[HIGH COURT OF AUSTRALIA.]

PETERS' AMERICAN DELICACY COMPANY LIMITED . . . . . APPELLANT;
DEFENDANT,

AND

HEATH AND OTHERS . . . . . RESPONDENTS.
PLAINTIFFS,

ON APPEAL FROM THE SUPREME COURT OF NEW SOUTH WALES.

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SYDNEY, 1938, *Nov.* 11, 14, 17.

MELBOURNE, 1939, *Feb.* 9.

Latham C.J., Rich, Dixon and McTiernan JJ.

Company—Capitalization of profits—Validity of alteration of articles—Prejudice of holders of partly paid-up shares—Benefit of company—Statements in circular explaining proposed alteration—Statements at meeting—Accuracy and completeness.

The share capital of a company consisted of a large number of fully paid shares and a smaller number of shares paid up to one-third. The articles of association contained a provision that cash dividends should be distributed in proportion to the amount of capital paid up on shares and a provision that "notwithstanding anything in any other article contained" under the authority of a general meeting profits might be distributed in the form of fully paid or partly paid shares in proportion to the number of shares held by the respective members. At a general meeting a special resolution was passed altering the article dealing with the capitalization of profits to the effect that when a capitalization took place the distribution of shares should be in accordance with the amount paid up on the respective shares of the members participating. This alteration formed part of a scheme for the formation of a subsidiary operating company and a transfer of the assets to it in exchange for shares. Further resolutions were passed at the meeting to give effect to this scheme. A circular explaining the purpose and nature of the proposed charge had been sent to shareholders with the notice of the meeting. The circular was capable of conveying a view of the situation arising by reason of the different

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bases of distribution of cash profits and of profits in the form of fully paid or partly paid shares which was not the correct legal result; but the relevant articles were set out therein and the circular was carefully and honestly drawn. At the meeting the chairman and the company's solicitor made statements, which were similarly mistaken, as to the effect of the proposed alteration. The opponents of the scheme put their views before the meeting. The plaintiffs, who were contributing shareholders, sought a declaration that the resolutions were invalid on the grounds (i) that the resolutions were passed solely for the purpose of benefiting fully paid shareholders to the disadvantage of partly paid shareholders and not in the interests of or for the benefit of the company, or the body of shareholders; (ii) that the circular issued with the notice convening the meeting was misleading; (iii) that at the meeting the chairman and the solicitor made statements which were not complete and not accurate and were misleading.

Held that the resolutions were not invalid.

Grounds on which an alteration by a company of its articles of association will be declared invalid considered.

Decision of the Supreme Court of New South Wales (*Nicholas* J.) reversed.

APPEAL from the Supreme Court of New South Wales.

In a suit brought in the Supreme Court of New South Wales, in its equitable jurisdiction, the defendant, Peters' American Delicacy Co. Ltd., was a limited liability company carrying on business in that State and incorporated therein on 14th September 1920. At the date of the commencement of the suit it had a total paid-up capital of £397,445 15s. 4d. which was divided into 511,364 shares of 14s. each fully paid up and 169,247 shares of 14s. each paid to 4s. 8d.

The plaintiffs to the suit, Thomas Wood Heath, Lynton Edward Palmer and Herbert Raymond Nettheim, were the holders of contributing shares, and they sued on behalf of themselves and all other holders of partly paid-up shares in the company who at an extraordinary general meeting held on 14th September 1937 did not vote in favour of the proposal to alter art. 120 of the company's articles of association.

At the hearing no exception was taken to the manner in which the suit was constituted.

The plaintiffs sought a declaration that the resolutions whereby the shareholders purported to alter the articles were not validly passed, and an injunction restraining the company and its directors

from acting upon those resolutions or making any distribution of the assets of the company inconsistent with art. 120 as it stood at the date of the extraordinary general meeting above mentioned.

The grounds upon which the declaration and the injunction were sought in the statement of claim as originally drafted were in substance: (i) that the resolutions were passed solely for the purpose of benefiting fully paid shareholders to the disadvantage of partly paid shareholders and not in the interests of or for the benefit of the company, or the body of shareholders; and (ii) that "the members of the company at all material times holding only partly paid shares were only a small minority of the shareholders and the plaintiffs charge and it is the fact that the fully paid shareholders used their majority voting power to pass the said resolutions to benefit themselves at the expense of the partly paid-up shareholders."

At the hearing the plaintiffs put their case on three additional and alternative grounds as follow: (i) that a circular issued with the notice convening the meeting was misleading; (ii) that speeches made at the meeting by the chairman of directors and the company's solicitor were, even although bona fide, incomplete, inaccurate and misleading; and (iii) that the chairman refused to put an amendment which was proposed at the meeting by a shareholder and which should have been put to the vote.

Art. 120 was headed "Capitalization of Profits" and was in the following terms:—"120. Notwithstanding anything in any other article contained the whole or any part of the undivided profits including amounts at credit of reserve or any other fund may with the sanction of the company in general meeting be converted into capital of the company by distributing the same amongst the holders of shares as a special dividend or bonus by issuing partly or fully paid-up shares in respect thereof to the holders of such shares in proportion to the shares held by them in the company. The directors may sell shares or make cash payments if necessary in order to adjust rights and a proper contract shall be filed in accordance with section 55 of the *Companies Act* 1899, and the directors may appoint any person to sign such contract on behalf of the persons entitled and such appointment shall be effective."

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By the resolution of which the plaintiffs complained it was resolved :—" That the articles of association be altered in manner following : ' Article 120 shall be cancelled and the following articles substituted therefor—120. Any general meeting declaring a dividend may resolve that such dividend be paid wholly or in part by the distribution of specific assets and in particular of paid-up shares, debentures or debenture stock of the company or paid-up shares, debentures or debenture stock of any other company or in any one or more of such ways. 120A. Any general meeting may resolve that any moneys investments or other assets forming part of the undivided profits of the company standing to the credit of the reserve fund or in the hands of the company and available for dividend (or representing premiums received on the issue of shares and standing to the credit of the share premium account) be capitalized and distributed amongst such of the shareholders as would be entitled to receive the same if distributed by way of dividend and in the same proportions on the footing that they become entitled thereto as capital and that all or any part of such capitalized fund be applied on behalf of such shareholders in paying up in full either at par or at such premium as the resolution may provide any unissued shares or debentures or debenture stock of the company which shall be distributed accordingly or in or towards payment of the uncalled liability on any issued shares or debentures or debenture stock and that such distribution or payment shall be accepted by such shareholders in full satisfaction of their interest in the said capitalized fund.' " Art. 120B was an article which it was proposed to substitute for the second portion of the original art. 120, and which it is not necessary to set forth in this report.

At the meeting at which the resolution for the alteration of the articles was proposed and carried resolutions were also proposed for increasing the capital of the company to £1,050,000 by the creation of 750,000 new shares of 14s. each, for the promotion of a new company to which the existing company was to sell portion of its assets, of which the most valuable was the goodwill of its business in New South Wales, and for the formation of a special reserve account to which the directors should carry all or such part as they should think fit of the moneys to be received from such sale or sales

with a view to the subsequent distribution thereof amongst the shareholders by way of a bonus dividend to be satisfied by the issue of shares in the company as fully paid, as thereafter mentioned.

