> which to do so. Burnstead is simply a creature company used for receiving profits for which equity holds Mr. Dalby to be accountable to ACP. Its knowledge was in all respects the same as his knowledge. The introduction into the story of such a creature company is, in my view, insufficient to prevent equity's eye from identifying it with Mr. Dalby: see generally, as to the readiness of the court in appropriate cases to pierce the corporate veil, *Re H (restraint order: realizable property)* [1996] 2 BCLC 500 at 511, per Rose LJ.[180]

6.6 Legislation

The Ordinance provides four specific circumstances pursuant to which the doctrine of separate legal entity may be disregarded. These are found in s31 (carrying on trade with knowledge that the company has less than the statutory minimum of two members), s93(5) (misdescription of the name of the company),[181] s344A(6) (entering into a relevant accounting transaction when the company has become dormant) and s275 (fraudulent and wrongful trading).[182]

7. Agency

It is possible in law for a company to act as an agent for another company or an individual who owns all, or substantially all, the shares in the company. In *Gramophone & Typewriter Ltd v Stanley,*[183] Cozens – Hardy MR said:

> I do not doubt that a person in that position [i.e., who owns all the shares in a company] may cause such an arrangement to be entered into between himself and the company as will suffice to constitute the company his agent for the purpose of carrying on the business, and thereupon the business will become for all taxing purposes, his business.[184]

In *Salomon v Salomon & Company Ltd,*[185] the agency argument was advanced in order to make Mr Salomon indemnify the company for its debts upon the argument that the business of the company was the business of Mr Salomon, the principal. This was rejected by the House of Lords. Lord Halsbury said:

180 *Ibid*, at p 744. See also *Trustor AB v Smallbone and others* [2001] 2 BCLC 436.
181 See also s26(1) Bills of Exchange Ordinance (Cap.19). See further *Cheung Yiu-wing v Blooming Textiles* [1975] HKLR 388, *Kwok Wing v Maytex Trading Co* [1977] HKLR 149.
182 *Aktieseskabet Dansk Skibsfinansiering v Brothers* [2001] 2 BCLC 324.
183 [1908] 2 KB 89.
184 *Ibid*, at p 96.
185 [1897] AC 22.

> I observe that the learned Judge (Vaugham William J) held that the business was Mr Salomon's business, and no one else's, and that he chose to employ as agent a limited company, and he proceeded to argue that he was employing that limited company as agent, and that he was bound to indemnify that agent (the company). I confess it seems to me that very learned judge becomes involved by this argument in a very singular contradiction. Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr Salomon. If it was not, there was no person and no thing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not.[186]

In *Smith, Stone and Knight Ltd v Birmingham Corporation,*[187] Atkinson J relied on the 'agency' principle to justify that the parent company was the correct party to claim compensation from the defendant.

In strict legal analysis, the 'agency' theory is not an exception to the doctrine of separate legal entity such as to make two entities as one. When the 'agency' argument is used for the purpose of attaching liability to another person other than the company under consideration, the basis of the liability is one of agent and principal. The agency argument involves an admission that there exists two separate legal entities. In *Good Profit Development Ltd v Leung Wai,*[188] Woo J (as he then was) said:

> If the third defendant is the same as the first and second defendants, its shareholders and directors, it cannot at the same time be a trustee for them. The 'alter ego' concept takes away the ground from under the feet of 'trusteeship'. In other words, 'alter ego' destroys the separate personality of the third defendant, and without such separate personality, it cannot be a trustee which is a legal entity separate from the beneficiaries.

In *E.B.M Co Ltd v Dominion Bank,*[189] in reversing the judgment of the Court of Appeal on the agency point, Lord Russell in the Privy Council said:

> In the Court of Appeal, divergent views were expressed. Riddell, J.A., would, their Lordships think, have allowed the appeal, but for the fact that he thought from the evidence:
>
> ...that the company was a sham simulacrum or cloak and that its business must be regarded as the business of these [three partners].
>
> He thought that the true position was that the old company, although a separate legal entity, was acting as the agent of the three partners, and was carrying on as such agent, not the business of the old company, but

186 *Ibid*, at p 31.
187 [1930] 4 All ER 116.
188 [1992] 2 HKC 539.
189 [1937] 3 All ER 555.

'in no true sense retrospective' because the alteration operated only from the date of the alteration.[220]

In *NRMA v Snodgrass*,[221] Windeyer J held that amendments to articles cannot operate retrospectively so as to take away some prior rights as opposed to creating new obligations operating in the future. The creation of new obligations operating in the future is not retrospective.

6.2 Statutory limitations on power of alteration

The power to alter articles of association is subject to the Ordinance and any conditions in its memorandum. Under the Ordinance, a special resolution[222] is required. Also, if the effect of the alteration is to require a member to take or subscribe for more shares than the number held by him as at the date of alteration, or in any way increases the member's liability to contribute to the share capital of or otherwise to pay money to the company, the member is not bound by such alterations unless by agreement in writing he or she agrees to be bound.[223]

6.2.1 Alteration affecting class rights

The Ordinance does not define what constitutes 'class rights' and what would amount to a 'variation' of class rights. Section 64 of the Ordinance merely provides that if the share capital of a company is divided into different classes of shares and there is power in the memorandum or the articles to vary or abrogate rights attached thereto, then those class rights may be varied or abrogated if sanctioned by a resolution passed at a separate meeting of the holders of the class shares. Even if a resolution varying or abrogating class rights is passed by the majority of the class involved, affected class shareholders holding not less than ten per centum of that class may apply to court to cancel the variation or abrogation. An application has the statutory effect of suspending the variations or abrogation until confirmed by the court, operating like an interlocutory injunction. The right to apply for cancellation of variation or abrogation of class rights is independent of the right to obtain relief under s168A of the Ordinance.[224]

The legislative intent of s64 of the Ordinance is to protect the rights of members which are different from other members from being altered by the company in general meeting consisting of members whose interests or rights are not common. These members' rights are

220 *Ibid*, at p 682.
221 (2001) 37 ACSR 382.
222 See s13. For definition of 'special resolution', see s116.
223 Section 25.
224 See s65.

protected by the requirement for a separate class meeting and the provision for judicial intervention either to deny or confirm the alterations made.

6.2.2 Meaning of 'class' and 'class rights'

In *Sovereign Life Assurance Co v Dodd*,[225] Bowen LJ, in defining the meaning of 'class' in s2 of the Joint Stock Companies Arrangement Act 1870, said:

> The word 'class' used in the statute is vague, and to find out what it means we must look at the general scope of the section, which enables the court to order a meeting of a 'class of creditors' to be summoned. It seems to me that we must give such a meaning to the term 'class' as will prevent the section being so worked as to produce confiscation and injustice, and that we must confine its meaning to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.[226]

Whilst the case dealt with the meaning of 'class of creditors,' it provides a workable formula for the purpose of determining the meaning of 'class of shares.' Accepting that definition, a 'class of shares' therefore exists in a company if members of that 'class of shares' possess some rights which are dissimilar to, or which are different from, or are inconsistent with, shares held by other members of a company.[227]

In *Re UDL Holdings Ltd*[228] in the Court of Final Appeal, Lord Millett NPJ said:

> The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.[229]

The leading case on what constitutes 'class rights' is *Cumbrian Newspaper Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd*.[230] Scott J held that the words 'rights attached to a class of shares' in s125 of the Companies Act 1985 (UK)[231] mean rights and benefits

225 (1892) 2 QB 573.
226 *Ibid*, at p 583.
227 *Re Hellenic & General Trust Ltd* [1975] 3 All ER 382, classification was made according to 'interest' as opposed to 'rights'. There is a growing body of authorities which have held that classification should be made according to rights. See *Re UDL Holdings Ltd, infra*, *Re BTR plc* [2000] 1 BCLC 740, *Re Bond Corporation Holdings Ltd* (1991) 9 ACLC 1264 and the South African case of *Borgelt v Millman No* [1983] 1 SALR 757.
228 [2002] 1 HKC 172.
229 *Ibid*, at p 184.
230 [1987] Ch 1.
231 The words used in s64 of the Ordinance are 'rights attached to any class of shares.'

