WCP LIMITED v GAMBOTTO & ANOR[1]

EXPROPRIATION OF MINORITY SHAREHOLDING IS NOT A *MALUM IN SE*

Introduction

The decision of the New South Wales Court of Appeal in *WCP Limited v Gambotto & Anor* to permit an amendment to the articles of association of a company enabling the majority shareholders to acquire compulsorily the shares of the minority has caused some disquiet.[2] The decision has been viewed as an erosion of minority rights in favour of the majority and as opening the way to the circumvention of the established statutory procedures for compulsory acquisition.[3]

It will be argued in this case note that these criticisms are unfounded and that the approach adopted by the court affords the minority no lesser degree of protection than they would be entitled to were the majority to adopt more conventional means of compulsory acquisition. If the majority can establish to the satisfaction of a court that the terms of expropriation reflect the fair value of the subject shares (or, *a fortiori*, if the minority is willing to concede the point), to permit the minority to veto expropriation will serve only to facilitate 'greenmail'[4] at the expense of legitimate business objectives.

The Facts

Approximately 99.7% of the issued shares in WCP Limited were held by wholly-owned subsidiaries of Industrial Equity Limited. On 15 April 1992, WCP Limited notified all members of a general meeting to be held on 11 May 1992 for the purpose of considering a special resolution for the amendment of the articles of association of the company to insert a new article 20A. The new article would empower any member who was 'entitled for the purposes of the Corporations Law to 90% or more of the issued shares' to acquire compulsorily, before 30 June 1992, the entire issued share capital of the company at a price of $1.80 per share. The notice of meeting was accompanied by a report prepared by Pannell Kerr Forster valuing the company's shares at $1.365 per share.

1 (1993) 30 NSWLR 385. New South Wales Court of Appeal, 7 May 1993, Priestley, Meagher and Cripps JJA (*Gambotto*). Note that the High Court of Australia heard an appeal by Mr Gambotto on 21 April 1994. Judgment has been reserved.

2 See, eg, Brook Turner, 'Judges give nod to expropriation of minority holdings', *Australian Financial Review* (Sydney), 10 May 1993.

3 Karen Yeung, 'WCP Ltd v Gambotto & Anor' (1993) 11 *Company & Securities Law Journal* 323; Vanessa Mitchell, 'Gambotto and the Rights of Minority Shareholders', National Corporate Law Teachers Conference, February 1994.

4 The exploitation of the nuisance value of a minority holding to force a majority shareholder to pay an excessive premium to buy out the minority holder. See, eg, Harold Ford and R Austin, *Ford's Principles of Corporations Law* (6th ed, 1992).

At the meeting on 11 May, the resolution was passed unanimously. The majority shareholders were present but did not vote. The respondents did not attend this meeting either personally or by proxy.

The respondents, who between them held approximately 0.1% of the issued shares in WCP Limited, commenced proceedings against the company in the New South Wales Supreme Court alleging, *inter alia*, that the amendment to the articles constituted an oppression of the minority and was for that reason beyond the scope and purpose of the power of alteration of the articles conferred by s 176 of the Corporations Law. This argument was successful at first instance before McLelland J who held that the resolution purportedly passed at the meeting of 11 May was invalid and ineffective.[5] WCP Limited then appealed to the Court of Appeal.

The Decision

The Court of Appeal unanimously upheld the appeal.

