

GUNS AND GREENMAIL: FEAR AND LOATHING AFTER GAMBOTTO

PETA SPENDER*

[This article explores the commentary which has followed the High Court's decision in Gambotto v WCP Ltd†. It focuses on three commentators who are representative of the general approach of the Australian academy to the decision. Themes which arose in the commentary (greenmail, distrust of the market and the conception of who derived the benefit from the attempted expropriation) are discussed. The article examines the High Court's recognition of the proprietary rights of shareholders, the legal and philosophical construction of property in shares and the relationship between property and liability rules in the context of takings of property. It is argued that there is a strong community disapprobation of private takings and compares the attempted acquisition in Gambotto with the scheme for the compulsory acquisition of semi-automatic firearms. This comparison is provocative but its purpose is to focus on aspects of the expropriation of shares which are neutralised in the commentary such as the expulsion of members and the morality of private takings. Finally the article will present a taxonomy of presuppositions adopted by the High Court and the commentators. Whilst the High Court adopted an associative model, the commentators and the wider academy favoured a liberal-utilitarian analysis.]

CONTENTS

Introduction.....	97
I The <i>Gambotto</i> Litigation.....	98
A What the High Court Said.....	100
II What the Commentators Said.....	102
A Greenmail.....	104
B Distrust of the Market.....	106
C Conception of Who Derived the Benefit.....	108
III Proprietary Rights.....	110
A What Is Property?.....	112
B The Legal Interpretation of the 'Property' in Shares.....	115
C Applying Liability Rules to Shares.....	117
IV Takings Not Permitted without a Public Benefit.....	118
V Why It Is Dangerous to Effect Compulsory Acquisition by Amendment to the Articles.....	122
VI What Is the Basis of the Disagreement?.....	126
A An Alternative Paradigm?.....	128
Conclusion.....	130

* BA (NSW), LLB (NSW), LLM (Syd); Barrister and Solicitor of the Supreme Court of the Australian Capital Territory, Barrister and Solicitor of the Supreme Court of New South Wales; Lecturer, Faculty of Law, Australian National University. The author wishes to thank Stephen Bottomley and Christos Mantziaris for their comments on an earlier draft and Matthew Crowley and Matthew Haslem for their assistance in the preparation of the article. The article is dedicated to Helen Bird, Michael Whincop and Saul Fridman for doing the work so that I could strenuously disagree with them.

† (1995) 182 CLR 432 ('*Gambotto*').

INTRODUCTION

On 14 September 1977 the Queensland government imposed a blanket ban on protest marches until April 1978.

On 10 March [1978] Harry Akers ... applied for a permit for a protest march. He planned to march in company with his dog Jaffa down an unnamed 'no through' road ... outside Bundaberg at 2.45 am on 1 April. He informed the police that he intended to march only one hundred metres and as he was a pacifist ... [his] march would be peaceful. ... Inspector Seaniger ... refused the application and told Akers 'that a permit could not be issued because it was a protest march'. ... Akers conducted his 'illegal procession' in the wee hours of the morning of April Fool's Day observed by ... [a] carload of plain clothes detectives.¹

He carried a placard bearing the words:

The majority is not omnipotent. The majority can be wrong and is capable of tyranny.²

This article explores the commentary which has followed the decision of the High Court in *Gambotto v WCP Ltd*.³ It focuses upon the commentary rather than the decision itself because of a conviction that the commentary has demonised the decision and created an ideological distortion in the debate concerning the rights of minority shareholders.

The article is divided into several parts. Part I of the article refers to the conduct of the *Gambotto* litigation, outlines the High Court decision and highlights some factual matters arising from the case.

Part II reviews the general response to the decision and focuses on three themes which arose from the commentary:

- greenmail;
- distrust of the market; and
- the conception of who derived the benefit from the attempted expropriation.

The first theme analyses an inference which is often drawn by commentators that the claims of minority shareholders amount to greenmail or invite greenmail. This assumption about the motives of minority shareholders distorts their legitimate claims. The second theme examines the scepticism of the market displayed by the High Court. Some commentators seized upon this scepticism and were highly critical of it. The third theme compares the view of the High Court to that of some commentators on the question of who would have derived the benefit of the attempted expropriation. This conception has critical flow-on effects in terms of legitimating the attempted transaction. It will be argued that it was the majority shareholder alone who would have derived the benefit.

The recognition by the High Court of the proprietary rights of shareholders has been the most loathed aspect of the judgment. Part III examines the legal and

¹ Frank Brennan, *Too Much Order with Too Little Law* (1983) 158.

² *Ibid.*

³ (1995) 182 CLR 432.

philosophical construction of property in shares and discusses the relationship between property and liability rules in the context of takings of property.

In Part IV it is argued that there is a strong community disapprobation of private takings. In this part, the basis of this disapprobation will be discussed and the requirement of a public benefit considered, in particular by comparing the attempted acquisition in *Gambotto* with the national scheme for the compulsory acquisition of semi-automatic firearms. This comparison is provocative but its purpose is to focus on aspects of the expropriation of shares which are neutralised in the commentary, such as the expulsion of members and the dubious morality of private takings.⁴

Part V argues that expropriation by way of amendment to the articles of association justifiably gives rise to protection of the minority by equitable doctrines restraining fraud on a power. There are insufficient safeguards available to the minority in this process, therefore it is inappropriate to extend the expropriation devices beyond those already contained in the *Corporations Law*.

Finally, Part VI explores a taxonomy of the presuppositions adopted by the High Court and the commentators. It suggests that the normative approach of the commentators owes much to the liberal-utilitarian paradigm. By contrast, the High Court adopted an associative model. The corporation was also conceived by the commentators as a nexus of contracts, whereas the High Court's model was more connected and based on responsibility. As such, the response to the decision has been revealing in terms of the normative direction of the academy.

I THE *GAMBOTTO* LITIGATION

The factual circumstances which arose for consideration by the High Court in *Gambotto* have been traversed in many articles. Briefly, 99.7 per cent of the share capital of the defendant ('WCP') was held by wholly owned subsidiaries of Industrial Equity Ltd ('IEL'). The remaining 0.3 per cent was held by various minority shareholders, including the plaintiffs. The plaintiffs held 15,989 shares. On 16 April 1992, the secretary of WCP sent a notice to its members stating that a general meeting was to be held for the purpose of passing a special resolution to amend the articles to insert a new Clause 20A which empowered any member who was 'entitled ... to 90% or more of the issued shares' to compulsorily acquire all the other issued shares at the price of \$1.80 per share. A valuation of shares on a net asset value basis of \$1.35 per share was attached to the notice of meeting. It was considered by the valuers that the net asset value was the most

⁴ Clearly comparisons may also be made with the compulsory acquisition of land, but the nature of the entitlements which might arise in land and the attachment of the holders of such entitlements gives rise to particular issues which do not arise in relation to shares. For example, some statutes dealing with the compulsory acquisition of land provide for a 'solatum' which is paid in addition to the market value of the land. This *solatum* recognises the deeply ingrained need to acquire and defend territory. See generally Graham Fricke, *Compulsory Acquisition of Land in Australia* (2nd ed, 1982) 1, Peta Spender, 'Compulsory Acquisition of Minority Shareholdings' (1993) 11 *Company and Securities Law Journal* 83, 90-1.

appropriate basis for the valuation, but the valuation did not include 'the future income tax benefit as a separate asset'.⁵

An exchange of letters occurred between the plaintiffs and the secretary of WCP in which the secretary indicated that the representatives of the principal shareholders would vote in favour of the resolution. The plaintiffs commenced proceedings to challenge the validity of the alteration prior to the meeting at which the special resolution was to be considered. However, the meeting proceeded and the resolution was duly passed. The plaintiffs did not attend or otherwise exercise their voting rights. The majority shareholders were in attendance but refrained from exercising their voting rights at a poll. Three minority shareholders, who were in attendance at the meeting, voted in favour of the amendment with their collective entitlement of 7900 shares. This holding represented only 16.4 per cent of the shares held by the minority.

The proceedings came before McLelland J.⁶ The defendant asserted at the hearing at first instance, that the principal purpose of the alteration and the expropriation of minority shareholdings was to enable the company to take advantage of 'unutilised tax losses' within the IEL group of companies, which would be available to the company if it and its subsidiaries were wholly owned subsidiaries of IEL. A director of WCP stated in evidence:

[I]f all the land holdings of the [company and its subsidiaries] were sold at a price equal to their current valuation, [the company] would become liable to income tax of approximately \$4.235 million. The IEL Group currently has available tax losses in excess of this amount which could be transferred to [the company] or its wholly owned subsidiaries to eliminate such a tax liability and increase the profitability of [the company].⁷

The principal assets of the company and its subsidiaries were seven tracts of land. The 'company had been selling off its land in recent years and ... "there [was] no intention of continuing the property development business" once the sales had been completed.'⁸ The respondent argued that the company stood to take advantage of tax losses of \$4 million if the expropriation proceeded. This quantum could only be achieved if the company sold off all its principal assets. Thus, it appears that it was intended that the company would be a shell after the sale of the assets and the transfer of losses.

It was also asserted by WCP that:

[T]he company would save approximately \$3,000 per year in accountancy fees 'by not having to prepare group accounts' and approximately \$1,300 per year as the result of terminating services in relation to maintaining the share register of the company.⁹

All parties accepted that the offer of \$1.80 per share was fair and indeed generous. The plaintiffs did not seek a higher price, rather they stated throughout the

⁵ *Gambotto* (1995) 182 CLR 432, 450 (McHugh J).

⁶ *Gambotto v WCP Ltd* (1992) 10 ACLC 1046.

⁷ *Gambotto* (1995) 182 CLR 432, 450 (text enclosed within square brackets in original).

⁸ *Ibid.*

⁹ *Ibid* 451.

litigation that they desired to hold their shares. The book value of the land held by the company at the time of the meeting was \$15,035,000, but its market value was estimated to be \$25,977,000. It is therefore a reasonable assumption that the value of the assets held by the company was increasing.

A *What the High Court Said*

Like McLelland J at first instance, and the New South Wales Court of Appeal,¹⁰ the High Court rejected the ‘bona fide for the benefit of the company as a whole’ test where there is conflict between the interests of shareholders. In its place the High Court proposed a two pronged test, depending on whether the proposed amendment gives rise to an actual or effective expropriation of shares, or of valuable property rights attaching to the shares.¹¹ Amendments which do not purport to effect an expropriation are valid unless they are ‘ultra vires, beyond any purpose contemplated by the articles or oppressive’.¹² However, where the alteration allows an expropriation by the majority of minority shares or proprietary rights, a more stringent two limbed test arises. Such an alteration is valid only if the majority shareholders prove that firstly it was made for a proper purpose and secondly it was fair. The court reversed the conventional onus of proof for compulsory acquisitions by requiring the majority to establish the two limbs of the test.¹³

The majority judgment considered that the balancing of interests between the minority and majority requires that where an alteration effects an expropriation the two limbed test is strictly applied. They drew a distinction between the situation where an expropriation clause is present in the company’s articles at its incorporation and where the majority seeks to insert the same. Because the power to alter cannot be exercised simply for the purpose of aggrandising the majority, their Honours considered that the amendment is only allowable to avoid a

¹⁰ *WCP Ltd v Gambotto* (1993) 30 NSWLR 385, 388 The Court of Appeal held that the expropriation was valid. Meagher J wrote the main judgment His Honour considered that the expropriation would provide ‘enormous taxation advantages’ and ‘considerable administrative savings’ to the company (at 389). He opined that the articles of association are ‘infinitely capable of amendment ... so long as the statutory procedures are utilised’, subject to the limitation imposed by equity that the alteration does not constitute oppression of the minority by the majority (at 387–8). Further, an expropriation of shares is not a *malum in se* and was permitted by several provisions of the *Corporations Law* such as ss 701–2, 411 and 414. However, these provisions do not constitute a code governing the expropriation of shares (at 389).