Resolution 4 of the resolutions put to the meeting was stated in the notice to be contingent on the previous resolutions having been passed. It was as follows: "That it is desirable that a sum of £397,446 which will be part of the undivided profits of the company and which will stand to the credit of the said special reserve account after the moneys shall have been received by the company from the said sale or sales be capitalized and accordingly that a special bonus dividend of 14s. per share be declared on each of the issued fully paid 14s. shares of the company and of 4s. 8d. per share on each of the shares of the company which have been partly paid namely to 4s. 8d. and that such dividend be satisfied by the company allotting to each holder of fully paid shares one new share of 14s. credited as fully paid for each one fully paid share held by him on 3rd September 1937, and by the company allotting to each holder of partly paid shares one new share of 14s. credited as fully paid for each three partly paid shares held by him on the same date."

At the meeting the chairman refused to put an amendment which a shareholder wished to move. The amendment was in the following terms: "That art. 120 be not cancelled and that the capitalization of profits involved in the resolution before the meeting be effected by making the distribution among shareholders, treating fully paid shareholders and contributory shareholders *pari passu* in accordance with art. 120 of the company's existing articles of association."

Other articles material to this report were as follows:—"36. The company in general meeting may before the issue of any new shares determine that the same or any of them shall be offered in the first instance and either at par or at a premium to all the then members or any class thereof in proportion to the amount of capital held by them or make any other provisions as to the issue and allotment of the new shares but in default of any such determination or so far as the same shall not extend the new shares may be dealt with as if they formed part of the shares in the original ordinary capital." "108. The profits of the company shall be divisible among the members in proportion to the capital paid up on the shares held by them

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respectively. 110. The company in general meeting may declare a dividend to be paid to the members according to their rights and interests in the profits and may fix the time for payment. 111. No larger dividend shall be declared than is recommended by the directors, but the company in general meeting may declare a smaller dividend. 112. No dividend shall be payable except out of the profits of the company and no dividend shall carry interest as against the company."

Sec. 20 of the *Companies Act* 1936 (N.S.W.) provides as follows: "(1) Subject to the provisions of this Act and to the conditions contained in its memorandum, a company may by special resolution alter or add to its articles. (2) Any alteration or addition so made shall be as valid as if originally contained in the articles, and be subject in like manner to alteration by special resolution."

A brief summary of the events preceding the general meeting of 14th September 1937 is as follows:—The defendant company was incorporated in 1920 on the reconstruction of a company which had for some years previously carried on the same business under the same name. From 1920 until 1929 all the shares in the company were £1 shares paid up to 15s., but in 1929 the company increased its capital by the issue of one contributing share paid up to 5s. for every three shares paid up to 15s. On 4th August 1931 it passed a resolution reducing its capital from £750,000 divided into 750,000 shares of £1 each to £525,000 divided into 750,000 shares of 14s. each by paying the holders of the shares issued as paid up to 15s. the sum of 1s. per share and by wholly extinguishing the liability on the uncalled capital thereon, and by reducing the nominal amount of each of the said shares from £1 to 14s., and by paying to the holders of the 169,247 shares that had been issued paid up to 5s. per share the sum of 4d. per share and by extinguishing the liability on these shares to the extent of 6s. per share, and by reducing the nominal amount of each of the said last-mentioned shares from £1 to 14s.

For some time prior to the year 1934 the company had enjoyed great prosperity, and for some years had paid dividends at the rate of 16 per cent per annum. Between the years 1931 and 1934 there had been discussion between the then chairman of directors and the

present chairman, on the advisability of distributing the whole or portions of the reserves, but owing to the ill-health of the then chairman, no decision was made. In 1934 the directors were warned by the auditor that if they intended to distribute part of the reserves it was desirable that they do so before the end of 1934 so as to avoid the extra taxation which came into force at that time. Counsel was thereupon consulted, but owing to his doubt about the exact effect of the articles it was regarded as impossible to take the steps necessary for a distribution before the end of that year. Between the months of May and June 1935, discussions took place between representatives of the company and a number of senior counsel, and also between officers of the company and the chairman of directors of a company which had recently succeeded in avoiding taxation on a distribution of profits. On 5th June 1935 the board of the defendant company resolved to leave the question of distribution temporarily in abeyance. No proposal to alter art. 120 had come before the board until early in 1937, although a suggestion had been made earlier that the wording of the article would create a difficulty. On 17th March 1937, the chairman submitted to the board a scheme of distribution which had been framed after lengthy consideration with the company's auditors and which was designed to secure for the shareholders immunity from taxation on the benefits to be received by them. At this meeting the chairman stated that there was another matter exercising the minds of the board and that was in regard to art. 120 of the company's constitution, "such article in its present form not appearing to be equitable." The board meeting was followed by a conference at the offices of the company's solicitor, and this conference by an opinion from senior counsel received on 4th April 1937. At the conference the directors were advised by their solicitor that the company could alter art. 120. It was not suggested that by doing so the majority would inflict an injustice on the contributing shareholders, but the opinion was expressed either then or at a later conference with senior counsel that it would be inequitable for shareholders who had paid 4s. 8d. to receive the same profit as those who had paid 14s. The advisability of the necessity of altering art. 120 was discussed in the opinion received on 4th April. In a later opinion from a fourth

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senior counsel the liability for taxation was again discussed, and the company was advised that it would be open to it to distribute its accumulated profits under art. 108 so that shareholders would benefit in proportion to the amounts paid up on their shares instead of under art. 120 in proportion to the number of shares held by them.

In the conferences and the board meetings held in 1937 the directors, acting on the advice of their experts, agreed that it would be injudicious to call up the amounts unpaid on their contributing shares and so make all the shares fully paid, and so avoid the difficulty said to be created by the wording of arts. 120 and 108. The company, it was held, had large funds available and could find no possible use for any additional moneys that might be called up. It was suggested also that the court might not give its sanction for a scheme for a reduction of capital which had been evolved in conjunction with a scheme for turning contributing into fully paid shares.

The opinions of counsel were tendered and evidence was given of conferences between solicitors and counsel, and between the directors and their expert advisers, for the purpose of showing (*a*) that the directors were engaged in the preparation of a scheme for the distribution of profits in such a way as to safeguard the shareholders against taxation, and (*b*) that the alteration of art. 120 was considered to be and was in fact essential to this scheme and that in placing their proposals before the shareholders the directors acted in accordance with the opinions of their expert advisers and gave to the shareholders a reasonably full and accurate account of this advice. The last of the opinions of senior counsel was received on 25th May 1937. It dealt with two questions : the avoidance of taxation by a revaluation of the goodwill and a subsequent sale to a new company, and the alteration of the articles, and, as already mentioned, it concluded with a suggestion that accumulated profit might be distributed under art. 108.

On the two following days conferences were held with other senior counsel at which this opinion was discussed. Subsequently the directors resolved that a general meeting of shareholders be held and the resolutions to be proposed at this meeting, together with a circular explanatory of these resolutions, were settled by senior counsel.

The meeting was addressed by the chairman of directors and by one of its solicitors. Speeches in opposition to the proposed amendment were made by two shareholders, one of whom stated his intention of moving an amendment, but he was prevented from doing so by the chairman.

There were 257 shareholders present. Of these 45 held no contributing shares, 35 more than one-third contributing and 14 more contributing shares than fully paid. The resolution for the alteration of art. 120 was carried with 19 dissentients, a poll was not called for, and for this reason proxies were not used, although a great number had been sent in.

