PROTECTING THE MINORITY SHAREHOLDER

The Fiduciary Duty and Oppression Remedy Compared

by

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ABSTRACT

This thesis examines two methods which have been developed to protect the minority shareholder. The first is the extension of the fiduciary duty concept in its application to majority or controlling shareholders. The second is a statutory "oppression" remedy.

The thesis begins with a brief history of the corporate form in England, the United States and Canada. Chapter II charts the evolution of shareholder rights from a right in property to an equitable right not to be unfairly treated. In chapters III & IV both the fiduciary duty and statutory oppression remedy are examined. The thesis concludes that meaningful protection will be afforded to the minority shareholder under both protection devices provided the judiciary are prepared to enforce a shareholder's reasonable expectations.

SOMMAIRE

La présente thèse a pour objet l'examen de deux méthodes qui ont été développées afin de protéger l'actionnaire minoritaire au sein d'une société commerciale. La première est le prolongement aux actionnaires majoritaires de l'obligation traditionnelle des administrateurs d'agir à titre de quasi fiduciaires de la compagnie. Le deuxième remède qui sera étudié est le recours statutaire en cas d'oppression.

Un bref historique de l'entité corporative en Grande-Bretagne, aux Etats-Unis et au Canada forme la première partie de cette thèse. Le deuxième chapitre trace l'évolution des droit des actionnaires, du simple droit de propriété à celui plus récent de ne pas être traité injustement. A l'intérieur des chapitres trois et quatre tant l'obligation quasi fiduciaire des actionnaires majoritaires que le recours statutaire en cas d'oppression seront examinés. La conclusion à laquelle arrive cette étude est que les deux recours ci-haut décrits offrent à l'actionnaire minoritaire une protection adéquate pourvu que l'appareil judiciaire s'engage à faire respecter les attentes légitimes de l'actionnaire.

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TABLE OF CONTENTS

Abstract i

Sommaire ii

Acknowlegements iii

INTRODUCTION vi

CHAPTER I ORIGINS OF THE CORPORATE FORM 1

- 1.1 Companies in England 1
- 1.2 Corporations in the United States 4
- 1.3 Business Organisations in Canada 6

CHAPTER II THE DECLINE OF THE SHAREHOLDER VETO 10

- 2.1 U.S. - The "Vested Rights" Doctrine 10
  - 2.11 *Intertemporal Conflict* 13
  - 2.12 *Vested Rights as a Rule of Statutory Construction* 14
- 2.2 U.K. - Partnership Principles 21

CHAPTER III USING THE FIDUCIARY DUTY TO REMEDY UNFAIRNESS 27

- 3.1 The Nature of the Relationship 28
  - 3.11 The Direct Approach 31
  - 3.12 The Indirect Approach 32
- 3.2 The Content of the Duty 34
  - 3.21 Phase I - The Duty's Application to Asset Sales 35
  - 3.22 Phase II - The Duty's Application to a Power to Dissolve 38
  - 3.23 Phase III - The Duty's Application to a Power to Merge 40
  - 3.24 Phase IV - The Duty and Proper Purpose 46
  - 3.25 Phase V - *Weinberger* - A Backward Step 52
- 3.3 The Content of the Duty Defined 55
- 3.4 Extending the Duty to All Shareholders in a Close Corporation 57
- 3.5 A Transatlantic Rediscovery of the Duty 59
  - 3.41 The Origins of the Duty in England 59
  - 3.42 The Recent Revival 62

CHAPTER IV A STATUTORY SOLUTION FOR UNFAIRNESS 69

- 4.1 Judicial Desertion of the Minority 69
- 4.2 The "Oppression" Remedy 71
  - 4.21 "Just and Equitable" 72
  - 4.22 "Oppression" 75

4.3 Protection From "Unfair Prejudice" 93
4.4 The Remedy in Canada 104
4.41 S.234 and Squeezing-Out the minority 107
4.42 The *Keeprite* Litigation 110
4.5 The Proper Approach to the Remedy 117

CHAPTER V CONCLUSION - FAIRNESS AS A REASONABLE EXPECTATION 121

Table of cases 126

Bibliography 136

INTRODUCTION

Writing in 1956 Professor Gower appealed to those studying corporate law in England to undertake comparative study in order to find new solutions to current problems.[1] He recognised that there is a wealth of jurisprudence in North America which can enrich, and equally be enriched by, English Company Law. This thesis, is in part, a response to Professor Gower's request.

The recent "Big Bang" in the City of London is indicative of a global capital market trend. Markets are freeing up old restrictive practices in order to attract the investor. Major corporations are now listed on stock exchanges from New York to Tokyo in their search to attract new capital at the lowest cost. Even the investor himself has changed, no longer is he the individual with either the wealth or the inclination to "play the markets". Instead the modern security holder is a financial institution whose size and global presence enable it equally to take advantage of these developments.[2]

Somewhere in the middle sits the individual investor. He is entitled to expect that securities and corporations laws will provide sufficient protection from capricious or malicious acts of those who control his corporation. This thesis examines the law's response to this need where control is exercised by a majority of the shareholders. Two approaches to protecting the shareholder are highlighted, both the extension of the fiduciary concept in its application to shareholders and the statutory "oppression" remedy.

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[1] L.B.C. Gower, "Some Contrasts Between British And American Corporation Law" (1956) 69 Harv. L.R. 1369.

[2] 68.5% of the shares listed on the London Stock Exchange are held by institutions, on the New York Stock Exchange the percentage is 46.4%. *The Economist*, 17th August, 1985 at 65 (U.S. Edition).

The subject matter of this thesis necessarily demands a case-by-case study. It is the judge who created the fiduciary duty and it is the judge who must interpret a statutory remedy. It is to the judge therefore that we must look in order to assess the relative merits of these methods of minority protection.

Our examination begins by charting the origins of the corporation and detailing the decline of the shareholder's veto right. From the very outset comparative analysis reveals that the corporate form in England and the U.S. was designed from two completely different conceptual standpoints. However, despite this conceptual divergence, the judiciary of both England and the U.S. attempted to protect the shareholder by appealing to common law principles of contract and partnership which would ensure that he remained indispensable to the running of the enterprise.

Economic development demanded a more flexible structure and the legal systems of both England and the U.S. responded with a decision-making process based on majority rule. The legislature delegated to the majority of a corporation's shareholders the right to decide for the minority, and the majority shareholder, now the recipient of a delegated power, was in a position to dictate to the minority.

The courts in America, faced with this unqualified legal grant of power, responded with the historic antipathy of Equity towards "unfair" abuses of power. The fiduciary duty concept was extended from its original application to the director and applied to the majority shareholder when he acted contrary to the interests of the minority.

In Britain, by contrast, the judiciary was to abandon the minority shareholder and maintain that intra-corporate disagreements were not to be brought before them. In response to this obvious inequity Parliament developed a statutory "oppression" remedy designed to protect the minority shareholder from abuse of majority power. Yet, consistent with their desire to avoid making business decisions, the English judiciary defined the remedy so restrictively that it became ultimately worthless.

Professor Gower, in his article, stated that in Canada Anglo-American corporations laws "meet and merge harmoniously on an unguarded border", and indeed, at the time he was writing all the Dominion's provinces, except Québec, had companies Acts modeled on English precedent. Much has changed in the decades since that statement was written. Today Canada has *corporations* acts which reflect both a breaking away from her British colonial past, and a recognition that she can receive more coherent conceptual inspiration from her southern neighbour. Canada is truly in a unique position. Whilst the results of her eclectic legal heritage may not always be "harmonious", she is in a position to select the most effective form of minority shareholder protection and apply it to her corporations law. She has a choice between the two approaches which this paper sets out.

CHAPTER I

ORIGINS OF THE CORPORATE FORM - A CONCEPTUAL SPLIT EMERGES.

1.1 Companies in England

The first institutions to be referred to as "companies" were the overseas trading companies granted a charter by the English monarch. These were usually monopolies created to exploit a particular colony.[1] At first the members traded separately on their own account but later they started to operate on a joint account and with joint stock.[2] There thus evolved a new type of company called the Joint Stock company.

The decline of the chartered monopolies coincided with the growth of domestic companies as the Industrial Revolution stimulated an increased demand for capital. Share dealing became commonplace, stockbroking a recognised profession, yet there remained no company law as such. These associations, whether incorporated or not, continued to be governed by the Law of Partnership.

Any legal development there had been was stopped abruptly by the infamous "South Sea Bubble" in 1720.[3] Parliament's response to this speculative mania was to pass the Bubble Act[4] which "condemned corporate development in England to a century of non-

[1] The "Eastland Company" was incorporated by Queen Elizabeth in 1566, the "Turkey and Levant Company" in 1581; the East India Company received its charter in 1600, Hudson's Bay Company in 1670. See G.W. Field, *A Treatise on The Law of Private Corporations* (Albany, N.Y.: John Parsons, 1877) at 14.

[2] See generally L.B.C. Gower, *The Principles of Modern Company Law*, 4th ed. (London: Butterworths, 1979) ch.2 [hereinafter *Gower*].

[3] The South Sea Company attempted to acquire the entire National Debt by exchanging the holders' notes for the company's stock. The company, now possessed of an interest bearing loan guaranteed by the Government, could use this income to finance exploration in the South Sea. The company's promoters spread false rumors of vast underwater gold reserves, failing to mention that the South Sea at that time was in fact controlled by the Spanish. Wild speculation in the company's shares ensued and when the crash came many prominent figures lost fortunes.

[4] 6 Geo. 1, c.18.

development".[5] Although the express purpose of this awkwardly drafted act was to restrain several "extravant and unwarrantable practices", its effect on English corporate law cannot be understated. For more than a century, until its repeal in 1825, the Bubble Act drove the corporate form underground.

Public confidence in the joint stock company had been destroyed. The Crown now reluctantly granted new Charters. Parliament made scant use of its power to grant statutory incorporation. And with these obstacles placed in the path of incorporation company promoters sought an alternative device which they found in the unincorporated association .

The Bubble Act had attempted to destroy the unincorporated association but expressly exempted partnerships.[6] At this time there was no legal restriction on the number of partners as it was believed that illegality rested on the existence of freely transferable shares (the cause of the speculative crash). The legal profession responded to this demand by drafting Deeds of Settlement which gave substantially all the advantages of incorporation and provided a flexible organisational structure which facilitated *inter alia* variation of the deed's provisions by majority consent and delegation of management function to a committee of directors. Although the capital of the enterprise did consisted of a joint stock divided into shares, the government, far from disapproving of these Deed of Settlement companies, seemed to prefer them to the grant of a charter.[7]

Thus, by the start of the nineteenth century the law had become hopelessly out of step with reality as unincorporated companies flourished. These, it must be emphasised, were little more than glorified partnerships, the only difference was that they had a joint rather than several capital base.

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[5] Bruce Welling, *Corporate Law in Canada - The Governing Principles* (Toronto: Butterworths, 1984) at 38 [hereinafter *Welling*].
[6] *Ibid.*, s.25.
[7] Gower, *supra*, note 2 at 34.

With the repeal of the Bubble Act in 1825[8] came a demand for state regulation. The Board of Trade, whose former president William Huskisson was responsible for the Bubble Act's repeal, now responded with legislation in 1844 and 1845.[9] These statutes are the theoretical basis out of which all subsequent English company legislation has evolved. The Acts drew a clear distinction between private partnerships and the company by requiring every company with more than 25 members to seek registration. These Acts provided for incorporation by mere registration thus dispensing with the need for a Special Act or Charter. The Deed of Settlement however was retained[10] and it was not until the Joint Stock Companies Act of 1856[11] that it was superseded by the modern memorandum and articles of association.

Although physically replaced, the Deed of Settlement's spirit lived on and can be seen in the drafting of the 1856 Act. A "memorandum of association" would henceforth be required to incorporate a company. This was essentially a Deed of Settlement, its only difference being that it would no longer be necessary for *all* members, and potential members, to execute a deed. They would be *deemed* to be bound by the terms of the articles:

> VII.
> The Memorandum of Association shall be in the Form marked A. in the Schedule hereto, or as near thereto as circumstances admit, and it shall, when registered, bind the company and the shareholders therein to the same extent as if each shareholder had subscribed his name and affixed his seal thereto or otherwise duly executed the same, and there were in such Memorandum contained, on the part of himself, his Heirs, Executors and Administrators, a Covenant to conform to all the Regulations of such Memorandum, subject to the Provisions of this Act.[12]

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[8] 6 Geo. 4, c.91.
[9] Joint Stock Companies Act, 1844 (U.K.), 7 & 8 Vict., c.47; Companies Clauses Consolidation Act, 1845 (U.K.), 8 & 9 Vict., c.16.
[10] The Joint Stock Company's Act, 1844 created an early form of company which was little more than a partnership. Section 7 of the Act retained the need for a Deed of Settlement binding on those who signed.
[11] Joint Stock Company's Act, 1856 (U.K.), 19 & 20 Vict. c.47.
[12] *Ibid.*, s.7.

This provision has been repeated in all subsequent legislation[13] and forms the nexus of a contractual web which is the basis for the English-model corporate enterprise. It is also the contract upon which a shareholder can rely if his rights are threatened.[14] This partnership heritage has been highlighted by one author:

> "Hence the modern English business corporation has evolved from the unincorporated partnership, based on mutual agreement, rather than from the corporation, based on a grant from the state, and owes more to partnership principles than to rules based on corporate personality. Thus we in England still do not talk about business corporations or about corporation law, but about companies and company law."[15]

Company law in England is not *sui generis*. Born of the Royal Prerogative and schooled in the ways of the Partnership it still struggles to define its own identity. Incorporation, once a jealously guarded privilege of the Monarch, evolved into an administrative device through which the economy could be monitored and, where necessary, controlled.

1.2 Corporations in the United States

U.S. corporate law development is entwined with that country's constitutional evolution. The Bubble Act and its effects were noticeably absent from the development of American corporations law before the Revolution. Although extended to the colonies in 1741[16] the Act appears to have been largely ignored.[17] America after independence was thus free to develop its own solution to the problem of incorporation, a solution based on the principles embodied in the U.S. Constitution.[18]

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13 It became s.16 of the Companies Act, 1862 (U.K.), 25 & 26 Vict., c.89; s.20(1) of the Companies Act, 1948 (U.K.), 11 & 12 Geo.6, c.38; s.14(1) of the Companies Act 1985 (U.K.).

14 Although it would appear that he must sue *qua* member see *Salmon v. Quinn & Axtens* (1909) A.C. 442. C.f. Wedderburn [1957] C.L.J. 193; Goldberg (1972) 35 M.L.R. 362.

15 L.B.C. Gower, "Some Contrasts Between British and American Corporation Law" (1956) 69 Harv. L.R. 1369 at 1371.

16 14 Geo. II, c.37.

17 See H.G. Henn & J.R. Alexander, *Handbook of the Law of Corporations*, 3rd ed. (St. Paul: West, 1983) at 24 [hereinafter *Henn*].

18 Machen, writing in 1908: "For, in a free commercial country, individuals should have the power by mere private contract or agreement to associate themselves

With the Declaration of Independence the Royal Prerogative was abolished and was not renewed or vested by the various state constitutions in the executive. The right to incorporate, with limited exceptions,[19] was granted to the states alone. As a result, a person seeking incorporation had to apply to the state legislature for a special act of incorporation. During the first half of the nineteenth century, as the demand for incorporation increased, incorporation by Special Act became slow and inefficient. This inefficiency, coupled with a fear of corruption, necessitated change. General incorporation acts were seen as the best way of relieving the legislatures from the pressure of this business and, moreover, they fitted better with the American belief that incorporation in the New World was to be a *right* and not a mere privilege.[20] Initially these statutes provided for incorporation in specific industries.[21] However, the earliest general law for the formation of business corporations was passed in New York State in 1811 and dealt with manufacturing companies.[22] It is thus with some justification that general incorporation laws can be claimed as an American invention.[23]

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together as a corporation for any merely private lawful object." A.W. Machen, *Modern Law of Corporations*, Vol. I (Boston: Little, Brown & Co., 1908) at 2.

19 The Federal Government has no express power to incorporate, this power is implied where "necessary and proper" to facilitate express powers. McCulloch v. Maryland 17 (4 Wheat.)U.S. 316 (1819) at 404: "Among the enumerated powers we do not find that of establishing a bank or creating a corporation. But there is no phrase in the instrument which, like the articles of confederation, excludes incidental or implied powers; and which requires that everything granted shall be expressly and minutely described."

20 J.S. Davis, *Essays in the Early History of American Corporations* IV (New York: Russell & Russell, 1965) at 7: "[T]he English tradition that corporate powers were to be granted only in rare instances, never deeply entrenched here, was opposed by a strong and growing prejudice in favor of equality - a prejudice which led almost at once to the enactment of general incorporation acts for ecclesiastical, educational, and literary corporations. Partiality in according such powers was to be expected of the English crown, but is was a serious charge to lay at the door of democratic legislatures after a Declaration of Independence which asserted so vigorously the natural equality of rights and privileges."

21 A North Carolina statute passed in 1795 applied to canals. The formation of aqueduct corporations was generally permitted in Massachusetts in 1799. See Henn, *supra*, note 17 at 25.

22 Law of N.Y., Sess.34, Chap. 67. For other early general incorporation laws, see Laws of Pa., Sess. of 1835-36, Chap. 194; Laws of N. Car. 1836 (2 Rev. Stats. of 1837,p.214).

23 This is Machen's claim. Machen, *supra*, note 18 at 15: "To be sure the statute of Elizabeth for the incorporation of hospitals preceded the New York statue by more

These acts were predicated on the belief that an individual had the right to organize his business in any way he thought fit and that the states should not interfere with this right. Consequently the early American general incorporation acts authorized incorporation for any lawful purpose by the mere execution and registration of a document setting forth the objects of the company and certain other particulars as to its proposed business and constitution.[24] This is to be contrasted with the common law notion of incorporation as a *franchise* or *special favour* from the crown.[25]

1.3 Business Organisations in Canada

Canada's corporate development seems to reflect her vacillation between two economic masters. After following first England, then America briefly, the Dominion was content for nearly a century to accept English company law precedent. The reforms of the 1970's, however, have again sent her south of the border in the search for conceptual inspiration.[26]

France, like Britain, exploited her colonial acquisitions through trading monopolies granted by Royal Charter. However, although the English monarch's royal prerogative in this area was greatly reduced by the Civil War, it remained substantially intact in France until 1789. As a result corporations law was undeveloped by the time New France was

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than two centuries; but there is every reason to suppose that the New York statute was an original invention and was not even suggested by the long-forgotten statute of Elizabeth."

[24] Evidence of this approach can be found in an early New York case on the 1811 Act, Slee v. Broom, 19 Johns. 456 (N.Y.1822), where Chief Justice Spencer said at p.474: "There is nothing of an exclusive nature in the statute; but the benefits from associating and becoming incorporated, for the purposes held out in the act, are offered to all who will conform to its requisitions. There are no franchises or privileges which are not common to the whole community."

[25] Machen, *loc cit*, at 18: "Always should the fact be recognized that nowadays when the right to organize a corporation is almost as free as the right to execute a deed of real estate, corporations are very different things from what they were when that right was confined to a few favorites of king or parliament."

[26] Welling, *supra* note 5, at 32: "Canadian corporate law entered a new phase during the 1970's, casting off the shackles of English jurisprudence and seeking new statutory inspiration in America."

ceded to the British crown in 1763 hence for its subsequent development in Canada we must look initially to England.

By the start of the nineteenth century incorporation in Canada could be achieved in one of three ways; by creation of the individual company by English parliament, by creation of the individual company by the Canadian government, or under a general incorporation act passed to facilitate the incorporation of companies in certain industries.[27]

Canada's first general Act of incorporation came in 1850[28] and took much from her southern neighbour, incorporation being obtained automatically on the filing of a charter.[29] This Act was based on the General Incorporation Acts which had spread throughout the United States following the lead of the state of New York in 1811. It was not tainted with the same concern for public scrutiny which had inspired the unwieldy 1844 English Act in the wake of the South Sea swindle.

Were development to have continued along these lines the development of Canadian corporations law might well have followed more closely that of the U.S. However, by 1864 the Canada had passed an Act[30] which was to form the pattern for subsequent development. Incorporation was no longer to be obtained as of right but by letters patent issued under the seal of the Governor General. Grant of incorporation was therefore in the discretion of an official of the government. This letters patent system[31] was much

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[27] *Ibid.*, at 40. Welling states that only four companies were incorporated in England to act in Upper and Lower Canada during the period 1800-1864.

[28] Although two Acts the previous year had provided for the formation of companies in Upper and Lower Canada these were concerned with construction companies only. See F.W. Wegenast *The Law of Canadian Companies* (Toronto : Burroughs, 1931) at 20.

[29] "An Act for the formation of incorporated Joint-Stock Companies, for Manufacturing, Mining, Mining, Mechanical or Chemical Purposes", 13 & 14 Vict., c.110 (Can., 1850).

[30] 27 & 28 Vict., c. 23 (Can., 1864).

[31] The practice of obtaining incorporation by grant of letters patent from the crown without the grant of a charter originated after the Trading Companies Act 1834 (U.K.). It was however a compromise which the English parliament had seen fit to

less flexible than the "incorporation-on-demand" model and yet it remained in place in Canada until the reforms of the 1970's.

Ontario, Québec, New Brunswick and Nova Scotia, all members of Confederation in 1867, provided for letters patent corporations, as did the Dominion Companies Act 1869. By 1971, however, Canada had a curious jurisdictional mosaic with the West, P.E.I., Nova Scotia[32] and Newfoundland all adhering to the English-model corporate statute yet with Central Canada and New Brunswick retaining letters patent.

Throughout this period the judiciary, rather to the surprise of several writers,[33] chose to adopt English judicial precedent. Where this related to memorandum and articles of association companies there was no problem, however, where the company involved was incorporated under letters patent the reasoning of the English judges should have been ignored or at least modified.

With the appointment of the Lawrence Committee in Ontario in 1969 the pendulum began to swing back to the U.S.[34] The task of the Committee was to consider the fundamental principles of corporations law in its general aspects. Such a comprehensive review of the corporate form was unheard of in Canada and its result was to recommend a radical change of approach.

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abolish with Gladstone's reforms of 1844. Why Canada opted for this regulated form of incorporation is far from clear. It did however maintain close governmental control over corporate activity which was more appropriate given the developmental state of the Canadian economy at that time.

[32] Nova Scotia had changed to the English model in 1900; R.S.N.S. 1900, c.128.

[33] Welling, *supra*, note 5 at 45: "Why Canadian judges gradually turned away from the American precedents they were accustomed to using in the third quarter if the nineteenth century and exclusively referred to English precedents during the first half of the twentieth century, [is a mystery] as yet unexplained in Canadian law". Wegnest, writing at in 1930, observed this shift. Wegnest, *supra*, note 28 at 20: "In its earlier stages the company law of Canada was largely influenced by the course of company legislation in the United States. Later legislation was of Canadian Draftsmanship. In recent years the tendency has been to look to English models."

[34] Ontario, *Interim Report of the Select Committee on Company Law* (Toronto: Queen's Printer, 1967) (Chair: A.F. Lawrence Q.C.) [hereinafter *Lawrence Committee*].

The Committee noted that Ontario, in common with the other letters patent provinces, was unique in the common law world by providing for incorporation by the exercise of ministerial or executive discretion,[35] observing that this method was inefficient in comparison with incorporation-on-demand in New York State[36]. The Committee was reluctant to recommend reform along an English model which was "showing signs of age"[37] and accordingly adopted the American approach. The reforms in Ontario stimulated a wave of reform across Canada. The Dickerson Committee[38] recommended substantially similar reforms for the federal statute[39] and now all provinces except British Columbia and Quebec have, or propose, reforms which reflect this conceptual watershed.[40]

The choice for Canada is between a system struggling to outgrow its partnership origins and one infused with the capacity to find original solutions to novel problems. Nowhere is this flexibility more apparent than in the context of protecting the minority shareholder.

[35] Lawrence Committee, para. 1.1.2.
[36] *Ibid.*, para. 1.1.7.: "As a practical illustration, the Committee is advised that to incorporate a company in Ontario under the letters patent system requires at least three weeks and that to incorporate a company by way of certificate of incorporation in New York State requires not more than 48 hours."
[37] *Ibid.*, para. 1.1.8. It would be interesting to hear Professor Gower's reply to such a glib dismissal of English Company Law. The author would doubt if such response would be printable.
[38] Dickerson, Howard, Getz, *Proposals for a New Business Corporations Act for Canada*, Vol. 1, commentary; Vol 2, Draft Act (Ottawa: Information Canada, 1971).
[39] Canada Corporations Act , R.S.C. 1970, c.C-32 [repealed and replaced by the Canada Business Corporations Act, S.C. 1974-75-76, c.33].
[40] Welling, *supra*, note 5 at 48.

CHAPTER II

THE DECLINE OF THE SHAREHOLDER VETO

In the United States incorporation was a right guaranteed under the Constitution. In England it was a privilege defined by the Law of Partnership. Thus, the two jurisdictions had chosen their conceptual paths.

As a consequence of the U.S. approach, American courts had to consider the conflict between a corporation's need to expand and the preservation of members' rights. Upon her independence from Britain, America's greatest need by the end of the nineteenth century was the multiplication of property and the legal system obliged by providing safeguards for the property holder at the expense of corporate flexibility.

2.1 U.S. - The "Vested Rights" Doctrine

By emphasising property rights the U.S. courts were to precipitate a conflict. How could expansion and economic growth be achieved without compromising an individual's property right? This issue was directly addressed when state legislatures attempted to amend the corporate charter.

Soon after the Revolution the New Hampshire legislator attempted to seize control of Dartmouth college by passing an act which purported to amend the College charter which had been granted by the English crown.[1] The United States Supreme Court

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[1] *Trustees of Dartmouth College v. Woodward* 17 U.S. (4 Wheat.) 316 (1819). This was an attempt by the legislature of New Hampshire to alter the Dartmouth college charter by increasing the number of the trustees. The New Hampshire court sought to distinguish between "public" and "private" corporations. The latter being created for public purposes, their property was to be devoted to the objects for which they were created: "The corporators have no private beneficial interest, either in their franchises or their property. The only private right which individuals can have in them, is the right of being and of acting as members." (1 N.H. 111, 116-7 (1817).) The Supreme Court reversed. An educational corporation was, they said, a private institution and its charter an inviolable contract. Chief Justice Marshall said at 712:

viewed this attempt to "nationalize" the College as tantamount to an expropriation of private property and held the Act unconstitutional. A corporate charter was, they said, a contract between the state and the corporation, protected by the U.S. Constitution against state impairment of the obligation of contracts.[2] Under this "contract theory" the corporate charter is viewed simultaneously as three contracts: (1) a contract among the shareholders; (2) a contract between the shareholders and the corporation and; (3) a contract between the shareholders and the state.[3]

Contract theory was used in *Dartmouth College* to make a shareholder's interest constitutionally immune from alteration without his consent. As the New Hampshire legislature had not granted the College its charter it could not retrospectively alter the rights flowing under the contract contained in the charter. The members' rights had become "vested" and thus immune from legislative interference by the state. The effect of this limitation on state sovereignty was to put those who had obtained a charter from the English crown and not a state legislature in a superior position to all other property owners. They had not only constitutional privileges but a charter which was immune from legislative interference.[4]

Mr. Justice Story suggested in his opinion in *Dartmouth College* that a legislature could alter a corporation's constitution provided it had reserved the power to do so in the

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"any act of a legislature which takes away any powers or franchises vested by its charter in a private corporation or its corporate officers, or which retains or controls the legitimate exercise of them, or transfers them to other persons, without its assent, is a violation of the obligations of that charter. If the legislature mean to claim such authority, it must be reserved in the grant."

[2] U.S. Const. art. I, para 10, cl.1.

[3] *Western Foundry Co. v. Wicker* 403 Ill. 260, 85 N.E. 2d. 722 (1949); *Pronik v. Spirits Distributing Co.* 58 N.J. Eq. 97, 42 Atl. 586 (1899); *Morris v. American Pub. Util. Co.* 14 Del Ch. 136 at 144, 122 Atl. 696, 700 (1923); *Faunce v. Boost Co.* 15 N.J. Super. 534, 83 A. 2d. 649(1951); *McNulty v. W.& J. Sloane* 184 Misc 835, 54 N.Y.S. 2d. 253 (Sup. Ct. 1945); *Schaad v. Hotel Easton Co.* 369 Pa.486, 87 A.2d. 227 (1952).

[4] For case law 1800-1830 concerning the scope of legislative power, see, E.M. Dodd, *American Business Corporations until 1860* (Cambridge, Mass.: Harvard Univ. Press, 1954) ch.1.

grant of incorporation.[5] The states, therefore, responded by reserving the power to alter charters in either the special or general acts authorising incorporation[6] or by amending the state constitution.[7] By associating special incorporation with the old enemy of crown privilege, however, *Dartmouth College* was to have a more lasting effect. By the end of the 19th century all American jurisdictions except Connecticut, Massachusetts, New Hampshire and the District of Columbia were to have ratified constitutional provisions prohibiting special incorporation and requiring incorporation under general law.[8]

When states passed acts permitting a specified majority of shareholders to alter the charter's provisions, the principles of *Dartmouth College* were applied. Although the case as decided concerned change effected by a state legislator and not a majority of members, the extension of the *ratio* in *Dartmouth College* is consistent with the private law notion of consent. If the consent of a party is required in order to change ~~a~~ contract's terms, ~~it~~ does not matter that the body inflicting change on the shareholder is a majority of his peers rather than a state legislature.

The vested rights doctrine evolved at the hands of judges until it split off into essentially two aspects. Firstly, a right was considered vested where the charter predated the amending statute. This is simply a question of the extent to which a particular law may have retroactive effect and is the true *ratio* of *Dartmouth College*. Secondly, the term "vested rights" began to be used by the courts as a tool of statutory interpretation in order to limit the majority's ability to amend the corporate charter. The effect of the doctrine here was to treat certain rights, although created after the reservation of a

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5 17 U.S. (4 Wheat.) at 712, 4 L.Ed. at 677 (1819).

6 Eg., Alaska, Connecticut, Florida, Illinois, Louisiana, Minnesota, Missouri, New Hampshire, Oregon, Rhode Island, West Virginia, District of Columbia.

7 Eg., Alabama, Arizona, Arkansas, Idaho, Kansas, Kentucky, Mississippi, Ohio, Pennsylvania, Utah, Washington, Wisconsin.

8 H.G. Henn & J.R. Alexander, *Laws of Corporations*, 3rd. ed. (St Paul, Minn.: West, 1983) at 26.

statutory power to amend the corporation's charter, as inherent to the status of a shareholder and thus incapable of alteration without his consent.[9]

2.11 *Intertemporal Conflict* - Where a corporation received its charter prior to the enactment of ~~a~~ statute permitting amendment, the court refused to allow a retroactive alteration of the contract's terms. A shareholder's rights had become "vested" and were constitutionally immune from alteration. This is essentially a problem of the intertemporal conflict of laws:

> "When a legislature adopts, repeals or amends a law, questions arise concerning the temporal limits of the new law's application. The most commonly recognised question is that of retroactivity, or the extent to which the new law will apply to events which occurred before its effective date."[10]

As long as courts persisted in characterizing the corporation as a triumvirate of contracts, they would protect a member from deprivation of his property without due process of law[11] or from state impairment of contracts.[12]

This approach, although on the decline, has been followed as recently as 1966 by the Supreme Court of Washington in *State of Washington ex. rel. Starkey v. Alaska Airlines Inc.*[13] Alaska Airlines had been incorporated in 1937 under a law which provided only for cumulative voting of directors. In 1964 the Alaska Legislature purported to permit any corporation to cancel cumulative voting rights. On June 1st 1964 the board of the airline amended the articles to facilitate this change. Minority stockholders successfully

[9] This doctrine reached its zenith with the decision of the Delaware Supreme Court in *Keller v. Wilson & Co., Inc.* 21 Del. Ch. 391, 190 Atl. 115 (1936), holding that the right to accrued dividends was "a vested right of property secured against destruction by the Federal and State Constitutions."
[10] J.K. McNulty "Corporations and the Intertemporal Conflict of Laws" (1967) 55 Calif. L. Rev. 12 at 12.
[11] U.S. Const. amend. XIV, para. 1. See *Smyth v. Ames* 169 U.S. 466 at 522, 526 (1898).
[12] U.S. Const. Art.1 Para.10.
[13] 68 Wn. 2d. 318, 413 P. 2d. 352 (1966).

challenged the alteration as it was , found that there was nothing in the Alaska constitution reserving to the state legislature the power to amend a corporate charter:[14]

> "If we were to hold that the 1964 amendment to the Alaska Corporations Statute authorized Alaska Airlines, Inc., to provide by its bylaws for the use of direct voting only in the election of directors, then we would be holding that the state legislature can authorize the directors to do what the state legislature had previously, *by contract*, originally agreed that the majority shareholders could not do."[15](Emphasis added.)

