A CONCEPTUAL ANALYSIS OF THE CONTROL OF COMPANIES

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[*The law relating to the control of companies has been complicated by the failure of the judiciary and legislature finally to resolve some profound questions regarding the nature of associations. According to the writer, the central stumbling-block involves the decision-making process of associations: how is a single intention to be distilled from those of the multitude? The necessary acceptance of majority rule by the law inevitably allows decisions to be made for the benefit of the majority at the expense of the minority. In order to provide some answers to the fundamental questions he poses, the writer, after establishing a conceptual framework within which to base his discussion, outlines and analyses the controls which the law has placed on the decision-making of directors and the majority in general meeting before introducing a new conceptual base for regulation of decision-making.*]

1. SOME QUESTIONS

The aim of this essay is to set out in a coherent fashion the modern company law in the area usually known as 'shareholder's rights and the rule in *Foss v. Harbottle*'.[1] Writers have not been negligent of this area,[2] rather in recent years the overall perspective has been lost. Certainly it is a peculiarly complex segment of the law but this is not to be taken to imply that it is incapable of being understood, rather that the legal system has failed to finally resolve some profound questions as to the nature of associations.[3] Some of these are: what are the relations between the constitutive parts, whether groups or individuals, of the association? Who or what

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[1] Wedderburn K. W., 'Shareholder's Rights and The Rule in Foss v. Harbottle' (1957) 15 *Cambridge Law Journal* 194 and (1958) 16 *Cambridge Law Journal* 93. Most writers use this nomenclature, but alternatives are 'internal management' and 'majority rule'. Topics included in the general area are '(in) fraud on (of) the minority', 'oppression', 'the division of powers', shareholders contract', and 'minority shareholders rights' and many others. I prefer to refer to 'control of the company'.

[2] The literature is all but overwhelming in quantity, if not in quality. A (very) select bibliography must begin with Wedderburn, *loc. cit.* Other sources (beyond the standard textbooks) are: Baxt R., 'Judges in their own Cause: the Ratification of Directors' Breaches of Duty' (1978) 5 *Monash University Law Review* 16; Beck S. M., 'An Analysis of Foss v Harbottle' in *Studies in Canadian Company Law* (1967); Beck S. M., 'The Shareholders' Derivative Action' (1974) 52 *Canadian Bar Review* 159; McPherson B. H., 'Oppression of Minority Shareholders' (1963) 36 *Australian Law Journal* 404, 427; Mason H. H., 'Ratification of the Directors' Acts: an Anglo-Australian Comparison' (1978) 41 *Modern Law Review* 161; Sealy L. S., 'The Director as Trustee' (1967) 25 *Cambridge Law Journal* 83; Smith R. J., 'Minority Shareholders and Corporate Irregularities' (1978) 41 *Modern Law Review* 147; Thomson C. J. H., 'Share Issues and the Rule in Foss v. Harbottle' (1975) 49 *Australian Law Journal* 134. A perusal of most editions of the *Modern Law Review* is sure to reveal an article on the topic.

[3] Whether final resolution would be a Good Thing is a different question of a jurisprudential nature. Certainly no result should be fixed for all time, but perhaps a degree of certainty greater than that currently available is desired by the business community: Beck S. M., 'The Saga of Peso Silver Mines: Corporate Opportunity Revisited' (1971) 49 *Canadian Bar Review* 80, 82; Baxt R., 'Judges in their own Cause: The Ratification of Directors' Breaches of Duty' (1978) 5 *Monash University Law Review* 16, 18. See generally for the relationship between managerial theory and the law, Willett F. J., 'Conflict between Modern Managerial Practice and Company Law' (1965-7) 5 M.U.L.R. 481.

decides any particular issues and how is this to be discovered? How is a decision to be reached by a group? To what extent can an association transform itself or itself alter the appropriate answers to the above questions? They are abstract questions and require a greater degree of abstraction to answer, which is the probable reason why the legal system has failed to resolve the issues: the common law is oriented towards solving particular problems on a case by case basis and the legislature has adopted the same approach.

In recent years the dilemmas have surfaced in such issues as: To what extent are the activities of directors in breach of their duties remedial by court action by a shareholder?[4] What additional remedies for oppression of minorities and other acts have been granted by statute? To what extent are the words of the statute to be interpreted as supplementary or complementary to common law concepts of company?[5] To what extent are the articles of association enforceable?[6] Even if it is claimed that statute has or should have replaced the common law, the content of the legislative solutions still remains governed by the principles and even problems of the common law.

2. A WORKING HYPOTHESIS

Perhaps the most fundamental error that has crept into the discussions to date has been lack of conceptual coherence.[7] It is as well to remedy the defect at the outset, not so much as an attempt at truth or correctness, since concepts are mutable, as to establish working hypotheses and definitions upon which the remainder of this essay may be founded.

[4] *E.g., Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1982] 1 All E.R. 354; *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All E.R. 437; *Clemens v. Clemens* [1976] 2 All E.R. 268; *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666, and many others. A more particular question is to what extent can the beneficiaries of a trading trust enforce duties owed by the directors of a trustee company? See *Hurley v. B. G. H. Nominees Pty Ltd* (1982-3) 1 A.C.L.C. 387.

[5] This issue is usually raised in the context of the statutory 'derivative' action of some Canadian Provinces: see Beck S. M., 'The Shareholders' Derivative Action' (1974) 52 *Canadian Bar Review* 159, 196-207; Buckley F. H., 'Ratification and the Derivative Action Under the Ontario Business Corporations Act' (1976) 22 *McGill Law Journal* 167; Thomson, *op cit.* 134-6.

[6] The most recent of a long line of cases are: *Papaioannoy v. The Greek Orthodox Community of Melbourne* (1978) 3 A.C.L.R. 801; *Clemens v. Clemens* [1976] 2 All E.R. 268; *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666; *Kraus v. J. G. Lloyd Pty Ltd* [1965] V.R. 232. The paradigm cases are, of course, *Mozley v. Alston* (1847) 1 Ph. 790, 41 E.R. 833; *MacDougall v. Gardiner* (1875) 1 Ch. D. 13; *Eley v. The Positive Government Security Life Assurance Company Ltd* (1876) 1 Ex. D. 88; *Pender v. Lushington* (1877) 6 Ch. D. 70; *Browne v. La Trinidad* (1887) 37 Ch. D. 1; *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame* [1906] 2 Ch. 34; *Salmon v. Quin & Axtens Limited* [1909] 1 Ch. 311; *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch. 881; *Brown v. British Abrasive Wheel Company Limited* [1919] 1 Ch. 290; *Sidebottom v. Kershaw, Leese and Co.* [1920] 1 Ch. 154; *Rayfield v. Hands* [1958] 2 All E.R. 194.

[7] Perhaps the most glaring example is the definition of the term 'company'. The company, the interests of which must be kept in mind by a majority altering the articles (as defined in *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 481, 512, *cf. Greenhalgh v. Arderne Cinemas Ltd* [1951] 1 Ch. 286, 291, as the corporation as a general body, taking into account the purposes and future shareholders) is quite a different body than that to which disclosure must be made (see *Bamford v. Bamford* [1969] 1 All E.R. 969, 972, 975, and *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666, 701) and both are not the institutions to which directors' duties are owed (*Percival v. Wright* [1902] 2 Ch. 421). Within each of the above uses of the term there is also considerable debate and confusion.

(a) *The corporation*[8]

A corporation is a bag of assets[9] dedicated to ascertainable purposes, owned by a group, individually called members, and recognized by society at large as being owned and subject to liabilities. Two aspects of corporations are immediately obvious.[10] The external face is that recognized by the legal system as the legal entity. It has characteristics such as being able to sue and be sued, own property, have perpetual existence and so forth. The internal associative aspect is less easily defined, is not recognized in law as a discrete concept and yet is that with which so many cases and so much legal writing is concerned. The members of the association pool their capital on certain common understandings and, consequently, form a group of people.[11] The group must rule and govern itself, secure itself and its property, ensure its purposes and understandings are carried out and cope with problems arising from all these activities. In other, and perhaps more mystical terms, the act of association creates a sovereignty in the group as such over its affairs. This sovereignty may or may not be recognized by the legal system or may be recognized in varying degrees.

(b) *The memorandum and articles*

The analysis in the preceding paragraph gives the memorandum and articles of the company a constitutive effect. As a constitution they do not create the legal entity, which is the product of an act of recognition by the legal system. Legal personality may be the result of the pooling of capital, with the association governed by its constitution, but it is unconnected in theory to the constitution except in so far as the legal system recognizes that type of pool as a 'person'. The memorandum and articles are constitutive of the shareholders as a group and, as will be later explained, are not contractual in the sense of being private legislation.[12]

[8] The theory here espoused owes much to Stoljar S. J., *Groups and Entities. An Inquiry into Corporate Theory* (1973) 175-89. However, I doubt that those who believe in the 'fictionalist' or 'realist' theories will find much in the essay with which their faith disagrees.

[9] *Cf.* the managerial approach in Willett, *loc. cit.* and the 'agency' approach developed in Jensen H. C . and Meckling H. W., 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305. The latter theory concentrates on the relations between ownership, management and control, assuming the pool of capital. See also (1983) 26 *Journal of Law and Economics* 235-496 which comprises articles largely devoted to these theories.

[10] The relations between the aspects is explored in Stoljar, *op cit.* 188-9.

[11] In most Companies Acts, the effect of incorporation stated to be: 'the subscribers to the memorandum, together with such other persons as from time to time become members of the company, are an incorporated company by the name set out in the memorandum' (s. 35(4) *Companies (Vic.) Code*. All references hereafter will be to this legislation, unless stated otherwise). The purported problem with this analysis is that it grants preeminence to unanimous consent, causing difficulties with sole beneficial shareholders: *Gramophone and Typewriter Ltd v. Stanley* [1908] 2 K.B. 89; *John Shaw & Sons (Salford) Ltd v. Shaw* [1935] 2 K.B. 113; *cf. Re Express Engineering Works* [1920] 1 Ch. 466; *Ho Tung v. Man On Insurance Co. Ltd* [1902] A.C. 232. An examination of these cases (see pp.629-30 *infra*) reveals that the dichotomy between legal entity and association sufficiently explains the law, even if the fact of complete control by a sole beneficial shareholder does not.

[12] *Bisgood v. Henderson's Transvaal Estates Ltd* [1908] 1 Ch. 743, 759: '[t]he purpose of the memorandum and articles is to define the position of the shareholder as shareholder, not to bind him in his capacity as an individual'.

(c) *Membership and shareholding*

Those pools of capital recognized as companies have the contributors of capital as the members of the group. Membership is the status of being part of the group constituted by and recognizable by means of the memorandum and articles. The criterion of recognition is contribution to the pool. The status of being a member is transferable, thus the notion of being the owner of the membership has grown, that is ownership of a share. But usual incidents of membership such as the right to vote and the right to receive dividends derive from the act of associating rather than any concept of ownership.[13] The purported contractual foundation of company law[14] is, therefore, misleading. A more accurate analysis is that the reason for enforcement of the rights and duties deriving from the association is the association itself. When enforceable they are enforced as contractual rights and obligations would be.[15] As a result, the type or nature of the association influences the particular rights which may be enforced.[16] A company formed as the institutionalization of a sector of society will have certain rights enforceable[17] when the same issue may not be the subject of enforceable rights in a trading company.[18] Thus the contract purported to be at the base of the nature of the corporation is a description of the enforceability of the rights deriving from the act of associating.[19]

[13] The famous definition of a share in *Borland's Trustee v. Steel Brothers and Co. Ltd* [1901] 1 Ch. 279, 288 may well mislead at this point. The definition describes the share and not membership, emphasises its measurement as value as a transferable security and does not equate shareholding with contractual rights. The phrase in the definition which describes the relationship between shareholding and contract, is '[t]he contract contained in the articles of association is one of the original incidents of the share'.

[14] A contract as the basis of a company is used as a working hypothesis in many cases: *e.g.* early cases including those concerning deed of settlement companies, *Sparks v. Liverpool Water Works Co.* (1807) 13 Ves. Jun. 428; 33 E.R. 354; *In re Norwich Yarn Company, ex parte Bignold* (1856) 22 Beav. 143; 52 E.R. 1062; *In re Tavarone Mining Company: Pritchard's Case* (1873) 8 Ch. App. 956; *Houldsworth v. City of Glasgow Bank* (1880) 5 App. Cas. 317; *Imperial Hydropathic Hotel Company, Blackpool v. Hampson* (1882) 23 Ch. D. 1. See also the paradigm cases of *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame* [1906] 2 Ch. 34, *Salmon v. Quin & Axtens Ltd* [1909] 1 Ch. 311, *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch. 881. More recent applications have been *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457; *Rayfield v. Hands* [1958] 2 All E.R. 194; *Papaioannoy v. The Greek Orthodox Community of Melbourne* (1978) 3 A.C.L.R. 801; *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666. Among the writers asserting the contract basis (other than in a purely descriptive sense of the above cases) are: Ford H. A. J., *Principles of Company Law* (3rd ed. 1982) 55-62, 337-44; Gregory R., 'The Section 20 Contract' (1981) 44 *Modern Law Review* 526; Goldberg G. D., 'The Enforcement of Outsider-Rights under s. 20(1) of the Companies Act 1948' (1972) 35 *Modern Law Review* 362; Lindgren K. E., 'The Fiduciary Nature of a Company Board's Power to Issue Shares' (1971-2) 10 *University of Western Australia Law Review* 364; Mason H. H., 'Ratification of the Directors' Acts: An Anglo-Australian Comparison' (1978) 41 *Modern Law Review* 161.

[15] Hence the confusions as to whether the constitution of unincorporated associations are enforceable. It is beyond the scope of this essay to examine the applicability of the concepts here developed to unincorporated associations, but it does seem that application of the concept of association separate from legal entity could clarify the area.

[16] The obvious corollary is that some provisions in the articles are not enforceable: *Eley v. Positive Government Life Security Assurance Co.* (1876) 1 Ex. D. 88; *Beattie v. E. & F. Beattie Ltd* [1938] Ch. 708; *Mozley v. Alston* (1847) 1 Ph. 790; 41 E.R. 833; *Pulbrook v. Richmond Consolidated Mining Co.* (1878) 9 Ch. D. 610; *Browne & La Trinidad* (1887) 37 Ch. D. 1; *Re Dale and Plant Ltd* (1889) 61 L.T. (N.S.) 206; *Baring-Gould v. Sharpington Combined Pick and Shovel Syndicate* [1899] 2 Ch. 80.

[17] *Papaioannoy v. The Greek Orthodox Community of Melbourne* (1978) 3 A.C.L.R. 801.

[18] *Mozley v. Alston* (1847) 1 Ph. 790; 41 E.R. 833.