The following extracts from the circular show the portions which were attacked :—" It will be seen that the said notice refers to two resolutions to be passed as special resolutions and two resolutions to be passed as ordinary resolutions at the said meeting. The passing of the said resolutions by the necessary majorities is required in order to give effect to proposals by which the issued capital of the company can be increased by the issue to shareholders of bonus shares fully paid. . . . In order to make such bonus shares fully paid it will be necessary to declare a dividend which can be set off against the amounts payable on the said shares. . . . As previously stated it is necessary to declare a dividend payable by the company to the shareholders which can be set off against the amount payable by the shareholder to the company in order to make the bonus shares fully paid. Art. 108 (*supra*) provides that the profits of the company shall be divisible among the members in proportion to the capital paid up on their shares while on the other hand art. 120 provides that when bonus shares are distributed amongst the shareholders they must be distributed according to the nominal amount of capital held by shareholders in the company irrespective of the amount paid up thereon. The two articles would only be consistent when, as was originally the case, all the issued shares of the company had been paid up to the same amount and would become inconsistent with one another when the issued shares are, as at present, paid up to two different amounts. In order therefore that the bonus dividend which the directors propose to declare should be available to make all the new bonus shares to be

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issued fully paid, it is proposed that art. 120 should be deleted and the new article referred to in the said notice substituted. Your directors wish to point out that one of the main objects in forming the proposed new subsidiary company is to make the above amount available as a bonus dividend free of such taxation in order to pay for such new bonus shares. In the event of the special resolutions altering the articles being defeated the directors may have to reconsider the whole position and for that reason the proposal of the fourth resolution referred to in the notice has been made contingent upon the carrying of the special resolution. The directors have been advised by counsel that the company would legally be entitled to declare a bonus and at the same time make available for issue sufficient new shares for the shareholders to take up and apply the said dividend to make the said shares fully paid so long as shareholders who did not desire to take up the said shares were paid their dividend in cash so that in this way the provisions of art. 120 would be avoided. This course would however be subject to many objections."

The following are extracts from the speech of the chairman:—"Your directors are of the opinion that the resolutions before you to-day are the only means whereby a bonus issue of shares can be properly made. In order to clear any doubt that you may have on the subject the company's solicitor is in attendance and counsels' opinions are available here. To-day it is not a debate on what alternatives any of you might imagine to be possible. Your board with its advisers has gone into all the pros and cons long ago and the matter before you is: Are you prepared to alter the articles as we suggest and thereby create the machinery which will enable the company to make the bonus issue of shares?" and from the speech of the solicitor:—"The difficulty arises, of course, out of the inconsistency between at least two of the articles of association of the company. Art. 108 provides that dividends shall be paid in proportion to the amount paid up on the shares. Art. 120, which is the article providing for the capitalization of profits, indicates that if that proceeding is availed of, then the amount paid up is not the criterion upon which the distribution is to be made, but the number of shares held. That inconsistency is what has given rise to so much talk and consultation on the part of your board." The speaker then

set out the steps which, he said, were implied in a distribution of shares and said : " It is illogical and the difficulty has arisen owing to the inconsistency between these two articles."

No charge of personal bad faith was made against any of the directors. It was, however, claimed that they took into consideration and put before the shareholders matters which should not have been considered and statements based on a misapprehension of the effect of the articles, that the circular accompanying the notice was misleading in a material respect, and that the action of the majority was such as to " oppress a minority " of their fellow shareholders.

Nicholas J. held that the shareholders voted under a misapprehension of the true relationship of art. 120 to the other articles, and therefore of the purpose of the resolution, and that it could not be said that the object of the resolution was the benefit of the company, or that the action of the shareholders was capable of being considered for the benefit of the company, or that the shareholders with the best motive had not considered matters which they ought not to have considered. He was of opinion that if the shareholders did not vote with a view of depriving the minority of its rights, they voted to remove an obstacle which did not exist. He made the declarations and granted the injunction sought by the plaintiff.

From that decision the defendant appealed to the High Court.

Dudley Williams K.C. (with him *Street*), for the appellant. The word " dividend " should be given the same meaning wherever it occurs in the articles, that is, a dividend declared on the paid-up value of the shares, so that the word " dividend " in art. 120 means a dividend declared in accordance with the rights of members as conferred upon them by art. 108. The words " notwithstanding anything in any other article contained " in art. 120 were inserted for the purpose of meeting the decision in *Wood* v. *Odessa Waterworks Co.* (1), and allow the appellant to apply a dividend to pay for bonus shares instead of paying the dividend in cash to the shareholders. The emphasis in art. 120 is upon the words " notwithstanding anything in any other article contained profits may be converted into capital." The word " profits " as there used means profits in

(1) (1889) 42 Ch. D. 636.

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the same sense as in other articles, that is, profits which under art. 108 are divisible in proportion to paid-up capital. Art. 120 and art. 108 are inconsistent. The real intention of the appellant was that instead of paying a dividend in cash that dividend should be converted into shares. To make art. 120 read sensibly the words " to be satisfied " should be inserted after the word " bonus." Upon the appellant's construction of art. 120 the only way the necessary dividend could be declared to pay for the bonus shares in full, or up to the same amount if the bonus shares are to be distributed in proportion to the shares held in the company, would be when all the issued shares were paid in full or to the same amount. The only way bonus shares can be issued paid up in full or to a certain amount is to declare a dividend under art. 108 and then to apply the dividend so declared in payment of the shares in full or that certain amount (*Inland Revenue Commissioners* v. *Wright* (1); *Hill* v. *Permanent Trustee Co. of New South Wales* (2); *Inland Revenue Commissioners* v. *Fisher's Executors* (3); *Inland Revenue Commissioners* v. *Blott* (4); *Bouch* v. *Sproule* (5); *Commissioner of Taxes* (*Vict.*) v. *Nicholas* (6); *Commissioner of Taxation* (*N.S.W.*) v. *Stevenson* (7); *James* v. *Federal Commissioner of Taxation* (8); *Palmer's Company Precedents*, 15th ed. (1938), vol. 1, p. 967).

[LATHAM C.J. referred to *Swan Brewery Co. Ltd.* v. *The King* (9).]

All that *Blott's Case* (10) really decides is that if in the ultimate result, if the requisite steps have been taken, the shareholder gets what is a capital asset, then for the purposes of income tax in England that is not income but capital. Alternatively art. 120 is open to the construction that in the allotment of bonus shares shareholders who hold fully paid-up shares would receive fully paid-up bonus shares, and shareholders who only had partly paid-up shares would receive partly paid-up bonus shares. In that way art. 120 would be reconciled with arts. 108 and 110. The reasoning of the

(1) (1927) 1 K.B. 333, at pp. 342, 348.
(2) (1930) A.C. 720, at p. 731.
(3) (1926) A.C. 395.
(4) (1921) 2 A.C. 171, at pp. 178, 183, 187, 204.
(5) (1887) 12 App. Cas. 385, at pp. 402-404.
(6) (1938) 59 C.L.R. 230, at pp. 239-242.
(7) (1937) 59 C.L.R. 80, at p. 98.
(8) (1924) 34 C.L.R. 404.
(9) (1914) A.C. 231.
(10) (1921) 2 A.C. 171.

House of Lords in *Hole* v. *Garnsey* (1) and *Biddulph and District Agricultural Society Ltd.* v. *Agricultural Wholesale Society Ltd.* (2) may be very apposite with the right of the company to offer partly paid-up shares to its members. A mistake or ambiguity in an article may be removed only by the machinery provided by and under the *Companies Act* for the alteration of articles; such a matter does not come within the court's jurisdiction to rectify documents on the ground of mutual mistake (*Evans* v. *Chapman* (3)). It is not suggested that art. 120, on any construction, is in any way *ultra vires* the *Companies Act*. In every case it is a question of fact: Did the shareholders vote to benefit the company or did they vote for the purpose of oppressing the minority of the shareholders?

[DIXON J. referred to *Miles* v. *Sydney Meat Preserving Co. (Ltd.)* (4) and *Dutton* v. *Gorton* (5).]

