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 its affairs in such a manner that no such unauthorised repayment will take place. It may be somewhat loosely said that the directors owe an indirect duty to the creditors not to permit any unlawful reduction of capital to occur, but I would regard it as more accurate to say that the directors owe a duty to the company in this respect and that, if the company is put into liquidation when paid-up capital has been improperly repaid, the liquidator owes a duty to the creditors to enforce any right to repayment which is available to the company. On the other hand, a company and its directors acting on its behalf, can quite properly expend contributed capital for any purpose which is intra vires the company. As I have already indicated, the purchase of the pension policy was, in my view, intra vires the company. It was not, however, within the powers of Mr Campbell-Dick and Mr Frank Horsley acting not as members of the board of directors but as individual directors. Unless the act was effectually ratified it cannot bind the company. They were, however, the only two shareholders. A company is bound in a matter which is intra vires the company by the unanimous agreement of its members (per Lord Davey in *Salomon v A Salomon & Co Ltd* **[2.01]**; and see *Re Express Engineering Works Ltd* [1920] 1 Ch 466 (CA) even where that agreement is given informally:*Parker & Cooper Ltd v Reading*.[52] That both Mr Campbell-Dick and Mr Frank Horsley assented to the transaction in question in the present case is beyond dispute. They both initialled the proposal form and they both signed the cheques for the premiums. Their good faith has not been impugned, nor, in my view, does the evidence support any suggestion that in effecting the policy they did not honestly apply their minds to the question whether it was a fair and proper thing for the company to do in the light of the company's financial state as known to **(p. 239)** them at the time. In my judgment, their assent made the transaction binding on the company and unassailable by the liquidator …

CUMMING-BRUCE and TEMPLEMAN LJJ delivered concurring judgments, in the course of which they made the following comments:

CUMMING-BRUCE LJ: On these facts it is unnecessary to decide whether, had misfeasance by the directors been proved, it was open to them in their capacity as shareholders to ratify their own negligence and so to prejudice the claims of creditors. It would surprise me to find that the law is to be so understood.

TEMPLEMAN LJ: If, however, there had been evidence and a finding of misfeasance and it appeared that the payment of £10,000 in the event reduced the fund available for creditors by that sum, or by a substantial proportion of that sum, I am not satisfied that the directors convicted of such misfeasance, albeit with no fraudulent intent or action, could excuse themselves because two of them held all the issued shares in the company and as shareholders ratified their own gross negligence as directors which inflicted loss on creditors. I should be sorry to find the scope of s 333 [IA 1986 s 212] so restricted and need not do so on this occasion.

An ordinary resolution of members which purports to ratify an irregular act of the directors is ineffective if it itself contravenes the articles.

[4.31] Boschoek Pty Ltd v Fuke [1906] 1 Ch 148 (Chancery Division)

The directors had purported to appoint Fuke managing director at a remuneration of £700 per annum notwithstanding that he did not hold 'in his own right' the number of qualification shares prescribed by the articles and that the maximum remuneration of the whole board was fixed by the articles at £500. The company later confirmed the appointment by resolutions passed unanimously at a general meeting; but the court ruled that the resolutions were invalid.

SWINFEN EADY J: The … ground on which the plaintiff company has objected to the validity of the … resolutions passed at this meeting is that they could only have been properly passed after the articles had been altered by special resolution. The company in general meeting could not appoint, and could not ratify, as from December 1901, the appointment of Fuke as managing director at £700 per annum as he had not the necessary qualification, and the maximum remuneration of the whole board was fixed by the articles at £500. The articles, until altered, bound the shareholders in general meeting as much as the board. The present case is unlike that of *Irvine v Union Bank of Australia*,[53] to which reference was made, as in that case the limitation of the power of borrowing and mortgaging was merely a limitation of the authority of the directors, and not a limitation of the general powers of the company. It was argued that the acts of the directors in excess of their authority might be ratified by the company and rendered binding, and that contention succeeded. Articles must first be altered by special resolution before the altered articles can be acted upon: *Imperial Hydropathic Hotel Co, Blackpool v Hampson* **[4.04]**.

A general meeting may ratify an act of the directors which is voidable as an irregular exercise of their powers.

