is genuinely for the benefit of the company …
>
> The question of fact then which I have to consider is whether the alteration of the articles which enables the majority of the shareholders to compel any shareholder to transfer his shares, can properly be said to be for the benefit of the company. It may be for the benefit of the majority of the shareholders to acquire the shares of the minority, but how can it be said to be for the benefit of the company that any shareholder, against whom no charge of acting to the detriment of the company can be urged, and who is in every respect a desirable member of the company, and for whose expropriation there is no reason except the will of the majority, should be forced to transfer his shares to the majority or to anyone else? Such a provision might in some circumstances be very prejudicial to the company's interest. For instance, on an issue of new capital, the knowledge that he might be expropriated as soon as his capital was on the point of producing profitable results might well exercise a deterrent influence on a man who was invited to take shares in the company
>
> … In my view it cannot be said that a power on the part of the majority to expropriate any shareholder they may think proper at their will and pleasure is for the benefit of the company as a whole. To say that such an unrestricted and unlimited power of expropriation is for the benefit of the company appears to me to be confusing the interests of the majority with the benefit of the company as a whole. In my opinion the power which, in this case, has been conferred upon the majority of the shareholders by the alteration of the articles of association in this case is too wide and is not such a power as can be assumed by the majority. The power of compulsory acquisition by the majority of shares which the owner does not desire to sell is not lightly to be assumed whenever it pleases the majority to do so. The shareholder is entitled to say non haec in foedera veni; and while on the authorities as they stand at present it is possible to alter the articles in such a way as to confer this power, if it can be shown that the power is for the benefit of the company as a whole, I am of opinion that such a power cannot be supported if it is not established that the power is bona fide or genuinely for the company's benefit …

[4.26] Peter's American Delicacy Co Ltd v Heath (1939) 61 CLR 457 (High Court of Australia)

As a result of an oversight by the draftsman, the company's articles of association contained inconsistent provisions governing the distribution of profits. Profits distributed as *dividends* were payable in proportion to the amounts paid up on shares, but distributions of *capitalised* profits ('bonus shares') were to be in proportion to the

nominal value of shares held. The issued capital consisted of 511,000 fully paid and 169,000 partly paid shares.

At a general meeting the articles were altered by special resolution so that the distribution of capitalised profits was to be made on the same basis as cash dividends, that is, in proportion to the amounts paid up on shares. Some holders of partly paid shares objected, and their objection was upheld at first instance; but on appeal the High Court ruled that the alteration was valid.[43]

> RICH J: Company law confers a power of alteration on a general meeting of shareholders requiring for any positive alteration a three-fourths majority. There is no other body to whom the question can be submitted. No rights given by articles of association can prevail against a three-fourths majority and it is well understood that all are subject to it. It is true that the power of alteration must be exercised bona fide with a view to the advancement of the company considered as a whole and not with a view to the advancement of the interests of a majority of voters or of a section of the company only … But in deciding what is for the interest of the company and what is bona fide, the constitution of **(p. 229)** the company, the condition and effect of the various articles of association and the extent to which rights are conferred upon different classes of shareholders are relevant and important … Where the very problem which arises contains as inherent in itself all the elements of a conflict of interests between classes of shareholders these authorities do not mean that the power of alteration is paralysed, they mean only that the purpose of bringing forward the resolution must not be simply the enrichment of the majority at the expense of the minority. The resolution in the present case was brought forward to solve a difficulty and make possible a capitalisation. It can hardly be supposed that the only solution of such a difficulty which can be lawfully adopted is that which gives the minority an advantage at the expense of the majority. In my opinion the case presents nothing but an ordinary example of an honest attempt on the part of the directors to clear up a difficulty by securing an alteration of the articles not unjust to any class of shareholders, but at the same time conserving the interests of the shareholders who form the great majority of the company …
>
> In my opinion the appeal should be allowed.
>
> DIXON J: Primarily a share in a company is a piece of property conferring rights in relation to distribution 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. For example, if there were no check upon the use of the power, it is conceivable that a three-fourths majority might adopt an article by which the shares which they alone held would participate, to the exclusion of other shares, in the surplus assets in winding up or even in distributions of profit by way of dividend. Again, authority might be obtained under an alteration so as to convert the assets or operations of a company into a source of profit not of the company but of persons forming part of or favoured by the majority. It has seemed incredible that alterations of such a nature could be made by the exercise of the power. But reliance upon the general doctrine that powers shall be exercised bona fide and for no bye or sinister purpose brings its own difficulties. The power of alteration is not fiduciary. 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, and it may be that an analogy may be found in other powers which though given to protect the donee's own interests affect the property rights of others, as, for instance, does a mortgagee's power of sale. Some such analogy probably gave rise to the suggestion made in Buckley on *The Companies Acts* that the limitation on the power is that the alteration must not be such as to sacrifice the interests of the minority to those of a majority without any reasonable prospect of advantage to the company as a whole …
>
> Apart altogether from altering articles of association, the voting strength of a majority of shareholders may be used in matters of management and administration to obtain for themselves advantages which otherwise would enure for the benefit of all the members of the company, and in some circumstances such an attempt on the part of the majority to secure advantages to the prejudice of the minority conflicts with ordinary notions of fair dealing and honesty. Often when this is done the thing attempted will be found by its nature to fall outside the power of the members in general meeting and even outside the corporate powers of the