[19] *Bisgood v. Henderon's Transvaal Estates Ltd* [1908] 1 Ch. 743, *cf.* s. 578 (1), *Rayfield v. Hands* [1958] 2 All E.R. 194, but note the doubt (199) as to whether the strict contract analysis was applicable to types of company other than those bearing a close analogy to partnerships.

(d) *Duties of the association*

As a corollary to the rights of members, the group is subject to duties under its constitution. Such duties may stop with the group, that is a group liability, or may attach to the members themselves. Both types of liability derive from the association and its nature, that is, from the act of becoming a member.[20]

(e) *Decisions*

Decisions of the group are, by definition, not made by any one individual. This is the central problem of the whole area of law: how is a single intention or desire to be distilled from those of a multitude? In most fields the law has long abandoned any hope of ascertaining what really goes on in the minds of people;[21] in the area of associations the problem is compounded by the nature of groups. Even if objective intention is ascertainable, which objective intention is that of the group? In company law diverse solutions are adopted for various situations, for example, the poll or voting on propositions for either a negative or positive result. This method implicitly rejects the notion of a harmonious meeting of minds and accepts the political nature of power, that there is only a yes or no answer and that the majority have the fundamental power to force their point of view on the minority. Naturally, violence has been buried deep in the intricacies of company law, yet there is no other inherent morality or justification for majority rule. The requirement[22] of a seventy-five per cent majority for fundamental matters, such as changes to the constitution, is a mere gloss on the nature of the group.[23] Decision by majority is so inherent in the conception of group held by society that it has needed no stricture in statute, nor any examination of case-law to support it.

The alternative method of decision-making is the delegation of decisions to representatives of the group.[24] Companies are concerned only with the use of the pool of capital[25] and the law to date has recognised that alone as the purpose of the

[20] Interesting reflections on the nature of liability in groups from an anthropological aspect can be found in Moore S. F., *Law as Process. An Anthropological Approach* (1978) Ch. 3 and Smith M. G., *Corporations and Society* (1974) Ch. 3.

[21] The reasonable man is the legal substitute for telepathy. His use is justified by concepts of one person's reasonable reliance on what would appear to be the intention of another person. Telepathy would solve all.

[22] Ss. 76(1), 73(1), 65(1), 69(4), 412(1), 129(10), 234, 129(10), 355(1), 34(4), 123, 114(2), 364(1), 392, 409(1), 333(1)(b), 338, 343(3), 344(3).

[23] Alterations to matters thought to be necessary to the nature of the company were impossible in *In re Norwich Yarn Company; ex parte Bignold* (1856) 22 Beav. 143, 52 E.R. 1062, but since then an increasing number of matters have been declared by parliament to be decided by special resolution. The seventy-five per cent of votes requirement is a statutory invention.

[24] The word 'representative' is not used in any technical legal sense. The concept of 'representative' refers to decisions being made by A on behalf of B affecting B's property or person. B grants to A the right to make the decision. In some economic theories of the firm the term 'agent' is used *e.g.* Jensen and Meckling, *loc. cit.* and numerous articles in (1983) 26 *Journal of Law and Economics* 235 ff.

[25] *Cf. Papaioannoy v. The Greek Orthodox Community of Melbourne* (1978) 3 A.C.L.R. 801 and *Hickman v. Kent or Romney Marsh Sheep-breeders' Association* [1915] 1 Ch. 881, in both of which cases the purpose of the company does not at first sight seem to be the use of the pool of capital. But 'use' does not necessarily equate to 'profit': 'use' can refer to advancement of purposes other than the financial, through the use of the pool of capital as a resource.

group.[26] Thus the use of representatives for decision-making is viewed as an entrusting of the pool of capital to the representatives, or 'directors'. Not surprisingly, this has resulted in the development of safe-guards upon the use of the pool of money by the directors in the form of equitable duties to avoid certain acts.

The constitution of the association is initially decided upon and accepted on acquisition of membership.[27] For each decision to be made there is allocated a method of decision-making by the constitution. The language used in law expresses this concept differently: that the 'powers of the company' are 'divided' between the various 'organs' of the company. The resulting rules are the same. No matter what the terminology, the consequence of decision-making processes which assume less than unanimity as their rationale is the opportunity for disagreement. The acceptance into the law of the necessary existence of minority and majority positions inevitably allows opportunity for the benefit of the majority to be paramount. The possibility of oppression or fraud is, therefore, inherent in the decision-making process. The directors, being entrusted with the use of assets may breach their trust[28] or the majority may take from the minority what was the minority's. Even apart from the particular method of making decisions, a combination of both may allow benefit to be derived by controllers. An examination of the legal principles and rules coping with these inherent defects will provide the answers to the fundamental questions posed at the outset of this essay.

3. DECISIONS BY DIRECTORS

(a) *Nature of the process*

It is beyond the scope of this essay to examine in detail the contents of the duties of directors, except to note that as 'vicarious acquisitiveness' lies at the basis of corporate capitalism[29] it is not really appropriate to trust the directors.[30] The opportunities for directors to enrich themselves are obviously great, thus the association must retain a degree of control over their actions, for example, the

[26] Hence the rejection of natural justice as a control on the acts of any method of decision making in all but very exceptional circumstances. See Mason H. H., 'Companies and the Principles of Natural Justice' (1973) 1 *Australian Business Law Review* 226; *Gaimman v. National Association for Mental Health* [1971] Ch. 317; *McNab v. Auburn Soccer Sports Club Ltd* [1975] 1 N.S.W.L.R. 54; *Thorburn v. All Nations Club* (1975) 1 A.C.L.R. 127.

[27] Membership may be acquired by contract with a previous member or the company. The usual assumption is that this contract has the same terms as the s. 78 contract. See Chantler D. W., 'The Shareholder's Corporate Contract in Western Australia' (1975-6) 12 *University of Western Australia Law Review* 333. This is not a necessary conclusion if the acquisition is of 'membership', whatever that might mean, and not of rights and liabilities as defined by the memorandum and articles. Certainly it is accepted that the mere fact of contracting to purchase a share, even from the company by original allotment, on the condition that the memorandum and articles are binding does not imply that they are completely binding (see *supra* p.604). Thus it is accepted that the contractual basis of acquisition of membership and the basis of the association are distinguishable and lead to differing sets of rights.

[28] The word 'trust' is used in a non-technical sense. This is not to say that the director's position and trust concepts are not linked, but that a direct equation of trust and a director's position is misleading. See: Sealy, *loc. cit.* and *infra* pp.610-2.

[29] Beck S. M., 'The Saga of Peso Silver Mines' 49 *Canadian Bar Review* 80, 83.

[30] The reasons for and costs associated with 'trusting' directors are the questions tackled by the financial theories adverted to *supra* n.24 and n.9.

power to dismiss, to seek remedies for actions which have caused loss to the association, or even to reverse decisions made by the board of directors. Unfortunately, as soon as this is accepted, a further decision is needed by the association and the same problems of how to determine the wish of a group are confronted.

Early in the development of the concept of company it was assumed the will of the majority was the will of the association. The association, by a delegation of power, appointed the directors to manage their affairs. The majority of members could, as a result, override any decision of the directors because a delegation of power does not take away the original power of the delegator.[31] During the latter quarter of last century, the contract basis theory of companies was developed, replacing the delegation theory. It depended on s. 20 of the *Companies Act* 1896 (U.K.)[32] and asserted that there existed a contract between the members and that this contract consisted of the memorandum and articles. For this reason it came to be realized that the articles were enforceable and therefore a stipulation that the directors were to decide a matter precluded the shareholders from overriding the decision:[33]

> . . . it seems to me that the shareholders have by their express contract mutually stipulated that their common affairs should be managed by certain directors to be appointed by the shareholders in the manner described by other articles, such directors being liable to be removed only by special resolution. If you once get a stipulation of that kind in a contract made between the parties, what right is there to interfere with the contract, apart, of course, from any misconduct on the part of the the directors?

The adoption of the contract basis to companies recognized the need for some basis for the binding nature of the constitution of the company. To refer the management of the business by the directors to the contract accepted that the powers of the board of directors derived from something other than a delegation of power. As Collins M.R. stated[34] in the same case:

> No doubt for some purposes directors are agents. For whom are they agents? You have, no doubt, in theory and law one entity, the company, which might be a principal, but you have to go behind that when you look to the particular position of directors. It is by the consensus of all the individuals in the company that these directors become agents and hold their rights as agents. It is not fair to say that a majority at a meeting is for the purposes of this case the principal so as to alter the mandate of the agent. The minority also must be taken into account. There are provisions by which the minority may be over-borne, but that can only be done by special machinery in the shape of special resolutions. Short of that the mandate which must be obeyed is not that of the majority — it is that of the whole entity made up of all the shareholders. If the mandate of the directors is to be altered, it can only be under the machinery of the memorandum and articles themselves.

[31] *A.-G. v. Davy* (1741) 2 Atk. 212, 26 E.R. 531; *Mayor and Commonalty of Colchester v. Lowten* (1813) 1 V. & B. 226, 35 E.R. 89; *Foss v. Harbottle* (1843) 2 Hare 461, 491, 67 E.R. 189, 202; *Exeter and Crediton Railway Co. v. Buller* (1847) 16 L.J. Ch. 449; *In re Norwich Yarn Co.; ex parte Bignold* (1856) 22 Beav. 143, 52 E.R. 1062; *In re Langham Skating Rink Co.* (1877) 5 Ch. D. 669; *Imperial Hydropathic Hotel Co. Blackpool v. Hampson* (1882) 23 Ch. D. 1; *Isle of Wight Railway Co. v. Tahourdin* (1884) 25 Ch. D. 320.

[32] The present s.78.

[33] *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame* [1906] 2 Ch. 34, 44 *per* Cozens-Hardy L.J. This case was the consequence of a line of cases slowly developing the concept. *Andrews v. Gas Meter Co.* [1897] 1 Ch. 361; *La Compagnie De Mayville v. Whitley* [1896] 1 Ch. 788; *North-West Transportation Company Ltd and J. H. Beatty v. H. Beatty* (1887) 12 App. Cas. 589; *In re State of Wyoming Syndicate* [1901] 2 Ch. 431.

[34] *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame* [1906] 2 Ch. 34, 42-3. Compare this with the rationale of Cozens-Hardy L.J. which is far from satisfactory: it is based on concepts of co-ownership and partnership, that is of co-operation for mutual benefit, which sit uneasily with fiduciary duties based on trust concepts.

The majority, the board of directors and even the special resolution are separate ways of ascertaining the will of the group, but are not a direct expression of that of 'the whole entity made up of all the shareholders'.

The second concept influencing the standards of conduct of directors has been the protection of investors from themselves. Although members are deemed to be bound by the rules of the association they join, usually by an act of free choice,[35] it is recognized that not all people are qualified to fully appreciate the consequences of their actions. A company is formed by a group whose interests may diverge from those of later members and society at large. The initial members define the purposes to which the pool of capital will be put, that is, of the group itself. In their hands lies the allocation of decison-making powers, which can be done in such a way as to endanger the benefits of all subsequent members. For this reason the courts of equity developed standards of conduct to which the persons in the positions of promoters and directors must adhere.[36] Initially, the individual was trusted to be sufficiently sensible not to join groups in the constitutions of which the incorporators had provided for the derogation of the standards of conduct to such a degree as to endanger their own benefit. This proved to be an ill founded trust and legislation was required to regulate the release of directors' duties.[37]

(b) *Enforcement of duties*

Having decided that directors were required to abide by standards of conduct, the courts of equity were faced with the problem of their enforcement. Those whose interests were being protected were clearly best suited to detecting breaches and deciding whether enforcement was warranted. Perpetual monitoring of the conduct of all directors of every company is obviously beyond the resources of cost-effective court systems. The interests being protected are those of the group because the members as an association entrust the pool of capital to the board of directors. The board is a decision-making process designed to be the, admittedly defective, expression of the will of the group. Thus the interests of an individual member are only relevant in so far as they are one variable within the multitude that comprise the unknowable formula for ascertaining the group interest. This has been recognized in law by the rule that the duties of directors are not owed to the individual shareholders.[38] To assert otherwise would be to undermine the whole notion of the association, let alone the acceptance of viable means of ascertaining

[35] The exception is when property passes by way of succession: see *Land Mortgage Bank of Victoria Ltd v. Jane Reid* [1909] V.L.R. 284, 289-90.

[36] For a description of the early development of the duties of directors, see Sealy L. S., *op cit.* 83 ff. Also see Beck S. M., 'The Saga of Peso Silver Mines' 49 *Canadian Bar Review* 80, 86-95.

[37] The present s. 237, originally enacted in the Companies Act 1929 (U.K.). See Parsons R. W., 'The Directors' Duty of Good Faith' (1965-7) 5 M.U.L.R. 395; Birds J., 'The Permissible Scope of Articles Excluding the Duties of Company Directors' (1976) 39 *Modern Law Review* 394; and also the relevant cases: *Costa Rica Railway Co. Ltd v. Forwood* [1901] 1 Ch. 746; *Imperial Mercantile Credit Association v. Coleman* (1871) L.R.6 Ch. App. 558, reversed in (1873) L.R. 6 H.L. 189, but affirmed on this point; *Peninsula and Oriental Steam Navigation Co. v. Johnson* (1938) 60 C.L.R. 189.

[38] *Percival v. Wright* [1902] 2 Ch. 421. *Cf. Allen v. Hyatt* (1914) 30 T.L.R. 444; *Coleman v. Myers* [1977] 2 N.Z.L.R. 225; but see *Hurley v. B.G.H. Nominees Pty Ltd* (1982-3) 1 A.C.L.C. 387, 392-3 *per* White J. The (rather hopeless) position of beneficiaries in a trading trust with a company as trustee is also discussed in that case (392-5). (See also Betts R. W., Buchanan R. F. and Baxt R., *Corporate Trustees: disclosure, taxation and the liability of officers* (1979) paras 328-30).

the decision of the group.[39] It has been accepted that it is the company to which the duties of directors are owed, but whether this refers to the legal entity or the association is a question of theory to which the law has not addressed itself. However, this much is known, that since the duties are owed to the 'company', it is the 'company' alone that can sue for their enforcement. This is known as the rule in *Foss v. Harbottle*[40] in its proper plaintiff aspect.