[4.32] Bamford v Bamford [1970] Ch 212 (Court of Appeal)

The directors of Bamfords Ltd (referred to in the judgment as 'the company') issued 500,000 shares at par to FH Burgess Ltd, one of the principal distributors of the company's products. **(p. 240)** They did so in exercise of a power vested in them by the articles, but (so the plaintiffs alleged) improperly, being primarily for the purpose of forestalling a takeover bid by JC Bamford (Excavators) Ltd. When the validity of the allotment was challenged by the issue of a writ, the directors convened a members' meeting at which the allotment was ratified and approved. (The newly issued shares were not voted.[54]) The Court of Appeal held as a preliminary point of law, on the assumption that the facts alleged were true, that such a ratification would be effective.

> HARMAN LJ: … [This] is a tolerably plain case. 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 done all right from the beginning. I cannot believe that this 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, the directors must pay for it.
>
> [His Lordship referred to *Regal (Hastings) Ltd v Gulliver* **[7.23]** and continued:] So it seems to me here that these directors, on the assumptions which we have to make, made this allotment in breach of their duty—mala fide, as it is said. They made it with an eye primarily on the exigencies of the take-over war and not with a single eye to the benefit of the company, and, therefore, it is a bad allotment. But it is an allotment. There is no doubt that the directors had power to allot these shares. There is no doubt that they did allot them. There is no doubt that the allottees are on the register and are for all purposes members of the company. The only question is whether the allotment, having been made, as one must assume, in bad faith, is voidable and can be avoided at the instance of the company—at their instance only and of no one else, because the wrong, if wrong it be, is a wrong done to the company. If that be right, the company, which had the right to recall the allotment, has also the right to approve of it and forgive it; and I see no difficulty at all in supposing that the ratification by the decision of December 15 in the general meeting of the company was a perfectly good 'whitewash' of that which up to that time was a voidable transaction. And that is the end of the matter. …
>
> RUSELL LJ delivered a concurring judgment.
>
> KARMINSKI LJ concurred.

For another part of the decision, see Note 1 in Further Notes following *Pender v Lushington* **[13.19]**.

[4.33] North-West Transportation Co Ltd v Beatty [1887] 12 App Cas 589 (Privy Council)

The facts appear from the judgment.

The opinion of their Lordships was delivered by SIR RICHARD BAGGALLAY: The plaintiff, Henry Beatty, is a shareholder in the North-West Transportation Company Limited, and he sues on behalf of himself and all other shareholders in the company, except those who are defendants. The **(p. 241)** defendants are the company and five shareholders, who, at the commencement of the action, were the directors of the company. The claim in the action is to set aside a sale made to the company by James Hughes Beatty, one of the directors, of a steamer called the *United Empire*, of which, previously to such sale, he was sole owner.

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.

The material facts of the case are not now in dispute …

It is proved by uncontradicted evidence, and is indeed now substantially admitted, that at the date of the purchase the acquisition of another steamer to supply the place of the *Asia* was essential to the efficient conduct of the company's business; that the *United Empire* was well adapted for that purpose; that it was not within the power of the company to acquire any other steamer equally well adapted for its business; and that the price agreed to be paid for the steamer was not excessive or unreasonable …

It is clear upon the authorities that the contract entered into by the directors on 10 February could not have been enforced against the company at the instance of the defendant JH Beatty, but it is equally clear that it was within the competency of the shareholders at the meeting of the 16th to adopt or reject it. In form and in terms they adopted it by a majority of votes, and the vote of the majority must prevail, unless the adoption was brought about by unfair or improper means.

The only unfairness or impropriety which, consistently with the admitted and established facts, could be suggested, arises out of the fact that the defendant JH Beatty possessed a voting power as a shareholder which enabled him, and those who thought with him, to adopt the bye-law, and thereby either to ratify and adopt a voidable contract, into which he, as a director, and his co-directors had entered, or to make a similar contract, which latter seems to have been what was intended to be done by the resolution passed on 7 February.

It may be quite right that, in such a case, the opposing minority should be able, in a suit like this, to challenge the transaction, and to show that it is an improper one, and to be freed from the objection that a suit with such an object can only be maintained by the company itself.