The court applied *Dartmouth College* approving the contractual analysis of the corporation[16] which provides that a statute in force at the time of incorporation becomes part of the charter and hence part of the contract which cannot be altered except with a shareholder's consent.[17]

2.12 – *Vested Rights as a Rule of Statutory Construction* - Courts were reluctant to see an individual's property right altered without his consent and fought a rearguard action against state legislatures who had passed statutes permitting alteration to the corporate charter. Courts invoked the doctrine even where the corporation had been formed subsequent to the constitutional amendment or statute permitting alterations to the charter,[18] using the term "vested rights" as a rule of statutory construction to limit the extent of the reserve power.

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[14] *Ibid.*, at 358.
[15] *Ibid.*
[16] The court reproduced a passage from Fletcher, *Cyclopedia of the law of Corporations*, vol 7 (Callaghan: Mundelein, Ill, 1964) para. 3658, at 815-816.
[17] See also, *General Investment Co. v. American Hide & Leather Co.* 97 N.J. Eq. 214, 127 A. 529 (1925); *Keetch v. Cordner* 90 Utah 423, 62 P. 2d. 273 (1936); *Peters v. U.S. Mortgage Co.* 114 Atl. 598 (Del.Ch. 1921).
[18] See, Note, "Limitations on Alteration of Shareholders' Rights by Charter Amendment" (1955-56) 69 Harv.L.Rev. 538; E.M. Dodd, "Accrued Dividends in Delaware Corporations - From Vested Right to Mirage" (1944) 57 Harv. L.Rev. 894; A.C. Brecht, "Changes in Interests of Stockholders" (1950) 36 Corn. L.Q. 1; G.D. Gibson, "How Fixed are Shareholder Rights?" (1958) 23 Law & Cont. Prob. 283.

New Jersey courts,[19] in common with some other states,[20] held that the reserved power did not extend to the contract among the shareholders, this could only be altered by the state in the "public interest". The effect of holding that only the contract between the corporation and the state could be amended was to prevent interference with class rights of the shareholder. In *Pronik v. Spirits Distributing Co.*[21] the New Jersey court of chancery refused to permit a reduction in the rate of dividend paid to preferred shareholders despite authority in the general corporations statute in force at the time the corporation received its charter to "amend its original certificate" with the assent of a majority of the stockholders. Even though the proposed amendment had received the support of more than two-thirds of the corporation's stockholders the court refused to permit the alteration:

> "In my judgment these general powers of amendment of the certificate, which originally fixed the relation between the stockholders inter sese, do not confer the power of altering the previous contract of the company itself with the stockholder as to the rate of dividend which was created by a stock certificate or contract of the company."[22]

The preferred stock certificate was a contract between the corporation and the stockholder, one of whose terms was the rate of dividend payable. Under contract law, any alteration of the contract's terms required the stockholder's consent. Mere majority approval could not coerce a contracting party to waive his legal right.

In states where legislative power to alter the contract among shareholders was recognized, courts construed the legislation strictly, refusing to give general words their

[19] *Zabriskie v. Hachensack & N.Y. Railroad* 18 N.J. Eq. 178 (1867); *Pronick v. Spirits Distributing Co.* 58 N.J. Eq. 97, 42 Atl. 586 (1899).
[20] *Jacobson v. Bachman*, 16 Utah 2d. 356, 401 P. 2d. 181 (1965); *Wheatley v. A.I. Root Co.* 147 Ohio St. 127, 69 N.E.2d 187 (1946); *Faunce v. Boost Co.* 15 N.J. Super. 534, 83 A2d. 649 (1951).
[21] *Pronik v. Spirits Distributing Co.* 58 N.J.Eq. 97, 42 Atl. 586 (1899).
[22] *Ibid.*, at 588.

full effect.[23] Certain rights, it appeared, were inherent to the shareholder and could not be removed by statute.

In one line of cases it was held that even if legislative authority had been clearly given for the alteration of class rights, it would not be effective where the proposed change was not *specifically* set out in the statute. In *Faunce v. Boost Co.*[24] a plan under which outstanding voting stock would be called in and exchanged for non-voting stock was held to be inequitable and an impairment of the contract. Despite express statutory wording which permitted the corporation to make certain amendments including "such amendment, change or alteration as may be desired", the Court again refused to permit the alteration:

> "The right to vote was a basic contractual right. It was an incident to membership of the property in the stock, of which the stockholder or member cannot be deprived without his consent:"[25]

The statutory authority to amend the charter must be read "with an unwritten understanding that such change would be a violation of constitutional guarantees."[26]

Attempts to enforce property rights in the face of a legislative preference for commercial flexibility led, in Delaware, to a game of cat and mouse between the state legislature and the Chancery court. In *Morris v. American Pub. Util. Co.*[27] the Court held that, although the legislature had reserved the power for any alteration of "preference" upon the majority assent of the affected class, accrued dividends which remained unpaid were a "vested right" rather than a "preference" and thus beyond the scope of the

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[23] A power "to classify of reclassify" or to change "preferences ...or other special rights" of shares did not permit the making of issued non-redeemable shares redeemable. See *Braslav v. New York & Queens Electric Light & Power Co.* 249 App. Div. 181, 291 N.Y.S. 932 (1936), aff'd 273 N.Y 593, 7 N.E.2d 708 (1937).
[24] 15 N.J. Super. 534, 83 A. 2d. 649 (1951).
[25] *Ibid.*, at 652.
[26] *Ibid.*
[27] 14 Del.Ch. 136, 122 Atl. 696 (1923).

reserved power. This reasoning necessarily assumed that an accrued, yet unpaid preferential dividend constituted an interest in property:

> "[A]s soon as the agreed dividend which the preferred stockholder is to receive is matured by time, a right to its ultimate payment as against those who have agreed to its payment becomes a vested right. It is a present property interest (...) If the foregoing views are sound, then it follows that the amendment in question disturbs the rights of the complainants, not in the enjoyment of a preference, but rather in the enjoyment of a vested right. It takes from an objecting stockholder that which in a real sense is his individual property interest."[28]

The Delaware legislature responded by broadening the scope of section 26 of the General Corporations Law to include "special rights" as well as "preferential rights". This was understood to allow the cancellation of accrued dividends.[29]

Then in a series of decisions the Delaware courts championed property rights. First in *Keller v. Wilson*[30] the Delaware Supreme Court invoked the vested right doctrine to hold that accrued dividends could not be canceled where the corporation had been formed prior to the amending statute. Layton C.J. struggled to define "vested right":

> "It is difficult to define "vested right" with exactness; but generally speaking, a vested right is property, as tangible things are, when it springs from contract or the principles of common law."[31]

A right to accrued dividends was, he said, a substantive right because an investor in preferred stock relies largely upon this right which acts as an inducement not only to buy but also to retain the share. The Court defined it as a right analogous to a debt.[32] The share certificate was a contract between the corporation and the shareholder which

[28] *Ibid.*, at 703.
[29] See Gibson, *supra*, note 18 at 286.
[30] 21 Del. Ch. 391, 190 Atl. 115 (1936).
[31] *Ibid.*, at 122.
[32] Classifying the right as equivalent to a contractual debt owed by the corporation was common at the time. See, *Roberts v. Roberts - Wicks Co.* 184 N.Y. 257, 77 N.E. 13 (1906); *Sutton v. Globe Knitting Works* 276 Mich. 200, 267 N.W. 815, 105 A.L.R. 1447 (1936); *Koakim v. Providence Blitmore Hotel Co.* 34 F. 2d. 533 (1st Cir. 1929). C.f. E.M. Dodd, "Fair and Equitable Recapitalizations" (1942) 55 Harv. L. Rev. 780 at 795.

contained the obligation to pay a fixed rate of dividend. It was not open to the corporation to unilaterally avoid this contractual duty, nor could the legislature retroactively cancel this right:

> "We think that if rights in the nature of a debt are to be destroyed by corporate action under subsequent legislation, the purpose and intent of the legislature to give its enactment a retroactive operation and thus to destroy those rights, should be expressed in language so clear and precise as to admit of no reasonable doubt."[33]

The reasoning adopted by the court in *Keller* is consistent with earlier cases on intertemporal conflict. The courts would not uphold a retroactive alteration of rights through the subsequent grant of reserved power to amend the charter.[34]

A more revolutionary stance was taken by the same court in *Consolidated Film Industries, Inc v. Johson.*[35] The facts were essentially identical with the *Keller* case *except* here the corporation received its charter after the 1927 amendment enabled "special rights" to be altered. The Delaware Supreme Court could see no distinction between the cases. An owner of cumulative preferred dividends was entitled to rely on his contractual right to dividends accrued through time until such time as the power granted by the legislature was in fact exercised,"to that time the right ought to be regarded as a fixed contractual right, not to be diminished or canceled against his consent, but to be recognised and protected."[36]

With hindsight, this case marks the high water mark for the vested rights doctrine. Here was an unalterable right which the courts would protect. It was as indestructible as the rights constitutionally protected by the U.S. Supreme Court in *Dartmouth College.* However the doctrine had evolved during the century which separated the two decisions and with *Consolidated Film* the metamorphosis was complete. No longer did the Court

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[33] *Keller v. Wilson* 21 Del. Ch. 391, 190 Atl. 115 at 125 (1936).
[34] E.g. *Smyth v. Ames* 169 U.S. 466 (1898).
[35] 22 Del Ch. 407, 197 Atl. 489 (1937).
[36] *Ibid.*, at 493.

feel constrained to use vested rights to reconcile an intertemporal conflict or as a tool of statutory interpretation. It used the doctrine to immunize a contractual obligation from interference by the majority of members.

In the author's opinion the court reached its decision *per incuriam*, it did not follow the principle in *Keller*, it extended it. As previously stated, under the contractual analysis of the corporation, the corporate statute existing at the time of incorporation would be read into the charter, its provisions becoming implied terms in that contract. The shareholder of Consolidated Film should, therefore, have been taken to have consented to the possibility of a subsequent cancellation of his dividend rights. This was the reasoning adopted in the previous cases and is consistent with the view of the corporation as a contractual being. In *Keller* the complainants argued that the state of the law existing at the time of the birth of the corporation and the isssuance of the stock is held to control, and that, therefore the rights of the shareholders are fixed or vested. The defendants replied that the state of the law existing at the time of the corporate action complained of must determine the rights incident to the stock. The Court accepted the complainants' view:

> "The right of a holder of cumulative preferred stock, issued at a time when the law did not permit of the cancellation of accrued and unpaid dividends against the consent of the holder, to such dividends, is, and ought to be regarded as a substantial right"[37]

The court in *Consolidated Film*, on the other hand, did not consider the point, they proceeded on the premise that the obligation to pay the dividend arose prior to the exercise of the corporate power. To permit the corporation to cancel the dividend was to give the amendment to section 27 retroactive effect, something the court would not do. In reaching this decision the Court thought it was merely following *Keller*.[38] Yet, if the

[37] *Keller*, *supra*, note 33 at 124.
[38] *Ibid.*, at 493: "The Chancellor correctly construed the language of the opinion in the Keller Case as being applicable to the situation presented here."

amended section 27 formed one of the terms of the original contract to which the shareholder had consented, no obligation could have existed. The shareholder had impliedly consented to a subsequent alteration of the charter.[39]

This principle of indestructibility was to be short-lived. In *Havender v. Federal United Corp.*[40] the court permitted the right to accrued dividends to be removed lawfully by a merger.[41]

In only a minority of jurisdictions does the contractual analysis still persist. Most courts accept that commercial necessity dictates a more flexible approach. They began to drop talk of property rights which can only be removed with the shareholders consent and came to view him as a creature of statute whose rights are delimited by legislative favour. Did this mean the shareholder would be forced to yield to the will of the majority and see his rights "become subservient to financing corporate needs"?[42] Henceforth, denied absolute protection of his rights, the shareholder would have to appeal to the equitable notion of "fairness".

[39] This is the reasoning adopted by the English courts who also follow contract theory. In *Allen v. Gold Reefs of West Africa* [1900] 1 Ch. 665, the Court of Appeal considered the status of a debt owed, not by the company, but by the shareholder. Lindley M.R. rejected the plaintiffs arguments that a subsequent alteration of the articles to impose a lien over his shares to secure the debt interfered with his contractual rights. He said at 675:

> "Every allottee was told by the memorandum that his rights as a shareholder were subject to alteration, and no allottee acquired any rights except on these terms."

[40] 11 A. 2d. 331 (Del. 1940).

[41] See E. Merrick Dodd, "Accrued dividends in Delaware corporations - From Vested Right to Mirage" 57 Harv. L.R. 894 (1944).

[42] *Keller*, *supra*, note 33 at 121.

2.2 U.K.- Partnership Principles

Judicial hostility in the face of a legislative preference for majority rule took a different, though no less effective, form in England. Whereas their New World brethren were fighting to preserve a citizen's constitutional right to hold property, English judges imported principles of the common law to frustrate Parliament's development of company law. Arguing by analogy the judges called in aid the only form of business association with which they were familiar - the Partnership.

Thus, when Parliament granted the majority the right to amend a company's articles of association by special resolution[43] courts sought to limit the extent of the grant. At common law there is a long recognized distinction between "ordinary matters" of the partnership and matters which relate to the "nature of the partnership business".[44] This dichotomy was adopted to entrench shareholders' rights in much the same way as the vested rights doctrine was used in the U.S.

In *Bryon v. The Metropolitan Saloon Omnibus Company Limited*[45] the Court considered the nature of a power to amend the articles of association granted by the 1856 Act. Lord Justice Turner adopted the partnership distinction:

> "If in articles of partnership there was a stipulation that three-fourths of the partners should have power to bind the other fourth, there can be no doubt that this would enable the three-fourths to make any provisions as to the conduct of

[43] Companies Act, 1856 (U.K.), 19 & 20 Vict, c.47, ss.33:"XXXIII Any Company registered under this Act may in General Meeting, from Time to Time, by such Special Resolution as is herein-after mentioned, alter and make new provisions in lieu of or in addition to any regulations of the company contained in the Articles of Association."

[44] *Lindley on Partnership*, 15th Ed. (London: Sweet & Maxwell, 1984) at 476 *et.seq.* See, *Const v. Harris* (1824) Turn & Russ. 496; *Att.- Gen v. Great Northern Rly.* (1860) 1 Dr. & Sm. 154; *Abbatt v. Treasury Solicitor & Others* [1969] 1 W.L.R. 1575. This Principle is embodied in the Partnership Act, 1890 (U.K.), s.24(8):" 24 - (8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners."

[45] (1858) 121 R.R. 35 (3 DeG. & J. 123).

the business which were *not inconsistent with the other terms of the partnership*"[46] (Emphasis added.)

It would be inconsistent with the terms of the contract upon which a shareholder entered the company for the majority to alter the nature of this relationship without his consent. The Act, he said, merely enabled the majority to make regulations as to the mode of conducting the business of the company, they could not, however, alter its general constitution.[47]

This distinction was adopted by Kindersley V.C. in *Hutton v. The Scarborough Cliff Hotel Company (Limited)*[48], where a company with only ordinary shares proposed to issue preference shares. The memorandum of association set out the company's capital divided into shares of certain fixed amounts. Alteration of the memorandum of association under English company law was, and still is, prohibited except where provided by statute. The 1862 Act permitted alteration to increase, consolidate or convert capital.[49] The Vice-Chancellor, however, saw the creation of preference shares as something more than this, it was an attempt to alter the very constitution of the company:

> "I think that the issuing of new shares with a preference dividend, is a variation of the constitution of the Company. It is clear that the intention of all parties to the original contract was, that the shareholders should stand *pari passu* as co-partners in respect of the receipt of dividends."[50]

This presumption of equality was not expressed in the memorandum but would be implied in the absence of any provision to the contrary.[51] The heritage of the learned

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[46] *Ibid.*, at 127.
[47] *Ibid.*, at 128.
[48] (1865) 2 Drew & Sim 521.
[49] Companies Act, 1862 (U.K.), 25 & 26 Vict., c.89, s.12.
[50] *Hutton v. Scarborough Cliff Hotel Co, supra*, note 48 at 526.
[51] C.f. the approach of the New York courts to the issuance of preferred shares; see *Hinkley v. Schwarzchild & s. Co.*, 107 App. Div. 470, 95 N.Y.S. 357 (1905). In that case the corporation's capital originally consisted of one class of share, the law at that time providing that no preferred stock could be issued except by unanimous consent of all the stockholders. A later amending act permitted the issuance of

Judge's reasoning is clear, it too stems from the presumption of equality which permeates the law of partnership.[52] There was nothing to prevent a company from starting out with preference shares, but where the memorandum did not so provide there was an implied principle of equality among shareholders.

After *Hutton* it became common to include the division of capital into separate classes in the memorandum. As alteration to the memorandum was only permitted in certain limited circumstances[53] and the memorandum had been held to prevail when in conflict with an inconsistent article[54], the capital structure of the corporation was effectively entrenched.[55]

The implied equality doctrine was to trouble the courts for the next thirty years. It was eroded in *Harrison v. Mexican Railway Company*[56] where the then Master of the Rolls held that the principle could be rebutted by a contradictory article in the articles of association. This approach was followed in several cases,[57] however it conflicted with the principle of the supremacy of the memorandum. If there was an implied doctrine of equality, the argument went, then surely this would prevail over an inconsistent article? After several judicial attacks[58] the doctrine was overruled in *Andrews v. Gas Meter*

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preferred stock upon the affirmative vote of two-thirds of the stockholders. The minority unsuccessfully challenged the authority of the state to interfere with the contract rights which the stockholders enjoyed against the corporation. The appellate court, whilst following the contractual analysis of the corporation, subroggated the shareholder's property rights to the greater public need to facilitate corporate expansion.

[52] The same reasoning was used by Cotton L.J in *Guiness v. Land Corporation of Ireland* (1883) 22 Ch. D. 349 at 377, to come to a different conclusion. The implication of equality, he said, did not stem from a construction of the memorandum but from an implication which the law raises between partners. This implication is, however, subject to contrary stipulation in the contract.

[53] See C.A. 1862 (U.K.), s.12.

[54] *Ashbury Rly. Co. v. Riche* (1875) L.R. 7 H. L. 653 at 667.

[55] *Ashbury v. Watson* (1885) 30 Ch. D. 376.

[56] (1875) L.R. 19 Eq. 358.

[57] *In re South Durham Brewery Co.* (1886) 31 Ch.D. 261; *In re Bridgewater Navigation Co.* (1888) 39 Ch.D. 1.

[58] See per Cotton L.J. in *Guiness v. Land Corporation of Ireland, supra,* note 52 and also per Lord Macnaughton in *British and American Trustee and Finance Corporation v. Couper* [1894] A.C. 416 at 417.

Company.[59] Lindley L.J. found it impossible to reconcile Kindersley V.C.'s principle with the conclusion reached in *Harrison*:

> "If the memorandum of association really prescribed equality amongst all the shareholders, as Kindersley V.C. held that it did, the articles of association could not override the memorandum of association in that particular."[60]

Accordingly *Hutton* was overruled. In doing so the Court sought to "remove from companies a fetter which ought never to have been imposed upon them."[61]

Although the general rule remains that the memorandum cannot be changed except as provided by statute,[62] the Companies Act 1985 permits extensive alteration.[63] By section 17 of the Act a condition in the memorandum which could lawfully have been contained in the articles may be altered by special resolution. This broad power originated in the 1948 Act[64] and would seem to give the majority power to alter every aspect of the company's constitution. However the section is subject to limitation where the memorandum sets out "special rights of any class of members"[65] and expressly prohibits alteration of these rights. Entrenchment of class rights would thus appear possible[66] because the memorandum cannot be changed even with unanimous shareholder

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59 [1897] 1 Ch. 361.
60 *Ibid.*, at 369.
61 The detrimental effects of the doctrine had been observed by Lord Macnaughton in the *British and American Finance* case, *supra*, note 58 at 417: "The practical result of Hutton has been that, except in cases coming within the rule in *Harrison v. Mexican Railway* - a decision which has not met with universal acceptance - no company limited by shares that has not taken power in its memorandum to issue preference share has been able to raise additional capital in the manner most advantageous to its shareholders."
62 C.A. (U.K.) 1985 s.2(7) - "A company may not alter the conditions contained in its memorandum except in the cases, in the mode and to the extent, for which express provision is made in this Act."
63 *Ibid.*: s.28(1) (company name); s.4 (objects); ss.49-52 (limited liability); s.121(2)(a) (increase in share capital).
64 Companies Act, 1948 (U.K.), s.23.
65 C.A. (U.K.) 1985, s.17(2)(b).
66 See J.H. Farrar, *Company Law* (London: Butterworths, 1985) at 183; Gower, *supra*, ch. 1 note 2 at 563. Alteration is only possible under a scheme of arrangement pursuant to s.425; see *City Property Investment Trust Corpn. Ltd.* [1951] S.L.T. 371.

consent.[67] In practice however, class rights seldom, if ever, appear in the memorandum and as a result the protection afforded to them is merely a quaint historical anomaly of nor more than academic interest.

The attempts by courts on both sides of the Atlantic to forestall the attainment of majority rule were frustrated by their legislatures. Despite the importation of common law contract and partnership principles a shareholder saw his right of veto disappear. Henceforth he would have to yield to the greater needs of society which benefited from possessing dynamic corporations able to adapt to changing circumstances:

> "May it not be assumed that the Legislature foresaw that the interests of the corporations created by it might, as experience supplies the material for judgment, be best subserved by an alteration of their intra-corporate and in a sense private powers, and, in the interest of a public policy which coveted their successful progress, have meant to reserve to itself by the general amendment clause a right to alter or enlarge such powers?"[68]

The shareholder, in the U.S. at least, was not to be deserted by the courts, they would offer him protection but not in the name of preserving property rights. . The way in which the courts made this shift and the subsequent evolution of the equitable doctrine of fairness represents the second phase of minority rights.

Majority rule was to be the accepted as the most efficient method of achieving fundamental change within the corporation, it promoted greater corporate flexibility and allowed those in control to respond to changed circumstances. In order to do so, however, it vested almost unlimited powers in the majority shareholder. To assume that this power was delegated to the majority without fetter would be wrong. There were to evolve judicial and legislative safeguards designed to protect the minority from prejudicial actions of the majority. A shareholder could no longer require that his

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[67] *Ashbury v. Watson* (1885) 30 Ch. D. 376.
[68] Per Chancellor Wolcott in *Davis v. Louisville Gas & Electric Co.* 142 A. 654 (Del. Ch. 1928).

consent be given to fundamental corporate decisions, the most he could expect was to be "fairly" treated by the majority.

The approach to "fairness" was not consistent however. American judges faced with a wide grant of power responded with the traditional tools of equity and imposed a fiduciary duty upon the recipient of the power. The American legislative safeguard, on the other hand, equated fairness with the fair value of a shareholder's investment. The "appraisal remedy" ensured that, if a minority dissented from his peers decision, he could leave the corporation and receive fair value.[69]

Parliament and the British judiciary, by contrast, refused to question the acts of the majority. Despite imposing a limited fiduciary duty when the articles of association were amended, the English courts refused to entertain minority complaints which fell short of claiming fraud.[70] Unfairness in Britain, it appeared, was to be equated with fraud. This desertion of the minority shareholder was belatedly rectified with the creation of a statutory remedy, first involving "oppressive" acts, and more recently those which "unfairly prejudice" the minority.[71]

We must now turn to consider the definition of "fairness" under these new approaches, for it is only when a court is willing to find "unfairness" that a shareholder will be adequately protected from the exercise of majority power.

[69] For a critical assessment of the appraisal remedy, see B. Manning, "The Shareholder's Appraisal Remedy: An Essay for Frank Coker" (1962) 72 Yale L.J. 223.
[70] This is a consequence of the so called rule in *Foss v. Harbottle* discussed, *infra*, chapter 3.
[71] The Oppression remedy originated in s.210 C.A. 1948. "Unfair prejudice" was added by s.75 C.A. 1980. See, *infra*, chapter 4.

CHAPTER III

USING THE FIDUCIARY DUTY TO REMEDY UNFAIRNESS

The imposition of a fiduciary duty upon someone in a position of superiority over another is a familiar device of Equity which the courts were quick to utilise as a method of control over the actions of directors. This fiduciary duty flows from the wide power to manage the corporation which corporation laws delegate to the board of directors:

> "Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation."[1]

This delegation of power, though wide, is not exclusive. Modern corporation laws provide that, whilst a shareholder may not vote on a matter of ordinary business judgment, he may exercise management functions where fundamental corporate actions are proposed.[2] In this context the shareholder has not delegated control but has assumed it for himself. A corporation may, therefore, act through *two* organs; the board of directors and the shareholders in general meeting. Both exercise delegated powers and both, therefore, receive the attention of Equity through the fiduciary concept.

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[1] Canada Business Corporations Act, s.97. Similarly see Del. Code Tit.8, Ch.1, s.141(a): "The business and affairs of every corporation organised under this chapter shall be managed by or under the direction of the board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."; Companies Act 1985 (U.K.), Table A, Art.70: "Subject to the provisions of the Acts, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company."

[2] The most obvious example of shareholder participation in corporate management is their right to elect and remove the directors. See C.B.C.A. ss.101(3), 104. C.A. (U.K.) 1985 s.303, Table A arts. 73-80. For examples of "fundamental" corporate decisions requiring shareholder approval see C.B.C.A. s.177(2) (amalgamation), ss.98(2),(4) (by-law amendment), s.183(2) (sale or lease of all or substantially all assets). Easterbrook & Fishcel point out that the justifications for giving this residuary power to shareholders are obscure. See Easterbrook & Fishcel, "Voting in Corporate Law" (1982-83) 26 J.L. & Econ. 395 at 415.

3.1 The Nature of the Relationship

There are problems with defining the term "fiduciary". While it is axiomatic to say that a fiduciary relationship exists between principal/agent, trustee/beneficiary, or solicitor/client, the content of such a duty varies with the context. As a result, the courts have yet to satisfactorally define the nature of the duty owed by a director and at various times have equated him with a trustee,[3] an agent,[4] or even a partner.[5]

Precise definition would appear to have eluded the courts[6] and the modern trend is to provide a statutory definition of a directors duties.[7] This concentrates on the obligation

[3] *Re German Mining Co. ex. p. Chippendale* (1853) 4 De G. M.& G. 19; *Great Eastern Rly. Co. v. Turner* (1872) 8 Ch. App. 149,152; *Selangor United Rubber Estates Ltd. v. Craddock (a bankrupt)(No.3)*[1968] 2 All E.R. 1073 at 1094. It would seem that they are treated as trustees whenever dealing with the company's property; per Lindley J. in *Re Lands Allotments Co,* [1894] 1 Ch. 616 at 631: "Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes into their hands or which is actually under their control." See also Sealy, "The director as Trustee" [1967] C.L.J. 83.

[4] The categorisation of a director as an agent is favoured by Gower, *supra*, ch. 1 note 2, he says at p.571: "[I]n truth, directors are agents of the company rather than trustees of it or its property". For a similar judicial view see *Aberdeen Rly Co. v. Blaikie Bros.* (1854) 1 Macq. 461; *Ferguson v. Wilson* (1866) 2 Ch. App. 77 at 89; *Re Faure Electric Accumulator Co.* (1889) 40 Ch.D. 141 at 151; *Northern Counties Securities Ltd. v. Jackson & Steeple Ltd.* [1974] 1 W.L.R. 1133 at 1144 per Walton J.: "[a] director is an agent, who casts his vote to decide in what manner his principal (ie. the company) shall act through the collective agency of the board of directors".

[5] *Re Forest of Dean Coal Mining Co.* (1878)) 10 Ch.D. 450 at 543. There are dicta equating the position of a director with a managing partner. See *Automatic Self-Cleaning Filter Syndicate Co, Ltd. v. Cunninghame* [1906] 2 Ch. 34 at 45 per Cozens-Hardy L.J.: "I do not think it true to say that the directors are agents. I think it is more nearly true to say that they are in the position of managing partners." If the director is also a shareholder than the partnership analogy is easier to understand, however, a director's powers are not analogous to those of a managing partner. He is subject to limitations in the constitution of the company, his liability, in common whith other shareholders is limited to the amount unpaid on his shares and, more fundamentally, a director, unless authorised to do so, may not bind his fellow directors. See also *Gore-Browne On Companies*, 43rd ed. (London: Jordan & Sons, 1977) para 27-4.

[6] Perhaps no attempt should be made: "It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise," per Romer J. in *In Re City Equitable Fire Insurance Co.* [1925] 1 Ch. 407 at 426.

[7] A.L.I.- A.B.A. Model Bus. Corp. Act, s.8.30; C.B.C.A., s.117. Both statutory definitions avoid the term "fiduciary". The M.B.C.A. annotation explains the section

to act bona fide with the standard of care of an ordinary prudent person, in what the director believes to be the best interests of the corporation.[8]

It is apparent that before extending fiduciary duties to cover the general body of shareholders, or even a majority of them, similar problems of definition arise. A shareholder is neither a trustee nor an agent for his fellow members. Anglo-American jurisprudence is liberally sprinkled with statements confirming that a shareholder may vote in his own self-interest, a proposition best illustrated by *North - West Transportation Co. v. Beattie*.[9] Beattie was the owner of a steamship which the company proposed to purchase. As he was also a director of the company, the contract had to be ratified at a general meeting of shareholders. At the meeting the proposal was narrowly accepted, Beattie using his own shares to secure ratification of the contract. The Privy Council upheld his right to vote as his self-interest dictated:

> "Every shareholder has a perfect right to vote upon any ...question although he may have a personal interest in the subject matter opposed to, or different from, the general and particular interests of the company."[10]

At this time it was believed that the interests of a stockholder could be equated with that of the corporation, his self-interested actions promoting rather than harming the welfare of all those involved with the enterprise. Because a majority stockholder has the

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does not include the term "because that term could be confused with the unique attributes and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation." See *Model Business Corporation Act Annotated*, 3rd ed. Vol.2 (Clifton, N.J.: Law & Business, 1984) at 929. Neither Delaware nor the U.K. attempt a statutory definition.

[8] A.L.I. - A.B.A. Model Business Corp. Act, s.8.30 (a)(1),(2),(3); C.B.C.A. s.117(a),(b).

[9] (1887) 12 App. Cas. 589 (P.C.).

[10] *Ibid.*, at 593. *Beattie* was soon followed in the U.S. See *Gamble v. The Queen's County Water Co.* 123 N.Y. 91, 25 N.E. 201 (1890) per Peckham J.: "A shareholder has a legal right at a meeting of the shareholders to vote upon a measuure, even though he has a personal interest therein separate from the shareholders."

greatest financial interest in the enterprise it was thought that he also has the greatest interest in seeing that the corporation is properly managed.[11]

A majority stockholder's self-interest, the courts soon discovered, is not the loyal slave of a corporation. In *Jackson v. Ludeling*[12] a bondholder, Gordon, who owned four out of some seven hundred and sixty bonds outstanding, obtained an order for the sale of property over which the bonds were secured. The property consisted of a railroad one hundred and ninety miles long which was sold at a gross undervalue.[13] The U.S. Supreme Court held that, in arranging for the sale, Gordon had breached his duty to the other bondholders:

> "When two or more persons have a common interest in a security, equity will not allow one to appropriate it exclusively to himself, or to impair its worth to the others. Community of interest involves mutual obligation."[14]

This same principle was swiftly applied to stockholders in cases where the majority shareholder sought to deny to the minority their rightful share in the proceeds of a sale of corporate assets. The right of the majority to alienate the corporation's property was held to an equitable limitation regardless of whether the sale was achieved by first appointing directors sympathetic to the majority view. Stockholders, as owners of the corporation, had a joint interest in the corporation's property. This joint interest imposed upon them a duty not to do anything to impair the property, "[i]t creates a fiduciary relation as makes it inequitable for any of those who thus share in the common property to do anything to or with it for their own profit at the expense of others who have the same rights."[15]

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[11] *Smith v. San Fransisco & N.P. Rly.* 115 Cal. 584, 47 P. 582 (1897); *Barnes v. Brown* 80 N.Y. 527 at 537(1880); *Faulds v. Yeats* 57 Ill. 416 at 421 (1870).
[12] 88 U.S. (21 Wall.) 616 (1874).
[13] The bondholder and his associates who purchased the property for $50,500 received an immediate offer of $1,000,000.
[14] 88 U.S. (21 Wall.) 616 at 622 (1874).
[15] *Jones v. Missouri-Edison Electric Co.* 144 F. 765 at 771 (1906), per Sanborn C.J. See also *Wheeler v. Abilene National Bank Bldg. Co.* 159 F. 391 (1908).