The reasons given for this rule are many and various in their expression. It is not sufficient to assert that it is merely an application of

> . . . the elementary rule that A cannot, as a general rule, bring an action against B to recover damages to secure other relief on behalf of C for an injury done by B to C. C is the proper plaintiff because C is the party injured and therefore the person in whom the cause of action is vested.[41]

This begs the question, why is the company defined as the person injured? In this essay I answer by drawing a distinction between the group and the individual and asserting that they are fundamentally different social entities and have different interests, although the interests of the group can only be ascertained by methods agreed on by the members. Most explanations do not proceed so far down the road of separate personality, yet for this reason leave themselves open to confusion and dispute. Bases of ratifiability[42] and futility[43] proceed from the assumption of a valid division of power between 'organs', which itself derives from confused notions of legal personality. The fear of multiplicity of actions[44] as an explanation may be taken to be a statement of the association theory, but more frequently is stated as a rationale in itself.[45]

[39] These fears are reflected in the pragmatic denials of standing to sue in the form of a fear of a multitude of actions and companies tearing themselves to pieces (*La Compagnie De Mayville v. Whitley* [1896] 1 Ch. 788, 807 *per* Kay L.J.).

[40] (1843) 2 Hare 461, 67 E.R. 189.

[41] *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1982] 1 All E.R. 354, 357.

[42] Gower L. C. B., *Principles of Modern Company Law* (3rd ed. 1969) 582-6; discussed and rejected in Wedderburn K. W., (1958) 16 *Cambridge Law Journal* 93, 105-6; asserted in *Foss v. Harbottle* (1843) 2 Hare 461, 493, 67 E.R. 189; *Kent v. Jackson* (1851) 14 Beav. 367, 51 E.R. 328; *Davidson v. Tulloch* (1860) 3 McQ. 783, 10 Scots Rev. Rep. 333; *Taunton v. Royal Assurance* (1864) 2 H. & M. 135, 140, 71 E.R. 413; *Cf. Hogg v. Cramphorn Ltd* [1967] Ch. 254, 270-2.

[43] See Gower, *op. cit.* 582; Ford, *op. cit.* 71; Boyle A. J., 'The Minority Shareholder in the Nineteenth Century: A Study in Anglo-American Legal History' (1965) 28 *Modern Law Review* 317, 319-321 (but doubted at 326-9); Beck S. M., 'An Analysis of Foss v. Harbottle' in *Studies in Canadian Company Law* (1967) 547-8; Buckley, *op. cit.* 202. Asserted in *MacDougall v. Gardiner* (1875) 1 Ch. D. 13, 25-6; *Bagshaw v. E. Union Ry Co.* (1849) 7 Hare 114, 130; 68 E.R. 46, 53; *Browne v. La Trinidad* (1887) 37 Ch.D.1.

[44] See Smith, *op. cit.* 157; Gower, *op. cit.* 582. Asserted: *Gray v. Lewis* (1873) L.R.8 Ch. App. 1035, 1050-1; *Lord v. Copper Miners* (1848) 2 Ph. 740, 751, 41 E.R. 1129, 1134; *Bailey v. Birkenhead Ry Co.* (1850) 12 Beav. 433, 50 E.R. 1127; *Orr v. Glasgow etc. Railway Co.* (1860) 3 McQ. 799, 10 Scots Rev. Rep. (H.L.) 341; *Re Gresham Life Assurance Society; ex parte Penney* (1872) 8 Ch. App. 446; *La Compagnie de Mayville v. Whitley* [1896] 1 Ch. 788, 807; *Spokes v. Grosvenor Hotel Co.* [1897] 2 Q.B. 124.

[45] Sometimes the simplistic 'when justice requires it' approach is taken, but this begs the question of what is justice in these circumstances: see *Wallersteiner v. Moir No. 2*[1975] Q.B. 373; *Forrest v. Manchester, Sheffield & Lincolnshire Ry Co.* (1861) 4 De GF & J 126, 45 E.R. 1131; *Prudential Assurances Co. Ltd v. Newman Industries Ltd* [1982] 1 All E.R. 354; but see *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All E.R. 437. White J. in *Hurley v. B.G.H. Nominees Pty Ltd* (1982-3) 1 A.C.L.C. 387, 394-5, examines the idea that a financial interest in the company is a necessary element for a shareholders' action, and concludes that a single share is sufficient interest. His discussion tends to emphasise the 'when justice requires' approach, but is really intended to dismiss a proposed limitation to the exception rather than propound some comprehensive theory.

(c) *Relationship with the association*

Powers are entrusted to the board of directors as a method of reaching decisions of the association. The form of the relationship between the board and the association is not inherent in the concept of the association as a group of individuals. The board may be entirely independent of the members,[46] yet it is tied to the association by the grant of powers on the one hand and required standards of conduct on the other. Individually, the directors usually have a contract with the company as a legal entity, giving mutual rights of enforcement of the matters which employment contracts cover. These contracts do not sufficiently explain the status of the board as they do not necessarily provide for the full range of powers and duties of the board. Neither does the notion of a contractual relationship between the association and the board as a group with the constitution as its terms provide a satisfactory explanation for the existence of duties or for the lack of a doctrine of law enabling the enforcement of the articles by the board.[47]

A trust relationship in its technical legal meaning is also an inadequate explanation for the legal position of the board of directors.[48] In many early cases the word 'trustee' was used instead of 'director', and sometimes is still so used.[49] Nevertheless, it has been recognized for a long while that the director is not a trustee,[50] but is in a position only analogous to one when duties are at issue. The standards of conduct required of each derive from similar requirements of protection. Both directors and trustees are placed in positions where unregulated ordinary standards of acquisitiveness required in a capitalist society would inevitably lead to the destruction of the institution placing the person in that position, when the institution is held to be necessary for the good government and legal health of that society.

The board of directors, it seems, has had a status peculiar to itself created for it in law. This has not been done through direct positive statement, but more through the deletion of the normal concepts applicable in such situations. The board or individual directors can only enforce those aspects of the constitution which

[46] Usually, however, there is a share qualification on the position of director.

[47] Contracts are strictly enforced, making the duty not to act with an improper purpose meaningless. The board is not an entity recognized as having rights, thus the directors can only sue individually or as co-plaintiffs: *Browne v. La Trinidad* (1887) 37 Ch. D.1. Since *Eley v. Positive Government Life Security Assurance Co.* (1876) 1 Ex. D.88 it has been recognized that the director as such is a mere outsider, and therefore cannot enforce the articles (*cf.* if in a separate contractual relationship: *Shuttleworth v. Cox Bros & Co. Ltd* [1927] 2 K.B.9; *Southern Foundries (1926) Ltd v. Shirlaw* [1940] A.C.701; *Shindler v. Northern Raincoat Co. Ltd* [1960] 1 W.L.R. 1038; *Carrier Australasia Ltd v. Hunt* (1939) 61 C.L.R. 534; *Ferguson v. Wilson* (1866) 2 Ch. App. 77). Another way of putting the same argument is that an action by a director is prohibited by *Foss v. Harbottle* (1843) 2 Hare 461, 67 E.R. 189 and *Mozley v. Alston* (1847) 1 Ph. 790, 41 E.R. 833. This approach was adopted in *Australian Coal and Shale Employees' Federation v. Smith* (1937) 38 S.R. (N.S.W.) 48, 56-7.

[48] See generally: Sealy, *op. cit.* 83 ff; Beck S. M., 'The Saga of Peso Silver Mines' (1971) 49 *Canadian Bar Review* 80, 82-92.

[49] The confusion as to language is revealed in *The Charitable Corporation v. Sutton* (1742) 2 Atk.400, 26 E.R.642; *Carlen v. Drury* (1812) 1 V. & B. 155, 35 E.R. 61; *Benson v. Heathorn* (1842) 1 Y. & C.C.C. 326, 62 E.R. 909; *Ferguson v. Wilson* (1866) 2 Ch. App. 77; *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474; it was disapproved in *Imperial Hydropathic Hotel Co. Blackpool v. Hampson* (1882) 23 Ch.D. 1.

[50] *E.g.* a trustee contracts for himself with a right of indemnity, whereas the corporate veil implies that a director acts as agent for or as the company.

pertain directly to its position as a means of making decisions. Thus a right to be a director is not enforceable,[51] but once a director is admitted to be such the notice requirements for meetings, the right to attend and not to attend may all attract the intervention of the court.[52] Even the 'division of powers' will be protected by the courts, despite such an exercise being ultimately futile.[53]

Powers are usually granted to the board of directors and not the directors individually. The board acts as the expression of the decision of the group, thus its acts are the acts of the legal entity.[54] Because the board is more than one person,[55] in order to represent the decision of the association it must itself make a decision. It therefore faces the same problem as the association itself in reaching a decision from the multiplicity of ideas and minds, but this is not usually troublesome because the number is small. It is usually left to the board to work out how it reaches a decision.

The problem is not so easy when standards of conduct are in question. Ostensibly they should be applied to the group as a whole, because the decision of a committee is not that of any single member. To ignore the benefits and motives of the individual would, however, be to ignore the reason for the standards. Fortunately, positive steps are not required by the law, merely the prevention of improper activities of well defined natures.[56] These can be prevented most easily by imposing individual liability on the directors. The defect with this approach is that where motive has to be examined there is confusion as to whether the motive of the individual or that of the group is impugned. In cases of conflict of interest a conflict in one director may well discredit the whole process of making the decision[57] and this is a logical approach for most of the standards. The duty to avoid improper motive is anomalous: the motive cannot be that of the individual directors because it is inherently impossible to discover and, if admitted, is covered by the duties not to have a conflict of interests. The motive must refer to that of the group, yet a group does not have a motive. Defined as a requirement that

[51] *Eley v. The Positive Government Security Life Assurance Co.* (1875) 1 Ex.D.88; *Browne v. La Trinidad* (1887) 37 Ch.D.17; *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch. 881. *Cf. Dicta* in *Australian Coal and Shale Employees' Federation v. Smith* (1937) 38 S.R. (N.S.W.) 48, 57-9.

[52] *Pulbrook v. Richmond Consolidated Mining Co.* (1878) 9 Ch. D. 610; *The Great Western Railway Co. v. Rushout* (1852) 5 De. G. & Sm. 290, 64 E.R. 1121; *Harben v. Phillips* (1883) 23 Ch. D. 14; but such 'rights' will only be enforceable if it is consonant with business practice and the concept of company: *La Compagnie de Mayville v. Whitley* [1896] 1 Ch. 788; *Browne v. La Trinidad* (1887) 37 Ch. D. 17.

[53] *Automatic Self-Cleansing Filter Syndicate Co. v. Cunninghame* [1906] 2 Ch. 34, *Gramophone and Typewriter Ltd v. Stanley* [1908] 2 K.B. 89, *Kraus v. J. G. Lloyd Pty Ltd* [1965] V.R. 232.

[54] See s. 80.

[55] See s. 219.

[56] Perhaps that the negative nature of the fiduciary duties (do not act for an improper purpose, do not have conflicting interests etc.) has permitted individual liability can also explain why standards of care, *i.e.* duties of care, skill and diligence, are so low: they require positive acts.

[57] Provided, of course, that the preconditions to rescission are satisfied: *Lagunas Nitrate Co. v. Lagunas Syndicate* [1899] 2 Ch. 382; *Erlanger v. New Sombrero Phosphate Co.* (1878) 3 App. Cas. 1218; *Spence v. Crawford* [1939] 3 All E.R. 271; also see s. 574, which applies to all breaches of duty. When improper motive is considered, there is rarely a distinction between acts of the board and acts of the individuals, evidence of dominant improper purpose being assumed by the circumstances of the case: see *Hindle v. John Cotton Ltd* (1919) 56 Sc. L.R. 625; *Ngurli Ltd v. McCann* (1953) 90 C.L.R. 425. *Cf.* the consequences of making gains in the course of office, for which the director is individually liable: *Cranleigh Precision Engineering Ltd v. Bryant* [1965] 1 W.L.R. 1293.

the principal objective reason for a decision must fall within the purposes of the association, that is, benefits the association,[58] the duty performs the function of providing a control on the whole of the board, which would otherwise be unregulated by the individual nature of the other duties. Nevertheless, the directors are individually liable for breaches of even this, a group duty, perhaps because of the lack of recognition in the law of group liability as such.[59]

4. MAJORITY IN MEETING

(a) *The concept*

The other method for an association to decide an issue is through the wishes of the majority expressed according to the complex law of meetings.[60] Although meetings are designed to come to the most appropriate decision, the real wish of a group is a myth and a common wish will remain an unobtainable ideal for as long as one person cannot read the mind of another. It is, therefore, a mistake to say the majority is the company, acts as the company[61] or has the interests of the company.

(b) *Controls on the acts of the general meeting*

(i) *Acting Outside its Powers*

The majority in general meeting suffers the same inherent defects as the board of directors. However, the remedy has been approached in a less clear-cut fashion. When powers are given to directors, it is assumed that their exercise must comply with the grant, that it must not be *ultra vires*. One would have assumed the majority in general meeting is subject to the same restraints and, as a fundamental proposition, this is true. The problem is again that of enforcement. As it is a decision of the association that is being made and as it is the interests of the association as such that are at issue, it should be the association that enforces the allocation of decision-making powers. This is not a feasible solution because there are only two forms of procedure for deciding issues, and the majority is accepted to be the more trustworthy and accurate even if less workable in a business environment. Thus a dilemma arises as to how the majority can be controlled. Soon after

[58] This is one of the rare areas in company law where the existence of the association is explicitly recognized. The board must exercise its powers for the benefit of 'the totality of members viewed in the light of their organization and corporate object': *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457; *Punt v. Symons & Co. Ltd* [1903] 2 Ch. 506; *Piercy v. S. Mills & Co. Ltd* [1920] 1 Ch. 77; *Hogg v. Cramophorn Ltd* [1967] Ch. 254. See also Sealy, *op. cit.* 83 ff. Perhaps the reason for the retention of the idea of association is that, as L. S. Sealy suggests, the duties of directors were well settled in principle last century, well before other ideas of company gained currency.

[59] The more usual explanation is simply that the directors are jointly and severally liable: *e.g.* Gower, *op. cit.* 553. Nevertheless, joint and several liability is a way of coping with the lack of a legal structure for the liability of groups which are not legal entities.

[60] Regulated in Part V Div. 3 ss. 239-254., but also subject to the general law of meetings. *E.g. La Compagnie de Mayville v. Whitley* [1896] 1 Ch. 788; *Wall v. London & Northern Assets Corporation* [1898] 2 Ch. 469; *Barron v. Potter* [1914] 1 Ch. 895; but not as a strict set of rules: *The Southern Counties Deposit Bank Ltd v. Rider and Kirkwood* (1895) 73 L.T.R.374; *Breay v. Browne* [1897] S.J. 159.

[61] Except when the consequences of the act are examined. Thus the meeting may loosely be said to 'act as the company' as compared to acting through an agent.

the enactment of the *Joint Stock Companies Act* 1842 (U.K.), in *Mozley v. Alston*[62] the distinction between the shareholder as member and the association was clearly recognized: since the constitution is that of the association, no single member can insist that it must be complied with.[63] Compliance must be enforced only by the association itself because it may be in the interests of the association as such that there be divergences from the constitution.[64] On the other hand, the case effectively allowed the majority to usurp the position of being the expression of the will of the association.

