WCP LTD V GAMBOTTO: AN OPPORTUNITY FOR THE HIGH COURT TO SET SOME CORPORATE LAW NORMS

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The High Court has recently heard argument in the case of *WCP Ltd v Gambotto*. The case is on appeal from the New South Wales Court of Appeal.[1] Although the facts of the case are relatively simple, the issues they raise are rather more complex. WCP Ltd is a company, the shares of which are almost entirely owned by Industrial Equity Ltd. In fact IEL owns all but 0.3 per cent of WCP's issued capital. IEL decided that there were advantages to be had by consolidating its control to 100 per cent ownership of WCP. In order to further this objective, an amendment to WCP's articles was proposed which would insert a new provision permitting the compulsory acquisition of shares by any member "entitled for purposes of the Corporations Law to 90 per cent or more of the issued shares" of the company. The effect of this amendment would be that IEL would be able to compel other shareholders in WCP to sell their shares to it at a price of $1.80 per share, a price well above the then current market value of the shares. The proposed amendment was passed at a meeting of the shareholders of the company convened for that purpose. IEL did not attend the meeting, personally or by proxy, and the amendment was approved unanimously by the minority shareholders present.

Mr. Gambotto, a minority shareholder not in attendance at the meeting, took issue with this attempt to compel him to part with his shares, and sought an order invalidating the amendment to the articles. He alleged that the amendment to the articles constituted an act of oppression or a fraud of the majority on the minority. At the trial, Gambotto succeeded in persuading McLelland J of the oppressive nature of the compulsory acquisition of his shares. McLelland J did not provide substantial reasons for judgement. He merely concluded that:

> The immediate purpose and effect of the amendment was to permit the shares of the minority shareholders to be expropriated by the majority shareholders. In my opinion such an amendment amounts to unjust oppression of those minority shareholders who object.[2]

WCP was successful in persuading the New South Wales Court of Appeal that the amendment to its articles should be permitted to stand. Meagher JA, with whom Priestley and Cripps JJA agreed, was at some pains to explain the reasons behind the

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1 Judgement reported at (1993) 10 ACSR 468.

2 (1992) 10 ACLC 1046 at 1049.

decision of the trial judge. He seemed to conclude that McLelland J's conclusion was reached on the basis that the expropriation of minority shareholdings by the majority was repugnant in and of itself. Speaking of the judgment of McLelland J he stated: "[H]is Honour's view is consistent with, and only with, some notion that in [*sic*] an expropriation of shares whether beneficial for the company or not is a *malum in se* and as such always enjoinable."[3]

The case presents an important opportunity for the High Court to clarify the extent of the rights attaching to share ownership. In addition, the facts of this case afford the High Court an ideal means to expound an authoritative view on the proper means of balancing the interests of majority shareholders with those of the minority.

It is unfortunate that, both in the lower courts and in the High Court, the parties seemingly restricted their argument to the common law and did not invoke the provisions of s 260 of the Corporations Law. This was despite the fact that the trial judge characterised the actions of the majority shareholder as "oppressive".[4] Also, given that the Corporations Law does not contain any general provision permitting majority shareholders to acquire by compulsion the shares held by minority shareholders, it would seem that a case such as this presents an equally compelling opportunity for the expression of judicial views on the matter of compulsory acquisition itself.[5] Neither the trial judge nor Meagher JA did more than state bald conclusions on the matter of the desirability or equity of compulsory acquisitions.

It is to be hoped that the High Court will take this opportunity to expound its views on the nature of share ownership. Cases of compulsory acquisition beg the question of whether there is anything about the ownership of a share, at least in a public company, which ought to preclude action which compels the owner of that share to part with it for fair compensation. In the writer's view, it is essential to have some authoritative statement of the essential rights of shareholders. Company lawyers have been attempting for many years to develop a reasonable means of balancing the legitimate interests of the majority with those of minority shareholders. The notion of majority rule within companies has been limited by various means by which the interests of the minority are protected.

In the early part of this century, the English Court of Appeal decided several cases raising this issue.[6] Those cases were all cited in argument before the various courts hearing this case. Unfortunately, neither McLelland J nor Meagher JA was prepared to acknowledge that the relevance of those early English cases has been severely limited by the development of statutory remedies which give modern courts substantial

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3 (1993) 10 ACSR 468 at 475.