But the constitution of the company enabled the defendant JH Beatty to acquire this voting power; there was no limit upon the number of shares which a shareholder might hold, and for every share so held he was entitled to a vote; the charter itself recognised the defendant as a holder of 200 shares, one-third of the aggregate number; he had a perfect right to acquire further shares, and to exercise his voting power in such a manner as to secure the election of directors whose views upon policy agreed with his own, and to support those views at any shareholders' meeting; the acquisition of the *United Empire* was a pure question of policy, as to which it might be expected that there would be differences of opinion, and upon which the voice of the majority ought to prevail; to reject the votes of the defendant upon the question of the adoption of the bye-law would be to give effect to the views of the minority, and to disregard those of the majority.

See also *Burland v Earle* [1902] AC 83, PC.

(p. 242) ➢ Question

This case has been understood for well over a century as one of the leading authorities for the principle that a general meeting may ratify an act of the directors which is voidable as an irregular exercise of their powers, on the basis that here the *directors* had entered into a contract which was voidable because of Beatty's undisclosed personal interest, but was rescued from invalidity because the contract was *ratified* by the members' resolution—a resolution on which, it was held, Beatty was not debarred from voting. A number of Sir Richard Baggallay's remarks are consistent with this view of the matter (eg his reference to a 'contract entered into by the directors on 10 February'). Later commentators have gone further, interpreting the case as one where there was a breach of duty by Beatty which he was able to whitewash by the use of his own votes. The CLR adopts this approach, taking *North-West Transportation v Beatty* as illustrating the case of a *wrongdoing* director voting in his capacity as a shareholder to ratify the transaction. It proposed by way of an amendment to the law that the member in question should be disenfranchised and the resolution should only be capable of being carried by a majority of disinterested shareholders (see CA 2006 s 239). A close examination of the facts, and of the arguments of counsel, however, suggests that the whole point of the proposed 'bye-law' was to put the proposal that the company should buy the ship *before the members* for them to decide.

Is there any material difference between the constraints that operate on the exercise of powers by members to affirm a voidable transaction, to waive a breach of duty, or to take a corporate decision *ab initio* ? If there is a difference, how can an observer decide what the members are trying to vote on?

[See also *Burland v Earle* [1902] AC 83, PC, and the *Multinational Gas* case **[7.39]**.]

➢ Notes

1. The principle established by these cases is subject to the limitation recognised in such cases as *Cook v Deeks* **[7.22]** and *Menier v Hooper's Telegraph Works*(1874) 9 Ch App 350, CA: the power to ratify cannot validate acts of fraud or expropriation, or, perhaps more specifically, that directors guilty of such acts cannot, in their capacity as members, ratify or condone their own wrongdoing. This rigorous approach has been extended to ratification of directors' negligence where that negligence also leads to personal benefit (*Daniels v Daniels* [1978] Ch 406, see Notes 2 and 3 following *Franbar Holdings Ltd v Patel* **[13.12]**, p 661).

2. But even that simple statement has its difficulties. On one measure, a company's claim against its defaulting directors *is* a 'corporate asset'. Accordingly, for the members to agree to waive the right, or give it away, amounts to much the same thing as 'giving away' a corporate opportunity as in *Cook v Deeks* **[7.22]**. That is something the members in general meeting could not do, at least where the resolution was carried by the votes of the wrongdoers. Yet examples abound of just this sort of ratification, where directors control the general meeting and are permitted to vote in favour of resolutions that allow them to keep the benefits of contracts with the company (*North-West Transportation Co Ltd v Beatty* **[4.33]**), or escape claims for compensation for negligence (*Pavlides v Jensen* [1956] Ch 565).

3. Two further points are material. First, there must be a members' decision to ratify: as *Re D'Jan of London Ltd* **[7.20]** shows, it is not enough that the decision of the general meeting would certainly have gone in favour of the errant director (here, the director owned 99% of the shares and his wife 1%). Secondly, as a company approaches insolvency, the shareholders lose their right to vote to distribute corporate assets to particular

individuals to the detriment of the claims of the company's creditors (*Kinsela v Russell Kinsela Pty Ltd* **[7.08]**).

(p. 243) 4. On the effect of a ratification or approval in relation to directors' duties, also see *Multinational Gas and Petrochemical Co Ltd v Multinational Gas and Petrochemical Services Ltd* **[7.39]** and *Madoff Securities International Ltd v Raven* **[7.40]**.