(ii) *Rights of Members*

In the absence of effective self-control by the association, external limitations have been placed on the general meeting. Where a breach of the constitution directly and personally affects a member, that member can seek redress. The rationale originally derived from principles of equity; if a person became a member in the confidence that the constitution would be adhered to, as it was perfectly reasonable to expect, then the expectation should be enforced when loss was suffered.[65] This became formalized in the language of contract.

The contract analysis of the binding nature of the constitution of the company derived support from a provision of the *Joint Stock Companies Act* 1856 (U.K.) which has been consistently re-enacted ever since that date. In reality, the section was enacted to cope with the much smaller problem of ensuring calls could be made against members by succession[66] but this clearly does not limit the applicability of the section in a broader context. The section has caused immense difficulty for reasons not apparent on first reading:

> . . . the memorandum and articles, when registered, bind the company and the members of the company to the same extent as if they respectively had been signed and sealed by each member and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.[67]

The section has not achieved the enforceability of the memorandum and articles as if they were a contract between the members. It has always been admitted to be

[62] (1847) 1 Ph. 790, 41 E.R. 833.

[63] Hence the early emphasis on deciding who had the right to use the company name: *e.g. The Great Western Railway Co. v. Rushout* (1852) 5 De. G. & Sm. 290, 64 E.R. 1121; *East Pant Du United Lead Mining Co. (Ltd) v. Merryweather* (1864) 2 H. & M. 254, 71 E.R. 460; *MacDougall v. Gardiner* (1875) 1 Ch. D. 13; *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474.

[64] If the company was set up by its own statute, the breach of the constitution was illegal. Thus there were many cases, mostly concerning railway companies, set up under statute where the language of illegality was used: *R. v. Varlo, Mayor of Portsmouth* (1775) 1 Cowp. 248, 98 E.R. 1068; *Colman v. Eastern Counties Railway Company* (1846) 10 Beav. 1, 50 E.R. 481; *Bagshaw v. Eastern Union Railway Co.* (1849) 7 Hare 114, 68 E.R. 46; *Salomons v. Laing* (1850) 12 Beav. 339, 50 E.R. 1105; *Orr v. Glasgow etc. Railway Co.* (1860) 3 McQ. 799, 10 Scots Rev. Rep. (H.L.) 341; *Fawcett v. Laurie* (1860) 1 Dr. & Sm. 192, 62 E.R. 352; *Welton v. Saffery* [1897] A.C. 299. From these, rather confused, beginnings the doctrine of *ultra vires* developed. The same sort of logic was applied in *Pacific Coast Coal Mines Ltd v Arbuthnot* [1917] A.C. 607 where an issue of debentures without approval of an ordinary resolution was invalid for being outside the private Act permitting such issues.

[65] An early control, later overruled in *Automatic Self-Cleansing Filter Syndicate Co. v. Cunninghame* [1906] 2 Ch. 34, was that constitutional matters could not be breached, *i.e.* there was a distinction between directory and imperative matters in the memorandum and articles: see *Imperial Hydropathic Hotel Co. Blackpool v. Hampson* (1882) 23 Ch. D. 1; *James v. Buena Ventura Nitrate Grounds Syndicate* [1896] 1 Ch. 456.

[66] *Land Mortgage Bank of Victoria Ltd v. Jane Reid* [1909] V.L.R. 284, 289-90 *per* Cussen J.

[67] S. 78(1).

severely restricted; for example, the provisions of the articles are binding only in respect of rights acquired as members.[68] Even if a provision grants a right in this respect, a member cannot enforce it if contravention can be remedied by a normal majority.[69] The essence of contract law is the enforceability of remedies for all breaches. Thus the memorandum and articles are not a contract, but merely enforceable as if they were when the member is bound by the memorandum and articles in its true aspect. I have in this essay called the binding nature of the memorandum and articles their 'constitutive effect': they constitute the association and grant the group a capacity to regulate itself in all matters for which it was constituted subject only to ensuring that the association retains its nature as a group. The law, therefore, creates rules intended to prevent the decision-making apparatus from reflecting anything other than group decisions. To breach the constitution in respect of a single member's rights does not reflect the decision of that member, whose opinion is part of the group decision. When dealing with the individual, the concept of majority rule breaks down and hence is controlled. The law will not interfere if the matter is one which is fit for the majority to decide. Immediately apparent is the problem which now bedevils discussions of this topic: where is the line between what should and what should not be a majority decision. The same problem is often expressed to be: to what extent can the internal management rule derogate from the rights of shareholders to have the memorandum and articles enforced or, conversely, to what extent can the memorandum and articles be enforced at all. The cases reveal no discernable trend. In *Papaioannoy v. The Greek Orthodox Community of Melbourne*[70] an article specifying the procedure to elect a representative whose job was to oversee the election of directors was enforced, whilst in *MacDougall v. Gardiner*[71] the right to insist on a poll was refused. In these cases the binding nature of the provision was assessed by reference to the nature of the company, its objects and business.[72] According to the analysis here adopted, this indicates that the enforceability of the article depends

[68] *Eley v. Positive Government Security Life Assurance Co. Ltd* (1876) 1 Ex. D.88; *Re Dale and Plant Ltd* (1889) 61 L.T. (N.S.) 206; *Baring-Gould v. Sharpington Combined Pick and Shovel Syndicate* [1899] 2 Ch. 80; *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch. 881; *Shuttleworth v. Cox Bros & Co. (Maidenhead) Ltd* [1927] 2 K.B. 9; *Beattie v. E. & F. Beattie Ltd* [1938] Ch.708.

[69] *Mozley v. Alston* (1847) 1 Ph. 790, 41 E.R. 833; *The Great Western Railway Co. v. Rushout* (1852) 5 De. G. & Sm. 290, 64 E.R. 1121; *Hattersley v. Earl of Shelburne* (1862) 7 L.T. Rep. N.S. 650; *Lord v. Copper Miners Co.* (1848) 2 Ph. 740, 41 E.R. 1129; *MacDougall v. Gardiner* (1875) 1 Ch. D. 13; *Browne v. La Trinidad* (1887) 37 Ch.D. 17; *Australian Coal and Shale Employees Federation v. Smith* (1937) 38 S.R. (N.S.W) 48, 56-9; *Beattie v. E. & F. Beattie Ltd* [1938] Ch. 708; *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.R. 666. *Cf. Cannon v. Trask* (1875) 20 L.R. Eq. 669; *Pender v. Lushington* (1877) 6 Ch. D. 70; *Harben v. Phillips* (1883) 23 Ch. D. 14; *Wood v. Odessa Waterworks Co.* (1889) 42 Ch. D. 636; *Kraus v. J. G. Lloyd Pty Ltd* [1965] V.R. 232; *Papaioannoy v. The Greek Orthodox Community of Melbourne* (1978) 3 A.C.L.R. 801.

[70] (1978) 3 A.C.L.R. 801; see also *Ryan v. South Sydney Junior Rugby League Club Ltd* (1974) 3 A.C.L.R. 486.

[71] (1875) 1 Ch.D. 13.

[72] *Ibid.* 23, *per* James L.J., where the purpose of meetings in a trading company is discussed. Also *ibid.* 25, *per* Mellish L.J.: nothing is more likely that meetings of businessmen will do things more or less irregularly. In *Papaioannoy v. The Greek Orthodox Community of Melbourne* (1978) 3 A.C.L.R. 801, 804-5, King J. looked to the nature of the community to ascertain if the right was personal and individual. The test used for the interference of the court, whether a different result would have been achieved if the correct procedure were followed, can also be linked to the nature of the company through the perception that the result was particularly important, and that the procedures enshrined in the articles gave a clear answer.

on the nature of the association. It is logical for the law to assess at different levels the control necessary to ensure that the particular process of decision-making does not diverge from being a valid method of expression of the group will.[73] Thus the results of cases differ as a function of differing types of association in addition to being a function of the type of membership right.

Unfortunately, the contract analysis of the memorandum and articles has a persuasive logic.[74] Some writers argue that the memorandum and articles should bind the company and the members to a greater extent than the cases seem to permit, even dismissing the lack of legal training of company chairmen and secretaries as a remedial defect.[75] It is probably true that if the memorandum and articles were totally enforceable as a contract chairmen and secretaries would become well versed in the appropriate regulations, yet the cost in terms of cases to both establish and maintain the sanction would be enormous. Furthermore, a demand for articles and memoranda to be drawn so loosely as to preclude such a necessity would inevitably raise the same problem as before: to what extent should controls be placed on the capacity of the general meeting to infringe the legitimate and rational expectations of a person on becoming a member? There is already a relationship between the growing enforceability of the constitution of companies and the enactment of legislation designed to protect minorities.[76] Much of the harm designed to be averted is the use to hurt others of rights specified in the constitution, a harm most easily caused when all rights are binding on the other members or the company.

Legislation is also aimed at further limiting the majority in circumstances where decisions made by the majority could not reasonably be said to approximate the will of the association. The right to demand rectification of the membership register,[77] a winding up[78] or even the right to prevent *ultra vires* activities[79] are all examples.[80] Perhaps the most obvious restriction on the power of the majority is the inability of the constitution to enable a simple majority to alter the constitution.[81]

[73] Not that the group has in reality a will, real mind or anything approaching the mystical brain of the realist theorists. It merely has an expression of will, i.e. a decision, accepted by the group. Some decisions cannot be valid expressions of the will of the group, and are controlled. The crux of the question is, therefore, how 'valid' is defined. This essay is an attempt to define it by assuming that the decision must reflect the will of every member, either by direct acceptance, or by the agreement to disagree.

[74] It is even applied where there is no provision giving contractual effect to the memorandum and articles; *i.e.* in the letters patent corporations of some Canadian Provinces: see Beck S. M., 'An Analysis of Foss v. Harbottle' in *Studies in Canadian Company Law* (1967) 587.

[75] This is probably true even of Professor Wedderburn in (1957) 15 *Cambridge Law Journal* 194, 210-3, where he asserts that the only restriction on the enforceability of the articles is that the member should sue as member and not as outsider. See: Goldberg, *op. cit.* 362 ff; Also Gower, *op. cit.* 264-5; Gregory, *op. cit.* 526 ff; Smith, *op. cit.* 147 ff; Bastin N. A., 'The Enforcement of a Member's Rights' [1977] *Journal of Business Law* 17.

[76] Legislation (ss. 320, 354) protecting minorities has three aims — to prevent the board of directors oppressing shareholders, to prevent the general meeting oppressing the minority and the use of powers by controllers of the company, regardless of organs, to oppress. Here I am referring to the use of the powers of the general meeting.

[77] S. 259.

[78] S. 364.

[79] S. 68.

[80] Some may be fairly tenuous, and as the parliamentary process has few checks on conceptual illogic, perhaps some are anomalous.

[81] Ss. 72, 73, 76, 65.

(iii) *The Limits of Disagreement*

The overall control of the majority is slight. The reason is that there are few situations where the interests of the group and the individual diverge. Thus the majority of individuals can represent a consensus even if the minority disagree with the decision. Even the dissenting minority, as members, are taken to acknowledge that there is more than one possible decision in each set of circumstances and that the majority expresses the best approximation to the decison of the group. In other words, it is accepted that the motive behind the reasons for any particular decision will be the same for all shareholders. The motives for joining the association govern the motive of decision-making, since the purposes of any particular association are defined even if only in terms of profit making. Thus the minority accept the methods of expression of the group and their controls at the time of joining.

Nevertheless, the group is comprised of individuals with diverse interests. It does not have a real group will or interest, although the individuals derive their benefits from acting as a group. The decisions must be expressed through a method of deriving a group decision from the collection of individual interests. It would be possible to require the individuals to act in the interests of the group, but also it would be unenforceable because the minds of individuals cannot be read. Thus the majority in general meeting is required to be a majority acting each for their own interest. This proposition is firmly rooted in law, although in many cases it is expressed in terms of the vote being a property right of a shareholder. It is difficult to discern whence the expression arose and why, and, indeed, why a vote as a property right cannot be defined more narrowly.[82]

Requiring shareholders to vote in their own interest is necessary to an associative analysis of company law. Voting is a procedure designed to elicit an acceptable expression of the group decision and depends on assumptions as to motive for its acceptability. These propositions have limits to their validity which are situated at the point where the majority motive cannot be assumed to be that of all the members of the group. One such point might be where the benefit of a decision devolves only on the majority and not on the whole group.

(iv) *Alterations to the Constitution*

When the decision to be taken is as to whether the constitution of the association should be changed and in what way, divergent motives are predictable because

[82] Apart from numerous references in passing, see *Exeter and Crediton Railway Company v. Buller* (1847) 16 L.J. Ch. 449, where the share as a set of marketable rights and the content of those rights is confused; *East Pant Du United Lead Mining Company (Limited) v. Merryweather* (1864) 2 H. & M. 254, 71 E.R. 460: 'The Shareholders of one company may have dealings with interests in other companies, and therefore would be manifestly unfair to prevent an individual shareholder from voting as a shareholder in the affairs of the company' (*per* Sir W. Page Wood V.C.); *Pender v. Lushington* (1877) 6 Ch. D. 70 where the vote is expressed, without preamble, to be a right of property by Jessel M.R.; and *North-West Transportation Co. Ltd & J. H. Beatty v. H. Beatty* (1887) 12 App. Cas. 589. The principle was somewhat softened in *Burland v. Earle* [1902] A.C. 83, 93-4; *Allen v. Gold Reefs of West Africa Ltd* [1900] 1 Ch. 656 and consequent cases *e.g. Dafen Tinplate Co. Ltd v. Llanelly Steel Co. (1907) Ltd* [1920] 2 Ch. 124. But see *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457 and *cf.* the anomalous cases of *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268 and *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All E.R. 437.

opportunities for profiting the individual in comparison to or even at the expense of the group exist. Controls on the decisions of the majority in this respect were set up early in the history of company law.[83] A seventy-five per cent majority was required, a percentage which endeavours to balance commonality of motive with expediency in the face of the irrationality of a few who might not agree no matter the good of all.