company. But this is not necessarily the case, and a thing not of its own nature ultra vires may be invalidated by the effect which it produces or is intended to produce in benefiting some shareholders at the expense of others or individuals at the expense of the company …

An example of a misuse of power on the part of shareholders constituting a majority in the administration of a company's affairs is the unjustifiable refusal to allow an action to be maintained in the name of the company to redress a wrong to it by one of themselves[44] …

In these formulations of general principle there is an assumption that vested in the company or in the minority of shareholders, as the case may be, is an independent title to property, to rights **(p. 230)** or to remedies, and the ground of the court's intervention is that by the course adopted by the majority, the company or the minority will be deprived of the enjoyment of that to which they are so entitled. The conduct of the majority is then given some dyslogistic description such as 'fraudulent', 'abuse of powers' or 'oppression'. A chief purpose of articles of association is to regulate the rights of shareholders inter se, and their relations to the profits and surplus assets of the company are governed by the provisions of the articles. A power to alter articles of association is necessarily a power to alter the rights of shareholders inter se, including their mutual rights in respect of profits and surplus assets. It is therefore evident that some difficulty must arise in applying to resolutions for the alteration of articles a statement of principle which assumes the independent existence of rights which should not be impaired or destroyed. Prima facie rights altogether dependent upon articles of association are not enduring and indefeasible but are liable to modification or destruction; that is, if and when it is resolved by a three-fourths majority that the articles should be altered. To attempt to distinguish between alterations which deserve the epithet fraudulent or oppressive or unjust and those deserving no moral censure without explaining the considerations upon which the distinction depends, is to leave the whole question to general notions of fairness and propriety … To base the application of these descriptions to a particular resolution upon the fact that it involves a modification or defeasance of rights of a valuable or important nature, is in effect to go back to the discarded distinction between articles affecting the constitution and those affecting the administration of the company or to a distinction very like it. To base the application of the epithets upon the circumstance that the majority obtain a benefit by the change seems to involve some departure from the principle that the vote attached to a share is an incident of property which may be used as the shareholder's interests may dictate …

