**IN THE HIGH COURT OF NEW ZEALAND**
**AUCKLAND REGISTRY**

**CIV-2006-404-519**

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| UNDER | Section 174 of the Companies Act 1993 |
| BETWEEN | BRIAN ROBERT FRANCIS<br>Plaintiff |
| AND | NEW ZEALAND FORGINGS LIMITED<br>First Defendant |
| AND | DOROTHY MARJORIE WALKER AND KEITH MALCOLM MACKINLAY AND KEITH ALLAN MORRIS<br>Second Defendants |

Hearing: 10 August 2006

Appearances: Mr S Judd for plaintiff
Mr J Atkinson for defendants

Judgment: 15 August 2006 at 4.30 p.m..

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**JUDGMENT OF ASSOCIATE JUDGE J P DOOGUE**

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*This judgment was delivered by me on 15.08.2006 at 4.30 pm, pursuant to Rule 540(4) of the High Court Rules.*

*Registrar/Deputy Registrar*
*Date……..…*

*Counsel:*
*Mr S Judd, P O Box 3320, Auckland*
*Mr J Atkinson, P O Box 105-750, Auckland*

## Background

[1] The plaintiff is a shareholder as to 20 percent of the shares in the first defendant New Zealand Forgings Limited (NZFL). The company's business as the name suggests consists of manufacturing brass forging products which include tooling, making bathroom fittings, marine components, plumbing items and other products.

[2] The second defendants own 80 percent of the shares. The plaintiff alleges the affairs of the company have been or are likely to be conducted in a manner that is oppressive or unfairly discriminatory or unfairly prejudicial to him.

[3] Mr Francis was appointed general manager in September 2001. He was dismissed from his position in December 2005 and also removed as a director of the company. The plaintiff has taken proceedings in the Employment Tribunal in respect of his dismissal.

[4] In the statement of claim that he has filed, the plaintiff says that the relationship between himself and the majority shareholder is in the nature of a partnership. He says he has been excluded from the management of the company. He says that over the period that he owned shares in the company, from September 2002 to date the company has failed to pay him his correct dividend entitlement and has paid the majority shareholders more than their correct entitlement. He goes on to seek orders under s 174 of the Companies Act 1993.

[5] He seeks an order that the defendants compensate him for his role with the company as shareholder, director and general manager, including dividends and remuneration (para 7(a)) of the statement of claim. He also seeks an order cancelling the agreements of July 2002 pursuant to which he purchased his shares and granting financial compensation: (para 7(b)). He also seeks an order that the second defendant purchases shares.

[6] The plaintiff has filed an affidavit in support of his application. The business was effectively owned by the late Mr and Mrs Walker. He said he regarded Mr Walker as a friend as well as a work colleague. He said he considered himself as a

business partner of the Walkers, that is the late Mr Walker and his widow Dorothy Majorie Walker. He says that before he bought his shares in the company the year after he joined it, he had discussions with Mr Walker with whom he had a close personal relationship. Mr Walker encouraged him to take an interest in the company and said that the purchase price of the shares would be advanced with the Walkers being relaxed about principal and interest payments on the share purchases, as they knew Mr Francis was in it for the "long haul". He says that he agreed to buy 20 percent of the shares in the company for $268,500.

[7] He claims to have been influenced by the fact that Mr Walker told him in mid 2002 that the company was worth $1.65 million. He said that the price was arrived at by the parties agreeing that the total value of the shareholdings in the company should be discounted to $1.34 million to reflect his minority shareholding and the resulting value was divided by five to arrive at the purchase price of $268,500. He says that he now has evidence that fair value of the shares that he purchased would have been about $84,000 and not the $268,500 that he actually paid.

[8] He said that under his stewardship the company prospered until 2005 when the terms of trade for the business sharply deteriorated but through his skill he managed to retain the company's market share.

[9] Under the share agreement the sale of the shares was structured so that there were two separate parcels sold, one by Mrs Walker and one by Mr Walker. Under each Mr Francis became liable to pay $45,000 on settlement date and two payments of $25,000 each on 19 September 2003 and 2004 together with a final payment of $39,250 on 19 September 2005. The purchaser was required to pay interest on the unpaid purchase price at the rate of 1.7 times the Government stock figure in each year.