The scheme put forward by the appellant is not a scheme which causes an expropriation of rights because: (i) art. 120 can only operate by resolution of a general meeting and it is obvious the shareholders in general meeting would not agree to an issue of bonus shares on the basis that one fully paid-up bonus share should be issued for each existing fully paid-up and partly paid-up share; (ii) it is within the power of the company by ordinary resolution in general meeting to provide that what would be equivalent to bonus shares should be allotted on the basis of art. 108; (iii) the only case in which the company would be likely to pass a resolution in general meeting under art. 120—if "dividend" in that article means dividend on nominal capital—would be when (*a*) all the issued shares were paid up to the same amount; (*b*) the holders of partly paid-up shares could outvote the holders of fully paid-up shares; and (iv) if the holders of partly paid-up shares are entitled to an injunction in the present case, then, if these holders could outvote the holders of fully paid-up shares and passed such a resolution under art. 120, the holders of fully paid-up shares might be entitled to an injunction to prevent a distribution of profits otherwise than in accordance with art. 108. The basic position is that the company in general

(1) (1930) A.C. 472.
(2) (1927) A.C. 76.
(3) (1902) 18 T.L.R. 506; 86 L.T. 381.
(4) (1913) 16 C.L.R. 50, at p. 90; 17 C.L.R. 639.
(5) (1917) 23 C.L.R. 362, at pp. 394, 395.

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meeting has complete control as to whether a dividend shall be paid in cash, or in shares, or at all. The advantages of the scheme attacked are: (*a*) the alteration of art. 120 can only be effected by special resolution; (*b*) it brings arts. 108 and 120 into conformity and should prevent in the future any disputes between shareholders; and (*c*) the proposed bonus distribution would clearly be capital in the case of settled estates. The matter of the alteration of articles is dealt with in *Palmer's Company Precedents*, 15th ed. (1938), pp. 586-590, where the relevant cases are discussed: See particularly *Pepe* v. *City and Suburban Permanent Building Society* (1); *Allen* v. *Gold Reefs of West Africa Ltd.* (2); *Batu Pahat Bank Ltd.* v. *Official Assignee* (3); see also *In re T. N. Farrer Ltd.* (4). The position here is similar to the position in *In re Imperial Chemical Industries Ltd.* (5). That decision was affirmed by the Privy Council (*Carruth* v. *Imperial Chemical Industries Ltd.* (6)). Cases in which an injunction has been granted are extremely rare. One such case is *Brown* v. *British Abrasive Wheel Co. Ltd.* (7), where the decision was simply on a question of fact.

[DIXON J. referred to *Dafen Tinplate Co. Ltd.* v. *Llanelly Steel Co. (1907) Ltd.* (8).]

The dictum in that case was disapproved by the Court of Appeal in *Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (9). If the suit succeeded the holders of partly paid-up shares would not obtain any real benefit. They would only prevent the adoption and application of the present scheme. They would not be entitled to have any profits capitalized. The proposed distribution will leave the proportionate amount of the total dividend payable to the existing shareholders unchanged whatever the future rate of dividend may be. The court will only interfere to prevent a company altering its articles when, as stated in *Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (9), the alteration of the articles is of such a character that no reasonable man could consider it to be for the benefit of the company. That is the true test. In this case a

(1) (1893) 2 Ch. 311.
(2) (1900) 1 Ch. 656.
(3) (1933) A.C. 691, at p. 697.
(4) (1937) Ch. 353, at p. 356.
(5) (1936) Ch. 587; see particularly pp. 609, 610, 615-619.
(6) (1937) A.C. 707.
(7) (1919) 1 Ch. 290.
(8) (1920) 2 Ch. 124.
(9) (1927) 2 K.B. 9.

reasonable shareholder acting bona fide could consider the proposed alteration of art. 120 to be for the benefit of the company. The test is not whether the proposed alteration is for the benefit of the company as a trading concern. If it were so, *Brown* v. *British Abrasive Wheel Co. Ltd.* (1) would have been differently decided. The decision in *Geary* v. *Melrose Co-operative Dairy Co. Ltd.* (2) was based on a statement which appeared in *Palmer's Company Precedents* but which has been eliminated from the 14th and 15th editions of that work. An alteration may be made in good faith even thought it may prejudice some shareholders. The question in each case is one of fact (*Sidebottom* v. *Kershaw, Leese & Co. Ltd.* (3)). The scheme proposed is not unconscionable and is a proper exercise of the power to alter the articles ; it is not animated by an improper purpose (*Mills* v. *Mills* (4)). The evidence strongly supports the finding of fact that throughout the directors acted in perfect good faith. The circular was an accurate circular and was not misleading. Its purpose was to explain the proposed resolutions set forth in the notice. Assuming, though not admitting, that the legal views expressed in the circular were erroneous, the notice and circular nevertheless accurately set forth sufficient facts to substantially put the shareholders in a position to know what they were being asked to vote about (*Carruth* v. *Imperial Chemical Industries Ltd.* (5)). The inaccurate statements in, and the omissions from the circular, if any, were not in respect of material matters and were completely different in character from those under discussion in *Kaye* v. *Croydon Tramways Co.* (6), *Tiessen* v. *Henderson* (7) and *Baillie* v. *Oriental Telephone and Electric Co. Ltd.* (8), nor were there any intentional and deliberate non-disclosures (*Bulfin* v. *Bebarfald's Ltd.* (9)). No shareholder possessing ordinary intelligence could have been misled by the notice, the circular, or the speeches at the meeting as to any matter before the meeting. The evidence shows that the matters before the meeting were freely and fully debated. The directors

(1) (1919) 1 Ch. 290.
(2) (1930) N.Z.L.R. 768.
(3) (1920) 1 Ch., at pp. 167, 171, 173, 174.
(4) (1938) 60 C.L.R. 150, at pp. 165-167, 179, 185.
(5) (1937) A.C., at pp. 760, 761.
(6) (1898) 1 Ch. 358.
(7) (1899) 1 Ch. 861.
(8) (1915) 1 Ch. 503.
(9) (1938) 38 S.R. (N.S.W.) 423, at p. 430.

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sought to bring about a result which was both necessary and desirable in the company's interests.

[RICH J. referred to *Topham* v. *Duke of Portland* (1).]

The amendment referred to by a shareholder was properly rejected by the chairman. It was not clearly indicated and was not within the scope of the notice convening the meeting (*Henderson* v. *Bank of Australasia* (2); *Halsbury's Laws of England*, 2nd ed., vol. 5, p. 368; *Palmer's Company Precedents*, 15th ed. (1938), p. 647).