Summary of limitations on members' voting

On one analysis, these cases appear to establish a general rule that members are free to use the votes attached to their shares as they think fit and that they may, if they so wish, use them to advance their own interests. This proposition is certainly true of most business and policy decisions, such as whether to make a purchase or whom to appoint as a director. However, there are a number of particular and important limitations on members' freedom to vote as they choose, some of which are well recognised and others of more questionable standing. It is not easy to unite these exceptions by any common theme, although it is probably significant that they belong mostly in the area of intra-corporate disputes,[55] where one group of members is complaining that the others have used their more powerful voting strength to gain an unfair advantage.

Some of these special situations are:

(i) Majority members may not use their votes to appropriate to themselves property which belongs to the company or to condone their own fraud (*Cook v Deeks* **[7.22]**;*Menier v Hooper's Telegraph Works* (1974) 9 Ch App 350, CA).
(ii) Where there is a resolution on an issue which affects the rights of members *inter se*, such as an alteration of the articles or a variation of class rights, the majority must act 'bona fide in the interests of the company (or class) as a whole' (*Allen v Gold Reefs of West Africa Ltd* **[4.22]**; *British America Nickel Corpn Ltd v O'Brien***[11.06]**).
(iii) Where it is sought to bring an action against persons who have allegedly committed wrongs against the company, the alleged wrongdoers may not use their votes to stop the action being brought (historically, an exception to the rule in *Foss v Harbottle* **[12.01]**; and also see 'Ratification of acts of directors: CA 2006 s 239', pp 437ff).
(iv) There are certain *statutory* remedies which may be sought by members who are disadvantaged as a result of some act of the majority, even though what is complained of is within the legal power of the majority. The most popular of these statutory remedies are relief against 'unfairly prejudicial' conduct (on predecessor provisions, see the influential *Scottish Co-operative Wholesale Society Ltd v Meyer* **[13.24]**, and, more generally, see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff), and winding up on the 'just and equitable' ground (*Ebrahimi v Westbourne Galleries Ltd* **[16.13]**).
(v) *Clemens v Clemens Bros Ltd* **[4.20]** and *Re Halt Garage (1964) Ltd* **[5.03]** appear to impose vaguer limitations on the members' voting powers: first, that votes must not be used 'oppressively', and, secondly, that they must be used for 'genuine' purposes. Neither limitation is supported by weighty authority; and nor is either strong enough to make any significant inroad into the line of cases which lay down the general rule.

It would be wrong to deduce from any of the exceptional situations listed here that a member is thereby placed under a *duty* to vote against his own interests, in the altruistic way disowned by Dixon J in the *Peter's American Delicacy* case **[4.26]**, although this is a trap into which judges do occasionally fall (*Re Holders Investment Trust Ltd***[10.04]**). The realistic choice faced by controlling members wishing to avoid having their role in the general meeting decision questioned may well be between abandoning or modifying the proposal, on the one **(p. 244)** hand, and, on the other, taking a calculated risk and pressing ahead in the knowledge that the burden of proof on any minority members seeking to challenge a decision has traditionally been a difficult one to discharge. However, the body of case law under CA 2006 s 994 (the 'unfair prejudice' section, previously CA 1985 s 459: see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff), and cases such as *Clemens v Clemens Bros Ltd* **[4.20]**, suggest that the balance may be tipping towards minority members—or may already have done so.

Some of the debate in this area (both judicial and extra-judicial) confuses the demands of fiduciary duties and the demands of public law or equitable rules on 'proper purposes'. Because shareholders are not constrained by the former, so the argument goes, they cannot be constrained by the latter (indeed, to some the latter are regarded simply as a subset of the former). It is true that shareholders are not constrained by fiduciary duties: unlike directors, they do not have to deny their own interests and favour those of the company or other shareholders (see 'Duty to avoid conflicts of interest: CA 2006 s 175', pp 361ff).[56] But it is not clear why they should not be subject to the same limitations that routinely apply elsewhere to those given a power to exercise—in those other cases it is not controversial that, to be valid, the power must be exercised bona fide and for proper purposes.

