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**Abstract**
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This short article examines the legal and intellectual bases for the judgments and concludes there is both a proper purpose test and a concept of fairness which are being appealed to by the High Court. A number of issues are referred to briefly, including the High Court's treatment of views on shares as an item of property, their view on section 180(3) of the Corporations Law and some possible implications for the future.

**Keywords**
minority shareholders, High Court

**NOTES**

# THE HIGH COURT AND MINORITY SHAREHOLDERS[1]

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## Introduction

Considerable controversy surrounded the judgment of the High Court in *Giancarlo Gambotto and Anor v WCP Limited and Anor*[2] which was handed down on 8 March 1995. In a joint judgment Mason CJ, Brennan, Deane, and Dawson JJ allowed the appeal (as did McHugh J in a separate judgment) and set aside the orders made by the New South Wales Court of Appeal. In both judgments it was held that the actions of WCP were oppressive, and, whilst this decision was based on the common law fraud on the minority doctrine and not on oppression under section 260 of the *Corporations Law*, the language used appears to indicate a blurring of the two areas. The judgments have largely reinstated the views underlying the three traditional British cases in this area, namely, *Brown v British Abrasive Wheel Co*,[3] *Dafen Tinplate Co v Llanelly Steel Co*[4] and *Sidebottom v Kershaw, Leese & Co*.[5] These cases stand for the principle that it is not permissible, in the absence of a specific statutory power, for the majority to alter the articles so that it can, simply for its own benefit, eliminate the minority.

This short article examines the legal and intellectual bases for the judgments and concludes there is both a proper purpose test and a concept of fairness which are being appealed to by the High Court. A number of issues are referred to briefly, including the High Court's treatment of views on shares as an item of property, their view on section 180(3) of the *Corporations Law* and some possible implications for the future.

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1 This article updates Mitchell V, 'Gambotto and the Rights of Minority Shareholders' (1994) 6 Bond LR 92 which was written prior to the High Court handing down its decision in *Giancarlo Gambotto and Anor v WCP Limited and Anor* (1995) 13 ACLC 342.

2 (1995) 13 ACLC 342

3 [1919] 1 Ch 290.

4 [1920] 2 Ch 124.

5 [1920] 1 Ch 154.

## Test for Alteration of Articles

After analysing the authorities in this area Mason CJ, Brennan, Deane and Dawson JJ went on to acknowledge that the cases can be seen as a struggle to balance the interests of the majority with the interests of the minority.[6] In searching for a test to determine when expropriation would be valid, they specifically rejected the 'bona fide for the benefit of the company as a whole' test of *Allen v Gold Reefs of West Africa Limited*[7] and followed *Peters' American Delicacy Co Ltd v Heath*,[8] which held that this test was not the sole test where the amendment in question affected the relative rights of different classes of shareholder.[9] The traditional test is basically rejected because shareholders do not have a fiduciary relationship with the company or with each other. Likewise McHugh J found that the 'bona fide for the benefit of the company as a whole' test is not always satisfactory for determining the validity of a proposed amendment to the articles, and certainly not in the circumstances of this particular case.[10]

Instead the majority decision was based on the notion of a proper purpose. This proper purpose must not be exercised in an oppressive manner. For the majority the expropriation of the shares of a minority cannot be 'simply for the purpose of aggrandising the majority',[11] nor 'merely in order to secure for themselves the benefit of a corporate structure that can derive some new commercial advantage'.[12] Expropriation is only possible if it is 'to secure the company from significant detriment or harm' such as to eliminate a shareholder who is competing with the company (as was the case in *Sidebottom v Kershaw, Leese & Co*),[13] or where it is necessary 'to ensure that the company could continue to comply with a regulatory regime governing the principal business which it carries on'.[14]

For McHugh J a statutory power such as section 176 cannot be construed as authorising the expropriation of a private right. In fact for his Honour the presence of statutory powers of expropriation in the context of takeovers strongly suggests that there is no general power of expropriation. However, the presence of a statutory power to alter articles is not to be interpreted to mean that it is never possible to compulsorily acquire shares outside the statutory regime. For McHugh J administrative convenience or cost could never of themselves justify an alteration of articles to allow compulsory acquisition. On the other hand McHugh J specifically endorses *Sidebottom v Kershaw, Leese & Co*[15] and situations where the acquisition

6 *Gambotto & Anor v WCP Limited & Anor* (1995) 13 ACLC 342, 348.
7 Ibid at 348.
8 (1939) 61 CLR 457.
9 Ibid at 504.
10 *Gambotto & Anor v WCP Limited & Anor* (1995) 13 ACLC 342, 352.
11 Ibid at 348.
12 Ibid at 349.
13 Ibid at 348.
14 Ibid at 348-9.
15 [1920] 1 Ch 154. In this case the English Court of Appeal allowed an expropriation of shares where a member was operating a business in direct competition with the company.

of shares will prevent harm to the company or there is a legitimate business interest involved.[16] However, an expropriation that is necessary for the protection or promotion of the company can still be oppressive to the minority subject to that expropriation.[17] Also, like the majority, McHugh J finds that the onus is on those proposing the alteration to the articles to prove that their actions are not oppressive. Thus for both the majority and McHugh J the free will of the individual is central and any interference with the autonomy of the individual must be justified if it is not to be regarded as oppressive.