In a separate judgment, Priestley JA commented that shares are a form of property and often ‘the divesting of property from an owner without that owner’s consent, will attract community opinion that the divestment [is] oppressive and/or unjust’ (at 386). However, that opinion does not apply here because just compensation had been offered and the expropriated member was bound by duly passed resolutions of the members of the company. In his view, ‘the shareholder has ... voluntarily become a member of a group of shareholders, binding themselves together by rules by which they agree to be bound by duly passed resolutions even if individual shareholders disagree with them. There are of course abuses of these rules from time to time by members with sufficient voting power; these abuses may be checked by the courts, if the statutory provisions are insufficient’ (at 386–7)

¹¹ *Gambotto* (1995) 182 CLR 432, 444–5

¹² *Ibid* 444

¹³ See generally Stephen Kevans, ‘Oppression of Majority Shareholders by a Minority? *Gambotto v WCP Ltd*’ (1996) 18 *Sydney Law Review* 110, 112.

detriment. The judgment cited *Dafen Tinplate Co v Llanely Steel Co*¹⁴ to illustrate the point:

[H]ow can it be said to be for the benefit of the company that any shareholder, *against whom no charge of acting to the detriment of the company can be urged*, and who is in every respect a desirable member of the company, and for whose expropriation [of shares] there is no reason except the will of the majority, should be forced to transfer his shares to the majority or to anyone else?¹⁵

Advancement of the interests of the company as a legal or commercial entity or the interests of the majority did not justify expropriation. To allow otherwise would be ‘tantamount to permitting expropriation by the majority for the purpose of some personal gain and thus be made for an improper purpose.’¹⁶ Moreover, ‘[i]t would open the way to circumventing the protection which the *Corporations Law* gives to minorities who resist compromises, amalgamations and reconstructions, schemes of arrangement and takeover offers’.¹⁷

On the fairness limb, the majority expressly rejected the suggestion that the shareholder’s interest could be valued solely by the current market value of the shares. Although fairness is predominantly an issue of price, the fairness of the price offered depends on a variety of factors, including assets, market value, dividends, the nature of the corporation and its likely future.

The majority judgment considered that these safeguards were necessary because of the proprietary nature of a share. Their Honours regarded a share as a form of investment that confers proprietary rights on the investor. Thus it is more than a ‘capitalised dividend stream’.¹⁸

In a separate judgment, McHugh J found that the alteration of the articles was authorised by statute, particularly s 176 of the *Corporations Law*. However

[i]n the absence of an unambiguous expression of legislative intention, a general statutory power such as s 176 is not to be construed as authorizing the expropriation of private rights. This presumptive rule is strengthened when the recipient of the power is a private citizen or group of private citizens. Legislative authority for one citizen or group of citizens to acquire the private property of other citizens compulsorily is a rare and exceptional occurrence (*Elkington v Shell Australia Ltd* (1993) 32 NSWLR 11 at 14 per Kirby ACJ). ... Section 176 of the *Corporations Law* lacks any express or necessarily implied indication that the power to alter the articles of a company can be used generally for the purpose of enabling one shareholder to acquire the shares of another. Moreover, the presence of ss 701–703 in the Act tells strongly against the intention to grant such a power in s 176.¹⁹

The section could authorise the expropriation of shares when it is necessary to do so in the interests of the company. His Honour rejected the benefit–detriment

¹⁴ [1920] 2 Ch 124.

¹⁵ *Ibid* 141 (Peterson J), cited in *Gambotto* (1995) 182 CLR 432, 441 (Mason CJ, Brennan, Deane and Dawson JJ) (emphasis in original).

¹⁶ *Gambotto* (1995) 182 CLR 432, 446.

¹⁷ *Ibid*.

¹⁸ *Ibid* 447

¹⁹ *Ibid* 453–4

distinction if the expropriation is commercially necessary to protect the assets of the company. However, his Honour considered that the expropriation would only be valid if it enabled

the company to pursue some significant goal, or to protect itself from some action, that is external to the company. Administrative convenience or cost, for example, could never by itself justify an alteration for the purpose of expropriation.²⁰

Even if the company does need to pursue a significant goal or protect itself, alteration of the articles to insert an expropriation power may still be oppressive because it defeats the 'legitimate expectation that, unless some exceptional circumstance should arise, they will be able to retain their shares until they wish to sell or until the company is wound up.'²¹

Like the majority judges, McHugh J considered that:

[A]ny benefits that will flow to the company from the acquisition will flow only to the remaining shareholders. Moreover, usually the expropriator is a person who controls the company and who often has access to information that is denied to other shareholders.²²

This cache of information together with the capacity of the controllers/majority to time the expropriation might mean that the shares are acquired at a price below their 'fundamental value'.²³ In this case the tax saving claimed by the company was regarded by McHugh J as a legitimate business object but the defendant had not discharged the burden of proving fair dealing or lack of oppression.

II WHAT THE COMMENTATORS SAID

In this part of the paper I review the general response to the decision and thereafter focus on three themes which arose from the commentary:

- greenmail;
- distrust of the market; and
- conception of who derived the benefit.

Another theme which assumed critical importance was the High Court's acknowledgment of the proprietary rights of shareholders. This is dealt with separately in Part III.

The decision has generated a vast amount of literature within a short period of time. Overwhelmingly, the response has been negative. This part of the article reviews the contributions of certain commentators to the debate following the decision, focussing on certain themes.²⁴ The articles I have chosen to discuss are

²⁰ Ibid 455.

²¹ Ibid 456.

²² Ibid.

²³ Ibid.

²⁴ I will primarily rely upon the following articles: Helen Bird, 'A Critique of the Proprietary Nature of Share Rights in Australian Publicly Listed Corporations' (1998) 22 *Melbourne University Law Review* 131; Saul Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted, and if So, What Ought the Rules Be?' in Ian Ramsay (ed), *Gambotto v WCP Limited*:

representative of the commentary on the theoretical implications of the decision and represent a view which is polarised to my own.²⁵

The response to the decision as represented by these articles reveals the normative direction of Australian corporate law reform which still places primacy upon majority shareholder rights. Although the development of the *Corporations Law* in the 20th century has been characterised by significant enhancement of minority shareholders' rights,²⁶ the Australian law of compulsory acquisition of shares operates in a climate which clearly favours the majority, and has done so since its inception in the recommendations of the British Greene Committee in 1926. Up until the High Court decision of *Gambotto*, the development of this body of law persistently facilitated the majority's strategy.²⁷

The day after the decision in *Gambotto*, the front page of *The Australian Financial Review* stated that the 'ruling has radically altered the balance of power within corporate Australia'.²⁸ This statement is overblown, because what the High Court decided was that the majority cannot alter the articles of association of a company in order to insert an article which will allow expropriation of minority shares, unless the expropriation is for a proper purpose and is fair. In the view of the writer this is quite narrow and moderate, especially since the decision is consistent with previous authority which differentiated between use of a pre-existing article to effect an expropriation and altering the articles to achieve that result.²⁹

In so far as the statement in *The Australian Financial Review* indicates that minority shareholders had almost no power to resist expropriation in certain contexts in the past,³⁰ I agree with it. However, it is fallacious to extrapolate from the decision and turn the minority into a David in contest with Goliath. Never-

Its Implications for Corporate Regulation (1996) 117; Michael Whincop, 'Gambotto v WCP Ltd. An Economic Analysis of Alterations to Articles and Expropriation Articles' (1995) 23 *Australian Business Law Review* 276.

²⁵ There are other articles which are more moderate but raise interesting issues in relation to the *Gambotto* decision and the rights of minority shareholders generally. See, eg, Vanessa Mitchell, 'Gambotto and the Rights of Minority Shareholders' (1994) 6 *Bond Law Review* 92; Vanessa Mitchell, 'The US Approach Towards the Acquisition of Minority Shares: Have We Anything to Learn?' (1996) 14 *Company and Securities Law Journal* 283; Damian Grave, 'Compulsory Share Acquisitions: Practical and Policy Considerations' (1994) 12 *Company and Securities Law Journal* 240; Kevans, above n 13; Brendan Pentony, 'Majority Interests v Minority Interests: Achieving a Balance' (1995) 5 *Australian Journal of Corporate Law* 117.

²⁶ For example, the legislature has passed *Corporations Law* ss 260 and 461, and the statutory derivative action has been proposed; the judiciary has decided *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 and made many incursions into the rule in *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189. Recent examples include *Biala Pty Ltd v Mallina Holdings Ltd* [No 2] (1993) 11 ACLC 1082, 1102 (Ipp J) and *Residues Treatment & Trading Co Ltd v Southern Resources Ltd* [No 2] (1989) 7 ACLC 1130, 1145-6 (Perry J).

²⁷ Spender, above n 4, 101.

²⁸ Chris Merritt, 'Gambotto: A Roar Deal for Corporate Mice', *The Australian Financial Review* (Sydney), 9 March 1995, 1.

²⁹ See the discussion in the majority judgment under the heading 'Expropriation of Minority Shareholdings', *Gambotto* (1995) 182 CLR 432, 439-42, which quotes *Re Bugle Press Ltd* [1961] Ch 270 (Harman LJ): 'it was a "fundamental rule of company law" that majority shareholders could not expropriate a minority, unless the articles contained an expropriation provision from the outset.'

³⁰ See, eg, Spender, above n 4, 101.

theless, the High Court had placed primacy upon the right of minority shareholders to hold their shares, emphasising in the language of the majority judgment that a share is a form of investment that confers proprietary rights on the investor or, in the words of McHugh J, that minority shareholders have a legitimate expectation that they will retain their shares until they wish to sell or until the company is wound up.³¹ These remarks seemed in themselves to be reasonably innocuous. However, commentators warned of the dire consequences of the decision. As Whincop stated:

The rule that the court has established harms society. Society loses if a corporate group refuses to pursue a profitable project because of the need to share its profits with the minority.³²

In its submission to the Companies and Securities Advisory Committee, the Law Council considered that:

[T]he resulting legal uncertainty and likely protracted litigation may become major obstacles to the efficient and fair operation of Australian securities markets.³³

This commentary has ultimately led the Committee to recommend that the *Gambotto* principles be confined.³⁴

In the following discussion, I explore some of the themes which formed part of the criticism of the decision.