The leading judgment was delivered by Meagher JA. His Honour observed that:

> The articles of association of a company, in their initial state, are subject to no restrictions other than those imposed by the doctrine of illegality; they are infinitely capable of amendment thereafter, so long as the statutory procedures are utilised; and any attempt to render them incapable of amendment will be invalid. The section of the Corporations Act [*sic*] which currently deals with the matter is s 176. But despite the apparent width of the right to alter the articles of a company, equity imposed a limitation; the alteration of the articles must not constitute an act where the majority oppress the minority.[6]

The usual starting point in any discussion of the equitable principles relating to oppression of the minority is the decision of the English Court of Appeal in *Allen v Gold Reefs of West Africa Ltd*[7] and, in particular, Lindley MR's shibboleth:

> It [the majority's power to amend the articles] must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded.[8]

As Meagher JA noted, '[t]hese words have beguiled and confused the Courts ever since.'[9] To demonstrate the point, his Honour discussed a line of English cases dating from immediately after World War I in which various restatements of the famous *dictum* had been attempted.[10] His Honour noted that whilst the touchstone of 'bona fide for the benefit of the company as a whole' was appropriate when applied to directors who have a fiduciary duty to the company

[5] *Gambotto & Anor v WCP Limited* (1992) 8 ACSR 141.

[6] *Gambotto* (1993) 30 NSWLR 385, 387-8.

[7] [1900] 1 Ch 656.

[8] Ibid 671.

[9] *Gambotto* (1993) 30 NSWLR 385, 388.

[10] *Brown v British Abrasive Wheel Co Ltd* [1919] 1 Ch 290; *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154; *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9.

(although not without its difficulties even in that context), '[I]t is scarcely an apt test to apply to shareholders, who are not fiduciaries, who can legitimately look after themselves, and do not have to concern themselves with the company's benefit.'[11] His Honour noted, with apparent approval, the conclusion reached by Latham CJ and Dixon J in *Peters' American Delicacy Co Ltd v Heath*[12] that 'Lindley MR's test, although constantly invoked, was almost meaningless.'[13]

Meagher JA then considered the enormous taxation advantages and considerable administrative savings which would accrue to WCP Limited upon becoming a wholly-owned subsidiary of Industrial Equity Limited and noted that no allegation had been made that the compensation to be paid was inadequate. Accordingly McLelland J's view that the amendment to the company's articles amounted to an unjust oppression of the minority shareholders was consistent only with some notion that an expropriation of shares, whether beneficial for the company or not, is a *malum in se* and, as such, always enjoinable. Meagher JA rejected this view, noting that the Corporations Law expressly permits expropriation in the context of takeover schemes, compromises and schemes of arrangement, and that articles of association regularly provide for liens leading to forfeiture. His Honour also noted that if the new article 20A had been contained in the articles of association when the company was incorporated 'it is difficult to see how anyone could object to it.'[14]

Meagher JA also rejected the minority's alternative argument that the proposed amendment constituted an impermissible restriction on the transferability of any shares affected. Shareholders remained free to transfer their shares without restriction, even after having received an expropriation notice under the article.

Priestley JA could also find no evidence of oppression or injustice. Although noting that '[s]hares are a form of property, and, often, expropriation of property, that is, the divesting of property from an owner without the owner's consent, will attract community opinion that the divestment was oppressive and/or unjust', his Honour went on to state that 'that opinion is frequently *not* applicable where the divesting is accompanied by just compensation (as is undisputedly the case here).'[15] Further, the minority knew, or should have known, that the membership of the company was bound by resolutions duly passed by the members in general meeting and '[a]ny divestment pursuant to, or dependent on, such a resolution, is, in a real sense, not a divestment against the shareholder's will'.[16] Although, of course, majority voting power could from time to time be abused, Priestley JA could see no sign of any such abuse before him.

Cripps JA agreed with Meagher JA.

11 *Gambotto* (1993) 30 NSWLR 385, 388.
12 (1938) 61 CLR 457.
13 *Gambotto* (1993) 30 NSWLR 385, 388.
14 Ibid 389.
15 Ibid 386 (emphasis added).
16 Ibid.

Analysis

Gambotto is one of a line of recent cases which has evidenced a less than sympathetic approach towards minority opposition to expropriation of their shares.[17] A number of objections have been raised against this trend generally, and the decision in *Gambotto* in particular.