5.3.1 Usual authority of secretaries

Seventy years ago it was held that it is outside the usual authority of a secretary to give confirmation as to the authority of directors: *Houghton and Company v Northard, Lowe and Wills Ltd*.[94] Today, secretaries of companies play important roles and it will not be correct in the current age to say that it is outside the scope of the usual authority of a secretary to give confirmation. Secretaries attend board meetings, draw up minutes and record resolutions. In *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd*,[95] Mr Bayne was the secretary of the defendant. He hired cars from the plaintiffs for his own use but purportedly on the defendant's behalf. Relying on the case of *Barnett, Hoares & Co v South London Tramways Co*,[96] the defendant argued that the secretary was a mere servant, doing what he was told to do. Accordingly, it was further argued, that no one could assume that the secretary had authority to do anything. In rejecting this argument, Lord Denning MR said:

> But times have changed. A company secretary is a much more important person nowadays than he was in 1887. He is an officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Act, but also by the role which he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company's affairs, such as employing staff, and ordering cars, and so forth. All such matters now come within the ostensible authority of a company's secretary.[97]

Salmon LJ, agreeing with Lord Denning MR, said that in current times a secretary may be regarded as 'the chief administrative officer' of a company.[98] However, in *Zanda Investment Ltd v Bank of America National Trust and Savings Association & Ors*,[99] it was held that in a property development company it was 'far from usual for a company...to appoint a secretary, whether alone, or even with any other officer of [a] company, to indorse away cheques'.[100]

94 [1927] 1 KB 246.
95 [1971] 2 QB 711.
96 (1887) 18 QBD 815.
97 *Supra*, note 95, at pp 716-717.
98 *Ibid*, at p 717.
99 [1994] 2 HKC 409.
100 *Ibid*, per Rhind J at p 417.

5.3.2 Usual authority of managing director

Traditionally, a managing director or chief executive officer of a company, whether *de jure* or *de facto*, is seen to have very wide powers. Probably, this is because he is treated as being the leading mind of a company. Also, articles of association usually empower the board of directors to appoint a managing director and sub-delegate to him all or any powers which the board may possess.

The 'usual' authority which attaches to the office of managing director includes the authority to engage contractors,[101] to execute guarantees or indemnities[102] and to assign debts.[103] However, it excludes the authority to use the company's name in litigation.[104]

5.3.3 Usual authority of managers

In modern companies, there are many types of managers - human resource, administration, sales and purchase, public relations, security, information systems, etc. What is their usual authority is a matter of legal inference which must be tested against the facts of each case. In *Armagas Ltd v Mundogas Ltd*,[105] Mr Magelssen was the vice-president (transportation) and chartering manager of the defendants. After the sale of a vessel, he backed it up with an onerous three years charterparty. It was held that the latter transaction was not within the 'usual' authority of an employee holding his position and in the absence of representation by the defendants,[106] no self-representation by Mr Magelssen could alter that fact.

6. Establishing ostensible authority

In modern times, the speed of transacting business is in many instances the key to gaining a competitive advantage. The formal authorisation of

101 *Freeman and Lockyer (A Firm) v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480. *First Consolidated Sdn Bhd v Padu Ehsan Sdn Bhd* [1994] 1 CLJ 375.
102 *Hely-Hutchinson v Braybead And Anor* [1968] 1 QB 549, *British-Houston Co Ltd v Federated European Bank Ltd* [1932] 2 KB 176.
103 *Bigger staff v Rowatt's Wharf Ltd* (1896) 2 Ch 93.
104 *Mitchell & Hobbs (UK) Ltd v Mills* [1996] BCLC 102. See the Australian case of *Nece Pty Ltd v Ritek Corporation* (1997) 24 ACSR 38. In this case, Lehane J held that a managing director would have implied actual authority to instruct solicitors to recover debts and resist claims in the day today affairs of a company. However, the managing director will not have such authority in substantial matters, such as to oppose a winding up petition.
105 [1986] AC 717.
106 *Ibid*, at p 783. See also *British Bank of Middle East v Sun Life Assurance Co of Canada (UK) Ltd* [1983] BCLC 78.

fide will be displaced as soon as it is demonstrated that directors acted out of conflict of interests: *Howard Smith v Ampol Petroleum Ltd & Ors*[85] The no conflict rule, as a disqualifying factor to the presumption of *bona fide*, has been applied to a wide variety of conflict situations dealing with breaches of duties in relation to the exercise of corporate powers. The conflict may be in respect of a duty and interest conflict or a duty to duty conflict. Duty and interest conflict includes the following situations:

- amending articles of association to impose a share qualification on directors where none previously existed for the purpose of perpetuating control in the hands of a select few;[86]
- issuing shares to perpetuate control over a company or manipulate voting power;[87]
- refusing to register a transfer of shares pledged to a bank by directors who were also shareholders so as to frustrate the contractual rights of the bank;[88]
- appointing additional directors for the purpose of enabling the new appointees to ratify a voidable service contract entered into by incumbent directors;[89]
- procuring a company to issue a guarantee and provide security to a financially stricken company in which its directors have interest;[90] and
- causing a company to enter into a 'poison pill' agreement for the alleged purpose of deterring a take over bid which exposes the company to grave contingent economic damages when the real effect is to entrench the position of the directors in management.[91]

Duty to duty conflict commonly arises where directors of a company are also directors of another company. In such cases, the directors must refrain from preferring or advancing the interests of one company whenever the interests of the two companies conflict: *Lee Panavision Ltd v Lee Lighting*[92] and *Scottish Co-operative Society Ltd v Meyer & Anor*.[93]

85 [1974] AC 821, per Lord Wilberforce at p 834.
86 See the Malaysian case of *Lim Hean Pin v Thean Seng Co Sdn Bhd & Ors* [1992] 2 MLJ 10. In this case, an interlocutory injunction was issued.
87 *Howard Smith v Ampol Petroleum Ltd, supra, Whitehouse & Anor v Carlton Hotel Proprietary Ltd* (1987) 162 CLR 285, *Punt & Symons* [1903] 2 Ch 506. See also the cases cited in this chapter at paras 9.4.1 and 10.2.3.
88 See the Malaysian case of *Allied Properties Sdn Bhd v Semua Holdings Sdn Bhd* [1988] 3 MLJ 185, per Siti Norma J (as she then was) at p 188.
89 See the Singaporean case of *Lim Koei Ing v Pan Asia Shipyard Engineering Co Pte Ltd* [1995] 1 SLR 499.
90 *Rolled Steel Products (Holdings) Ltd v British Steel Corp & Ors* [1985] 3 All ER 52.
91 *Criterion Properties plc v Stratford UK Properties LLC and Others* [2002] 2 BCLC 151.
92 [1991] BCLC 375.
93 [1959] AC 324.

6. Meaning of 'interests of the company as a whole'

In *Brady & Anor v Brady & Anor*,[94] Nourse LJ in the Court of Appeal said:

> The expression the interests of the company is one which is often used but rarely defined. It seems quite likely that it is sometimes misunderstood and it is possible that it has slightly different meanings in different contexts.[95]

It will be rather unfortunate that the phrase, if it is at all capable of being defined with exactitude, be defined. Defining the phrase will not serve the need for flexibility in dealing with unpredictable situations which may arise from an infinite variety of circumstances or for the purpose of coping with ever changing patterns of commercial life. In the words of Rich J in *Mills v Mills*[96] 'the phrase tends to become a cant expression ... but is not yet a shibboleth'.[97] Depending on the factual circumstances which may confront a judge, the phrase can mean several things. In the absence of a dispute between competing rights of shareholders, it may mean in the primary sense the interests of the company as a commercial entity which is distinct from its corporators,[98] or where there is conflict between majority and minority shareholders interests or where the decision will affect shareholders in general, it may mean in the primary sense the interest of the corporators as a general body,[99] or when the company is or is prospectively insolvent, it may mean in the primary sense the interest of the company's creditors.[100] It is not suggested that each case will fall to be decided within a distinct category of interests.

94 (1988) BCLC 20.
95 *Ibid*, at p 40.
96 (1938) 60 CLR 150.
97 *Ibid*, at p 169.
98 *Re W & M Roith Ltd* [1967] 1 All ER 427, *Ridge Securities Ltd v IRC* [1964] 1 All ER 275, *Charterbridge Corp Ltd v Lloyds Bank* Ltd [1969] 2 All ER 1185, *Re Lee Behrens & Co Ltd* [1932] 2 Ch 46, *Rolled Steel Products (Holdings) Ltd v British Steel Corp & Ors* [1985] 3 All ER 52, *ANZ Executors & Trustee Co Ltd v Quintex Australia Ltd (Rec & Mgrs Apptd)* (1990) 2 ACSR 676, *Kinsela v Russel Kinsela Pty Ltd* (1986) 10 ACLR 395, *Bailey v Mandala Private Hospital Pty Ltd* (1987) 12 ACLR 641 and *Pine Vale Investments Ltd v McDonnel & East Ltd & Anor* (1983) 8 ACLR 199.
99 *Allen v Gold Reefs of West Afrika Ltd* [1900] 1 Ch 656, *Greenhalgh v Arderne Cinemas Ltd* (1951) Ch 286, *Parke v Daily News Ltd* [1962] 2 All ER 929, *Henderson v Bank of Australasia* (1888) 40 Ch D 170, *Hutton v West Cork Railway Co* (1883) 23 Ch D 654, *Ngurli v McCann* (1953) 90 CLR 425, *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199.
100 *Walker v Wimborne & Ors* (1976) 137 CLR 1, *Nicholson v Permakraft (NZ) Ltd* (1985) 1 NZLR 242, *Kinsela v Russel Kinsela Pty Ltd* (in liquidation) (1986) 10 ACLR 395, *Grove v Flavel* (1986) 11 ACLR 161, *Jeffree v NCSC* (1989) 15 ACLR 217, *West Mercia Safety Wear Ltd (in liq) v Dodd & Anor* (1988) BCLC 250, *Lee Panavision Ltd v Lee Lighting Ltd* [1992] BCLC 22.