[10] The agreement for the sale of the shares contained provisions that would apply to the plaintiff's termination of employment with the company. The effect of those provisions, which are grouped together under Clause 9, was that if the purchaser ceased to be in the employ of the company, then within seven days he would offer to sell his share to the vendor who would be bound to purchase them.

Clause 10 then sets out a mechanism for the share buy-back. It provides that the purchase price for the shares shall be fixed in accordance with the constitution of the company.

[11] In 2005 a report was commissioned from the accountants, Deloittes. The plaintiff says that after that report was obtained the atmosphere between himself and the other directors deteriorated. He says that in December 2005 he was dismissed on two months' notice.

[12] The defendants have taken steps to initiate a buy-back. In a letter which their solicitors, Howard-Smith and Co, wrote to the plaintiff's solicitors 21 December 2005, they proposed that a Mr Appleby should value the shares. The solicitors expressed the view, though, that the company is insolvent and that the shares have no value. It is not clear whether matters have progressed any further with the share buy-out. The plaintiff as I have noted, seeks an order directing the defendants to purchase the shares and a valuation would obviously be required for that purpose.

[13] In the meantime the second defendants issued proceedings in the District Court at Auckland to recover the sum of $191,359.08 owing on the share sale agreement, together with interest and costs.

[14] I understand that in those proceedings Mr Francis proposed to raise by way of defence, misrepresentations which Mr Richard Walker allegedly made concerning the value of the company. In his notice of opposition to the summary judgment proceedings, Mr Francis said that he cancelled the agreement to purchase the shares and he sought relief pursuant to s 9 of the Contractual Remedies Act 1979. He claimed in his Notice of Opposition that he agreed to pay $268,500 for the shares when they were worth in fact only $84,000. He also pleaded that he would be relying on the Contractual Mistakes Act 1977 and the Fair Trading Act 1986. He said in his Notice of Opposition that he had been wrongfully dismissed and would be taking proceedings arising out of that circumstance and that he would be filing proceedings in the High Court under s 174 of the Companies Act 1993.

[15] The summary judgment proceedings did not reach the point where they were determined by a Judge. Apparently a hearing commenced before a District Court Judge but the plaintiff in the summary judgment proceedings, Mrs Walker, accepted the invitation of the Judge not to proceed before him and to have the entire proceeding to recover the price of the shares transferred to the High Court, so that it could be dealt with together with the s 174 proceeding.

[16] There was some discussion at the hearing before me whether it was open to Mrs Walker to continue with the summary judgment application given the circumstance that she agreed not to press the summary judgment application to the point where a determination was required in the District Court. The various arguments and the merits of those claims arising out of that circumstance are not something which I must consider.

[17] In the s 174 proceedings, the first and second defendants in answer to the plaintiff's claim denied the various pleadings including that of misrepresentation of the value of the company. They deny that the Court has jurisdiction to grant the various aspects of relief sought by the plaintiff including compensation for his role with the company as director and general manager including remuneration. They also denied that the Court has jurisdiction under s 174 to make orders cancelling the share purchase agreements of July 2002 and the consequent relief that the plaintiff seeks following such cancellation.

[18] In the course of his submissions to me, Mr Atkinson elaborated on the defence relating to the claims arising out of dismissal stating that the Employment Relations Tribunal unarguably had exclusive jurisdiction to deal with such matters.

[19] Mr Judd submitted that the plaintiff was not trying to seek relief arising out of his employment contract under the s 174 proceedings. Rather that was a relevant circumstance that the Court could take into account when determining whether or not the company had oppressed Mr Francis.

[20] The defendants have filed an application to strike out the plaintiff's pleading. The grounds included the following:

1. That this Court lacks jurisdiction to grant the relief in para 7 of the statement of claim;

2. That the statement of claim contains no reasonable causes of action appropriate to the nature of the pleadings;

3. That the pleading is likely to cause prejudice, embarrassment or delay in proceedings commenced by the defendant DOROTHY MAJORIE WALKER against the plaintiff in the District Court at Auckland under number CIV2005-004-3546.

[21] In the Notice of Opposition to the strike out application the plaintiff says, inter alia,

> 2.0 The cause of action under s 174 of the Companies Act 1993 is that the shareholder considers that the affairs of the company have been, or are being, or are likely to be, conducted in a manner that is, or any act or acts of the company have been, or are, or are likely to be, oppressive, unfairly discriminatory, or unfairly prejudicial to him or her in that capacity *or in any other capacity*. The statement of claim pleads facts which disclose a cause of action under s 174 of the Companies Act 1993.