One criticism which has been levelled at the Court of Appeal decision in *Gambotto* is that it undermines the express provisions of the Corporations Law permitting expropriation in limited circumstances and subject to appropriate safeguards.[18] It is submitted that such an objection is without merit. There is no readily apparent reason to construe the various statutory means of compulsory acquisition or extinguishment of minority interests (that is takeover, scheme of arrangement, share acquisition under s 414 of the Corporations Law or selective reduction of capital) as constituting a code, and Meagher JA's rejection of the contrary view[19] is consistent with recent authority.[20] Nor is there any basis for suggesting that those statutory means are rendered otiose by the decision; expropriation by amendment of the articles is only an option where the intending acquirer can secure the passage of a special resolution (almost certainly having to abstain itself from voting — see below) and satisfy a court that the terms offered are fair and not oppressive.

Expropriation in the manner adopted by the majority in *Gambotto* does not deny the minority the benefit of the protections traditionally afforded to them by the Corporations Law. Certainly, had the majority been compelled to proceed by way of takeover, it would have been necessary for them to have obtained acceptances from three-quarters in number of the minority shareholders[21] whereas the special resolution to amend the articles required only the approval of the holders of 75% in nominal value of the shares held by shareholders who voted at the meetings either in person or by proxy. But this does not automatically render the means adopted by the majority repugnant to the legislative policy.[22] The elimination of minority interests has been permitted by means of a scheme of arrangement[23] where the threshold approval requirements are significantly less stringent than those for compulsory acquisition under Chapter 6.[24] The approach now adopted by the courts and the Australian Securities

17 *Nicron Resources Ltd v Catto and others* (1992) 8 ACSR 219; *Elkington v Vockbay Pty Ltd* (1993) 10 ACSR 785; *Elkington v Shell Australia Limited* (1993) 11 ACSR 583.

18 An argument which appealed to McLelland J at first instance: (1992) 8 ACSR 141, 145.

19 *Gambotto* (1993) 30 NSWLR 385, 389.

20 *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219, 234; *Re Stockbridge Ltd* (1993) 9 ACSR 637.

21 Corporations Law s 701(2)(c).

22 Note the remarks of the Legal Committee of the Companies and Securities Advisory Committee ('CASAC') in its 'Compulsory Acquisitions Issues Paper', March 1994, 3:

> In some respects the existing compulsory acquisition provisions may be too restrictive, particularly in regard to the pre-requisites for compulsory requisition under s 701. They could be relaxed without compromising the goals of equity and fairness.

23 *Re Stockbridge Ltd* (1993) (1993) 9 ACSR 637.

24 The threshold requirement for approval of a scheme or compromise under Ch 5 of the Corporations Law is 75% in value and 50% in number *of those present and voting* at the meeting of the class of shareholders affected: Corporations Law s 411(4).

Commission is in effect to recognise the use of a scheme of arrangement as an alternative to a takeover, notwithstanding the more relaxed approval thresholds, where the acquirer can demonstrate the degree of disclosure contemplated by the Eggleston Principles.[25]

Similarly, the courts have rejected the argument that to permit a majority to achieve 100% ownership by means of a selective reduction of capital is contrary to the spirit and purpose of Chapter 6 of the Corporations Law.[26] Indeed, it could well be contended that the treatment of the minority in *Gambotto* was analogous to the treatment they would have received under a selective reduction of capital affecting their shares. In particular, the extinguishment of their interests would similarly have required only a special resolution with no additional 'head count' requirement. Further, as will be argued below, there is no reason to doubt that had the issue of 'fairness' been raised, the Court in *Gambotto* would have applied the principles of fairness and equity which would guide it in exercising its discretion to approve a reduction of capital in determining whether the amendment of the articles was vitiated by oppression or injustice.[27] Hence, although in neither case is there a formal requirement for the majority to abstain from voting on the relevant resolutions, the majority would, in practice, run a significant risk in not doing so.