4 See the passage quoted above: "In my opinion such an amendment amounts to unjust oppression of those minority shareholders who object." (1992) 10 ACLC 1046 at 1049.

5 The Corporations Law does contain provisions permitting compulsory acquisition of minority interests in ss 411 and 701-702; however these provisions restrict such activity to that occuring in the context of a takeover scheme or a compromise with the company's creditors.

6 *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656; *Brown v British Abrasive Wheel Co Ltd* [1919] 1 Ch 290; *Sidebottom v Kershaw Leese & Co Ltd* [1920] 1 Ch 154 and *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9.

discretion to effect appropriate remedies to safeguard the interests of minority members.[7]

To put it simply, modern corporate law places great stock in the concept of majority rule. The Corporations Law explicitly grants the majority substantial powers with respect to fundamental matters of corporate governance.[8] Hence, those who hold the majority of voting shares can, by special resolution, amend the company's articles of association. Likewise, generally speaking, those controlling the majority of voting shares also elect the company's directors. Note that the reference is to the majority of voting shares and not the majority of shareholders. Thus, in corporate law, majority rule means something different from what it means in political democracy.[9] It has long been recognised that the principle of majority rule presents difficulties to minority shareholders. The earliest attempt to incorporate a means of protecting minority shareholders was to place an equitable restraint on the manner in which shareholders voted their shares. This was despite earlier decisions holding that shareholders were free to vote their shares in any manner they pleased, as the share was an item of personal property belonging to the shareholder.[10]

Conceptually, the notion of an equitable restraint on the manner in which a share is voted has always presented problems. Even if one were to accept that such a restraint could be justified, it would be hard to articulate a test which could be applied in any consistent manner. The test articulated by Lindley MR in *Allen v Gold Reefs of West Africa* was deceptively simple. Speaking of the majority's recognised power to alter the articles of association, he said: "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...".[11] Meagher JA recognised the difficulties that this statement has caused when he said of it: "These words have beguiled and confused the courts ever since".[12] Nonetheless, neither the trial court nor the Court of Appeal saw any reason to follow a different path and rendered their decisions on the basis of the application of the test propounded by Lindley MR.

I will not dwell on a criticism of the indeterminacy of the traditional test. Others have done so, and there is little to add to the substantial criticisms that have already

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7 In the form of provisions such as ss 260 and 1324 of the Corporations Law.

8 Such as the power to amend the articles of association by special resolution: s 176(1).

9 Note here the observations recently made in the Report by Expert Panel of Inquiry into Desirability of Super Voting Shares for Listed Companies: "The principle of democratic political theory is one person, one vote. This survives in the Corporations Law in respect of voting on a show of hands. However on a poll, we are talking not about one shareholder, one vote but one share one vote. It is clearly recognised that there can be differences between shareholders depending on the number of shares which they hold and that this will be based on their wealth. At this point the analogy with political theory starts to disintegrate and is being used emotively." Report by Expert Panel of Inquiry into Desirability of Super Voting Shares for Listed Companies, *Corporations Law Super Voting Shares* (1994) at 27.

10 In *Pender v Lushington* (1877) 6 Ch D 70 at 75-76, the Court stated: "There is ... no obligation on a shareholder of a company to give his vote merely with a view to what other persons may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interest."

11 [1900] 1 Ch 656 at 671.

12 (1993) 10 ACLC 468 at 470.

been made.[13] Lindley MR's words were written at a time when judicial reluctance to interfere with the actions of either the majority or company management ruled the day. Consequently, perhaps the only available means to thwart the otherwise uncontrolled power of majority shareholders was to articulate an equitable restraint on the voting power of the majority. If such were Lindley MR's intent, then he is to be credited with great judicial innovation and with having seized upon the potential of equitable doctrine to protect the vulnerable from the unbridled exercise of power. However, we are fortunately not so limited as was his Lordship. Courts have been given great discretion to apply common sense to internal corporate disputes in the form of s 260.