➢ Question

Should members exercising their majority power be constrained to vote both bona fide and for proper purposes?[57]

Shareholders' agreements

The company's constitution may be supplemented by a *shareholders' agreement*—a contract, usually of a quite formal kind, entered into by the shareholders either at the time of the company's formation or at some subsequent time (eg when a family company, in need of extra capital to finance an expansion of its business, invites an outsider to join the company as an additional shareholder).[58]

To be fully effective as a constitutional document, it is necessary that all of the members for the time being should be made parties to the agreement, and so the use of a shareholders' agreement in this way is practicable only if the membership is not too large. Shareholders' agreements are also possible between only some of the members, but for different objectives and with different impact. Historically, the company itself was sometimes also joined as a party, but there are dangers in doing so if there is any risk that it will be held to have fettered its statutory powers (see *Russell v Northern Bank Development Corpn Ltd* **[4.34]**).[59]

The shareholders' agreement is used, almost as a matter of routine, to supplement the constitutional documents of smaller companies in Canada and the United States, and its importance has been recognised by legislation in those jurisdictions. In the UK, there is no legislative recognition, but its use is now standard practice for some purposes, for example joint ventures, management buy-outs, and in loan related securities required by lenders.

(p. 245) A shareholders' agreement might typically contain provisions that each of the shareholders should be entitled to appoint a director, that no shareholder should vote in support of an alteration of the company's articles or its capital unless all the members agreed to it, and that except in specified circumstances a shareholder would not require the repayment of money which he or she had lent to the company.

The main advantage of a shareholders' agreement is that normal contractual rules apply, so, unlike the articles of association or the rules governing a company's capital structure, its terms cannot be altered by a majority vote (see 'Alteration of the articles', pp 219ff). Further, contractual obligations are in principle enforceable as of right, and, where appropriate, by injunction. By contrast, most company law remedies are discretionary, and a member who has only a minority shareholding may have no standing to take a complaint to the court. In addition, being normal contracts, shareholders' agreements are not constrained by the odd medley of rules governing enforcement of the articles by individual members (where the courts have added a gloss to the statutory rules so that enforcement must be *qua* member, not in some other capacity, and must concern matters that go beyond mere internal irregularities; see 'Personal claims by members', pp 667ff). On a practical level, unlike the articles of association which is a public document available for inspection by members of the public, a shareholders' agreement offers enhanced privacy which is more fitting for dealing with such matters as directors' remuneration, dividend policy and other sensitive internal management matters. Finally, as per contract law principles, a shareholders' agreement may be set aside where one party entered into the agreement under duress: *Antonio v Antonio* [2010] EWHC 1199 (QB). See also the recent case of *Borrelli v Ting* [2010] UKPC 21, in which the Privy Council found that the liquidators had been induced to enter into a settlement agreement with the defendant shareholder, as a result of the illegitimate economic duress exerted by the latter.

On the other hand, there are disadvantages, the main one being that under the rules of privity of contract a shareholders' agreement is binding only on its immediate parties and not on anyone who later takes a transfer of shares or joins the company as a new member. (The Contracts (Rights of Third Parties) Act 1999 is unlikely to be relevant in this context, since it is concerned only with rights and not obligations.) This is often cured by joining subsequent transferees as parties to an existing shareholders' agreement by requiring the newcomer to execute a 'Deed of Adherence'.

Judges have been known to *imply* a shareholders' agreement and give effect to it (eg in *Pennell Securities Ltd v Venida Investments Ltd* (25 July 1974, noted Burridge (1981) 44 MLR 40)), and the terms of a shareholders' agreement will carry much weight in proceedings brought by a minority shareholder for relief against 'unfairly prejudicial' conduct ('Unfairly prejudicial conduct of the company's affairs', pp 681ff) or for a winding-up order on the 'just and equitable' ground ('Compulsory winding up on the "just and equitable" ground', pp 795ff). Note, however, *Sikorski v Sikorski* [2012] EWHC 1613 (Ch), in which the court held that a breach of an agreement between shareholders would not *ipso facto* constitute 'unfair prejudice'; it still falls upon the petitioner to establish that their interests have been unfairly prejudiced.