The fiduciary duty doctrine was extended in the U.S.[16] to include not only cases concerning an expropriation of company property but to *any* exercise of managerial power by a majority or controlling stockholder. Two approaches to explain the theoretical basis of this extension of the fiduciary duty have been proposed:[17] (a) the *direct approach* and (b) the *indirect approach.*

3.11 The Direct Approach

It is a principle of Equity that whenever a person who is in a superior position to others exercises his power he owes them duties of good faith and fairness. This principle was clearly stated by the English Court of Appeal in *Allen v. Gold Reefs of West Africa.*[18] The case concerned an exercise of majority power to amend the articles of association under a power granted by s.50 of the U.K. Companies Act, 1862.[19] The statute appeared to give the holders of sufficient shares to pass a special resolution unfettered power to alter the articles. Lindley M.R. disagreed:

> "Wide, however, as the language of s.50 is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised not only in the manner required by law, but also bona fide for the benefit of the company as a whole and must not be exceeded. These conditions are always implied and seldom if ever expressed."[20]

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[16] In England the judges expressed similar outrage at attempts to short-change the minority. Sir W.M. James L.J. in *Menier v. Hooper's Telegraph Works* (1874) 9 Ch. App. 350 at 353, thought such activities "shocking". In coming to the minority's aid, however, English judges were not to use the same equitable doctrine of fiduciary duties. To succeed in England a shareholder would have to show that a "fraud on the minority" had been committed. See chapter 4, *infra.*

[17] Finch & Long, "The Fiduciary Relation of the Dominant Shareholder To the Minority Sareholders" (1958) 9 Hast. L.J. 306.

[18] [1900] 1 Ch. 656.

[19] Companies Act, 1862 (U.K.), 30 & 31 Vict., c.131, s.50.

[20] *Ibid.*, at 671. Lamentably English judges did not take Lindley M.R. at his word. They restricted the fiduciary duty thus imposed to those cases concerning alteration of articles, relying on the general principle in *N.W. Transportation v. Beattie* (1887) 12 App. Cas. 589 (P.C.).

The same conclusion was reached by the U.S. Supreme Court in *Southern Pacific Co. v. Bogert.*[21] A controlling shareholder has the right to appoint the directors and thereby determine corporate policy. In effect therefore he manages the corporation. Although he may never exercise this right, if he does so then a fiduciary duty will be imposed upon him and a minority shareholder can insist that, irrespective of the extent of the legal power granted to him, he exercise that power fairly and in good faith.

3.12 The Indirect Approach

Under this approach a duty is imposed upon the majority only where the participation of the directors is necessary. Since they bear a fiduciary duty to the shareholders, where their actions are dictated by a controlling shareholder, he equally should bear an identical relationship to the minority.

The case of *Zahn v. Transamerica Corp.*[22] provides a good illustration. The plaintiffs owned Class A shares in Axton-Fisher, a tobacco company, which were subject to redemption terms in the corporation's charter. Transamerica Corp. purchased virtually all the voting Class B stock and elected a majority of the board. Axton-Fisher's principle asset was a supply of leaf tobacco which had increased in value from $6.4M to over $20M. The complaint alleged that Transamerica, knowing of the increase in value, conceived of a plan to appropriate the increase for themselves by redeeming the Class A shares and subsequently liqudating Axton-Fisher. The redemption being made to appear as if "incidental to the continuance of the business of Axton-Fisher as a going concern." The plan was duely carried out and the plaintiff sought damages for fraud when he discovered the increase in value of the tobacco.

[21] 250 U.S. 483 at 487-88 (1919), per Mr. Justice Brandeis: "The majority has the right to control, but when it does so, it occupies a fiduciary relation towards the minority, as much so as the corporation itself, or its officers or directors." See also *Pepper v. Litton* 308 U.S. 295 at 306 (1939); *Heffern Co-Op Consolidated Gold Mining Co. v. Gauthier* 22 Ariz. 67, 193 P. 1021 (1920).

[22] *Zahn v. Transamerica Corp.* 162 F.2d. 36 (3rd Cir. 1947).

The Court of Appeals for the Third Circuit discussed the nature of the relationship between majority and minority shareholders. There was, the Court said, a "radical difference" between voting strictly as a stockholder and voting as a director:

> "When he votes as a stockholder he may have the legal right to vote with a view of his own benefits and to represent himself only; but when he votes as a director he represents all the stockholders in the capacity of a trustee for them and cannot use his office as a director for his personal benefit at the expense of stockholders."[23]

The directors had the right to call the Class A shares and the plaintiffs argued this was a valid exercise of managerial judgment. The Court stated that in exercising this power the directors had to observe their fiduciary duty to shareholders. If the facts alleged were true, and that the sole purpose of the call was to deny the minority of their rightful share in the increased value of a corporate asset, then "it follows that the directors of Axten-Fisher have been derelict in that duty."[24] Through Transamerica's domination of the board there existed, as between the directors and majority shareholder, a "puppet-puppeteer" relationship. Hense, the liability which flowed from the directors dereliction of duty, "must be imposed upon Transamerica which, under the allegations of the complainant, constituted the board of Axten-Fisher and controlled it."[25]

It is submitted, however, that the *indirect* approach is wrong. It does not explain those cases where board decisions are subsequently ratified by a majority of the shareholders or where such ratification is a pre-requisite to action by the directors.[26]

Moreover, objection to the indirect approach can be sustained on the basis of principle. The duty arises *independently* of any duty owed by the directors. It derives from the general obligation of fair play inherent to a grant of majority power:[27]

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[23] *Ibid.*, at 45.
[24] *Ibid.*, at 46.
[25] *Ibia.*
[26] See Finch & Long, *supra*, note 17.
[27] See eg. *Jackson v. Ludling*, *supra*, note 12; *Allen v. Gold Reefs of West Africa* [1900] 1 Ch. 656.

> "If the majority is going to manage, and such is its prerogative under the statutes, then the ethics of the situation demand there be some restraint. The retraint has evolved in the form of the fiduciary concept."[28]

Control can be exercised *inter alia* by the appointment of a sympathetic board of directors, but this is no more than a manifestation of control, evidence of those activities which require equitable limitation. This is not the *origin* of the duty, which stems from the statutory grant of a power to the majority.

Once it is recognised that the fiduciary duty of the controlling stockholder and director are not *eiusdem generis*, some attempt can be made to define the extent of the duty. The value of this instrument of equity as a method of minority shareholder protection rests ultimately on the willingness of the courts to define the duty's content.

3.2 The Content of the Duty

> *But to say that a man is a fiduciary only begins analysis; it gives direction to further enquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary?*
>
> Mr. Justice Frankfurter in *S.E.C. v. Cheney Corp.*[29]

Denied a comprehensive statement of principle, we must look to those cases in which fiduciary duty has been imposed in order to discern its content. With the decline of contract rights in favour of majority rule came a shift in the court's approach towards the minority. It may be characterised as a shift from contract to status.[30] Despite the wide and unequivocal grant of power to them, courts of equity refused to permit the majority to argue that the minority had impliedly consented to any exercise of this power, no matter what the consequences.[31] The courts, however, were inconsistent in

[28] Sneed "A shareholder may vote as he pleases: Theory and Fact" (1960) 22 U.Pitt.L.Rev. 23 at 54.

[29] 318 U.S. 80 at 85

[30] See W. J. Carney, "Fundamental Corporate Changes, Minority Shareholders, and Business Purposes" [1980] A.B.F.Res.J. 69 at 74.

[31] In *Ervin v. Oregon Rly & Nav. Co.* 27 Fed. 577 at 630 (S.D.N.Y. 1886) the Court said: "Plainly the defendents have assumed to exercise a power belonging to the

their approach to the duty which has as a consequence been transformed during the century of its application.

3.21 Phase I - The Duty's Application to Asset Sales

(a) From Positive to Negative Obligation

A fiduciary duty was initially imposed through analogy with those duties which a co-owner owes in equity to his fellow title holders on the disposition of property:

> "It was [the majority's] duty, to the extent of their power, to secure for all those whose interests were in their charge to secure the highest possible price for the property which could be obtained."[32]

Lip-service was paid to this positive obligation, especially where the court was faced with self-dealing on the part of the majority.[33] In such a situation the duty became a negative one not to profit at the *expense* of the minority.[34]

This change of emphasis was accompagnied by a change in vocabulary. The majority was equated, not with a co-owner, but with a trustee or agent whose duties include not

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majority in order to secure personal profit for themselves, without regard to the interests of the minority. They repudiate the suggestion of fraud, and plant themselves upon their right as a majority to control the corporate interests according to their discretion. They err if they suppose a court of equity will tolerate a discretion which does not consult the interests of the minority". See also *Southern Pacific v. Bogert* 250 U.S. 483 at 487-488 (1919).

[32] *Jackson v. Ludeling*, *supra*, note 12 at 625. See also, *Menier v. Hooper's Telegraph Works* (1874) 9 Ch. App. Cas. 350 at 352; *Gamble v. Queen's County Waterworks Co.* 123 N.Y. 91 at 99, 25 N.E. 201 (1890).

[33] In *Wheeler v. Abilene Nat. Bank Bldg. Co.*,*supra*, note 15 at 394, Sanborn C.J. restated the positive duty. The majority must "exercise care and diligence to make the property of the corporation produce the largest possible amount". Despite this statement the case was decided on the issue of conflict of interest.

[34] In *Goodin v. Cincinnati & Whitewater Canal Co.* 18 Ohio St. 169 the Court held: "Any act of the directory by which they intentionally diminish the value of the stock or property of the company is a breach of trust". See also *Meeker v. Winthrop Iron Co. (C.C.)* 17 Fed. 40 (1883); *Pondir v. N.Y., L.E. & W.R.R. Co.* 25 N.Y Supp. 560 (1893); *Wheeler v. Abeline National Bank Building Co.*, *supra*, note 15; *Heffern Co-Op Gold Mining Co. v. Gauthier*, *supra*, note 21.

receiving a secret profit and avoiding a conflict of interest with those he serves.[35] A self interested disposition of corporate assets offends both these principles yet, in an attempt to permit such dispositions, the courts sought ways to relieve the majority of the duty they had just imposed. In *Wheeler v. Abiline Nat Bank Bldg. Co.*, Sanborn C.J., after stating that "one may not be an agent to sell for another and a purchaser at the same time,"[36] conceived of a situation where this would be permitted:

> "If [the sale] had been fair and open, after full opportunity to all those interested to bid, for the highest amount that could be obtained for the property, it might have been sustained."[37]

Thus the breach of duty came to be associated not with the reduction in value received by the minority, but with the profit obtained by the majority.[38]

(b) Towards "Fraud"

By 1923 the Delaware Court of Chancery had proclaimed a bifurcated standard for the fiduciary duty. In *Allied Chemical & Dye Corp. v. Steel & Tube Co.*[39] Chancellor Wolcott refused to permit the minority to question the majority decision to sell all the corporations assets, even where the sale was not in the interests of the corporation.[40]

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[35] P. Finn, *Fiduciary Obligations* (Sydney: Law Book Co., 1977) at 47.
[36] *Wheeler, supra,* note 15 at 394.
[37] *Ibid.*, at 395. Similarly in *J.H. Lane v. Maple Cotton Mills* 226 F. 692 at 679 (1916) where the sale was by public auction, the judge held that this discharged the fiduciary duty: "When no effort is made to shut him out, the minority stockholder can claim no protection except competition at a public sale."
[38] See *Jones v. Missouri Edison Co., supra,* note 15 at 771; *Southern Pacific v. Bogert* 250 U.S. 483. In *Gomberg v. Midvale Co.* 157 F. Supp. 132 at 137 (E.D.Pa. 1955) the court placed an additional burden on the plaintiffs to show "that the disparity between the value of the property to be sold and the money to be received is so unreasonable as to indicate that the sellers are recklessly indifferent to the interest of the whole body of stockholders."
[39] 120 A. 487 (1923).
[40] *Ibid.*, at 490: "As I read the statute, therefore, the bald question of whether the entire assets should be sold is to be determined by the stockholders entirely aside from the question of whether is would be to the best interests of the corporation to sell them."

However, consistent with the jurisprudence he did not allow the majority unfettered discretion. A court of equity would intervene where "fraud" has been shown:

> "The requirements of the statute and of the certificate of incorporation all being satisfied, as they are in this case, it will be manifest that the only ground upon which he can base his claim for relief is that of fraud."[41]

The court, Chancellor Wolcott said, would find fraud in two cases: a) where the majority "use their power to advantage themselves at the expense of the minority",[42] or b) where they fail to sell the assets at a "fair and adequate price".[43] Even inadequacy of price was insufficient; to bring suit a minority would have to show that the price was grossly inadequate:

> "[I]nadequacy of price will not suffice to condemn the transaction as fraudulent, unless the inadequacy is so gross as to display itself as a badge of fraud."[44]

On the facts the learned judge was satisfied that the discrepency between the sale price and true market value was so great as to warrant further investigation, he therefore granted a preliminary injunction restraining the sale.[45]

The metamorphosis of the duty as it applied to asset sales was now complete. It originally comprised a positive obligation to obtain the highest value possible, then after being associated with the profit obtained by the majority it became a negative duty not to profit at the minority's expense. Finally the minority could only claim unfairness where there had been a fraudulent sale of assets at a *gross* undervalue.[46]

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[41] *Ibid.*, at 491.
[42] *Ibid.*
[43] *Ibid.*, at 494.
[44] *Ibid.*
[45] *Ibid.*, at 496-7.
[46] Chancellor Wolcott's statements were to influence the courts when they came to examine the fairness of a corporate merger. A merger was equated with an asset sale and the judges accordingly would only hold a merger to be unfair where the terms of the merger grossly undervalued the plaintiff's corporation. See *infra* under merger.

3.22 Phase II - The Duty's Application to a Power to Dissolve

When the majority used their power to dissolve a solvent corporation as a method of "squeezing-out" the minority,[47] the courts again attempted to articulate the duty which had been breached. In *Green v. Bennett*[48] the Court refused to permit the minority to challenge the majority decision to dissolve. They were merely entitled to receive their fair share of the proceeds of sale.[49]

It has been argued that few courts took this narrow view,[50] other courts being more willing to question the majorty decision to dissolve their corporation. In *Ervin v. Oregon Rly.*[51] the majority sought to dissolve a"healthy and prosperous" corporation, purchase all the assets and then continue in business without the minority.[52] The court refused to permit what it saw as an abuse of power:

> "It is the essence of the contract [of association] that the corporate powers shall be exercised to accomplish the objects for which they were called into existence."[53]

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[47] *Lebold v. Inland Steel Co.* 125 F.2d 369 (7th Cir 1941); *Green v. Bennett* 110 S.W. 108 (Tex. Cir. App. 1908); *Kavenaugh v. Kavenaugh Knitting Co.* 226 N.Y. 185, 123 N.E. 148 (1919).

[48] 110 S.W. 108 (Tex. Cir. App. 1908).

[49] The Court refused to limit the wide power contained in the statute. *Ibid.*, at 115: "Unless we go outside the laws passed by Congress for implied limitations upon this power, its exercise rests upon the mere will of those owning two-thirds of the stock of the bank."

[50] Norman D. Lattin, "Equitable Limitations On Statutory or Charter Powers Given To Majority Stockholders" (1932) 30 Mich. L.R. 645 at 650, where he distinguishes two cases which support the restrictive doctrine in *Green v. Bennett*. See *Watkins v. National Bank of Lawrence* 51 Kan. 254, 32 Pac. 914 (1893); *Slattery v. Greater New Orleans Realty and Development Company* 128 La. 871, 55 So. 558 (1911).

[51] 27 F. 625 (S.D.N.Y. 1886).

[52] In the *Ervin* case, *ibid.*, one Villard organized a new corporation, purchased a majority of the stock of the Oregon Steam Navigation Co. and thereupon elected its directors. The board of the steam navigation company then voted to dissolve, transfering its assets to the new corporation. This transfer was made at a gross undervalue. The holder of a minority of the stock of the Oregon Steam Navigation Co. brought a suit in equity on his own behalf and on behalf of other stockholders against Villard and the new corporation claiming that the sale was fraudulent and seaking his fair share of the proceeds of sale.

[53] *Ibid.*, at 631.

It is far from clear what object of the majority the court thought was improper. Was the improper object the sale at an undervaluation, the use of a power to dissolve to effect an indirect merger? Alternatively, was the impropriety the "squeezing-out" of the minority?

The Court had little difficulty in holding that a self-interested sale at a gross undervaluation breached the majority's fiduciary duty.[54] Furthermore, it stated that the purpose of a dissolution was to bring the corporation's business to an end, sell its assets and distribute fairly the proceeds of sale amongst those who had formerly participated in the enterprise.[55] This had never been the majority's purpose here, they used the power to effect an indirect merger and the court would not permit them to achieve indirectly what could not be done directly:

> "A dissolution under such circumstanes is an abuse of the powers delegated to the majority. It is no less a wrong because accomplished by the agency of legal forms."[56]

This was not the basis of the Court's decision, however. Quoting cases on the breach of a trustee's duty not to profit from his office,[57] Wallace J. concluded that the wrong committed was the appropriation of corporate assets for an inadequate consideration:

> "Applying these principles to the case in hand, *although the minority of stockholders cannot complain merely because the majority have dissolved the corporation* and sold its property, they may justly complain because the majority, while occupying a fiduciary relation towards the minority, have exercised their powers in a way to buy the property for themselves, and exclude the minority from a fair participation in the fruits of sale."[58](Emphasis added.)

Accordingly the minority were entitled to a lien, to the extent of the undervaluation, over the property of the old corporation.

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[54] *Ibid.*, at 631-2. The majority are under "an obligation to make the property or fund productive of the most that can be obtained from it for all who are interested in it", citing *Jackson v. Ludeling*, *supra*, note 12.
[55] *Ibid.*, at 629.
[56] *Ibid.*, at 631.
[57] *Ibid.*, at 632.
[58] *Ibid.*

It is impossible to reconcile the two passages quoted above. In the former Wallace J. states clearly that the power had been abused as it had been used to achieve an indirect merger. In the latter he states that the minority could not question the majority decision to dissolve, they were merely entitled to a fair share of the proceeds of sale.

In the author's opinion the *Ervin* case cannot be cited in support of the view that the content of the fiduciary duty includes an obligation to use a delegated power for a "proper purpose". True, the Judge refered *obiter* to purpose, however his conclusion was based on the traditional duty of a trustee not to profit from the sale of trust property.[59] Judicial preoccupation with the benefit accruing to the majority rather than the detriment suffered by the minority persisted.

Whilst there are dicta in some dissolution cases which refer to purpose,[60] it is only when the courts came to examine the statutory grant of a power to merge that the issue is clearly addressed.

3.23 Phase III - The Duty's Application to a Power to Merge

The early merger statutes required that shareholders receive stock in the surviving corporation.[61] Although this prohibited merger as a method of squeezing-out the minority, it did not prohibit other forms of oppression. In *Small v. Sullivan*[62] the majority used a merger to effect a reduction in the corporation's capital. As the

[59] The minority had sought merely to receive their *pro rata* share of the true value of their corporation's assets. Accordingly there was no discussion as to the majority's right to squeeze-out the minority.
[60] E.g. *Finch v. Warrior Cement Co.* 141 Atl. 54 at 59 (Del. Ch. 1928); *Paine v. Sailsbury* 200 Mich. 58, 166 N.W. 1036 (1918) at 66, 166 N.W. at 1039: "[I]f counsel's contention is to prevail, [the minority shareholders] may be driven out by a forced sale of their investment for no better reason than that a larger stockholder desires to aquire it in the interests of economy. It is not conceivable that the Legislature ever intended that the statute should be used for such a purpose... Such a construction would be injurious to the public interest and not beneficial to the stockholders as a whole." See Lattin, *supra*, note 50 at 651.
[61] eg. Act of May 27, 1896 Ch. 932 s.58 1896 N.Y. Laws 996 (merger).
[62] 245 N.Y. 343, 157 N.E. 261 (1927).

corporation laws prohibited a corporation from reducing its capital, the New York Court of Appeals refused to permit this to be achieved indirectly.[63]

Merger also became the preferred method of effecting an oppressive sale of corporate assets - the target corporation would be merged with one owned by the majority. Under the terms of the merger agreement the stock received by the majority would not fairly represent the assets given up by the target corporation. Courts imposed a fiduciary duty here because they viewed a merger as equivalent to a sale of assets.[64] Unfortunately this reasoning by analogy brought with it the same preoccupation with the profit obtained by those in control and not an enquiry into the impact a merger would have on a shareholder's position within the corporation.[65]

In Delaware, the Court of Chancery was not afraid to evaluate the terms of a merger in order to see if they were "fair" to existing stockholders. In *Cole v. National Cash Credit Ass'n*,[66] however, the Court followed *Allied Chemical & Dye* and required that the shareholder show actual or constructive "fraud" in order to prove unfairness. Chancellor Wolcott acknowledged that the existence of a statutory appraisal remedy put the shareholder to an election between accepting the offer of the majority or disassociating himself from the consolidation and securing a valuation of his stock. This however was not the full extent of a minority's rights:

> "[T]he election which is given to a stockholder is one that he is not, under any and all circumstances, required to exercise. The exercise of the statutory right of merger is always subject to nullification for fraud."[67]

[63] *Ibid.*, at 264: "I know of no form of law or statute which will prevent a court of equity from seaking out the fraud, looking beyond the forms to the actual facts and compelling restitution."
[64] *Jones v. Missouri-Edison Co., supra*, note 15 at 771; *Cole v. National Cash Credit Ass'n* 18 Del.Ch. 47, 156 A. 183 (Ch.1931) at 188.
[65] In *Jones v. Missouri-Edison Co.,supra*, note 15. The court did not question the majority's right to force a merger on the minority, it merely examined whether the consideration received by the minority was fair.
[66] 18 Del. Ch. 47, 156 A 183 (1931).
[67] *Ibid.*, at 187.

In the instant case the fraud alleged was a constructive fraud based on an alleged discriminatory undervaluation of the assets of the Association in the terms of the merger agreement. As Chancellor Wolcott viewed a merger as equivalent to a sale of asset,[68] the learned judge applied his test from *Allied Chemical*, and equated unfairness with fraud. In doing so, however, he further refined the concept by stating that mere inadequacy of price would not reveal fraud. The inadequacy had to be so gross as to lead the court to conclude that it was due, not to an error of judgment, but bad faith or a reckless indifference to the rights of others.[69] Furthermore, the court would presume that the majority were acting in good faith.[70]

The Chancellor then undertook a "rather painstaking" study of the evidence in which he attempted his own valuation of the interests of the minority shareholders. He concluded that, as there had been no gross undervaluation of the minority's interest, constructive fraud had not been shown and therefore the terms of the sale were fair.[71]

When the Delaware Supreme Court in *Federal United Corp. v. Havender*[72] permitted a power to merge to be used to cancel accrued but unpaid dividends on preferred shares, the Court refused to qualify the legislature's unconditional grant to the majority of a power to merge:

> "It is for the legislature not for the court, to declare the public policy of the state; it is not, therefore, the function of the court to graft an exception on the plain and positive terms of the statute."[73]

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[68] *Ibid.*, at 188: "While a consolidation is quite distinct from a sale, yet from the viewpoint of the constituant companies, a sale of assets is in substance involved."
[69] *Ibid.*
[70] *Ibid.*, at 188: "The same presumption of fairness that supports the discretionary judgment of the managing directors must also be accorded to the majority of the stockholders whenever they are called upon to speak for the corporation."
[71] In fact there was no question of gross undervaluation here as the value determined by the Chancellor was substatially identical to that offered by the majority.
[72] 28 Del.Ch. 318, 11 A 2d. 331 (Sup.Ct. 1940).
[73] *Ibid.*, at 337.

This decision seemed to imply that, as the legislature had made an unqualified grant of power to the majority, a court could no longer test the majority decision to merge to see if it was fair. However, as it was accepted in *Havender* that the recapitalization plan was in fact "fair and equitable",[74] the court did not refer to its right, articulated in *Cole*, to examine the terms of a merger where fraud had been alleged. Thus, after the *Havender* case it was uncertain whether the right of a Delaware court to challenge the fairness of a merger had been extinguished by the Delaware Supreme Court's strong words indicating that a power to merge was not to be qualified by restriction or limitation. If this was the case then the fiduciary duty, from which this enquiry flowed, would have no application to mergers.

The first case to consider this apparent contradiction treated *Cole* as good law. In *Porges v. Vasco Sales Corp.*[75] the corporation had unpaid accumulated dividends on preferred stock amounting to $1,839,156. During 1942 the directors and majority shareholder decided on a recapitalization plan under which each of the preferred stock would be converted into one preferred and five common shares of the surviving corporation. The complainant held two preferred shares and challenged the merger as being so unfair and inequitable as to amount to a fraud upon the present preferred shareholders. He based his complaint exclusively on the changes the merger would have on the book value of his investment. This was the basis upon which a merger had previously been attacked in order to prove a gross undervaluation and, therefore, fraud. Pearson V.C., however, refused to consider fairness in such narrow terms:

> "Complainant ignores the important fact that the old common stockholders have voting control, and that by the merger control would pass to the holders of the old preferred stock."[76]

[74] *Havender*, *supra*, note 72 at 343.
[75] 32 A 2d. 148 (Del. Ch. 1943).
[76] *Ibid.*, at 151.

In addition the merger terms included provisions for class rights, pre-emptive rights, and a sinking fund; "changes which may be of substantial value, depending upon future events."[77] Evaluatuon of the fairness of the merger was, the Vice-Chancellor said, a process underwhich the benefits and detriments of the plan are weighed up.[78] He did not attempt to evalute the benefits preferred shareholder would receive but their very inclusion meant that the minority had failed to rebut the presumption that the majority had acted in good faith.

The "gross unfairness" test was thus firmly established in Delaware.[79] To challenge the majority decision to merge a shareholder would have to rebut the presumption of bona fides of purpose by proving that the action taken was so unfair as to amount to constructive fraud.[80]

The above cases are a good illustration of the shift by the courts towards equating the fiduciary duty with "constructive fraud". There is little discussion of purpose except where it was clear that the majority sought to benefit at the minority's expense. When the courts came to deal with a cash-merger statute's "take out" potential, however, they had to address purpose.

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77 *Ibid.*

78 *Ibid.*: "Surely, this is not a situation where the real and only purpose of the merger is to promote the interests of one class of stock to the detriment, or at the expense of another. In such a situation, the favoured class would give up no benefits comparable to those it would receive; and the unfavoured class would obtain no benefits comparable to those it would lose".

79 See also; *Hottenstein (Moore) v. York Ice Manufacturing Co.*, 136 F2d. 944 at 953 (3rd Cir.1943); *MacFarlane v. North American Cement Corp.* 16 Del. Ch. 172, 157 A. 396 (1928); *Mitchell v. Highland-Western Glass Co.* 19 Del. Ch. 326, 167 A. 831 (1933); *Maddock v. Vorclone Corp.* 17 Del Ch. 391, 147 A. 255 (1929).

80 The "gross unfairness" test was criticised by one federal court judge for being too formalised. In *Barrett v. Denver Tramways Corp.* 53 F. Supp. 198 (D.Del. 1944) Leahy J. accepted that he was bound to apply the Delaware courts' view of fairness but felt that a court of equity should evaluate a merger scheme irrespective of issues such as "fraud" or "bad faith". c.f. *Krantman v. Liberty Loan Corp.* 152 F. Supp. 705 (1956) where the terms of the merger were not held to constitute "constructive fraud".

In *Outwater v. Public Service Corp.*[81] the merger agreement provided the minority common stockholders with preferred stock which would be callable after three years. This consideration was, in effect, a promissory note payable at the option of the buyer. Although Backes V.C. had to accept that the merger was in legal form he could find no public merit in it, since it was merely for the "greater financial convenience" of the parent corporation.[82] While conceding that the N.Y. statute permitted the consideration received by shareholders to be "stock or obligations", the learned judge put a limit on the statute by saying:

> "[F]airnes in mergers dictates that, when obligations are given in exchange for stocks of the character here involved, they at least should bear a corresponding permanent investment value... otherwise the merger would be a simple medium for a compulsory sale, and that is not permissible."[83]

The merger was enjoined as being "oppressive" given that its purpose was to force an indirect sale of assets.

Professor Weiss, citing *Outwater*, concludes that courts were hostile to those take-out attempts which involved an unfair exchange of stock, or the issue of a short-term debt obligation or callable stock.[84] He argues that cash merger statutes were enacted to provide corporate managers "with additional flexibility in structuring clearly permissible transactions".[85] In other words, the spirit of the statute assumed that the corporate controllers had a bona fide purpose.

Judicial hostility to take-out attempts was tempered with the passing of cash merger statutes. New York extended its short-form merger statute to all corporation in 1949,[86]

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[81] 103 N.J. Eq. 461, 143 A. 729 (1928).
[82] *Ibid.*, at 730.
[83] *Ibid.*, at 732. Banks V.C. had already observed that "continued membership, until dissolution, is an inherent property right in corporate existence."
[84] E.J. Weiss, "The Law of Take-Out Mergers: A Historical Perspective" (1981) 56 N.Y.U.L.Rev. 624 at 636.
[85] *Ibid.*, at 637.
[86] Act of Apr. 22, 1949, ch. 762 s.1(1), 1949 N.Y. Laws 1707.

and in 1961 authorized cash long-form mergers.[87] In 1957 Delaware adopted a short-form merger statute (modelled on the New York law but applicable to 90% - owned subsidiaries[88]) and added cash as an acceptable form of consideration in long-form mergers in 1967.[89]

The N.Y. courts, as shown above, took a restrictive approach to their statute's wording; the Delaware courts by contrast called in aid the fiduciary duty to prevent "unfair" short- or long-form amalgamations. A number of decisions followed *Federal United Corp. v. Havender*[90] and refused to examine a merger where the statutory requirements were met.[91] The conclusion appeared to be that even "take-out" mergers were within the express wording of a merger statute and were consistent with the goal of increasing the flexibility of corporate controllers to effect a reorganisation.

3.24 Phase IV - The Duty and Proper Purpose

Faced with unhelpful state courts the minority looked to the Federal Securities Acts and in particular s.10-b and Rule 10b-5 for protection.[92] In *Santa Fe Industries Inc. v. Green*[93] the minority argued that a proposed merger, although complying with the relevent provisions of Delaware law, constituted a "device, scheme or artifice to defraud".[94] This argument succeeded in the Second Circuit Court of Appeals where a

87 N.Y. Bus Corp. Law s.902(a)(3).
88 Act of June 5, 1957, ch. 121, s.253(a), 51 Del Laws 186 (1957).
89 General Corporation Law, ch. 50, s.251(b)(4), 56 Del. Laws 206. For similar provisions in New Jersey and Model Business Corporations Act see 14A N.J. Stat. Ann s.s.10-1(2)(c), M.B.C.A. s.s.68A, 71.
90 28 Del.Ch. 318, 11 A 2d. 331 (Sup.Ct. 1940).
91 See *Coyne v. Park & Tilford Distillers Corp.* 38 Del. Ch. 514, 154 A 2d. 893 (1959); *Stauffer v. Standard Brands Inc.* 41 Del. Ch. 7, 187 A 2d. 78 (Del. Ch. 1962); *David J. Green & Co. v. Schenley Industries Inc.* 281 A 2d. 30 (Del Ch. 1971).
92 For how the Rule has been used to evaluate corporate decisions see D.S. Ruder, "Challenging Corporate Action Under Rule 10b-5" (1969) 25 Bus. Lawyer 75.
93 533 F. 2d. 1283 (1976) rev'd and remanded 430 U.S. 462 (1977).
94 Kirby, a 95%-owned subsidiary of Santa Fe, had stock trading at less than $100 per share, but its assets were estimated to be worth at least $600 per share. Santa Fe

divided bench held that Rule 10b-5 included constructive fraud.[95] The Supreme Court reversed. It held that under Rule 10b-5 a plaintiff had to show *actual* deception or manipulation[96] and that, as constructive fraud did not come within the Rule, the plaintiffs' only remedy was appraisal.