The hypothetical shareholder test as phrased by Evershed MR, if read literally, contains an objective and subjective element. To this extent there is a contradiction in the test. However, when the quotation above is read together with the passages which immediately followed,[50] it appears that what Evershed MR meant was that if a hypothetical shareholder takes the view that a proposed resolution equates the interests of the company with only the interests of the majority to the unfair prejudice of the rights of the minority, then that proposed resolution does not benefit the company but only the majority who voted for it.

4.2 The unfair prejudice or discrimination test

In *Greenhalgh v Arderne Cinemas Ltd*, Evershed MR also held that the converse way of attacking the validity of resolutions is to examine whether the resolutions passed by the majority are unfairly discriminatory:

> I think that the matter can, in practice, be more accurately and precisely stated by looking at the converse and by saying that a special resolution of this kind would be liable to be impeached if 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 were deprived.[51]

Applying this test, the argument of the plaintiff that the amendments were prejudicial in that it deprived him of the right of pre-emption was rejected:

> ... Mr Jennings said, in effect, that there are still grounds for impeaching this resolution: first, because it goes further than was necessary to give effect to the particular sale; and, secondly, because it prejudiced the plaintiff and minority shareholders in that it deprived them of the right which, under the subsisting articles, they would have of buying the shares of the majority if the latter desired to dispose of them.
>
> What Mr Jennings objects to in the resolution is that if a resolution is passed altering the articles merely for the purpose of giving effect to a particular transaction, then it is quite sufficient (and it is usually done) to limit it to that transaction. But this resolution provides that anybody who wants at any time to sell his shares can now go direct to an outsider, provided that there is an ordinary resolution of the company approving the proposed transferee. Accordingly, if it is one of the majority who is selling, he will get the necessary resolution. This change in the articles, so to speak, franks the shares for holders of majority interests but makes it more difficult for a minority shareholder, because the majority will probably look with disfavour upon his choice. But, after all, this is merely a relaxation of the very stringent restrictions on transfer in the existing article, and it is to be borne in mind that the directors, as the articles stood, could always refuse to register a

50 See discussion in this chapter at para 4.2, *infra*.
51 *Ibid*, at p 291.

> transfer. A minority shareholder, therefore, who produced an outsider was always liable to be met by the directors (who presumably act according to the majority view) saying, 'We are sorry, but we will not have this man in.'[52]

It has been criticised that the effect of the amendment in that case was in fact discriminatory in that it emplaced the majority in a position to sell to an outsider whereas the minority could not.[53] However, it appears that Evershed MR did think that there was discrimination but that the discrimination was not sufficiently unfair to constitute fraud:

> I felt at one time sympathy for the plaintiff's argument, because, after all, as the articles stood he could have said: 'Before you go selling to the purchaser you have to offer your shares to the existing shareholders, and that will enable me, if I feel so disposed, to buy, in effect, the whole of the shareholding of the Arderne company.' I think that the answer is that when a man comes into a company, he is not entitled to assume that the articles will always 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 of shares would be lost by the lifting of the restriction. I do not think that it can be said that that is such a discrimination as falls within the scope of the principle which I have stated.[54]

Further on in the judgment, Evershed MR underscored his reasoning by holding that the amendments did not have the flavour of:

> ...[giving] the majority the right to expropriate a minority shareholder, whether he wanted to sell or not, merely on the ground that the majority shareholders wanted the minority man's shares.[55]

It is doubtful that a Hong Kong court faced with identical facts as that in *Greenhalgh v Arderne Cinemas Ltd* would conclude that there was no unfair discrimination or unfair prejudice.[56] Pre-emptive provisions on disposal of shares in the articles of association are a contractual fetter on the common freedom of proprietary rights[57] and freeing the majority shareholders from this common restriction must serve some purpose. It is one thing to say that minority shareholders cannot expect the articles of association to be immutable and another to say that an amendment carried out by the majority with the substantial object of benefiting themselves by placing the minority at their mercy is fair

52 *Ibid*, at pp 291-292.
53 Gower, Principles of Modern Company Law (Sweet & Maxwell, 6th Ed) at pp 714-715
54 *Supra*, note 48 at p 292.
55 *Ibid*, citing *Dafen Tinplate Co Ltd v Llanelly Steel Co* [1920] 2 Ch 124 as an example.
56 In the Singaporean case of *Tong Kok Chai v Ocean Front Pte Ltd & Anor* [1988] 3 MLJ 125, an interlocutory injunction was issued against a proposal to amend the articles by deleting the pre-emptive provision to allow for free transferability.
57 Disposals of shares in contravention of pre-emptive provisions are invalid. See *Lee Chee Ngor Moreta v Prudential Enterprises Ltd* [1991] 2 HKC 499.

On the point that Mr O' Neill had 'legitimate expectation', it was said:

> The same reasoning applies to the sharing of profits. The judge found as a fact that Mr Phillips made no unconditional promise about the sharing of profits. He had said informally that he would share the profits equally while Mr O' Neill managed the company and he himself did not have to be involved in day to day business. He deliberately retained control of the company and with it, as the judge said, the right to redraw Mr O' Neill's responsibilities. This he did without objection in August 1991. The consequence was that he came back to running the business and Mr O' Neill was no longer managing director. He had made no promise to share the profits equally in such circumstances and it was therefore not inequitable or unfair for him to refuse to carry on doing so. The Court of Appeal seems to have contemplated that Mr Phillips might have been entitled to do what he did if he had given Mr O' Neill notice of his intentions and treated him more politely at the meeting on 4 November 1991. But these matters cannot affect the question of whether a change in the profit-sharing arrangements was a breach of faith.
>
> It follows in my opinion that there was no basis for the Court of Appeal's finding that Mr O' Neill had been driven out of the company. He may have decided that he had lost confidence in Mr Phillips and that he could no longer work with him. After Christmas 1992 Mr Phillips said that he recognised that Mr O' Neill had come to this conclusion and that there was no way in which he could put their relationship together again. But Mr O' Neill's decision was not the result of anything wrong or unfair which Mr Phillips had done.[143]

The decision in *O'Neill v Phillips* has put certainty to circumstances under which 'legitimate expectation' may be found. Mere talk or speculation is not enough. While a contractual promise is not required, there must be something more than mere wishes on the part of a petitioner. On the facts of the case, two matters stood out clearly.

First, Mr Phillips had only indicated a willingness to increase Mr O' Neill's shareholdings to 50% during an informal social occasion. Mr O' Neill asked his sister, a solicitor, to follow up on the matter. She did not receive any reply from Mr Phillips for a year. Thereafter the matter was further pursued but Mr Phillips declined to execute the documents prepared by Mr O' Neill's sister and from further documents which were exchanged, nothing definite could be said to have been concluded on the matter [144] of increasing Mr O' Neill's shareholdings to 50%.

Second, on the 'legitimate expectation' to share profits equally, the facts did not justify such an expectation. Right from the beginning, the right to equal sharing of profits was predicated upon the basis that Mr O' Neill would be managing the business and not Mr Phillips.

143 *Ibid*, at p 13.
144 See the judgment of the High Court reported as *Re a company (No. 00709 of 1982)* [1997] 2 BCLC 739.