The chief reason for denying an unlimited effect to widely expressed powers such as that of altering a company's articles is the fear or knowledge that an apparently regular exercise of the power may in truth be but a means of securing some personal or particular gain, whether pecuniary or otherwise, which does not fairly arise out of the subjects dealt with by the power and is outside and even inconsistent with the contemplated objects of the power. It is to exclude the purpose of securing such ulterior special and particular advantages that Lord Lindley used the phrase 'bona fide for the benefit of the company as a whole'. The reference to 'benefit as a whole' is but a very general expression negativing purposes foreign to the company's operations, affairs and organisations. But unfortunately, as appears from the foregoing discussion, the use of the phrase has tended to cause misapprehension. If the challenged alteration relates to an article which does or may affect an individual, as, for instance, a director appointed for life or a shareholder whom it is desired to expropriate, or to an article affecting the mutual rights and liabilities inter se of shareholders or different classes or descriptions of shareholders, the very subject-matter involves a conflict of interests and advantages. To say that the shareholders forming the majority must consider the advantage of the company as a whole in relation to such a question seems inappropriate, if not meaningless, and at all events starts an impossible inquiry. The 'company as a whole' is a corporate entity consisting of all the shareholders. If the proposal put forward is for a revision of any of the articles regulating the rights inter se of shareholders or classes of shareholders, the primary question must be how conflicting interests are to be adjusted, and the adjustment is left by law to the determination of those whose interests conflict, subject, however, to the condition that the existing provision can be altered only by a three-fourths majority. Whether the matter be voting rights, the basis of distributing profits, the basis of dividing surplus assets on a winding-up, preferential rights in relation to profits or to surplus assets, or any other question affecting mutual interests, it is apparent that though the subject-matter is among the most conspicuous of those governed by articles and therefore of those to which the statutory power is directed, yet it involves

little if anything more than the redetermination of the rights and interests of those to whom the power is committed. No one supposes that in voting each shareholder is to assume an inhuman altruism and consider only the intangible notion of the benefit of the vague abstraction called by Lord Robertson in *Baily*'s case **[3.18]** 'the company as an institution'. An investigation of the thoughts and motives of each shareholder voting with the majority would be an impossible proceeding … [When] the very question to be determined is a **(p. 231)** conflict of interests, unless the subject-matter is held outside the power, the purpose of the resolution, as distinguished from the motives of the individuals, often must be to resolve the conflict in favour of one and against the other interest.

In my opinion it was within the scope and purpose of the power of alteration for a three-fourths majority to decide the basis of distributing shares issued for the purpose of capitalising accumulated profits or profits arising from the sale of goodwill, and in voting for the resolution shareholders were not bound to disregard their own interests. I am far from saying that the resolution for the alteration of the articles would have been bad if the existing articles had been uniform and clear in requiring that, however the 'capitalisation' was effected, the basis of distribution should be the number of shares respectively subscribed for by members. But the facts of the case were that by one method, the older indirect method, a capitalisation might have been effected which would mean a distribution according to capital paid up. Doubts were felt about the propriety of adopting this course, and doubts were agitated as to the meaning of the article providing for the direct method. If there were no capitalisation, the accumulated profits would not be distributed in proportion with capital subscribed. In these circumstances the holders of partly paid shares had no 'right' to receive the profits in proportion with capital paid up. As the articles stood they were entitled only to receive shares in that proportion if and when issued by way of direct capitalisation. That event would never be likely to occur; for the holders of fully paid shares were perfectly entitled to prevent it and would no doubt do so. In these circumstances it appears to me that the resolution involved no oppression, no appropriation of an unjust or reprehensible nature and did not imply any purpose outside the scope of the power …

LATHAM CJ delivered a concurring judgment.

MCTIERNAN J concurred.

➢ Note

Ironically, this powerfully reasoned case may no longer carry weight in its native Australia. In *Gambotto v WPC Ltd* (1995) 182 CLR 432, the High Court ruled that the 'bona fide for the benefit of the company as a whole' test should be replaced by a test which asks whether the alteration or proposed alteration is 'beyond any purpose contemplated by the articles or oppressive as that expression is understood in the law relating to corporations' (paras [25] and [26]). The case itself was concerned with an alteration of the articles which gave the company rights to buy out minority shareholders compulsorily, and it would be tempting to treat the judgment as limited to the special case of alterations conferring expulsion or expropriation rights; but the court went out of its way to disown the English line of authority in general terms.