For examples of the use (and limitations on the use) of shareholders' agreements, see *Russell v Northern Bank Development Corpn Ltd* **[4.34]**; *Puddephatt v Leith* **[4.19]**;*Euro Brokers Holdings Ltd v Monecor (London) Ltd* **[4.16]**; *Punt v Symons & Co Ltd* **[4.21]** (noting that this agreement was with the *company*, but the judgments allow for inferences to be made about the potentially different treatment of shareholders' agreements). See also, recently, *Westcoast (Holdings) Ltd (formerly Kelido Ltd) v Wharf Land Subsidiary (No 1) Ltd* [2012] EWCA Civ 1003, CA, in which Rimer LJ (with whom Pitchford and Mummery LJJ concurred) highlighted the importance of accurate and precise drafting. The claimant sought to bring a petition to wind up the company for an unpaid shareholders' loan, but this would ordinarily **(p. 246)** be precluded by art 5.3 under the shareholders' agreement. It was however provided under art 19 that the agreement would expire upon, at the latest, its fifth anniversary, and thus the claimant would prima facie be free to bring such petition after the agreement had lapsed. Yet there was a proviso to art 19, which bound the shareholders to the agreement 'to such extent and for so long as may be necessary to give effect to the rights and obligations embodied herein'. The appeal therefore turned on the effect of this 'obscure' proviso, and the Court of Appeal held that art 19 could not revive art 5.3 beyond the five-year period, as the parties' commercial arrangement as a whole demonstrated a consistent intention that the company should have five years in which to make use of the loan and to develop the business venture, and that it would subsequently be open to shareholders to have recourse to all such rights and remedies to recover any unsatisfied debts.

A company may not bind itself not to exercise the power conferred on it by statute, but an agreement by members that they will not support such a resolution is binding.

[4.34] Russell v Northern Bank Development Corpn Ltd [1992] 1 WLR 588 (House of Lords)

A company (referred to in the report as TBL) was set up in 1979 as the parent company in a group of brick-making companies based in Northern Ireland. It had five shareholders: the respondent bank, which held 120 shares, and four executives (including Russell), who each held 20 shares. Soon after the incorporation of TBL, an agreement was entered into between the five shareholders and the company which provided (inter alia) that no further share capital would be created or issued without the consent of each of the parties. In 1988 the board of directors proposed to make an increase of capital to £4 million by a rights issue. Russell objected to this and was successful in obtaining a declaration that the agreement was binding on his fellow shareholders (although not on the company itself).

> LORD JAUNCEY OF TULLICHETTLE: … The issue between the parties in this House was whether art 3 of the agreement constituted an unlawful and invalid fetter on the statutory power of TBL to increase its share capital or whether it was no more than an agreement between the shareholders as to their manner of voting in a given situation. Both parties accepted the long-established principle that 'a company cannot forgo its right to alter its articles' (*Southern Foundries (1926) Ltd v Shirlaw* **[6.04]**, per Lord Porter), a principle that was earlier stated in *Allen v Gold Reefs of West Africa Ltd* **[4.22]** per Lindley MR:

> … the company is empowered by the statute to alter the regulations contained in its articles from time to time by special resolutions …, and any regulation or article purporting to deprive the company of this power is invalid on the ground that it is contrary to the statute …

Murray J and MacDermott LJ [judges in the courts below] both considered that this principle applied also to the right of a company to alter its memorandum and I agree that this must be the case. Mr McCartney QC for the appellant advanced a number of arguments to the effect that the agreement in no way contravened the above principle inasmuch as it was merely an agreement between shareholders outside the scope of company legislation which in no way fettered the statutory power of TBL to alter its memorandum and articles. Mr Girvan QC, on the other hand, submitted that the agreement was not only a voting arrangement between shareholders inter se but was tantamount to an article of association which constituted a restriction on the power of TBL to alter its share capital.

My Lords, while a provision in a company's articles which restricts its statutory power to alter those articles is invalid an agreement dehors the articles between shareholders as to how they shall exercise their voting rights on a resolution to alter the articles is not necessarily so. In **(p. 247)** *Welton v Saffery*,[60] which concerned an ultra vires provision in the articles of association authorising the company to issue shares at a discount, Lord Davey said:

> 'Of course, individual shareholders may deal with their own interests by contract in such way as they may think fit. But such contracts, whether made by all or some only of the shareholders, would create personal obligations, or an exceptio personalis against themselves only, and would not become a regulation of the company, or be binding on the transferees of the parties to it, or upon new or non-assenting shareholders. …'

I understand Lord Davey there to be accepting that shareholders may lawfully agree inter se to exercise their voting rights in a manner which, if it were dictated by the articles, and were thereby binding on the company, would be unlawful.