A Greenmail

Probably one of the more fascinating aspects of the decision is the motivation of Mr Gambotto. As stated by DeMott:

United States lawyers would be startled by the fact that Mr Gambotto represented himself in the lawsuit and by his resilience as a pro se litigant, given the duration of the lawsuit and the relatively small value of his investment.³⁵

Moreover, his argument was that he wanted to hold his shares. This was not an issue of price and there was no evidence of any attempt by Mr Gambotto to extract an extra sum other than the price of \$1.80 which was admitted to be fair. Some applauded his spirit, as evidenced by the editorial in *The Australian Financial Review* which stated that 'the spirit of Giancarlo Gambotto's historic victory deserves to remain part of Australian company law.'³⁶ To others however, this aspect was troubling because his persistence seemed irrational.

But why stand in the way of a good story? Instead, Mr Gambotto was reinvented in order to be consistent with the general characterisation of minority

³¹ *Gambotto* (1995) 182 CLR 432, 456.

³² Whincop, above n 24, 292.

³³ Legal Committee of Companies and Securities Advisory Committee, *Compulsory Acquisitions Report* (1996) 8.

³⁴ *Ibid* 10.

³⁵ Deborah DeMott, 'Proprietary Norms in Corporate Law. An Essay on Reading *Gambotto* in the United States' in Ramsay (ed), above n 24, 90, 91.

³⁶ Editorial, *The Australian Financial Review* (Sydney), 10 March 1995, 28.

shareholders in Australian legal discourse as being either apathetic or extortionate.³⁷

The commentary quickly turned to greenmail.³⁸ Whincop provides us with a description of greenmail in this context as follows:

Minority shareholders often refuse to agree to sell their shares, even where the price offered is objectively fair and would compensate any loss. Minority shareholders will often be aware that majority shareholders benefit substantially from owning all ordinary shares. ... Holding the value of the share (as an interest in net assets) constant, and assuming the benefits of 100 per cent ownership significant, the value of the shares to the majority shareholder rises in exponential, inverse proportion to the number of minority shares outstanding. Although not true in every case, ... [minority] shareholders hold out in order to obtain as large a share of this prospective increase in value as they are able. In publicly listed companies, hold-out behaviour cannot easily be explained by any other motivation, since shares are fungible and, in a diversified portfolio, a perfectly substitutable commodity. Taste and disposition will determine whether one regards such behaviour as self-protection, shrewd bargaining or opportunism.³⁹

Although the High Court characterised Mr Gambotto's motivation as fulfilling his legitimate expectation to hold his investment, the effect was alleged to 'turn Australia into a greenmailer's paradise'.⁴⁰

The term 'greenmail' is certainly a pejorative term in corporate culture. As Macey and McChesney state:

It has been called everything from 'extortion' and 'a disgrace' to 'unfair, unjust, and wrong'. Such negative opinions surface among 'conservatives' as well as 'liberals', for 'nearly everyone agrees that greenmail should be stopped.'⁴¹

Studies conducted in the United States generally indicate that greenmail payments cause a stock's price to fall.⁴² The primary concern about the practice is that it discriminates among a corporation's shareholders, especially shareholders with less diversified portfolios. This concern has particular force in Australia because of the Eggleston principles which embody the philosophy of the regulation of takeovers in chapter 6 of the *Corporations Law*.⁴³ One of the Eggleston principles states that as far as practicable, the shareholders of a company should

³⁷ Spender, above n 4, 93.

³⁸ In applauding the NSW Court of Appeal decision which was adverse to Mr Gambotto, Elliott stated that 'to permit the minority to veto expropriation will serve only to facilitate "greenmail" at the expense of legitimate business objectives': Andrew Elliott, '*WCP Limited v Gambotto & Anor*. Expropriation of Minority Shareholding Is Not a *Malum In Se*' (1994) 19 *Melbourne University Law Review* 776, 776.

³⁹ Whincop, above n 24, 277-8.

⁴⁰ Ivor Ries, 'Chanticleer', *The Australian Financial Review* (Sydney), 9 March 1995, 60.

⁴¹ Jonathan Macey and Fred McChesney, 'A Theoretical Analysis of Corporate Greenmail' (1985) 95 *Yale Law Journal* 13, 14.

⁴² Note, 'Greenmail. Targeted Stock Repurchases and the Management-Entrenchment Hypothesis' (1985) 98 *Harvard Law Review* 1045, 1053.

⁴³ Company Law Advisory Committee, *Report to the Standing Committee of Attorneys-General on Disclosure of Substantial Shareholdings and Takeovers*, Interim Report No 2 (1969) 8 ('Eggleston Report'). These principles are now set forth in *Corporations Law* s 731.

have equal opportunity to participate in any benefits accruing to shareholders under any proposal under which a person would acquire a substantial interest in the company.⁴⁴ For a practice that appears to be universally reviled, it is surprising that greenmail is still legal in Australia.⁴⁵ The same applies in the United States, where neither state corporate laws nor federal securities laws constrain the practice.⁴⁶ It has been suggested that a categorical ban is the only effective way to deal with the practice, measured in terms of shareholder welfare and economic efficiency.⁴⁷

Getting back to *Gambotto*, it is an irony that the judgment may in fact provide greater protection against greenmail than previously. The reason is that greenmail probably constitutes a detriment to the corporation, especially in the context of the Eggleston principles. Thus, the company could with impunity expropriate the shares of the greenmailer by means of alteration to the articles.⁴⁸

If greenmailing is in fact the evil which must be combatted, it is important that we focus on that evil rather than reinventing and thereby distorting minority shareholders' claims.

B *Distrust of the Market*

The High Court in *Gambotto*, especially McHugh J, expressed some distrust of the market as a mechanism for valuation of minority shares. There is no standard definition of 'value' for all purposes and in all circumstances. As stated by Adamson and Adamson:

The word 'value' cannot be defined in a decisive sense which will meet all purposes. Although property must at any given time have the same value for the same purpose, it is evident that it could have differing values on the same day according to the reason for which it is necessary to establish a value.⁴⁹

There can be as many as nine types of value which can be applied to shares, eg book value, going concern value and tangible assets value.⁵⁰ In the context of judicial determinations of value, questions often arise about the relationship between *fair* value and *market* value. Where there are no guidelines provided by the articles of association or a shareholder's agreement, the courts have held that

⁴⁴ Eggleston Report, above n 43.

⁴⁵ It has been suggested that breach of the Eggleston principles may lead to remedial action even if there would otherwise be no breach of any specific provision in ch 6 of the *Corporations Law*: Rodd Levy, *Takeovers: Law and Strategy* (1996) 2. Contradicting this suggestion is the fact that a decision of the Australian Securities Commission ('ASC') under s 31 which is contrary to the principles will nevertheless be valid: *OPSM Industries Ltd v National Companies and Securities Commission* (1982) 7 ACLR 192, 196 (Needham J).

⁴⁶ Note, 'Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis', above n 42, 1056.

⁴⁷ *Ibid* 1061, 1064–5.

⁴⁸ This is also the view of Andrew Rogers, formerly chief judge of the Commercial Division of the NSW Supreme Court. See Andrew Rogers, 'Correct but Delicate Balance', *The Australian Financial Review* (Sydney), 13 March 1995, 19.

⁴⁹ A V Adamson and M S Adamson, *The Valuation of Company Shares and Businesses* (1980) 11.

⁵⁰ Steven Sirianos, 'Problems of Share Valuation under Section 260 of the Corporations Law' (1995) 13 *Companies and Securities Law Journal* 88, 90–1.

the price of the shares must reflect their fair value, that is, the value which is fair to the parties in the circumstances of the case.⁵¹ Therefore, fair value does not necessarily mean market value, and the market value will have a varying influence upon the determination of fair value.

McHugh J in *Gambotto* referred to the decision of *Re Sheldon; Re Whitcoulls Group Ltd*⁵² where Holland J held that the compulsory acquisition of shares at \$2 per share was fair because at the time the current market price had been \$1.65. That was the lowest trading price of the shares in 'the preceding three years'. Six months later the majority shareholder contracted to on-sell its shareholding for \$2.65 per share. Holland J opined that:

In the case of a company with shares quoted on the Stock Exchange it would be rare indeed that a Court could be satisfied that a price substantially higher than that ruling on the public market was anything other than a fair value for those shares.⁵³

McHugh J considered that this decision should not be followed in Australia. Rather, the court endorsed the approach adopted by the Supreme Court of Delaware in *Weinberger v UOP, Inc*⁵⁴ which treats fair price as constituted by a number of factors. One important aspect of the *Weinberger* test is that it requires the valuation to take account of the value of the company to its acquirer, and to include in that assessment the improvements to value which that acquirer can reasonably expect to obtain from its acquisition. This raises the interesting question of whether the concession of fair price in *Gambotto* was appropriate, since McHugh J expressly stated that this price did not include the alleged tax benefits which would flow to WCP/IEL from the acquisition.⁵⁵

The question which arises is whether it is valid for courts to be sceptical about market pricing and to substitute their own principles of valuation in this context. Whincop discusses the efficient capital market hypothesis⁵⁶ and is highly critical of the notion that judges think they can outperform the market in valuing publicly traded shares:

[T]he notion that a judge (assumed to be untrained [in finance]), on the basis of evidence selected by the litigants, can systematically outperform a market in which experienced persons and institutions, with access to high-quality information, stake their reputations and fortunes in a battle on market prices, seems ludicrous.⁵⁷

⁵¹ *Diligenti v RWMD Operations Kelowna Ltd [No 2]* (1977) 4 BCLR 134, 166; *Re Bagot Well Pastoral Co Pty Ltd; Shannon v Reid* (1992) 9 ACSR 129, 146.

⁵² (1987) 3 NZCLC 100,058.

⁵³ *Ibid* 100,060.

⁵⁴ 457 A2d 701, 711 (Del, 1983) ('*Weinberger*')

⁵⁵ *Gambotto* (1995) 182 CLR 432, 450.

⁵⁶ The theory which asserts that markets for financial instruments impound into price all information relevant to the return on the instrument either before or when the information becomes publicly available. See generally Eugene Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 *Journal of Finance* 383.

⁵⁷ Whincop, above n 24, 289. Robert Campbell, 'Opportunistic Amendment of the Corporate Governance Contract' (1996) 14 *Company and Securities Law Journal* 200, 205 observed that the High Court in *Gambotto* 'displayed an alarming ignorance of capital market efficiency.'

Certainly questions arise as to the scope of material taken into account by judges when decisions are made, although it is not uncommon for judges in valuation disputes to refuse to accept the expert evidence of both parties.⁵⁸ Furthermore, the efficient capital market hypothesis has been around for a long time, but it seems that judges do not subscribe to it. The comments of the former judge, Andrew Rogers, serve as an illustration of this aspect of the *Gambotto* decision:

The court injected a welcome dose of commercial realism into the judgment by recognising that the market price of shares on the stock exchange, while cogent evidence of value, may not be at all decisive of the fair value.⁵⁹

McHugh J himself stated that '[j]udges cannot delegate to the market the duties of courts to fix a fair price for shares.'⁶⁰ It may be that his Honour has a different assessment of the concept of 'access to high quality information' referred to by Whincop, exemplified by his insistence upon detailed disclosure as a component of fair dealing.

Considering that the participants in the securities markets are willing, the use of market values for a coercive transaction like an expropriation is a little perplexing. One could even argue that there is no market for a parcel of shares when the holder refuses to sell.