## Fairness

As well as the proper purpose test the other main issue discussed was that of fairness. The majority discussed this notion briefly and held it involves disclosure of all relevant information and also a fair price, which itself involves a number of factors including the nature of the company and its future prospects.[18]

McHugh J states that in order not to act oppressively the expropriators must act fairly. In his search for what it is to act fairly, his Honour discussed the leading American case on compulsory acquisition, *Weinberger v UOP, Inc*[19] in some detail. McHugh J appears to be persuaded by that case and its finding that fairness has two elements, fair dealing and fair price. In particular his Honour states that fair price in a public company is neither simply the current market price nor simply a price slightly above market price. In relation to fair dealing he is also influenced by the approach taken in the United States, in particular the Securities and Exchange Commission Rule 13e-3, stating that in most cases there must be full disclosure which will require:

> [I]nformation concerning the current and historical market prices of the shares where they are applicable, the net book value of the assets, and the value of the company both as a going concern and on a liquidation together with any reports or appraisals prepared in relation to the alteration and any firm offers for, or serious inquiries about the purchase of, the assets of the company.[20]

As to the validity of article 20A, which would have allowed compulsory acquisition, in this instance McHugh J found that the price offered for the shares may well have been fair but there is an onus on the party attempting to compulsorily acquire the shares to show fair dealing and under the circumstances of this case this was not done. Whilst the other judges also were concerned with fairness and the same constituent

16 *Gambotto & Anor v WCP Limited & Anor* (1995) 13 ACLC 342, 353.
17 Ibid at 354.
18 *Weinberger v UOP, Inc* (1983) 457 A 2nd 701.
19 (1983) 457 A 2nd 701.
20 *Gambotto & Anor v WCP Limited & Anor* (1995) 13 ACLC 342, 355.

elements, they do not appear so stringent in their interpretation of fairness, being more rigorous in their interpretation of the proper purpose doctrine.

Thus whilst the majority in this case found the proposed article was not for a proper purpose, McHugh J instead seemed less concerned with purpose and more concerned with fairness, especially fair dealing.

## Who Can Vote?

One interesting issue that was not addressed was the question of whether interested shareholders could vote on a resolution to alter the articles. In the context of the *Gambotto* case this was not significant as only minority shareholders voted, and in fact, Mr Gambotto did not vote. The majority alluded to the issue in the context of fairness but held that it was a question best left open at this stage. However, if note is taken of the trend in other areas of corporate law[21] then it would appear that interested shareholders could not vote. For example, the new Part 3.2A of the *Corporations Law* only allows non-arms length financial benefits for related parties of public companies if approved at a general meeting where neither the related party nor any associate of the related party can vote. In reductions of capital it has been held that it would be difficult to persuade the court that a vote was fair unless the majority shareholders who stood to benefit from a reduction of capital refrained from voting.[22]

## Section 180(3)

Section 180(3) in part states members are not bound by 'restrictions on the right to transfer shares' placed in the articles after they become members unless they agree in writing. The majority cursorily dismissed the arguments based on section 180(3). Whilst admitting that it was not really necessary to deal with this issue the majority agreed with the respondent's submission that article 20A would not impose any restriction on the right of the appellants to transfer their shares. The writer has already argued[23] that to interpret section 180(3) as consistent with an article allowing for compulsory acquisition, is a very strained interpretation of language. However, admittedly, if the literal wording had been accepted then it might be thought that shares of the minority could never be expropriated against the will of the minority, an outcome that the High Court, when looked at in the context of the reasoning in the judgments, wished to avoid. Perhaps the natural consequence is that it must be accepted that at least in the context of a case like *Gambotto* section 180(3) is simply to be ignored. To avoid confusion it might be better that consideration be given to a re-wording of section 180(3) so it requires a less strained interpretation in the future.

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21 For a fuller discussion see Boros LE, 'Implications of *Gambotto's* Case for Minority Shareholders' unpublished paper delivered at a meeting of the University of Melbourne Corporate Law Interest Group, June, 1995.

22 *Nicron Resources Ltd v Catto* (1992) 10 ACLC 1, 186, per Bryan J.

23 Above n 1 at 109.

## Shares as 'Property'

It has frequently been argued that ownership of shares gives rise to no more than the entitlement to a dividend. However, both the majority and McHugh J hold that a share is more than a mere right to a dividend stream. Instead a share is a form of property. Neither the majority nor McHugh J go into any detail as to precisely what form of property it is, nor what entitlements would ensue. However, McHugh J (following Kirby ACJ in *Elkington v Shell Australia Ltd*[24]) points out that 'legislative authority for one citizen or group of citizens to acquire the private property of other citizens compulsorily is a rare and exceptional occurrence'.[25] Perhaps then it is not surprising that the High Court found that an article such as the proposed article 20A could not be inserted as it would interfere with the proprietary rights of the minority shareholders.