Mason K.C. (with him *Wickham*), for the respondents. There is not any inconsistency as between art. 108 and art. 120. Those articles deal with separate matters; they are entirely independent of one another, and as the shareholders accepted their shares with notice of those articles no question of "fair and equitable" or "more fair" and "more equitable" can arise (*Oakbank Oil Co.* v. *Crum* (3)). Under art. 108 the profits of the company must be distributed by way of cash dividends (*Wood* v. *Odessa Waterworks Co.* (4)). Art. 120 is concerned only with the capitalization of profits. It is the direct method provided for that purpose; therefore indirect methods are not permissible. Upon a scheme for the capitalization of profits the company may have recourse only to art. 120, and may not, as part of that scheme, purport to declare a dividend under art. 108. Regard must be had to the substance of the transaction: to the question whether it is intended to declare a dividend, or to capitalize the profits (*Bouch* v. *Sproule* (5); *Inland Revenue Commissioners* v. *Blott* (6)). Whether or not art. 120 may be altered would depend upon the special circumstances of the case. The circumstances proved in this case do not show that the proposals under consideration were for the benefit of the company (*Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (7); *Sugden* v. *Urban Fire Insurance Co. Ltd.* (8)). The effect of those proposals is to take from the contributing shareholders something conferred upon them by the articles as existing and to give that something to the holders

(1) (1863) 1 De G.J. & S. 517, at p. 570; 46 E.R. 205, at pp. 226, 227.
(2) (1890) 45 Ch. D. 330.
(3) (1882) 8 App. Cas. 65, at pp. 70, 71, 75.
(4) (1889) 42 Ch. D. 636.
(5) (1887) 12 App. Cas., at pp. 398, 399.
(6) (1921) 2 A.C., at p. 198.
(7) (1927) 2 K.B. 9.
(8) (1931) 75 Sol. Jo. 60.

of fully paid-up shares, that is, those proposals are designed to bring about an alteration of rights in favour of the majority at the expense of the minority. The nature and effect of that alteration was not accurately and fully explained by those in charge of the company's affairs. Some of the information contained in the circular, particularly as regards an alleged inconsistency between art. 108 and art. 120, and the necessity to alter art. 120, was inaccurate, which together with some important and material omissions therefrom tended to cause, and, doubtless, did cause, some shareholders to be misled; consequently the resolutions were vitiated (*Bulfin* v. *Bebarfald's Ltd.* (1)). Profits capitalized under art. 120 are changed in character and thereafter can reach shareholders only upon a winding up. It follows from *In re Driffield Gas Light Co.* (2), that if the company were wound up after a capitalization the distribution would go eventually on the basis provided for by art. 120. That article is a fair compromise of the rights that should attach as between paid-up and contributing shareholders. *Inland Revenue Commissioners* v. *Blott* (3), *Inland Revenue Commissioners* v. *Fisher's Executors* (4), *Commissioner of Taxation* (*N.S.W.*) v. *Stevenson* (5) and *Commissioner of Taxes* (*Vict.*) v. *Nicholas* (6) are "income tax" cases in which the respective decisions depended upon the terms of the particular statute involved, and thus are not applicable to this case. The meaning of the expression "distribute in proportion" was considered in *Oakbank Oil Co.* v. *Crum* (7) and *Birch* v. *Cropper*; *In re Bridgewater Navigation Co. Ltd.* (8). Upon an alteration of articles the test is: Is there any reasonable prospect of advantage to the company as a whole? (*Buckley* on *The Companies Act*, 10th ed. (1924), pp. 25, 26). An attempt to reconcile the two lines of cases was made in *British America Nickel Corporation Ltd.* v. *M. J. O'Brien Ltd.* (9). When exercising his vote a shareholder should have greater regard for the benefit of the company as a whole than for his personal enrichment. Directors, as fiduciary agents, are under a special obligation in this regard (*Mills* v. *Mills* (10)). The

(1) (1938) 38 S.R. (N.S.W.) 423.
(2) (1898) 1 Ch. 451.
(3) (1921) 2 A.C. 171.
(4) (1926) A.C. 395.
(5) (1937) 59 C.L.R. 80.
(6) (1938) 59 C.L.R. 230.
(7) (1882) 8 App. Cas. 65.
(8) (1889) 14 App. Cas. 525.
(9) (1927) A.C. 369.
(10) (1938) 60 C.L.R., at pp. 185, 186.

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effect of the evidence is that persons did buy contributing shares because of the special benefits that attached to them under art. 120. The only purpose served by the proposed art. 120A is to divert money which under art. 120 would go into another channel; it is not possible to conclude that this was for the benefit of the company. There is abundant evidence to justify the finding of fact by the judge of first instance that the proposals were not for the benefit of the company. The test of what is for the benefit of the company is dealt with in *Halsbury's Laws of England*, 2nd ed., vol. 5, pp. 295, 410, and the cases there cited: See also *Miles* v. *Sydney Meat Preserving Co. (Ltd.)* (1) and *Dutton* v. *Gorton* (2). The shareholders were not given any opportunity of considering any other scheme. The matter was not properly put before the shareholders (*Bulfin* v. *Bebarfald's Ltd.* (3)) and shareholders who on the faith of the circular refrained from attending the meeting in person were prejudiced thereby (*In re Quebrada Railway, Land and Copper Co.* (4); *Carruth* v. *Imperial Chemical Industries Ltd.* (5)).

[RICH J. referred to *In re Union Plate Glass Co.* (6).]

Upon any proposal to alter a person's rights it is essential that a full and fair explanation free from ambiguity be made (*In re Imperial Chemical Industries Ltd.* (7); *Clarkson* v. *Davies* (8); *Baillie* v. *Oriental Telephone and Electric Co. Ltd.* (9); *Bulfin* v. *Bebarfald's Ltd.* (10); *Kaye* v. *Croydon Tramways Co.* (11)). Owing to non-disclosures and misstatements the shareholders were not only misled but were officially misled. The amendment, the nature of which, as found as a fact by the judge of first instance, had been indicated, should have been accepted by the chairman and submitted to the meeting. Notice of the amendment was not necessary; but the amendment itself was necessary in order fully to ascertain the opinions of the shareholders. It was not a direct negative to the proposals before the meeting (*Henderson* v. *Bank of Australasia* (12)).

(1) (1912) 16 C.L.R., at p. 90.
(2) (1917) 23 C.L.R., at pp. 394, 395.
(3) (1938) 38 S.R. (N.S.W.) 423.
(4) (1888) 40 Ch. D. 363, at p. 367.
(5) (1937) A.C., at p. 746.
(6) (1889) 42 Ch. D. 513.
(7) (1936) 1 Ch. 587.
(8) (1923) A.C. 100, at p. 108.
(9) (1915) 1 Ch., at pp. 514, 515, 518.
(10) (1938) 38 S.R. (N.S.W.), at pp. 430 et seq.
(11) (1898) 1 Ch. 358.
(12) (1890) 45 Ch. D., at pp. 343, 349.

Dudley Williams K.C., in reply. There was not any amendment actually proposed at the meeting. The amendment intended to be moved was a direct negative of the matter before the meeting and was very different in its terms from the amendment under consideration in *Henderson* v. *Bank of Australasia* (1). The intended amendment was not within the scope of the business before the meeting (*Betts & Co. Ltd.* v. *Macnaghten* (2)). The cases where amendments of special resolutions have been allowed have been very special cases (*Torbock* v. *Westbury (Lord)* (3)). *In re Quebrada Railway, Land and Copper Co.* (4) was a reduction case in which the court has a discretion: it differs from the present case. The circular was not misleading in the sense of being a "tricky" circular, or misleading in the sense that the shareholders were not placed in a position to know substantially what they were voting about; it is not a ground for an injunction against the company acting on the resolution. The shareholding of the company is such that there is not any reasonable probability of a resolution ever being carried under art. 120 as it now stands; therefore it would be for the benefit of the company that art. 120 should be altered in the manner suggested. A shareholder may, in the absence of unfairness and oppression, vote in accordance with his individual interests (*Goodfellow* v. *Nelson Line (Liverpool) Ltd.* (5); *British America Nickel Corporation Ltd.* v. *M. J. O'Brien Ltd.* (6)). The special resolution was validly passed by the bona fide exercise of the power of the company in general meeting.

Cur. adv. vult.

1939, Feb. 9.