Even seventy-five per cent may find it profitable to take from twenty-five per cent or less. The courts of equity stepped in by disallowing certain amendments to the constitution. In *Allen v. Gold Reefs of West Africa*[84] the expression 'bona fide for the benefit of the company as a whole' was referred to as the criterion by which such actions should be judged. In the ensuing years this phrase proved confusing for the judiciary[85] because it is a positive statement of duty in a situation where it was accepted that it was logical to allow shareholders to vote in their own interests. No resolution between the principles has been reached in the United Kingdom, primarily, it seems, because there is no connecting principle accepted in law relating the two.[86] In Australia, the anomolous situation in *Peters' American Delicacy Co. v. Heath*[87] gave the lead to an acceptable solution. The facts were that the good of the company required an alteration to the articles. The alteration was to resolve a conflict but there were two alternative solutions[88] and each derogated from the rights of a class of shareholders. Thus there was a situation where a majority voting in its own interest gained a benefit at the expense of the minority but for the benefit of the company as a whole since not to choose would be detrimental to the company. The High Court of Australia was obliged to reject controls on the minority founded on simple detriment tests. It accepted the phrase 'bona fide for the benefit of the company as a whole' as a negative test of objective motive.[89] Where motives could be expected to conflict, such as where benefit was being received by individuals, and if the proposed action could also be for the benefit of the group including the minority, then it should not be proscribed but allowed as a valid decision of the group.

The position is further complicated where the memorandum or articles provide a method for altering the rights of classes of shareholders, for example, a

[83] S. 50 *Companies Act* 1862 (U.K). Originally the capacity of the company to alter even its articles was limited, despite s. 50, by the doctrine of necessary process elucidated in *Imperial Hydropathic Hotel Company, Blackpool v. Hampson* (1882) 23 Ch. D. 1. This was overruled in *Automatic Self-Cleansing Filter Syndicate Co. v. Cunninghame* [1906] 2 Ch. 34, and the trend is for the legislature to increase the mutability of the constitution of companies (*e.g.* alteration of corporate objects s. 73(1), introduced in 1981 together with s. 73(2) giving a limited general power of alteration of the memorandum. See also s. 23 *Companies Act* 1948 (U.K.)).

[84] [1900] 1 Ch. 656, 671 *per* Lindley M.R.

[85] *E.g.* In *Punt v. Symons & Co. Ltd* [1903] 2 Ch. 506 Byrne J. thought it was a positive requirement, as did Ashbury J. in *Brown v. British Abrasive Wheel Co. Ltd* [1919] 1 Ch. 290 where, however, the test was divided into two, to be reunited, but still as a positive requirement in *Sidebottom v. Kershaw, Leese & Co. Ltd* [1920] 1 Ch. 154

[86] *E.g. Bamford v. Bamford* [1969] 1 All E.R. 969, 976, *per* Russell L.J.; *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268, 282; *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All E.R. 437.

[87] (1939) 61 C.L.R. 457. See also *Ngurli Ltd v. McCann* (1953) 90 C.L.R. 425; *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.R. 66.

[88] The articles provided that dividends were to be paid according to paid up value, but bonus shares to be allotted pro rata according to number of shares held. A restructuring of the company was in progress which involved distributing accumulated profits as bonus shares.

[89] *Ibid.* 481-3, *per* Latham C.J.; 507-13, *per* Dixon J.

requirement that a meeting of a particular class be held and approve by a seventy-five per cent majority any reduction in the rights of that class of shareholders.[90] The method of expression of the decision of the group could be said to be defined by the provision. On the other hand, the relevant companies Act will state that the only method of expression of the group when altering the constitution is a seventy-five per cent majority in general meeting and neither a lesser majority nor a different venue is permitted. Thus the question is whether the seventy-five per majority in general meeting can override the wishes of a seventy-five per cent majority of a class. The cases on the point have divided each way.[91] The issue is a point of conflict between concepts of company and legalistic interpretations of statutory fiat. In Australia the legislature has resolved the problem, admittedly one of its own making, by stipulating the procedures for determining the decision of the group as to the rights of members.[92]

(v) *The Generalization?*

It is more difficult to discern an abstract description of the situations where the decision of the majority comprised of individuals acting in their own interest does not reflect an acceptable decision of the group. The courts have not been able to make one, with the result of a series of *ad hoc* rules. The legislature has had more success, primarily through the imposition of rules in disregard of the concepts developed in common law.[93]

The reason for the legal confusion is that the problem is fundamental to the nature of all groups. The benefit of the group cannot always be attained without sacrifice by an individual member, thus detriment to the individual cannot of itself be a sufficient criterion for assessing whether a particular decision could represent that of the group. Some reference should be made to the constitution and circumstances to determine to what extent individuals have agreed to subordinate their interest to the group.[94] Secondly, potential members cannot be expected to be able to predict all the possible circumstances where they might be willing to subordinate their interests: the group has been prevented from taking certain decisions where no individual would sacrifice themselves to the extent proposed. The courts under this analysis have had to decide what the interests of the group could have been before deciding whether the detriment did serve the interest of the group. This also has been ascertained from the constitution and decisions of the group. The interest of the group, the constitutions have implied, in respect of decisions to be taken by the majority, if not defined in the constitution, is expressed through the

[90] *E.g.* Art. 4 Table A Schedule 3.

[91] *Crumpton v. Morrine Hall Pty Ltd* [1965] N.S.W.R. 240; *contra*, *Fischer v. Easthaven Ltd* [1964] N.S.W.R. 261.

[92] Ss. 124-8.

[93] S. 320 and s. 364 the first providing a remedy in cases of a course of conduct being oppressive, unfairly discriminatory against or unfairly prejudicial to one or more members and where directors act in their own interests rather than the interests of the members as a whole or unjustly or unfairly to one or more members. S. 364 enables a member to seek that that company be wound up in a variety of circumstances, particularly where 'the Court is of opinion that it is just and equitable' (s. 364(1) (j)). Admittedly the concepts with which these rules are incompatible are those developed in this essay.

[94] This approach was adopted in *Phillips v. Manufacturers' Securities Ltd* (1917) 116 L.T. 290.

majority. Yet it is the validity of the interests of the majority which is in doubt.

The analysis states that there are two variables to be considered. These are the interests of the group and the accepted extent of sacrifice. Neither can be fixed with certainty because the association is a collection of individuals varying in interests both between individuals and over time.

The legislature has approached the problem by giving remedies when the detriment reaches a point defined by statute. 'Oppressive' behaviour was the original criterion[95] but it had a restricted application and definition.[96] Recent amendments in a variety of jurisdictions[97] and now implemented under the Australian National Companies Scheme have tended to amplify the protection by also allowing a remedy for 'unfair prejudice', a term intended to increase the scope of the remedy by including actions that are quite legal but have an effect of causing detriment. In addition, whereas the original provision needed a 'course of conduct', modern versions tend to apply to single acts. The legislature has thus intended to provide a detriment oriented approach. There has been a gradual reduction in the permissible sacrifices on the altar of group welfare.

The remedies available for the anti-detriment provisions are wide. In contrast, when the court is asked to decide what the motives of the group are, it is only granted the option of winding up the company.[98] The 'just and equitable' ground for winding up has been interpreted as enabling a decision as to whether the motives of the group still exist or are impossible of expression because of deadlock.[99] This legislation gives a remedy when the first variable, the interests of the association, is ascertainable and the detriment not. It has restricted remedies because of the difficulty and uncertainty involved in ascertaining interests, especially where there is no necessity to prove detriment.

The common law has failed to ennunciate any general principle for determining whether or not the general meeting can express the decision of the group or, more conventionally, when a resolution of the general meeting fails for being 'in fraud of the minority'.[1]

[95] In the precursors to the present s. 320. The remedy was introduced as a result of the Cohen Committee (1945) Cmd 6654 at para 60 and introduced in s. 210 *Companies Act* 1948 (U.K.).

[96] The two most important restrictions have been that the remedy only applies where there is a course of conduct. (*Re H. R. Harmer Ltd* [1959] 1 W.L.R.62, *Re Five Minute Car Wash Service Ltd* [1966] 1 W.L.R. 745) and the oppression must be to the member as such (*Re Bright Pine Mills Pty Ltd* [1969] V.R. 1002, *Re Tivoli Freeholds Ltd* [1972] V.R. 448, *cf. Re H. R. Harmer Ltd*). The section has been rigidly applied to only a few circumstances defined as 'harsh burdensome and wrongful'. See generally Shapira A., 'Minority Shareholders' Protection — Recent Developments' (1982) 10 *New Zealand University Law Review* 134.

[97] *Companies Code* 1961 (Ghana) s. 218; *Companies Act* 1965 (Singapore) s. 181; *Companies Act 1967 (Malaysia) s. 181; Companies Act* 1973 (B.C.) C18 s. 234; *Business Corporations Act* 1974-5 (Ontario) s. 234; *Companies Act* 1980 (U.K.) s. 75; *Companies Act* 1955 (N.Z.) s. 209. See Shapira *loc. cit.*

[98] S. 364(1)(j) *cf. Re Tivoli Freeholds Ltd* [1972] V.R. 448.

[99] *Loch v. John Blackwood Ltd* [1924] A.C. 783; *Ebrahimi v. Westbourne Galleries Ltd* [1973] A.C. 360; *Re Yenidje Tobacco Co. Ltd* [1916] 2 Ch. 426; *Re Tivoli Freeholds Ltd* [1972] V.R. 445.

[1] There are many expressions of such a principle, but few authoritative decisions. *E.g. Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268: 282 *per* Foster J.; *Prudential Assurance Co. Ltd v. Newman Industries Ltd* (No. 2) [1980] 2 All E.R. 841, 875 *per* Vinelott J.; *Crumpton v. Morrine Hall Pty Ltd* [1965] N.S.W.R. 240, 244 *per* Jacobs J.; *Australian Fixed Trusts Pty Ltd v. Clyde Industries Ltd* [1959] S.R. (N.S.W.) 33, 56; *Greenhalgh v. Anderne Cinemas* [1951] Ch.D. 286, 291 *per* Evershed M.R.; *Ngurli Ltd v. McCann* (1953) 90 C.L.R. 425, 438.

(vi) *Abuse of Power*

Besides the principle applicable when the memorandum or articles are being altered, there are some isolated instances of abuses of power being held to be invalid. The confirmation of voidable transactions,[2] the election of directors[3] and the allotment of shares[4] have all been avoided for abuse of power. However, each decision has been subject to doubt.[5]

(vii) *Want of Natural Justice*

Vitiation for want of natural justice has been the aim of some plaintiffs, with limited acceptance by the judiciary. The argument is that where the board or controlling body of the company is exercising a quasi-judicial function, the rules of natural justice should apply.[6] The approaches of the courts of Great Britain and Australia would seem to diverge, again because of the greater reluctance in the former to recognize the dichotomy between the legal entity and the association. The entity is owed the duties of directors and these duties are not subject to modification by duties to individuals.[7] In Australia, the members are seen to be a part of that to which the duties are owed and therefore a reconciliation between the duties is required.[8] Despite these trends, the general recognition of natural justice as a limit on the power of a majority cannot proceed far. Even without incorporation, the extent of its applicability is slight as it usually is limited to where a proprietary right of livelihood is at stake and a quasi-judicial function is being exercised.[9] On the other hand, the recognition of the object of the duties being separate from the legal entity is consistent with associative theory and may well lead to a reassessment of the majority function in the terms of the theory.

(viii) *Decision Not to Sue*

Decisions of the majority not to sue, to release officers from their duties, to affirm voidable transactions or to ratify acts of the board is the final category of uses of majority power to have been, on occasion, avoided.[10] Such decisions have given rise to the third area for control outlined at the beginning of this essay, namely where the action to be controlled is undertaken by a combination of

[2] *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666 (although this is perhaps better seen as an instance of forgiveness of breach of director's duties).

[3] *Theseus Exploration N.L. v. Mining and Associated Industries Ltd* [1973] Qd. R. 81.

[4] *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268.

[5] See the evident disgust of the Court of Appeal at a similar approach adopted at first instance in *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1982] 1 All E.R. 354.

[6] *McNab v. Auburn Soccer Sports Club Ltd* [1975] 1 N.S.W.L.R. 54.

[7] *Gaiman v. National Association for Mental Health* [1971] Ch. 317.

[8] *McNab v. Auburn Soccer Sports Club Ltd* [1975] 1 N.S.W.L.R. 54; *Thorborn v. All Nations Club* (1975) 1 A.C.L.R. 127.

[9] Obviously, this is an oversimplification. See *Cooper v. Wandsworth Board of Works* (1863) 14 C.B. (N.S.) 180; *Ridge v. Baldwin* [1964] A.C. 40; *Durayappah v. Fernando* [1967] 2 A.C. 337.

[10] I have here lumped them all together, which seems in accord with most authority; *cf.*, however, *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)*. [1982] 1 All E.R. 354.

decision-making methods. It is also the most hotly debated area of internal management of companies. The problem is conceptually simple and arose early in the history of company law.[11] If a wrong is done to the company, a decision must be made as to whether a remedy will be sought or not. It can be of benefit for the company not to sue, as was forcefully put in *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)*[12] where the minority action was said to be 'killing the company with kindness'.[13] The costs of the action compared with even the best estimates of return, the bad publicity or any other detriment may convince even the most disinterested observer that the action is not beneficial to the company. If the wrong is done by the controllers of the company, the decision whether or not to sue will be made by the wrongdoer. Thus opportunities exist to do wrong to the company without suffering consequences. Such is the traditional statement of the problem, to which there are traditional solutions. Duties are owed to the company,[14] the members merely being the contributors of capital.[15] Thus the proper plaintiff is the company itself as a legal entity.[16] No single shareholder can take the action on behalf of the company unless the body empowered with the right to use the name of the company in litigation consents.[17] Whilst originally the decision could always be taken by the general meeting, the advent of the contract analysis adopted as a result of *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame*[18] has caused conceptual difficulties in circumstances where the wrong was a breach of directors' duties and the directors, whether as shareholders or directors, had the power to decide whether or not the company should sue. Two discrete concepts collide, the division of power as an exclusive grant by some undefined 'higher' body and the power in the majority to decide not to bring the legal action.[19]

To cope with the common situation of the wrongdoers being in control of the general meeting an exception to the rule in *Foss v. Harbottle* had been made: where there was fraud by a controller, a shareholder could take action on behalf of

[11] During the 1840's alone the following cases were reported: *Foss v. Harbottle* (1843) 2 Hare 461, 67 E.R. 189; *Coleman v. Eastern Counties Railway Co.* (1846) 10 Beav. 1, 50 E.R. 481; *Exeter & Crediton Railway Co. v. Buller* (1847) 16 L.J. Ch. 449; *Mozley v. Alston* (1847) 1 Ph. 790, 41 E.R. 833; *Lord v. Copper Miners' Co.* (1848) 2 Ph. 740, 41 E.R. 1129; *Bagshaw v. Eastern Union Railway Co.* (1849) 7 Hare 114, 68 E.R. 46. The same problems were faced in the U.S.A. See Boyle, *op. cit.* 317.

[12] [1982] All E.R. 354.

[13] *Ibid.* 368.

[14] *Percival v. Wright* [1902] 2 Ch. 421.

[15] Despite the interests of the company not being the interests of the legal entity, but of the association. See *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 481 *per* Latham C.J., 512 *per* Dixon J.