4.3 Beyond *O' Neill v Phillips*

In *Re Guidezone Ltd*,[145] following *O' Neill v Phillips*, Johnathan Parker J (as he then was) said:

> 'Unfairness' may arise from agreements or promises made, or understandings reached, during the life of the company which it would be unfair to allow the majority to ignore. Applying traditional equitable principles, equity will not hold the majority to an agreement, promise or understanding which is not enforceable at law unless and until the minority has acted in reliance on it. In the case of an agreement, promise or understanding made or reached when the company was formed, that requirement will almost always be fulfilled, in that the minority will have acted on the agreement, promise or understanding in entering into association with the majority and taking the minority stake. But the same cannot be said of agreements, promises or understandings made or reached subsequently, which are not themselves enforceable at law. In such a case, the majority will not as a general rule be regarded in equity as having acted contrary to good faith unless and until it has allowed the minority to act in reliance on such an agreement, promise or understanding . Absent some special circumstances, it will only be at the point, and not before, that equity will intervene by providing a remedy to the minority which is not available at law.[146]

The content of 'legitimate expectation' only resides within circumstances which will attract the application of traditional equitable principles. Evidence justifying equitable restraint must be capable of precise identification and the jurisdiction is akin to the concept of estoppel by conduct or convention in equity. The facts must justify the imposition of equitable restraint against the principle of majority rule as in the *Ebrahimi* case, *Re Lau Chor Heung Restaurant Company Limited*,[147] *Re Ching Hing Construction Company Limited*,[148] *Tay Bok Choon v Tahansan Sdn Bhd*,[149] *Kitnasamy s/o Marudapan v Nagatheran s/o Manogar and Anor*,[150] *Re Centre Restaurant Pty Ltd*,[151] *Re Regional Airport Ltd*,[152] *Re Kai Lan Co and Re Safe Steel Furniture Factory Ltd*[153] and *Lunn v BCL Holdings Inc*.[154]

145 [2000] 2 BCLC 321.
146 *Ibid*, at p 356.
147 Unreported judgment dated 31 March 2000 in HCCW 63/1999.
148 Unreported judgment dated 23 November 2001 in HCCW 889/1999.
149 [1985] 1 MLJ 58 (HC), [1987] 1 MLJ 433 (PC).
150 [2000] 2 SLR 598 .
151 (1982) 6 ACLR 481.
152 [1999] 2 BCLC 30.
153 [1988] 1 HKLR 257.
154 30 BLR (2d) 114.

> that a gift accepted by a person in a fiduciary position as an incentive for his breach of duty constituted a bribe and, although in law it belonged to the fiduciary, in equity he not only became a debtor for the amount of the bribe to the person to whom the duty was owed but he also held the bribe and any property acquired therewith on constructive trust for that person, that if the value of the property representing the bribe depreciated the fiduciary had to pay the injured person the difference between that value and the initial amount of the bribe, and if the property increased in value the fiduciary was not entitled to retain the excess since equity would not allow him to make any profit from his breach of duty; and that, to the extent that they represented bribes received by the first respondent, the New Zealand properties were held in trust for the Crown, and the Crown had an equitable interest therein.[119]

The decision in *A-G for Hong Kong v Charles Warwick Reid & Ors* reaffirms the principle that an appreciation in value of property held in constructive trust belongs to the beneficiary and if there is depreciation, the beneficiary is to be compensated by the difference in value. This principle is also applicable in cases of breach of the self-dealing rule: *Re Duckwari plc (No. 2)*.[120]

5.2 Compensation

If loss has been suffered by a company, equitable damages or compensation is payable[121] on a full indemnity basis. The purpose of equitable compensation is to make good the loss caused by the breach of fiduciary duties: *The Board of Trustees of the Sabah Foundation & Ors v Datuk Syed Kechik Bin Syed Mohamed & Anor*.[122]

5.3 Recovery from third parties

A third party may be liable to a beneficiary as constructive trustee in two principal ways. First, when the third party receives trust property with knowledge of breaches of fiduciary duties or trust by a director. This is commonly known as 'knowing receipt' liability. Second, when the third party dishonestly procures or assists the director in the breach of his fiduciary duties. This is commonly known as 'knowing assistance' liability[123]: *Barnes v Addy*.[124] In the former case, liability attaches to the

119 *Ibid*, at p 325.
120 [1998] 2 BCLC 315, per Nourse LJ at p 324.
121 *Maxwell Bros Pty Ltd v CPN (Diesels) Queensland Pty Ltd* (1982) 7 ACLR 425. *Kumagai-Zenecon Construction Pte Ltd v Low Hua Kin* [2000] 2 SLR 501, per GP Selvam J at p 509.
122 [1999] 6 MLJ 497. See also the cases cited in the judgment.
123 Note that in *Royal Brunei Airlines Sdn Bhd,, infra*, Lord Nicholls said that the word 'knowingly' is better avoided as a defining ingredient in accessory liability. This is because the phrase 'knowing assistance' seems to suggest that the trustee must also be acting dishonesty before liability attaches to the third party. See discussion, *infra*.
124 (1874) LR 9 Ch App 244, at p 252.

third party as a recipient of trust property and the remedy is restitution based. In the latter case, liability attaches to the third party as an accessory to the trustee's breaches of trust even though no trust property passes into the hands of the third party.

The wrong lies in interference with the due performance of fiduciary obligations: *Royal Brunei Airlines Sdn Bhd v Phillip Tan Kok Ming*.[125]

5.3.1 Accessory liability

In *Royal Brunei Airlines Sdn Bhd v Phillip Tan Kok Ming*, a case dealing with accessory liability, the Privy Council explained the meaning of the words 'assist with knowledge in a dishonest and fraudulent design on the part of the trustees.' In this case, the plaintiff appointed Borneo Leisure Travel Sdn Bhd as its agent for the sale of passenger and cargo transportation. The agreement provided that all moneys collected by the agent shall be the property of the plaintiff and unless instructed otherwise, the agent shall remit such moneys to the plaintiff less the applicable commission. Mr Phillip Tan was the managing director and principal shareholder of the agent. The agent failed to pay the plaintiff moneys due to it within the contracted times under the express trust as evidenced by the agreement. The agreement was terminated. The agent became insolvent and proceedings were filed to recover the moneys due to the plaintiff. Evidence showed that the agent had used the moneys belonging to the plaintiffs for its own purposes and the assumption was that the defendant, Mr Phillip Tan, had authorised the use of the trust money for the agent's purposes. In the High Court, it was held that the defendant, as an accessory was liable as a constructive trustee. The Court of Appeal overturned the decision on the ground that it was not established that the agent was guilty of fraud or dishonesty in relation to the moneys it held in trust for the plaintiff. As such, the defendant was not liable. The Privy Council restored the judgment of the High Court on the ground that the liability of a third party is not dependent upon the state of mind of the trustee. Rather, it depended upon the state of mind of the third party. It was said:

> ...what matters is the state of mind of the third party sought to be made liable, not the state of mind of the trustee. The trustee will be liable in any event for the breach of trust, even if he acted innocently, unless excused by an exemption clause in the trust instrument or relieved by the court. But *his* state of mind is essentially irrelevant to the question whether the third party should be made liable to the beneficiaries for the breach of trust. If the liability of the third party is fault-based, what matters is the

125 [1995] 2 AC 378, at p 382. See also *Houghton and Others v Fayers and Another* [2000] 1 BCLC 511.

be instituted against that person in respect of the same conduct[17]. By the same token, if market misconduct proceedings under section 252 of the SFO have previously been instituted against a person and those proceedings remain pending or by reason of the previous institution of those proceedings, no proceedings may again be lawfully instituted against that person, then no criminal proceedings may be instituted against that person in respect of the same conduct[18].

The Financial Secretary and the Secretary for Justice have the right of choice to institute either civil proceedings or criminal proceedings. However, once an election has been made, it is irreversible. This is to prevent suspected market defaulters from suffering the prejudice of defending himself or herself twice in two different sets of proceedings.

The decision to institute criminal proceedings rests with the Secretary for Justice and senior officers of the Prosecution Division of the Department of Justice. Guidelines to institute criminal proceedings are contained in the 'Department of Justice Prosecution Policy: Guidance for Government Counsel'. The two basic requirements are that there must be sufficient evidence that an offence has been committed and that there is reasonable prospect of securing a conviction based on the evidence and that a criminal prosecution will be in the interest of the public. It is proposed that the SFC will publish its own guidelines to assist its officers in recommending civil or criminal prosecution.[19]

2.4 Private cause of action

Traditional common law and equitable remedies have long been recognised as being inadequate to deal with issues arising from misconduct in the trading of securities. This prompted statutory intervention on a piecemeal basis over the course of history. This is amply borne out by the legislative history in the field of prospectus liability and insider dealing. In *Derry v Peek*,[20] the directors issued a prospectus that was said to contain false statements. The plaintiffs sued in deceit. The action failed because it was held that carelessness and absence of reasonable grounds of belief of its truth do not necessarily amount to actual fraud. The effect of this decision was overcome within a year by s3 of the Directors' Liability Act 1890 and s38 of the Companies Act 1867.[21] Commenting upon the decision in *Derry v Peek* in the context of the securities legislation of the United States, the court in *Rosenberg v Hano*,[22] said:

17 Section 283, *ibid.*
18 Section 307, *ibid.*
19 Consultation Document on the Securities and Futures Bill, April 2000, at para 11.19.
20 (1889) 14 App Cas 337.
21 See *McConnel v Wright* [1903] 1 Ch 546, a case decided on the statutes cited.
22 121F. 2d 818.