The following written judgments were delivered:—

LATHAM C.J. This is an appeal from a decree of the Supreme Court of New South Wales in its equitable jurisdiction whereby it was declared that certain resolutions of the shareholders in the appellant company were not validly passed as special resolutions and that the articles of the company were not validly altered by such resolutions. The court also granted an injunction restraining

(1) (1890) 45 Ch. D. 330.
(2) (1910) 1 Ch. 430.
(3) (1902) 2 Ch. 871.
(4) (1888) 40 Ch. D. 363.
(5) (1912) 2 Ch. 324, at p. 333.
(6) (1927) A.C., at p. 374.

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the company, its directors, servants and agents from acting upon the resolutions or making any distribution of the assets of the company thereunder.

The action was brought by three shareholders on behalf of themselves and other shareholders in the company holding partly paid shares. By amendment the title of the statement of claim was altered so as to bring about the result that the plaintiffs were suing on behalf of themselves and other shareholders in the company holding only partly paid shares who did not vote at an extraordinary general meeting held on 14th September 1937 in favour of the cancellation or amendment of art. 120 of the articles of association of the company. The special resolutions provided for the alteration of the articles and for a capitalization of profits by a distribution of bonus shares in proportion to the amount paid up on their shares by the respective shareholders. The nominal capital of the company was £525,000, divided into 750,000 shares of 14s. each. The company had issued 511,364 shares each all fully paid, and 169,247 shares each paid to 4s. 8d. Thus the partly paid shareholders had paid up one-third of their capital liability.

The difficulties which have led to this litigation arose from the form of the articles of association of the company. Arts. 108, 110 and 111 were as follows:—" 108. The profits of the company shall be divisible among the members in proportion to the capital paid up on the shares held by them respectively. 110. The company in general meeting may declare a dividend to be paid to members according to their rights and interests in the profits and may fix the time for payment. 111. No larger dividend shall be declared than is recommended by the directors but the company in general meeting may declare a smaller dividend."

These articles provided for dividends to be paid in proportion to the amount of capital paid up on shares, and they also provided that the company could not declare a dividend larger than that recommended by the directors.

Art. 120 was as follows:—" 120. Notwithstanding anything in any other article contained the whole or any part of the undivided profits including amounts at credit of reserve or any other fund may with the sanction of the company in general meeting be converted

into capital of the company by distributing the same amongst the holders of shares as a special dividend or bonus by issuing partly or fully paid-up shares in respect thereof to the holders of such shares in proportion to the shares held by them in the company. The directors may sell shares or make cash payments if necessary in order to adjust rights and a proper contract shall be filed in accordance with section 55 of the *Companies Act* 1899 and the directors may appoint any person to sign such contract on behalf of the persons entitled and such appointment shall be effective." (Sec. 55 of the *Companies Act* 1899 (N.S.W.) is now sec. 145 of the *Companies Act* 1936 (N.S.W.).)

If action were taken under art. 120 by distributing what is described as a special dividend or bonus in the form of shares, the article required that the distribution should be in proportion to the number of shares held by the shareholders in the company and not in proportion to the amount paid up on the shares.

There was unanimous agreement among all concerned that it was desirable to make a distribution of profits in the form of bonus shares. The company had been prosperous and for some years had been paying dividends of 16 per cent. There were obvious reasons of a business character, if it appeared probable that the same amount of money would be available in the future for the payment of dividends, for an adjustment of the rate of dividends to the moneys of the shareholders which were actually used in the enterprise. There were accumulated profits and the value of the goodwill had increased. It was therefore proposed to double the capital so as to halve, not the amount of the dividend, but the rate of dividend. In order to achieve this result a special resolution was proposed for the alteration of the articles under which art. 120 would be cancelled and other articles substituted under which it would be possible to make a distribution of new shares proportionately to the amount of capital paid up on the shares. Another special resolution provided for increasing the capital of the company to £1,050,000 by the creation of 750,000 shares of 14s. each. By an ordinary resolution it was proposed that (if the special resolutions were carried) the directors should be authorized to promote a company to take over the goodwill and certain property of the appellant

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company to be paid for partly by shares in the new company. A further ordinary resolution was also to be proposed in the event only of the special resolutions being duly passed. Under this resolution a sum of £397,446 would be capitalized and a special bonus dividend of 14s. per share declared on the fully paid shares and 4s. 8d. per share on the partly paid shares, such dividend to be satisfied by allotting to each holder of fully paid shares one new share for each fully paid share already held by him, and by allotting to each partly paid shareholder one new fully paid share for each three contributing shares held by him.

In the case of any particular shareholder the effect of these changes depended upon the character of his shareholding. If he owned only fully paid shares it was entirely advantageous to him. So also it would be advantageous to him if he held fully paid shares and a number of contributing shares less than one-third of the number of fully paid shares held by him. Without going into details, it is sufficient to state that the evidence shows that there were 94 shareholders to whom the proposals were disadvantageous when those proposals were compared with a distribution under art. 120 in its original form. At the meeting at which the resolutions were passed 257 shareholders were present. Only 19 voted against the resolutions.

The plaintiffs allege that the resolutions were invalid upon three grounds: (i) That a circular issued by the directors and distributed to the shareholders before the meeting was not fair and frank and that it was misleading; (ii) that in the speeches at the meeting the chairman of directors and the solicitors for the company made statements which were not complete and not accurate but were misleading; (iii) that those who voted for the resolutions did so solely for the purpose of benefiting fully paid shareholders to the disadvantage of partly paid shareholders and not in the interests of or for the benefit of the company or the whole body of shareholders.

A further objection was taken that the chairman acted wrongly in refusing to accept an amendment. I do not propose to deal with this objection in detail because the amendment, as to part, was a direct negative of the motion before the chair, and as to another part was relevant only to the last resolution to be proposed and the

proposal of that resolution was contingent upon the passing of the other resolutions. The proposed amendment would have been inconsistent with the articles as altered by the special resolutions and as an amendment to the last resolution would have been out of order upon that ground.

The effect of the judgment of the learned judge (*Nicholas* J.) may be stated in the following extract from his reasons for judgment: —"I hold that the shareholders voted under a misapprehension of the true relationship of art. 120 to the other articles, and therefore of the purpose of the resolution, and that it could not be said that the object of the resolution was the benefit of the company, or that the action of the shareholders was capable of being considered for the benefit of the company, or that the shareholders with the best motive have not considered matters which they ought not to have considered: See *Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (1). If the shareholders did not vote with a view to depriving the minority of its rights in the interests of the majority, they voted to remove an obstacle which in my judgment did not exist."

His Honour accordingly made the order the terms of which have already been stated.

I propose first to state some relevant principles of law.

(1) The *Companies Act* 1936 (N.S.W.), sec. 20, provides: "Subject to the provisions of this Act and to the conditions contained in its memorandum, a company may by special resolution alter or add to its articles." A company cannot deprive itself of this statutory power either by agreement or by a provision contained in the articles (*Malleson* v. *National Insurance and Guarantee Corporation* (2); *Allen* v. *Gold Reefs of West Africa Ltd.* (3)). It is not possible, by articles of association, to make an unalterable article. If it is desired to place the rights of particular shareholders beyond the risk of being affected by an alteration of articles it is possible to include a provision in the memorandum of association which will have that effect. Sec. 20 empowers a company to alter its articles only subject to the conditions contained in the memorandum of association. There are no conditions contained in the memorandum of association

(1) (1927) 2 K.B., at pp. 18, 23.
(2) (1894) 1 Ch. 200.
(3) (1900) 1 Ch., at pp. 671, 676.

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of the appellant company which limit the right to alter the articles.