[16] *Foss v. Harbottle* (1843) 2 Hare 461, 67 E.R. 189.

[17] In *East Pant Du United Lead Mining Co. (Ltd) v. Merryweather* (1864) 2 H. & M. 254, 71 E.R. 460 this issue is discussed in some depth. See also *Taunton v. Royal Insurance Co.* (1864) 2 H. & M. 135, 71 E.R. 413; *Foss v. Harbottle* (1843) 2 Hare 461, 493, 67 E.R. 189, 202; *Great Western Railway Co. v. Rushout* (1852) 2 De. G. & Sm. 290, 64 E.R. 1121; *MacDougall v. Gardiner* (1875) 1 Ch.D. 13, 22-3; *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474, 482; *Pender v. Lushington* (1877) 6 Ch. D. 70; *In re The Transvaal Gold Exploration and Lead Company (Ltd)* (1885) 1 T.L.R. 604; *Alexander v. Automatic Telephone Company* [1900] 2 Ch. 56.

[18] [1906] 2 Ch. 34.

[19] See pp.626-30 *infra*.

the company.[20] A narrower interpretation of the exception is that the decision to sue is subject to disallowance by a properly made decision of the general meeting in situations where the board of directors has the original power to decide to sue.[21] If the general meeting has the original power to decide to sue, the qualification is not needed. No matter the interpretation, the cases have left the questions of what is 'fraud', what is 'control' and how they can be decided to exist without deciding the case as a whole, in a state of confusion. The first two in particular have exercised the minds of a multitude of lawyers and been discussed in numerous cases with no concrete result.

'Control' varies from being more than fifty per cent of the votes[22] to being in a position to ensure that action will not be brought by manipulating a position in the company.[23] 'Fraud' has had a history of postulated definitions, none of which have provided criteria by which actions of the majority can be judged. Corporate opportunity was used in *Cook v. Deeks*[24] to justify the use of the exception, but, as has often been shown,[25] 'opportunity' is so wide as to disentitle the majority from allowing a director to take on any other business. Taking property of the company as a definition has indeterminate limits when the distinction between information and property is examined. Certainly the contracts the subject of *Cook v. Deeks*[26] could easily be considered to be the product of the use of company information and therefore to be company property. If so, why did the House of Lords in *Regal (Hastings) Ltd v. Gulliver*[27] say that the actions of the board of directors were ratifiable?

Regal (Hastings) Ltd v. Gulliver[28] gave rise to the school of ratification. As Professor Wedderburn points out, ratification can be seen to be at the basis of the problem, yet as a theory, ratification is a mere tautology, if the general meeting can

[20] This is the 'one true exception' according to Wedderburn K. W., (1958) 16 *Cambridge Law Journal* 93, 106. Of course, what is an exception is a matter of definition of the rule. For examples of the exception, after being postulated in *Foss v. Harbottle* itself,((1843) 2 Hare 461, 492) see: *Salomon v. Laing* (1850) 12 Beav. 377, 50 E.R. 1105; *Davidson v. Tulloch* (1860) 3 McQ. 783, 10 Scots Rev. Rep. (H.L.) 333; *Seaton v. Grant* (1867) 2 Ch. App. 459; *Atwool v. Merryweather* (1867) L.R. 5 Eq. 464 and many later cases. The actual statement of the exception has been accepted in many cases: *Ngurli Ltd v. McCann* (1954) 90 C.L.R. 425, 447; *Prudential Assurance Co. Ltd v. Newman Industries Ltd* (No. 2) [1982] 1 All E.R. 354, 358-362; *Edwards v. Halliwell* [1950] 2 All E.R. 1064.

[21] See Ford, *op. cit.* 338-45.

[22] *Cook v. Deeks* [1916] 1 A.C. 554, 564; *Hogg v. Cramphorn* [1967] Ch. 254; *Peninsular and Oriental Steam Navigation Company v. Johnson & Ors* (1938) 60 C.L.R. 189, 255. The requirement of 50 per cent of the votes has never seriously been put as a requirement, merely as a position that guarantees the satisfaction of the test for control (Wedderburn K. W., (1958) 16 *Cambridge Law Journal* 93, 94). Ford, *op. cit.* 54 states that 51 per cent of the voting power was the accepted definition until recently.

[23] See the discussion in Wedderburn K. W., (1958) 16 *Cambridge Law Journal* 93, 94-6. In *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1980] 2 All E.R. 841, Vinelott J. accepted the test, and although the Court of Appeal soundly rejected the decision ([1982] 1 All E.R. 354), no alternative test was proposed. It is interesting that the decision of the Court of Appeal reveals no real discussion of what 'control' is, merely an assumption that the delinquent did not have it.

[24] [1916] 1 A.C. 554.

[25] *Peninsular and Oriental Steam Navigation Co. v. Johnson* (1938) 60 C.L.R. 189, 248-50. Wedderburn K. W., (1958) 16 *Cambridge Law Journal* 93, 103-5; Baxt, *op. cit.* 44-9; Beck S. M., 'The Saga of Peso Silver Mines', (1971) 49 *Canadian Bar Review* 80, 116-9; Buckley, *op. cit.* 182-8; Beck S. M., 'An Analysis of Foss v Harbottle' in *Studies in Canadian Company Law* (1967) 545, 574-8.

[26] [1916] 1 A.C. 554.

[27] [1942] 1 All E.R. 378.

[28] *Ibid.*

take action on behalf of the company.[29] Some cases have taken ratifiability further. The consequence of an abuse of power is a voidable, not void, decision. It is within the power of the general meeting, as recipient of all residual power, to decide whether the abuse of power will be confirmed or not.[30] This argument is usually used to justify a broad power to ratify. It is amenable to attack on two grounds. First, when is a breach of directors' duty a mere abuse of power and when a nullity due to being a fraud? The distinction between improper use of power and conflict of interest is notoriously fine and ill-defined. The second attack asserts that the principles of abuse of power, if applied to decisions of the board, ought equally be applied to decisions of the general meeting. This immediately returns the discussion to whether there is a general duty on the general meeting to act 'properly',[31] whatever that might mean. In other words, again begs the question.

In *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)*[32] the Court of Appeal took a novel approach to the problems with the exception to the rule in *Foss v. Harbottle*.[33] A distinction was made between decisions to approve the particular act of the director after he had been found guilty of fraud and decisions not to proceed whilst the case was *'in limine'* (as yet unheard). Not surprisingly, it was held that in the first circumstance the votes of the delinquent should be disregarded. It was admitted that the second, the normal situation, was an undecided area. The distinction pointed out the dilemma raised by the exception:

> If, on such an application, the plaintiff can require the court to assume as a fact every allegation in the statement of claim, as in a true demurrer, the plaintiff will frequently be able to outmanouvre the primary purpose of the rule in *Foss v. Harbottle* by alleging fraud and 'control' by the fraudster. If on the other hand the plaintiff has to prove fraud and 'control' before then he can establish his title to prosecute his action, then the action may need to be fought to a conclusion before the court can decide whether or not the plaintiff should be permitted to prosecute it. In the latter case the purpose of the rule in *Foss v. Harbottle* disappears. Either the fraud has been proved, so *cadit quaestio*; or the fraud has been proved and the delinquent is accountable unless there is a valid decision of the board or a valid decision of the company in general meeting, reached without impropriety or unfairness to condone the fraud.[34]

With respect it seems that this ignores the issue of control. In the court below Vinelott J. held there was the 'control' necessary to bring the exception into operation,[35] whereas in the Court of Appeal it was assumed the board of directors let alone the general meeting could make a valid decision not to sue. *Prima facie* cases are well known to the law and should be applicable to the question of 'fraud'.[36]

[29] Wedderburn K. W., (1958) 16 *Cambridge Law Journal* 93, 93-101. The argument goes deeper in some cases where shareholders' actions are allowed for ratifiable breaches (*Alexander v. Automatic Telephone Co.* [1900] 2 Ch. 56). Nevertheless, one of the points made in the article is that ratifiability could provide a solution, which is the point here being disputed. See also *Hogg v. Cramphorn* [1967] Ch. 254; *Bamford v. Bamford* [1969] 1 All E.R. 969; Beck S.M., 'An Analysis of *Foss v. Harbottle*' in *Studies in Canadian Company Law* (1967) 573-81.

[30] Sometimes expressed as the 'futility' principle. See Buckley, *op. cit.* 167 ff, but more often criticized. Derived from *Hogg v. Cramphorn* [1967] Ch. 254; *Bamford v. Bamford* [1969] 1 All E.R. 969; *Winthrop Investments v. Winns Ltd* (1975) 2 N.S.W.L.R. 666; *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268.

[31] This is the analysis adopted in Ford, *op. cit.* 30, 68-83, 341-3.

[32] [1982] 1 All E.R. 354.

[33] (1843) 2 Hare 461, 67 E.R. 189.

[34] [1982] 1 All E.R. 354, 364.

[35] [1980] 2 All E.R. 841, 870-5.

[36] *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All E.R. 437, 447. But *cf.* comments of King C.J. and White J. in *Hurley v. B.G.H. Nominees Pty Ltd* (1982) 1 A.C.L.C. 387, 389-90, 396, where the limitations of this approach were discussed.

In this plethora of possible but meaningless distinctions, what are the solutions postulated by writers?

One of the simplest schemes is to postulate a duty owed by the directors to the shareholders individually.[37] In order to avoid *Percival v. Wright*,[38] most writers complicate matters by putting a two-stage argument that it is a personal right of each shareholder to have the fiduciary duties of the directors' enforced.[39] The defect with all such arguments is that they support the extreme point of view that the company should sue for every breach of fiduciary duty, regardless of whether it harms the prospects of the company. If its proponents desire to move away from the extreme there are only two avenues: either rely on a formulation of the internal management rule or cut down breaches of the duty of the directors for which they can be sued. Either course renders the direct duty to the shareholders pointless as a solution to the present problems of the law because both are mere reformulations of the questions which caused the difficulties in the first place.

A further modification to the argument indirectly draws the necessary line. In Canada some jurisdictions have given ten per cent of the shareholders a right to sue for wrongs done to the company.[40] By placing a requirement[41] that a certain proportion of members seek to assert the right, the legislature ensures that trivial matters are not litigated. Thus an arbitrary, but workable line is drawn, even if in red tape.[42] The arbitrary nature of the criterion for the right to sue is the chief defect of the system. Even if business people desire certainty at the expense of rationality,[43] there is a limit to the degree of arbitrariness a legal system or principle can have before disrepute is risked.[44]

Another solution to the dilemma of 'fraud on the minority' is similar to the first: a fiduciary duty is to be applied in favour of the individual shareholders. In contrast to the first, however, the duty is to be laid upon the majority. Whenever a decision is made by the shareholders, they would be restrained from engaging in conduct which would infringe the fiduciary duties. Thus for directors to use controlling votes to obtain benefits available through their office would infringe the duty. A criterion such as benefit to the directors[45] would be justified as that which

[37] Buckley, *op. cit.* 177.

[38] [1902] 2 Ch. 421.

[39] See *e.g.* Lindgren, *loc. cit.*; Slutsky B; 'Shareholders' Personal Actions — New Horizons (1976) 39 *Modern Law Review* 331. Beck S. M., 'The Shareholders' Derivative Action' (1974) 52 *Canadian Bar Review* 159, 173-5; Baxt, *op. cit.* 53; There is some Canadian authority in this direction: *Goldex Mines Ltd v. Revill* (1974) 54 D.L.R. 3d 672.

[40] This is a statutory form of the derivative action: Business Corporations Act 1970 (Ontario) c. 53, s. 99; Business Corporations Act 1974-5 (Ontario) c. 33, s. 232; Companies Act 1973 (B.C.) ss. 224, 225.

[41] There are, of course, other and varying requirements as to time of ownership, discretion of court and wrongs to be righted.

[42] See: Beck S. M., 'The Shareholders Derivative Action' (1974) 52 *Canadian Bar Review* 159; Buckley, *op. cit.* 167 ff.

[43] 'Rationality' is more often expressed as 'flexibility'. 'Flexibility' refers to the ability to make decisions appropriate to changing conditions, or the *ad hoc* application of supposedly rational solutions.

[44] The proposal does have some merit under an associative analysis, as a simple formula for deciding implied acquiescence: if ten per cent disagree with that particular type of matter then no individual could be taken to agree. Nevertheless, it is rigidly arbitrary.

[45] This was the logic overruled in the Court of Appeal in *Prudential Assurance Ltd v. Newman Industries Ltd (No. 2)* [1980] 2 All E.R. 841 (Vinelott J.) [1982] 1 All E.R. 354 (C.A.); See also *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268.

distinguishes acceptable conduct from that which would infringe the duty.[46] The problem with this idea is that there is a long line of cases absolutely repudiating the concept.[47] From the earliest beginnings it has been asserted that the shareholder's right to vote is a property right not to be removed without good reason. To say that should be removed in some circumstances because its application does not have defined limits is probably not a sufficiently convincing argument. This logic can be seen in the decision of the Court of Appeal in *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* reversing the judgment of Vinelott J..[48] The concept of the vote as a property right derives from the nature of the voting procedure, it being impossible to determine what interests are served in each poll. When a minority asserts that the fiduciary duty has been infringed it must be assumed to be acting in its own interest. But the minority will argue not that the majority did not act in the interests of the minority, but that the majority did not act in the interests of the whole. The issue behind the whole conundrum is raised by the purported solution: how is the distinction to be made between an acceptable deprivation of rights in the interests of the company as a whole and a deprivation of rights in self interest? For example, again in *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)*, it was asserted that Newman had benefitted himself, yet the Court of Appeal thought it acceptable that the company make the decision not to sue.[49]

The third and most pragmatic solution is to bar directors from using voting powers in their own interest.[50] This is attractive at face value but has fundamental flaws. Firstly, it also fails to cope with the line of cases holding the vote to be a proprietary right, not purely because of their precedent value but as a result of the impossibility of analysis of real motive. Directors, from one point of view, hold and vote their shares to give them an interest in the company in order to ensure the desire for mere power will not subordinate profit for shareholders. The converse is also true: the directors' interests form an indivisible part of the interests of the whole of the shareholders. If their vote is not taken into account the interests of the company cannot be said to be adequately represented. On a less theoretical level, the company is deprived of the benefit of the knowledge of the directors as to the interests of the company in an uncertain category of situations, with consequent inefficiencies in the broader spectrum of circumstances where the directors will not vote because their actions just might be impugned. Further, control is placed in the hands of a different set of shareholders for a limited category of polls with consequent inconsistency in company policy. Finally, the law will, yet again, face

[46] Baxt, *op. cit.* 16 ff; Gower, *op. cit.* 570 ff.