> The purpose of the civil liability provisions of the first Act was to broaden the law of deceit. In that branch of the law of torts there had raged one of those controversies that delight lawyers and disgust laymen. It had its inception in the famous case of *Derry v Peek* and stemmed from a 19th Century English Court's conservative reluctance to believe ill of the tycoons of its day.[23]

In the context of insider dealing, the content of the issue is different. Traditionally, under common law, the general principle is that directors of a company may make profits from buying shares of the company from its shareholders without disclosing to the vendor 'inside information', which will have a material effect on the decision of the vendors whether to sell the shares and at what price to the directors. This is because directors' fiduciary duties are primarily owed to the company and not to the shareholders: *Pervical v Wright.*[24] In this case, the plaintiffs failed to set aside the sale to the directors on the ground that the directors did not disclose to them that there was a pending takeover of the business of the company at the time when the purchase was being concluded.

The decision in *Pervical v Wright* has been distinguished in several Commonwealth cases: *Allen v Hyatt*[25], *Coleman v Myers*[26] and *Brunninghausen & Anor v Glavanics*.[27] It was not because the general principle was wrongly stated in *Pervical v Wright*, but the facts in the latter cases were exceptional such as to justify judicial determination that a fiduciary relationship existed between the directors and the shareholders. In effect, the present state of law is that the general principle that fiduciary duties are only owed to a company still holds good. However, this does not preclude the recognition of a fiduciary duty being owed to shareholders in circumstances where the transaction does not concern the company but another shareholder. The recognition of this duty does not conflict with the general principle that directors' duties are owed to the company: *Brunninghausen & Anor v Glavanics.*[28]

The decision in *Pervical v Wright* has been severely criticised but the general principle that fiduciary duties are only owed to the company is a vital company law principle and its importance and validity as a whole remains undiminished despite criticisms.[29] Nonetheless, its inadequacy in tackling the problem of dealings in shares of a company by directors

23 *Ibid*, at p 819.
24 [1902] 2 Ch 421.
25 (1914) 30 TLR 444.
26 [1977] 2 NZLR 225.
27 (1999) 32 ACSR 294.
28 *Ibid*, per Handley JA at p 304. The circumstances under which fiduciary relationships exist is incapable of being defined. Each case must be decided on its particular facts. For general guidelines, see *Hospital Products Ltd v United States Surgical Corp & Ors* (1984) 156 CLR 41, *Tengku Abdullah Ibni Sultan Abu Bakar & Ors v Mohd Latiff bin Shah Mohd & Ors* [1996] 2 MLJ 265.
29 *Brunninghausen & Anor v Glavanics* (1999) 32 ACSR 294, per Handley JA at p 304.

Counsel's first submission for the plaintiff under this head was made with a view to showing that the conglomerate assembly in the cinema, the overflow rooms and the foyer could not constitute a meeting. He submitted that for there to be a meeting at all everyone must be in the same place, face to face. If this submission were correct, even if the audio-visual links had worked perfectly, there would still have been no meeting at the Barbican on 19 October since all the members attending would not have been face to face but scattered between different rooms. In support of this submission counsel relied on the definition of the word 'meet' in the *Shorter Oxford English Dictionary*, viz 'To come face to face with or into the company of [another person]'. He also relies on the fact that the requirement in s378 of the Companies Act 1985 that an extraordinary resolution has to be passed at a general meeting has a long statutory history dating back to times long before the invention of audio-visual links. This, he submits, shows that a meeting for the purpose of the Act requires that everyone shall be physically present in the same room or space.

I do not accept this submission. The rationale behind the requirement for meetings in the 1985 Act is that the members shall be able to attend in person so as to debate and vote on matters affecting the company. Until recently this could only be achieved by everyone being physically present in the same room face to face. Given modern technological advances, the same result can now be achieved without all the members coming face to face; without being physically in the same room they can be electronically in each other's presence so as to hear and be heard and to see and be seen. The fact that such a meeting could not have been foreseen at the time the first statutory requirements for meeting were laid down, does not require us to hold that such a meeting is not within the meaning of the word 'meeting' in the 1985 Act.[54]

5.2 Telephone

In Australia, in *Magnacrete Ltd v Douglas Hill & Anor*,[55] Perry J held that unless provided by the articles, a meeting cannot in law be conducted by separate telephone calls but left open the question whether a meeting can be conducted by a telephone conference during which all directors can communicate with each other simultaneously and instantaneously. In that case, the company had seven directors of whom three were disqualified from voting on a transaction. Two of the directors met at the solicitors' office and then called the other two eligible directors over the telephone to enter into a contract and to affix the common seal of the company to the contract. After agreement was obtained from the other two directors over the telephone, minutes were drawn up as a meeting 'conducted by telephone'. The articles did not provide for conducting 'meetings' over the telephone. Perry J on a construction of the articles as a whole held that there was no valid meeting. However, in *Re Giga*

54 *Ibid*, at pp 564-565.
55 (1989) 7 ACLC 117.

Investments Pty Ltd (In admin),[56] Branson J held that the words 'meet together' meant a meeting of minds made possible either by proximity or technology. If the principle of construction is to be applied, it is suggested that whether a telephone-call conference would constitute a meeting or not will depend on the way in which the articles are drafted. In Canada, the Ontario Business Corporation Act allows for meeting by telephone conference unless the articles provide otherwise.[57]

6. Meeting of single person: the Ordinance

Section 111(3) of the Ordinance empowers the court to direct the calling of an annual general meeting if there is default in holding such a meeting as is required to be held within the time frame stipulated in s111(1). Additionally, the court may give a direction that one member present in person or by proxy shall constitute a 'meeting'. Section 114B(1) of the Ordinance also empowers the court to give direction that one member present in person or by proxy shall constitute a meeting in circumstances where it is impracticable to call a meeting of a company in any manner, or to conduct one in the manner prescribed by the articles or the Ordinance. The difference between s111 and s114B of the Ordinance is that the former applies only to 'default' in holding annual general meetings while the latter deals with practical impossibility to convene or conduct general meetings.

6.1 Limitations on statutory power

Where 'impracticability' is proved under s114B(1), it does not necessarily follow that the court will automatically exercise its statutory power to order a meeting and direct that one member of the company present in person or by proxy shall constitute a meeting. The statutory power is a discretionary power that must be exercised on rational grounds. There are limitations to this discretionary power. First, if there is a shareholders' agreement containing contractual terms to the effect that the presence of the other member is required for the transaction of business, the court will not make the direction if it has the effect of unfairly prejudicing the other partner. This is because the court will not rewrite the terms of shareholders' agreement: *Mansfield Coatings Co Ltd v Springfield Coatings Co Ltd & Anor*[58] and *Re Rich Treasure Enterprises Ltd.*[59] Second, the court will not act if the direction from the court is sought for the substantial purpose of achieving a collateral

56 (1995) 13 ACLC 1047.
57 Section 126(3), Ontario Business Corporation Act.
58 [1995] 1 HKC 74.
59 [2001] 3 HKLRD 769. See discussion in chapter 25, para 7.4.4.

- specify the intention to propose a particular resolution as a special resolution.

In *MacConnell v E Prill & Co Ltd*,[94] s69(1) of the Companies (Consolidation) Act 1908 (UK) provided that whenever an extraordinary resolution[95] was proposed to be passed, the notice must '[specify] the intention to propose the resolution as an extraordinary resolution'. The notice to convene the extraordinary general meeting in that case was not specific. It was in the following terms:

> You are kindly requested to attend an extraordinary general meeting, to be held at the above address on Friday, 25 February 1916, at 12 noon — Agenda: To pass resolution to increase capital of the company.

The extraordinary resolution passed at the meeting was:

> That the capital of the company be increased to 3500*l* by the creation and issue of 1500 shares of 1*l* each.

The plaintiff sought to restrain the company and its directors from implementing the resolution that was passed on the ground that the notice of the meeting at which the increase in capital was sanctioned was an insufficient notice in that:

- the resolution which was actually passed pursuant to the notice did not specify into what shares the proposed increase in capital were to be divided; and
- contrary to s69(1), the notice did not specify the intention to propose the resolution as an extraordinary resolution.