The Supreme Court in *Sanfa Fe* recognised that there was a lacuna in state corporations law but refused to use the Federal Securities Acts to federalize a substantial portion of the law of corporations:

> "There may well be a need for uniform fiduciary standards to govern mergers such as that challenged in this complaint... But those standards should not be supplied by judicial extension of s.10b and Rule 10b-5 to "cover the corporate universe"."[97]

A warning shot had been fired and, faced with a potentially disasterous loss of sovereignty, the Delaware courts took the hint. In a line of cases the fiduciary duty concept, ignored in *Stauffer*[98] and *Schenley*,[99] was once again called in aid. In its penultimate transformation the duty tackled the dual notions of "fairness" and "purpose" head on.

In *Singer v. Magnavox*[100] the plaintiff sued on behalf of the minority as a class. He alleged that the merger was fraudulent in that its only purpose was to eliminate the minority shareholders at an inadequate price.[101] This purpose breached the fiduciary

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merged one of its wholly owned subsidiaries into Kirby in a short-form cash merger offering the minority $150 per share.

[95] 533 F. 2d. 1283 at 1291 (2nd Cir. 1976).

[96] 430 U.S. 462 at 474-74 (1977). Actual deceit could not be proved by the minority as the corporation had made full disclosure.

[97] *Ibid.*, at 479-80.

[98] *Stauffer v. Standard Brands, Inc.* 41 Del. Ch. 7, 187 A.2d. 78 (1962).

[99] *David J. Greene & Co. v. Schenley Industries Inc.*, Del. Ch., 281 A.2d. 30 (1971).

[100] 367 A 2d. 1349 (Del. Ch. 1976), aff'd in part rev'd in part 380 A 2d. 969 (Del. 1977).

[101] The complaint arose from North American Philip's Corporation's tender offer for Magnavox Corp.. Philip's had created a wholly owned subsidiary for the purpose of the merger and informed Magnavox's shareholders that if their tender offer did not result in the aquisition of all the outstanding shares they would aquire the

duty owed by a controlling shareholder to the minority. The Court of Chancery, following *Stauffer* and *Schenley*, holding that a merger designed to eliminate minority shareholders was not improper.[102] On appeal, the Delaware Supreme Court reversed.[103] Minority shareholders, it held, are entitled to judicial scuruteny of merger terms to decide if thay are entirely fair. The Court rejected the argument that appraisal was plaintiff's only remedy, thus overrulling *Stauffer* and *Schenley*. While a shareholder could not veto a merger, equally those in control of a corporation could not invoke the statutory power when their sole purpose was to get rid of the minority.[104] Purpose, the court said, was an aspect of the fiduciary duty:

> "In such a situation, if it is alleged that the purpose is improper because of the fiduciary obligations owed to the minority, the court is duty-bound to closely examine that allegation even when all the relevant statutory formalities have been satisfied."[105]

The court then drew an analogy with those cases in which it had invalidated actions by corporate managers or controlling shareholders designed to perpetuate themselves in office,[106] concluding that they stood for two principles of law. First, a court of equity must scrutenize a corporate act when it is alleged that its purpose violates the fiduciary duty; second, those who control the corporate machinery owe a fiduciary duty to the minority in the exercise of corporate powers or use of corporate property, and their use of such a power to perpetuate control is a violation of that duty.[107]

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remaining shares by "any means deamed advisable" including "merger, sale of assets, liquidation".

[102] 367 A 2d. 1349 at 1356 (Del. Ch. 1976)

[103] 380 A 2d. 969 (Del. 1977).

[104] *Ibid.*, at 978.

[105] *Ibid.*, at 979.

[106] Citing *Condec Corp. v. Lunenheiner Company* 43 Del. Ch. 353, 230 A 2d. 769 (1967) (issuance of shares to thwart take-over bid); *Schnell v. Cris-craft Industries Inc.* 285 A.2d. 437 (Del.Sup.1971) (advancement of the date of annual meeting to prevent removal of directors).

[107] *Singer v. Magnavox Corp.* 380 A.2d. 969 at 979-80 (Del.1977)

These statements of the Delaware Supreme Court go further to linking the fiduciary duty to purpose than any previous characterization of the duty. Indeed, the Court said that, whilst a merger whose sole purpose is to freeze-out the minority would violate the fiduciary duty, it is not limited to this situation:

> "On the contrary, the fiduciary obligation of the majority to the minority remains and proof of a purpose other than such freeze-out, without more, will not necessarily discharge it. In such a case the court will scrutinize the circumstances for compliance with the Stirling rule of entire fairness."[108]

Conscious of the difficulties a precise definition of "fairness" would have created, the Court did not attempt to elaborate on the "purpose test" it just created.[109]

A test without definition, however, is of limited utility as the Delaware Supreme Court soon found. Despite nimbly sidestepping the issue in *Singer*, the Court had to confront it in *Tanzer v. International General Industries Inc.*[110] where, on similar facts, a parent corporation (IGI) undertook a cash merger with its 81% owned subsidiary (Kliklok Corp.) for the purpose of facilitating long-term debt financing by IGI. A shareholder in Kliklok challenged the merger on the basis that it was undertaken solely to serve the business interests of the parent corporation thus thus breaching the parent's fiduciary duty as controlling stockholder. The Delaware Supreme Court refused the minority's request for an injunction. Despite reaffirming a minority's right to challenge the "entire fairness" of a take-out merger, the Court refused to dwell exclusively on the rights of the minority:

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[108] *Ibid.*, at 980.

[109] Oblique reference to the definition of "proper purpose" appears in a footnote to the judgment, *Ibid.*, at 980: "Plaintiffs contend that a "business purpose" is proper in a merger only when it serves the interests of a subsidiary corporation; defendants contend, on the other hand, that if any such purpose is relevant, it is only that of the parent corporation since resolution of that question is not necessary to the disposition of this appeal, and since it was not central in the briefing and argument, we leave it to another day". That other day was to come in the *Tanzer* and *Najjar* cases *infra*.

[110] 379 A 2d. 1121 (Del. 1977).

> "While the focus here and in Singer has been on the rights of minority stockholders, we are well aware that a majority stockholder has its rights, too. And among these is exercising a fundamental right of a stockholder in a Delaware corporation; namely the right to vote his shares."[111]

This is a remarkable statement. The same conflict, the same irreconcilable self-interest which drove the courts over a century to move toward an equitable limitation of majority actions, is cast aside. The court in *Tanzer* was faced with the difficult task of defining the *Singer* "purpose test" and its attempt was not reassuring. Under the *Tanzer* definition, the purpose test would be satisfied if the exclusive needs of the parent corporation were served by the merger.

This conclusion is perverse for it entirely ignores the fact that the merger had to be approved by the subsidiary's board who owed their corporation a duty of loyalty.[112] Furthermore, the fiduciary duty, whose content the court was defining, is owed to the minority *of the subsidiary*. How, therefore, could a duty owed to the subsidiary's shareholders be satisfied where any benefits resulting from the majority's action accrue to an entirely unrelated enterprise?

Where did *Tanzer* leave the fiduciary duty? True, a merger whose sole objective was the expulsion of the minority would be enjoined, but what constituted a "valid business

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[111] *Ibid.*, at 1123.

[112] To avoid dealing with this inconsistency the Delaware Supreme Court reasoned that, as the board was appointed by the majority stockholder, their actions were derivative and flowed from the control exercised by the majority stockholder. *Ibid.*, at 1123:

> "[I]t would not be fair to IGI to examine only its director control of Kliklok which is a consequence of its power and not the source thereof."

Although this may be true it does not explain why the court then went on to ignore the directors duties altogether. This reasoning looks strikingly similar to the indirect theoretical approach towards the imposition of a fiduciary duty upon majority shareholders adopted by the court in *Zahn v. Transamerica Corp.* 162 F.2d 36 at 44 (1947). Why this reasoning should be rejected has already been discussed by the author, see *supra*, chapter 2. See also Weiss, *supra*, note 84 at 665.

purpose"? One writer has cynically suggested that this was a standard incapable of definition.[113]

The whole fiduciary duty concept was in disarray after *Tanzer*. A director of a subsidiary corporation need not look to the subsidiary's best interests when exercising his judgment. The rot, it appeared, had transcended the fiduciary concept as it related to controlling shareholders and called into doubt a director's duty of loyalty. Far from dissipating the confusion, the Delaware Supreme Court made the situation worse with its decision in *Roland International Corp. v. Najjar*.[114]

By the time *Najjar* came to court, Delaware had developed a rigid approach to the valuation of a dissenter's shares in an appraisal hearing. This method of valuation, known as the "Delaware Block",[115] prompted some dissient shareholders to maintain an action in equity alleging "unfairness" where in substance their only complaint was that the price offered by the majority was inadequate.[116] *Najjar* was one such case. As Justice Quillen noted in his dissenting judgment, whilst the minority recited the post-*Singer* claim that the "sole purpose of the merger was to eliminate the minority", they did not seek injunctive relief of any kind. They merely wanted to be "cashed out".[117]

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113 Weiss, *ibid.*, at 667. See also, E.J. Weiss, "The Law of Take-Out Mergers; Weinberger v. O.U.P. Inc. Ushers In Phase Six", (1982-83) 4 Cardozo L.R. 245 at 249: "A few years experience with Singer, particularly as it was modified by Tanzer, made clear that a purpose orientated appraoch to regulating take-out mergers was unworkable."

114 407 A. 2d. 1032 (Del. 1979).

115 Under the Delaware Block method of valuation, earnings value, asset value and market value of a corporation are detemined and a proportion of the fair value of the corporation is assigned to each. See e.g. *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del 1980); *Tri-Continental Corp. v. Battye*, 31 Del. Ch. 523, 74 A.2d 71 (Del. 1950).

116 See Weiss, *supra*, note 84 at 672.

117 407 A 2d. 1032 at 1039 (Del. 1979); "In short, the plaintiff comes to Court more than five months after the required notice to the corporation under the statutoryily established appraisal procedures and says he wants more money for his shares and the privilege of subjecting the defendants to a separate class action. He does not allege or even argue to any precision why the appraisal procedure is inadequate in this case."

After *Najjar*, therefore, the Delaware courts found they had to deal with *two* procedures through which fair value could be calculated. The first was the statutory appraisal hearing persuant to s.261 Del. Code; the second, a suit in equity, was a judicial creation.

3.25 Phase V - *Weinberger* - A Backward Step

Faced with a duality of actions the Delaware Supreme Court overreacted. The *Singer* purpose test was blamed for this absurdity and in *Weinberger v. O.U.P.*[118] it was expressly overruled:

> "For the reasons herein set forth we consider that the business purpose requirement of [Singer] is no longer the law of Delaware."[119]

In its place the Court substituted its own dual standard for fairness. Fairness, the court said, has two basic elements - fair dealing and fair price.[120] The former aspect includes questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors and how the approvals of the directors and stockholders were obtained. The latter aspect relates to the economic and financial considerations of the merger, including all relevant factors: assets, market value, earnings, future prospects and any other factors that affect the inherent value of a company's stock.[121]

In *Weinberger* the merger was initiated by Signal Corp., the parent of OUP, because it regarded the purchase of the 49% of OUP that it did not already own as the best use for a cash surplus generated after the sale of a subsidiary. Six of OUP's thirteen directors were appointed by Signal and as a result the transaction was not at arm's length. The Court, therefore, placed emphasis on the OUP's directors responsibility to conduct

118 457 A. 2d. 701 (Del. Sup. 1983).
119 *Ibid.*, at 704.
120 See Nathan & Shapiro, "Legal Standard of Fairness of Merger Terms Under Delaware Law" 2 Del.J.Corp.L. 44 at 46-47 (1977).
121 *Weinberger*, *supra*, note 118 at 713.

genuine negotiations over the purchase price of the minority's shares to ensure a fair valuation.

Several aspects of the negotiations disclosed "unfair dealing": i) a director's report, prepared by the Signal appointees, was not disclosed to the outside directors;[122] ii) although one of OUP's directors was a member of the banking firm retained by Signal to advise on the merger, it was clear that the "fairness opinion" he prepared was little more than a rubber stamp. This memo has been aptly described as the "smoking gun" indicating unfairness.[123]

The court also went on to discard the Delaware Block method of valuation in favour of a more realistic standard based on the "future prospects"[124] of the merged entity. In creating a more liberalized appraisal remedy the court felt a suit in equity would no longer be appropriate where the complainant merely sought recissory damages for an unfair price. Unfortunately the court's statements can be interpreted to deny *any* form of equitable relief in a cash-out merger:

> "[After February 23, 1983] the provisions of 8 Del. C. s.262, as herein construed, respecting the scope of an appraisal and the means for perfecting the same, shall govern the financial remedy available to minority shareholders in a cash-out merger. Thus we return to the well established principles of Stauffer v. Standard Brands, Inc. and David J. Green v. Schenley Industries Inc., mandating a stockholder's recourse to the basic remedy of an appraisal."(Citations omitted.)[125]

This is not, however, the author's interpretation of *Weinberger*. The case was a welcome attempt to fuse the dual valuation techniques which Delaware had created for take-out

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[122] This nondisclosure was also held to have breached the directors' duty of loyalty: "Certainly, this was a matter of material significance to OUP and its shareholders. Since the study was prepared by two OUP directors, using OUP information for the exclusive benefit of Signal, and nothing whatever was done to disclose it to the outside OUP directors or the minority shareholders, a question of breach of fiduciary duty arises." *Ibid.*, at 709.
See also *Lynch v. Vickers Energy Corp.* 383 A.2d 278, 281 (Del Sup. 1971).
[123] Weiss, *supra*, note 113 at 255.
[124] *Weinberger*, *supra*, note 118 at 713.
[125] *Ibid.*, at 715.

mergers. A liberal appraisal remedy made a suit in equity redundant. The case did not remove the fiduciary duty from a majority's decision to merge, it merely further redefined it; the *Singer* purpose test was removed and "fair dealing" substituted. It is submitted that this test provides no guidance as to fairness. It is concerned merely with a minority's right to full information and adequate notice.[126] If this is the correct interpretation of "fair dealing" then the standard is preoccupied with the wrong issues - substantive considerations *inevitably* include an examination of the majority's motivations.

If, on the other hand, fair dealing includes an examination of the majority's purpose in exercising their power then the test differs from *Singer* only in semantics. The link is the Court's use of the term "fraud" i.e. full disclosure of a dishonest plan will not prevent a court of equity evaluating the merger and enjoining it if necessary. The court was at pains to reaffirm this in *Weinberger*:

> "While primary monetary remedy ordinarily should be confined to the more liberalized appraisal proceeding herein established, we do not intend any limitaiton on the historic powers of the Chancellor to grant such other relief as the facts of a particular situation may dictate. The appraisal remedy we approve may not be adequate in certain cases, *particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets or gross and palpable overreaching are involved*"[127](Emphasis added.)

The examples quoted by the court are exactly those situations in which the fiduciary duty has traditionally been imposed. In *Singer* the court defined fraud to include a merger solely for the purpose of expelling the minority. *Weinberger*, as interpreted by the author, can be no substitute for *Singer*. The court's conclusion that appraisal is inadequate where fraud has been alleged reopens old wounds because fraud can embrace

[126] A merger whose only purpose was to squeeze-out the minority yet which was adequately disclosed and fairly negotiated, would not seem to breach the *Weinberger* test.

[127] *Ibid.*, at 714.

a transaction purely designed to eliminate the minority. Fraud, in other words, can have purpose as a component.

If *Weinberger* stands for the proposition that an adequately disclosed merger at a transparently fair price whose sole purpose is to exclude the minority is consistent with the majority's fiduciary duty, then it is wrong. The fiduciary duty forms the basis of an equitable limitation on the majority's power to merge their corporation. Surely the duty can never be satisfied where what is proposed is the expulsion of those to whom the duty is owed?

3.3 The Content of the Fiduciary Duty Defined

This lengthy and somewhat dispiriting survey of the jurisprudence in which a fiduciary duty has been applied to majority stockholders discloses much confusion and contradictory reasoning. Whilst some judges speak in terms of "good faith",[128] others equate the duty with "fairness"[129] or "fraud".[130]

The author would argue that the fiduciary duty cases can be reconciled. The nomenclature quoted above was merely a smoke screen behind which the judges masked their true disapproval of the motivation or *purpose* of the majority in exercising a

[128] E.g., *Lebold v. Inland Steel Co.* 125 F.2d. 369 (7th Cir. 1941); *J.H. Lane v. Maple Cotton Mills* 226 F. 692 (4th Cir. 1915); *Porges v. Vasco Sales Corporation* 27 Del.Ch. 127, 32 A.2d. 148 (1943); *Cole v. National Cash Credit Association* 18 Del.Ch. 47, 156 A. 183 (1931); *Gamble v. Queen's County Water Co.*, 123 N.Y. 91, 25 N.E. 201 (1890); *Wheeler v. Abilene Nat. Bank Bldg. Co.* 159 Fed. 391 (8th Cir. 1908).

[129] E.g., *Bennett v. Breuil Petroleum Corp.* 99 A.2d. 236 (Del.Ch. 1953); *Washington National Trust Co. v. W. M. Dary Co.*, 116 Ariz. 171, 568 P.2d. 1069 (1977); *Krantman v. Liberty Loan Corp.*, 152 F.Supp. 705 (N.D.Ill. 1956).

[130] E.g., *Allied Chemical & Dye Corp. v. Steel & Tube Co.*, 120 A. 486 (1923); *Hottenstein v. York Ice Machinery Corp.*, 136 F.2d. 944 (1943); *Krantman v. Liberty Loan Corp.* 152 F.Supp. 705 (N.D.Ill. 1956); *Barrett v. Denver Tramway Corp. supra*; *Porges v. Vasco Sales Corporation, supra*.

delegated power. A few cases expressly discuss purpose[131] but generally majority intent is linked to good faith or the absence of fraud.

The court in *Ervin* refused to permit the power to dissolve a corporation to be used for an indirect object,[132] yet this was permitted in *Maple Cotton Mills.*[133] The distinction lies in the fact that, in the latter case, the corporation was in financial difficulties and the arrangement proposed by the majority was the only method of saving it from liquidation. In other words the majority's purpose was proper. In the former case, by contrast, the indirect merger was executed just to permit the majority to obtain the old corporation's assets at an undervaluation. Here the purpose was improper.

It was in *Singer v. Magnavox* that the courts courageously tackled the essence of the duty by articulating a "purpose test". It is the author's view that this case provided the basis from which the content of the duty could have been elucidated. That the courts backed away is lamentable, that they did so behind a "fair dealing" requirement is potentially disastrous for, no matter what epithet the judges may attach to their reasoning, they cannot avoid evaluating the purposes for which the majority have exercised a delegated power.

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[131] E.g., *Ervin v. Oregon Rly & Nav. Co.*, 27 F. 625 (S.D.N.Y. 1886); *Kavenaugh v. Kavenaugh Knitting Co.* 123 N.E. 148, 226 N.Y. 185 (1919); *Farmer's Loan & Trust Co. v. N.Y. & Norhtern Rly Co.*, 44 N.E. 1043, 150 N.Y. 410 (1896); *Gaines v. Long Mfg. Co.*, 234 N.C. 331, 67 S.E. 2d. 355 (1951); *Benett v. Breuil Petroleum Co.* 99 A.2d. 236 (Del.Ch. 1953).

[132] *Ervin v. Oregon Rly. & Nav. Co.,ibid* at 629: "They (the majority) never contemplated winding up the business of the old company.... What they intended to do, and what they practically did, was to effect a consolidation of the old company."

[133] In *J. H Lane & Co. v. Maple Cotton Mills*, 226 F 629 at 696 (4th Cir. 1915), Woods, C.J. said: "The fact that the state has not provided for consolidation without a dissolution and sale of the property by no means implies that there is any policy of the state against dissolution and sale resulting in consolidation."

3.4 Extending The Duty to All Shareholders in Closely-Held Corporation

In Massachusetts the fiduciary duty concept has been recently extended to include all shareholders in a closely held corporation. In *Donahue v. Rodd Electrotype Co. of New England*[134] the plaintiff, Mrs. Donahue, argued that a purchase of the ex-Presidents shares by the company amounted to a diversion of corporate assets for the majority's own benefit in breach of their fiduciary duty.

The Supreme Court of Massachusetts undertook a detailed examination of the nature of the relationship among shareholders in a closely-held corporation. Many closely-held corporations, the Court concluded, are "really partnerships".[135] Accordingly it imposed a quasi-partnership duty on a close corporation's shareholders:

> "Just as in a partnership, the relationship among the stockholders must be one of trust, confidence and absolute loyalty if the enterprise is to succeed."[136]

This duty is of a more stringent standard than that recognized for directors or majority shareholders in corporations generally,[137] it is "the more rigorous duty of partners and participants in a joint adventure".[138]

Applying this new duty to the facts of *Donahue*, the court accepted that the company had the power to buy its own shares, but held that those in control when exercising this power, must act with the "utmost good faith and loyalty".[139] In the context of a share

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[134] 328 N.E. 2d. 505 (Mass. 1975).
[135] *Ibid.*, at 512, citing *Kruger v. Gerth* 16 N.Y. 2d. 802, 805, 210 N.E. 2d. 355 (1965).
[136] *Ibid.*, at 512.
[137] *Ibid.*, at 516: "We contrast this strict good faith standard with the somewhat less stringent standard of fiduciary duty to which directors and stockholders of all corporations must adhere in the discharge of their corporate responsibilities."
[138] Chief Justice Cardozo's often cited words in *Meinhard v. Salmon* 249 N.Y. 458, 164 N.E. 545 at 546 (1928) were approved by the court: "Not honesty alone but the punctilio of an honor the most sensitive, is then the standard of behavior."
[139] *Ibid.*, at 518.

purchase, the quasi-partnership fiduciary duty would be satisfied if *all* shareholders are given an "equal opportunity" to have their shares purchased on the same terms.[140]

Donahue has since been followed in Massachusetts[141] but in the author's view the case is merely a recognition of a stringent duty which has existed in the close company context for nearly a century.[142] As the court observed in *Donahue*, whilst the corporate form may provide many benefits for quasi-partnerships, it also provides an environment in which the minority stockholder may be uniquely oppressed or disadvantaged.[143] This disadvantage is compounded by the judiciary's reluctance to challenge a decision of those in control. The minority shareholder is, therefore, left with two options: he can either suffer the losses or seek a buyer for his shares. However, as there is no ready market for his shares he is trapped in a disadvantageous situation.

Oppression may take the form, *inter alia*, of the withholding of dividends or dissmissal from office. In both cases the courts have recognized a breach of fiduciary duty.[144] *Donohue* is to be welcomed to the extent that it acknowledges an existing state of affairs. The case, however, adds yet more confusion to the nature and extent of the fiduciary duty. Continuing uncertainty over the duty's application is, after all, the last refuge of a majority shareholder with a machiavellian intent.

[140] *Ibid*: "To meet this test, if the stockholder whose shares were purchased was a member of the controlling group, the controlling stockholders must cause the corporation to offer each stockholder an equal opportunity to sell a ratable number of his shares to the corporation at an identical price."

[141] *Wilkes v. Springside Nursing Home Inc.* 370 Mass. 842, 353 N.E. 2d. 657 (1976).

[142] See, *Hampton v. Buchanan* 51 Wash. 155, 98 Pac. 374 (1908); *Bennet v. Breuil Petroleum Corp.* 99 A 2d. 236 (Del Ch. 1953); *Faunce v. Boost Co.* 15 N.J. Super. 534, 83 A 2d. 649 (1951); *Kavenaugh v. Kavenaugh Knitting Co.* 226 N.Y. 185, 123 N.E. 148 (1919); *Anderson v. W.J. Dyer & Bro.* 94 Minn 30, 101 N.W. 1061 (1904).

[143] *Donahue*, *supra*, note 134 at 513.

[144] *Anderson v. W.J. Dyer & Bro.* 94 Minn. 30, 101 N.W. 1061 (1904) (declaration of dividends); *Hampton v. Buchanan*, *supra*, note 142 (dissmissal from office). For declaration of dividend cases see, Note, "Minority Shareholder's power to Compel Declaration of Dividends in Close Corporations - A New Approach" (1955-56) 10 Rutgers L. Rev. 723.

3.5 A Transatlantic Rediscovery of the Duty

Before leaving the fiduciary duty our examination must turn away from the U.S. to Britain where the concept has been undergoing something of a renaissance.

3.51 The Origins of the Duty in England

The English judges originally imposed a fiduciary duty upon the majority through an analogy with the obligations a partner owes to his collegues. The judges knew that a partnership could not expel a partner, even where provision was made in the partnership deed, unless the partners acted in good faith and for a proper purpose.[145] In *Allen v. Gold Reefs of West Africa*[146] Lindley M.R. imposed a similar duty on shareholders when altering the articles of association.[147]

This principle, to act bona fide and for the benefit of the company as a whole, forms the basis of the protection afforded to minorities under English law from capricious acts of the majority. As originally stated by the Master of the Rolls it is unqualified and optimistically wide ranging, indeed it seems to cast a general fiduciary duty on majority shareholders similar to that found in the U.S.. It was not long, however, before the *ratio* of *Allen* was interpreted, and limited, in the common law tradition.

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[145] *Blisset v. Daniel* (1853) 10 Hare. 493; *Wood v. Wood* (1874) 9 L.R. Ex. 190. See *Lindley on Partnership, loc cit*, 15th ed. (London: Sweet & Maxwell) at 215.
[146] [1900] 1 Ch. 656.
[147] *Ibid.*, at p. 671: "Wide, however, as the language of [the Act] is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed."

The judiciary struggled to define "bona fide in the interests of the company as a whole". In *Brown v.British Abrasive Wheel Co.*[148] the company had two groups of shareholders. The group which held 98% of the shares was willing to inject further capital into the venture provided the other group of shareholders also did so. On their refusal, the majority purported to pass a special resolution excluding them from the company. Astbury J. observed that the majority's actions were only incidentally concerned with the raising of further capital; altering the articles of association in the manner proposed in no way guaranteed that capital would in fact be provided:

> "It is merely for the benefit of the majority. If passed the majority may aquire all the shares and provide further capital."[149]

To accept the amendment was to equate the interests of the company as a whole with those of the majority. This the court would not do.

Could it ever be in the interests of the company to squeeze-out the minority? The case of *Sidebottom v. Kershaw Leese & Co.*[150] can be contrasted with *Dafen Tinplate Co. v. Llanelly Steel Co.*[151]. In the former case the articles were altered to compel a shareholder who competed with the company's business to sell his shares. This was permitted. It is desirable, the Court said, for a company to rid itself of a competitor who might obtain some opportunity detrimental to the company through his continued membership. In the latter case, however, the proposed amendment was in much wider terms. Here the majority would have been able to compel *any* shareholder to transfer his shares to them. As in *Brown* this proposal equated the majority interest with that of the company:

148 [1919] 1 Ch. 290.
149 *Ibid.*, at 296.
150 [1920] 1 Ch. 154.
151 [1920] 2 Ch. 124.

"In my view it cannot be said that a power on the part of the majority to expropriate any shareholder they may think proper at their will and pleasure is for the benefit of the co. as a whole."[152]

The words of Lindley M.R. received their greatest qualification in *Greenhalgh v. Arderne Cinemas Ltd*.[153] where the then Master of the Rolls, Sir Francis Evershed, stated that "bona fide in the interests of the company as a whole" meant not two things but one:

"It means that the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase, "the company as a whole", does not (at any rate in such a case as the present) mean the company as a commercial entity , distinct from the corporators: it means the corporators as a general body."[154]

Unfortunately Evershed M.R. then set out *two* tests for discerning the interests of the company. Firstly the case may be taken of the hypothetical member and it may be asked whether what is proposed is for that person's benefit. Alternatively, and more accurately, the proposition may be put into the negative: an amendment would not be permitted where the "effect of it were to discriminate between the majority shareholders and the minority shareholders, so as to give to the former an advantage of which the latter was deprived."[155]

Despite articulating a dual test, the learned Master of the Rolls then went on to apply only his discrimination standard. In doing so he emphasised that a shareholder cannot expect to see his position in the enterprise remain inviolable.[156]

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[152] *Ibid.*, at 141.
[153] [1951] Ch. 286.
[154] *Ibid.*, at p.291.
[155] *Ibid.*
[156] *Ibid.*, at 292: "I think the answer is that when a man comes into a company he is not entitled to assume that the articles will remain in a particular form; and that, so long as the proposed alteration does not unfairly discriminate in the way which I have indicated, it is not an objection, provided that the resolution is passed bona fide, that the right to tender for the majority holding shares would be lost by lifting the restriction."

There the fiduciary duty remained for many years, the confused test of Evershed M.R. ensuring that it would receive little judicial attention. In 1976, however, the duty was once again called in aid by an "oppressed" minority.

3.52 The Recent Revival

In *Clemens v. Clemens Bros. Ltd.*[157] the plaintiff sought to set aside a general meeting resolution increasing the share capital of the company. The plaintiff held 45% of the shares in the company and her aunt held the remaining 55%. The aunt, however, was also a director. The new shares would be issued both to the directors, other than the aunt, and to a new trust for employees, controlled by the directors. Whilst the board stated that the purpose of the issue was to give those who worked for the company a stake in its future,[158] it did not escape Foster J.'s notice that the effect would be to reduce the plaintiff's holding below 25% thus denying her "negative control".[159]

The judge acknowlegded that directors have a fiduciary duty, but was there, he asked, a similar restraint on shareholders?[160] Foster J., after citing *Allen v. Gold Reefs of West Africa* and *Greenhalgh*, purported to apply Evershed M.R.'s "hypothetical member" test.[161] He tried to reconcile this approach with those cases decided under s.210 Companies Act 1948[162] in which "oppression" was pleaded, concluding:

[157] [1976] 2 All E.R. 268.
[158] *Ibid.*, at 273.
[159] *Ibid.*, at 279. Under English company law the articles of association may be altered by a "special majority" consisting of three-quarters of those members present and voting at a shareholder's meeting. s.9 of the Companies Act (U.K.) 1985.
[160] *Ibid.*, at 280.
[161] In doing so he equated the "hypothetical member" with the *actual* minority and thus equated the plaintiffs interests with those of the company as a whole under Evershed M.R.'s test. As Gower has pointed out, "whatever "the interests of the company as a whole" may mean it can scarcely mean that" (Gower, *supra*, ch. 1 note 2 at 628). This is no criticism of Foster J., but merely serves to illustrate that the "hypothetical member" test is useless.
[162] This section permitted a shareholder to petition the court for a remedy provided he could show both that the affairs of the company were being conducted in a

"I think one thing which emerges from the cases to which I have referred is that in such a case as the present [the aunt] is not entitled to exercise her majority vote in whatever way she pleases. The difficulty is in finding a principle, and obviously expressions such as "bona fide for the benefit of the company as a whole", "fraud on a minority" and "oppressive" do not assist in formulating a principle."[163]

One cannot but sympathize with the learned Judge. He was faced with an obvious misuse of majority power and sought to provide the minority with a remedy.[164] In doing so he extended the fiduciary duty concept as hitherto understood under English law whilst refusing at the same time to define the content of the duty he had just imposed.[165]

The author would agree with Professor Gower that *Clemens v. Clemens Bros. Ltd.* lends support to the view that the fiduciary duty imposed upon majority shareholders is to "exercise their powers for a proper corporate purpose."[166] This conclusion follows from Foster J.'s belief that the stated purpose of the board was not their true motivation for the share issue:

"I for my part am driven to the conclusion that the figure of 850 [shares] was arrived at in order that the plaintiff's percentage of votes should be below 25 per cent. This is clearly shown, since there is no reason why the shares given to the employees' trust should have a vote and, if they were non-voting shares, the relative voting percentages would be the plaintiff 32.14 per cent, Miss Clemens 39.28 per cent and the four directors 28.56 per cent."[167]

Although the judgment in *Clemens* is a commendable response to an obvious deficiency in English company law, it is far from clear why the case was heard at all. In England

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manner "oppressive" to him and that it was "just and equitable" that the company be wound-up. See chapter 4, *infra.*

[163] *Ibid.*, at 282.