[47] *Exeter and Crediton Railway Co. v. Buller* (1847) 16 L.J. Ch. 449; *East Pant Du United Lead Mining Co. (Ltd) v. Merryweather* (1864) 2 H. & M. 254, 71 E.R. 460; *Pender v. Lushington* (1877) 6 Ch. D. 70; *Imperial Hydropathic Hotel Co. Blackpool v. Hampson* (1882) 23 Ch. D. 1; *In re The Transvaal Gold Exploration and Lead Co. (Ltd)* (1885) 1 T.L.R. 604; *North-West Transportations Co. Ltd & J. H. Beatty v. H. Beatty* (1887) 12 App. Cas. 589; *Burland v. Earle* [1902] A.C. 83; *Dafen Tinplate Co. Ltd v. Llanelly Steel Co. (1907) Ltd* [1920] 2 Ch. 124; *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457; *Prudential Assurance Ltd v. Newman Industries Ltd (No. 2)* [1982] 1 All E.R. 354 (C.A.); *cf. Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268; *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All E.R. 437.

[48] [1982] 1 All E.R. 354.

[49] *Ibid.*

[50] Presumably by legislative action: Beck S. M., 'The Saga of Peso Silver Mines' (1971) 59 *Canadian Bar Review* 80; Baxt, *op. cit.* 16 ff.

the same question of where lies the line between acceptable and fraudulent votes, because even the poll for the positions of director is a matter of the directors' own interest. There is little in the business of the average company that does not affect the fortunes of directors.

(ix) *A Radical Approach: The Associative Analysis*

If the associative concept of company is adopted a coherent approach to the problem is possible. The majority in general meeting is a method of obtaining a decision by a group. Each member accepts as a corollary of being a member that he will sometimes be in a minority, implying that mere disagreement does not cause the decision to be any less than that of the group. The interests of the individual members are expressed in the vote and in the agreement to acquiesce to the majority vote. The interests of the company are defined by the summation of the individual interests each of which includes the implied acquiescence. There is a point, however, where the implied acquiescence can no longer be said to exist. Then the majority vote can no longer be said to be the summation of the interests of the individuals and hence the decision of the group. Where that point lies can be ascertained by examining the nature of the acquiesence with questions such as: in view of the nature of this company, could the decision being made be said to be one of the type to which the complaining member has acquiesced? Tests as to the benefits taken from shareholders, benefits received by the wrongdoers and so forth could then be applied as and when appropriate, taking into account the size of the firm, whether or not it is a closely held company and other relevant factors.[51]

5. DIVISION OF POWER

To this point the existence of a division of decision-making duties between the general meeting and the board of directors has been assumed. The analysis adopted first in *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame*,[52]

[51] 'Fraud' and 'control' would be seen to be aspects of these tests. The very diversity of cases on these points supports the theory as being appropriate because the criteria in each case should differ. Supporting evidence can also be found in the plea for absolute discretionary power adopted in *Clemens v. Clemens Bros Ltd* [1976] 2 All E.R. 268, 282; *Crumpton v. Morrine Hall Pty Ltd* [1965] N.S.W.R. 240, 244; also by Wedderburn K. W., (1957) 15 *Cambridge Law Journal* 194, 214 that the question is ultimately one of a value judgment of the conduct in question. These opinions are rooted in the long history of founding the 'exception to the rule in *Foss v. Harbottle*' on fairness whatever the criteria: *Blackburn v. Jepson* (1823) 3 Swans 133, 36 E.R. 802; *Foss v. Harbottle* (1843) 2 Hare 461, 492, 67 E.R. 189, 202; *Orr v. Glasgow etc. Railway Co.* (1860) 3 McQ. 799, 10 Scots Rev. Rep. (H.L.) 341; *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474; *In re Langham Skating Rink Co.* (1877) 5 Ch. D.669, *Baillie v. Oriental Telephone and Electric Co. Ltd* [1915] 1 Ch. 503; *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All E.R. 437. Specific criteria for when conduct by controllers is unacceptable will vary, thus are impossible to define. Hence develops the retreat in some cases to ideas of purpose of the corporation: *Gramophone and Typewriter Ltd v. Stanley* [1908] 2 K.B. 89; *Peters' American Delicacy Co. Ltd v. Heath* (1938-9) 61 C.L.R. 457, 507 *per* Dixon J. See also Ford, *op. cit.* 339. Such analyses will equate fraud on the minority with *ultra vires*, which is not reflected in the cases: see Vann R. J., 'Share Allotments, Ultra Vires, and Foss v. Harbottle' (1978) 52 *Australian Law Journal* 490. To propose that the corporation has a characteristic such as 'purpose' anthropomorphizes it, even if synergistically derived. It is less romantic, but more real, to accept that only people have purposes.

[52] [1906] 2 Ch. 34. See also *Gramophone and Typewriter Ltd v. Stanley* [1908] 2 K.B. 89; *Salmon v. Quin & Axtens Ltd* [1909] A.C. 442; *cf. Isle of Wight Railway Co. v. Tahourdin* (1884) 25 Ch. D. 320, distinguished as being an interpretation of specific articles, *Marshall's Valve Gear Co. v. Manning Wardle & Co. Ltd* [1909] 1 Ch. 267.

provides that the powers of the various 'organs' of the company are given originally to each organ and there is no delegation of power by the general meeting as the company. As the articles and memorandum are the contract,[53] the division of power between the various organs is a matter of construing their provisions.[54] This is a convenient manner of approaching the problem faced in *Automatic* where the general meeting and the board of directors held differing opinions as to the advisability of selling the business of the company, but it does not solve all the problems surrounding the relationship of the two organs. Contract analysis has difficulty with unanimous consent by all the shareholders to a particular decision. No case has satisfactorily answered whether the board of directors acting *intra vires* itself could be overriden by all the shareholders acting together.[55]

The unresolved problem with the contract analysis as to residual powers was referred to earlier.[56] Where the board of directors is deadlocked or lacks a quorum the general meeting may resolve the issue.[57] Similar situations which may be resolved by the general meeting are the ratification of acts *ultra vires* the board of directors even if the general meeting is not given the original power to do the act,[58] releasing breaches of directors' duties[59] and overriding the directors in an improper decision not to sue.[60] Few cases even attempt a justification in theory of these pragmatically derived powers. The authorities usually cited were decided prior to

[53] In *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame* [1906] 2 Ch. 34 the memorandum and articles were referred to as the consensus of all the individuals in the company (*per* Collins M.R., 43), and as 'the contract' (*per* Cozens Hardy L.J., 45).

[54] *Mills v. Mills* (1938) 60 C.L.R. 150; *Campbell v. Rolfe* [1933] A.C. 91; *Salmon v. Quin & Axtens Ltd* [1909] A.C. 442 and *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame* [1906] 2 Ch. 34. See generally, Aickin K. A., 'Division of Power between Directors and General Meeting as a matter of Law, and as a matter of Fact and Policy.' (1965-7) 5 M.U.L.R. 448; Slutsky B., 'The Division of Powers between the Board of Directors and the General Meeting, in *Studies in Canadian Company Law. Corporation and Securities Law in the 'Seventies* (vol. 2 1973) 166; Goldberg G.D., 'Article 80 of Table A of the Companies Act 1948' (1970) 33 *Modern Law Review* 177.

[55] On a strict division of powers analysis unanimous comment would only be relevant in so far as it would be an ordinary special majority. Thus a sole beneficial shareholder would be in no better position than if it held the seventy-six percent of the shares. In *Gramophone and Typewriter Ltd v. Stanley* [1908] 2 K.B. 89, this analysis would seem to have been applied. See also *John Shaw & Sons (Salford) Ltd v. Shaw* [1935] 2 K.B. 113, 134. However, there are numerous cases where the efficacy of a unanimous resolution is considered to be greater: *Re Express Engineering Works* [1920] 1 Ch. 466; *Ho Tung v. Man On Insurance Co. Ltd* [1902] A.C. 232; *Parker and Cooper Ltd v. Reading* [1926] Ch. 975; *Buchanan Ltd v. McVey* [1954] I.R. 89; *Dey (E.H.) Pty Ltd v. Dey* [1966] V.R. 464. In all of the cases the issue is stated to be a difficult problem. As is later noted, associative analysis is consistent with all the cases and with the language and distinctions used therein. Admittedly, the issue is rather academic in view of the almost universal provision enabling directors to be removed from office: Reg. 62 Table A, Schedule 3 and s. 225.

[56] *Supra* p.621.

[57] *Barron v. Potter* [1914] 1 Ch. 895, *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666; *Foster v. Foster* [1916] 1 Ch. 532.

[58] In *Boschoek Proprietary Co. Ltd v. Fuke* [1906] 1 Ch. 148 it was accepted that the general meeting could ratify, but limited the power to those matters not excluded by the memorandum or articles. See also *Bamford v. Bamford* [1970] Ch. 212.

[59] *Bamford v. Bamford* [1970] Ch. 212; *Hogg v. Cramphorn Ltd* [1967] Ch. 254; *Regal (Hastings) Ltd v. Gulliver* [1967] 2 A.C. 134; *Pavlides v. Jensen* [1956] Ch. 565; *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1982] 1 All E.R. 354; *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666. This power is limited in the manner discussed previously.

[60] This is the narrowest statement of the power: see *Winthrop Investments Ltd v. Winns Ltd* [1975] 2 N.S.W.L.R. 666; *Pavlides v. Jensen* [1956] Ch. 565; *Ngurli Limited v. McCann* (1953) 90 C.L.R. 425; *Kraus v. J. G. Lloyd Pty Ltd* [1965] V.R. 232. *John Shaw & Sons (Salford) Ltd v. Shaw* [1935] 2 K.B. 113. In *Marshall's Valve Gear Co. v. Manning Wardle & Co. Ltd* [1909] 1 Ch. 267 the power was more broadly stated: the general meeting can override the board of directors no matter whether the decison not to sue was or was not improper.

the adoption of the contract analysis of the division of powers and the development of concepts of shareholders' rights. It has been easy to adapt the old ideas of the overriding power of the general meeting to imply that where the board of directors is unable to act whether through procedure or lack of power or because the decision is in some sense improper and therefore to be avoided, the general meeting has the power to act. This implies that what is not given to the board is given to the general meeting,[61] but there is no convincing modern rationale.[62] The only possible theoretical justification on current theories is through implied terms to the contract in the memorandum and articles. The shareholders upon joining the company agree not only to the terms of the constitution but also to the extra powers of the general meeting as necessary to make a functioning institution.[63] Although consistent with the law, the justification is strained especially when the power to decide not to sue is at issue. If the wide version of the power is adopted, the implied provision allowing the general meeting to override the board directly contravenes the articles.[64] On the other hand even if the narrower formulation is adopted[65] the power of the general meeting to disallow a derivative action and the power of the individual shareholder to bring the action in the first place must be explained. The usual justifications are *Mozley v. Alston*[66] and *Foss v. Harbottle*[67] respectively, yet these are founded on the power of the general meeting to review.[68]

Many of these difficulties can be resolved by again examining the concept of company in law and social reality and discovering the association of all members to exist in social reality but not as a legal concept. The main assertion of this essay is that both the board of directors and the general meeting are means to the expression of the decisions of the group, but each has inherent limitations in this task. The memorandum and articles constitute the members as a group and divide the decisions to be made between two procedures. In most circumstances this division will be enforced by the courts because it is accepted by the members on formation or at the time of otherwise becoming a member. In this way the group has its own sovereignty, even as to alterations to the constitution.[69] The courts will

[61] Gower, *op. cit.* 136.

[62] Aickin, *op. cit.* 462-4. This is especially true where the articles, as is usually the case, define the powers of the general meeting and give residual power to the board of directors.

[63] In the true tradition of *The Moorcock* (1889) 14 P.D. 64, [1886-90] All E.R. 530 and *Shirlaw v. Southern Foundries (1926) Ltd* [1939] 2 K.B. 206.

[64] On true contract principles, this is not possible. But see: *Marshall's Valve Gear Co. v. Manning Wardle & Co. Ltd* [1909] 1 Ch. 267, where Neville J. expressly stated that 'in the absence of any contract to the contrary', the shareholders have ultimate control of its affairs.

[65] See Ford, *op. cit.* 340.

[66] (1847) 1 Ph. 790, 41 E.R. 833.

[67] (1843) 2 Hare 461, 67 E.R. 189.

[68] For discussions of this conflict see Ford, *op. cit.* 338-45; Aickin, *op. cit.* 448 ff. Professor Ford makes a valiant attempt at reconciliation, whilst K.A. Aickin gives up in disgust, as, incidentally, does Wedderburn K. W., (1957) 15 *Cambridge Law Journal* 194, 214-5.

[69] One difficulty is unintentional membership through devolution, succession *etc*. These problems with acceptance as the basis of decision-making are ameliorated by the share being a transferable security, and the inherent limitations on the power of companies to bind in ways which infringe on the personal rights of individuals. The company would not be formed were it not to have at least the prospect of advantage. Thus s. 78 was passed to formalize the binding nature of membership on successors in title. It avoided with only a slight chance of injustice the necessity of generations of litigation defining the extent of acceptance of decision-making by the group. See *Land Mortgage Bank of Victoria Ltd v. Jane Reid* [1909] V.L.R. 284.

only interfere when in no circumstances could the decision being made be said to be that of the group. The implicit criterion for this has been that an individual member could be said to have never accepted that this decision be made or that the decision-making body could never have made a decision for the group in these circumstances. Thus decisions are avoided or the capability of making the decision is given to the body which is best able to represent the decision of the group. Accordingly, judicial pronouncements on the powers of the general meeting give it residual power, the power to decide to sue and to resolve deadlocks whilst sternly asserting that there is a 'division of power' and that the general meeting is not 'the company'.[70] The judgments cannot refer to the association as such and as distinct from the legal entity because the group is not a recognized legal concept.[71] Thus it has not been possible to construct the link, which exists in a variety of forms in social reality, between the board of directors and the general meeting, recognizing both as mere means to the expression of decisions, yet one more accurate and therefore appropriate in certain circumstances.

An associative analysis would give the unanimous consent[72] of all the members preeminence. If ascertainable, the common decision of all members is that of the group.[73] Yet even this as a method of decision-making has its limitations. Practical obstacles are obvious.[73a] The members must all be members at the relevant time and the question or decision must be in the form which expresses the opinion of the members. The consent of the members must be real and informed. If a member

[70] See *supra* pp.627-8.

[71] Probably (and I here speculate) because of the difficulty in recognizing the group as a concept without giving it legal personality or indulging in sentimental metaphysical fancy. The inchoate nature of the law relating to unincorporated associations may well be also a result, but it is not my intention to draw a definite parallel. Lest the contention of this essay be impugned for not solving all the problems of unincorporated associations, I must, at this stage in my research, state that the group at the basis of company law may be a legal concept because of the grant of personality. What effect the absence of acceptance by the legal system as a person has on the concept of group is beyond the scope of the essay. See, perhaps, Stoljar, *op. cit.*.