(2) It follows that the contract between members of the company and between the company and its members which is constituted by the articles must be regarded as containing among its terms a provision that articles may be altered in the manner provided by the Act, that is, by special resolution. An alteration in a particular case may constitute a breach of contract with a shareholder, but such a breach of contract does not invalidate the resolution to alter the articles (*Allen's Case* (1)).

(3) It follows that where the rights of members of the company depend only upon the articles it is possible to alter the rights of members or of some only of the members by altering the articles. The fact that an alteration prejudices or diminishes some of the rights of the shareholders is not in itself a ground for attacking the validity of an alteration: See *Sidebottom* v. *Kershaw, Leese & Co. Ltd.* (2) (expelling a shareholder); *Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (3) (disqualifying a director); *Allen's Case* (4) (creating a lien upon shares). Any other view would, in effect, make unalterable and permanent any articles of association which conferred rights upon a class of shareholders, or possibly upon any shareholder, if they or he desired that those rights should continue to exist unchanged. It is plainly not the law that the fact that an alteration of articles alters the rights or prejudices the rights of some shareholders is sufficient to prevent the alteration from being validly made.

(4) The power to alter articles must be exercised bona fide. It is generally said that the power must be exercised bona fide for the benefit of the company as a whole, and all the recent authorities refer to the statement by *Lindley* M.R. in *Allen's Case* (5) :—" The power thus conferred on companies to alter the regulations contained in their articles is limited only by the provisions contained in the statute and the conditions contained in the company's memorandum of association. Wide, however, as the language of sec. 50 " (in the New South Wales Act of 1936, sec. 20) " is, the power conferred by

(1) (1900) 1 Ch., at p. 672.
(2) (1920) 1 Ch. 154.
(3) (1927) 2 K.B. 9.
(4) (1900) 1 Ch. 656.
(5) (1900) 1 Ch., at p. 671.

it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed." In *Allen's Case* (1) an article was altered in such a way as to prejudice quite seriously a single person who was the only holder of fully paid-up shares. The alteration had the effect of creating a lien for unpaid calls upon those shares. The articles before the alteration provided that such a lien existed upon "all shares not being fully paid." Thus the alteration was definitely directed against the interests of one member; but it was for the benefit of the company to recover moneys due to it, and, as the alteration was found to have been made bona fide for that purpose, it was upheld.

(5) It is not for the court to impose upon a company the ideas of the court as to what is for the benefit of the company. It is for the shareholders to determine whether an alteration of the articles is or is not for the benefit of the company, subject to the proviso that the decision is not such as no reasonable man could have reached (*Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (2)). This is not an absolute rule, but it is the prima-facie general rule (*Carruth* v. *Imperial Chemical Industries Ltd.* (3)).

(6) The benefit of the company as a corporation cannot be adopted as a criterion which is capable of solving all the problems in this branch of the law. An alteration which is made bona fide and for the benefit of the company, if otherwise within the power, will be good, but it is not the case that it is necessary that shareholders should always have only the benefit of the company in view. In cases where the question which arises is simply a question as to the relative rights of different classes of shareholders the problem cannot be solved by regarding merely the benefit of the corporation. I refer to *Pender* v. *Lushington* (4) and *Mills* v. *Mills* (5), a case of the exercise of powers of directors in relation to the "interests of the company." See *North-West Transportation Co. Ltd.* v. *Beatty* (6),

(1) (1900) 1 Ch. 656.
(2) (1927) 2 K.B. 9.
(3) (1937) A.C. 707.
(4) (1877) 6 Ch. D. 70, at pp. 75, 76.
(5) (1938) 60 C.L.R., at p. 164.
(6) (1887) 12 App. Cas. 589.

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where it was held that a shareholder may vote as he pleases even when his interests are different from or opposed to those of the company. Shareholders are not trustees for the company or for one another and the relations between them cannot be identified with the relations between partners (*Phillips* v. *Manufacturer's Securities Ltd.* (1)). But though a shareholder may vote in his own interests the power of shareholders to alter articles is limited by the rule that the power must not be exercised fraudulently or for the purpose of oppressing a minority: See *Cook* v. *Deeks* (2); *Menier* v. *Hooper's Telegraph Works* (3); *Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (4); *Carruth* v. *Imperial Chemical Industries Ltd.* (5).

(7) When the validity of a resolution of shareholders is challenged, the onus of showing that the power has not been properly exercised is on the party complaining. The court will not presume fraud or oppression or other abuse of power. See the cases as to validity of acts of directors when exercising a fiduciary power—where a higher standard would be required than in the case of shareholders, who do not, in voting at a meeting, exercise any power of a fiduciary character (*In re Gresham Life Assurance Society*; *Ex parte Penney* (6); *In re Coalport China Co.* (7); *In re Hannan's King (Browning) Gold Mining Co. (Ltd.)* (8)). It cannot be the law that a resolution of shareholders is to be presumed to be invalid until the defendants in an action positively establish that it is valid.

The result of applying these principles is that the special resolution altering the articles cannot be declared to be invalid merely upon the ground that the original articles conferred special rights upon the holders of partly paid shares of which the alteration deprived them, or upon the ground that the voting holders of fully paid shares were interested in making the alteration adversely to the holders of partly paid shares. If, however, the resolution was passed fraudulently or oppressively or was so extravagant that no reasonable person could believe that it was for the benefit of the company, it should be held to be invalid.

(1) (1917) 116 L.T. 290.
(2) (1916) 1 A.C. 554, at p. 564.
(3) (1874) 9 Ch. App. 350.
(4) (1927) 2 K.B., at p. 27.
(5) (1936) Ch. 587; (1937) A.C. 707.
(6) (1872) 8 Ch. App. 446.
(7) (1895) 2 Ch. 404.
(8) (1898) 14 T.L.R. 314.

Before considering the specific objections raised in the present case it is necessary to understand the problem which presented itself to the directors after it had been agreed that it was desirable to increase the capital of the company, to make a distribution of bonus shares, and to reduce the dividend rate. The question which arose was whether this objective should be achieved under art. 120 or by some other means. If it were accomplished under art. 120 some holders of partly paid shares would gain at the expense of some holders of fully paid shares. It is obvious that there is room for difference of opinion as to the fairness of distribution upon the basis of shareholdings as opposed to the basis of amounts of capital paid up. On the one hand it can be said that the partly paid shareholders bought their shares on the faith of the existing articles and that, although they had not paid as much towards the capital of the company as fully paid shareholders, they had been subject at all times to the risk of having calls made. On the other hand, as already stated, the contract between the partly paid shareholders and the company must be regarded as a contract which was subject to the statutory provision that its terms could be altered, in effect, by an alteration of the articles. Further, it is quite possible for any person to hold a bona fide opinion that such an article as art. 120 is in itself not equitable.

Apart from these considerations, difficulties arose by reason of the concurrent existence of arts. 108 and 120. Art. 108 provided for the payment of dividends in proportion to capital paid up. But art. 120 provided that the company might capitalize profits by distributing shares as a special dividend in proportion to the number of shares held by shareholders. If the procedure of capitalization involves the real or notional declaration of a dividend to be applied in satisfaction of the liability upon bonus shares, then there is a difficulty in applying art. 120 in face of art. 108. Art. 108 would require the declaration of a dividend upon one basis, and art. 120 would permit (even if in the case of capitalization it did not require) the declaration of what is called in that article a " special dividend or bonus " upon another basis. The decision in *Blott's Case* (1) was doubtless intended to place beyond controversy the rule that

(1) (1921) 2 A.C. 171.