This new test is clearly one which is almost entirely, if not wholly, objective; and one which will allow the court to play a much more interventionist role. A test based on 'proper purposes' has already gone some way towards displacing one based on 'bona fides' for the purpose of reviewing directors' discretionary decisions: see 'Failure to act for proper purposes', pp 331ff. However, it seems unlikely that *Gambotto* will ever be followed in the UK (and see the Privy Council confirmation of this in the *Citco*case **[4.24]**). The CLR considered the possibility and drew attention to the fact that in *Gambotto* the alteration of articles was undoubtedly of benefit to the company as a whole (it stood to gain tax advantages), and the minority were to be fully compensated. It considered that there is no case for displacing the 'bona fide in the best interests of the company as a whole' test with some other concept to deal specially with expropriation cases.

➢ Question

Is it consistent to say that the power to alter articles 'shall be exercised *bona fide* and for no bye or sinister purpose' and (in the next sentence) 'the power of alteration is not fiduciary'?

(p. 232) [4.27] Greenhalgh v Arderne Cinemas Ltd [1951] Ch 286 (Court of Appeal)[45]

The articles of the defendant (a private company) provided that existing members should have pre-emptive rights if a member wished to sell his shares. Mallard, the managing director, had negotiated with an outsider, Sol Sheckman, for the sale to Sheckman of a controlling interest in the company at 6 *s* [30p] per share. Mallard had procured the passing of a special resolution to give effect to this agreement. In effect this negated the pre-emptive rights of the existing members. One of the latter, Greenhalgh, claimed a declaration that the resolutions were invalid as a fraud on the minority.[46] The Court of Appeal, affirming Roxburgh J, refused a declaration.

> EVERSHED MR: The burden of that case is that the resolution was not passed bona fide and in the interests of the company as a whole, and there are, as Mr Jennings has urged, two distinct approaches.
>
> The first line of attack is this, and it is one to which, he complains, Roxburgh J paid no regard: this is a special resolution, and, on authority, Mr Jennings says, the validity of a special resolution depends upon the fact that those who passed it did so in good faith and for the benefit of the company as a whole. The cases to which Mr Jennings referred are *Sidebottom v Kershaw, Leese & Co Ltd* **[4.23]**, Peterson J's decision in *Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd* **[4.25]** and, finally, *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* **[6.06]**. Certain principles, I think, can be safely stated as emerging from those authorities. In the first place, I think it is now plain that 'bona fide for the benefit of the company as a whole' means not two things but one thing. It means that the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase 'the company as a whole' does not (at any rate in such a case as the present) mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body. That is to say, the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is, in the honest opinion of those voted in its favour, for that person's benefit.
>
> I think that the matter can, in practice, be more accurately and precisely stated by looking at the converse and by saying that a special resolution of this kind would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and the minority shareholders, so as to give to the former an advantage of which the latter were deprived. When the cases are examined in which the resolution has been successfully attacked, it is on that ground. It is therefore not necessary to require that persons voting for a special resolution should, so to speak, dissociate themselves altogether from their own prospects and consider whether [the proposal is] for the benefit of the company as a going concern. If, as commonly happens, an outside person makes an offer to buy all the shares, prima facie, if the corporators think it a fair offer and vote in favour of the resolution, it is no ground for impeaching the resolution that they are considering their own position as individuals.
>
> Accepting that, as I think he did, Mr Jennings said, in effect, that there are still grounds for impeaching this resolution: first, because it goes further than was necessary to give effect to the particular sale of the shares; and, secondly, because it prejudiced the plaintiff and minority shareholders in that it deprived them of the right which, under the subsisting articles, they would have of buying the shares of the majority if the latter desired to dispose of them.
>
> What Mr Jennings objects to in the resolution is that if a resolution is passed altering the articles merely for the purpose of giving effect to a particular transaction, then it is quite sufficient (and it is **(p. 233)** usually done) to limit it to that transaction. But this resolution provides that anybody who wants at any time to sell his shares can now go direct to an outsider, provided that there is an ordinary resolution of the company approving the proposed transferee. Accordingly, if it is one of the majority who is selling, he will get the

necessary resolution. This change in the articles, so to speak, franks the shares for holders of majority interests but makes it more difficult for a minority shareholder, because the majority will probably look with disfavour upon his choice. But, after all, this is merely a relaxation of the very stringent restrictions on transfer in the existing article, and it is to be borne in mind that the directors, as the articles stood, could always refuse to register a transfer. A minority shareholder, therefore, who produced an outsider was always liable to be met by the directors (who presumably act according to the majority view) saying, 'We are sorry, but we will not have this man in.' …