[22] The Notice of Opposition also alleges that it is inappropriate for Dorothy Walker to commence summary judgment proceedings against the plaintiff in the District Court.

[23] The further ground relied upon in opposition is that the procedure under s 174 is particularly well suited for resolving disputes such as the present where the plaintiff had a relationship with the company as a shareholder, director and employee and where his relationship with other shareholders was in the nature of a partnership.

## Strike out rules and principles

[24] The relevant rule, r 186, reads:

> **186 Striking out pleading**
>
> Without prejudice to the inherent jurisdiction of the Court in that regard, where a pleading -
>
> (a) Discloses no reasonable cause of action or defence or other case appropriate to the nature of the pleading; or

(b) Is likely to cause prejudice, embarrassment, or delay in the proceeding; or

(c) Is otherwise an abuse of the process of the Court, -

the Court may at any stage of the proceeding, on such terms as it thinks fit, order that the whole or any part of the pleading be struck out.

[25] I adopt the following statement of principle from *Sim's Court Practice,* HR 186.3

> The jurisdiction is to be sparingly exercised and only in a clear case where the Court is satisfied that it has all the requisite material to reach a definite and certain conclusion; the plaintiff's claim must be so clearly untenable that it cannot possibly succeed: *Electricity Corporation Ltd v Geotherm Energy Ltd* [1992] 2 NZLR 641, 645 (CA). It is important to distinguish between the plainly untenable where there is no cause of action or abuse is involved, and a proceeding of dubious merit. The former should be struck out but not the latter: *G v B* (High Court, Christchurch CP105/02, 19 November 2002, Panckhurst J).

## The statutory provisions

[26] S 174 provides:

> 174 Prejudiced shareholders
>
> (1) A shareholder or former shareholder of a company, or any other entitled person, who considers that the affairs of a company have been, or are being, or are likely to be, conducted in a manner that is, or any act or acts of the company have been, or are, or are likely to be, oppressive, unfairly discriminatory, or unfairly prejudicial to him or her in that capacity or in any other capacity, may apply to the Court for an order under this section.
>
> (2) If, on an application under this section, the Court considers that it is just and equitable to do so, it may make such order as it thinks fit including, without limiting the generality of this subsection, an order—
>
> (a) Requiring the company or any other person to acquire the shareholder's shares; or
>
> (b) Requiring the company or any other person to pay compensation to a person; or
>
> (c) Regulating the future conduct of the company's affairs; or
>
> (d) Altering or adding to the company's constitution; or
>
> (e) Appointing a receiver of the company; or
>
> (f) Directing the rectification of the records of the company; or

(g) Putting the company into liquidation; or

(h) Setting aside action taken by the company or the board in breach of this Act or the constitution of the company.

No order may be made against the company or any other person under subsection (2) of this section unless the company or that person is a party to the proceedings in which the application is made.

[27] "Entitled person" is defined in s 2 of the Act as follows:

entitled person, in relation to a company, means —

(a) A shareholder; and

(b) A person upon whom the constitution confers any of the rights and powers of a shareholder.

## Authority

[28] In *Re a Company (No 00709 of 1992) O'Neill v Phillips* [1999] 2 All ER 961 (HL) the House of Lords considered a provision which is the equivalent of New Zealand's s 174. Lord Hoffman (with whom the other Lords agreed) considered "unfairly prejudicial" conduct. His remarks have application in New Zealand (see *Re Environmental Products (New Zealand* ) *Ltd*, (2005) 9 NZCLC 263, 779 – a judgment of Heath J who said the passage now quoted contained a number of observations equally applicable in the New Zealand environment. The following is an excerpt from Lord Hoffman's speech at 966:

(5) 'Unfairly prejudicial'

In s 459 Parliament has chosen fairness as the criterion by which the court must decide whether it has jurisdiction to grant relief. It is clear from the legislative history (which I discussed in Re Saul D Harrison & Sons plc [1995] 1 BCLC 14 at 17-20) that it chose this concept to free the court from technical considerations of legal right and to confer a wide power to do what appeared just and equitable. But this does not mean that the court can do whatever the individual judge happens to think fair. The concept of fairness must be applied judicially and the content which it is given by the courts must be based upon rational principles. As Warner J said in Re J E Cade & Son Ltd [1992] BCLC 213 at 227: 'The court . . . has a very wide discretion, but it does not sit under a palm tree.'