[164] "Oppressive" share issues have been litigated in the U.S. where the fiduciary duty was imposed. See, *Gaines v. Long Mfg. Co.* 234 N.C. 331, 67 S.E. 2d. 355 (1951); *Bennett v. Breuil Petroleum Corp.* 99 A. 2d. 236 (Del. Ch. 1953).

[165] *Clemens, supra,* note 157 at 282: "I have come to the conclusion that it would be unwise to try to produce a principle, since the circumstances of each case are infinitely varied."

[166] Gower, *supra*, ch 1 note 2 at 629.

[167] *Clemens, supra,* note 157 at 279.

there is no statutory right of action for a shareholder, he must first overcome the rule in *Foss v. Harbottle*[168] which is an effective bar to shareholder litigation. In *Clemens* the wrong committed (loss of "negative control") affected the plaintiff personally and was not a wrong done to the company. In order to avoid *Foss v. Harbottle* the plaintiff would have had to show that a "personal right" had been infringed. As there has never been a case in which negative control has been recognized as a personal right, the defendants should have challenged the niece's right to bring the action.[169]

These issues were directly addressed in the case of *Estmanco (Kilner House) Ltd. v. Greater London Council*[170] where Sir Robert Megarry V.C. had to consider whether a shareholder could ever comit a "fraud on a minority" by exercising his vote at a general meeting. Thereby entitling a minority to challenge the act under this exception to *Foss v. Harbottle.*

In *Estmanco* the Greater London Council owned a block of flats which were to be sold off under long leases, each tenant receiving one share in the management company created to run the property. Initially only those shares owned by the council could carry a vote, however once all the flats had been sold all the shares would carry full voting rights. After twelve flats had been sold there were council elections and the new council adopted a different housing policy. Their plan was to use the block to accomodate low income families, but in doing so they breached a covenant between the council and the company that the council would use its best endeavours to dispose of the dwellings by long lease. The company commenced proceedings to enforce the covenant but, at an extraordinary general meeting called for the purpose, the council used its votes to

168 (1843) 2 Hare 461, 67 E.R. 189, 9 digest (Reissue) 689, 4094.

169 See Gower, *supra*, ch.1 note 2 at 654 where he states that personal rights consist of class rights, the right to vote *simpliciter*, or a right conferred in the articles of association. Plaintiff's claim in *Clemens* concerned none of these. See *Pender v. Lushington* (1877) 6 Ch.D. 70; *Edwards v. Halliwell* [1950] 2 All E.R. 1064; *Punt v. Symonds & Co.* [1903] Ch. 506; *Hogg v. Cramphorn Ltd.* [1967] Ch. 254.

170 [1982] 1 All E.R. 437.

instruct the company to discontinue the action. The plaintiff, the owner of one of the flats, sought leave to intervene and prosecute the action. To do so ,however, she would have to fall within one of the exceptions from *Foss v. Harbottle*.[171]

Megarry V.C. began by rejecting that an exception to *Foss v. Harbottle* existed "wherever the interests of justice required";[172] it was, he said, "not a practical test".[173] Thus, to succeed the plaintiff would have to show, in effect, that a "fraud on the minority" had been committed by the majority exercising their votes at a general meeting.

Counsel for the council did not follow *North-West Transportation v. Beattie*[174] and argue that a shareholder owed no fiduciary duty to his fellow shareholders. Instead he claimed that such duty as did exist was the same as that owed by a majority when exercising its power to alter the articles i.e. he had a duty to act "bona fide in the interests of the company as a whole".[175] Counsel adopted Evershed M.R.'s subjective test in *Greenhalgh* and concluded that the duty was satisfied if the majority genuinely believed that what they did was in the company's interest provided that this was a belief which a reasonable shareholder could come to.[176] The duty to the minority was not breached because the majority did believe they were acting in the best interests of the company. As there could be no "fraud", the exception to *Foss v. Harbottle* had not been made out and the plaintiffs motion should be struck out.

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171 Counsel for the plaintiff also sought an order under s.75 C.A. (U.K.) 1980 (the "oppression remedy") but, as this had to be made in the Company's Court and not the Chancery Division, only the existing proceedings were continued.

172 c.f. *Edwards v. Halliwell, supra*, note 167.

173 This was the Court of Appeal's view in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No.2)* [1980] 2 All E.R. 841. See also *Clemens v. Clemens Bros. Ltd., supra*, note 157.

174 (1887) 12 App. Cas. 589, 36 W.R. 647, 3 T.L.R. 789.

175 From *Allen v. Gold Reefs of West Africa* [1900] 1 Ch. 656.

176 *Estmanco, supra*, note 170 at 444.

Megarry V.C. refused to accept that there could be no "fraud" where the majority thought they were acting in the company's interests.[177] Crucially, however, the Vice-Chancellor saw that he was dealing with *an abuse of power*:

> "Apart from the benefit to themselves at the company's expense, the essence of the matter seems to be an abuse or misuse of power. Fraud in the phrase "fraud on a minority" seems to be used as comprising not only fraud at common law but also fraud in the wider equitable sense of that term, as in the equitable concept of fraud on a power."[178]

A conclusion which the mighty common law had arrived at when Queen Victoria was still on the throne, yet had persistently refused to recognize. This is, after all, exactly the result envisaged by Lindley M.R. in *Allen v. Gold Reefs of West Africa.* Is Sir Robert Megarry not in fact saying that "the power must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities"?[179]

Magarry V.C. was driven to this conclusion just as his U.S. brethren had been a century earlier. The reason why English courts had not pronounced on the issue was that *Foss v. Harbottle* had prevented them from hearing a shareholder suit. It was only once the "fraud on a minority" exception was given a wide definition that a case such as *Estmanco* could be heard at all.

The above case, moreover, acknowledges that "control" is vested in *two* organs of the corporation. It is, therefore, absurd to deny the shareholder a remedy just because the

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[177] *Ibid.*: "Plainly there must be some limit to the power of the majority to pass resolutions which they believe to be in the interests of the company and yet remain immune from interference by the courts. ..... If a case falls within one of the exceptions from *Foss v. Harbottle*, I cannot see why the right of the minority to sue should be taken away from them merely because the majority of the company reasonably believe it to be in the best interests of the company that this should be done."

[178] *Ibid.*, at 445.

[179] Per Lindley M.R. in *Allen v. Gold Reefs of West Africa, supra*, note 173 at 671. The juxtaposition is truely revealing.

majority "care to reach their decisions not by voting as directors but by voting as shareholders".[180]

Despite rejecting counsel's characterisation of the fiduciary duty as an extension of the definition in the *Allen* case relating to an alteration of articles of association, the learned Judge could find no satisfactory definition of fraud:

> "All I need say is that in my judgment the exception usually known as "fraud on a minority" is wide enough to cover the present case, and if it is not, it should be made wide enough."[181]

The *Estmanco* case goes further even than did *Clemens v. Clemens Bros. Ltd* in recognising a fiduciary duty upon shareholders. An Englishman, like his American counterparts, may not vote his shares as he pleases.[182]

Faced with the problem of having to elucidate a new principle, Megarry V.C., like Foster J. before him, refused to define the content of the duty imposed. The author, however, would suggest one characterisation of the fiduciary duty: *A shareholder when exercising a management function must act for a proper corporate purpose.*

This definition is consistent with the author's assessment of the American jurisprudence. It is also Gower's characterisation of the English fiduciary duty.[183] *Estmanco*, it is submitted, as did *Clemens* before it, fits within this principle. Megarry V-C observed that the true motivation of the council was to use their votes to promote the new

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[180] *Estmanco, supra,* note 170 at 445. C.f. *Daniels v. Daniels* [1978] 2 All E.R. 89, [1978] Ch. 406, where the court was concerned with directors' actions.

[181] *Estmanco*, *ibid.*, at 447.

[182] This is also Peter Xuereb's conclusion, see Xuereb, "The Limitation on the Exercise of Majority Power" (1985) 6 Co. Lawyer 198 at 208: "[I]n the light of the general applicability to all powers of the limitation on the exercise of general meeting power as stated in *Allen v. Gold Reefs of West Africa Ltd.*, the correctness of the restriction of the principle's application to the exercise of the power to alter the articles appears doubtful." For a detailed analysis of the fetters upon the freedom of a shareholder to vote in the U.S. see Earl Sneed "The Shareholder May Vote As He Pleases: Theory and Fact" (1960) 22 U. Pitt. L.R. 23.

[183] Gower, *supra*, ch.1 note 2 at 629 where he states that *Clemens* is consistent with this definition.

council's housing policy. This self-interested purpose conflicted with the purposes for which the company was formed, and therefore the actions of the council could never be in the company's best interests:

> "The company was formed for a particular purpose, namely, to manage the block of flats under the control of the purchasers of the flats; and the covenant by the council with the company was part of the mechanism for securing this result. On the face of it I do not think that it can readily be said to be for the benfit of a company to stultify a substantial part of the purpose for which it was formed."[184]

This salutary recognition of a fiduciary duty on shareholders will, it seems, be stifled at birth. After 1980 a shareholder in England need no longer concern himself with proving "fraud", he can avoid *Foss v. Harbottle* by using the statutory remedy for "oppressive" actions of the company.[185] It is to this statutory limitation on the actions of majority shareholders that we must now turn.

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[184] *Estmanco, supra*, note 170 at 445.

[185] Megarry felt that, despite the existence of a statutory remedy for minority shareholders, the exceptions to *Foss v. Harbottle* would be further defined. He said *Ibid.*, at 444: "no doubt one day the courts will distil from the exceptions some guiding principle that is wide enough to comprehend them all and yet, narrow enough to be practical and workable."

CHAPTER IV

A STATUTORY SOLUTION FOR UNFAIRNESS

4.1 Judicial Desertion of the Minority

In England it was the legislature, and not the courts, which was to come to the aid of an "oppressed" minority. The judiciary having effectively refused to hear shareholder actions by creating the now infamous rule in *Foss v. Harbottle*.[1]

The Rule, which may be simply stated, is majority rule taken to its extreme - if a wrong is done to a company, then it is for the company alone to decide whether or not to sue and that decision is to be taken by the majority.[2] Even if the Rule does have any

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[1] *Foss v. Harbottle* (1843) 2 Hare 461. For a detailed description of the Rule see K.W. Wedderburn, "Shareholder's Rights and the Rule in *Foss v. Harbottle*" [1957] C.L.J. 194; [1958] C.L.J. 93.

[2] A classic statement of the rule can be found in *Edwards v. Halliwell* [1950] 2 All E.R. 1064 at 1066 per Jenkins L.J.:

> "First the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company and association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter, for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done then *cadit quaestio*."

Thus the Rule, although referred to in the singular, in fact embodies two aspects. Firstly, the proper plaintiff where a wrong done to the company is the company itself. Secondly, where the actions of the directors or those in control could have been ratified by an ordinary resolution then "there can be no use having litigation about it, the ultimate end of which is only that a meeting has to be called and then ultimately the majority gets its wishes." See *MacDougall v. Gardiner* (1875) 1 Ch. D. 13 at 25, per Mellish L.J. See also *Mosley v. Alston* (1847) 1 Ph. 790, 16 L.J. Ch. 217, 4 Ry & Can. Cas. 636.

advantages,[3] its practical result is to prevent action against the directors or other controllers as long as they retain voting control.[4]

Were the rule in *Foss v. Harbottle* to be exclusive a shareholder would be denied any remedy through the courts.[5] It is not surprising, therefore, that a series of "exceptions" evolved.[6] A shareholder can bring an action where what is proposed is *ultra vires*,[7] requires a special rather than ordinary resolution,[8] infringes personal rights of the plaintiff,[9] or constitutes a "fraud on a minority".[10] It was formerly argued that a fifth exception existed where the "interests of justice" required the rule to be disregarded,[11] but this has been emphatically rejected by the English Court of Appeal as "impractical".[12]

All the above exceptions can be summarised by saying that an individual shareholder can always sue, notwithstanding the rule in *Foss v. Harbottle*, when what he complains of

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[3] Viewing the Rule in the most charitable light it could be argued that it: i) prevents a multiplicity of actions; ii) eliminates wasteful or futile litigation where the only outcome is that the majority pass a resolution approving the "wrongdoing"; iii) prevents cantankerous shareholders intimidating the company in order to be bought off (the "strike suit" in the U.S.). This latter aspect seemed to preoccupy the Jenkins committee see Evidence, *infra*, note 110 at paras. 4909-4918 (questioning the U.S. witnesses about "strike suits").

[4] See A.B. Afterman, "Statutory Protection For Oppressed Minority Shareholders: A Model For Reform" (1969) 55 Va. L. R. 1043 at 1047.

[5] This was not the intention of the court in *Foss v. Harbottle*. The Rule could be departed from but not without very good reason, see (1843) 2 Hare 461 at 490-491.

[6] See generally Gower, *supra*, ch.1 note 2 at 644-5 and Farrar, *Company Law* (London: Butterworths, 1985) at 362-367.

[7] E.g., *Simpson v. Westminister Palace Hotel Co.* (1860) 8 H.L.C. 712; *Hutton v. West Cork Railway* (1883) 23 Ch. D. 654.

[8] E.g. *Edwards v. Halliwell* [1950] 2 All E.R. 1064.

[9] E.g., *Pender v. Lushington* (1877) 6 Ch.D. 70; *Wood v. Odessa Waterworks Co.* (1889) 42 Ch.D. 636; *Salmon v. Quin & Axtens* [1909] 1 Ch. 311

[10] E.g. *Menier v. Hooper's Telegraph Works* (1874) 9 Ch. App. 350; *Cook v. Deeks* [1916] 1 A.C. 554 (P.C.); *Daniels v. Daniels* [1978] Ch. 406.

[11] See *Russell v. Wakefield Waterworks Co.* (1875) LR 20 Eq. 474. Also per Vinelott J., in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No.2)* [1980] 2 All E.R. 841 at 877.

[12] See, *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No.2)* [1982] Ch. 204 at 221, 1 All E.R. 354 at 366. Also dicta to the same effect by Megarry V.C. in *Estmanco (Kilner House) Ltd. v. G.L.C.* [1982] 1 All E.R. 437 at 444, [1982] W.L.R. 2 at 11.

could not be validly effected or ratified by an ordinary resolution.[13] It may be readily appreciated, however, that these are not true "exceptions" to the Rule, but merely instances where the rule simply does not apply.[14]

It is the "fraud on a minority" exception which bedevilled the courts. The term was given such a restrictive meaning that it effectively prevented a shareholder bringing an action except where those in control were attempting to expropriate company property[15] and it is only recently that the courts have recognised the need to extend the ambit of the term.[16] It was left to Parliament, therefore, to enable the minority to challenge an abuse of power by the majority.

4.2 The "Oppression" Remedy

The Cohen Committee recommended that protection of minority shareholders be accomplished through a remedy based on the "just and equitable" ground for winding-up a company.[17] The right of an individual shareholder to petition the court on this ground has a long history[18] and derives from the traditional right of a partner to seek the

[13] This is Gowers formulation. See Gower,*supra*, ch.1 note 2 at 645.

[14] A shareholder enforcing a personal right, for example, is not suing to correct a wrong done to the company but merely enforcing the terms of his contract with the company under s.14 C.A. (U.K.) 1985. See Farrar, *supra*, note 6 at 362.

[15] See Gower, *supra*, ch.1 note 2 at 616-623 where the author details three heads of "fraud": i) expropriation of the Company's property ii) release of the directors from their duties of good faith; and iii) expropriation of other members' property. Similarly, Farrar, *supra*, note 6 at 364-5. Both authors accept that the term is difficult to define and is wider than mere deceit but Gower argues, *ibid.*, that ""fraud" connotes an abuse of power analogous to its meaning in a court of equity to describe a misuse of a fiduciary position".

[16] See discussion of *Estmanco, supra*, note 12, and of *Clemens v. Clemens Bros. Ltd*. [1976] 2 All E.R. 268, in previous chapter.

[17] U.K., *Report Of The Committee On Company Law Amendment Cmnd.*6659 (London: H.M.S.O. 1948) (Cohen Committee) at 95.

[18] The provision first appeared in the Joint Stock Companies Winding Up Act, 1848 (U.K.), 11 & 12 Vict. c.45, s.5:

> "V. And be it enacted, That it shall be lawful for any Person who shall be or claim to be a Contributory or a Company to present a Petition to the Lord Chancellor or to the Master of the Rolls in A summary Way for the Dissolution and Winding-Up or for the Winding-Up of the Affairs of such Company, in any of the following Cases: (that is to say)
>
> ....

dissolution of the partnership where the essential bonds of good faith and mutual trust are no longer present[19].

4.21 "Just and Equitable"

In the context of the partnership, the words "just and equitable" were liberally construed, the courts not fettering themselves by any rigid rules.[20] In its application to company law Lord Wilberforce has recently reaffirmed that such general words must remain general and should not be reduced to the sum of particular instances.[21] Nevertheless several categories have been advanced to determine the extent of the just and equitable provision.[22]

For our purposes, the most interesting category of cases where a petition succeeded were those which involved so called "quasi-partnerships" i.e. a company which is in substance a partnership even though operating in corporate form. Here the court would look to see if the personal relationship among the incorporators, so essential in a partnership, had broken down. If so then, provided the facts would have given grounds for dissolution of a partnership under partnership law, the company would be wound up.[23]

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8. Or if any other Matter or Thing shall be shown which in the Opinion of the Court shall render it just and equitable that the Company should be dissolved."

[19] Contained in Partnership Act, 1890 (U.K.), s.35(f).

[20] See, *In re Bleriot Manufacturing Aircraft Company (Ltd)* (1916) 32 T.L.R. 253 at 255; *Amalgamated Syndicate* [1897] 2 Ch. 600. *Lindley on Partnership*, 15th ed. (London: Sweet & Maxwell, 1984) at 707.

[21] *Ebrahimi v. Westbourne Galleries Ltd.* [1973] A.C. 360 at 374, [1972] All E.R. 492 at 496.

[22] See B.H. McPherson, "Winding Up on the "Just and Equitable" Ground" (1964) 27 M.L.R.282 at 285. McPherson argues there are three categories which are as follows: "(1) where initially it is, or later becomes, impossible to achieve the objects for which the company was formed; (2) where it has become impossible to carry on the business of the company; and (3) where there has been serious fraud, misconduct or oppression in regard to the affairs of the company."
Gower, by contrast, divides his analysis into four categories: a) expulsion from office; b) justifiable loss of confidence; c) deadlock; and d) failure of substratum. Gower, *supra*, ch.1 note 2 at 662-3.

[23] See generally M.R. Chesterman, "The "Just and Equitable" Winding Up of Small Private Companies" (1973) 36 M.L.R. 129.

A good example of this approach is *Re Yenidje Tobacco Co. Ltd.*[24] The two shareholders held equal voting rights in a company which they had formed to assume their tobacco businesses. After a year one of the "partners" commenced an action alleging he had been induced to sell his business as a result of a fraud. Their relationship deteriorated to such an extent that they did not speak to each other at board meetings. Cozens-Hardy M.R. in granting the petition proceeded on the basis that he was concerned with a private company which was in substance a partnership.[25] He concluded that the circumstances were such as would justify the winding up of such a partnership.[26] Further, it was irrelevant to such a decision that the company was making large profits. What was essential was that the *arrangement contemplated by the parties* no longer existed and that therefore the company should be wound up:

> "I think the circumstances are such that we ought to apply, if necessary, the analogy of the partnership law and to say that this company is now in a state which could not have been contemplated by the parties when the company was formed and which ought to be terminated as soon as possible."[27]

The obvious drawback with such an approach is in deciding which companies are in substance partnerships, and which are not. Whilst the judges strove to discern the "essential" aspects of a partnership, perhaps all the cases show is that at least a "personal relationship" (which can include participation in management) is a prerequisite for a quasi-partnership.[28]

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[24] [1916] 2 Ch. 426. See also *Symington v. Symington Quarries Ltd.* [1906] S.C. 121; *Re Loch v. John Blackwood Ltd.* [1924] A.C. 783, [1924] All E.R. 200; *Re Davis and Collett Ltd.* [1935] Ch. 693; *Re Wondoflex Textiles Pty. Ltd.* [1951] V.L.R. 458.

[25] [1916] 2 Ch. 426 at 429.

[26] *Ibid.*, at 432: "I think that in a case like this we are bound to say that circumstances which would justify the winding up of a partnership between these two by action are circumstances which should induce the Court to exercise its jurisdiction under the just and equitable clause and to wind up the company."

[27] *Ibid.*

[28] In *Re Wondoflex Textiles Pty. Ltd.* [1951] V.L.R. 458 at 465, Smith J. found a quasi-partnership where "a relatively small number of persons [have] become associated as members in pursuance of an agreement or arrangement involving the creation of a personal relationship between them and where, in addition, there are restrictions upon the transfer of shares which, as in the case of a partnership, prevent a member from extricating his interest upon just terms without a winding

The advantage of such an analysis is that it recognises the true relationship which exists where the members have merely incorporated a joint endeavour for e.g. liability or tax reasons. Here it is essential to discern what was in the contemplation of the parties at the time the incorporation agreement was signed, as it may be inequitable for the majority to exercise their strict legal powers in breach of this tacit understanding. As Smith J. said in *Re Wondoflex Textiles Pty. Ltd.*:[29]

> "I think, that even when there has been nothing done in excess of power it is necessary to consider whether the situation which has arisen is not quite outside what the parties contemplated by the arrangement they entered into, and whether what has been done is not contrary to the assumptions which were the foundation of their agreement."

Thus the quasi-partnership interpretation of "just and equitable" is a laudable attempt to provide an equitable limitation on the exercise of majority power. Its efficacy as a minority remedy, however, has been aptly equated with that of a sledge-hammer: "to threaten it may frighten the patient into getting better, but to apply it has one possible result only, a fatal one."[30]

Euthanasia, the Cohen committee recognised, was an extreme remedy which was not always appreciated by the party seeking treatment.[31] After noting that it was "impossible to frame a recommendation to cover every case", the committee concluded that adequate protection for the minority would be provided by creating an "alternative remedy" where the court is satisfied that the shareholder is being "oppressed" but that it would be unjust to order a winding-up.[32] The committee's intention was to give the court the power to

up". To Megarry J. in *Re Fildes Bros. Ltd.* [1970] 1 W.L.R. 592, 596-597, the definition included those cases where managerial responsibility was contemplated. See also Chesterman, *supra*, note 23 at 132.

[29] *Ibid.*, at 467.

[30] Chesterman, *supra*, note 23 at 150.

[31] The Cohen Committee, *supra*, note 17 at para. 60: "In many cases, however, the winding-up value of the assets may be small, or the only available purchaser may be that very majority whose oppression has driven the minority to seek redress."

[32] *Ibid* at 95: "II. That there be a new section under which, on a shareholder's petition, the Court, if satisfied that a minority of the shareholders is being oppressed and that a winding-up order would not do justice to the minority, should

impose upon the parties to a dispute whatever settlement the court considered just and equitable.[33] The reasons why the "oppression remedy" never fulfilled this goal must now be examined.

4.22 "Oppression"

The recommendations of the Cohen committee became s.210 of the Companies Act 1948. As a result of what, with hindsight, is extremely lax drafting, the section proved not to be the broad remedy which the committee had intended. The petitioning shareholder had to show that a) the "affairs of the company are being conducted in a manner oppressive to some part of the members", and b) the "facts would justify the making of a winding-up order on the ground that it was just and equitable but to do so would "unfairly prejudice" that part of the members.[34]

Having been bequeathed a complex and awkwardly worded section, the judiciary set about adding further limitations to the scope of the remedy. Poor drafting combined with the judiciary's traditional reluctance towards intervening in business matters, ensured that the Cohen committee's panacea would soon become a hollow placebo.

In *Elder v. Elder Watson Ltd.*[35], the first case to interpret the new section, the Court of Session heard a petition by two shareholders who claimed "oppression" as a result of being dismissed from employment with the company.

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be empowered, instead of making a winding-up order, to make such other order, including an order for the purchase by the majority of the shares of the minority at a price to be fixed by the court, as to the Court may seem just."

[33] *Ibid.*, para. 60.

[34] Although the English remedy is the most well known, it was adopted in a number of other jurisdictions. See e.g. Uniform Australian Companies Act of 1961 s.186; Companies Act, Act No. 63 of 1955, s.209 (New Zealand); Companies Code 1961 s. 218 (Ghana); Companies Act 1965 s.181 (Malaysia); Companies Act s.111 (South Africa); Companies Act, Act No.42 of 1967, s.181 (Singapore).

[35] 1952 S.C. 49.

Counsel for the petitioners argued, following *Re Yenidje Tobacco*, that the case had to be treated exactly as if it were an application under s.35(d) of the Partnership Act.[36] Lord Cooper refused to import "detailed provisions of the Partnership Act"[37] when interpreting s.210, but held that the court had to interpret the specific requirements of that section. He focused upon the word "oppression" which, in his view, meant oppression of the shareholder in his capacity as a shareholder. Being dismissed from office, accordingly, did not "oppress" the petitioners:

> "I do not consider that section 210 was intended to meet any such case, the "oppression" required by the section being oppression of members in their character as such."[38]

Lord Keith , in the House of Lords, refused to follow the *Re Yenidje Tobacco* line of cases because he did not feel the loss of confidence experienced by the "partners" in those cases satisfied s.210. "Oppression" related, not to some subjective understanding among the participants, but to the objective manner in which the affairs of the company were being conducted.[39]

The *Elder* case effectively stifled the new section at birth. Interpreted thus, a squeeze-out in which a shareholder is dismissed from his office and company profits are absorbed through directors salaries would remain unremedied.[40]

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[36] I.e. the section authorising the Court to decree dissolution of a partnership when a partner, other than the partner sueing, so conducts himself in matters relating to the partnership business that it is not reasonably practical for the other partner or partners to carry on the business in partnership with him.

[37] 1952 S.C. at 56.

[38] *Ibid.*, at 57. This is exactly what the remedy was intended to cover, see Cohen Committee, *supra*, note 17 at para 59.

[39] *Ibid.*, at 60: "It is not lack of confidence springing from oppression *per se* that brings section 210 into play, but lack of confidence springing from oppression of a minority by a majority in the management of the company's affairs, and oppression involves, I think at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a shareholder."

[40] See A.B. Afterman, "Statutory Protection For Oppressed Minority Shareholders: A Model For Reform" (1969) 55 Va. L.R. 1043 at 1049. C.f Cohen Committee, *supra*, note 17 para 59, where the committee specifically set out excessive directors remuneration as one of the examples of "oppression" which the section was intended to remedy. C.f. the approach of Fulton J. in Canada interpreting s.221 B.C.C.A.

The courts came to interpret s.210 more and more strictly whilst at the same time refusing to limit the general wording of s.222. Consequently in *Re Lundie Brothers Ltd.*,[41] where the petitioner had been dismissed from his office as a director and the company's profits were being absorbed in the other directors salaries, Plowman J. refused s.210 relief. He followed *Elder* and held that the petitioner was being oppressed *qua* director and not *qua* shareholder. Perversely the Judge did, however, grant a winding-up order under s.222. He viewed the case as "in substance a partnership case"[42] and, applying *Re Yenidje Tobacco*, held that the petitioner was entitled to a winding-up order as he had been denied equal participation in management.[43] Something more, however, was required for oppression to be shown:

> "[The Petitioner] has to go beyond making out a case for winding-up on the principle of *Re Yenidje Tobacco Co. Ltd.*, and has to establish some element of lack of probity or fair delaying to him in his capacity as a shareholder in the company."[44]

The judiciary grafted more restrictions onto the oppression remedy. A shareholder was required to satisfy the *full* requirements of a winding-up petition in order to succeed under s.210. Thus, where a company was insolvent and the petitioners would probably have received nothing on a liquidation, they were held not to have a "tangible interest" within the ordinary rule of company law which requires such an interest in a contributory petitioning for winding-up.[45]

1973 where he held dismissal from office could constitute oppression, see *Diligenti v. RWMD Operations Kelowna Ltd.* (1976) 1 B.C.L.R. 36 (B.C.S.C).

[41] [1965] 2 All E.R. 692, [1965] 1 W.L.R. 1051. Noted in (1966) 29 M.L.R. 321.

[42] [1965] 2 All E.R. 692 at 697.

[43] *Ibid.*, at 698: "Bearing in mind those principles, if this were a partnership and not a company I should have no hesitation in concluding that Mr. Blackmore is entitled to an order for dissolution on the ground that the termination of his employment as a working partner was an unjustified exclusion of him from the partnership business."

[44] [1965] 2 All E.R. 692 at 699.

[45] *Re Bellador Silk Ltd.* [1966] 2 W.L.R. 288 at 294; [1965] 1 All E.R. 667 at 672.

of Meyer, his colleague and three nominee directors of the society. At the end of five years, when Meyer was no longer needed, the Society attempted to force him out by setting up a department to perform the subsidiary's tasks and deliberately allowing the company's business to decline.[54]

Viscount Simmonds had to consider whether the actions of the parent constituted oppression. In his view the parent had embarked upon a lethal policy in order to destroy their subsidiary.[55] The society's nominee directors, by action or omission, carried through the parent's plan in breach of their fiduciary obligations to the company. Having placed their nominees in a position of divided loyalty it was incumbent upon the parent to act "with scrupulous fairness" to the minority.[56] The society had failed in this duty and that failure constituted "oppression". A term which Viscount Simmonds attempted to define:

> "[The society] had the majority power and they exercised their authority in a manner "burdensome, harsh and wrongful" - I take the dictionary definition of the word."[57]

Lord Keith saw the company as "in substance, though not in law, a partnership" which required that there should be the utmost good faith between the constituent members. In these circumstances he had little doubt that the conduct of the society was oppressive.[58]

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shares. 4000 were issued to the society, 3450 to Meyer, 450 to Lucas. One of the society's idle plants produced the fabric and the society was the company's only purchaser. A year after the company's formation the shareholdings were realigned so as to give the society 70% and the petitioners 30%. Also at this time the nominee directors looked into the possibility of purchasing the petitioners shares but on receiving a high valuation figure, dropped the plan.

[54] When licensing control was finally removed in 1951 neither the society nor the company depended on the personality of the petitioners. It therefore began to divert business from the company and succeeded in almost driving it to bankruptcy. The Society believed that the company had "served its purpose".

[55] [1959] A.C.324 at 340: "I have no doubt that at any rate by the end of 1952 it was the policy of the society by one means or another to destroy the company it had created, knowing that the minority shareholders alone would suffer in the process."

[56] *Ibid.*, at 341.

[57] *Ibid.*, at 364. A similar definition was adopted in Canada, see *Redkop v. Robco Construction Ltd.* (1978) 89 D.L.R. (3d) 507, 5 B.L.R. 58 (B.C.S.C.).

[58] *Ibid.*, at 361.