As to the second point, I felt at one time sympathy for the plaintiff's argument, because, after all, as the articles stood he could have said: 'Before you go selling to the purchaser you have to offer your shares to the existing shareholders, and that will enable me, if I feel so disposed, to buy, in effect, the whole of the shareholding of the Arderne company.' I think that the answer is that when a man comes into a company, he is not entitled to assume that the articles will always remain in a particular form; and that, so long as the proposed alteration does not unfairly discriminate in the way which I have indicated, it is not an objection, provided that the resolution is passed bona fide, that the right to tender for the majority holding of shares would be lost by the lifting of the restriction. I do not think that it can be said that this is such a discrimination as falls within the scope of the principle which I have stated …

ASQUITH and JENKINS LJJ concurred.

➢ Notes

1. See also *Clemens v Clemens Bros Ltd* **[4.20]**, where the issue before the court was similar, although no alteration of the articles was involved; the court, although purporting to apply the same principles, reached the opposite conclusion.

2. It is worth noting that all[47] the events complained of in the sorry history of Mr Greenhalgh and his company took place before there was any statutory provision allowing the court to grant relief to a minority shareholder on the ground of 'oppression' (CA 1948 s 210) or 'unfairly prejudicial' conduct (CA 1985 s 459, CA 2006 s 994): see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff. Given the long history of the 'salami tactics' by which Mr Greenhalgh's stake in the company was systematically eroded, he might well have succeeded in an application for relief under these provisions—although there is a possibility that they will be construed more restrictively following the ruling of the House of Lords in *O'Neill v Phillips* **[13.30]**.

3. *Greenhalgh v Arderne Cinemas Ltd* is a very difficult judgment. We can put some of the problems which it raises in the form of questions, but it is not possible to give any confident answer to most of them.

➢ Questions

1. The first test posed by Lord Evershed seems to be a subjective one: the shareholders' bona fide opinion is determinative. In the next paragraph, with talk of discrimination, the test is apparently an objective one. Are the two passages consistent with each other, or is the court having the best of both worlds? Could this second limb provide 'some other test' which was seen as necessary by Lord Hoffmann in *Citco* **[4.24]** ?

2. Is it possible to reconcile 'the corporators as a general body' (distinct from 'the company as a commercial entity') and 'the company as a going concern'? What weight do you think **(p. 234)** should be given to the phrase 'at any rate in such a case as the present'? Are Lord Evershed's remarks intended to be confined to special resolutions, or to special resolutions altering articles, or to apply generally to all resolutions?

3. A claimant does not go to court unless he has a grievance. Would it not be true to say that in all the *unsuccessful* cases in which an alteration has been challenged, as well as the successful ones, the

minorities were complaining of discrimination?

4. Whom should the court identify as 'the individual hypothetical member' in a case such as *Clemens v Clemens Bros Ltd* **[4.20]**, where the only two actual shareholders have fallen out?

[4.28] Rights and Issues Investment Trust Ltd v Stylo Shoes Ltd [1965] Ch 250 (Chancery Division)

The defendant company passed special resolutions increasing the issued share capital and doubling the voting rights of the management shares. The purpose was to preserve the voting strength of the existing 'management shares' notwithstanding the new issue. The resolutions were carried by a large majority at a general meeting of the company and approved by a class meeting of the ordinary shareholders;[48] the holders of management shares did not vote on either occasion. The court ruled that the resolution altering the voting rights was valid.