Some commentators have expressed alarm at the possibility that the case might be taken as authority for the proposition that expropriation of minority interests by inserting a provision in the company's articles permitting compulsory acquisition at or above the 'market value' of their shares is permissible *per se* and that such an approach 'seems to regard the property rights of minority shareholders as far from sacrosanct, treating a share as little more than a capitalised dividend stream'.[28] It is submitted that there is no basis in principle why minority interests should be regarded as sacrosanct: as demonstrated above, this has never been the approach adopted by either the common law or the legislature.[29] It is scarcely plausible that minority shareholders in general feel any sense of emotional attachment to their shares or ascribe any value to them beyond their monetary value. In all but the most exceptional cases, to argue that a minority shareholder is in any real sense treated unfairly if he or she receives an independently determined fair value for his or her holding is unsustainable.

[25] Australian Securities Commission, Policy Statement 60, *Schemes of Arrangement — s 411(17)*, 15 July 1993.

[26] *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219.

[27] For examples of the approach taken in the context of selective reductions of capital see *Catto v Ampol Ltd* (1989) 16 NSWLR 342 and *Re Campaign Holdings Pty Ltd* (1989) 15 ACLR 762; see also Australian Securities Commission, Practice Note 29, *Selective Capital Reductions*, 20 January 1993.

[28] Yeung, above n 3, 326, discussing a point made in Peta Spender 'Compulsory Acquisition of Minority Shareholdings' (1993) 11 *Company and Securities Law Journal* 83, 90.

[29] Note the remarks of Bryson J in *Nicron Resources Ltd v Catto* (1993) 8 ACSR 219, 229:

> [T]he courts act on the basis that it is enough if the [selective reduction of capital] is fair and equitable to all concerned: they do not act on the basis that the extinguishment of shareholdings can or should only take place by consent, or that extinguishment is unfair per se. The courts appear to me to have equated payment of the fair equivalent in money of the value of the shares with fair and equitable treatment.

In any event, it is difficult to see why intangible detriment should be permitted to outweigh the very substantial and tangible economic benefits flowing from rationalisation.[30] Indeed, commentators and the judiciary seem generally now to acknowledge (if somewhat euphemistically) that the objections raised by minorities frequently spring more from the hope of being bought out at a higher price than from any genuine sense of moral indignation at the loss of their proprietary rights.[31]

Perhaps the aspect of *Gambotto* which has drawn the strongest criticism is not the result itself but the absence of any detailed analysis of the requirement of 'fairness' in the majority's treatment of the minority.[32] It has been suggested that the Court of Appeal effectively reduced the requirement of fairness to a single and inadequate criterion: the 'market price'. The decision has been contrasted with the United States' approach exemplified in *Weinberger v UOP, Inc*[33] where 'fairness' was held to be constituted by 'fair dealing' and 'fair price'.

This criticism is unfounded for a number of reasons. First, given that the minority did not allege that they had been treated unfairly and merely sought to argue that they were entitled to resist expropriation of their shares at any price, it is hardly to be expected that the Court would embark on a detailed examination of the fairness requirement.[34] Secondly, the supposed consequences of the Court's failure to provide such an analysis are greatly exaggerated. The 'thorough examination'[35] of the requirement of fairness in the *Weinberger* case is, in reality, largely a discussion of particular facts of that case spiced with unhelpfully broad statements of principle such as: 'However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.'[36] This is not a criticism of the Court's reasoning in *Weinberger*; it is merely intended to point out that fairness will always be largely a matter of an individual judge's reaction to the particular circumstances of the case and is simply not susceptible to the kind of sophisticated analysis called for by some commentators. Thirdly, critics of the primacy given to 'market price' in *Gambotto* fail to define what

30 See also the remarks of the Legal Committee of CASAC, above n 22, 3:

> The Legal Committee considers that compulsory acquisitions are an appropriate and acceptable aspect of Australian commerce notwithstanding that they override the proprietary rights of individual shareholders.