Sarjant J upheld the objections and granted the injunction. It was said:

> As regards the first objection, it is obvious that the notice signifies merely an intention to propose some increase or other in the capital of the company, and not an intention to make the specific increase embodied in the resolution that was actually passed. It seems to me of great importance that shareholders should be protected in matters of this kind by specific notice of what is intended to be done... As regards the second objection, nothing can be clearer than the very precise language of s 69 of the Act of 1908, which requires, in the case of an extraordinary resolution, that the notice shall specify the intention to propose the resolution as an extraordinary resolution.[96]

In *Re Moorgate Mercantile Holdings Ltd*,[97] the court was called upon to confirm a special resolution passed at a general meeting to reduce the share account of the company. However, the substance of the special resolution before the court differed from that which was set out in the notice

94 [1916] 2 Ch 57.
95 Now known as special resolutions.
96 [1916] 2 Ch 57 at p 61. Applied in *Hong Kong Racing Pigeon Association Limited & Ors v Lam Koon Nam & 12 Ors*, unreported judgment dated 21 June 2002 in HCA 18376/1999.
97 [1980] 1 All ER 40.

convening the general meeting, which was to cancel the amount standing in the share premium account. An objection was raised on the ground that the resolution before the court for confirmation was not a resolution passed at the general meeting to which a requisite notice specifying an intention to propose the resolution as an extraordinary resolution within the meaning of s141(2) of the Companies Act 1948 (UK) had been given. Slade J (as he then was) refused to confirm the special resolution, which was before him on the ground that the special resolution was different from that set out in the preceding notice. Slade J (as he then was) said:

> Neither the precise form nor the substance of the intended resolution was communicated to the shareholders, and this necessarily rendered the notice invalid ... It is therefore all the more important that each shareholder should now have clear and precise advance notice of the substance of any special resolution which it is intended to propose, so that he may decide whether he should attend the meeting or is content to absent himself and leave the decision to those who do; the provisions imposed by s141(2) of the 1948 Act must be intended as much for the protection of the members who in the event decide to absent themselves as for those who decide to attend: see for example *Tiessen v Henderson* [1899] 1 Ch 861 per Kekewich J. If it were open to the members who did attend to propose and vote on a special resolution differing in substance (albeit slightly) from the resolution of which notice had been given, there would be a risk of unfair prejudice to those members who, after due consideration, had deliberately absented themselves. I do not think that their interests would be sufficiently protected by the safeguard suggested by counsel for the company, namely that an amendment could properly be put to and voted on by the meeting only if a member, who had formed a view or intention with regard to a resolution as circulated, could not reasonably adopt a different view on the amended version. Nor do I think that the alternative 'whittling down' criterion suggested by him would offer them adequate protection. In many circumstances, albeit not on the facts of the particular case, either test when applied in practice could involve serious uncertainties and difficult questions of degree. Furthermore, in many cases it would present substantial embarrassment both to the chairman of the meeting who had to apply it and to any persons holding 'two-way' proxies on behalf of absent members. The absent members would be correspondingly faced with unpredictable risks.[98]

The significance of the decision in *Re Moorgate Mercantile Holdings Ltd* lies in the interpretation given to s141(2) of the Companies Act 1948 (UK),[99] namely, that it was impossible to specify the intention to propose a special resolution without first setting out or disclosing in the notice the entire content or substance of the actual resolution proposed to be passed. Slade J (as he then was) said:

> The relevant condition precedent to the validity of an extraordinary resolution, as set out in s69(1) of the 1908 Act, is that 'notice specifying the intention to propose the resolution as an extraordinary resolution has been

98 *Ibid*, at pp 53-55.
99 The Hong Kong equivalent is s116(1). Section 152, Companies Act 1965 (Malaysia), s184 Companies Act (Cap. 50) (Singapore).

amendment could not have materialised. In rejecting the argument that the *Duomatic* rule applied, Meagher JA said:

> What is that principle? That principle is I think this: where it can be shown that all shareholders having a right to attend and vote at a general meeting of a company assent with full knowledge and consent to some matter which a general meeting of the company could carry into effect, that assent is as binding as a resolution in general meeting would be. In other words, it is a doctrine dispensing with the consumptive effect of formalities. It is a doctrine that formalities may be disregarded if they have been waived by all shareholders acting in concert who want the same substantial result.[17]

3. Application

The principle of unanimous consent has been applied in three principal circumstances – the absence of a formal meeting, irregularly convened meeting and decisions made without the passage of formal resolutions. The circumstances are discussed below.

3.1 No formal meeting

In *Parker & Cooper Ltd v Reading*,[18] the articles of the company allowed the directors to contract with the company so long as the nature of their interests were disclosed. However, interested directors were prohibited from voting on the proposed contract. Further, the articles provided that the seal of the company could only be affixed pursuant to a board resolution in the presence of two directors and the secretary. The company was in need of funds and it decided to issue a debenture to Mr Reading, one of the directors, who had agreed to make advances to the company. The arrangement was discussed among all the shareholders, one with another and from time to time. Although there was no actual meeting, all the shareholders gave their consent. Following that, at a board meeting, the debenture was issued but the sealing was irregularly carried out as Mr Reading had signed the debenture document at his house and not at the board meeting. When the company defaulted under the debenture, a receiver was appointed. The company subsequently went into voluntary liquidation. The liquidator challenged the transaction on three principal grounds. First, the informal assent of all the shareholders given individually was invalid as there was no semblance of a complete meeting. Second, the directors' meeting which authorised the issue of the debenture was an inquorate meeting because of the interest of Mr. Reading. Third, the sealing of the document was irregularly done as Mr Reading executed the debenture document at his house. Astbury J held that even on an

17 *Ibid*, at p 83.
18 [1926] 1 Ch 975.

assumption that the debenture was irregularly issued, it did not matter that the shareholders' assent to the irregular transaction was not given at an actual meeting. The company was bound. Astbury J said:

> Now the view I take... is that where the transaction is *intra vires* and honest, and especially if it is for the benefit of the company, it cannot be upset if the assent of all the corporators is given to it. I do not think it matters in the least whether that assent is given at different times or simultaneously.[19]

Astbury J in arriving at his decision declined to follow the case of *Re George Newman & Co Ltd*,[20] and distinguished that case on the ground that the transaction there was *ultra vires* the company. The learned judge relied on the case of *Re Express Engineering Works*[21] and the statement of Lord Davey in *Salomon v Salomon & Co Ltd*.[22] The significant point in Astbury J's decision is that the assent need not be given contemporaneously under the same roof and at a meeting. It would suffice even if the consent of directors were given individually and separately. In *EBM Co Ltd v Dominion Bank*,[23] the Privy Council declined to express a view whether the decision of Astbury J that unanimous agreement of all the shareholders ascertained otherwise than in a general meeting would be sufficient[24] in law. However, in an earlier decision of the Privy Council delivered in *A-G for the Dominion of Canada v Standard Trust Co of New York*,[25] it was held that the transaction there could not be impeached on the ground that no general meeting had been held. Viscount Haldane said:

> The only persons beneficially interested in the company were the four members of the syndicate. The law gave them the complete control of its action. Under that control the company gave effect to the policy of the only persons who had any beneficial interest in its capital. The case is not one in which the apparent procedure can be said to have been unreal, or to have been a cloak under which a conspiracy to defraud was concealed. Under these circumstances, their Lordships are of opinion that the company, notwithstanding that no general meeting, apart from the meeting of directors, appears to have been held for the purpose, was completely bound by the transactions sought to be impeached...[26]

The decision in *Parker & Cooper Ltd v Reading*[27] has been consistently applied and approved without any adverse comment in other English cases. In *Cane v Jones & Ors*,[28] for example, the equal shareholders of

19 *Ibid*, at p 984.
20 [1895] 1 Ch D 674.
21 [1920] 1 Ch 466.
22 [1897] AC 22.
23 [1937] 3 All ER 555.
24 *Ibid*, at p 566.
25 [1911] AC 498.
26 *Ibid*, at pp 504-505.
27 [1926] Ch 975.
28 [1981] 1 All ER 533. See also *Re Fletcher Hunt (Bristol) Ltd* [1989] BCLC 108, per Knox J at p 113.

court wide discretion to deal with litigation costs.... The court has a discretion to order that the company shall indemnify the plaintiff against the costs incurred in the action. The test is whether an independent board, exercising the standard of care which a prudent businessman would exercise in his own affairs, would have decided to bring the action: per Lord Buckley in *Wallersteiner v Moir (No.2)* at p 404; see also *Jaybird Group Ltd v Greenwood* [1986] BCLC 319 and *Smith v Croft* [1986] 2 All ER 551. This test, in my judgment, is wider than what a plaintiff in a derivative action is required to show before he is allowed to proceed with his action, namely, that there is a *prima facie* case that the company is entitled to the relief claimed and the action falls within the proper boundaries of the exception to the rule in *Foss v Harbottle: Prudential Assurance Co Ltd v Newman Industries Ltd (No.2)* [1982] Ch 204 and *Tan Eng Guan v Southland Co Ltd* [1996] 2 HKC 100. In determining whether a plaintiff in a derivative action should be granted an indemnity to his costs, the court, apart from having regard to the merits of the case, may also take into account a variety of other factors. These factors include the wishes of the genuinely independent shareholders: *Smith v Croft*, whether the action is for the benefit of the shareholders: *Watts v Midland Bank plc* [1986] BCLC 15, 22F and the impecuniosity or the financial strength of the plaintiff: *Wallersteiner v Moir (No.2)* and *McDonald v Horn* at p.973h-j.[35]