> PENNYCUICK J: I am not persuaded that there has been here any discrimination against or oppression of the holders of the ordinary shares. What has happened is that the members of this company, other than the holders of the management shares, have come to the conclusion that it is for the benefit of this company that the present basis of control through the management shares should continue to subsist notwithstanding that the management shares will henceforward represent a smaller proportion of the issued capital than heretofore. That, it seems to me, is a decision on a matter of business policy to which they could properly come and it does not seem to me a matter in which the court can interfere. So far as I am aware there is no principle under which the members of a company acting in accordance with the Companies Act and the constitution of the particular company and subject to any necessary consent on the part of a class affected, cannot, if they are so minded, alter the relative voting powers attached to various classes of shares. Of course, any resolution for the alteration of voting rights must be passed in good faith for the benefit of the company as a whole, but, where it is so, I know of no ground on which such an alteration would be objectionable and no authority has been cited to that effect. So here this alteration in voting powers has been resolved upon by a great majority of those members of the company who have themselves nothing to gain by it so far as their personal interest is concerned and who, so far as one knows, are actuated only by consideration of what is for the benefit of the company as a whole. I cannot see any ground on which that can be said to be oppressive. …

➢ Notes

1. It is apparent from such cases as *North-West Transportation Co Ltd v Beatty* **[4.33]** and *Northern Counties Securities Ltd v Jackson & Steeple Ltd* **[4.18]** that the holders of the management shares were under no legal obligation to abstain from voting. Their self-denying act was, however, a very effective piece of window-dressing. In contrast with the rule which normally governs the acts of *directors*, there seems to be no *general* common law rule that a vote by an interested shareholder renders a decision invalid, or even raises a presumption of *mala fides*. The only situation in which it is clearly improper to exercise the voting rights attached to shares (fraud apart) is where the validity of the shares concerned is at stake, when to allow **(p. 235)** the vote would be to beg the very question in issue: see *Hogg v Cramphorn Ltd***[7.11]** and *Bamford v Bamford* in Note 1 of Further notes following *Pender v Lushington* **[13.19]**.

2. It has from time to time been suggested that it would be a desirable change in the law to allow some issues to be resolved by submitting them to the votes of 'independent' members only. But this would be very difficult to enforce (consider, eg, relatives, nominees, trustees and friends of 'interested' members), and it would deprive those with most at stake from a meaningful say in their company's affairs.

3. Denying 'interested' members a vote is easier, and there are, indeed, one or two special situations where the holders of 'interested' shares are disfranchised by statute (CA 2006 s 239 is the most obvious one, but also ss 695, 717), and by the Listing Rules in regard to transactions between a listed company and a 'related

party', such as a substantial shareholder or director.

4. In *Smith v Croft (No 2)* **[13.17]**, Knox J held that it was proper for the court, in deciding whether to allow a minority shareholder's action to be brought as an exception to the Rule in *Foss v Harbottle* ('The old common law rule in *Foss v Harbottle*', pp 639ff), to have regard to the views of 'independent' shareholders, that is, those who were not involved in the proposed litigation as defendants or as persons closely connected with them. The judgment (and that of the Court of Appeal in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* **[13.21]** on which it is based) comes very close to suggesting that this issue is to be resolved by summoning a general meeting, perhaps under the direction of the court, at which the defendants and those in their camp should be disenfranchised. This was something that the Court of Appeal had said that it had no power to do in *Mason v Harris* (1879) 11 Ch D 97, but it appears to have become an accepted part of modern thinking—and, indeed, has now been adopted as a statutory rule in many contexts (eg the ratification of breaches of directors' duties: 'Members' decisions concerning directors' breaches', pp 235ff and 'Ratification of acts of directors: CA 2006 s 239', pp 437ff).

➢ Question

Given these authorities, what legal rule or principle restricts shareholders' freedom to vote as they wish for a change in their company's articles? Does the rule or principle have wider general application?[49] Should it?

Variation of class rights

See 'Variation of class rights', pp 563ff, and the cases extracted there.

Members' decisions concerning directors' breaches

Breaches of duty by directors are not always inimical to the company's interests. Consider *Regal (Hastings) v Gulliver* **[7.23]** or *Brady v Brady* **[10.08]**. If the company's directors *propose* to engage in an activity that is beyond their powers, or in breach of their duties to the company, but is nevertheless an activity that the majority of the members wish the company to pursue, the members may:[50]

(i) take the decision themselves to commit the company to the activity (but see *Barron v Potter* **[4.08]**, on the members' limited power to manage the company's business in this way);
(p. 236) **(ii)** authorise the directors to engage in the activity (again, the members need to have the necessary power to authorise the directors to proceed).