31 See the cases cited in *Nicron Resources Ltd v Catto* (1993) 8 ACSR 219, 231.

32 See the trenchant criticism in Mitchell, above n 3, 27:

> the [court's] analysis of whether the majority shareholders should be able to compulsory acquire shares of the minority in the absence of any wrongdoing or evidence of 'green-mailing' was disappointingly superficial and failed to indicate any principles or guidelines for the future.

See also Yeung, above n 3, 325-6.

33 457 A 2d 701 (1983), 711 (*Weinberger*).

34 It is also interesting to note the remarks in *Weinberger* 457 A 2d 701 (1983), 711: 'in a non-fraudulent transaction we recognise that price may be the preponderant consideration outweighing other features of the merger.' The Court of Appeal's approach is entirely consistent with this.

35 Mitchell, above n 3, 18.

36 *Weinberger* 475 A 2d 701 (1983), 711.

they mean by this expression, merely alleging that many more elements go to make up a 'fair price'. But the so-called 'market price' in *Gambotto* was not merely a price prevailing on the stock market but a value determined after investigation by an independent expert (plus a premium of 32%!). There is no evidence to suggest that the valuation omitted any relevant factors and, given that the minority accepted it as fair, it is a reasonable assumption that it did not. Finally, and most importantly, the matters in *Weinberger* which were taken to impinge upon the question of 'fair dealing' — failure to make full and frank disclosure to minority shareholders and the hurried and cursory nature of the expert's investigation — are matters which, whether before or after the *Gambotto* case, would certainly be relevant to an Australian court's consideration of an allegation of oppression.[37] It is clear law in Australia that the majority must not mislead nor conceal material information from the minority so that its consent is fully informed. Had allegations of inadequate information actually been made in the *Gambotto* case, the Court of Appeal would no doubt have held differently.[38]

Conclusion

The decision in *Gambotto* strikes a fair balance between the rights of the majority and the minority in a manner consistent with longstanding legislative and judicial policy. The use of expropriation articles as a means of compulsory acquisition at a fair value independently assessed is no different in principle to any of the more traditional methods of eliminating minority holdings and is subject to equivalent safeguards. The 'danger' that minority shareholders will lose their shares for a price at or above their 'market value' is the danger inherent in any form of compulsory acquisition and is no danger at all.[39] Criticisms founded on the notion that shareholders' proprietary rights are sacrosanct are demonstrably without foundation: they accord with neither the common law nor statute law.

The criticism of the Court of Appeal's decision for its lack of detailed analysis is also unwarranted. The point of the decision is that expropriation of itself is not oppressive. A gratuitous and hypothetical judicial discussion of the kind of conduct which might have constituted oppression had the majority engaged in it would have been at most unremarkable and, at worst, unhelpful (as the *Weinberger* case demonstrates). The fact that the Court did not do so in no way derogates from the ample Anglo-Australian authority on the issue of oppression

[37] Or indeed breach of the general requirements relating to the contents of notices of meeting.

[38] It is not the purpose of this note to examine the technical merits of the minority's alternative argument that article 20A restricted their ability to transfer their shares contrary to s 180(3)(c) of the Corporations Law. It is submitted, however, that the better view is that the section is aimed at pre-emptive rights which prevent a shareholder from transferring its shares without first giving the other members an opportunity to purchase them at a specified price. In any event, given that shareholders apparently remained free to transfer their shares at any time until they in fact ceased to own those shares as a result of compulsory acquisition by the majority, the Court of Appeal's decision on this point would seem to be clearly correct.

[39] *Contra* Yeung, above n 3, 325.

generally and the wealth of highly persuasive authority dealing with 'fairness' in analogous contexts. Absence of fairness will in most cases be fairly readily apparent. In marginal cases, the decision will inevitably depend upon the individual judge's subjective assessment of the particular facts. To attempt any more sophisticated analysis of the process is unrealistic. It is hoped that the High Court will eschew any temptation to do so and simply confirm the fundamental principle that expropriation by amendment of the articles of association is not a *malum in se.*

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