C Conception of Who Derived the Benefit

As stated above, fundamental to the High Court decision in *Gambotto* was an interpretation of who would benefit from the transaction. Both the majority and McHugh J considered that it was the majority shareholder and not the company which was the ultimate beneficiary. This approach was followed by certain media analysts, one of whom made the following comment:

Mr Gambotto had objected to IEL's tactic of having WCP change its articles of association in 1992 to permit IEL to forcibly buy up the shares it did not already own.⁶¹

Another example:

IEL stood to gain tax and cashflow benefits that came from owning 100 per cent of WCP's capital. WCP, in itself, would not be advantaged.⁶²

A few days later, again in *The Australian Financial Review*, Fridman referred to the view in the majority judgment that to allow the expropriation would result in a personal gain accruing to the majority shareholders. Fridman stated that 'this

⁵⁸ See, eg, *Mike Gaffikin Marine Pty Ltd v Princess Street Marina* (1995) 13 ACLC 991, 1001; *Sapir v Sapir [No 2]* [1989] FLC 77,540, 77,542-3

⁵⁹ Rogers, above n 48, 19.

⁶⁰ *Gambotto* (1995) 182 CLR 432, 458.

⁶¹ Merritt, above n 28, 1, 6.

⁶² Ries, above n 40, 60.

argument is simply misconceived. It ignores the central and crucial fact that, once incorporated, a company is a separate legal entity'.⁶³

Fridman extended this argument in a subsequent article where he argued again that the viewpoint

ignores the essence of the company as a commercial entity and as a result ignores the indirect benefits that may flow to other stakeholders in the corporation, such as employees and creditors.⁶⁴

There are two explanations here:

- both the High Court and *The Australian Financial Review* were in error in ignoring separate legal personality; or
- both the High Court and *The Australian Financial Review* took a pragmatic approach to separate legal personality and drew a strong inference from the facts that the company would not derive a benefit from the transaction.

Was this inference justified and if so, how do we regard separate legal personality in this context?

As stated above, the company was in the process of selling the land which it held as its principal assets. The \$4 million which were said to inure to the company as a result of the transfer of tax losses was calculated on the basis of the profit which would be made from the sale of *all* the tracts of land.

After this transaction had been completed, the company would have had either no assets or no substantial assets. It may have had cash with which to satisfy its creditors, but it is unlikely to have had employees. It is most likely that the profits would have been distributed to shareholders by way of dividend or on a winding-up.

Therefore, in the view of the writer, this is an example of the corporation existing as a metaphor rather than a reality. As James states, the concept of separate legal personality exists both as a 'powerful metaphor and a judicial reality'.⁶⁵ It can sometimes be a mistake to imagine similarity for real identity, so that the metaphor obscures the true relations between participants. This is summed up by Bijur J:

[T]he law in dealing with a corporation ... may treat it as a name for a useful and usual collection of jural relations, each one of which must in every instance be ascertained, analysed and assigned to its appropriate place according to the circumstances of the particular case, having due regard to the purposes to be achieved.⁶⁶

However, the issue of who derived the benefit has a broader importance beyond the technical issue of separate legal personality.⁶⁷ It has a significant

⁶³ Saul Fridman, 'No Definitive Statement on Issue', *The Australian Financial Review* (Sydney), 13 March 1995, 19.

⁶⁴ Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 121.

⁶⁵ Nicholas James, 'Separate Legal Personality, Legal Reality and Metaphor' (1993) 5 *Bond Law Review* 217, 217.

⁶⁶ *Farmers' Loan and Trust Co v Pierson*, 222 NYS 532, 543-4 (1927).

⁶⁷ It was held in the recent decision of *Re Albert Street Properties Ltd* (1997) 15 ACLR 603 that although the *Gambotto* principles did not apply to a selective reduction of capital, the failure of

bearing on the ideological characterisation of the decision as favouring individual autonomy over collective rights.⁶⁸ If the company in fact derives no benefits or inconsequential benefits from the expropriation and the purpose of the expropriation is to entitle a majority shareholder to 100 per cent ownership,⁶⁹ then the dispute becomes a dispute between two individuals who have competing claims. The majority becomes an individual and not a collective. If we then factor in power relations, a further distortion occurs because the majority as an individual shareholder is generally vested with greater resources.

The conception of who derives the benefit is also important in terms of legitimating the transaction. If the company in fact derives a benefit, the issue can be characterised as an individual being required to surrender rights for the benefit of the collective good. If the majority shareholder alone derives the benefit, one individual is required to surrender rights for another. By analogy with the laws of eminent domain which are discussed in Part IV, the first situation is a taking for public use, the second is a taking for private use, or a private taking. It will be demonstrated in Part IV that there is a strong community disapprobation of private takings and therefore private takings need to be carefully regulated.

III PROPRIETARY RIGHTS

The recognition by the High Court of the proprietary rights of shareholders has been the most condemned aspect of the judgment. In this part I review the commentary, examine the legal and philosophical construction of property in shares and discuss the relationship between property and liability rules in the context of takings of property.

As stated above, the majority judgment in *Gambotto* considered that safeguards should be imposed because of the proprietary nature of a share.⁷⁰ McHugh J's reasoning was that the safeguards should be imposed because requiring shareholders to sell their shares against their will is 'an infringement of their rights as autonomous beings to make their own decisions and to carry out their own actions'.⁷¹

This construction of shareholder proprietary rights has been greatly criticised, as has the conclusion that shares are more than a capitalised dividend stream. As stated by Fridman:

[A] difficulty with the judgments ... is the reliance on the shareholder's proprietary rights as justification for the special approach taken to the expropria-

an expert to provide information to shareholders about the advantages which would accrue to the remaining shareholder after the reduction invalidated the proposed reduction. Due to the omission, Hansen J was unable to be satisfied that the proposed reduction was fair and reasonable to the non-associated shareholders. See also *Melcann Ltd v Super John Pty Ltd* (1994) 13 ACLC 92.

⁶⁸ Bird, above n 24, 159.

⁶⁹ Note that the 'majority shareholder' in *Gambotto* consisted of a few subsidiaries of IEL. However, in accordance with my earlier arguments and following the interpretation of *The Australian Financial Review* (Sydney), they constituted one entity for the purpose of the dispute because they were capable of achieving 100 per cent ownership.

⁷⁰ (1995) 182 CLR 432, 447.

⁷¹ *Ibid* 456.

tion cases. This ... [is] despite the fact that both judgments recognise the defeasible nature of ... share[s] as property.⁷²

Whincop goes further in arguing that the nature of corporate organisation itself is incompatible with both proprietary rights and democratic principles:

[T]he corporation emphasised (and perfected) the concept of transferability of membership by making the share a fungible commodity that could be bought and sold. Accordingly, principles of democracy seem much less applicable when one can, without loss, cease to be a member and obtain full value for one's membership rights.⁷³

I return to the question of the application of democratic principles later in the article. For now, the question is whether the nature of the entitlement to shares is or should be protected by property rules. Based on an analysis originally made by Calabresi and Melamed,⁷⁴ Fridman has suggested that the High Court in *Gombotto* has imposed a property rule when a liability rule is more appropriate.⁷⁵ The question of whether the law should impose a liability or a property rule arises in the context of 'entitlements'. Calabresi and Melamed describe entitlements as follows:

Whenever a state is presented with the conflicting interests of two or more people, or two or more groups of people, it must decide which side to favor. Absent such a decision, access to goods, services, and life itself will be decided on the basis of 'might makes right' — whoever is stronger or shrewder will win. Hence the fundamental thing that the law does is to decide which of the conflicting parties will be entitled to prevail. The entitlement to make noise versus the entitlement to have silence, the entitlement to pollute versus the entitlement to breathe clean air, the entitlement to have children versus the entitlement to forbid them — these are the first order of legal decisions.⁷⁶

Once society has made its choice as to which entitlement will prevail, it must simultaneously make a series of 'second order' decisions, which go to the manner in which entitlements are protected and whether a person is allowed to sell or trade an entitlement. These second order decisions are necessary because merely selecting the entitlement does not avoid the 'might makes right' problem.

Simply put, if an entitlement is protected by a property rule and someone wishes to remove that entitlement, he/she must buy it from the holder in a voluntary transfer in which the value of the entitlement is agreed upon by the seller. It lets each of the parties say how much the entitlement is worth to him or her and gives the seller a veto over the proposed transfer of the entitlement if the buyer does not offer enough. A liability rule applies whenever someone can destroy an initial entitlement if he/she is willing to pay an objectively determined

⁷² Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 125.

⁷³ Whincop, above n 24, 291.

⁷⁴ Guido Calabresi and A D Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1971–72) 85 *Harvard Law Review* 1089.

⁷⁵ Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 131.

⁷⁶ Calabresi and Melamed, above n 74, 1090

value which is usually set by the court.⁷⁷ The ‘value may be what it is thought the original holder of the entitlement would have sold it for. But the holder’s complaint that he would have demanded more will not avail him once the objectively determined value is set.’⁷⁸ The selection of a particular entitlement and its corresponding protection by property or liability rules is dependent upon economic efficiency, distribution of wealth goals and ‘other justice grounds’.

As stated above in relation to *Gambotto*, the commentators have argued that shares as an entitlement have certain qualities such as defeasibility and fungibility which means that the liability rules should apply.⁷⁹ However, in an overwhelming number of transactions, shares will be dealt with under the property rules, ie a transferee will buy them from the holder in a voluntary transaction in which the value of the shares must be agreed to by the seller. This is clearly the *raison d’être* of the securities markets. If the property rules are the predominant means by which the entitlement to shares is protected, when will the liability rules come into play? To suggest that the liability rules should operate when the majority contemplates an expropriation is circular and does not address the ‘might makes right’ problem referred to by Calabresi and Melamed. If the liability rules are to have any operation in this context, the cross-over point between the property and liability rules must be discerned. We also need to understand more clearly the concept of property in shares because it may be that the conceptual operation of ‘property’ in this context is more flexible and variegated than its portrayal by the commentators. The next section begins exploring this issue.

A *What Is Property?*

In order to understand the operation of property rules in share transactions, we must first ask what are the characteristics of property and what is meant by the term ‘proprietary rights’? Sometimes ‘property’ refers to the legal relation and sometimes to the thing which is the object of the relation. Hohfeld made a similar point:

Sometimes it is employed to indicate the physical object to which various legal rights, privileges, etc, relate; then again — with far greater discrimination and accuracy — the word is used to denote the legal interest (or aggregate of legal relations) appertaining to such physical object.⁸⁰

Due to the intangible nature of shares, an important first step in grappling with the meaning of property in this context is to conceptualise it not as a thing but as a bundle of rights. Accordingly, we should adopt Gray’s definition of ‘property’

⁷⁷ *Ibid.*

⁷⁸ *Ibid.*

⁷⁹ There may be some contention about the nature of the property rule which was set by the High Court in *Gambotto*. In the view of the writer, the nature of the property rule set by the High Court in that case is not that each shareholder has an absolute right of veto over the sale of his/her shares, rather that such a veto can be exercised where an expropriation is attempted by way of an alteration of articles and the majority cannot establish that his/her continuing ownership is detrimental. See further, DeMott, above n 35, 97

⁸⁰ Wesley Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning and Other Legal Essays* (1923) 28.

as a 'power-relation constituted by legally sanctioned control over access to the benefits of excludable resources'.⁸¹

What are the indicia of this power-relation? Honoré has provided a list of the standard incidents of the concept of ownership.⁸² Ownership is relevant because Snare's work on the use of the terms 'property' and 'ownership' in ordinary language indicates that the terms are interchangeable.⁸³ Honoré also asserts that the term 'property' is used to designate both the idea of the thing owned and the concept of ownership. The incidents on Honoré's list are not individually necessary though together they may be sufficient conditions for a person to be designated the 'owner' of a particular thing in a mature legal system. Where the property consists not of a thing but of a bundle of rights, then the first two incidents would be omitted.