[72] Distinguish this from the concept which states that if but one member disagrees the matter may be forced onto the company. This refers more to the capability to take legal action. If all members consent to the particular matter, there is no member who will take legal action. Such analyses flow more from estoppel than unanimous consent being the expression of the decision of the group.

[73] *Supra* n. 53, p.627. In *E.B.M. Co. Ltd v. Dominion Bank* [1937] 3 All E.R. 555, 564-5, a distinction was made between acting as the members, in right as shareholders and acting otherwise. Acting as members even if unanimously gives no greater efficiency than a majority or special majority, *i.e.* the members must act in accordance with the memorandum and articles. Under associative analysis this is acting as a method of decision-making as specified in the constitution. Legal personality has been granted for this method, and thus the constitution. Thus a distinction can be made between the control by a sole beneficial shareholder in *Gramophone and Typewriter Ltd v. Stanley* [1908] 2 K.B. 89 and the association here asserted to exist. The court held that the requirement for identity of business referred to legal entity, and decided that the corporate veil was not to be pierced. On the facts the German company was operated separately. The Gramophone and Typewriter Ltd acted only as shareholder, and as shareholder the English company exercised no more control than shareholders can exercise. Similarly the famous statement by Greer L.J. in *John Shaw & Sons (Salford) Ltd v. Shaw* [1935] 2 K.B. 113, 134 that the company is an entity distinct alike from its shareholders and directors is a matter of asserting that the association as a group is separate. In *Ho Tung v. Man On Insurance Co. Ltd* [1902] A.C. 232 the Privy Council asserted the majority is only the machinery for securing the assent of the shareholders and in *In re Express Engineering Works Ltd* [1920] 1 Ch. 466 the unanimous consent of all the shareholders effectively bound the company in breach of the formalities in the articles. See also *Parker & Cooper Ltd v. Reading* [1926] Ch. 975; *Buchanan Ltd v. McVey* [1954] I.R. 89. It is left undecided as yet whether unanimous consent would override the board of directors.

[73a] Even if we avoid the alarming conclusions of Arrow's theorem: Arrow K. J., *Social Choice and Individual Values* (2nd ed. 1963).

later changes its mind the decision is no longer that of the group and therefore is challengeable given that doctrines, such as estoppel, designed to remedy the consequences of reasonable reliance are not attracted.[74] A more fundamental difficulty arises from the distinction between the association and the legal entity. The legislature has provided that alterations to the constitution of a company may be made only by a special majority or not at all.[75] This has the affect of deleting from the possible range of cases most circumstances where unanimous consent might be required.[76] In most other respects the decision relates to a matter which was a condition to the grant of the status of legal entity. To alter such a matter is to flout the will of Parliament and is therefore illegal.[77] *Ultra vires* is one example: the capacity of the company is defined by the memorandum as required by statute.[77a] The requirement is interpreted as implying that legal personality is only granted for the purpose of actions within that capacity. The unanimous consent of all the members cannot extend the legal personality of the legal entity.[78]

In circumstances which do not fall within these limitations, the courts have been reluctant to deny the effectiveness of unanimous consent.[79] Unfortunately, the courts have not used an associative analysis and as a result their reluctance has not been well articulated or based on any strong principle. Yet the very impulse not to entirely discredit the idea of unanimous consent, despite the implications of the contract analysis, has tended to prevent the modern technical visions of company law from becoming all-pervasive. This reluctance of the courts asserts the existence of the members as a group.

6. PROCEDURAL MATTERS

(a) *Derivative actions*

There were many cases in the middle years of last century concerned with the right to use the name of the company in legal action.[80] If a director breached duties and controlled the company, the other members might wish to gain recompense and would sue using the name of the company. At this stage the directors could seek to have the writ struck out for want of a plaintiff, having had a resolution

[74] *Supra* n.72, p.629. Also *Henderson v. Bank of Australasia* (1889) 40 Ch. D. 170.

[75] *Supra* n.22, p.605.

[76] *Cf.* the cases prior to *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cunninghame* [1906] 2 Ch. 34, in which a distinction was made between mandatory clauses which could not be altered and advisory provisions that were alterable: *e.g. Hutton v. Scarborough Cliff Hotel Co. (Ltd)* (1865) 2 Dr. & Sm. 521, 62 E.R. 717.

[77] This may well extend to prevent the general meeting overriding the board of direction even if acting unanimously. *Supra* n.73, p.629.

[77a] The amendment, effective as from 1 January 1984, to ss. 67-8 may have altered *ultra vires* so that it no longer is a matter of capacity, but rather is one of internal relationships between the shareholders and management.

[78] *Ashbury Railway Carriage and Iron Co. v. Riche* [1875] L.R. 7 H.L. 653.

[79] *Supra* n.73, p.629.

[80] *Great Western Railway Co. v Rushout* (1852) 5 De. G. & Sm. 290, 64 E.R. 1121; *East Pant Du United Lead Mining Co. (Ltd) v. Merryweather* (1864) 2 H. & M. 254, 71 E.R. 460; *Atwool v. Merryweather* (1867) L.R. 5 Eq. 464. *MacDougall v. Gardiner* (1875-6)1 Ch. D. 13; *Russell v. Wakefield Waterworks Co.* (1875) L.R. 20 Eq. 474; *Pender v. Lushington* (1877) 6 Ch. D. 70; *Duckett v. Gover* (1877) 6 Ch. D. 82; *In re The Transvaal Gold Exploration and Land Co. (Ltd)* (1854-5)1 T.L.R. 604.

passed by the relevant body that the action be discontinued. The court would do so unless circumstances were such that justice required that it be continued, in other words, unless it fell within the exception to the rule in *Foss v. Harbottle*.[81] Under associative analysis, the court examined whether or not the decision not to sue could be that of the group or whether the issuing of the writ was the decision of the group acting within its purposes.

The original system for dealing with disputes as to who had the right to use the corporate name was recognized to be risky for the shareholders and cumbersome in the bureaucracy of the court system. It was just as simple, it was decided, for the shareholders to sue in their own name and join the company as a co-defendant with the delinquents.[82] The complaining members had control of the action, the company was a party so that the matter would be *res judicata* for the company and all shareholders and the company would be awarded whatever remedy were appropriate. It was recognized that the company as defendant was artificial, but the benefits of the system were great and after a little difficulty with the conceptual anomalies it was accepted as viable.[83] During the 1950's and 1960's[84] this came to be known as the 'derivative' action and the terminology was accepted by the courts in the 1970's.[85] The term is useful and descriptive, but has the defect that it seems to have more meaning or conceptual depth than it actually possesses. It is, in essence, a statement that the action of the member 'derives' from that of the company if the preconditions to the action by members, fraud and control, are met.[86] It merely restates and reaffirms the proper plaintiff expression of the rule in *Foss v. Harbottle*. The danger in its use is that it accepts the action as 'belonging' to the company and the exception as given. It does not ask why the action by the member exists at all or as a possible conceptual unity with the nature of the company. It tends to imply the question the court faces is, in what circumstances can the member sue in the place of the company, instead of the question, in what circumstances will the court disregard the decision by a body set up under the constitution of the company and allow the opinion of a single member to be that of the company. The misleading nature of the term is not only damaging to associative analysis but also to all concepts of the nature of the rule in *Foss v. Harbottle* whether they be based on majority rule or ratifiability.

[81] See especially the *East Pant Du United Lead Mining Co. (Ltd) v. Merryweather* (1864) 2 H. & M. 254, 71 E.R. 460; and its sequel *Atwool v. Merryweather* (1867) L.R. 5 Eq. 464.

[82] See the comments of Lindley M.R. in *Alexander v. Automatic Telephone Co.* [1900] 2 Ch. 56, 69. For a time the judiciary had flirted with the idea of the company as co-plaintiff with the aggrieved shareholder but this proved too difficult in *Alexander* because consent was necessary and the whole point of changing the procedure was to allow the compulsory joining of the company to the action. Also *Mason v. Harris* (1879) 11 Ch. D. 97; *Spokes v. The Grosvenor and West End Railway Terminus Hotel Co. Ltd* [1897] 2 Q.B. 124; *Silber Light Co. v. Silber* (1879) 12 Ch. D. 717.

[83] *E.g.* if the company receives money in satisfaction of the claim by the plaintiff shareholders for the wrong to the company: *Peninsular and Oriental Steam Navigation Company v. Johnson & Ors* (1938) 60 C.L.R. 189; see also *Menier v. Hooper's Telegraph Works* (1874) 9 Ch. App. 350.

[84] Originating form the U.S.A. the term seems to have been promoted notably by Professor Gower.

[85] *Wallersteiner v. Moir (No. 2)* [1975] 1 All E.R. 849; *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1982] 1 All E.R. 354.

[86] Perhaps also the dilemma pointed out in *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1982] 1 All E.R. 354, 364; but see pp. 623-4 *supra*.

(b) *Personal actions*

'Derivative action' is used to distinguish 'personal' actions from those of the company. Personal actions derive from the constitution or contract and seek to remedy injuries directly suffered by the member as distinct from those suffered through a fall in the price of shares. The distinction would be a matter of mere terminology were it not for the procedural point that in derivative actions the member need not have been a member at the time of the alleged wrongful act whereas this is not true of personal actions.[87] Nevertheless, the distinction is not obvious. No court has as yet decided whether an action to prevent the general meeting from altering the articles is not a derivative action because personal rights are altered and therefore personal injury is caused or not a personal action because the alteration causes injury to the company not being *bona fide* for the benefit of the company as a whole.[88] Under associative analysis the question does not arise. The sole issue is whether the decision affecting a plaintiff can be validly said to be made by the decision-making process. If so, it stands and no action can be taken to reverse it. If not and the decision cannot be said to be that of the group, it fails and any consequences must be remedied. If the decision is not able to be made by the particular process, but can be by another process, it is voidable.[88a] It is the time of the decision or the existing fact of an omission rather than the time of the wrong which matters.

7. CONCLUSION

The theory of the company has been through many transformations over the last one hundred and forty years. Originally it was a set of people working under an inviolable charter or model code which directed the affairs of their pool of capital and delegated control to a board of directors or any other structure they chose but over which they always retained a veto. This concept gradually altered under the pressures of growing economic and legal complexity to an anthropomorphized model, wherein the corporation was a real entity in itself.[89] It held its personality as a quality arising from its own nature and it had organs to carry out its functions.[90] Gradually the contradictions of this model and its sheer mysticism began to pall. As a theorem it failed to resolve the problems created by internal dispute. The last model to be adopted may be called the 'technical' version. The existence of the

[87] *Seaton v. Grant* (1867) 2 Ch. App. 459; *Bloxam v. Metropolitan Railway Co.* (1868) 3 Ch. App. 337.

[88] See *Pender v. Lushington* (1877) 6 Ch. D. 70; *Australian Coal and Shale Employees Federation v. Smith* (1937) 38 S.R. (N.S.W.) 48.

[88a] Hence the decision in *Houldsworth v. City of Glasgow Bank* (1879-80) 5 A.C. 317 that damages are not payable to shareholders as a remedy for corporate decisions. The court is faced with a case about decisions, not wrongs.

[89] For descriptions of the 'realist', 'fictional' 'bracket' *etc.* theories, see particularly Stoljar, *op. cit.*; Hallis F., *Corporate Personality: a study in jurisprudence* (1930); Derham D. P., 'Theories of Legal Personality' in *Personality and Political Pluralism* (1958) 1.

[90] This rather grotesque theory is still adopted for criminal liability: *Lennard's Carrying Co. Ltd v. Asiatic Petroleum Co. Ltd* [1915] A.C. 705; *Tesco Supermarkets Ltd v. Nattrass* [1972] A.C. 153; and for piercing the corporate veil: *Smith, Stone and Knight Ltd v. The City of Birmingham* [1939] 4 All E.R. 116.

institution is accepted, as is the fact of a set of rules defining and regulating it. If defects in the rules arise, they should be remedied, but as the institution has proven effective in dealing with the twentieth century and as it is deeply rooted in our economy and society it cannot be subject to too radical change. Unfortunately, the modern version leaves the resolution of problems to plunge in the darkness of social or economic experiment with no knowledge of the nature of the institution as a guide.

The associative model, whilst answering the questions posed at the outset of this essay, is also an attempt to explain without mysticism the nature of the company in such a way that there can be a coherent and rational approach to the future problems engendered by proposed changes in the law.[91] It also provides convenient tests to resolve the existing problem areas of the law without contradicting authority.

The model involves just a few simple concepts.[92] The association, rather than the legal entity, is the primary unit of company law. The association is conceptually separate from the personality granted by law although it is the association which is recognized as a legal entity. They are the two faces of a single unit in society, yet are analytically separate. There is no need to enquire into the mechanics of the grant of legal entitihood, the courts are merely directed that it exists.[93] The association is comprised of members who contribute to a pool of capital to be used according to the constitution of the association. The act of contribution by the members, when it complies with the preconditions set by law, will be recognized as creating the legal entity, but the nature of the association as such is not thereby removed.

The second concept is of the means by which the association, or group, makes decisions. A decision of a group has to be that of every member of the group. They have to all agree, but they can agree to differ. The constitution of the group defines this primary agreement as to how decisions will be made and to what extent a member agrees that the rest of the members may decide issues in ways with which that member disagrees. This process has been regulated by the application of both common law and statutory limitations to the agreement making membership of such a group a less risky proposition.

[91] Further implications can be made for discretions granted to the court (*e.g.* ss. 320, 364) and to administrative bodies (*e.g.* the National Companies and Securities Commission under s. 542). Indeed, the analysis suggests that the widely/closely held corporation dichotomy need not be reflected in legislation in any fundamental way.

[92] There is no particular originality in the concepts. Elements can be seen in *Gramophone and Typewriter Ltd v. Stanley* [1908] 2 K.B. 89; *John Shaw & Sons (Salford) Ltd v. Shaw* [1935] 2 K.B. 113, 134; *Peters' American Delicacy Co. Ltd v. Heath* (1938-9) 61 C.L.R. 457, 507 ff; Ford, *op. cit.* 339-41; and Eisenberg M.A., *The Structure of the Corporation* (1976). The additional features included here are the idea of an association all but incapable of directly making a decision and its relation with legal entity. Indeed, my colleague R. L. Brown accuses me of 'reinventing the wheel' when the processes of decision-making are being discussed. Much of the material is covered in welfare economics, *e.g.* Winch D. M., *Analytical Welfare Economics* (1971); Buchanan J. M. and Tullock, *The Calculus of Consent. Logical Foundations of Constitutional Democracy* (1965).

[93] Ss. 35(4), 549.