In the case, Chu J refused to grant an order for the company to indemnify the plaintiffs' costs because of the absence of a plea of loss and damages to the company. It was also held that a hypothetical independent board, exercising the standard of care which a prudent businessman would exercise in his own affairs would not ordinarily incur expenses in litigating a dispute when there is no apparent pecuniary or other advantage and benefit to be gained from such a course, having regard to the inherent risks in and the high costs of litigation.[36]

3.5 Determination of *locus standi* generally

A defendant may, as a first step in resisting the action, make an application under Order 33 rule 3 or Order 33 rule 7 of the Rules of the High Court, to determine the *locus standi* of the plaintiffs as a preliminary issue before the plaintiffs are allowed to proceed further in the action,[37] or take out an application to strike out the action under Order 18 rule 19.[38] In *Prudential Assurance v Newman Industries (No. 2)*,[39] it was said:

> The plaintiff ought at least to be required before proceeding with his action to establish a *prima facie* case: (1) that the company is entitled to

35 *Ibid*, at p 415.
36 *Ibid*, at p 419.
37 *Prudential Assurance Co Ltd v Newman Industries Ltd* [1981] Ch 229.
38 *Smith & Ors v Croft &Ors (No. 2)* [1987] BCLC 206.
39 [1982] Ch 204.

> the relief claimed and (2) that the action falls within the proper boundaries of the exception to the rule in *Foss v Harbottle*.[40]

In a derivative action, there are good reasons why the question of *locus standi* should be decided upon at the earliest opportunity. First, it discourages unmeritorious or unnecessary actions. Second, if an action is stopped at an early stage, the company's expense and judicial time are saved.

In the Malaysian case of *Huang Ee Hoe & Ors v Tiong Thai King & Ors*,[41] Chong Siew Fai J (as he then was) explained that the rationale is:

> ... to avoid unjustifiably subjecting the company to a full trial in order to enable the court to determine whether the plaintiffs were entitled in law to make the company undergo the entire action.[42]

At the other extreme, the procedure in Order 33 should not be resorted to as a short cut as it can produce results which negate the underlying rationale for the very existence of the procedure. In *Peck v Russell & Ors*,[43] Reay JC said:

> ...a plaintiff should not be shut out from resort to the court except on the clearest grounds. It is better to run the risk of interfering with the internal management of a company than to run the risk of denying justice to a party by refusing to hear his case.[44]

The guiding principle is that the procedure should be applied only in clear cases. Any departure from this guiding principle should only be made in exceptional cases. In *Tilling v Whiteman*,[45] Lord Wilberforce in the House of Lords said:

> I, with others of your Lordships, have often protested against the practice of allowing preliminary points to be taken, since this course frequently adds to the difficulties of courts of appeal and tends to increase the cost and time of legal proceedings. If this practice cannot be confined to cases where the facts are complicated and the legal issue short and easily decided, cases outside this guiding principle should at least be exceptional.[46]

Lord Scarman said:

> Preliminary points of law are too often treacherous short cuts. Their price can be, as here, delay, anxiety, and expense.[47]

An issue which deals with the whole subject matter of the action without the benefit of facts being properly proved in evidence, or

40 *Ibid*, at pp 221-222.
41 [1991] 2 MLJ 51.
42 *Ibid*, at p 53.
43 (1923) 4 FMSLR 32.
44 *Ibid*, at p 46.
45 [1980] AC 1.
46 *Ibid*, at pp17-18.
47 *Ibid*, at p 25.

Long ago, in *Drincqbier v Wood,*[171] Byrne J said:

> It should be understood that a director consenting to be a director, has assumed a position involving duties which cannot be shirked by leaving everything to others.[172]

In *Re Park House Properties Ltd,*[173] Neuberger J said:

> As a matter of principle, it appears to me that it cannot be right that a director of a company involved in activities which justify a disqualification order against the director directly responsible for those activities can escape liability simply by saying that he knew nothing about what was going on. The court must inquire whether in the circumstances the failure to discover what was going on was attributable to ignorance born of culpable failure to make inquiries or, whether inquiries were made, of culpable failure to consider or appreciate the results of those inquiries: if such culpability is established, then the court would have to go on to decide whether, in all the circumstances, the culpability was sufficient to justify the conclusion that the conduct of the person concerned was such as to make him unfit to be concerned in the management of a company.[174]

In disqualification proceedings, directors have been disqualified on the ground that they have abdicated their individual responsibility as members of the board by leaving everything to others, acting on blind reliance, or for failure to join with co-directors to supervise, monitor or control the business and affairs of the company. Examples of such conduct are discussed in paragraph 7.4 below.

6.9 Reliance on professional advice

In some disqualification cases, applicants have relied upon failure or refusal to act on professional advice by the respondents to demonstrate unfitness. In other cases, respondents have relied on professional advice as a defence. In either situation, it is a relevant consideration to be taken into account for the purpose of assessing unfitness. Whether failure to act on, or acting upon, professional advice would be determinative of the issue of unfitness or not must be decided on a case to case basis. Invariably, the importance to be attached to this consideration is a matter of fact and degree. In *Re Bath Glass Ltd*,[175] reliance on professional advice was a complete defence in circumstances where probity and diligence were not lacking or challenged.

171 [1899] 1 Ch 393 .
172 *Ibid*, at p 406. See also *Law Wai Duen & Anor v Boldwin Construction Co Ltd & Ors* [2001] 4 HKC 403, per Rogers VP at p 407.
173 [1997] 2 BCLC 530.
174 *Ibid*, at p 554.
175 [1988] BCLC 329.

In *Re Hitco Ltd 2000*,[176] even though there was no lack of probity, failure to act on professional advice was found to be fatal in circumstances where the respondent did not understand financial matters and had no system of financial controls. It is also fatal that, contrary to professional advice, directors should entertain unreasonable belief that the company could trade out of its difficulties. In *Re GSAR Realisations Ltd,*[177] the company was operated on the basis of an increasing overdraft. Accountants (instructed on the insistence of the company's bank) had reported that the company was insolvent and the directors should consider the company's position. Nevertheless, Mr Smith, a director of the company drew an unjustified degree of comfort from the fact that the company's bank had extended its overdraft despite the financial difficulties faced by the company. Mr Smith shut his eyes and closed his ears to the professional advice. He had refused to implement the recommendations of the professional adviser. In finding unfitness, Ferris J said:

> …his failure to accept in full the conclusions of the Hacker Young report manifest, in my judgment, a degree of indifference to his duties which constitutes unfitness. Moreover I think that Mr Smith drew a wholly unjustified degree of comfort from the fact that the bank was prepared to increase the company's overdraft. The Hacker Young report had shown that the position of the bank was extremely precarious, but that it would be better off with the company continuing as a going concern than going into receivership. It was not surprising, therefore, that the bank was willing to provide additional finance against extra security. But Mr Smith seems to have interpreted the increased facility as something nearly equivalent to a clean bill of financial health, consistent with his own disagreement with the Hacker Young report.
>
> In taking this line Mr Smith was, in my view, guilty of significantly more than mere commercial misjudgement. To my mind he was obstinately and unjustifiably backing his own assessment of the company's position and largely ignoring the assessment made by Hacker Young. I accept that Mr Smith may himself have believed that the company could trade out of its financial difficulties. I do not accept that such belief was reasonable. After the Hacker Young report Mr Smith ought to have appreciate that it was unreasonable to proceed on this basis without compliance in full with the Hacker Young recommendations. This failure of appreciation was, in my view, made more culpable when, after a brief improvement in December 1988 and January and (perhaps) February 1989, the company's position deteriorated from March 1989 onwards without immediate action being taken by Mr Smith.[178]

In *Re McNulty's Interchange Ltd*,[179] it was said that to rely on professional advice which is self-evidently wrong is no defence. Blind

176 [1995] 2 BCLC 63.
177 [1993] BCLC 409.
178 *Ibid*, at p 422. See also *Re Park House Properties Ltd* [1997] 2 BCLC 530.
179 [1989] BCLC 709, at p 712.

court to speculate whether the disputed facts might, if pursued, be proved or to ask itself whether, if they were proved, the seriousness of the unfitness would be affected.