By the terms of the section, even if the minority could have shown that the circumstances warranted a winding-up, they additionally had to show that to do so would "unfairly prejudice" them,[46] a stringent requirement which, ironically, made it easier to obtain the original s.222(f) relief.[47]

It was the definition of "oppression" which caused the courts the most difficulty. The section referred to cases where the affairs of the company "are being" conducted in an oppressive manner, relief being granted by the court "with a view to bringing to an end the matter complained of".[48] This was interpreted by the courts to require a continuing course of oppressive conduct - a *single* oppressive act was not sufficient to satisfy the section.[49] However, it has been argued that "almost all seriously objectionable conduct may be said to have a continuing effect upon the affairs of the company"[50] and the Jenkins Committee accordingly recommended that this requirement be dropped.[51]

During the remedy's lifetime there were only two instances where it was successfully relied upon. The first of these cases was *Scottish Co-operative Wholesale Society Ltd. v. Meyer*.[52] In 1946 the Co-operative society formed a subsidiary to manufacture rayon, employing Meyer because of his expertise in the field.[53] The company's board consisted

[46] C.A. (U.K.) 1948, s.210(2)(b).
[47] See *Ebrahimi v. Westbourne Galleries* [1973] A.C. 360 and *Re Lundie Bros.* [1965] 2 All E.R. 692, two cases where the minority obtained the "sledge-hammer" remedy despite asking in the alternative for general equitable relief.
[48] C.A. (U.K.) 1948, s.210(2).
[49] *Re Jermyn St Turkish Baths Ltd.* [1971] 1 W.L.R. 1042, [1971] 3 All E.R. 184 at 198: "The terms of s.210 make it clear that the oppression complained of must be operative at the time the petition is launched". In that case it was claimed that an issue of shares had an oppressive effect which continued up until the petition was filed. This argument was accepted by the trial judge but rejected by the Court of Appeal.
[50] Afterman, *supra*, note 40 at 1058.
[51] U.K., *Report of the Company Law Committee* Cmnd. No.1749 (London: H.M.S.O, 1962) (Jenkins Committee) at paras. 204 and 212(b).
[52] [1959] A.C. 324.
[53] The manufacture of rayon at that time was strictly controlled by the post-war government through a licensing system. As licenses were only granted to persons of the necessary skill and experience, the society had approached the petitioners, Meyer and Lucas, who had extensive experience in the trade. They were unwilling however, to act merely as employees and so a company was formed with 7900

Lord Denning, by contrast, looked at the invidious position of the nominee directors concluding that, as they viewed their first duty as being to the co-operative society, they had breached their fiduciary duty to the company:

> "By subordination the interests of the textile company to those of the co-operative society, they conducted the affairs of the textile company in a manner oppressive to the other shareholders."[59]

The Meyer case has been used by one writer to suggest that a further limitation on the remedy existed, namely, that a shareholder had to show that the oppressor had violated a legal rule in order to succeed.[60]

It was never stated judicially that illegality was a prerequisite for relief. This conclusion rests on the breach of fiduciary duty found in *Meyer* and on the only other successful case under s.210, *Re H.R. Harmer Ltd.*[61] In that case the sons who were directors and minority shareholders of the company petitioned under s.210 for relief from the oppressive acts of their father who was both majority shareholder and chairman of the board. The business had originally been carried on by the father alone and despite incorporation, he continued to treat the company as his own, believing that he could disregard board resolutions as long as he retained voting control.

The Court of Appeal granted the sons' s.210 petition. In doing so Jenkins L.J. quoted at length from *Elder v. Elder Watson Ltd.* and the *Meyer* case, also citing authorities under the old "just and equitable" winding-up remedy. He did not, however, attempt a further definition of oppression but felt that:

> "[t]here may well be oppression from the point of view of member-directors where a majority shareholder (that is to say, a shareholder with a preponderance of voting power) proceeds, on the strength of his control, to act contrary to the

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59 *Ibid.*, at 367.
60 See K.W. Wedderburn, "Oppression of Minority Shareholders" (1966) 29 M.L.R. 321 at 324.
61 [1958] 3 All E.R. 689.

decisions of, or without the authority of, the duly constituted board of directors."[62]

The illegal conduct here, therefore, was the breach of the company's articles by the father. If he had chosen a democratic cloak for his autocratic actions by using his 78% majority to make legal alterations to the company's constitution, it would seem that the sons' petition would have failed.[63]

It is submitted that it is wrong to suggest that a further limitation requiring "illegal conduct" was added to the oppression remedy. In the *Harmer* case, although the actions of the father were illegal, they were ratifiable. Had the court considered illegality to be an issue it could have ordered that in future the articles be observed or amended. This the Court did not do. In *Scottish Co-operative v. Meyer*, by contrast, it is far from clear whether there had been a breach of a legally recognised duty. Wedderburn argues that the case rested on the breach of duty committed by the nominee directors.[64] This is not the author's interpretation of the case. Whilst Lord Denning saw the case as one of breach of duty *by the directors* the other law lords, in common with the Court of Session, saw the breach originating with the *majority shareholder* i.e. the oppression resulted from the society's diversion of business from their subsidiary not the nominee directors acquiescence in that policy. As there was no fiduciary duty to which the majority shareholder was subject, there could not, therefore, be any illegal conduct such

[62] *Ibid.*, at 703.

[63] See H. Rajak, "The oppression of Minority Shareholders" (1972) 35 M.L.R. 156 at 160. Further, as counsel for the father pointed out, if the father's actions could have been done lawfully by a general meeting passing an ordinary or special resolution, how could this be "oppression". Jenkins L.J. replied that "[t]he proper procedure cannot be put on one side as mere machinery. It is the duty of the board to consider any proposal. If a majority shareholder desires to override the board, there must be a proper meeting, whether of the board or the company, and at least an opportunity of discussion." *Ibid.*, at 704. C.f. the "internal management" limb of the rule in *Foss v. Harbottle* where it is precisely because these actions can be ratified that the court will not hear the action.

[64] K.W. Wedderburn, *supra*, note 60 at 324.

as that contemplated by Wedderburn.[65] The House of Lords, and particularly the Court of Session, refused to restrict the section to illegality alone.[66] Whilst proving a breach of the company's articles did help the minority show that they had been affected *qua* shareholder rather than *qua* director,[67] thus overcoming the hurdle introduced by *Elder v. Elder Watson Ltd.*, it was not a requirement of the section.

If Wedderburn's argument is rejected it is difficult to reconcile the *Harmer* case with the decision in *Re Five Minute Car Wash Services Ltd.*[68] In this case the petitioner set out a long list of acts and omissions of the majority shareholder (Mr. Evison) which he claimed constituted oppression. There were fifteen allegations of oppressive conduct including non-payment of accounts, ruination of the company's good name, failure to remove inefficient staff, etc. Buckley J., however, searched the petition in vain for evidence of oppression. Some of the allegations amounted to nothing more than disagreements as to policy, others were examples of careless or inefficient management:

> "I can find in them no suggestion that he has acted unscrupulously, unfairly, or with any lack of probity towards the petitioner or any other member of the company, or that he has overborne or disregarded the wishes of the board of directors, or that his conduct could be characterised as harsh or burdensome or wrongful towards any member of the company."[69]

Why did the petitioner succeed in *Harmer*, yet fail in *Five Minute Car Wash*? The answer is that in the latter case there was at most a loss of confidence between the shareholders,

[65] Lord Keith in *Scottish Co-Op Wholesale Society v. Meyer* [1959] A.C. 324 at 363 held: "A partner who starts a business in competition with the business of the partnership without the knowledge and consent of his partners is acting contrary to the doctrine of utmost good faith between partners. He is also acting in a manner which, I think, may be regarded as oppressive to his partners for he is doing them an injury to their business." See also Viscount Simmond's speach *ibid.* at 342.

[66] Per Lord Cooper in *Scottish Co-Op Wholesale Society v. Meyer* 1954 S.C. 381 at 391: "In my view, the section warrants the court in looking at the business realities of a situation and does not confine them to a narrow legalistic view."

[67] Oppressive conduct will invariably affect the petitioner in both capacities. However, where a violation of the articles has been shown a shareholder may sue to enforce the contract contained in the articles by virtue of s.14 C.A. See *Salmon v. Quin & Axtens Ltd.* [1909] 1 Ch. 311 at 318.

[68] [1966] 1 W.L.R. 745, [1966] 1 All E.R. 242.

[69] [1966] 1 All E.R. 242 at 247.

similar to that experienced in the "quasi-partnership" cases. This since *Elder*, had been insufficient to ground relief under s.210. In *H.R.Harmer Ltd.*, however, the actions of the cantankerous father were so severe as to be viewed by the court as "burdensome, harsh and wrongful". It is a question of degree and not simply one of illegality.[70]

The Court was in effect choosing between the business judgment of the parties, something the judiciary has steadfastly maintained it will not do. Accordingly it was only in extreme cases that the courts intervened, and when they did so their intervention was tethered to traditional company law concepts such as the fiduciary duty or breach of the contract between the company and the shareholders.[71]

That the true issue is one of business judgment is aptly illustrated by the two decisions in *Re Jermyn Street Turkish Baths Ltd.*[72] The company, which represented a joint venture between Mr. Littman and Mr. Stealey, was incorporated in 1946 with a nominal capital of £1000, the two men subscribing for 50 £1 shares. The articles of association, so far as they are relevant, gave the directors unfettered power to allot or dispose of shares and provided that remuneration of the directors was to be determined by the company in general meeting.[73] In May 1952, Stealey transferred his shares to Mrs. Pescoff. Littman died in 1953, following which his shares were held by his administrators. At the time of Littman's death the company was insolvent but, through the efforts of Mrs. Pescoff, by the time the petition was presented the company had been turned around into a prosperous concern.

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[70] See also the discussion of *Re Jermyn Street Turkish Baths, infra*, where, despite a breach of the articles by the controllers, a s.210 petition did not succeed.
[71] See Rajak, *supra*, note 63 at 167 where he argues that the courts, in those cases when a petition was granted, were acting against what they believed to be business inefficiency.
[72] [1970] 3 All E.R. 57 (Ch.D.), [1971] 3 All E.R. 184 (C.A.).
[73] [1970] 3 All E.R. 57 at 59: "Article 15. The remuneration of the Directors shall from time to time be determined by the Company in General Meeting and, unless otherwise directed any such remuneration shall be divided amongst them as they may agree, or, failing agreement, equally."

In 1954 the company was in urgent need of cash and Mrs. Pescoff approached the administrators asking them to advance £8000. On their refusal, Mrs. Pescoff herself advanced £1000 and managed to keep the company afloat, taking a debenture to secure the loan. In addition Mrs. Pescoff used her position as director to issue a further 100 shares to herself and one share to Mr. Wooley her fellow director. The effect of the issue was to increase her interest from one half to three-quarters and thus reduce the proportionate interest of the Littman estate. In 1955 the directors purported to pass a resolution regulating their own salary which included a provision setting "bonuses" totaling 25% of the company's receipts. As the company began to prosper the remuneration taken by the directors increased sharply and for the nine years prior to the presentation of the petition no dividends were paid on the shares. For a prolonged period there were negotiations between the administrators and the company for a settlement of their interests in the company but these came to nothing and, accordingly, in 1969 the s.210 petition was presented.

Pennycuick J. at first instance found that the share issue breached the directors duty to act in good faith for the benefit of the company. The company only received the nominal sum of £100 in return for the shares, leading the Judge to conclude that the shares were issued solely to allow Mrs. Pescoff to increase her interest in the company and not in order to increase the company's capital. This was not a proper purpose for the share issue.[74]

The resolution authorising the issue of itself did not represent oppressive conduct, which was required to continue up until the presentation of the petition. It did, however,

[74] *Ibid* at 66: "In the course of her cross-examination it became clear to my mind beyond doubt that Mrs. Pescoff and Mr. Woodley, when they issued these new shares, did not do so in good faith for the benefit of the company. It is quite true that in 1954 the company needed money, and Mrs. Pescoff quite properly advanced £1000 of new money against debentures. But the sole purpose of issuing the new shares was not to raise another trifling sum, namely £100, but to increase Mrs. Pescoff's interest in the company as against the interest of Mr. Littman's estate."

represent the first of a chain of events which included the taking of excessive remuneration by the directors. This "chain of events" was sufficient, Pennycuick J. found, to satisfy s.210.[75]

On appeal Buckley L.J. came to the opposite conclusion. The company had been in dire need of cash and Mrs. Pescoff, unlike the Littman estate, was prepared to inject more money into the business at a considerable risk. The court did not accept that the £100 received by the company for the shares could be divorced from the £1000 loan which Mrs. Pescoff was prepared to make to the company:

> "The allotment of the shares, in our view, formed part and parcel of the arrangement under which this injection of cash was made."[76]

The company therefore did not receive a trifling sum for the shares The share issue was the *quid pro quo* of the loan, it being quite proper that Mrs. Pescoff claim an additional stake in the equity of the company in return for her investment.

Having found the share issue to be valid, the Court of Appeal went on to consider the excessive remuneration drawn by the directors. There was the Court said, no link between the share issue and the drawing of excessive remuneration:

> "The voting power attached to the shares was not used in any way to procure the remuneration, nor was any threat to use those voting powers employed to discourage the petitioners or their predecessors in title from taking any step that they might choose with regard to the remuneration."[77]

This, with the greatest respect to the Court of Appeal, is flawed reasoning. As previously stated article 15 specifically required that directors remuneration be set by the general meeting. The directors resolution setting their own salaries and bonus

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[75] *Ibid.*, at 67.
[76] [1971] 3 All E.R. 184 at 198.
[77] *Ibid.*

entitlements was, therefore, clearly beyond their powers.[78] In order for Mrs. Pescoff to ensure that she and her fellow directors could draw whatever remuneration they pleased, she had to control the general meeting and after the share issue she gained that control.[79] The fact that Littman's administrators never complained of the *ultra vires* directors' resolution or the share issue seems to have unduly influenced the Court of Appeal in their finding that these two acts were not linked.[80]

The court then considered the directors' remuneration and defined "oppressive" in this context:

> "Oppression must, we think, import that the oppressed are being constrained to submit to something which is unfair to them as the result of some overbearing act or attitude on the part of the oppressor."[81]

The court concluded that the drawing of excessive remuneration, of itself, did not come within this definition. Again, Buckley L.J. seemed to put stress on the fact that the petitioners never asked for the level of remuneration to be reduced and that the directors made full disclosure at all times. Further, although no dividend had been declared for the last 18 years, the Judge refused to accept that the petitioners had not benefited from Mrs. Pescoff's efforts. Substantial sums had been re-invested in the business and shares which had once been worthless now carried a "substantial value".[82] The appeal was, accordingly, allowed.

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[78] The resolution, whilst capable of ratification, had never been validated by the company in general meeting.

[79] In fact she held 150 of the 201 shares. Together with the one vote of Mr. Woodley she held 75% and could thus alter the article which set the directors' remuneration.

[80] *Ibid.*, at 198: "No effective protest was ever made about the allotment at any time before presentation of the petition, nor was any step taken to challenge its validity. This was not in any way due to the acts or attitude of Mrs. Pescoff. It seems to us strange in these circumstances that the petitioners should assert in May 1969 that what took place more than 15 years earlier was an act of oppression or a link in a chain of oppressive acts."

[81] *Ibid.*, at 199.

[82] *Ibid.*, at 200.

Buckley L.J.'s conclusion is remarkable for it flies in the face of the purpose of s.210. In a private company where there is no ready market for shares, the shares may notionally carry a "substantial value" yet be worthless where there is no one to sell to. When the company's profit is absorbed in directors remuneration a share is little more than an I.O.U. for the liquidation value of the company. The Cohen committee recognized that a shareholder was thus "locked in" and susceptible to oppression.[83] The petitioners in *Re Jermyn Street Turkish Baths* were merely asking that they realize the value of their shares and leave Mrs. Pescoff to own and run what had effectively become her business.

Juxtaposed, the decisions of Pennycuick J. and Buckley L.J. highlight the difficulty which a court faces when asked to assess the merits of a particular action of those in control of a company. The court is required to tamper with the business judgment of the controllers and, where necessary, replace it with that of a judge[84].

Once it is recognized that the true issue is one of business judgment a number of alternatives present themselves. Several writers argue that the statutory remedy will only have value if the judiciary take a more active involvement in the affairs of a company.[85] However, the prospects for such an intervention "must be virtually nil."[86] In consequence, Wedderburn favours replacing the bench with an expert panel who will not only accept that they are required to soil their hands with the dirt of commercial considerations but also possess the necessary qualifications to make an informed decision.[87]

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[83] Cohen committee, *supra*, note 17 at para 59. It is instructive to compare the English Court of Appeal's approach with that adopted by the Massachusetts Supreme Court in *Donahue v. Rodd Electrotype Ltd.* 367 Mass. 578, 328 N.E.2d. 505 (1975) where that court made similar observations to those of the Cohen Committee.

[84] The case, moreover, cannot be reconciled with Wedderburn's conclusion that illegality was present in every successful case under s.210. In *Re Jermyn Street Turkish Baths* there had been a clear breach of the articles such as that found in *Re H.R. Harmer*, yet, unlike that case, oppression was not made out.

[85] See Afterman, *supra*, note 40 at 1076.

[86] Rajak, *supra*, note 63 at 169.

[87] Wedderburn makes this suggestion in (1966) 29 M.L.R. 321 at 327: "There [is] a strong case for handing the task to an inspector or a tribunal staffed at least partly

The author would welcome Wedderburn's suggestion, however, unless or until it is implemented there is, it is submitted, a path for the judiciary to follow which does not involve them in "the management of every brewhouse and playhouse in the Kingdom."[88] It is, simply stated, a recognition that the articles of association do not embody the entire agreement entered into by the members of a company. There are in addition the "reasonable expectations" of the parties which must be respected.[89]

This approach was followed by the House of Lords in *Ebrahimi v. Westbourne Galleries Ltd.*[90] The case, it will be recalled, concerned the removal of a shareholder from his position as director.[91] At first instance the Judge had refused a s.210 petition but ordered that the company be wound-up. Following the "quasi partnership" line of cases, Plowman J. held that the exercise of a legal power to remove a director would nevertheless constitute an abuse of power where the partners had embarked upon the basis that all should participate in management.[92] This breach of good faith made it just and equitable that the company should be wound up but was not sufficient to constitute "oppression".[93]

On appeal there was no further discussion of oppression, the Court of Appeal only being required to consider whether removal from management *simpliciter* could ever justify a

with men of business who might be less reluctant to see some types of gross mismanagement as "unfair prejudice" or even "oppression". He repeats it in (1983) 46 M.L.R. 643 at 645.

88 Per Lord Eldon L.C. in *Carken v. Drury* (1812) 1 Ves & B 154.

89 See Afterman, *supra*, note 40 at 1063 and Note, [1965] Duke L.J. 128 at 141.

90 [1972] 2 All E.R. 492.

91 The petitioner and one Nazer had, since 1946, been engaged in the business of carpet dealers. In 1956 the company was incorporated with the petitioner, Nazer and Nazer's son George becoming its directors. The company had 1000 shares issued as follows; Mr Nazer 400, the petitioner 400 and George 200. The substance of the complaint was: 1) that in July 1969 the petitioner was removed from his position as director; 2) Mr. Nazer had sold carpets to the company at arbitrary prices thus profiting at the company's expense ; and 3) Mr. Nazer improperly carried on an antiques business at one of the company's showrooms.

92 *Re Westbourne Galleries* [1970] 3 All E.R. 374 at 384.

93 Nor was oppression made out if the dismissal was added to the other allegations in the petition.

winding up order. Russell L.J., delivering the opinion of the court, recognized that there were two opposing views: either removal of a director by a majority in general meeting, for whatever motive, could never be a ground for winding up, or the removal *per se* could justify dissolution. He rejected both views but, drawing on familiar company law language, held that the removal would be valid "unless it be shown that the power was not exercised bona fide in the interests of the company."[94] Russell L.J. accepted that the majority shareholders thought the petitioner's removal form office was in the interests of the company and, as this was a view which a reasonable man could have come to, the winding-up order would be set aside.

The decision of Buckley L.J. was welcome as it attempted to realign the winding-up remedy with company law doctrine and prevent any further drift towards partnership law. Here was a power being exercised in general meeting, it, like the power to amend the articles, should be subject to equitable limitation. In attempting to apply Lord Greene's test from *Greenhalgh v. Arderne Cinemas*,[95] Buckley L.J. substituted the views of the majority shareholders for those of the "hypothetical member" and in doing so, it is submitted, came to the wrong conclusion.

The desire to articulate the remedy without undue emphasis on partnership principles was reflected in the judgment of Lord Wilberforce in the House of Lords. His Lordship pointed out that the "just and equitable" provision enabled the courts to "subject the exercise of legal rights to equitable considerations." In deciding when to apply these principles, his Lordship continued in his speach by saying that, whilst it might be convenient to refer to "quasi partnerships", this can also be confusing for it disguises the fact that the enterprise is governed by company law.[96] When should the courts exercise

94 [1971] 1 All E.R. 561 at 565.
95 [1946] 1 All E.R. 512.
96 [1972] 2 All E.R. 492 at 500: "[T]he expressions may be confusing if they obscure, or deny, the fact that the parties (possibly former partners) are now co-members in a company, who have accepted, in law, new obligations."

this discretion? Having discarded the "quasi-partnership" approach, Lord Wilberforce attempted to define those cases when equity would intervene. The fact that a company is small or private, he said, is not enough:

> "The super-imposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding that all, or some...of the shareholders shall participate in the conduct of the business; (iii) restriction on the transfer of the members' interest in the company."[97]

His Lordship then dealt specifically with the power to remove a director under s.184 C.A. 1948. Whilst there was undoubtedly a legal power to remove a director, the just and equitable provision would come to a shareholders assistance if he could prove "some special underlying obligation of his fellow member(s) in good faith, or confidence, that so long as the business continues he shall be entitled to management participation".[98] On the facts of the case, this "special obligation" existed and the winding-up order would be reinstated.[99]

It is clear from Lord Wilberforce's judgment that courts may no longer look purely at the articles when deciding the nature of the obligations which a shareholder has undertaken. Strict legal powers of the majority are subject to equitable limitation. His approach is instructive for, as it is not concerned with the *purposes* for which the power was exercised, he is not concerned, as the Court of Appeal was, with whether the majority's actions were for the benefit of the company. His Lordship's inquiry is into the *effects* of that decision upon the minority.

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97 *Ibid.*
98 *Ibid.*
99 Lord Wilberforce found two factors which supported the existence of a "special relationship". First, because of the petitioner's long association with the appellant, they were in substance partners. Second, as no dividend had ever been paid, on losing his status as director he would effectively lose his right to share in the profits. It was not sufficient that the respondents assured the court that this practice would not be continued.

Under such an analysis the court is considering the terms of the original bargain struck by the parties at the inception of the relationship.[100] Traditionally the courts have confined their analysis to the written embodiment of this accord i.e. the articles of association. Lord Wilberforce's analysis embraces also the parties' "legitimate expectations". Following this approach, where an agreement can be found amongst the shareholders that, for example, all shall continue in management, no exercise of a power delegated to the majority under the companies acts can alter this arrangement.[101]

Enforcing the parties "reasonable expectations" is not without its problems. Shorn of any written statement of intention, it can turn out to be one shareholders word against the other.[102] In reply it is submitted that this task is undertaken by courts every time they interpret a contract - a judge is attempting to discern the intentions of the parties. It is, moreover, familiar ground to the judiciary unlike the unchartered waters of the business world.[103]

By the time *Ebrahimi* arrived in the House of Lords, it was no longer a case under the "oppression remedy". The courts of England had created a judicial absurdity - a remedy intended to be broader than the "just and equitable" ground for winding-up a company had been defined and limited into non-existence. Undaunted Parliament, acting on the advice of the Jenkins Committee, tried again to legislate with what it hoped would

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[100] Lord Wilberforce approved the judgment of Smith J. in *Re Wondoflex Textiles Pty Ltd.* [1951] V.L.R. 458 and in particular the passage reproduced, *supra*, note 28.

[101] The examination need not stop at managerial participation. If the minority joined the company with a view to receiving steady dividend payments, withholding dividends would be oppressive; if a subsidiary was set up by the parent only to serve the short-term needs of the larger organisation then a minority could not claim oppression if it is liquidated once it has "served its purpose". C.f. *Scottish C.W.S. v. Meyer, supra*, note 65. The supreme merit of this analysis is its flexibility, see Afterman, *supra*, note 40 at 1064.

[102] This is essentially Chesterman's complaint. He could find no "special relationship" from the facts of *Ebrahimi*. See M.R. Chesterman, "The 'Just and Equitable' Winding Up of Small Private Companies" (1973) 36 M.L.R.129 at 143.

[103] For enthusiastic support for the "reasonable expectations" doctrine see, Afterman, *supra*, note 40 at 1063-1065 and Comment, "Oppression As A Statutory Ground For Corporate Dissolution" [1965] Duke L.J. 128 at 141.

constitute real protection for the minority. The word "oppression" was replaced by "unfair prejudice". This was yet another attempt to force the courts to come to the minority's aid. However, before examining the new remedy, it is sad to record that neither the Jenkins Committee nor Parliament saw fit to try to follow the approach of Lord Wilberforce. Instead the game of cat and mouse between Parliament and a judiciary reluctant to interfere in company affairs continued. All that had changed were the semantics.

4.2 Protection From "Unfair Prejudice"

The first attempt to provide a statutory remedy for minority shareholders subject to "oppression" at the hands of their company had failed. S.210 had "not produced the results expected of it".[104] Thus when the Jenkins Committee was appointed in 1960 to review the workings of the Companies Act 1948 it heard extensive evidence on the subject of protection of minorities. Of the witnesses before the Committee only one thought that the protection afforded to the minority was adequate[105]. The vast majority of witnesses recommended altering the scope of the existing remedy by dropping the requirement that a petitioner show facts sufficient to justify a winding up order.[106]

The review, conducted only a year after the *Meyer* and *Harmer* decisions, appeared to have breathed new life into a section which was generally considered to be a dead letter.

[104] U.K., *Report of the Company Law Committee* Cmnd. 1749, (Jenkins Committee) (London: H.M.S.O.; 1962) at para 200. The art of understatement, it would seem, is not outside a parliamentary select committee's terms of reference:

[105] See the submissions of the National Chamber of Commerce in *Minutes of Evidence Taken Before The Company Law Committee* (London: H.M.S.O., 1960) [hereinafter Evidence] at 338.

[106] See e.g., "The Economist" in Evidence, *supra*, at 263; The Companies Registrar, *ibid.*, at 330: Association of British Chambers of Commerce, *ibid.*, at 478; British Insurance Association, *ibid.*, at 618; Institute of Chartered Accountants, *ibid.*, at 1406.

The Committee's views were, therefore, tainted with optimism that, with a little tampering, the remedy could become truely effectve.[107]

The Jenkins Committee was conscious that a provision to protect minority shareholders had to deal with two kinds of wrong which they might suffer. First, there are those cases where the harm is suffered directly by the shareholder, for example, where he is not registered as a member or the directors are withholding dividends. To deal with these cases the committee recommended: 1) that the link with winding up be dropped; 2) that s.210 be amended to include isolated acts as well as courses of conduct; 3) and that the term "Unfair prejudice" replace "oppression".[108] Second, there are those cases where the wrong is done to the company itself and the control vested in the majority is wrongfully used to prevent any action being taken. In such a case the minority is indirectly wronged - this is the realm of the rule in *Foss v. Harbottle*, the exceptions to which the Committee was reluctant to embody in statutory language. They did, however, recommend that s.210 be extended to give the court an express power to authorize proceedings in the name of the company against a third party.[109]

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[107] At para. 200: "The view expressed in [*Meyer* and *Harmer*] as to the scope and effect of the section have undoubtedly given applications made under it a better prospect of success.". With hindsight it can only be conjectured what the Committee might have recommended had there not been two successful petitions the previous year.

[108] Jenkins Committee, *supra*, note 104 at para 212 (a)-(d).The committee was keen that the section afford effective protection in cases falling short of actual illegality. As the word "oppression" had received this restrictive interpretation by the courts it was no longer felt to be appropriate. Those who submitted evidence to the committee suggested a number of alternative formulations, for example, the Law Society suggested "hardship" (Evidence, *supra*, note 105 at 1192), the Companies Registrar, "unfairness" (*ibid* at 286). The committee approved the statement of Lord Cooper in *Elder v. Elder & Watson Ltd.*, 1952 S.C. 49 at 55 that:

> "the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely."

The committee felt that s.210 was originally intended to cover not only those cases where the affairs of the company were being conducted in a manner oppressive (in the narrower sense) to the members but also where the company's affairs were being conducted so as to "unfairly prejudice" a member's interests.

[109] Jenkins Committee, *supra*, note 104 at para 212(e).

This latter recommendation reflects the Committee's paranoia that a liberal derivative action would open a floodgate of litigation.[110] The compromise stance they recommended puts the decision as to whether or not to sue in the name of the company in the hands of the judiciary[111] and, in the author's view, represents an unnecessary procedural hurdle in the path of a potential litigant. It has been observed[112] that a judge will be motivated by a desire to decrease, rather than increase litigation, with a view to disposing of the matter expeditiously. Thus, in *Peterson and Kanata Investments Ltd*,[113] a case decided under the equivalent British Columbia provision, the court refused a litigation order, preferring those remedies which would conclude the dispute without the trouble and expense of further litigation.

To pollute the statutory remedy with the notoriously vague rule in *Foss v. Harbottle* is to further confuse the extent to which a shareholder can sue to correct a breach of a fiduciary duty. It would have been preferable to have articulated a derivative action[114] which contained sufficient safeguards to prevent frivolous litigation.[115]

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[110] The committee heard evidence from several U.S. witnesses who emphasised the benefits of shareholder litigation on U.S. corporate law. Evidence, *supra*, note 105 at 1012: "Generally speaking, the right of stockholders to bring actions in such cases has a good effect in our corporate law, despite the fact that it is often abused."

[111] This is essentially the same position as that adopted under the C.B.C.A. s.232 derivative action were a shareholder must apply to the court for leave to bring an action in the name of the company. See Welling's enthusiastic support for this use of judicial discretion in B. Welling, *Corporate Law in Canada- The Governing Principles* (Toronto: Butterworths, 1984) at 503.

[112] B.M. Hannigan, "Statutory Protection For Minority Shareholders. Section 75 of the Companies Act 1980" (1982) 11 Anglo-Am L. Rev. 20 at 33.

[113] (1975) 60 D.L.R. (3rd.) 527 (B.C.S.C).

[114] The term derivative action is misleading as it implies a right which derives from the corporation. A shareholder's statutory right to bring a s.234 action derives, not from the corporation, but from the statute itself. The suit is, therefore, better termed a "representative action" as the shareholder is relying on a right which he possesses through his status as a shareholder. See Welling, *supra*, note 111 at 517.

[115] This was the recommendation of the Law Society of Scotland (Evidence,*supra*, note 105 at 1309). As the U.S. witnesses pointed out, the abuse of the American derivative action known as "strike suits" (where a shareholder holds the corporation to ransom just for personal gain), was as much the fault of the lawyers in search of large contingency fees as of deliberately malicious shareholders. This practice could not have been repeated in the U.K. where a solicitor may not charge contingency fees and thus abuse of the system would be less likely.

The recommendations of the Jenkins Committee remained unimplemented for almost twenty years, before being contained in s.75 of the Companies Act 1980.[116] This section has since become Part XVII of the Companies Act 1985. S.459 reads as follows:

> **459(1) [Application for order that affairs conducted in unfairly prejudicial way] A member of a company may apply to the court by petition for an order under this Part on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial)**

This section has remedied some of the defects contained in the old s.210. A shareholder need no longer show that the circumstances justify a winding-up order. The reference in s.210 that "the affairs of the company *are* being conducted in a manner oppressive", etc. has been dropped and it is now sufficient that the affairs of the company "*have* been conducted in a manner", etc. Thus isolated acts may constitute "unfairly prejudicial" conduct.[117] The Jenkins Committee, however, gave no guide as to how the courts should interpret "unfair prejudice".[118]

In many respects the new section represents little advancement on the old law. The language of s.459(1) seems to imply that the former requirement that a shareholder sue *qua* member still applies.[119]

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[116] Although other jurisdictions had implemented some or all of the Jenkins committee's recommendations see eg. British Columbia Company Act, 1979 s.224.

[117] The editors of the latest edition of Gore-Browne suggest that the addition of the words "is or would be so prejudicial" could permit an action where seriously negligent management has damaged the value of the petitioners shares. See *Gore Browne On Companies*, 44th Ed.(London: Jordans, 1986) at para. 28.020.

[118] Although similar wording appeared in s.72(3) C.A. 1948 (now s.127(4) C.A. 1985) this section has never been satisfactorily interpreted and thus gives the courts no guidance.