I turn to examine the agreement in more detail. It appears from the narrative clauses that the agreement was intended to regulate the relationship between the shareholders with regard to the management and control of TBL. Clause 1 provides that the terms of the agreement shall have precedence '*between the shareholders*over the articles of association' (the emphasis is mine). It further provides that where there is a conflict between the provisions of the agreement and the articles parties shall co-operate where necessary to have the articles amended to take account of the provisions of the agreement. It further provides that no further share capital shall be created or issued in TBL without the written consent of the parties to the agreement. … clause 3 affects only existing shareholders and does not purport to bind other persons who may at some future date become shareholders in TBL by allotment or transfer. Clause 3 at least so far as shareholders are concerned constitutes an agreement collateral to the provisions of [the company's articles] and is, as MacDermott LJ has concluded, neither in substitution for nor in conflict with [them].

However it must be remembered that the agreement was executed not only by the shareholders but also by TBL. In *Bushell v Faith* **[6.02]** one of the articles of a private company provided that in the event of a resolution being proposed at a general meeting of the company for the removal of a director any share held by him should carry three votes per share. The issued capital of the company was equally divided between three persons and an attempt by two shareholders to remove the third from the office of director failed because his 300 votes outnumbered the 200 of the two other shareholders. It was held that the article in question was not invalidated by [the equivalent of CA 2006 s 168] which empowered a company by ordinary resolution to remove a director. Russell LJ said, at pp. 447–448:

> 'Mr. Dillon argued … that a company cannot by its articles or otherwise deprive itself of the power by

> special resolution to alter its articles or any of them. But the point is the same one. An article purporting to do this is ineffective. But a provision as to voting rights which has the effect of making a special resolution incapable of being passed, if a particular shareholder or group of shareholders exercises his or their voting rights against a proposed alteration, is not such a provision. An article in terms providing that no alteration shall be made without the consent of X is contrary to [the Act] and ineffective. But the provision as to voting rights that I have mentioned is wholly different, and it does not serve to say that it can have the same result.'

Both parties sought to derive comfort from this dictum. Mr McCartney [counsel for the claimant] relied on it as demonstrating that a provision as to the exercise of voting rights, even although it had the effect of preventing a resolution being passed, was nevertheless valid. Mr Girvan [counsel for the defendant] argued that the effect of clause 3 was the same as that of an article containing a provision that 'no alteration should be made without the consent of X.'

(p. 248) I do not doubt that if clause 3 had been embodied in the articles of association so as to be binding on all persons who were or might become shareholders in TBL it would have been invalid but it was, of course, not so embodied. To my mind the significant part of this dictum for the purposes of this appeal is the words 'articles or otherwise' occurring in the first sentence thereof. These words appear to recognise that it is not only fetters on the power to alter articles of association imposed by the statutory framework of a company which are obnoxious.

Turning back to clause 3 of the agreement it appears to me that its purpose was twofold. The shareholders agreed only to exercise their voting powers in relation to the creation or issue of shares in TBL if they and TBL agreed in writing. This agreement is purely personal to the shareholders who executed it and as I have already remarked does not purport to bind future shareholders. It is, in my view, just such a private agreement as was envisaged by Lord Davey in *Welton v Saffery*. TBL on the other hand agreed that its capital would not be increased without the consent of each of the shareholders. This was a clear undertaking by TBL in a formal agreement not to exercise its statutory powers for a period which could, certainly on one view of construction, last for as long as any one of the parties to the agreement remained a shareholder and long after the control of TBL had passed to shareholders who were not party to the agreement. As such an undertaking it is, in my view, as obnoxious as if it had been contained in the articles of association and therefore is unenforceable as being contrary to the provisions of art 131 of the Companies (Northern Ireland) Order 1986 [CA 2006 s 617]. TBL's undertaking is, however, independent of and severable from that of the shareholders and there is no reason why the latter should not be enforceable by the shareholders inter se as a personal agreement which in no way fetters TBL in the exercise of its statutory powers. I would therefore allow the appeal.