In itself, s 260 does little to advance the cause of certainty in the regulation of corporate affairs. It provides courts with great discretion to remedy "oppressive", "unfairly prejudicial" or "unfairly discriminatory" conduct. It would be unfortunate indeed if the High Court did not use *WCP v Gambotto* as a means of articulating some norms for the application of this important provision. At the very least, given the degree of criticism which Lindley MR's words have provoked, it would be a welcome development for the Court to indicate that, in future, all such cases ought be decided with reference to the statute.

The case on appeal therefore squarely raises the matter of the ability of the Court to review the actions of a majority of shareholders. Notwithstanding the wide discretion conferred by s 260, many Australian courts still feel compelled to follow earlier decisions of minimal relevance in the era of statutory remedies. Hence, even the rule in *Foss v Harbottle*[14] is cited[15] as well as the law imposing an equitable restraint on the shareholder's right to vote. Despite the history of judicial non-intervention in internal corporate disputes, some Australian courts are beginning to apply s 260 in a meaningful way.[16] Nonetheless, the High Court has not had an opportunity to consider the exercise of discretionary curial power in the context of internal corporate disputes since its decision in *Wayde v New South Wales Rugby League Ltd*[17] and the time is ripe for a clear statement that courts are no longer "bound to have regard to the fact that [a] decision was ... made by experienced administrators"[18] when reviewing a decision of a company's board of directors.

Since the federalisation of corporate law in this country, the Commonwealth Parliament has had effective control of the Corporations Law. We have, in the last three years, seen hundreds of pages of statutory amendments. However, none of the amendments has addressed a fundamental problem presented by the Corporations Law. It is a hybrid statute. Imported from England in the last century, the statute has retained provisions which are conceptually inconsistent. A good example of this

13 See, eg, the judgments of Latham CJ and Dixon J in *Peter's American Delicacy Co Ltd v Heath* (1938) 61 CLR 457. See also S Fridman, "Ratification of Directors' Breaches" (1992) 10 *Co & Sec LJ* 252 and references therein.

14 (1843) 2 Hare 461; 67 ER 189.

15 See for example the reasons for judgement in *Residues Treatment and Trading Co Ltd v Southern Resources Ltd* (1988) 51 SASR 177 at 198.

16 In recent years, Australian courts have been more inclined to seize the opportunity presented to them by s 260 to use the judicial discretion granted therein to fashion appropriate remedies to protect the interests of minority shareholders: see particularly *Re Enterprise Gold Mines NL* (1991) 3 ACSR 531 and *Re Spargos Mining NL* (1990) 3 ACSR 1.

17 (1985) 59 ALJR 798.

18 Ibid at 804.

problem is the tension between s 180 and s 260. Section 180 designates the corporate constitution as having the same force and effect as a contract under seal between various parties, including the members and the company. In the past, this contractual force of the articles and memorandum has been used as an effective means of circumventing the rule in *Foss v Harbottle*.[19] So long as judges treated themselves as constrained by the historical reluctance of courts to intervene in what they determined were matters of internal management, s 180 remained of some importance. However, the ability of the statutory contract to protect the legitimate expectations of shareholders was severely limited by laws restricting the courts' ability to enforce the provisions of the contract to situations where the shareholder was seeking to protect an entitlement enjoyed in his or her capacity as a shareholder.[20] No such limitation exists in s 260.[21] The presence of both statutory provisions shows that Australian corporate law possesses characteristics of two different models of corporate law. On the one hand, it retains the contractual basis of English corporate law, while, on the other, it has imported the statutory discretions that are indicative of a model of corporate law conceptualised by a statutory division of powers between the members and company management.[22] It is submitted that, restrained as it is by early English decisions severely limiting the discretionary power of courts, the contractual framework of corporate law ought be rejected in favour of a more elegant and flexible approach represented by provisions such as s 260. This move, it is hoped, might signal the end of the grip that Messrs Foss and Harbottle have had on the development of means of protecting the reasonable expectations of shareholders in Australia.