More commonly, however, the members will only discover the directors' breach after the event. If they nevertheless support the directors' activity, they may:

(i) ratify (or, more accurately, affirm) the *impugned transaction*, if that is necessary for its validity;
(ii) ratify (waive or forgive) the *breach*, so that the directors are secure in the commitment that the company will not sue them at a later date for the wrongdoing: this might be especially important if the company is taken over and a new board is put in place, or the company becomes insolvent and a liquidator is appointed, so that the members who now express support for the directors are no longer in a position to deliver their promises.

Each of these options seems to have slightly different requirements attached to it. The cases that follow expose some of the rules. In addition, CA 2006 enacts new requirements.

These authorisation and ratification decisions warrant such detailed scrutiny because of the acknowledged risk that defaulting directors, in their role as members, often have the power to obtain or at least influence company decisions that may permit them to get away with unacceptable wrongdoing.

CA 2006 s 180: consent, approval or authorisation by members

CA 2006 s 180 is a general section covering each of: *authorisation* by the directors, according to the terms of the Act, of what would otherwise be a conflict of interest for one of their board members; *approval* by the members of transactions required by statute to have such approval; and, finally, preservation of the general law on *authorisation by the company* of anything that would otherwise be a breach of duty by the directors. This last option is the one under review in this section.

CA 2006 s 239: ratification of acts of directors

CA 2006 s 239 preserves the current law on ratification of acts of directors, but with one significant change. Any decision by a company to ratify conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be taken by the members, but *without* reliance on the votes in favour by the director (as member) or any connected person. Section 252 defines what is meant by a person being 'connected' with a director. For the purposes of this section it may also include fellow directors (s 252(5)(d)).

If the ratification decision is taken at a meeting, those members whose votes are to be disregarded may still attend the meeting, take part in the meeting and count towards the quorum for the meeting (if their membership gives them the right to do so) (s 239(4)).

The company in general meeting may by ordinary resolution ratify an act of the directors which is within the powers of the company but beyond the authority or competence of the directors.

[4.29] Grant v United Kingdom Switchback Railways Co [1888] 40 Ch D 135 (Court of Appeal)

Article 100 of the articles of association of Thompson's Patent Gravity Switchback Railways Co (the second defendant) disqualified any director from voting at a board meeting in relation to any contract in which he was interested. The directors of this company agreed to sell the company's undertaking to the United Kingdom Co (the first defendant) despite the fact **(p. 237)** that they were the promoters of the purchasing company. [The remaining facts appear from the judgment.]

> COTTON LJ: This is an appeal from a decision of Mr Justice Chitty refusing an injunction to restrain Thompson's Company and the United Kingdom Company from carrying into effect a contract for the sale of part of the undertaking of the former company to the latter. The ground of the application was that the directors of Thompson's Company had no authority to enter into the contract, as the articles prohibited a director from voting upon a contract in which he was interested, and here all the directors but one were interested. An application for an injunction was made in the Long Vacation, and ordered to stand over till the Michaelmas Sittings, the companies undertaking not to act upon the agreement in the meantime, but being left at liberty to call meetings of their shareholders with reference to the agreement. A general meeting of the shareholders of Thompson's Company was accordingly held, and passed a resolution approving and adopting the agreement, and authorising the directors to carry it into effect. Mr Justice Chitty under these circumstances refused an injunction, and the plaintiff has appealed.
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> It was argued for the appellant that the directors could not, being interested, make a contract which would bind their company, and that a general meeting could not, by a mere ordinary resolution, affirm that contract, for this would be an alteration of the articles, which could only be effected by a special resolution. This is a mistake. The ratifying of a particular contract which had been entered into by the directors without authority, and so making it an act of the company, is quite a different thing from altering the articles. To give the directors power to do things in future which articles did not authorise them to do would be an alteration of the articles, but it is no alteration of the articles to ratify a contract which has been made with authority.
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> It was urged that the contract was a nullity, and could not be ratified. That is not the case. There was a contract entered into on behalf of the company, though it was one which could not be enforced against the company. Article 100 prevented the directors from binding the company by the contract, but there was nothing in it to prevent the company from entering into such a contract. Two passages in *Irvine v Union*