Although fairness is a notion which can be applied to all kinds of activities, its content will depend upon the context in which it is being used. Conduct which is perfectly fair between competing businessmen may not be fair between members of a family. In some sports it may require, at best,

> observance of the rules, in others ('it's not cricket') it may be unfair in some circumstances to take advantage of them. All is said to be fair in love and war. So the context and background are very important.
>
> In the case of s 459, the background has the following two features. First, a company is an association of persons for an economic purpose, usually entered into with legal advice and some degree of formality. The terms of the association are contained in the articles of association and sometimes in collateral agreements between the shareholders. Thus the manner in which the affairs of the company may be conducted is closely regulated by rules to which the shareholders have agreed. Secondly, company law has developed seamlessly from the law of partnership, which was treated by equity, like the Roman societas, as a contract of good faith. One of the traditional roles of equity, as a separate jurisdiction, was to restrain the exercise of strict legal rights in certain relationships in which it considered that this would be contrary to good faith. These principles have, with appropriate modification, been carried over into company law.
>
> The first of these two features leads to the conclusion that a member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted. But the second leads to the conclusion that there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith.

[29] This citation explains that the jurisdiction under section 174 will be exercised to mitigate the rigour of the situation that would result if the other shareholders in the company are able to exercise the powers, rights and entitlements vested in them by the companies constitution where to do so will be oppressive of the complaining shareholder.

[30] There seems to be no doubt in this case that Mr Francis's employment with the company and his ownership of shares in that company were inextricably linked. Now that his employment has come to an end, he is entitled to end his relationship with the company *qua* shareholder. In fact, his employment contract with the company accorded him that right in clause 9.1 of the agreement.

## Can Mr Francis bring a claim that share sale was misrepresented to him in proceedings under s 174?

[31] As I have noted, Mr Francis in his statement of claim says that the affairs of the company have been or are being or are likely to be conducted in a manner that is

oppressive or unfairly discriminatory or unfairly prejudicial to him in his capacity of shareholder of the company and in his previous capacities as director and general manager of the company. In paragraph F he give particulars of one of the ways in which the conduct was oppressive:

> (f) One of the second defendants, Dorothy Walker, has commenced proceedings in the District Court at Auckland seeking to enforce certain share purchase agreements entered into by the plaintiff in 2002. The terms of those agreements are not enforceable by Dorothy Walker because the terms in question were waived and/or Dorothy Walker is estopped from enforcing the terms and/or the agreements have been cancelled for misrepresentation and/or relief should be granted as a result of mistake and/or as a result of misleading and deceptive conduct. Furthermore, the agreements are collateral to and interdependent with the other contractual and equitable relationships between the plaintiff, the company and Dorothy Walker.

[32] In his s 174 proceedings he seeks, inter alia:

> (b) An order cancelling the agreements of July 2002 under which the plaintiff purchased his shares and granting relief in relation to those agreements in such a way as to put the parties in the position that they would be in if the parties had used a reasonable and proper basis for valuing the shares of the company in July 2002.

[33] I do not consider that questions of the misrepresentations and misleading and deceptive conduct which allegedly induced the plaintiff to buy the shares in the company are matters which can be considered in the context of the present proceedings. My reasons for saying that are threefold.

[34] First, relief is available for the effects of the affairs of the company being conducted in a manner that is oppressive etc. The alleged misrepresentation of the position of a company by the vendor of shares in that company does not relate to the conducting of the affairs of the company; nor does it involve any act or acts of the company.

[35] Secondly, the rights of the defendant in matters affecting his shares in the company, can only be raised if they affect him *qua* shareholder. By definition, at the time when he was negotiating for the purchase of shares, he was not a shareholder.

[36] Thirdly, the process of acquiring shares seems to fall into two distinct phases. First, the parties enter into a contract pursuant to which the vendor will deliver shares to the purchaser. The second stage occurs if the contract comes to fruition and the shares are transferred to the purchaser. At that stage, and only at that stage, the purchaser acquires the property rights in the shares and from that point forward is relevantly a shareholder in the company and able to bring himself within the class of persons with which s 174 is concerned, namely prejudiced shareholders.

*Alleged breach of employment contract and s 174*

[37] Any claim for compensation relating to Mr Francis's employment agreement has to be dealt with by the Employment Relations Authority (ERA) which has exclusive jurisdiction to deal with "personal grievances" by s 161 of the Employment Relations Act 2000. A personal grievance includes a claim for unjustified dismissal: see s 103 of the Act. S 113 reinforces that a claim for wrongful dismissal "or any aspect of it" can only be brought as a personal grievance claim before the ERA.

[38] By virtue of s 161 (1) (a) (3) of the Act, the concept of personal grievance extends to a matter arising because of a claim:

> that the employee's employment, or 1 or more conditions of the employee's employment (including any condition that survives termination of the employment), is or are or was (during employment that has since been terminated) affected to the employee's disadvantage by some unjustifiable action by the employer;

[39] It is not permissible to bring a claim that falls within the boundaries of the above formulation. The Court would be justified in staying or striking out such a claim. I will return to this aspect later in my judgment.

[40] Some of the plaintiff's claims, though, are maintainable. The claim arising out of the defendants alleged removal of the plaintiff as a director is not a claim that is barred. Indeed, Mr Atkinson accepted that such a claim may be brought under the oppression provisions of the Companies Act 1993.

*The share buy-back and s 174*

[41] In his statement of claim, the plaintiff seeks an order requiring the second defendants to purchase the plaintiff's shares in the company for such amount as the Court considers just and equitable. He also seeks such other orders as the Court considers just and equitable. There may be some argument concerning his entitlement to such an order where the buy-out provisions of the company constitution and the agreement have not been complied with, but his claim is sufficiently tenable to survive a strike out application.

[42] Again, the plaintiff complains that he was not paid the correct dividend entitlement during the time that he was a shareholder in the company. I cannot rule out the possibility that if the plaintiff is able to satisfy the Court that it is just and equitable to do so, a Court might order (whether in addition to a share buy-out or otherwise) that the company or any other person pay compensation to the plaintiff pursuant to section 174(2)(b).

## Conclusion on strike out and orders

[43] From what I have said above, it will become obvious that the strike out application is to be allowed in part. The claim in paragraph 7(a) seeking compensation for the plaintiff *qua* "general manager" must be excised. The position of general manager is not a status in the company that affords the claimant any right that is separate and distinct from his entitlements under his employment contract with the company. While there can be no objection to the Court, as a matter of evidence, hearing about the employment contract as a background circumstance, it cannot be relied upon, in my view, as a circumstance that qualifies the plaintiff for relief under s 174. The pleading will have to be amended to reflect that fact.

[44] In addition, the whole of paragraph 7(b) must be struck out for the reasons that I have given above.

[45] One of the bases upon which Mr Atkinson sought orders to strike out or stay the oppression orders as they related to the share purchase was because the

proceedings covered the same ground as matters that were to be raised in the summary judgment proceedings. I consider that the problem of duplication of proceedings has been resolved by my orders striking out such parts of the s 174 proceedings as relate to the share purchase. I do not therefore consider that any further orders are justified. It may well be that given the form of the orders I have made, the plaintiff will give thought to reformulating his claim for misrepresentation in relation to shares, possibly as a cross-claim in the proceedings in which the second defendants sue for the price of the shares.

[46] I consider that it would be helpful if orders are made requiring the plaintiff to file and serve an amended statement of claim and I direct that he is to do so by 5 September 2006. I also direct that any amendment to the pleadings in the summary judgment matter that Mr Francis wishes to initiate are to be carried out within the same time period. The defendants are to file and serve any response to Mr Francis's proceedings by 26 September 2006.

[47] I direct the Registrar to allocate a hearing time for this matter in one of my Chambers lists so that progress can be reviewed and any further interlocutory applications considered.

[48] The parties should give consideration to whether the proceedings are all to be heard together or if sequentially, in what order and whether or not a consolidated statement of claim would be useful. These are matters that I would invite counsel to raise at the chambers hearing.

[49] The applicant is entitled to costs which I allow on a 2B basis.

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J.P. Doogue
Associate Judge