Underlying the approach of the majority and McHugh J, and McLelland J at first instance, is a view that highlights the significance and rights of the individual. This can be equated with an analytical jurisprudential approach with an emphasis on what is 'fair'. This individualist approach of the High Court not only followed the precedent of the English cases of early this century, cited above, but is not altogether surprising as it follows the trend of the High Court in more recent years in cases such as *Mabo v Queensland (No.2)*[26] and *Theophanous v Herald and Weekly Times Ltd*.[27] However, the approach of the High Court may well alter since the retirement of Mason CJ and the elevation of Deane J to the Governor-Generalship.

By contrast, the Court of Appeal's approach was more majoritarian or utilitarian in nature where the right of the group had more significance than that of the individual. This largely equates with a view based on what could be called economic rationalist principles. The harsher commentaries on the High Court's decision in *Gambotto* have been from those bringing such an analysis to the case.[28]

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24 (1993) ACLC 942, 943-4.

25 *Gambotto & Anor v WCP Limited & Anor* 13 ACLC 342, 353.

26 (1992) 175 CLR 1.

27 (1994) 68 ALJR 713.

28 For example, Michael J Whincop in the introduction to his article *'Gambotto v WCP Ltd*: An Economic Analysis of Alterations to Articles and Expropriation Articles' 23 Australian Business Law Review 276 claims the analysis of the High Court is analytically deficient and historically indefensible. It is not the purpose of this piece to enter into a lengthy dialogue on this topic. However, from arguments presented here and in the previous article (see above n 1) an approach on analytically jurisprudential grounds is at least as defensible as one based on economic rationalist grounds. Both approaches have strengths, but also have inherent assumptions which many choose to overlook. As to the question of history there is no doubt that the approach of the High Court and McLelland J at first instance is historically defensible in light of cases such as *Brown v British Abrasive Wheel Co Ltd*.

## Implications for the Future

This decision will have implications in Australia not only for the rights of minority shareholders but will impinge on other areas such as capital reconstructions and takeovers. For example, it appears to have been instrumental in the decision by those involved in attempts to demutualise the NRMA not to pursue those endeavours further. It seems the attitude of the High Court to minority shareholders' rights was thought by NRMA's legal advisers to herald the possibility of the High Court not allowing the attempts to demutualise the NRMA on similar grounds. Also the treatment of the High Court of the 'bona fide for the benefit of the company as a whole' concept and its reliance on a proper purpose test and the concept of fairness in the context of rights of shareholders has interesting parallels with these two concepts in the context of directors' duties. This leads to the possibility that the High Court may look at proper purpose and fairness more deeply if given the opportunity in the context of directors' duties, and put less emphasis on the flawed 'bona fide for the benefit of the company as a whole' test.[29] The writer may be reading too much into this possibility but nevertheless it is an intriguing thought.

The main judgment certainly takes Australia back to the United Kingdom tradition on expropriation of shares of minorities. Undoubtedly simple tax savings and administrative benefits are not of themselves a proper purpose in the absence of other reasons such as the necessity to comply with a regulatory regime.

However, McHugh J appears to leave a chink open and might allow such an expropriation if the majority was able to show fairness. As noted, His Honour follows the American case of *Weinberger v UOP, Inc*.[30] but that case is the American precedent for fairness in the context of appraisal remedies, a different context than here.

Under appraisal in the United States, since taken up in Canada in the 1970s and in 1994 in New Zealand, the majority can, in cases such as *Gambotto*, expropriate the shares of the minority, subject to the proviso of their actions being 'fair'. There is no equivalent to a proper purpose requirement in the United States. The desire of the majority to alter the articles to eliminate the minority for financial or administrative reasons is generally acceptable subject to a fair price being paid and fair dealing. Thus if the reasoning of McHugh J were to be taken up then possibly a type of appraisal system would be introduced with the majority being able to eliminate the minority with greater ease. However, this would be balanced by more stringent conditions as to price and procedures to be undertaken to show fairness to the minority. Companies wishing to eliminate minorities

29 Note the writer has already given a brief overview of some of the fundamental flaws in this doctrine and has discussed the issue of 'fairness' in general, and particularly as analysed in *Weinberger*, in her previous article on *Gambotto*, see above n 1 at 99 and following.

30 (1983) 457 A 2nd 701.

may seize on this judgment and start lobbying for an appraisal remedy based on that found in America, Canada and New Zealand. However, in those jurisdictions the introduction of this remedy has been accompanied by a freeing up of regulation and a strengthening of the power of the majority at the expense of the minority. We must wait and see if a push for such a change occurs in Australia.[31]

31 In fact, the Legal Committee of the Companies and Securities Advisory Committee has looked at this issue but has not proceeded with it.