They are as follows:

1. the right to possess (right to exclude);
2. the right to use;
3. the right to manage;
4. the right to income of the thing;
5. the right to capital;
6. the right to security;
7. the rights of transmissibility;
8. the incident of absence of term;
9. the prohibition of harmful use;
10. liability to execution; and
11. incident of residuary.

Let us apply these tests to determine ownership in shares.

Number 1 and number 2 — given that we are dealing with intangible property, I will borrow the gloss put upon these characteristics by Gray, who states that a resource is excludable 'if it is feasible for a legal person to exercise regulatory control over the access of strangers to the various benefits inherent in the resource.'⁸⁴ Section 1085 of the *Corporations Law* contemplates such regulatory control by the shareholder by the declaration that a share is personal property.

Number 3 — whilst shareholders manage their share portfolios, management in some corporations is divorced from ownership of the shares. Honoré regards this development merely as a reduction in the liberties of the owner.

Number 4 — shareholders derive the income from their capital invested in the company, predominantly in the form of dividends.

⁸¹ Kevin Gray, 'Property in Thin Air' (1991) 50 *Cambridge Law Journal* 252, 295.

⁸² A M Honoré, 'Ownership' in Anthony Guest (ed), *Oxford Essays in Jurisprudence* (1961) 107, 113.

⁸³ Ordinary language is not quite common usage; it refers rather to careful speech, and analysis of it tries to bring out the complexity of distinctions embodied in usage: see generally Frank Snare 'The Concept of Property' (1972) 9 *American Philosophical Quarterly* 200.

⁸⁴ Gray, above n 81, 268

Number 5 — the right to the capital is primarily concerned with the power to alienate the thing. This comprises the power to alienate wholly or partially during life⁸⁵ or on death⁸⁶ by way of sale, mortgage,⁸⁷ gift⁸⁸ or other mode.

Number 6 — the right to security is clearly contentious here. Honoré's comments are worth quoting at length:

An important aspect of the owner's position is that he should be able to look forward to remaining owner indefinitely if he so chooses and he remains solvent. ... Legally, this is in effect an immunity from expropriation, based on rules which provide that, apart from bankruptcy and execution for debt, the transmission of ownership is consensual.

However, a general right to security, availing against others, is consistent with the existence of a power to expropriate ... in the state or public authorities. From the point of view of security of property, it is important that when expropriation takes place, adequate compensation should be paid; but a general power to expropriate subject to paying compensation would be fatal to the institution of ownership as we know it.⁸⁹

Number 7 — shares are transmissible to the holder's successors.

Number 8 — Honoré distinguishes between determinate, indeterminate and determinable interests. Indeterminate interests are those such as ownership and easements where no term is set. But indeterminate interests are really determinable because '[t]he rules of legal systems always provide some contingencies such as bankruptcy, sale in execution, or state expropriation on which the holder of an interest may lose it.'⁹⁰

Number 9 — this incident makes the property amenable to the legal regulation of harm. Although shares do not have the same potential to harm as do, say fireworks, their ownership is regulated in ways that avert certain harms, eg under the *Broadcasting Services Act 1992* (Cth) or the *Foreign Acquisitions and Takeovers Act 1975* (Cth).

Number 10 — shares will form part of debtor's property which is liable to execution to satisfy a judgment debt or upon an insolvency of the shareholder.

Number 11 — the residuary character refers to the capacity to transfer part of an interest which will revert to the owner after a time. One important example of this characteristic in shares has been the creation of options. Another example is

⁸⁵ Courts have a bias against restrictions on transfer (see, eg, H Ford and R P Austin, *Principles of Corporations Law* (7th ed, 1995) 794) and have taken the view from an early stage that shares should be presumed to be freely transferable: *New Lambton Land & Coal Co Ltd v London Bank of Australia Ltd* (1904) 1 CLR 524, 543–4. Although memoranda and articles frequently place restrictions upon transfers of shares such as rights of pre-emption, s 1085 of the *Corporations Law* probably operates to invalidate an absolute prohibition on the transfer of shares: *Wellington Bowling Club v Sievwright* [1925] GLR 227.

⁸⁶ Pursuant to s 1085(1) of the *Corporations Law*, a share is personal property and therefore capable of devolution by will or by operation of law.

⁸⁷ Phillip Lipton and Abe Herzberg, *Understanding Company Law* (5th ed, 1993) 177.

⁸⁸ 'If there are no restrictions in the articles ... a [shareholder] may transfer [his/her shares] by way of gift. The donee's acquisition of legal ownership occurs on registration of the transfer': Ford and Austin, above n 85, 789

⁸⁹ Honoré, above n 82, 119.

⁹⁰ *Ibid* 121–2.

that a resulting trust may operate where there has been an ineffective disposition of shares.⁹¹

It is clear from the above that shares overwhelmingly have the character of property. The qualities of fungibility and defeasibility, which the commentators highlighted, do not stop the share having the quality of property in mature legal systems nor create any impediment upon the shareholder asserting ownership. Honoré presupposes that alienation will take place by consensual bargaining, so fungibility is a subsidiary issue. Defeasible interests are still proprietary interests, since the notion of property is relative and not absolute. As Gray states, '[p]roprietiness is represented by a continuum along which varying kinds of "property" status may shade finely into each other.'⁹² Property is not a fixed concept, but shares clearly pass the Honoré test of property. Thus, it was not inappropriate of the High Court to have recourse to the proprietary rights of shareholders. These rights are correlative to the property in the shares. Moreover, the right to security inherent in that proprietary interest dictates that expropriation only occur by the state, as is discussed in Part IV.

B *The Legal Interpretation of the 'Property' in Shares*

Reeve has concluded that an analysis of the concepts of property and ownership in law is surprisingly difficult:

The surprise arises from the expectation that here we shall find a clear technical vocabulary, an expectation defeated by the fact that lawyers can often achieve their practical results without making much use of these concepts.⁹³

The share is a concept which is fundamental to corporate law, yet there is still significant uncertainty about its legal nature. Tomasic and Bottomley suggest that the reason for this may be that the share has to do double duty — it has significance for the shareholder due to the rights attached to the share and to the corporation as a measure of the corporation's capital.⁹⁴ The textbooks often use the language of property to describe shares, commonly stating that shares are intangible property.⁹⁵ Section 1085 of the *Corporations Law* now clearly states that a share is personal property. However, there is always an accompanying statement in the textbooks that some of the rights and obligations attaching to shares are contractual in nature with the obligatory reference to the articles of association and the status of a share as a chose in action. Sometimes there is an explanation of the term 'chose in action'. For example, in Tomasic and Bottom-

⁹¹ *Re Vandervell's Trusts [No 2]* [1974] Ch 269.

⁹² Gray, above n 81, 296.

⁹³ Andrew Reeve, *Property* (1986) 22–3.

⁹⁴ An interesting observation though, is that all texts which the writer examined commenced with a discussion of capital before exploring the nature of a share. See, eg, Roman Tomasic and Stephen Bottomley, *Corporations Law in Australia* (1995) ch 16; Ford and Austin, above n 85, ch 17; Lipton and Herzberg, above n 87, ch 8.

⁹⁵ Ford and Austin, above n 85, 619, Tomasic and Bottomley, above n 94, 469, Lipton and Herzberg, above n 87, 177.

ley, 'a chose (or thing) in action is personal property which cannot be enjoyed by physical possession but which is enforceable by legal action.'⁹⁶

Categorising a share as a chose in action highlights the relationship between the proprietary and contractual aspects of shares.⁹⁷ Fridman argues that a share is analogous to other choses in action, such as rights in a contract, and considers that this analogy is very appropriate given the contractarian nature of Australian corporate law. He then draws an analogy with the right to receive performance of a contractual promise, arguing that such a promise is only susceptible to specific performance where the subject matter of the contract is unique. This can never apply to shares which are easily capable of objective valuation.⁹⁸

But it may be that the connection between the proprietary and contractual elements of a share as a 'chose in action' is more complicated. Consider Gray's view:

This curiously proprietary turn of phrase carries in itself a clue to the ambivalence of the contractual relationship. The basic proprietary feature of the chose in action is that it performs the exclusory and regulatory functions which comprise the primary hallmark of 'property'.⁹⁹

One complicated feature of the connection between the proprietary and contractual elements of a share is the right to vote. A critical respect in which a share differs from the right to receive performance of a contractual promise is that most shares carry rights of participation. The right to vote has been described as an incident of property attaching to a share.¹⁰⁰ It is part of the property right represented by a share, although it is said not to be a separate item of property.¹⁰¹ This is curious because interference with voting rights may be asserted in proceedings, at least for the purposes of standing,¹⁰² and voting rights may be regulated by shareholder agreements. Such stipulations in shareholder agreements may be protected by mandatory injunction.

Bird has argued that the right to vote is an implied incident of the statutory contract.¹⁰³ This argument is contentious because there are several provisions in the *Corporations Law* which regulate voting by shareholders which operate outside the articles. For example, s 249 states that each member has one vote per share in default of articles and ss 197 and 198 provide for the right of a member to vote in a separate class vote even in the absence of a provision in the articles.

The right to vote informs the nature of the property in a share. A vote cannot be divided and consequently a share as an item of property is indivisible. Ford and Austin state that it might be otherwise if the 'share carried only financial

⁹⁶ Tomasic and Bottomley, above n 94, 469. The category of 'choses in action' is clearly a grab bag and includes many types of property with distinct characteristics, eg debts, patents and copy-right.

⁹⁷ For an excellent discussion of this relationship, see Bird, above n 24.

⁹⁸ Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 126-8.

⁹⁹ Gray, above n 81, 274.

¹⁰⁰ *Peters American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, 504

¹⁰¹ *Re Alex Russell* [1968] VR 285.

¹⁰² *Residues Treatment & Trading Co Ltd v Southern Resources Ltd [No 4]* (1988) 14 ACLR 569

¹⁰³ Bird, above n 24, 137-8.

rights ... but a share carries rights of membership, and the whole scheme of the *Corporations Law* does not admit of membership referable to a fraction of a share.¹⁰⁴ Further, the right informs the strategic importance of the shareholding. Note the comments of Fridman:

Simply put, where the shares are a minute parcel, conferring no rights of control, positive or negative, and further carry no special rights, such as the right to appoint a director ... there would seem little reason indeed to treat the share as anything other than a 'capitalised dividend stream'.¹⁰⁵

The point is that shares always carry some form of control in so far as shareholders vote for the board of directors. The question of whether ordinary shareholders are capable of controlling the general meeting, and therefore the composition of the board, is a question of quantum. The point at which a mere capitalised dividend stream becomes control of the general meeting is arbitrary. All the more so because actual control of the general meeting is often effected upon a show of hands. Factually, not all shareholders will conform to the Berle and Means thesis of shareholder apathy and some will strenuously exercise their right to vote.¹⁰⁶ Which shareholders have constituted the majority on any motion before the meeting will often be impossible to determine before the show of hands. Conversely this suggestion means that the right to hold property in the shares would diminish with the number of shares held by a shareholder.

In summary, proprietary rights are pivotal to the legal nature of the share as expounded by the courts. Historically, it may be that courts resorted to an 'underlying half-conscious perception of "property"'¹⁰⁷ in explicating the nature of a share, but the creation of some proprietary rights for shareholders in their shares is inescapable.¹⁰⁸ As a result shares may be bought and sold, bequeathed and given as security. The efficacy of these transactions cannot be dependent upon the quantum of the shares.

C Applying Liability Rules to Shares

The arguments made above indicate that the reliance by the High Court upon the notion of the proprietary rights of shareholders is justifiable philosophically and consistent with the legal interpretation of shares.

However, Fridman considers that liability rules should apply in the *Gambotto* situation because these rules are economically efficient in that they minimise transaction costs, whereas property rules incur transaction costs such as the costs

¹⁰⁴ Ford and Austin, above n 85, 620.

¹⁰⁵ Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 128

¹⁰⁶ Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (1939). There have been several recent examples where shareholders have demonstrated behaviour which is far from apathetic. See, eg, 'Coles Myer. Lew Triumphs, Greiner Survives Protest Firestorm at AGM' (1996) 22 *Butterworths Corporation Law Bulletin* [445].

¹⁰⁷ Gray, above n 81, 306.

¹⁰⁸ Recently the New South Wales Court of Appeal adopted the dicta in *Gambotto* by stating in a valuation dispute that a share is more than a capitalised dividend scheme because it confers proprietary rights on the investor: *Holt v Cox* (1997) 23 ACSR 590, 600.

of individual price negotiations. Where transaction costs are high, voluntary transactions are inefficient.

It has been argued elsewhere that where transaction costs are high and bargaining is impossible, property rules may lead to better outcomes than liability rules.¹⁰⁹ So the question niggles. Property rules will apply in most transactions involving shares and it is appropriate that they do, so how can we determine the point at which liability rules should operate? Fridman states that this point is determined by economic efficiency,¹¹⁰ but it seems that the determination of economic efficiency will lead to the same result as a less scientific normative appraisal of the outcome of *Gambotto*.

The indeterminacy of economic efficiency as a guideline is illustrated by extending the argument further, that is, to suggest that all property rules be converted into liability rules. This question is posed by Calabresi and Melamed:

Beginning students, when first acquainted with economic efficiency notions, sometimes ask why ought not a robber be simply charged with the value of the thing robbed. ... If it is worth more to the robber than to the owner, is not economic efficiency served by such a penalty?¹¹¹

They reply that property entitlements should not be converted to liability entitlements because liability rules represent only an approximation of the value, and we should not without special reasons impose an objective selling price upon a vendor. To return to Calabresi and Melamed:

The thief not only harms the victim, he undermines rules and distinctions of significance beyond the specific case. Thus even if in a given case we can be sure that the value of the item was no more than X dollars, and even if the thief has been caught and is prepared to compensate, we would not be content simply to charge the thief X dollars. Since in the majority of cases we cannot be sure about the economic efficiency of the transfer by theft, we must add to each case an undefinable kicker which represents society's need to keep all property rules from being changed at will into liability rules. In other words, we impose criminal sanctions as a means of deterring future attempts to convert property rules into liability rules.¹¹²

In the next section I explore an application of society's need to keep all property rules from being changed at will into liability rules in the context of takings.

IV TAKINGS NOT PERMITTED WITHOUT A PUBLIC BENEFIT

In the discussion at Part II above, I referred to the conception of who derived a benefit from the transaction in the *Gambotto* case and argued that it was in fact the majority shareholder alone who derived the benefit. I also foreshadowed an argument that there is a strong community disapprobation of private takings. In this part, I discuss the basis of this disapprobation and consider the requirement

¹⁰⁹ Louis Kaplow and Steven Shavell, 'Property Rules Versus Liability Rules: An Economic Analysis' (1996) 109 *Harvard Law Review* 715, 718.

¹¹⁰ Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 131.

¹¹¹ Calabresi and Melamed, above n 74, 1124-5.

¹¹² *Ibid* 1126.

of a public benefit, in particular by comparing the attempted acquisition in *Gambotto* with the national scheme for the compulsory acquisition of semi-automatic firearms.

In western liberal societies it is a fundamental community value that, generally speaking, an individual cannot take the property of another without consent, even if fair compensation is to be paid. A 'value' in this context must be distinguished from an 'attitude'. As stated by Braithwaite:

Rokeach defined an attitude as a set of beliefs about a specific object or situation (such as an attitude to slavery). A value, in contrast, is a single belief of a specific kind. It is a trans-situational guide to attitudes, actions and judgments. It lifts us above attitudes about specific objects and situations, to more ultimate goals that affect how we should judge a wide sweep of objects and situations.¹¹³

Thus people irreconcilably hold different attitudes to abortion, but during the debates about abortion, they tend not to disagree about the underlying values such as respect for human life, health and freedom of choice.¹¹⁴

There is a community recognition or value that people's sense of ownership should not be unduly interfered with, which is the policy underlying the property rule which was discussed above.¹¹⁵

The recognition of community values in general and the value which upholds the sense of ownership is critical to the development of legal doctrine. Sir Anthony Mason aptly described the contention which arises when judges take account of values. He suggested that these values

should be accepted community values rather than mere personal values. The ever present danger is that 'strict and complete legalism' will be a cloak for undisclosed and unidentified policy values. ... As judges who are unaware of the original underlying values, subsequently apply that precedent in accordance with the doctrine of *stare decisis*, those hidden values are reproduced in the new judgment — even though the community values may have changed.¹¹⁶

There are many significant legal doctrines which deal with the sense of ownership. In the law of real property there is a fundamental rule that an intruder cannot take over private property simply because he is prepared to pay the owner a price equal to its fair market value. The owner is normally entitled to enjoin

¹¹³ John Braithwaite, 'Community Values and Australian Jurisprudence' (1995) 17 *Sydney Law Review* 351, 354. See also Milton Rokeach, *Beliefs, Attitudes and Values* (1968); Milton Rokeach, *The Nature of Human Values* (1973)

¹¹⁴ Braithwaite, above n 113, 355.

¹¹⁵ *Ibid* 356–9. In his article, Braithwaite listed 45 values which he described as attracting consensus in the Australian community. His purpose in doing so was to redefine the rationale that appellate courts ought to be responsive to 'community values' in exercising their responsibility to keep the law in good repair. In creating the list, Braithwaite relied upon survey evidence where the participants were asked about certain values. For personal goals, people were asked to say what they felt about the value 'as a principle for you to live by' For the social goals, they were asked to accept or reject them as 'principles that guide your judgments and decisions' The value which was listed 32nd on Braithwaite's list was 'a sense of ownership', meaning 'the knowledge that the things you need and use belong to you'.

¹¹⁶ Sir Anthony Mason, 'The Role of a Constitutional Court in a Federation. A Comparison of the Australian and United States Experience' (1986) 16 *Federal Law Review* 1, 5

such actions of the intruder in order to retain or regain the property.¹¹⁷ Another important manifestation is the eminent domain (or takings) clause of the *United States Constitution* which provides that ‘no private property shall be taken for public use without just compensation’.¹¹⁸ The public use requirement is a strict limitation upon the power of the government to take private property. Epstein explains that when the state acquires private property for public use, the public use requirements ensure the fair allocation of surplus by preventing any group from appropriating more than a pro rata share. Similarly, ‘[t]akings for private use are therefore forbidden because the takers get to keep the full surplus, even if just compensation is paid. ... Only takings for public use are allowed’.¹¹⁹

The public use criterion is a critical distinction between the law of real property and the operation of the eminent domain power. Where the transaction is strictly private, the owner is permitted to keep the surplus value of his/her property from expropriation.

In sharp contrast, the state’s exercise of its eminent domain power forces the private party to accept damages by way of just compensation. The state is thereby allowed to capture without negotiation all the transactional surplus, but only for the benefit of the public at large.¹²⁰

As stated above, the situation in *Gambotto* involved a private taking, but can we allege that the taking involves an indirect benefit in which the whole public will share? Suppose it can be argued that the public benefits by paying lower prices for IEL products or that allowing takings by amendment to the articles facilitates general takeover activity which ultimately leads to lower prices for all. Epstein is dubious about the assertion of indirect benefit when determining whether the public use test is satisfied because it is very difficult to identify *any* instance where a taking with full compensation fails the public use test. He states:

Presumably the taking occurs only because the property in its new private use will have a value equal to or greater than its former use. Some portion of the public will always benefit from the transaction (just as others will lose) because of the resulting changes in relative prices. To allow this form of indirect public *benefit* to satisfy the requirement for a public use is to make the requirement wholly empty.¹²¹

To test Epstein’s assertions, it is worth comparing a recent Australian example of the exercise of a compulsory acquisition power by the state. Following the tragic events at Port Arthur on 28 April 1996, the Federal Government proposed a scheme which required the compulsory surrender of and payment of fair compensation for certain types of automatic and semiautomatic firearms. As stated by the federal Attorney-General:

¹¹⁷ F W Maitland, *Forms of Action at Common Law* (1936)

¹¹⁸ *United States Constitution*, Fifth Amendment.

¹¹⁹ Richard Epstein, *Takings. Private Property and the Power of Eminent Domain* (1985) 164.

¹²⁰ *Ibid.*

¹²¹ *Ibid* 170 (emphasis in original).

The standards proposed by the Commonwealth are designed to reduce the overall number of firearms in Australian society; and to ensure that guns are only available to those persons with a genuine reason.¹²²

The Commonwealth released a set of guidelines which were agreed to by a meeting of Police Ministers from each Australian State and Territory on 10 May 1996. The surrender of the firearms was to be effected by State and Territory legislation, but the Commonwealth allocated \$500 million raised through a levy on Australian taxpayers to fund the payment of compensation.

There are certain interesting comparisons to be drawn between this scheme and the transaction which formed the subject matter of the *Gambotto* case. For example, the nature of the property in both cases gives rise to an argument about the proprietary rights of the holder. A gun is a chattel and the expropriation will require a deliberate act of surrender by the holder. If the holder resists, the resistance is met with criminal sanctions.¹²³ Nevertheless, the owner can still hold and some owners have threatened resistance by burying their guns. By contrast, because shares are incorporeal, the expropriation can still be effected even with resistance due to the power of the company to cancel the shares of the holder. The rules regulating the acquisition in the case of guns are derived by an ad hoc agreement between representatives of constituents. In the *Gambotto* case it was by way of constitutional amendment. If we look at the association of persons which is involved in the transaction, the acquisition of the gun has no effect on continuing participation, because the association is the Australian community at large. Therefore the former holder of an expropriated gun can still continue to participate in debate surrounding the issue. The effect of the expropriation of shares is expulsion from the association of persons, in this case the company.

Most important, however, are the benefits which are said to accrue from the transaction. In the *Gambotto* case the benefits were said to be 100 per cent ownership, freedom to deal with the assets of the company without consultation with the minority, lower administrative costs and group tax benefits. These benefits devolved to the majority shareholder. Consider the benefits of the firearm acquisition, as expressed by s 3 of the *Firearms Act 1996* (NSW):

- (1) The underlying principles of this Act are:
 - (a) to confirm firearm possession and use as being a privilege that is conditional on the overriding need to ensure public safety, and
 - (b) to improve public safety:
 - (i) by imposing strict controls on the possession and use of firearms, and
 - (ii) by promoting the safe and responsible storage and use of firearms, and
 - (c) to facilitate a national approach to the control of firearms.

¹²² Daryl Williams, *Commonwealth Proposals for Nationwide Control of Firearms*, Press Release, (7 May 1996) 1.

¹²³ *Firearms Act 1996* (NSW) s 7.

In the case of guns, the benefit of the acquisition in the form of enhanced public safety flows to the association of which the former gun-owners still form part. In *Gambotto*, the former holders will be excluded from the benefit of the transaction, due to expulsion from the association.

Making use of the imperfect analogy with the compulsory acquisition of guns, a transaction involving amendment of the articles to effect an expropriation of shares cannot be justified. In summary, there is no public benefit which flows from the attempted transaction in *Gambotto*. By comparison, the whole community benefits by the acquisition of certain guns by virtue of enhanced public safety. An argument based on the public benefit which is derived by enhancing takeover activity is unconvincing due to the plethora of alternative methods which are subject to detailed regulation. This facet is discussed in the next part. A sectional interest benefits from the attempted *Gambotto* transaction by the majority shareholder acquiring surplus value from the minority. This gives it the quality of a private taking. The minority shareholder cannot resist, even by illegal activity, like the gun owners who choose to bury their guns. The effect of the expropriation of shares is to expel.

V WHY IT IS DANGEROUS TO EFFECT COMPULSORY ACQUISITION BY AMENDMENT TO THE ARTICLES

In this part, I argue that attempted expropriation by way of amendment to the articles of association justifiably gives rise to the protection of the minority by equitable doctrines restraining fraud on a power. There are insufficient safeguards available to the minority in this process, therefore it is inappropriate to extend the expropriation devices beyond those already contained in the *Corporations Law*.

A significant focus of the reasoning of the High Court in *Gambotto* was concerned with the fact that the expropriation was attempted by means of an alteration of the articles. The judgments indicated that the power to amend articles is a special power which attracts the equitable doctrines of fraud on a power. Consequently, the power 'should not be exercised simply for the purpose of securing some personal gain which does not arise out of the contemplated objects of the power'.¹²⁴ Where there is an expropriation involved, the limitation on the power takes the form of a proper purpose test.

This approach has been criticised by Fridman as being inappropriate to s 176, because that section amounts to a grant of power by the legislature. It is inappropriate for the court to be 'inferring proper purposes in the context of a raw grant of power by the legislature'.¹²⁵

With respect, there are some tricky chicken-and-egg questions about this analysis. Dixon J wrestled with the evolution of this 'raw grant of statutory power' in *Peters American Delicacy Co Ltd v Heath*:

The power of altering the articles of the company is now derived from sec. 20 of the *Companies Act* ... which is a general statutory provision. ... But the

¹²⁴ *Gambotto* (1995) 182 CLR 432, 444.

¹²⁵ Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 123.

power of altering articles now conferred by statute had its analogue, if not its source, in clauses found in deeds of settlement by which a specified majority of the members of companies constituted or regulated by such instruments were empowered to alter or add to their provisions. The mala-fide use or abuse of such powers would naturally fall under the jurisdiction of courts of equity and ... it has never been conceded that the power is unrestrained.¹²⁶

Dixon J considered that the power to amend the articles could not purely be a raw grant of power because the exercise of the power is restrained by equitable considerations. Bird argues that the analogy with the joint stock companies is antiquated because shareholders in those companies undertook, by the terms of the deed, to conform to their mutual covenants. Share investors saw themselves as 'owners' in the partnership sense of the enterprise.¹²⁷ A preferable analysis invokes s 180 which states that the articles are a statutory contract which consists of the articles which are in force for the time being.¹²⁸

Ford and Austin are in partial agreement with Bird, but their description of the effect of the alteration of articles is more far reaching. They state:

The fact that an alteration, complying with the *Corporations Law* and passed bona fide and not for purposes foreign to the company's operations, affairs and organisation, can disturb existing rights of a member is a sign that articles are not exactly the same as contractual provisions but have some of the characteristics of legislation. They are regulations for the government of a voluntary association of persons.¹²⁹

The suggestion of the statutory contract does not entirely deal with Dixon J's dilemma because Dixon J presupposes that the majority is capable of tyranny and it is the task of equity to check that capability. The answer given by Bird and Fridman to this dilemma is that the powers of the court under s 260 are more than adequate to deal with oppressive, unfairly prejudicial or unfairly discriminatory acts of tyranny.

However, my suggestion is that the imposition of the proper purposes tests and the general operation of the equitable doctrines of fraud on a power, perform a critical prophylactic function. In positing this argument, it is useful to consider the exercise of power more broadly, adopting the analysis made by Finn, writing extrajudicially. Finn examines the way in which the exercise of power is controlled by the common law. The analysis straddles several doctrinal categories to enable general principles to arise out of different contexts. He argues that power can be characterised in a variety of ways based on particular distinctions. The first distinction relates to the form of the power. Here there are two distinct types:

- formal power — which is positively conferred on a person or body by or under the law, eg by a constitution, statute or contract; and
- informal power — which consists of the personal capacity possessed by an individual or body to affect the interests of another whether arising from some

¹²⁶ *Peters American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, 502–3.

¹²⁷ Bird, above n 24, 153.

¹²⁸ *Ibid* 138.

¹²⁹ Ford and Austin, above n 85, 181.

attribute, contrivance or superior relative position on the power possessor's part or from a trust, confidence or reliance placed in that person by the other.¹³⁰

We are concerned at the moment with formal power exercisable under s 176 of the *Corporations Law*. Finn argues that the controls placed on formal power are not limited to answering the question of whether the power has been exercised regularly and in good faith. Considerations also arise as to both the conduct of the power holder and the impact of the power's exercise on the interests and expectations of those affected by that exercise.

The second distinction considers whether the power must be exercised in the interests of another. For example, is it fiduciary or self-serving in character? If the power is self-serving, a crucial point is made by Finn:

[S]ignificant changes are occurring in what today will be regarded as permissible self-interested decisions or actions where a decision or action has adverse consequences for a person with whom one is in some relationship or dealing. Increasingly ... the right to act selfishly is being qualified by some level of obligation to have regard to the interests or expectations of others affected by one's actions, with the consequences that one may need to modify one's action because of the manner in which, or degree to which, that other's interests are likely to be affected.¹³¹

Parkinson has made a similar observation in discussing the reticence displayed by courts of equity over the last few decades to assist transactions which operate purely to serve the interest of a stronger party:

[B]eneath the detail of individual cases lies an ideological shift. Increasingly, courts are curtailing the pursuance of self-interest, where, in times past, it would have been encouraged as a virtue. For example, no longer is it likely that judges will say, as did Wills J in *Allen v Flood*,¹³² that 'any right given by contract may be exercised as against the giver by the person to whom it is granted, no matter how wicked, cruel or mean the motive may be which determines the enforcement of the right'.¹³³

So the exercise of power under s 176 to amend the articles to serve the interests of the majority will be monitored carefully by the common law, especially where the self-serving amendment advances the interests of one shareholder and expels another.

Returning to Finn's argument, he suggests that where the exercise of power is controlled by the common law, that control may take the form of, inter alia:

- a denial or limitation on the power itself because of the significance attributed to the rights and interests of the individual that would be affected by the exercise of the power claimed; or

¹³⁰ Justice Paul Finn, 'Controlling the Exercise of Power' (1996) 7 *Public Law Review* 86, 87.

¹³¹ *Ibid* 87-8.

¹³² [1898] AC 1, 46.

¹³³ Patrick Parkinson, 'The Conscience of Equity' in Patrick Parkinson (ed), *The Principles of Equity* (1996) 28, 31.

- a pronouncement that the manner of the exercise of the power is disproportionate or unfair, when due regard is had to the outcome which results from its exercise.¹³⁴

Finn places the control exercised by the High Court in *Gambotto* in the latter mentioned category, relying on the statement in the majority judgment which stated that the alteration was invalidated because there was no reason in the circumstances to apprehend 'that the continued shareholding of the minority [was] detrimental to the company, its undertaking or the conduct of its affairs'.¹³⁵

However, if the power in question is defined narrowly, it is also arguable that the High Court denied the exercise of power by the majority to amend its articles to effect an expropriation and expulsion.

There are several significant reasons why expropriation of minority shares by amendment to the articles is more hazardous to the minority than the statutory methods available under ss 701, 411–13 and 195 of the *Corporations Law* and therefore should be subject to common law control. These reasons are as follows:

- the statutory methods are subject to judicial/ASC scrutiny;
- the majority shareholders would have a carte blanche to determine the terms of the expropriation, whereas the procedures are clearly defined under the statutory methods;
- there are no checks upon the majority using its voting power to effect the expropriation and timing the same to capture a benefit of which the minority is not aware; and
- the change takes place immediately, and there is no opportunity for the minority to challenge the expropriation itself or the price until after the event.

The checks put in place by the High Court in *Gambotto* are therefore justified and entirely consistent with Finn's analysis of the general development of the common law.¹³⁶ The most interesting development to ponder at this time, however, is the proposal by the Corporate Law Economic Reform Program ('CLERP') that a compulsory acquisition power be introduced which will ensure, in the interests of economic efficiency, that a person who acquires overwhelming ownership of a class of securities is able to achieve 100 per cent control of that class.¹³⁷

Given the potential of the judiciary to control the exercise of the compulsory acquisition power and the increasing tendency of the common law to monitor self-interested decisions, it may be that the legislative fiat suggested by CLERP will be unworkable.

¹³⁴ Finn, 'Controlling the Exercise of Power', above n 130, 88

¹³⁵ (1995) 182 CLR 432, 445.

¹³⁶ For example, the *Gambotto* principle was used by Young J in *Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd* (1995) 13 ACLC 965 to invalidate an amendment to the articles where the expropriation was not a reasonable means of eliminating or mitigating a detriment. The principle was not applied in *Helprin v Westfield Ltd* (1996) 68 IR 25 because Marks J considered that the rights of a convertible note holder ensuing from an executive incentive scheme were different from those of a minority shareholder

¹³⁷ These recommendations are in turn based on the proposals of the Legal Committee of Companies and Securities Advisory Committee, above n 33.

In the next part I explore the basis of the disagreement between the High Court and the commentators about the *Gambotto* case and attempt to explain that divergence by the normative approaches adopted by each camp.

VI WHAT IS THE BASIS OF THE DISAGREEMENT?

This part provides a taxonomy of the presuppositions adopted by the High Court and the commentators. It suggests that the normative approach of the commentators owes much to the liberal-utilitarian paradigm. By contrast, the High Court adopted an associative model. The corporation was also conceived by the commentators as a nexus of contracts, whereas the High Court's model was more connected and based on responsibility.

I say nothing new or surprising in suggesting that many of the tensions in today's law are the products of one, or other, or both, of two antitheses. The first antithesis ... can be summed up biblically on the one side, by Cain's rhetorical question: 'Am I my brother's keeper?' and on the other by Christ's injunction: 'Love thy neighbour as thyself'. The second antithesis expresses, variously, the utilitarian idea that 'the interests of the few should be subordinated to the good of the many', and, contrarily, that 'the few should be protected from the tyranny of the majority'.¹³⁸

It is easy in fields of law such as corporations law to lose sight of the contestable philosophical and political presuppositions that lie buried beneath the doctrinal superstructure. Much of the commentary on the *Gambotto* decision adopts a liberal-utilitarian paradigm in criticising the decision. The classical liberal paradigm describes the social world as populated by individuals rationally (if sometimes imperfectly so) pursuing their own goals. The role of legal institutions in this model is to keep the peace and to ameliorate problems that individuals cannot effectively resolve through bargaining. As stated by Allen:

For classical liberals, the law ... should be utilitarian. Thus, ideally, the law should be a clear set of *rules* that facilitate the private ordering of human affairs. If the law comprised such a set of clear rules, individuals would have maximum control over their condition, and presumably free bargaining would lead towards better states of the world.¹³⁹

An alternative paradigm has been described as an associative model. This model describes the world as populated not by atomistic rational maximisers, but by persons of lesser rationality who lead lives embedded in the social context of a community. This social context includes affective relationships with others such as families and neighbours. Whilst this perspective acknowledges individual autonomy and rationality as aspects of the human experience, it believes their significance to be exaggerated.

The liberal-utilitarian explanation and prescription of the social order has been substantially relied upon and extended by the work of the law and economics

¹³⁸ Justice Paul Finn, 'The Courts and the Vulnerable' (1996) 162 *The Law Society of the Australian Capital Territory Gazette* 61, 63.

¹³⁹ William Allen, 'Contracts and Communities in Corporation Law' (1993) 50 *Washington and Lee Law Review* 1395, 1396 (emphasis in original).

scholars. On this view, the corporation is not a social institution, but rather a nexus of contracts. The corporation is a utilitarian invention designed to reduce the costs of administering a web of ongoing contracts between real people. Thus corporate law is seen as a set of standard instructions for contractual governance.¹⁴⁰

The associative position is that actual bargains provide an incomplete account of the social order we find in organisations. For example, achievement of corporate goals may depend upon trust and loyalty of human actors where monitoring is costly or ineffective.¹⁴¹ Note again the comments of Allen:

The provision of pre-defined roles and rules in the ongoing organization and the social-psychological processes of identification that successful organizations promote are seen by some as vital components of economic organizations *that simply are not visible to the 'network of contracts' vision of the firm.* ... Some of those who hold a social ... perspective tend normatively to be concerned with a corrosive effect that interpreting social life as a continuous, self-interested negotiation may have.¹⁴²

The nexus of contracts paradigm was relied upon by many commentators in criticising the High Court's approach in *Gambotto*.¹⁴³ The normative approach of these commentators owes much to both the liberal-utilitarian paradigm and the law and economics analysis. By contrast, the High Court adopted an associative model.

To explain the use of the associative model by the High Court, the significance of the *Gambotto* decision lies in the recognition by the High Court of the corporation as a community in circumstances where there was no pre-existing relationship which would supply that association such as a family or neighbourhood. Relying on an analysis originally posited by Dworkin, the characteristics of such an association are as follows:

- members of the group must believe the group's obligations to be specific to that group, extending to members, but not 'outsiders';
- members must believe that the obligations apply from each member to each other member, not just the group as a whole in some collective sense;
- members must perceive their responsibilities to their fellow members as flowing from a general *concern* for the well-being of others in the group; and
- the group's practices show equal *concern* for all members.¹⁴⁴

Note the use of the word 'concern' in this context. According to Dworkin, for a 'true' community

¹⁴⁰ This concept has its origins in Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386 and was elaborated by Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305

¹⁴¹ Herbert Simon, 'Organisations and Markets' (1991) 5(2) *Journal of Economic Perspectives* 25, 34–8

¹⁴² Allen, above n 139, 1402 (emphasis in original)

¹⁴³ See, eg, Fridman, 'When Should Compulsory Acquisition of Shares Be Permitted?', above n 24, 126, Whincop, above n 24, 277.

¹⁴⁴ Ronald Dworkin, *Law's Empire* (1986) 195–202.

[t]he concern they require is an interpretive property of the group's practices of asserting and acknowledging responsibilities ... not a psychological property of some fixed number of the actual members. So ... associative communities can be larger and more anonymous than they could be if it were a necessary condition that each member love all others, or even that they know them or know who they are.¹⁴⁵

In the context of the expropriation of shares, arguably an associative interpretation would preclude expulsion by stealth of a member by changing the rules to expropriate his/her shares. Rather, an associative interpretation requires the recognition of the adverse consequences of such acts upon the other members, and thereby requires the assumption of some responsibility by the majority. The High Court expressed this responsibility by voicing the community value referred to in Part IV of this article which holds that individuals cannot take the property of another without consent, even if fair compensation is to be paid. This background principle allowed the High Court to find that the right of Mr Gambotto to retain his shares would trump the wishes of the majority of shareholders.¹⁴⁶

A *An Alternative Paradigm?*

The law and economics or contractarian paradigm offers a very coherent conception of corporations law as a system of rules facilitating wealth maximisation through contracts. By comparison, the conception of corporations law offered by the High Court in *Gambotto* might appear to focus too closely upon human connectedness and responsibility.

The challenge of the corporate law academy in the last two decades has been to develop an alternative theory of corporations in which connectedness and responsibility have force. In relation to the American academy, much of the development of alternative theories of the corporation has focussed upon corporate social responsibility. The communitarian debate in particular has criticised the norm of shareholder primacy in corporate law which disregards the claims of various non-shareholder constituencies such as employees, whose interests may be adversely affected by the managerial pursuit of shareholder welfare. Like the associative model discussed above, the communitarian position is also based on the concept of community, but in this case the community is broader. The communitarians differ from the contractarians in emphasising the broad social effects of corporate activity. They see corporations as more than just agglomerations of private contracts, but rather as powerful institutions whose conduct has substantial public implications.

Ultimately, the divide between the liberal-utilitarian/contractarian and the associative/communitarian positions is based on a profound difference in normative world view. As Millon states:

¹⁴⁵ Ibid 201.

¹⁴⁶ Dworkin argued that in addition to positive rights enshrined in legal rules such as articles of association, there are background rights or principles which judges use to decide hard cases: Ronald Dworkin, *Taking Rights Seriously* (1981) 22 ff. These background rights operate like the community values discussed in Part IV of the present article.

Simply by virtue of membership in a shared community, individuals owe obligations to each other that exist independently of contract. We are born into civil society and thereby inherit the benefits of life in a community. The value of those benefits depends in large part on the quality of the social environment. That in turn is determined by the behaviour of one's fellow citizens, which is largely a matter of their values and goals. If we are to discharge our obligation to preserve and strengthen the social fabric that is our heritage, we cannot ignore those aspects of the material and cultural landscape that shape those values and goals. Acknowledging our interdependence, we must recognize our responsibility for the quality of the lives of all community members. ... Insistence on the market's sufficiency for the sake of individual liberty ... ignores those civic obligations that flow from the social aspect of human existence.¹⁴⁷

Theorists such as Bratton and Brudney have focussed upon the ideological force of nexus of contracts paradigm. Brudney argues that the rhetoric of contract has eased the evolution of the theory of the corporation from the vision of the concession granted by the state, often to do public good, to that of contractual arrangements between private parties. The notion of private contract implied less state involvement to impose limits and restraints upon corporate freedom of action, which in turn lessened public concern about the impact of the new entrepreneurial giants upon consumers, employees and the public generally.¹⁴⁸ Bratton asserts that

'[O]rganisation' as well as 'contract' remains central to our experience of corporations. ... [T]he corporation is a complex of relationships — legal ... social, as well as economic — and ... corporate law mediates between actors and concepts in the complex.¹⁴⁹

As mediator, corporate doctrine mediates disputes between corporate participants and those of the group. In doing so, it draws on the values of discrete contract and on relational values of mutual support.¹⁵⁰

In the Australian academy, Bottomley has begun working on reconceiving corporate organisation in a way which will acknowledge its political dimension. In the context of corporate governance, the political perspective is given the label of 'corporate constitutionalism' to suggest that there are values and ideas in our public political life which should be considered in the legal regulation of this area.¹⁵¹

Whilst we are awaiting or working upon the development of alternative theories, the discussion of the commentary upon the *Gambotto* decision above indicates that the High Court has issued a challenge to the corporate law academy to consider its presuppositions.

¹⁴⁷ David Millon, 'New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law' (1993) 50 *Washington and Lee Law Review* 1373, 1382–3.

¹⁴⁸ Victor Brudney, 'Corporate Governance, Agency Costs, and the Rhetoric of Contract' (1985) 85 *Columbia Law Review* 1403.

¹⁴⁹ William Bratton, 'The Economic Structure of the Post-Contractual Corporation' (1992) 87 *Northwestern University Law Review* 180, 185.

¹⁵⁰ William Bratton, 'The "Nexus of Contracts" Corporation: A Critical Appraisal' (1989) 74 *Cornell Law Review* 407, 430.

¹⁵¹ Stephen Bottomley, 'From Contractualism to Constitutionalism: A Framework for Corporate Governance' (1997) 19 *Sydney Law Review* 277, 278–9.

CONCLUSION

This article was written in reply to the academy on the issues which arose from the *Gambotto* case. It was written from a conviction that the fear and loathing which greeted the decision was at best an overreaction and at worst a vilification of the High Court's recognition of minority rights. A more famous recent example of this type of vilification has been the reaction to the recent High Court decision in *The Wik Peoples v Queensland; The Thayorre People v Queensland*.¹⁵² The parallels can be seen in Brysland's comments on *Mabo v Queensland [No 2]*:¹⁵³

It is the idea, that it is the legitimate business of governments to extinguish property and other rights of minorities when convenient, which represents another example of legal fundamentalism. The belief that 'majoritarianism' may be enlisted at any turn is one reason for the growth of judicial review. We may say that it is ok for the majority to take away minority rights, but [what] will we be invited to vote on next?¹⁵⁴

Brysland is referring to attempts by governments to extinguish property rights, *Gambotto* dealt with a private taking. This article has attempted to establish that the High Court was correct in expounding the legitimacy of Mr Gambotto's claim, the proprietary nature of the shares held by him and that the court was acting in accordance with legal principle and community values in refusing to sanction a private taking by an ex post facto amendment of the rules. Moreover, in so doing, the High Court has focussed upon the internal community of the corporation, attributing responsibilities to its membership. This focus could ultimately lead to the development of an alternative paradigm of the corporate community.

To refer back to the opening quote, this article has been written to remind the academy of Australian corporate lawyers of the message on Harry Akers' placard — the majority is not omnipotent; the majority can be wrong and is capable of tyranny.

¹⁵² (1996) 187 CLR 1.

¹⁵³ (1992) 175 CLR 1.

¹⁵⁴ Gordon Brysland, 'Legal Fundamentalism and *Mabo*' (1993) 18 *Alternative Law Journal* 212, 215.