The parties cannot, however, by their agreement require a judge to find that the director's conduct as described in an agreed statement of facts warrants a disqualification order. I find it almost inconceivable that, in a case where the director agrees that his conduct warrants a disqualification order, the judge would not so find. But a judicial finding must remain a matter for the judge's judgment reached on the facts agreed or proved before him. Similarly, the parties cannot by their agreement require the judge to conclude that a disqualification order of a specified period or falling within a specified bracket should be made. That, too, must remain a matter of judicial judgment formed, of course, on the basis of the agreed statement of facts. It would, naturally, be unusual for a judge to disagree with a period of disqualification thought both by the Secretary of State and by the respondent director to be suitable. But the principle remains that the judge would not be bound by their agreement in that regard.[323]

In *The Official Receiver v Chan Min Simon*,[324] Yuen J (as she then was) held that there cannot be objection, 'whether in theory or practice why, a similar summary procedure should not apply in Hong Kong.' This is a sensible assimilation of the approach taken in the UK.

9.5 Notice before action

Section 168P(1) requires an applicant who intends to apply for a disqualification order to give at least 10 days' notice of his intention to do so to a proposed respondent. In the High Court in *Secretary of State for Trade and Industry v Langridge*,[325] Mummery J (as he then was) held that the giving of 10 days' notice is mandatory and failure to do so is fatal. On the appeal, it was held by the majority that short notice is merely a procedural irregularity and is not fatal.

In the High Court, Mummery J (as he then was) explained that the notice is intended to serve at least the following functions:

> Prior notice of intended legal proceedings involving potentially serious and damaging allegations provides a valuable safeguard for an intended respondent to those proceedings. With the benefit of advanced warning of proceedings he can take steps to dissuade the intended applicant from bringing the proceedings under what may be a mistake or misunderstanding as to the identity, status or actions of the intended respondent. The intended respondent may be able to produce clear

323 *Ibid*, at pp 517-518.
324 Unreported judgment of Yuen J (as she then was) dated 26 June 2002 in HCMP 6570/2000. See also *Re Emperor Hotel Management Co Ltd* [2002] 3 HKLRD 805.
325 [1991] BCLC 543.

> documentary evidence of mistaken identity or showing that there has been a fundamental misunderstanding of certain actions on his part. The intended respondent can, on receipt of the notice, take legal advice and ask the intended applicant for details of the grounds which will be relied upon. He can ask for the issue of proceedings to be deferred while he responds to them or seeks legal advice or even takes legal action, such as by way of judicial review, to challenge the lawfulness of the decision to institute the proceedings against him.[326]

In the Court of Appeal, the majority disagreed, with Nourse LJ dissenting. Balcombe LJ said:

> While I do not disagree with the generality of what the judge said on this point it has to be said that the ten day notice under s16(1) has a very limited ability to confer the advantages to which the judge refers in the passage cited. In the first place no notice has to be served in those cases where the court is empowered, and decides, to make a disqualification order of its own motion, although doubtless the rules of natural justice will require that the person concerned should be given some notice that the court is contemplating making a disqualification order. Secondly, no notice has to be served when the application for a disqualification order is made to a court other than the winding up court, although again the rules of natural justice will have effect. Thirdly, the letter does not have to give the grounds on which the application is made, so that although the intended respondent may ask for those grounds, the intended applicant is under no obligation to give them. Finally, the period of the notice ten days is too short for the recipient to be able to do much. He may, as the judge says, be able to produce clear evidence of mistaken identity, or he may be able to seek to challenge, by way of judicial review, the lawfulness of the decision to seek a disqualification order against him, but beyond that the importance of the notice seems to be limit the shock to the intended respondent which he might otherwise sustain if the first intimation he has of the application is when the proceedings are served on him. In my judgment Mr Charles was justified in describing the notice as 'an unparticularised letter before action', conferring only a limited benefit on the recipient.[327]

Leggatt LJ, on the other hand, said that the purpose of the notice is 'to inform of intentions rather than to protect rights.[328] It was also said:

> Ways in which notice under s16(1) of the 1986 Act might be supposed to benefit the director were suggested by Mummery J in his judgment. They boil down to the opportunity – (a) 'to dissuade the intended applicant from bringing proceedings'; (b) to enable the director 'to produce clear documentary evidence of mistaken identity or show that there has been a fundamental misunderstanding'; (c) to 'take legal advice and ask for details of the grounds which will be relied on'; and

326 *Ibid*, at pp 549-550.
327 *Ibid*, at p 550.
328 *Ibid*, at p 550.

company to the true party interested, who in that case was a director and shareholder, and who had caused the company to expend its money on an unsustainable case.

In my view however the order under s127 would in no way deprive the court of jurisdiction to deal with the costs in such a way on the hearing of the petition. The possibility of a Bathampton order would exist even if the petitioning creditor was an entirely unconnected party. I do not think in such a case the court would exclude payment of costs from a s127 order. That would in some cases have the effect of depriving the company of the ability to defend itself and thereby pre-empt the question of whether or not the defence was a good one.[146]

The *Bathampton* order referred to by Hoffmann J (as he then was) in the case is to mitigate against the risk of prejuding the merits of defences or claims in advance. It is to be noted that in *Re Bathampton Properties Ltd*, Brightman J (as he then was) held that the jurisdiction to make such types of orders was found in s50(1) of the Judicature Act 1925 (UK) and rule 195 of the Companies (Winding up) Rules 1949 (UK). It appears to be against common sense that costs, being largely a matter of discretion, Hong Kong courts cannot make a *Bathampton* order in appropriate cases.

4.4.5 Nature of complaints in the petition

The grounds advanced for winding up and whether the disposals sought to be validated are in the ordinary course of business are important matters that go into the basket of considerations forming the judicial content of discretion in s182 of the Ordinance. Underscoring these considerations is the financial health of the company.

In a creditor's petition grounded on alleged insolvency, and insolvency is apparent, it does not necessarily follow that dispositions will not be allowed even if the dispositions are not in the ordinary course of business. The test is whether such dispositions will prejudice or benefit the creditors in real terms. So, in *Re A.I. Levy (Holdings) Ltd* and *Re Park Ward Company Limited*, the dispositions were validated. Otherwise, the creditors in these cases would have suffered greater losses.

In a contributory's petition for winding up that is not grounded on insolvency, the general principles of law applicable to directors' powers in the management of the business and affairs of the company assume greater significance in cases where the company is an active company. This is but an application of common sense – the court does not interfere with mere disagreements in matters of business management or judgments. In *Re Burton & Deakin Ltd*,[147] Slade J (as he then was) said:

146 *Ibid*, at p 39.
147 [1977] 1 All ER 631.

The position of contributories, however, appears to me to be very different. As counsel for the company pointed out, the responsibility of managing the business of the company is entrusted by its articles of association to its directors. At least so long as a winding up petition has not been presented, the court will not generally, save in the case of proven bad faith or other exceptional circumstances, interfere with the exercise of the discretion conferred on the directors by a company's articles of association at the instance of a shareholder. Thus, if before the presentation of a petition a shareholder were to come to the court in an attempt to restrain a particular disposition of the company's property contemplated by the board of directors and falling within their powers, he would not generally succeed, unless he could prove bad faith or other exceptional circumstances. He would not be able, merely by adducing prima facie grounds for criticising the wisdom or beneficial nature of a particular transaction, to place on the company or its board of directors the onus of justifying the proposed disposition by detailed evidence.

I can see no good reason why the rights of interference by a shareholder vis-à-vis the company or its directors should, in this kind of situation, for practical purposes be drastically improved during the interim period, merely because he happens to have presented a winding up petition which is not demurrable and has not yet been heard. The interim period may be quite a long one. In the present case from what I have been told, it looks like being between three and six months. In a case such as the present, the court at the time when the application under s227 comes before it generally has not sufficient evidential material to enable it properly to form even a prima facie view whether the petition itself is ultimately likely to succeed or fail. It must therefore necessarily assume that the petition is at least as likely to fail as it is to succeed.[148]

However, a word of caution is warranted. The case of *Re Burton & Deakin Ltd* included a prayer for buying out the petitioner's shares in the company. However, in the authors' view, such objections to dispositions should be given less weight as there is discretion vested in the court to adjust upwards the price of shares to be compulsorily purchased if it could eventually be proved that the dispositions rendered the petitioner's shares less valuable. Nevertheless, if there is serious doubt as to the company's solvency and continuation of trading is likely to deplete assets, then no validation order should be made: *Re a Company (No. 0075123 of 1986)*.[149]

The considerations of solvency and the need to avoid paralysis of a company's trading power are irrelevant if the winding up petition is based on grounds of public interests:[150] *Re a Company (No. 007130 of 1998)*.[151]

In *Re Five Lakes Investment Co. Ltd and Multiford Co Ltd*[152] Clough J

148 *Ibid*, at pp 636-637.
149 [1987] BCLC 200.
150 See s218(1)(g)(i), s218(1)(m) and s218(1)(n).
151 [2000] 1 BCLC 582.
152 [1985] HKLR 273.