It only remains to consider the relief which would be afforded to the plaintiff. He stated in evidence that he had no objection to the proposed resolutions in themselves but that he wished to establish the validity of clause 3 … In these circumstances it would be inappropriate to grant him the injunction sought in his writ [which was an injunction to prevent the defendants 'considering and/or voting' on the proposed resolutions]. In my view the proper order would be a declaration as to the validity of clause 3 of the agreement as between the shareholders. No argument was addressed to your Lordships as to the form of such a declaration and accordingly the case must be remitted back to the Court of Appeal to make the appropriate order in the light of such submissions as counsel may think fit. …

LORDS GRIFFITHS, LOWRY, MUSTILL and SLYNN OF HADLEY concurred.

➢ Questions

1. Lord Jauncey said that the company could not fetter the exercise of its statutory powers. Which powers are these? Which powers are outside this classification, and could they be fettered?

2. If the company cannot fetter the exercise of *its* powers, *who*, precisely, has to be left free to act, since a company can only act by human agents?

3. The contractual clause binding the company in *Russell v Northern Bank Development Corpn Ltd* was held to be 'unenforceable'. Does this mean it was void (as against the company)? What, if anything, is the difference? Also see the Notes following *Punt v Symons & Co Ltd* **[4.21]**, pp 221ff.

4. By contrast, the contractual clause binding the shareholders in *Russell v Northern Bank Development Corpn Ltd* was enforceable. The House of Lords declined to order an injunction in the circumstances. Would the court *ever* order an injunction to restrain a breach by shareholders, or would it only ever order damages on breach? If it would order an injunction, what impact would this have on fettering the company's exercise of its statutory powers? If it would not order an injunction, what is the value of a shareholders' agreement?

(p. 249) ***A shareholders' agreement may alter the orthodox corporate law rules that govern amendments to the company's constitution and enforcement of directors' duties.***

Read *Wilkinson v West Coast Capital* **[7.28]**.

The shareholders' agreement in *Wilkinson* provided that certain corporate actions could only be pursued with the consent of more than 65% of the shareholders (Clause 5), and that each shareholder should use all reasonable and proper means to promote the interests of the company (Clause 7). Warren J held that Clause 7 must be read subject to Clause 5, and that, therefore, Clause 5 enabled controlling shareholders who were also directors to use their vote to decide that the company should not pursue a new business opportunity, with the result that the opportunity would not then be regarded as a 'corporate opportunity', and so pursuit of it by the directors would not constitute a breach of the conflicts rule (see *Bhullar v Bhullar* **[7.25]**). A minority shareholder unsuccessfully sought a remedy under the unfair prejudice provisions of the Act (CA 1985 s 459; now see CA 2006 s 994). Also see *Breckland Group Holdings Ltd v London & Suffolk Properties Ltd* [1989] BCLC 100 (Ch).

➢ Note

This decision confirms that shareholders exercising their rights under a shareholders' agreement can use their votes as they wish. Applying general contract law principles, such a conclusion is unsurprising. However, in the context of this case, the finding ensured that the directors (as controlling shareholders) could effectively determine changes to the company's business objects without the constraints inherent in cases such as *Allen v Gold Reefs* **[4.22]**, and could ensure that they were not caught by the fiduciary conflicts rule in pursuing new corporate opportunities.[61]

➢ Questions

1. There are good commercial reasons for shareholders' agreements in this form, allowing the shareholders to limit the future business direction of the company. But if this right is unqualified, what protection exists for the dissenting minority? (Here, the dissenting minority was unsuccessful in claiming 'unfair prejudice'—CA 2006 s 994.) Is the response simply that the minority should not have submitted themselves to the terms of the shareholders' agreement?

2. Should *all* exercises of majority power—that is, *all* cases where a majority can compel a dissenting minority to conform to a decision that they have not consented to—be constrained by the (fairly minimal) requirements that the power should be exercised in good faith and for proper purposes (a subjective test) and for proper purposes (an objective test)? In this case, there would then be serious assessment of whether the directors voted as they did in good faith and for proper purposes (see this issue assessed at 'Limitations on the free exercise of members' voting rights', pp 213ff, and at 'Duty to promote the success of the company: