Oppression of Majority Shareholders by a Minority? *Gambotto v WCP Ltd*

1. *Introduction*

On 8 March 1995, the High Court of Australia dramatically turned the tide of corporate power in favour of minority shareholders.[1] Representing himself, Mr Giancarlo Gambotto achieved a remarkable victory by defeating an attempt by Industrial Equity Ltd (IEL) to expropriate his minority shareholding in WCP Ltd through an alteration of WCP's articles of association.[2] This victory is remarkable because it represents an interventionist approach which traditionally courts have been reluctant to take in the corporate context.[3] It is also significant because the High Court took the opportunity to lay down a new stringent rule to test the validity of such alterations of a company's articles.

2. *The Facts*

Through wholly owned subsidiaries, IEL held approximately 99.7 per cent of the issued capital of WCP. The IEL group wanted to acquire all of WCP's shares because this would lead to tax benefits of approximately $4.235 million and also reduce WCP's administrative costs by $4 300 per annum.[4] IEL sought to acquire the 50 590 minority shares by altering WCP's articles of association under section 176 of the *Corporations Law*. This alteration would enable IEL to expropriate these minority shares at a price of $1.80 each. The shares had been valued, on a net asset value basis, by an independent expert at $1.365 each.

Two minority shareholders, Mr Giancarlo Gambotto and Ms Eliana Sandri, objected to this alteration. Between them, Gambotto and Sandri held 15 898 shares. In light of the dispute, WCP proceeded with the general meeting to vote upon this alteration subject to an undertaking not to expropriate any shares until the dispute was resolved. Presumably resigned to their lack of voting power, neither Gambotto nor Sandri attended this general meeting. Representatives of the majority shareholders and three minority shareholders, who held 7 900 shares, attended this meeting. Upon a poll, the resolution to

---

1 *Gambotto v WCP Ltd* (1995) 69 ALJR 266 (*Gambotto*).

2 The term "expropriation" includes compulsory acquisition for value as in Legal Committee of the Companies and Securities Advisory Committee, *Compulsory Acquisitions: Issues Paper* (March 1994) at 1.

3 For example, Latham CJ stated that "[i]t is not for the court to impose upon a company the ideas of the court as to what is for the benefit of the company" in *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at 481. Similarly, in *Shuttleworth v Cox Bros Ltd* [1927] 2 KB 9, the English Court of Appeal refused to impose its views as to whether an alteration of articles was for the benefit of a company.

4 Section 80G of the *Income Tax Assessment Act* 1936 allows the transfer of tax losses amongst companies within a wholly owned corporate group. IEL could take advantage of this provision if it wholly owned WCP. In evidence at first instance, a director of WCP estimated these amounts would be the benefits that would flow from an expropriation of the minority shareholdings.

alter WCP's article was unanimously passed by the three minority shareholders. The majority did not vote in this poll.

Gambotto did not contest the independent valuation of his shares, but principally argued that the alteration of WCP's articles was invalid because it was oppressive and thus beyond the scope of the power in section 176.

3. *Lower Courts*

A. *First instance*[5]

In the Equity Division of the Supreme Court of New South Wales, McLelland J found for Gambotto. He started by pointing out that the traditional test — that a resolution altering the articles be "bona fide for the benefit of the company as a whole"[6] — was inappropriate in the present case. Then, without providing an alternative test, he held that the alteration of WCP's articles was invalid because it amounted to an unjust oppression of the dissident shareholders.[7]

B. *The Court of Appeal*[8]

On appeal, the New South Wales Court of Appeal unanimously rejected McLelland J's decision. Meagher JA, with whom Cripps JA concurred, agreed with McLelland J that the "bona fide for the benefit of the company as a whole" test was "scarcely an apt test to apply to shareholders".[9] However, according to Meagher JA, McLelland J seemed to suggest that an alteration of a company's articles permitting an expropriation of shares would always be invalid when a minority shareholder objected. This, Meagher JA held, was a false suggestion because section 176 gives shareholders the power to alter a company's articles by a special resolution, subject to the equitable limitation that the majority must not oppress the minority.

Meagher JA concluded that Gambotto was not oppressed because enormous tax benefits and administration savings would flow from the expropriation, and the price to be paid for the expropriated shares was not alleged to be inadequate. Thus, the alteration of WCP's articles was valid.

Priestley JA also allowed the appeal. While recognising that shares are a form of property, Priestley JA stressed they may be expropriated because shareholders' rights are subject to the power of a majority to alter a company's articles under section 176.[10] Consequently, since just compensation was to be paid for Gambotto's shares, the alteration of WCP's articles was valid.

---

5 *Gambotto & Anor v WCP Ltd* (1992) 10 ACLC 1046.
6 Lindley MR in *Allen v Gold Reefs of West Africa* (1900) 1 Ch 656 at 671.
7 Above n5 at 1049.
8 *WCP Limited v Gambotto & Anor* (1993) 11 ACLC 457.
9 Id at 460.
10 Id at 459.

4. *The High Court*[11]

The High Court took a starkly different view from the Court of Appeal and allowed Gambotto's appeal. In so doing, the position of minority shareholders has been dramatically strengthened.

The High Court's decision was separated into a joint judgment by Mason CJ, Brennan, Deane and Dawson JJ and a separate judgment by McHugh J. Both judgments agreed on the test to be applied in the present case, but they differed on its application, with the joint judgment adopting a much stricter interpretation of the test than McHugh J.

Like the lower courts, the High Court rejected the "bona fide for the benefit of the company as a whole" test where there is a conflict of interest between shareholders. Refreshingly, unlike the lower courts, the High Court established two new tests in its place. The first test applies to alterations of articles giving rise to a conflict of interest between shareholders but not involving "an actual or effective expropriation of shares or of valuable property rights attaching to shares".[12] According to the joint judgment, such alterations are valid unless they are "ultra vires, beyond any purpose contemplated by the articles or oppressive".[13]

The second test applies where the conflict involves alterations of articles which "allow an expropriation by the majority of shares, or of valuable proprietary rights attaching to the shares, of a minority".[14] For such situations, a new and very stringent two limbed test was unanimously adopted by the High Court.Such an alteration is valid only if the majority shareholders prove that first, it was made for a proper purpose and second, it was fair. Not only are these two limbs unique, but the court also reversed the traditional onus of proof by placing it squarely upon majority shareholders. Clearly, this was the test applied in *Gambotto* and it was in its application that the paths taken by the joint judgment and McHugh J parted, with the joint judgment adopting a much stricter proper purpose test than McHugh J.

A. Expropriation of Shares or Valuable Proprietary Rights?

The two limbed test developed in *Gambotto* applies where either shares or valuable proprietary rights attaching to shares are expropriated. Attempted expropriations of shares are readily identifiable. The questions that beg asking are: what are valuable proprietary rights attaching to shares? Perhaps such rights include shareholders' rights to dividends or bonus shares? Are alterations which expropriate such proprietary rights those which impact on all shareholders equally, or does there need to be some discrimination between shareholders?[15] If discrimination becomes an issue, will the focus be upon discrimination in form or in substance?[16] Unfortunately, the court did not answer these questions.

---

11 Above n1.
12 Id at 271.
13 Ibid.
14 Ibid.
15 See DeMott, D A, "Proprietary Norms in Corporate Law: An Essay on Reading Gambotto in the United States", in Ramsay, I (ed), *Gambotto v WCP Ltd: Its Implications for Corporate Regulation* (1996).
16 Traditionally the focus has been on discrimination in form rather than in substance. A classic example of this is *Greenhalgh v Arderne Cinemas Ltd* [1951] 1 Ch 286.

Therefore, the scope of *Gambotto*'s two limbed test beyond expropriations of shares is uncertain.[17]

B. The First Limb: A Proper Purpose

Mason CJ, Brennan, Deane and Dawson JJ held that a proper purpose is one which aims "to secure the company from significant detriment or harm".[18] Further, expropriation must be a reasonable means of achieving this purpose. Examples of proper purposes given by the court include the expropriation of shares of a competitor,[19] or expropriation of shares held by foreigners so that the company complies with some regulatory scheme. This limb is much more stringent than the traditional "bona fide for the benefit of the company as a whole" test with its subjective focus because, according to the joint judgment, the pursuit of a substantial commercial benefit is never a proper purpose. To allow an expropriation through an alteration of the articles of a company, for the purpose of pursuing a benefit, would "not attach sufficient weight to the proprietary nature of a share".[20]

Consequently, the joint judgment found the purported alteration of WCP's articles invalid. This was simply because it was not for a proper purpose. There was no substantial detriment that the company sought to avoid; it merely sought to gain a benefit which is not a proper purpose. There are several problems with this reasoning.

First, the distinction made by the joint judgment between the purpose of pursuing a benefit and the purpose of avoiding a detriment is logically tenuous at best. If achieved, both objects have a positive impact on a company. Avoiding a detriment is a benefit, and conversely, denying a company the pursuit of a benefit can be of significant detriment to it. Thus, this distinction has been correctly criticised as "a distinction without a difference."[21]

Second, the basis for denying the pursuit of a benefit rests on a questionable view of the proprietary nature of shares. According to the joint judgment, a share is "more than a 'capitalised dividend stream'; it is a form of investment that confers proprietary rights on the investor".[22] Unfortunately, in propounding this view, the joint judgment failed to differentiate between different situations. An emphasis on the proprietary nature of shares may be justified in a small private company where there is an expectation amongst shareholders that they will take part in the management of the company because such shareholders are particularly susceptible to being treated unfairly.[23]

---

17 See Fridman, S, "*Gambotto v WCP Ltd*: An analysis of the High Court decision" (1995) 6 *Butterworths Corporation L Bulletin* 4; Boros, E, "The Implications of Gambotto for Minority Shareholders", in Ramsay, I (ed), *Gambotto v WCP Ltd: Its Implications for Corporate Regulation* (1996).

18 Above n1 at 271.

19 See, for example, *Sidebottom v Kershaw, Leese & Co* [1920] 1 Ch 154. Arguably, this example is only valid in small private companies where shareholders play a central role in the management of a company. To allow the expropriation of small passive shareholders in a large public company merely because they have an interest in a competitor must be doubted because such shareholders would present little potential detriment to the company.

20 Above n1 at 271.

21 Fridman, above n17 at 6.

22 Above n1 at 272.

23 See Hill, J, "Protecting Minority Shareholders and Reasonable Expectations" (1992) 10

However, such an emphasis is poorly founded for small passive shareholdings in large public companies. Almost without exception the former shareholders hold their shares as an investment. It has been said that such shareholders are "investors" who invest "in the investment, not in the corporation."[24] An exception to this was found in the Canadian case *Re Shoppers*.[25] In that case a minority shareholder objected to the use of a Canadian expropriation provision because of a sentimental attachment to his shares. They were a Christmas present from his wife and he intended to give them to his son, then aged three, when he turned 21. The court rejected his attempt to prevent the expropriation. In *Gambotto*, the joint judgment noted this case as a comparison when stating its view about the proprietary nature of shares. Presumably, they would have decided *Re Shoppers* differently if the expropriation was achieved by an attempted alteration of the company's articles unless the purpose of the expropriation was to avoid a detriment. This would be an unfortunate result.

In large public companies, shares are generally held as an investment. Thus, any significant advantage should justify expropriation if it is done fairly. However, in a small private company where shareholder involvement in management is an expectation upon which the company was formed, an advantage justifying expropriation should be more significant as being dealt with fairly may not be sufficient to compensate such a shareholder. Unfortunately, in *Gambotto*, the High Court appears to have "elevated share investment virtually to the level of ownership of the family home."[26]

Third, the stringent proper purpose test adopted in the joint judgment has been criticised for facilitating "greenmailing".[27] This occurs where a person acquires target minority shares in a company and attempts to extract an inflated price for their transfer to the majority. "Greenmailing" will be a significant practical problem arising from *Gambotto* because the strict proper purpose test places minority shareholders in a supreme position. When the purpose is the pursuit of a benefit, a majority simply cannot expropriate minority shares through an alteration of the company's articles, even though the expropriation may be fair. This can cause "in effect an oppression of the majority by a minority".[28]

Finally, the joint judgment does not consistently identify the interests of a company as those of its majority shareholders.[29] On the one hand, the court held that to allow an alteration of articles, which enables an expropriation for the purpose of pursuing a benefit, would be "tantamount to permitting expropriation by the *majority* for the purpose of some personal gain".[30] On the other hand, the

---

Company and Securities LJ 86.

24 Buxbaum, R M, "Corporate Legitimacy, Economic Theory, and Legal Doctrine" (1984) 45 *Ohio State LJ* 515 at 526.

25 *Re Shoppers City Ltd and M Loeb Ltd* [1969] 3 DLR (3d) 35 HC.

26 Westfield, M, "Judgment backs the little man" *The Australian* 9 March 1995 at 35.

27 Arvanitis, K G, "Gambotto and Anor v WCP Ltd" (1995) 13 *Company and Securities LJ* 326; Ries, I, *The Australian Financial Review* 9 March 1995 at 60; Bartholomeusz, S, "Court ruling returns power to minorities" *The Age* 9 March 1995 at 21 and 24; Editorial, *AFR* 10 March 1995 at 28.

28 Great Britain & Ireland Board of Trade, *Company Law Amendment Committee 1925–26 Report* (1926) Cmnd 2567 at 44.

29 Fridman, above n17 at 6.

30 Above n1 at 272 (italics added).

joint judgment did not identify a company's interests as those of its majority shareholders when the purpose "of the alteration is to secure the *company* from significant detriment".[31] This second view is inconsistent with the first because when minority shares are expropriated, a company's interests coincide solely with the interests of its majority shareholders.

In contrast to the joint judgment, McHugh J adopted a wider view as to what constituted a proper purpose, holding that it may be either to protect or *promote* the interests of the company.[32] Unlike the joint judgment, he believed no distinction should be made between these purposes; either may be a "legitimate business objective".[33] However, for a benefit to be a proper purpose, it must be something "external" to the company.[34] Thus, administrative advantages alone could never justify an alteration of a company's articles to enable expropriation. Applying his test, McHugh J held that the pursuit of substantial tax benefits by WCP was a proper purpose.

Due to the many inadequacies of the distinction between the purpose of pursuing a benefit and the purpose of avoiding a detriment made in the joint judgment, McHugh J's proper purpose test is a superior one.

C. The Second Limb: Fairness

In the context of alterations of articles enabling expropriation, *Gambotto* has improved the position of minority shareholders not only by developing a stringent proper purpose test, but also by requiring that the majority prove that the minority has not been oppressed. That is, that the expropriation is "fair in the circumstances".[35] According to the joint judgment, this has two elements — procedural and substantive fairness. Procedural fairness requires "the majority shareholders to disclose all relevant information",[36] and that the shares be valued by an independent expert. However, the joint judgment expressly did not decide whether the majority should refrain from voting on such an alteration. Substantive fairness relates to the price to be paid for the expropriated shares. The joint judgment recognised that the market price may not always be sufficient. However, "it would be unusual for a court to be satisfied that a price substantially above market value was not a fair value".[37]

McHugh J focused on this limb in much greater detail because, unlike the joint judgment, he found that the alteration of WCP's articles was for a proper purpose. Like the joint judgment, McHugh J saw disclosure as essential to ensure procedural fairness, or what he labelled fair dealing. This involves such questions as "when the transaction was timed, how it was initiated, structured, negotiated and disclosed and how approvals to the transactions by directors and other shareholders were obtained".[38]

---

31 Id at 271 (italics added).
32 Id at 275.
33 Id at 279.
34 Id at 277.
35 Id at 272.
36 Ibid.
37 Ibid.
38 Id at 278.

Similarly, McHugh J expressed concern about the use of the market price as an indicator of the fair price because stock markets can be volatile and may undervalue shares.[39] Thus, McHugh J agreed with Rogers AJA who refused to accept current market prices as representing the true fair value of the shares in *Catto v Ampol Ltd.*[40] Other factors such as assets, earnings and future prospects must be considered.

While McHugh J found that the alteration of WCP's articles was for a proper purpose, he found that the proponents of this alteration had failed to prove that there was both a fair price and fair dealing. This is a little surprising given that Gambotto did not contest the fairness of the price to be paid for the expropriation. Nevertheless, by this reasoning, McHugh J came to the same conclusion as the joint judgment, finding the alteration invalid.

The introduction of a fairness element represents a marked departure from previous decisions. For example, in *Peters' American Delicacy*, Dixon J did not want to leave the distinction between valid alterations and ones which were oppressive, and thus invalid, "to general notions of fairness and propriety."[41] Later, Jacobs J decided that such attempts to avoid value judgments were doomed to failure.[42] This traditional reluctance to look at the fairness of such alterations was related to "the strongly entrenched tradition of non-interference by the courts in internal corporate regulation".[43]

Gambotto marks a shift away from this tradition of non-interference.[44] This development is to be highly commended because it addresses several causes of potential unfairness in situations where minority shareholdings are expropriated.[45]

First, a majority shareholder can choose when to expropriate and, therefore, may choose to do so when the market price is depressed. This is tackled by the requirement of substantive fairness or, according to McHugh J, a fair price. The wariness of the High Court about the use of the market price as an indicator of a fair price of expropriation is a "welcome dose of commercial realism".[46] Interestingly, in *Nicron Resources Ltd v Catto*,[47] Bryson J found that an independent valuation of shares, which were to be extinguished by a capital reduction under section 195 of the *Corporations Law*, was not voided for being lower than the market price. The reason for this was the lack of volume of shares traded on the market compared to the amount of capital that was extinguished. If a shareholder tried to sell all the shares that were extinguished, this would drive down the market price so they could not hope to get the price

39 Id at 277.
40 (1989) 16 NSWLR 342 at 361.
41 Above n3 at 507.
42 *Crumpton v Morrine Hall Pty Ltd* [1965] NSWR 240 at 244.
43 Above n23 at 87.
44 For example, see also *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 where the House of Lords looked at the circumstances surrounding a shareholder's removal as director of a small private company to find that the just and equitable course to take was to dissolve the company.
45 See Digby, Q, "Eliminating Minority Shareholdings" (1992) 10 *Company and Securities LJ* 105 at 123–4.
46 Rogers, A, "Correct but delicate balance" *AFR* 13 March 1995 at 19.
47 (1992) 8 ACSR 219.

the shares were traded on in the market. This type of argument has a fatal flaw. What if some shareholders whose shares are extinguished held relatively few shares? They would have been able to sell these at the market price. Thus, while applicable to large shareholdings, it would be blatantly unfair to allow expropriation at below market price for small shareholdings. In light of the willingness displayed by the High Court in *Gambotto* to look at several factors when evaluating a fair price, *Nicron Resources* may be decided differently today.

Apart from the commercially realistic caution of the High Court in *Gambotto* towards the market price of shares as an indication of their fair value, it is arguable that a fair price should also include a proportion of the advantage that the majority seeks to exploit by excluding the minority. For instance, in *Gambotto* the shares were independently valued at $1.365. This did not include the taxation benefits of approximately $4.235 million, or 25 cents per share, that would result from the expropriation. Thus, ignoring any other factors, the lowest price for expropriation which would be fair should be $1.615 per share and, consequently, the $1.80 expropriation price in *Gambotto* was prima facie fair.

Second, the greater access majority shareholders have to information about the company allows them to have a better understanding of its value. This is largely dealt with by the requirement that there be procedural fairness, or, according to McHugh J, fair dealing. The essential element of this requirement is that there be full disclosure. This requirement has been acclaimed as "arguably the most important long-term consequence of the decision"[48] although it has also been criticised for being vague.[49] From the point of view of minority shareholders, such a criticism is of little merit because vagueness will require a majority to err on the side of caution. The majority should provide all information to the minority that such shareholders may consider important. This is to a minority's benefit so, given the inherent potential for unfairness, such vagueness is not a serious flaw. Independent valuations are also required for procedural fairness. This correctly reflects the fact that a majority is likely to act in its own interests and, therefore, some independent confirmation of fairness is necessary.

Finally, not being fiduciaries for one another, shareholders can vote at general meetings in their own interests. Thus, traditionally, the majority could vote to the detriment of the minority.[50] However, in *Gambotto*, the joint judgment expressly left open the question as to whether their requirement of procedural fairness precludes a majority from voting, and McHugh J did not even mention this issue. This was not necessary for the court to decide because the majority did not vote on the alteration of WCP's articles. There is a tension here

---

48 Above n46.

49 Fridman, above n17 at 6.

50 For example, Dixon J stated that "shareholders ... occupy no fiduciary position and are under no fiduciary duties. They vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage" in *Peters' American Delicacy*, above n3 at 504, and in the same case, Latham CJ similarly stated that "[s]hareholders are not trustees for the company or for one another" at 482.

between the joint judgment's emphasis on the proprietary nature of shares held by the minority and a failure to recognise that not permitting the majority to vote would necessarily be an infringement of their proprietary rights. Leaving this question open appears incongruous and it is to be hoped that, in future, the court allows such a vote by the majority. If the majority has proved that the alteration is fair, then there seems no reason why they should not be able to vote in its favour.[51]

Unlike the flaws of the joint judgment's proper purpose test, the whole court has taken a commendable approach to the requirement of fairness. This development will redress the imbalance of power in favour of minority shareholders and confirms a trend by courts to look at the commercial fairness of the exercise of corporate power.

D. Section 180(3)

Apart from alleging that the alteration itself was invalid, Gambotto also argued that the alteration would impose a restriction on the right to transfer shares as prohibited by section 180(3) of the *Corporations Law*. In obiter, the joint judgment rejected this argument because, even if the alteration of WCP's articles was valid, shares could be freely traded at any time prior to their expropriation.

E. Specific Corporations Law Expropriation Provisions

Another important aspect of *Gambotto* is how it relates to the specific expropriation provisions contained within the *Corporations Law*. Two notable provisions are sections 414 and 701. These allow for expropriation in the case of a non-Chapter 6 scheme or contract and a Chapter 6 takeover bid respectively. If 90 per cent of shares are acquired by either method, these sections enable the "bidder" to expropriate the remaining shares. If, however, the "bidder" commenced with 10 per cent of the shares, then there is the additional requirement that 75 per cent of the shareholders dispose of their shares during the scheme or bid time-period.

By laying down a strict test for the alteration of articles for the purpose of enabling an expropriation of shares, the High Court has in *Gambotto* effectively forced majority shareholders to consider specific provisions such as sections 414 and 701. This could be beneficial because it forces corporate controllers to consider methods of expropriation which, presumably, reflect well thought out and coherent legislative policies which balance conflicting interests. This, in part, guided the joint judgment which noted that to allow substantial benefits to be a proper purpose 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".[52]

However, these statutory provisions have been criticised for being too strict.[53] Indeed, they were not available to the majority in *Gambotto*. In particular, the 75

---

51 A different opinion has been given by Boros, above n17.
52 Above n1 at 272.
53 Above n45.

per cent in number requirement has been criticised for providing a method for "greenmailers" to thwart such a scheme or bid. Such a person can acquire a target minority shareholding in a company and dispose of small blocks of shares to associates such that the 75 per cent in number rule will never be satisfied. They can then attempt to extract a much higher price for their minority shareholding. Another criticism is that over time share registers may become dated, thus making it difficult for a "bidder" to meet these approval requirements. This may have been the reason these provisions were unavailable in *Gambotto* given that WCP had 71 minority shareholders.

Gambotto highlights the need for legislative reform of such specific expropriation provisions because of the above criticisms. Indeed, the issue is currently being considered for reform following a Legal Committee of the Companies and Securities Advisory Committee *Issues Paper*.[54]

5. *Conclusion*

It is hoped that the lasting influence of *Gambotto* will be to encourage open corporate governance rather than to stifle fair expropriations motivated by legitimate business objectives. The result that prevails will depend not only on future High Court decisions, but also on the extent to which *Gambotto* stimulates legislative reform. Given the traditional difficulty courts have found in this area, prompt but coherent legislative reform would be the best way to balance the interests of minority and majority shareholders and ensure that neither can oppress the other.

STEPHEN KEVANS*

---

54 Above n2.

* BEc (Hons), LLB (Hons), University of Sydney, Cutler Hughes & Harris. I would like to thank Jennifer Hill for her most helpful comments on earlier drafts of this Note.