[119] The argument is that in the absence of express statutory wording to the contrary a common law rule is deemed still to apply, therefore, as Parliament was silent on the matter in s.459, the restriction must be read into the new section. It is a pity that Parliament did not follow the example of s.234(2) C.B.C.A. which includes actions which prejudice the shareholder in his capacity of "security holder, creditor, director or officer". See also South Carolina statute which permits relief without regard to the capacity in which the shareholder is affected; S.C. Code Ann. s.12-22.15, s.12-22.23.

In one recent case, *Re A Company*,[120] Lord Granchester, sitting as a deputy Chancery judge, was faced with a petition presented by an executor on behalf of a deceased shareholder's infant children. The petition alleged that a refusal by the directors to purchase the petitioners shares or to formulate a scheme of reconstruction under s.287 Companies Act 1948 (now s.582 Companies Act 1985), constituted unfairly prejudicial conduct. In striking out the petition the learned Judge did not attempt to define "unfair prejudice", he merely restricted s.75 to prejudice *qua* member.[121] This conclusion was reached in spite of the decision of the House of Lords in *Ebrahimi v. Westbourne Galleries*, where the House permitted a shareholder petitioning under s.222(f) to rely not only on his rights as member but also on any circumstances of justice or equity which affected his relationship with the company. Lord Granchester, however, concluded:

> "The decision in that case was primarily concerned with the rights of a member to obtain a winding-up order on just and equitable grounds, and not on what constituted "oppression" for s.210 purposes."[122].

This conclusion can be contrasted with dicta by Vinelott J. in *Re A Company*,[123] (a petition for a "just and equitable" winding up under s.222(f)) where the Judge could see "considerable force" in counsel's submission that Parliament intended a shareholder in the

[120] [1983] BCLC 151, [1983] Ch. 178, [1983] 2 All E.R. 36. See J. McMullen, "Minority Protection and Section 75 of the Companies Act 1980" (1983) C.L.J. 204 and Wedderburn (1983) 46 M.L.R. 643.
[121] [1983] 2 All E.R. 36 at 44: "In my judgment s.75 is to be construed as confined to "unfair prejudice" of a petitioner "qua member"; or, put in another way, the word "interests" in s.75 is confined to "interests of the petitioner qua member"".
[122] *Ibid*. Further support for the view that s.75 was restricted to unfair prejudice qua member comes from Vinelott J.'s conclusion in *Re Carrington Viyella*, F.T. Comm. Law Reports 16 February 1983, that a minority shareholder was not affected *qua* member when the majority shareholder did not honour an undertaking to a third person not to vote more than 35% of the 49.36% shareholding it held. C.f. *Johnson v. West Fraser Timber* (1983) 19 B.L.R. 193, a decision under the equivalent British Columbia section where a shareholder was not entitled to argue unfair prejudice when an undertaking to a third party was not honoured.
[123] [1983] 2 All E.R. 854 at 859. See Note, [1983] J.B.L. 486.

position of Mr Ebrahimi to be included in s.75 and that therefore exclusion from management might well come within the new section.[124]

In the author's view Lord Granchester could have decided the above case without recourse to the restrictive common law rule. The essence of the problem is that any decision of the company will have ramifications for its shareholders but the effect of the decision on a *particular* shareholder may well depend on a number of extraneous factors. Thus, where dividends are withheld from a widow who relies on them as her only source of income she will be prejudiced. Where executors are in need of cash to to provide for the infant children of a deceased shareholder then a failure to purchase their shares may well constitute prejudice. It is submitted that the proper line of inquiry is to look, not to the capacity in which the shareholder suffers, but to the overriding considerations of fairness embodied in the phrase "*unfair* prejudice". It is not prejudice *per se* which satisfies the section but prejudice which is "unfair". In other words it is necessary to balance the needs of the company against the prejudice which a particular corporate decision might cause. Thus, where there is an understanding that all shareholders in a company are to participate in management, exclusion from management would *prima facie* be "unfair" because a legitimate expectation of the shareholder has been violated. For the company to successfully defend the action it would have to show very good reasons for his expulsion.[125] To have accepted the proposition of the executors in *Re A*

[124] Vinelott J. speaking extra-judicially in a moot organised by the Company Law Society rejected the argument that *Re Carrington-Viyella* supports the view that a shareholder must sue *qua* member. He observed that "such a severance of interests is, in the context of a small company of a quasi-partnership nature, artificial and unreal." See "Section 75 - an Aid to the Oppressed or, an Interference in Company Policy? (2)" (1985) 6 Co. Lawyer 21 at 29.

[125] This goes some way to meeting Chesterman's complaint that, if the power of expulsion provided for in s.184 C.A. 1948 (now s.303 C.A. 1985) is limited by a special agreement or understanding outside the articles, is there ever an occasion where dismissal will be "justified"? See Chesterman, *supra,* note 102 at 147. Dismissal, in the author's view, would be justified were the shareholder concerned had acted contrary to the interests of the other members. Lord Cross in *Ebrahimi* referred to *Re Leadenhall General Hardware Stores Ltd*. (1971) 115 S.J. 202, where a member-director was dismissed on suspicion of theft. This is an extreme example of conduct contrary to the members interests. The author would include

Company, by contrast, would have been to hold that a shareholder "locked in" to a private company has a legitimate expectation that he may demand the liquidation value of his shares whenever he is in financial difficulty.[126]

There is a depressing sense of *déjà vu* as one approaches the few English cases which have interpreted the new section. It says much for the resourcefulness of the English judiciary that they can now create new limitations for the section which had not even occured to them in the context of s.210. S.459 requires that "some part" of the members be unfairly prejudiced. This has been interpreted to mean that an action cannot be brought where the conduct complained of has affected all members and not just some of them.[127] "Prejudice", the judiciary reasoned, implies discrimination. The need for discrimination between shareholders was rejected by Lord President Cooper in *Scottish Co-operative Wholesale Society v. Meyer*.[128] Had discrimination been required for s.210 the petition in *Meyer* would have failed as the policies of the parent company depressed the value of all the shares in its subsidiary <u>including</u> its own interest.[129]

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participation in a competing business or failure to devote adequate time to the company as conduct sufficient to justify dismissal. C.f. *Gabhart v. Gabhart* 267 Ind. 370, 370 N.E. 2d 345 (1977) where the Supreme Court of Indiana refused to permit the other shareholders to convert the plaintiff's holding into debt after he had resigned his directorship when his outside affairs made participation difficult for him. The court held that the proposed merger breached the majority's fiduciary duty because the sole purpose of the merger was to eliminate the minority.

[126] I.e. all that is being argued is that the petitioner has suffered "hardship" as the result of a particular decision. The Law Society, in their submissions to the Jenkins Committee proposed that s.210 be amended by replacing the word "oppression" with "hardship" (Evidence, *supra*, at 1193). However, as the Companies Registrar pointed out this wording would have required an evaluation of a particular shareholder's financial situation in order to discern whether he had suffered "hardship". See *ibid.*, at 286.

[127] In *Re Carrington-Viyella* F.T. Comm law Reports, 16th February 1983, the petitioner alleged that a director's service contract had not been entered into in the best interests of the company. The action failed for the judge held that if there had been a breach of directors duties this would have affected *all* the shareholders.

[128] 1954 S.C. 381 at 392: "In other words it is maintained that the section has no operation where Samson destroys himself as well as the Philistines in a single catastrophe...I have come to think that this is to give too narrow a meaning to this remedial provision, and to place on the words "some part" and emphasis which they were not intended to bear."

[129] The editors of Gore-Browne reject this limited interpretation. See *supra*, note 117 at para 28.13.

There is some judicial support for limiting the remedy to cases where the member can show that the action complained of has reduced or at least jeopardised the value of his shares.[130] One author has replied that any damage thus suffered would be consequential to damage caused to the company and therefore not suffered by the member *qua* member.[131]

Despite these restrictive dicta there is some indication that finally the judiciary have been dragged reluctantly to the shareholders aid. In *Re Whyte (Petitioner)*[132] the court held that a *proposed* act can come within s.75; in *Re A Company*[133] Hoffman J. held that the section can give relief against unfairly prejudicial conduct by a respondent who is no longer a member of the company.[134]

Two recent cases support this liberal approach. In *Re London School Of Electronics Ltd.*[135] the petition was brought by a director who held 25% of a company set up to provide courses in electronics. The company was a quasi-partnership between the petitioner and City Tutorial College Ltd. holders of 75%. In 1983 the relationship

[130] Reference to a requirement that the share value be reduced appears in *Re A Company* [1983] 2 All E.R. 36 at 47 and in *Re Bovey Hotel Ventures* (31 July 1981, unreported) per Slade J. This case was applied by Nourse J. in *Re R.A. Noble (Clothing) Ltd.* [1983] B.C.L.C. 273 at 290-1. See also Boyle (1980) 1 Co. Law 280 at 281; *Gore-Browne on Companies* 44th ed (London: Jordans, 1985) para 28-13.
[131] See Farrar, *supra,* note 6 at 382 citing *Prudential Assurance Co. v. Newman Industries Ltd (No.2)* [1982] 1 All E.R. 354 at 366, 367. Vinelott J., again speaking extra-judicially, has rejected this limitation, see (1985) 6 Co. Lawyer 21 at 31.
[132] (1984) SLT 330.
[133] [1986] 2 All E.R. 253, [1986] 1 W.L.R. 281.
[134] The company was controlled by the respondent who sold his shares and the assets of the company to a Gibraltarian company, the purchase price being paid to bank accounts abroad. On his failure to account for the minority's share of the purchase price, the minority presented the petition. The respondent applied to be struck out as a party on the grounds that under s.459 relief granted under s.461 could only be granted against a member of the company and he was no longer a shareholder. *Ibid* at 256: "[A]lthough it is true that s.461(2) shows that the normal order under s.461 will be an order against the company or another member, there is no reason why the words of s.461(1) should not be given their full effect and allow the court to give relief in respect of a complaint that the company's affairs have been conducted in a manner unfairly prejudicial to the interests of members, even when this would involve giving relief against a respondent who is no longer a member."
[135] [1985] 3 W.L.R. 474. See [1985] J.B.L. 187.

between the quasi-partners broke down, the cause of the breakdown was found to be C.T.C.'s decision to appropriate to itself students wishing to enroll in a B.Sc. course. In June 1983 C.T.C. purported to remove the petitioner as a director and dismissed him as a teacher. Before his dismissal, the petitioner had set up another instructional institution and on being dismissed he took with him a number of electronics students who had either enrolled with the company or enquired of it.

Counsel for the company argued that the "just and equitable" provision which applied to s.210 was also applicable to s.75 and that, as the petitioner had wrongfully taken with him a number of students enrolled with the company, he had not come to court "with clean hands".[136] Nourse J. rejected this argument, holding that the section must be construed "as it stands".[137] He went on to hold that the conduct of the petitioner may,however, be material in two ways: first, it may render the conduct on the other side, even if it is prejudicial, not unfair; and second, even if the conduct on the other side is both prejudicial and unfair, the petitioner's conduct may nevertheless affect the relief which the court will grant under subsection (3). On the facts it was the intentional diversion of B.Sc. students by C.T.C. away from the company which was unfairly prejudicial conduct and the subsequent removal of students by the petitioner did not render the prejudicial conduct no longer unfair.

The judgment of Nourse J. is to be welcomed for it makes clear that s.75 is not to be interpreted by reference to the old authorities under s.210. Thus, it is to be hoped, removing many of the restrictions associated with that section. It is unfortunate that Nourse J. chose to characterise the undertaking as a quasi-partnership, a practice

[136] The doctrine was enunciated in *Ebrahimi*. See also *Palmer's Company Law* (London: Stevens, 1982) at 1123

[137] [1985] 3 W.L.R. at 482. The same argument was advanced by counsel in a Canadian case, *Journet v. Superchef Industries Ltd* (1985) 29 B.L.R. 206 at 224 (Q.S.C.). The court rejected it both on the facts of the case and also on the ground that it is not a requirement of s.234 C.B.C.A. (the Canadian equivalent of s.459 C.A. 1985).

disapproved of by Lord Wilberforce in *Ebrahimi v. Westbourne Galleries*. The danger with such an analysis is that it creates a dual standard that does not appear in the section. Actions which are unfairly prejudicial where a quasi-partnership is found will not satisfy the section in its absence.

The author, like Lord Wilberforce, rejects such a regimented approach. The court should not attempt to identify the company with some partnership paradime, this is merely a convenient appellation. The court is in reality discerning the "reasonable expectations" of the company's members; in a company which resembles a partnership these will be greater than in a widely held multinational enterprise. Support for this view comes from the most recent decision on s.459 to be reported, *Re A Company (No. 004377 of 1986)*.[138] The company had an issued share capital of 100 shares of £1 each, 39 of which were held by the petitioner, who was also its managing director, and 61 by T., his family and associates. In 1982 the company by special resolution adopted new articles of association, article 10 of which provided that on ceasing to be an employee or director a member was required transfer his shares to the company. The relationship between the petitioner and T. deteriorated to such an extent that he was removed from employment and dismissed as a director. After his dismissal the company, pursuant to article 10, offered to purchase his shares for £900 or, if that sum was not acceptable, then at a valuation set by the auditors pursuant to article 9. This offer was rejected and on 11th June 1986 a petition was presented to restrain the compulsory acquisition of the shares.

The petitioner argued that, as the company was a quasi-partnership, he had a legitimate expectation that he would continue to participate in management. Hoffmann J. rejected this submission;

> "I cannot accept that if there is an irretrievable breakdown in relations between members of a corporate quasi-partnership, the exclusion of one from management and employment is *ipso facto* unfairly prejudicial conduct. It must

[138] [1987] 1 W.L.R. 102.

> depend on whether, if there is to be a parting, it is reasonable that he should leave rather than the other member or members and on the terms he is offered for his shares or in compensation for his loss of employment."[139]

The judge followed the inquiry of Lord Wilberforce into the legitimate expectations of the parties.[140] In this case the parties had made express provision for what was to happen in the event of their falling out - under article 10 one party could buy out the other. The petitioner could not have a legitimate expectation that in the event of a breakdown of relations this article would not be relied upon:

> "To hold the contrary would not be to "superimpose equitable considerations" on his rights under the articles but to relieve him from the bargain he had made."[141]

The decision of Hoffmann J. is to be welcomed as evidence of the proper approach to the statutory remedy. The judge avoided looking at the commercial objectives of those exercising the power, but concentrated on the effects of its exercise upon the minority. The Judge held that, the plaintiff, by voting his shares in favour of the amendment in 1982, was to be taken to have consented to the effects of the alteration and it was not now open to him to escape the consequences of his consent merely because he objected to the result.[142]

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[139] *Ibid.*, at 109.

[140] Hoffmann J. followed this approach in two earlier cases, see *In Re A Company (No. 007623 of 1987)* [1986] B.C.L.C. 362 and *In Re Posgate & Denby (Agencies) Ltd*. (1986) B.C.C. 99, 352 where he said:

> "But the concept of unfair prejudice which forms the basis of the jurisdiction under section 459 enables the court to take into account not only the rights of members under the company's constitution but also their legitimate expectations arising from the agreements or understandings of the members inter se."

[141] [1987] 1 W.L.R. at 11.

[142] The situation would presumably have been different were T. to have held 75% of the shares and therefore been in a position to amend the articles without the agreement of the petitioner. In such a case the petitioner's consent would not be required in order to make the amendment effective and, therefore, were T. to purport to use the powers he had given himself through the amendment, this could constitute unfairly prejudicial conduct.

At first sight it is difficult to reconcile this conclusion with *Ebrahimi*. In *Ebrahimi*, the power relied on was statutory (s.184 of the Companies Act 1948), in *Re A Company* it was contained in the articles. In the latter case, it is true, the petitioner had voted in favour of the amendment which was ultimately to be used against him. However, his counsel argued that he had not understood the full implications of the new articles and that the company was under a duty either to explain their effects to him or allow him time for consideration. Hoffmann J. rejected this argument. The fact that the petitioner cast his votes in favour of the amendment evidenced his approval. Yet, if the petitioner did not understand what he was voting for then surely he could still have a legitimate expectation that he was not to be removed from management? If the inquiry is not into the subjective belief of the petitioner then it could be argued that *Ebrahimi* consented to the effects of the Companies Acts by becoming a member of his company and should have foreseen the consequences of s.184 of the Companies Act 1948. After all, *ignorantia iuris haud excusat.*

The distinction lies in the interpretation of the word "legitimate" in the phrase legitimate expectation. This is an objective standard and it is submitted "reasonable" would be a better term. Hoffmann J. concluded that it was unreasonable for a shareholder to have an expectation that an article which he had voted in favour of would not be used against him. Lord Wilberforce, by contrast, thought it reasonable that Ebrahimi had an expectation that a statutory power would not be used against him in certain circumstances.

As this analysis shows, there are encouraging signs from England that at last the statutory remedy is, to use the words of the Jenkins Committee, "starting to produce the result expected of it." Even this development, however, has been eclipsed by the remedy's evolution in Canada where the courts have had a more liberal section to interpret.

4.3 The Remedy In Canada

A statutory remedy based on the English model first appeared in Canada in British Columbia. An identical provision to s.210 of the Companies Act 1948 was contained in s.221 of the British Columbia Companies Act 1960.[143] The province, however, was quicker than the English parliament to act upon the Jenkins Committee recommendations and these were implemented in s.224 British Columbia Company Act 1973.[144] This section was soon given a wide interpretation by the courts. In *Diligenti v. RWMD Kelowna Ltd.*,[145] Fulton J. held that, whilst the section still required that a petitioner be affected *qua* member, exclusion from management in certain circumstances could affect his rights *qua* member. The learned Judge found that the company had been set up on a partnership basis and that accordingly each of its members had a "very real interest and concern in the management of the affairs of the company".[146] Although there was clear English precedent to the effect that exclusion from management did not affect a shareholder *qua* shareholder,[147] the Judge followed Lord Wilberforce in *Ebrahimi* and held that, whilst the majority might have been entitled as a matter of strict law to remove the petitioner as a director, there were "rights expectations and obligations inter se" which made his removal if not oppressive, then at least unfairly prejudicial to him in his status as member.

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[143] B.C.C.A. 1960, R.S.B.C 1960, c.67.
[144] B.C.C.A. 1979, R.S.B.C. 1979, c.59.
[145] (1976) 1 B.C.L.R. 36 (B.C.S.C.).
[146] *Ibid.*, at 43.
[147] E.g. *Elder v. Elder Watson Ltd* 1952 S.C. 49; *Scottish Co-Op v. Meyer* [1959] A.C. 324.

The statutory remedy also appears in the federal corporations statute - the Canada Business Corporations Act[148] at s.234.[149] This provision is far wider than even s.459 of the U.K. Companies Act as it permits not only members to petition but also creditors[150] as well as directors or officers of the corporation. The section also makes clear that the prejudice may be suffered not only *qua* member but also *qua* security holder, creditor, director or officer.[151] The Ontario Business Corporations Act originally did not include an oppression remedy, however, following its amendment in 1982, a broad remedy is now contained in s.247.[152] A similar remedy appears in the corporations acts of the other Canadian provinces.[153]

There is now quite a considerable body of case law dealing with the interpretation of these sections and it is reassuring to observe that Canadian judges are not showing the reluctance of their English brethren to give the section its full effect. The remedy has

[148] C.B.C.A., S.C. 1974-75-76, c.33 as amended.

[149] **Sect. 234. Application to court re oppression.-(1) A complainant may apply to a court for an order under this section**

(2) Grounds.- If, upon an application under subsection (1), the court is satisfied that in respect of a corporation of any of its affiliates

(a) any act or omission of the corporation or any of its affiliates effects a result,

(b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or

(c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner

that is oppressive or unfairly prejudicial to or that unfairly disregards the unterests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

[150] A "complainant" is defined in s.231 to include a security holder. "Security" is defined in s.2(1) as "a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation."

[151] S.234(2), *supra*, note 149.

[152] O.B.C.A. 1982, R.S.O. 1982, c.4. There have been few cases decided under this provision, however see, *Abraham v. Interwide Investments* (1985) 30 B.L.R. 177 (Ont. S.C.); *Re Union Enterprises Ltd.* (1985) 29 B.L.R. 128 (Director, C.B.C.A.). In *Vedova v. Garden House Inn Ltd.* (1985) 29 B.L.R. 236 (Ont. S.C.), a judge of the Ontario High court held that the section could not be used where there were two *equal* interests in a corporation. It applied, he said, only to minorities. It is respectfully submitted that such a conclusion is wrong. The remedy can be most useful when attempting to relieve "deadlock" caused by equal groups holding opposing views.

[153] Saskatchewan, Manitoba and Alberta Business Corporation Acts, s.234(2); New Brunswick Business Corporations Act, s.166.

been used to enforce directors' fiduciary duties[154] and attack their defence tactics on a take-over bid.[155]

Canadian judges seem to have adopted the approach of Lord Wilberforce and look to the expectations of the parties. Thus in *Jackman v. Jackets Enterprises Ltd*,[156] Fulton J. distinguished his finding in *Diligenti* and held that those who formed the corporation had not intended that all would have an equal voice in management:

> "Mrs. Jackman's share were, in effect a gift, and there was never that relationship which would establish an equitable, let alone legal, right to be consulted with respect to the management of the company."[157]

The majority shareholder had breached the Companies Act requirements as to annual general meetings and although this amounted to oppression it was not serious enough to entitle the petitioner to have her shares purchased. The Judge used his wide remedial powers under the section and held that Mrs. Jackman would be adequately compensated by receiving financial statements and attending General Meetings.

These two decisions by the same judge show how flexible the statutory remedy can be when coupled with the approach of Lord Wilberforce. Superficially the two corporations were identical, the only distinction lay in the expectations of the parties:

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[154] See *Redekop v. Robco Construction Ltd*. (1979) 5 B.L.R. 58 (B.C.S.C.) and *Re Little Billy's Restaurant* (1983) 21 B.L.R. 246 (B.C.S.C.). Both cases dealt with a director's conflict of interest. See also *Appotive v. Computrex Centres Ltd*. (1982) 16 B.L.R. 133 (B.C.S.C.).

[155] See *Re Union Enterprises Ltd*. (1985) 29 B.L.R. 128 (Director, C.B.C.A.) and *Intersiones Monteforte S.A. v. Javelin International Ltd*. (1982) 17 B.L.R. 230 (Q.S.C.). In the latter case the directors had spent large amounts of the corporation's money to remain in control. The Court found oppression and ordered a receiver-manager be appointed with extensive powers to carry out the affairs of Javelin. See also *Sparling v. Royal Trustco* (1984) 24 B.L.R. 145 (Ont. C.A.), where the Court held that "affairs of the corporation" in s.234 C.B.C.A. includes take-overs. Therefore a failure to disclose material information in a directors circular can come within the definition of "oppression" or "unfairly prejudicial conduct", An English court would apparently agree, see *In Re a Company No. 008699 of 1985, The Times*, January 18th, 1986. Noted in [1986] J.B.L. 77.

[156] (1977-78) 2 B.L.R. 335 (B.C.S.C.).

[157] *Ibid*., at 338.

"The relationship between the parties, and the purpose for which the company was set up, must...be borne in mind."[158]

In *Re Sabex Internationale Ltée*[159] Gonthier J. refused to permit a majority shareholder to use his bare majority (he held 54%) to oppress the minority through a rights issue which would further dilute the minority's holding. Following the approach of Lord Wilberforce, the Judge held that there had been an informal understanding that both groups would share equally in decision-making:

"[L]es décisions se prenaient conjointement même s'il n'y avait à l'origine aucune entente formelle quant à la nomination des administateurs. Le Tribunal croit donc qu'il y a lieu d'appliquer le concept de "société incorporée" ("Incorporated Partnership") que l'on retrouve dans la jurisprudence anglaise."[160]

Although this right was not absolute, the majority would have to justify any departure from the original understanding. The Judge found that, as there were alternative methods of financing open to the company which would not dilute the minority interest, there was no justification in this case for departing from the informal agreement.

4.41 S.234 and Squeezing-Out the Minority

The most interesting development for the oppression remedy in Canada has been its application to "squeeze-out" mergers. Using the Vertical Short-Form Amalgamation provision in s.178 C.B.C.A. a merger can be arranged in such a way that the majority receive common shares in the amalgamated enterprise whereas the minority receive only redeemable preference shares. The minority is squeezed out when the shares are redeemed.[161] The C.B.C.A. does provide a measure of minority protection in the case of

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[158] *Ibid.*, at 339. It is clear that removal from office *per se* does not amount to oppressive conduct sufficient to entitle a petitioner to have his shares purchased. C.f. *Re Cucci's Restaurant Ltd.* (1985) 29 B.L.R. 196 (Alta. Q.B.) where the Alberta Court of Queen's Bench, interpreting s.234 C.B.C.A., seemed to imply that dismissal from directorship could *never* amount to unfairly prejudicial conduct.

[159] (1979) 6 B.L.R. 65 (Q.S.C.).

[160] *Ibid.*, at 88.

[161] The procedure would work something like this: a corporation, usually after a partially successful take-over bid, would transfer the acquired shares to a shell

an amalgamation; the holders of a separate class of shares are entitled to vote separately if their rights are altered.[162] But, as the minority were only common shareholders, they were not entitled to a separate class vote.

To complicate matters the Canada Business Corporations Act, in common with the U.S. statutes which inspired it, provides a further "remedy" where amalgamation is proposed. This is the so called "appraisal remedy" which, in essence, allows the shareholder to receive the fair value of his shares where the majority propose to make a fundamental change to the enterprise.[163] The courts in Canada, therefore, had to decide whether a shareholder faced with a squeeze-out merger was entitled not only to receive fair value, but also to prevent the merger through claiming "unfair prejudice". In other words, is a shareholder entitled to challenge the substantive fairness of the merger?

This question, as we have already seen, was faced a decade earlier by the Delaware courts in the *Singer v. Magnavox* and *Weinberger v. O.U.P.* line of cases.[164] In Delaware, Equity's fiduciary duty was used to challenge the substantive fairness of the merger, here in Canada it is the oppression remedy which provides equitable jurisdiction. Unfortunately in Canada, unlike Delaware, the litigation has not gone beyond interlocutory applications and as a result the issues have not been fully argued.[165]

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corporation, using its votes in the target corporation to pass a resolution to amalgamate the two corporations. The terms of the amalgamation agreement would be that the shell corporation would receive common shares in the new enterprise whereas the minority would merely receive redeemable, non-voting preference shares or cash. After the amalgamation the preference shares would be redeemed and, as the corporation was now a wholly-owned subsidiary it could be amalgamated with the parent using s.178.

162 S.177(4) C.B.C.A.

163 See generally, B. Manning "The Shareholder's Appraisal Remedy: An Essay for Frank Coker" (1962) 72 Yale L.J. 223; Coleman, "The Appraisal Remedy In Corporate Freeze-Outs: Questions of Valuation and Exclusivity" (1984-85) 38 Sw. L.J. 775; D. Fischel, "The Appraisal Remedy in Corporate Law" [1983] A.B.F.Res.J. 875.

164 *Supra*, Chapter 3.

165 See, *Carlton v. Maple Leaf Mills Ltd.* (1978) 4 B.L.R. 300 (Ont. S.C.); *Alexander v. Westeel-Rosco* (1978) 4 B.L.R. 313 (Ont. S.C.); *Ruskin v. Canada All-News Radio Ltd.* (1979) 7 B.L.R. 142 (Ont. S.C.); *Nasgovitz v. Canadian Merrill Ltd.* (1980) 9 B.L.R. 261 (Q.S.C.); *Burdon v. Zeller's* (1981) 16 B.L.R. 59 (Q.S.C.);

Despite being interlocutory applications, the decisions do give some guidance to the approach of the Canadian judiciary when faced with a squeeze-out merger. In some cases the judges have argued that as the majority do not have the necessary 90% holding which would permit them to eliminate the minority pursuant to s.199(2), the amalgamation is an impermissible attempt to do indirectly what they could not do directly.[166]

The courts have also objected to the discrimination which the minority suffer by only receiving redeemable shares. In *Alexander v. Westeel-Rosco Ltd.*,[167] Montgomery J. looked to the common law rule from *Greenhalgh v. Arderne Cinemas Ltd.*[168] He concluded that, using Lord Evershed's test, the merger would not be for the "benefit of the company as a whole" because it would discriminate between majority and minority shareholders:

> "It appears on the facts before me that the minority are being treated as second class citizens."[169]

Similar reasoning was adopted by a Québec judge who held that the proposed amalgamation would discriminate between shareholders of the same class contrary to s.24(3) C.B.C.A..[170]

It is significant that injunctions were granted in the above cases, as one of the requirements of an injunction is that the applicant cannot be adequately compensated by

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Re Domglas (1981) 13 B.L.R. 135 (Q.S.C.). See also L.M. Schaef, "The Oppression Remedy For Minority Shareholders" (1985) 23 Alta L.Rev. 512 at 514-516.

166 See *Carlton v. Maple Leaf Mills Ltd*. (1979) 4 B.L.R. 300 (Ont. S.C.) and *Burdon v. Zeller's* (1981) 16 B.L.R. 59 (Q.S.C.).

167 (1979) 4 B.L.R. 313.

168 [1951] Ch. 286, [1950] 2 All E.R. 1120 (C.A.).

169 *Alexander v. Westeel-Rosco, supra*, note 164 at 324.

170 *Burdon v. Zellers Ltd*. (1982) 16 B.L.R. 59 at 64 (Q.S.C.) per Bisaillon J.: "En effet, les actionnaires majoritaires ne sont pas traités sur le même pied que les actionnaires minoritaires, contrairement à ce que demande l'article 24(3) de la loi."

damages. This clearly implies that appraisal is not the shareholder's only remedy and that he is entitled to something more than the cash value of his shares.[171]

Despite these interlocutory judgments which seem to uphold a shareholder's right to challenge an unfair merger, there has yet to be full judicial consideration of the issues involved. A recent case which has yet to be reported, *Brant Investments Ltd. v. Keeprite Inc.*,[172] does consider a shareholder's position in an alleged squeeze-out. Unfortunately it does not concern an amalgamation using s.178 C.B.C.A. but a minority complaint that a proposed rights issue was being used to force them out.

4.42 The *Keeprite* Litigation

Keeprite Inc. (Keeprite) was a manufacturer of refrigeration and air-conditioning products. Inter-City Gas Corporation (ICG) is a diversified conglomerate which carries on various businesses. One of its subsidiaries, Inter-City Manufacturing Ltd. (ICM), was engaged in the manufacture and sale of heating equipment. In April 1981 ICG made a take-over bid for Keeprite conditional on receiving 90% of the shares outstanding (its intention being to use s.199 C.B.C.A. to create a wholly owned subsidiary). On failing to obtain 90% the offer was varied and made conditional on obtaining 50.1%. As a result of the bid ICG obtained 64% of Keeprite. One of ICG's considerations in purchasing Keeprite was to integrate its operations with ICM as they were both seasonal and subject to large fluctuations in product demand. Various attempts at harmonization failed and a joint Keeprite-ICG task force was formed to consider full integration. The task force reported to Keeprite's board that there would be synergistic benefits resulting from a combination of the two companies' operations and acting on this advice the board

[171] Steel J. in *Carlton v. Maple Leaf Mills Ltd.*, *supra*, note 165 at 309 argued that a "person is entitled to retain his property if he so wishes, except where there is a right held by another to forcibly take it."
[172] *Brant Investments Ltd. v. Keeprite Inc.* [1987] O.J. No. 574 (H.C.).

appointed an independent committee to consider a proposed purchase of ICM's assets by Keeprite. The acquisition was to be financed by a rights issue.

The independent committee reported that, subject to some conditions, the purchase made good business sense and therefore, to facilitate the rights issue, a combined annual and special meeting of shareholders was called in April 1983. It resolved by special resolution to alter the articles of Keeprite by removing the limit on the authorized common shares. Shareholders representing 265,000 shares exercised dissenting rights on the resolution and, in view of the serious financial consequences this dissension could cause, the rights issue was delayed. At a board meeting in June 1983 the asset purchase and an offer of $9 per share to dissenting shareholders were approved. Five days later the assets of ICM were acquired for $20M and articles of amendment were filed to permit the rights issue to go ahead. In August Keeprite applied to the court to set a fair value for the dissenters shares who in return commenced proceedings under s.234. In March 1984 the rights offering raised $22.3M of which $20.6M was provided by ICG.