Were that to be the case, the High Court might be able to indicate the circumstances amounting to oppression in the context of the compulsory acquisition of the minority's shares. In order to come to any reasonable view, it would be essential for the Court to articulate the reasonable expectations of shareholders.[23] This in turn would probably necessitate a distinction between closely held proprietary companies and other entities, as, in the former, share ownership is more a means of effecting participation in the governance of the company than merely a manner of investment. It might also be the

19 See for example, *Residues Treatment and Trading Co Ltd v Southern Resources Ltd* (1988) 51 SASR 177 where the Full Court of the South Australian Supreme Court held, in a case dealing with a shareholder's challenge to the exercise of the power of the company's directors to issue shares, that shareholders were possessed of a personal right "to be protected against dilution of [their] voting rights in the company" (at 201). This personal right, according to the Court, was "fortified by the nature of the contract between the company and the members constituted by the memorandum and articles of association and given statutory force by s 180(1)" (at 202). The personal right, thus founded, allowed the Court to permit shareholder action despite the "proper plaintiff" principle emanating from the rule in *Foss v Harbottle*.

20 See *Eley v Positive Government Security Life Assurance Co* (1876) 1 Ex D 88.

21 Section 260(5)(c) provides: "[A] reference to an act or omission by or on behalf of a company or a resolution of a class of members of a company being oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member is a reference to an act or omission by or on behalf of a company or a resolution of a class of members of a company being oppressive or unfairly prejudicial to, or unfairly discriminatory against, a person who is a member, whether in the person's capacity as a member or in any other capacity."

22 See B L Welling, *Corporate Law in Canada: The Governing Principles* (1992) at 55-73.

23 See J Hill, "Protecting Minority Shareholders and Reasonable Expectations" (1992) 10 *Co & Sec L J* 86.

case that the contractual framework of corporate law could be applied to the closely held corporation in a meaningful way. One of the criticisms the contractual theoretical framework has drawn is that it does little to explain the process by which a person becomes a shareholder in a public company.[24] By contrast, the contractual theory of corporate law possesses great relevance for those companies which can be regarded as "incorporated partnerships".[25] I realise that the line between the closely held "incorporated partnership" and the public company is a hard one to draw. However, by recognising this distinction, the High Court would lend additional support to the efforts of the Attorney-General's Department to articulate a new corporate jurisprudence for small business.[26]

The expropriation of the shares of minority members is a matter which necessitates consideration of what it means to hold shares in a company. Many would argue that where a minority shareholding is so small that it cannot reasonably be expected to confer on the shareholder any participatory interest in the company, it would be unreasonable to vest the shareholder with negative control by allowing him or her to thwart a majority shareholder's efforts to consolidate ownership to 100 per cent. As Meagher JA pointed out: "[I]t can hardly be contended that all powers of expropriation are repugnant to the Corporations Law", citing ss 701-702 and 411.[27] In fact, as his Honour implicitly recognised, there would seem to be no basis for confining permissible expropriations to takeovers and compromises. Of course, the determination of this matter requires the proper consideration of the nature of the property interest represented by share ownership.[28] It may be asserted that, where share ownership cannot realistically be linked to a participatory interest in the governance of a company, the proper means of protecting the interests of the minority is to ensure that the compensation provided for shares compulsorily acquired is fair.[29] The Canadian legislation reinforces the notion that the primary remedy for disaffected minority shareholders is fair compensation for their shares by including a provision granting shareholders a statutory right of dissent.[30]

Beyond questions of fair value, other matters need to be addressed, such as the question of the propriety of voting participation by majority shareholders seeking to expropriate shares of the minority. Although the majority shareholder in *Gambotto* did

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24 See V Brudney, "Corporate Governance, Agency Costs and the Rhetoric of Contract" (1985) *Columbia L Rev* 1403.

25 See for example *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360.

26 The Simplification Task Force, Attorney-General's Department, has recently released proposals to simplify and reform the law relating to proprietary companies: Corporations Law Simplification Program, *Small Business: Proposal to Simplify Proprietary Companies*, (1994). Note that the proposal does not include any mention of reform to the shareholder remedies provisions of the legislation insofar as they affect small businesses.

27 (1993) 10 ACSR 468 at 474.