Bank of Australia[51] were referred to. Being in the same judgment, they must be taken together, and they appear to me to express what I have said—that power to do future acts cannot be given to directors without altering the articles, but that a ratification of an unauthorised act of the directors only requires the sanction of an ordinary resolution of a general meeting, if the act is within the powers of the company.

LINDLEY and BOWEN LJJ delivered concurring judgments.

[4.30] Re Horsley & Weight Ltd [1982] Ch 442 (Court of Appeal)

The company's memorandum included among its objects, by clause 3(o): 'to grant pensions to employees and ex-employees and directors and ex-directors …' and further provided that all the objects should be read and construed as separate and distinct objects. The respondent, Mr Stephen Horsley, had served the company as a director and worked for it as an estimator for many years. The other directors were Mr Campbell-Dick and Mr Frank Horsley (who were the only two members of the company at the material time) and their two wives. Just before the respondent was due to retire from active work at the age of 65, Mr Campbell-Dick and Mr Frank Horsley, purporting to act on behalf of the company, took out a retirement pension policy for his benefit at a cost of over £10,000. The company went into liquidation a year later and in these proceedings the liquidator attacked the validity of the pension payment.

BUCKLEY LJ: I now turn to the second head of Mr Evans-Lombe's argument, viz that the purchase of the pension was effected by Mr Campbell-Dick and Mr Frank Horsley without the authority of the board of directors or of the company in general meeting, and was an act of misfeasance which **(p. 238)** was not validated as against the company's creditors by virtue of the fact that Mr Campbell-Dick and Mr Frank Horsley were the only shareholders. Ignoring for the moment that Mr Campbell-Dick and Mr Frank Horsley were the only shareholders, the transaction in question was indeed carried out by them without the sanction of any board resolution, whether antecedent, contemporary or by way of subsequent ratification. It was an unauthorised act which they were, as two only of the company's five directors, incompetent to carry out on the company's behalf. It therefore cannot stand unless it has in some way been ratified. The question is whether the fact that Mr Campbell-Dick and Mr Frank Horsley were the only shareholders of the company has the effect of validating the transaction.

Mr Evans-Lombe has submitted that there is a general duty incumbent on directors of a company, whether properly described as owed to creditors or not, to preserve the company's capital fund (which he identifies as those assets which are not distributable by way of dividends) and not to dispose of it otherwise than for the benefit or intended benefit of the company. He submits that creditors dealing with the company are entitled to assume that directors will observe that duty; and that creditors although they are not entitled to interfere in the day-to-day management of a company which is not in liquidation, are entitled through a liquidator to seek redress in respect of a breach of the duty. Consequently, Mr Evans-Lombe submits, the members of the company cannot, even unanimously, deprive the creditors of any remedy so available to them.

On this part of the case Mr Evans-Lombe mainly relies upon *Re Exchange Banking Co, Flitcroft's Case* **[10.13]** … The facts of that case were very different from those of the present case and the principles applicable were, in my opinion, also different. A company cannot legally repay contributed capital to the contributors otherwise than by way of an authorised reduction of capital. Nothing of that kind occurred in the present case. There is nothing in the statute or in the general law which prevents a company or its directors expending contributed capital in doing anything which is an authorised object of the company. In the present case the cost of effecting the pension policy was, in my view, incurred in the course of carrying out an express object of the company.

It is a misapprehension to suppose that the directors of a company owe a duty to the company's creditors to keep the contributed capital of the company intact. The company's creditors are entitled to assume that the company will not in any way repay any paid-up share capital to the shareholders except by means of a duly authorised reduction of capital. They are entitled to assume that the company's directors will conduct