In their statement of claim the minority made a number of allegations of oppressive or unfairly prejudicial conduct, alleging *inter alia* that that the terms of the rights offering were made deliberately unfair in order to force the minority to dissent thereby achieving ICG's original aim of obtaining 100% ownership of Keeprite.

Anderson J. had first to consider whether a shareholder who has exercised his right to dissent is thereby precluded from using s.234 because s.184(11) states that a shareholders rights "cease" after he has sent in his notice of dissent.[173] In interlocutory proceedings Callaghan J. had permitted both actions to proceed seeing nothing inconsistent with permitting a dissenting shareholder to exercise his appraisal remedy under s.184 and at

[173] C.B.C.A., s.184(11) "Suspension of rights - On sending a notice under subsection (7), a dissenting shareholder ceases to have any rights as a shareholder other than the right to be paid the fair value of his shares"

the same time proceed as a complainant under s.234.[174] Anderson J. recognized that, as he had found that the oppression action failed, he was not strictly concerned with the matter. *Obiter* the Judge approved of Callaghan J.'s decision, but did recognize that there was an anomaly involved:

> "Assertion of the right to dissent, which is granted by s.184, logically implies a decision on the part of the shareholder to sever his connection with the company, recover the amount of his investment and be gone. Assertion of a claim under s.234 on the other hand implies a continued interest in and concern for the affairs of the corporation."[175]

Yet this statement is hardly consistent with the power in s.234(3)f) to purchase a security holders interest. Under such an application the avowed purpose of the complainant is to leave the corporation and "be gone". This is precisely the remedy sought by the complainants in *Keeprite*. Their statement of claim did not ask for the rights issue to be set aside or for another order which would enable them to continue as members. All the complainant wanted was to be "cashed out".[176]

Anderson J. was in fact faced with a duality of actions under which a shareholder could obtain the fair value for his shares. First, he could exercise a right of dissent giving him a statutory right to receive fair value. Second, he could allege oppression yet claim as his only remedy that his shares be purchased by the company or the wrongdoers, again receiving fair value.

This absurdity comes from the attempt in the C.B.C.A. to fuse Anglo-American corporations law. There is no appraisal remedy in the England and, therefore, the

[174] *Re Brant Investments v. Keeprite Inc.* (1984) 5 D.L.R. (4th) 116 (Ont. S.C.). The Judge noted that the definition of "complainant" in s.231 includes "a *former registered holder* or beneficial holder of a security." C.f. *McConnell v. Newco Financial Corporation* (1979) 8 B.L.R. 180 at 185 (B.C.S.C.).
[175] *Ibid.*, at 38.
[176] These are the words of Justice Quillen in *Roland International Corp. v. Najjar* 407 A. 2d. 1032 at 1039 (Del. Sup. Ct. 1979).

statutory remedy includes the power of a court to purchase a petitioners shares.[177] It is the only way he can receive fair value. If a shareholder has a right of dissent in Canada and yet can also claim oppression, the court is faced with two actions where all it is required to do is assess fair value. The courts in Canada are thus in exactly the position that the Delaware courts found themselves after *Roland International Corp. v. Najjar*,[178] a case which, as will be recalled,[179] permitted a shareholder to bring an action in equity where his only claim was that he had not received fair value in a cash out merger. The Delaware Supreme Court attempted to fuse the two actions by overruling the "business purpose" test from *Singer v. Magnavox*,[180] and in doing so it brought into doubt a shareholders right to challenge an "unfair" merger. Canada is on the edge of the same precipice. Were her courts to react with similar venom, the oppression remedy would be rendered impotent.

In the author's view the appraisal remedy and oppression remedy concern different claims by the shareholder. In the former case, the minority's cry to the majority is "OK, you *can* do what you propose but don't expect me to remain a shareholder". In the latter case their cry is "You *can't* do it because t'aint fair".[181] Appraisal is not concerned with the substantive fairness of the transaction, it merely provides an escape route for a dissident shareholder. Thus in those few cases where a shareholder has a right of dissent under s.184 he is not denied s.234 relief *but* if he merely claims, as the minority in *Keeprite* did, that his shares be purchased, then the proper course is for his s.234 petition to be struck out.

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177 It is, in the case of a private company where there is no market for his shares, the only way a shareholder can obtain fair value. Indeed this is the remedy most commonly requested in the private company context.
178 *Supra*, note 176.
179 See, *supra*, Chapter 3.
180 See *Weinberger v. O.U.P.* 457 A. 2d. 696 (Del. Sup. Ct. 1983).
181 The minority owes his vocabulary to Welling. See B. Welling, *Corporate Law in Canada: The Governing Principles* (Toronto: Butterworths, 1984) at 529.

There is a striking parallel between the state of the law presently in Canada and that in Delaware during the *Singer/Weinberger* era. It permeates Anderson J.'s judgment. It will be recalled that the Delaware courts struggled to determine whether or not a shareholder could prevent unfair mergers which caused him to be "squeezed-out" of the enterprise. The court concluded in *Singer* that he could do so where the sole purpose of the merger was to effect a squeeze out. The claim by the minority in *Keeprite* that a rights issue was part of a deliberate plan to exclude them raises this same issue.

Anderson J. found he had to undertake the same exhaustive review of the business merits of the impugned transaction[182] as that performed by the Delaware Supreme Court in *Singer*.[183] Here the existence of the independent committee set up by Keeprite assumed paramount importance for, if the Judge were to find independent opinion approving the business purpose of the merger, he would not be forced to substitute his own business judgment for that of the board of directors of Keeprite.[184]

After a lengthy and detailed examination of the recent history of Keeprite Anderson J. concluded that there had been no oppression because it had not been the intention of the respondents to "trigger" minority shareholder dissent:[185]

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[182] *Keeprite, supra,* note 172 at 81: "I am unhappily conscious that in my review of the impugned transaction I have been led to do that which I have said a court should not do: examine the minutiae."

[183] 380 A.2d. 969 at 976 (Del. 1977): "It seems to us that the approach to the purpose issue should be made by first examining the competing claims between the majority and minority stockholders of Magnavox."

[184] The Judge placed a lot of emphasis on the evidence of McKay, a director of Keeprite who was initially "cool" about the proposal but "[a]s the impugned transaction was ultimately developed, his objections to it were overcome and he was prepared, as a director of Keeprite, to recommend it as being beneficial to Keeprite and its shareholders." *Keeprite, supra,* note 172 at 63.

[185] The Judge seemed to favour the respondents' submission that "oppression" requires bad faith. He found that in every case to which he had been referred in which oppression had been made out there was always "a finding of conduct clearly inconsistent with good faith and honesty."(*Ibid.,* at 74). He accepted that, as he had found no oppression in this case, there was no necessity to decide the issue. However, he was "skeptical" of the submission that bad faith need not be shown. The view that a petitioner needs to show lack of probity on the part of the oppressors is a dangerous judicial addition to the wording of the section. It is

"The record does not establish any of the grounds of oppression enumerated in s.234(2). There were valid corporate purposes for the transaction."[186]

It had not been ICG's plan to exclude the minority. This, the judge said, was shown by ICG's variation of the initial take over offer from 90% acceptance to 50.1%. Further, the judge found that "far from wanting the minority out, ICG and Keeprite would have welcomed participation in the equity offering."[187] In other words, unlike Weinberger, there was no "smoking gun" indicating unfairness.

So, as with *Singer* a decade ago, the judiciary have been called upon to enquire into the purpose of a transaction. The future for Canada in this respect looks bleak. Precious court time will be taken up with experts arguing for and against a particular corporate decision. The Lawrence Committee's worst fears will have been realised[188] and the judiciary will be asked to undertake the management of the "brewhouses of the Kingdom".

4.43 The Solution

It is submitted that the "inquiry into the minutiae" undertaken by Anderson J. would have been unnecessary were the court to have adopted the "reasonable expectations" approach advocated by the author. The Court should have looked at what the minority were in effect arguing through challenging the rights issue. Their claim was that they had a reasonable expectation that their *pro rata* share of Keeprite would not be unfairly diluted.[189] The "unfairness" here was that, in order to maintain their *pro rata* share, the

furthermore inconsistent with those cases attacking squeeze-out mergers for it *assumes* that the majority are in bad faith through wishing to remove the majority.

[186] *Ibid.*, at 79.

[187] *Ibid.*, at 72.

[188] Thus vindicating the Lawrence committee's view that an oppression remedy is a "complete dereliction of the established principle of judicial non-interference in the management of companies." Lawrence Committee, *loc cit*, para. 7.3.12.

[189] This claim is consistent with a number of cases, notably *Re Sabex Internationale Ltée* (1979) 6 B.L.R. 65 (Q.S.C.) in Canada and *Clemens v. Clemens Bros. Ltd.*[1976] 2All E.R. 268 ~~in the~~ U.K.. See also, *Re Jermyn Street Turkish Baths* [1970] 1 W.L.R. 1194 and *Journet v. Superchef Industries Ltd.* (1985) 29 B.L.R. 206 (Q.S.C.).

minority would have had to more than double their investment in Keeprite in order to make a purchase of assets which, they claimed, was only beneficial to ICG.

There is a contrary expectation. Are the majority not equally entitled to expect the minority to pull their weight and contribute further funds when necessary?[190] The corporation needed refinancing and the courts analysis should have been confined to examining first, whether the majority explored *alternative* methods of refinancing which would not have diluted the minority holding and second, the *terms* of the method chosen. The minority are entitled to expect that the corporation attempt any reasonable financing alternative which does not affect their own investment. The majority, however, are equally entitled to expect that the minority will make a contribution if a rights issue is needed.

This approach was followed by the judge in *Re Sabex Internationale Ltée.*[191] He found that, although financing was needed the bánk had not specified that a rights issue was necessary nor that its terms were fair:

> "[L]es banquiers n'ont fait aucune exigence quant au mode de la mise de fonds et le prix de 5c l'action n'a pas été justifié. Les intimés n'ont donc justifié ni l'émission proposée ni ses conditions bien qu'ils aient tenté de le faire."[192]

With this approach proper purpose is not addressed, the court is merely fulfilling its role as the interpreter of an immensely complex contract. To determine the contract's terms the judge must transcend the articles of association and look to the *consensus ad idem* of the parties, embodied in their reasonable expectations.

There is inevitable conflict between a broad equitable remedy and the power of those in control of a corporation to manage its affairs. Canada has started to address this conflict

[190] The issue is an old one. See *Brown v. British Abrasive Wheel Co.* [1919] 1 Ch. 290 where a 98% majority attempted to expropriate a 2% minority who would make no further contribution to the company.
[191] (1979) 6 B.L.R. 65 (Q.S.C.).
[192] *Ibid.*, at 90.

just as the Chancery courts of Delaware did ten years before them. It is to be hoped that they will not be distracted by the same desire to evaluate a proposed transaction's proper corporate purpose.

4.5 The Proper Approach to the Remedy

Following the lead of South Carolina several U.S. states have included an oppression remedy in their corporations laws.[193] The majority of these "new wave" American corporations statutes are modelled on the Model Business Corporations Act Close Corporations Supplement which provides a general equitable remedy similar to the English or Canadian provision.[194]

An instructive example of this statutory approach in the U.S. is the recent Minnesota Business Corporations Act.[195] The primary protection afforded noncontrolling shareholders is provided by s.751 which authorises equitable relief when those in control of the corporation have acted in an "unfairly prejudicial" manner toward the nonconctrolling shareholders. The intention of those who drafted the section is clear,

[193] S.C. Code Ann., ss. 12-22.15, 12-22.23.

[194] A.B.A. - A.L.I. Model Bus. Corp. Act Close Corporation Supplement (1984 revision) s.40:

> (a) Subject to satisfying the conditions of subsections (c) and (d), a shareholder of a statutory close corporation may petition the [name or describe] court for any of the relief described in section 41,42, or 43 if:
>
> (1) the directors or those in control of the corporation have acted, are acting or will act in a manner that is illegal, oppressive. frauduldent, or unfairly prejudicial to the petitioner, whether in his capacity as shareholder, director, or offficer, of the corporation;
>
> (2) the directors or those in control of the corporation are deadlocked in the management of the corporation's affairs, the shareholders are unable to break the deadlock, and the corporation is suffering or will suffer irreparable injury or the business and affairs of the corpoaration can no longer be conducted to the advantge of the shareholders generally because of the deadlock; or
>
> (3) there exists one or more grounds for judicial dissolution of the corporation under [MBCA s. 14.30]

[195] Minn Stat. ch. 302A. For a detailed discussion of the provision see Joseph E. Olson, "A Statutory Elixir for the Oppression Malady" (1985) 36 Mercer L.R. 627.

"unfair prejudice" is to be equated with a violation of the parties' "reasonable expectations":

> "The *law* is now clear - minority shareholders have a right to relief from "mistreatment" that exploits their vulnerability and defeats their reasonable expectations."[196]

The unequivocal link between the shareholder's equitable remedy and his reasonable expectations has been made. The courts must look, not to the *purpose* for which a delegated power has been used, but to the effects of the power's exercise upon the minority. The key to defining what conduct is unfairly prejudicial, therefore, is the *impact* that the conduct has on the minority.[197]

This approach to the remedy, ironically provided by the newest jurisdiction to embrace its application, escapes an examination of the corporate purposes served by a particular majority decision. The court is enforcing the bargain struck by the parties and, whilst some expectations will be common to all minority shareholders, the reasonable expectations of a particular shareholder will vary with the circumstances.

The shareholder's right to be fairly treated is being uniformly interpreted to encompass his reasonable expectations. The Securities Commissions here in Canada have used their wide discretionary powers to transcend the start made by the courts. The Ontario Securities Commission has stated that a "squeeze-out" merger may not proceed unless a majority of the minority have voted in favour of it.[198] The majority of the minority requirement has since been applied to all going private transactions.[199]

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[196] Olson, *supra*, at 633. Professor Olson drafted the 1983 Amendments to the Minn. Bus. Corp. Act.

[197] *Ibid.*, at 640.

[198] See *In re Cablecasting Ltd.* [1978] O.S.C. Bull. 37 (February).

[199] O.S.C. Policy 9.1, 3 CCH Can. Sec. L.Rep., para 471-901. The rule was applied in *In re M. Loab Ltd.* [1978] O.S.C. Bull 333 (December), where the O.S.C. said, at 348:

> "When the company that now wishes to go private sold its securities to the public it accepted certain obligations of so doing; one of those obligations is to deal fairly with those members of the public who have invested in the

The approach of the Securities Commissions highlights the universal application of shareholder expectations. The current trend of limiting the statutory remedy in the U.S. to private or closely held corporations is wrong.[200] Securities commissions are by their very nature concerned with issues to the public and the commissions have recognised that the mere existence of a market for shares is not a sufficient safeguard against unfairness. The public is entitled to more than this.

The needs of a shareholder in a close corporation, it is true, vary from those of a participant in a public enterprise. As the M.B.C.A. Close Corporations Supplement quite properly recognizes, he may wish to take over the running of the undertaking[201] or provide for supermajority agreement on certain issues.[202] However, just because oppression is more visible in the close corporation is no reason for limiting equitable relief to this area. Particularly in the context of a take-over bid or squeeze-out merger a minority shareholder in the public corporation is also vulnerable to being short-changed by a majority acting in its own self-interest.

> corporation. It is fairness that policy 3-37 is directed to, and it is not for the majority to make that decision by majority vote."

See P. Anisman, "Majority-Minority Relations In Canadian Corporation Law: An Overview" (1986-87) 12 C.B.L.J. 473 at 489.

[200] For a critical assessment of the recent trend toward special close corporation legislation see D.S. Karjala, "A Second Look at Special Close Corporation Legislation" (1980) 58 Tex. L. Rev. 1207. Karjala isolates two approaches to special statutory treatment of the close corporation. The first approach is to merely give statutory recognition to a unanimous written shareholder agreement. This was the approach of North Carolina. The second is to provide specific sections applicable only to the close corporation, either as part of the General Corporations Act or in a special supplement. This is the approach adopted by Delaware and the M.B.C.A. His criticism of both approaches is that, by attempting to create the model close corporation, the statutes create a legislative fetter on the ability of a judge to provide an equitable solution:

> "[N]o statute can eliminate the need for judicial sensitivity when the parties have tried to plan carefully but facts have changed, new parties have entered the scene, or relationships unforeseeably have broken down." *Ibid.*, at 1268.

[201] See A.L.I. - A.B.A. Model Bus. Corp. Act (1984 Revision) Close Corporation Supplement, s. 8.01, which permits a close corporation with less than 50 members to dispense with a board of directors in whole or in part.

[202] *Ibid.*, at s.10.21 and 10.22. In many respects these provisions reflect the contents of a partnership deed. See also Delaware Code Tit. 8 Ch.1 s.355(a) which permits the shareholders of a close corporation to provide for dissolution "at will".

The public/private corporation dichotomy is too simplistic.[203] Some very widely-held corporations can, in substance, resemble private companies. To give a recent example, in a very well publicized battle for control of Canadian Tire, a major Canadian corporation, the public shareholders who owned Class A non-voting shares were deliberately excluded from sharing in the proceeds of sale. Under the share structure of Canadian Tire the founder's family retained voting control but held only 2.5% of the capital, the balance being provided by the Class A shareholders. Was Canadian Tire, therefore, a private or public corporation? It exhibited one of the essential characteristics found by Lord Wilberforce in the *Ebrahimi* case and by the Court in *Donahue* namely "integration of ownership and management"[204] and it is this, and not designation as a private or public company, which creates the environment in which oppression may occure. The Canadian securities commissions recognized that the minority[205] had been treated unfairly and prohibited a sale which did not allow public participation.[206]

Both the courts and the administrative agencies which regulate the securities market have been drawn to a wide definition of fairness which favours a minority's expectations over the exercise of a legal power delegated to the majority.

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[203] See L.D. Soderquist, "Reconciling Shareholder's Rights and Corporate Responsibility: Close and Small Public Corporations" (1980) 33 Vand. L. Rev. 1387. Sonderquist rejects the traditional framework for distinguishing between public and private corporations ie. distinguishing on the basis of whether or not the corporate shares are generally traded in the securityies markets. He argues that the rationale for the distinction is the relationship of shareholders to the corporation. In the close corporation this is the relationship of traditional owners, while in public corporations it is that of investors. This definitional problem has had to be faced both by the courts and those legislatures which have special close corporation statutes. See Lord Wilberforce's attempt to define when a court would subect legal rights to equitable considerations in Ebrahimi v. Wesbourne Galleries [1972] 2 All E R. 492 at 379; cf. the approach of the Massachusetts Supreme Court toward defining a close corporation in *Donahue v. Rodd Electrotype Co. of New England Inc.* 328 N.E.2d. 505 at 511. (Mass. 1975). M.B.C.A. Close Corp. Supp. s.3; Del Code Tit. 8 Ch.1 s.342.

[204] *Donahue v. Rodd Electrotype Co. of New England Inc.* 328 N.E.2d. 505 at 511. (Mass. 1975).

[205] Although it is hardly appropriate to refer to the Class A shareholders in Canadina Tire as a minority as they held the overwhelming *majority* of shares.

[206] *In re Canadian Tire Corp. Ltd.* (1987) 10 O.S.C. Bull 858 affd. 10 O.S.C. Bull. 1772.

CHAPTER V

CONCLUSION - FAIRNESS AS A REASONABLE EXPECTATION

Comparative legal study reveals both a reassuring similarity between the problems various legal systems have to face and a disappointing reluctance on the part of those systems to look further than their own borders for a solution. Nowhere is this better illustrated than in the context of corporations law where three Common Law systems have unwittingly converged in an attempt to protect the minority shareholder.

Once commercial flexibility demanded a dynamic organizational structure for the business enterprise, the shareholder saw his role in his corporation decline. As the courts on both sides of the Atlantic were frustrated in their attempts to protect an individual shareholder's voice within his company, he ceased to be fundamental to the decision making process and had to accept that the views of the majority would prevail.

Majority rule cannot be an instrument of tyranny. A legal system must adequately balance the need to facilitate dynamic decision making processes against a shareholder's right to be treated fairly by the omnipotent majority. The minority is in need of protection when a delegated power has been abused.

This paper has examined two approaches to protecting the minority and both have different strengths. The fiduciary duty is, like all equitable tools, both flexible and adaptable: although originally applied to a sale of corporate assets at an unfair price, it is equally capable, a century later, of challenging unfair director's actions when defending a take-over bid. It has one further advantage. Because the fiduciary duty is used to provide a restraint over the actions of the board of directors it would be consistent to use this same protective device to restrain another corporate body when it undertakes managerial functions. As the modern corporation may act through two organs (the board of directors and the shareholders in general meeting), it is submitted that when either body exercises delegated powers, they be subject to *identical* equitable restraint. It is the great advantage of the fiduciary duty that, as it is imposed on a recipient of a power, it can be applied to director and majority shareholder alike.

The fiduciary duty's very flexibility is also its disadvantage. During the century of its application in the United States, this notion has evolved and developed to such a extent that it is almost impossible to state the content of the duty. After all, a duty which is uncertain is no duty at all.

The statutory remedy, by contrast, suffers from the opposite affliction. By ancoring the court to the interpretation of a statutory section, the remedy imports an unwelcome fetter upon a court of equity. This attempt to provide a legislative solution to a judicial problem is both rigid and inflexible and therefore incapable of responding to the complexities of the corporate world.

The law, as so often in the past, is faced with the choice between two courses: one course is relatively predictable and administrable; it is also conceptual, formal, and in its results silly. The other is relatively functional and sensible; it is also unadministrable, unpredictable, and in its results unworkable. The English oppression remedy giving relief only if the majority's actions fit the narrow statutory wording follows the first course; the fiduciary duty providing a remedy whenever a court finds unfairness follows the second. And the law rocks between them.

Oblivious to developments outside their jurisdictional lines, like ships passing in the night, Britain and North America are each moving off into the waters the other has already chartered. In England the judiciary have rediscovered the fiduciary duty's application to the shareholder. In the United States more and more states are including a statutory remedy in their corporations laws.

The majority of the new American corporations law statutes apply the remedy only to close corporations. Equally it has been argued that the fiduciary duty concept adopted in the *Donahue* and *Clemens* cases should not be applied to public companies where the essential bonds of mutual good faith and confidence which form the basis of the duty do not exist.[1] Whereas in the close company there is a blurring of the management and ownership roles, in the public company distinct separation between share ownership and management functioning is the norm.

The author would argue that to restrict either the fiduciary duty or an oppression remedy to the close corporation is to once again elevate form over substance. Just because oppression is more visible in the close corporation is no reason for limiting equitable relief to this area. We have seen that, particularly in the context of take-over bids or "squeeze-out" mergers, a minority shareholder in the public corporation is also vulnerable to being short-changed by a majority acting in his own self-interest.

Oppression does not stop merely because the company is "public". A widely-held corporation in which management and ownership are vested in the same group as, for example, in a subsidiary where the parent corporation owns a majority of the shares and appoints a majority of the board, resembles a private corporation. Again the minority are susceptible to capricious acts of the majority. To deny them equitable relief is to limit the extent of their rights to receiving the appraised value of their shares. Courts in both Canada and Delaware have refused to be so restrictive. They recognize that a shareholder has a substantive right to wider equitable remedies which can include, in certain cases, enforcing his right to remain a shareholder.

Oppression is not concerned with the characteristics of a close corporation, but is likely to occur whenever an organizational structure permits the majority shareholder to

[1] See S.J. Leacock, "Close Corporations and Private Companies Under American and English Law: Protecting Minorities" (1982-83) 14 Lawyer of the Americas 557 at 573

exercise a delegated power without the consent of the minority. Oppression, in other words, involves an abuse of power. Corporations statutes permit a specified majority of members in both public and private companies to exercise delegated powers, therefore both types of business enterprise deserve the attention of equity.

In the author's view there is a need to subject the actions of corporate controllers to general equitable limitation regardless of which body they care to act through. It is irrelevant whether this limitation is achieved through a broad statutory remedy or flexible common law rule. Both have their strengths, both have their weaknesses. What is ultimately important is the attitude of the judiciary upon whom the efficacy of a legal rule must rely. It is no longer sufficient for judges to refuse to decide shareholder disputes, they must take an active role in a corporation's affairs and if they are not prepared to do so then they must be replaced by a panel which will.

A general fiduciary duty or an adequately worded oppression remedy provide ample protection for the minority as long as those who interpret the rule are prepared to give it maximum effect. On those occasions when it has been tried the judiciary have been frightened off. The Delaware Supreme Court linked their inquiry to the *purposes* for which a delegated power was exercised and in so doing became embroiled in corporate policy. A similar judicial preoccupation with bona fide purpose seems in prospect for Canada.

It is the judiciary's *approach* once asked to intervene, and not the legal formula permitting judicial intervention, that is important for a minority shareholder.

If a legal system is to provide adequate protection for the minority shareholder whilst at the same time refraining from interference with corporate policy, then the approach of the judiciary should be to examine the "reasonable expectations" of those who own the enterprise. In other words a judge must look not to the *purposes* for which a power was exercised, but to its *effects* on the members.

Inquiry into a shareholder's reasonable expectations is to be favoured over recent attempts to articulate a shareholder's "Bill of Rights".[2] This approach is too rigid. All public and all private companies are the *not* the same. The rights and expectations of the parties will vary with the context and the law must respond by enforcing the bargain struck by the parties, regardless of whether this is formally contained in the corporations constitution. A corporation is more than a mere legal entity with a personality of its own. The law must recognize that behind it, or amongst it, there are individuals with rights, expectations and obligations which may not be made subservient to the wishes of the controlling or majority shareholder.

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[2] See e.g. William L. Cary, "Federalism and Corporate Law: Reflections Upon Delaware" (1974) 83 Yale L.J. 663 and M.A. Chirelstein in The Role of the Shareholder in the Corporate World, *in* Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Comm. on the Judiciary, 95th Cong., 1st Sess. 264 (June 27,28, 1977).

TABLE OF CASES

A

Abbatt v. Treasury Solicitor & Others [1969] 1 W.L.R. 1575 21

Aberdeen Rly Co. v. Blaikie Bros. (1854) 1 Macq. 461 28

Abraham v. Interwide Investments (1985) 30 B.L.R. 177 (Ont. S.C.) 105

Alexander v. Westeel-Rosco (1979) 4 B.L.R. 313 (Ont. S.C.) 108,109

Allen v. Gold Reefs of West Africa [1900] 1 Ch. 656. .... 20,31,33,59,62, 65,66,67

Allied Chemical & Dye Corp. v. Steel & Tube Co. 120 A. 487 (1923) 36,41,42,55

Amalgamated Syndicate [1897] 2 Ch. 600 72

Anderson v. W. J. Dyer & Bro. 94 Minn 30, 101 N.W. 1061 (1904) 58

Andrews v. Gas Meter Company [1897] 1 Ch. 361 33

Appotive v. Computrex Centres Ltd. (1982) 16 B.L.R. 133 (B.C.S.C.) 106

Ashbury Rly. Co. v. Riche (1875) L.R. 7 H. L. 653 23

Ashbury v. Watson (1885) 30 Ch. D. 376 23,25

Att.- Gen v. Great Northern Rly. (1860) 1 Dr. & Sm. 154 21

Automatic Self- Cleaning Filter Syndicate Co. Ltd. v. Cunninghame [1906] 2 Ch. 34 28

B

Barnes v. Brown 80 N.Y. 527 at 537(1880) 30

Barrett v. Denver Tramways Corp. 53 F. Supp. 198 (D.Del. 1944) 44,55

Bell v. Kirby Lumber Corp., 413 A.2d 137 (Del 1980) 51

Bellador Silk Ltd., Re [1966] 2 W.L.R. 288; [1965] 1 All E.R. 667 77

Bennett v. Breuil Petroleum Corp., 99 A.2d. 236 (Del.Ch. 1953) 55,56,58,63

Bleriot Manufacturing Aircraft Company (Ltd), Re (1916) 32 T.L.R. 253 72

Blisset v. Daniel (1853) 10 Hare. 493 59

Bovey Hotel Ventures, Re (31 July 1981, unreported)....................99

Brant Investments Ltd. v. Keeprite Inc.[1987] O.J. No. 574 (H.C.)....................110-115

Braslav v. New York &. Queens Electric Light & Power Co., 249 App. Div. 181, 291 N.Y.S. 932 (1936), aff'd 273 N.Y 593, 7 N.E.2d 708 (1937)....................16

Bridgewater Navigation Co., Re (1888) 39 Ch.D. 1....................23

British and American Trustee And Finance Corporation v. Couper [1894] A.C. 416....23,24

Brown v. British Abrasive Wheel Co. [1919] 1 Ch. 290....................60,115

Bryon v. The Metropolitan Saloon Omnibus Company Limited (1858) 121 R.R. 35 (3 DeG. & J. 123)....................21

Burdon v. Zeller's (1981) 16 B.L.R. 59 (Q.S.C.)....................108,109

C

Cablecasting Ltd., Re [1978] O.S.C. Bull. 37 (February)....................118

Canadian Tire Corp. Ltd., Re (1987) 10 O.S.C. Bull 858 affd. 10 O.S.C. Bull. 1772..120

Carken v. Drury (1812) 1 Ves & b 154....................88

Carlton v. Maple Leaf Mills Ltd. (1978) 4 B.L.R. 300 (Ont. S.C.)....................108,109,110

Carrington Viyella, Re F.T. Comm Law Reports 16 February 1983....................97,98

City Equitable Fire Insurance Co, Re [1925] 1 Ch. 407....................28

City Property Investment Trust Corpn. Ltd. [1951] SLT 371....................24

Clemens v. Clemens Bros. Ltd. [1976] 2 All E.R. 268....................62,63,64,65, ...67,71,115

Cole v. National Cash Credit Ass'n 18 Del. Ch. 47, 156 A 183 (1931)....................41,43,55

Company, A., Re (No. 004377 of 1986) [1987] 1 W.L.R. 102....................101

Company, A., Re (No. 007623 of 1987) [1986] B.C.L.C. 362....................102,103

Company, A., Re [1983] 2 All E.R. 854....................96

Company, A., Re [1983] BCLC 151, [1983] Ch. 178, [1983] 2 All E.R. 36....................96

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D

Dafen Tinplate Co. v. Llanelly Steel Co. [1920] 2 Ch. 124...60

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E

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....100,101,103,104,
....120

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....70,71

F

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G

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H

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I

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J

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K

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L

Lands Allotments Co, Re [1894] 1 Ch. 616 28

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London School Of Electronics Ltd., Re [1985] 3 W.L.R. 474. See [1985] J.B.L. 187 ... 99

Lundie Brothers Ltd., Re [1965] 2 All E.R. 692, [1965] 1 W.L.R. 1051 78,79

Lynch v. Vickers Energy Corp. 383 A.2d 278, 281 (Del Sup. 1971) 53

M

MacDougall v. Gardiner (1875) 1 Ch. D. 13 69

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N

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O

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P

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R

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Russell v. Wakefield Waterworks Co. (1875) LR 20 Eq. 474 70

S

Sabex Internationale Ltée, Re (1979) 6 B.L.R. 65 (Q.S.C.) 107,115,116

Salmon v. Quin & Axtens [1909] 1 Ch. 311 82

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Schaad v. Hotel Easton Co., 369 Pa.486, 87 A.2d. 227 (1952) 11

Schnell v. Cris-craft Industries Inc. 285 A.2d. 437 (Del.Sup.1971) 48

Scottish Co-operative Wholesale Society Ltd. v. Meyer. [1959] A.C.324 ....78,80,81,82, ...92,93,104

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T

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U

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V

Vedova v. Garden House Inn Ltd. (1985) 29 B.L.R. 236 (Ont. S.C.)....................105

W

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Weinberger v. O.U.P. 457 A2d. 701 (Del. Sup. 1983)....................52,53,54,55, 108,113

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Western Foundry Co. v. Wicker, 403 Ill. 260, 85 N.E.2d. 722 (1949)....................11

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Y

Yenidje Tobacco Co. Ltd., Re [1916] 2 Ch. 426..73,76,77

Yoakim v. Providence Blitmore Hotel Co. 34 F.2d. 533 (1st Cir. 1929)........................17

Z

Zabriskie v. Hachensack & N.Y. Railroad, 18 N.J. Eq. 178 (1867) 15

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