28 See P Spender, "Compulsory Acquisition of Minority Shareholdings", 11 *Co & Sec L J* 83 at 89-92.

29 Note that Canadian provisions dealing with compulsory acquisitions are substantially concerned with ensuring that the value offered for the securities is fair: see Canada Business Corporations Act RSC 1985, c C-44, s 206 (hereinafter "CBCA") and the Ontario Business Corporations Act RSO 1990, c B-17 (hereinafter "OBCA"), s 189.

30 CBCA s 190 and OBCA s 185. The statutory right of dissent is essentially the right to require the corporation to purchase one's shares for fair value. It is triggered by, amongst other things, the amendment of the company's articles.

not vote on the amendment to the articles, there would seem to be nothing to prevent it from choosing to do so. In fact, this matter was the subject of comment by McLelland J at the trial, when his Honour remarked that "... had [the] minority shareholders not voted in favour of the amendment, the majority shareholders would have used their voting power to effect the amendment...".[31] In the analogous situation dealing with the expropriation of minority interests by means of a selective reduction of capital, the ASC has opined that majority shareholders should not vote on the relevant proposal.[32] The ASC's views are also instructive on the question of expropriation generally. In Practice Note 29, dealing with selective reductions of capital, the ASC said of proposals to reduce capital that are subject to Court approval:

> The Court will also consider whether the proposal is fair to minority shareholders, and is "fair and equitable" between the different classes of shareholders. The mere fact that the minority shareholders may effectively be removed from the company, regardless of whether or not a particular affected minority shareholder voted in favour of the special resolution, does not mean that the proposal is necessarily unfair to minority shareholders as a group.[33]

Despite my views that the statutory contract is likely to be of limited value in terms of protecting the interests of minority shareholder, it strikes me that, were it inclined to use s 180 to resolve the issues in *Gambotto*, the High Court might develop a new framework within which to apply contractual principles to internal corporate disputes. In this case, the shareholder's argument would rest on the assertion that the property rights represented by shares ought be protected by specific performance of the statutory contract. When looked at in the contractual framework, the rights of shareholders can be conceptualised as the right to ensure that the articles are properly enforced. It is here that the uniqueness of the statutory contract presents problems, as the rights afforded by the contract are subject to variation by the means set out in the Corporations Law. Nonetheless, the law of contract has developed a principled approach to the question of when property rights contained in a contract are to be protected by means of a proprietary remedy. The right to specific performance of a contract is generally restricted to cases where the property involved is unique. In the case of shares, the question then becomes whether there is anything unique about the shares requiring their expropriation to be restrained by means of court order. Once again, this raises the question of whether the shares themselves are anything more than a passive investment in a company. Where, by controlling a parcel of voting shares, a shareholder is able to exert influence in the affairs of a company and its management, it would be relatively simple to conclude that the shares represent property that is unique. In such a case, then, applying analogous principles of contract law, the shareholder ought be able to resist the expropriation of shares. However, where the shares realistically represent nothing more than an investment, the mere fact that

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31 (1992) 10 ACLC 1046 at 1049.

32 ASC, Practice Note 29, Selective Capital Reductions, para 34 states: "The Law does not prohibit the instigator of the proposal (often the controlling shareholder or an associate of the controlling shareholder) voting on the proposal to cancel the share capital of the other minority shareholders. However, to demonstrate fairness to the minority shareholders as a group: (a) the interests of such persons should be fully disclosed; and (b) they should not vote on the resolution."

33 Ibid at para 35.

expropriation would deprive the shareholder of a favourable investment cannot be relevant to the question of expropriation.[34]

There are therefore several alternatives open to the High Court in deciding this case. It is hoped that the Court will opt for an approach whereby it can lend new vigour to the development of the principled application of judicial discretion in the resolving of internal corporate disputes. At the very least, the *Gambotto* case presents the High Court with an opportunity to streamline corporate jurisprudence in Australia. Corporate lawyers can only hope that this opportunity is firmly grasped.

34 See for example the speech of Lord Simonds in *Scottish Insurance Corp Ltd v Wilsons & Clyde Coal Co Ltd* [1949] AC 462, dealing with the return of capital to preference shareholders. The preference shareholders had argued that if their capital were returned they would be deprived of an investment that they could not hope to replace. This argument was not sufficient to persuade the court that the reduction of capital proposed would be unfair.