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profits could be capitalized by " a direct and simple process " (See per Viscount *Finlay* in *Blott's Case* (1)) without any declaration, real or notional, of a dividend. But the dissenting judgments of Lord *Dunedin* and Lord *Sumner*, which had declared that shares must be paid for in some manner by a shareholder before they can be regarded as paid up, have not been without their effect, even though they were dissenting judgments. The case of *Swan Brewery Co. Ltd.* v. *The King* (2), where the dissenting view is clearly and shortly expressed, has been distinguished on more than one occasion (See *Commissioner of Income Tax, Bengal* v. *Mercantile Bank of India Ltd.* (3)), but the decision in the *Swan Brewery Case* (2) has not been declared to be wrong: See per *Scrutton* L.J. in *Inland Revenue Commissioners* v. *Wright* (4). In the present case it may be urged that the reference in art. 120 to the distribution of shares as " a special dividend " helps to make applicable the reasoning of Lord *Sumner* in his dissenting judgment in *Blott's Case* (5) and in the *Swan Brewery Case* (2).

On the other hand it is urged that the introductory words " notwithstanding anything contained in any other article " place art. 120 in what has been called a dominant position, so that the provisions of art. 108 may be regarded as irrelevant when a capitalization is made under art. 120. As against this contention it is argued that the only object of these words is to meet the decision in *Wood* v. *Odessa Waterworks Co.* (6) and to make it possible to pay a dividend otherwise than in money.

A further question which arises upon the construction of the articles is whether art. 120 is intended to be the only method of capitalizing profits. The article certainly confers a power of capitalizing profits, but only in language which is permissive. Under art. 34 the company may increase its capital by the creation of new shares. Under art. 35 the new shares may be issued with preferential or qualified rights or other special rights and privileges. Under art. 36 the company in general meeting may, before the issue of any new shares, determine that they shall be offered to all the then members of any class of the shareholders in proportion to the amount of

(1) (1921) 2 A.C., at p. 193.
(2) (1914) A.C. 231.
(3) (1936) A.C. 478.
(4) (1927) 1 K.B., at pp. 346, 347.
(5) (1921) 2 A.C., at pp. 206 et seq.
(6) (1889) 42 Ch. D. 636.

capital held by them or " make any other provisions " as to the issue and allotment of the new shares. It is contended that under these articles the company could increase its capital by creating new shares, and could then distribute the shares among the shareholders in proportion to the amount paid up on their shares and not in proportion to the number of shares held by them.

Various questions of difficulty thus arose upon the construction of the articles, and it was not easy for the directors to be completely satisfied as to the course which it was best, or possibly most proper, to pursue. It is important to remember that in the statement of claim no charge of bad faith is made against the directors or against any other person.

The directors took the advice of three leading counsel and the objectors took the advice of leading counsel also. The company was advised that possibly the object in view could be attained by the application of art. 36, but that it might be thought that the use of art. 36 would be a back-door method of achieving the desired result, and that therefore, on the whole, it was wiser to propose the deletion of art. 120 and the substitution of a new article so that the transaction should be direct and straightforward. In the opinions given to the company attention was directed to the various questions of interpretation to which I have referred. The objectors on the other hand were advised that art. 120 provided the only means of bringing about a capitalization of profits, and, in substance, that the company in general meeting could not alter those rights. As I have already said, I do not agree that the law is that such rights are unalterable by an amendment of the articles of association.

It should be observed that, if the directors had made calls upon the partly paid shares so as to require them to be fully paid up, there would then have been no difficulty in applying both arts. 108 and 120, because a distribution on the basis of share for share would, in those circumstances, have satisfied both articles. But it was agreed by all concerned that the company did not require any new capital, and it was feared that the making of the call might be challenged as not bona fide in the interests of the company and as being only an indirect method of evading art. 120.

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In all these circumstances the directors determined to propose the cancellation of art. 120 and the substitution of a new article which would enable them to carry out what was proposed. The contention of the plaintiffs is that the alteration was necessarily unfair to the partly paid shareholders who were deprived of their rights under art. 120 and that the shareholders were misled by the circular which was distributed by the directors and by the statements made by the directors at the meeting of shareholders.

In my opinion it cannot properly be held by a court that either art. 120 or the new article substituted for it is necessarily unfair. As I have already said, it is a controversial question whether profits are most fairly distributed in proportion to shareholdings or in proportion to the amount of money actually paid (as distinct from put at risk) by the shareholder. Quite reasonable men may hold differing opinions upon such a question.

Further, for reasons which I have already stated, it cannot be said that any alteration of an article of association which diminishes the rights of any class of shareholders is necessarily and as of course outside the powers conferred by the statute to alter articles.

The circular is attacked on the ground of inaccuracies and omissions: See *Bulfin* v. *Bebarfald's Ltd.* (1), where the duty of directors to make proper and accurate disclosures to shareholders is fully stated. It is said that the circular wrongly represented that the only method of giving effect to any proposal to increase the capital and to distribute bonus shares was the method proposed by the directors, involving the cancellation of art. 120. In my opinion this objection is not sustained. The proposals to which the circular referred were the particular proposals of the directors. These proposals did involve the cancellation of art. 120. It was made clear in the circular that the directors were not prepared to recommend any distribution of bonus shares unless the articles were altered so as to place beyond doubt the power to make such a distribution in proportion to capital paid up. They were entitled to adopt this attitude. The circular stated :—" In the event of the special resolution altering the articles being defeated, the directors may have to reconsider the whole position and for that reason the proposal of

(1) (1938) 38 S.R. (N.S.W.) 423.

the fourth resolution referred to in the notice has been made contingent upon the carrying of the special resolutions." The fourth resolution was the resolution providing for the issue of new shares in proportion to capital paid up. This proposal did involve the cancellation of art. 120. But the circular did state that the same result could, legally, be reached under the existing articles. The directors explicitly stated in the circular that they had been advised that the company "would legally be entitled to declare a bonus dividend upon the amount paid on the shares that had been issued and at the same time make available for issue sufficient new shares for the shareholders to take up and apply the said dividend to make the said shares fully paid so long as shareholders who did not desire to take up the shares were paid their dividend in cash and that in this way the provisions of art. 120 would be avoided. This course, however, would be subject to many objections." Some reference was then made to these objections. Accordingly I do not think that it can fairly be said that the directors represented that the only possible method of making any distribution of bonus shares was a method involving the cancellation of art. 120.

But it is further objected that the directors misrepresented the position by stating that arts. 108 and 120 were inconsistent and that for this reason it was necessary to alter art. 120 in order to bring about any distribution of bonus shares. The circular stated that it was necessary to declare a dividend in order to make the new shares fully paid. Art. 120 in terms authorizes the conversion of profits into capital "by distributing the same among holders of shares as a special dividend or bonus." As I have already said, these words may, notwithstanding the decision in *Blott's Case* (1), introduce the principle insisted upon in *Swan Brewery Co. Ltd.* v. *The King* (2). But, whether they do so or not, the question is an arguable one. The directors were putting their views forward for the consideration of the shareholders. Even if their views were wrong, there was no dishonesty or trickery. The shareholders could get their own advice and use their own minds. The circular was almost necessarily argumentative. That this was in fact the case was obvious upon the face of the document. An expression of an honest opinion

(1) (1921) 2 A.C. 171.

(2) (1914) A.C. 231.

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upon such a matter does not amount to misrepresentation or even to inaccuracy if the opinion, even if wrong, is accurately stated as an opinion. In so far as the circular stated that it was necessary to declare a dividend in order to bring about a capitalization, it stated what was, I think, plainly a matter of legal opinion. The same observation applies to the statement that arts. 108 and 120 would only be consistent when all the issued shares of the company were paid up to the same amount. The substance of the matter was that profits could be distributed in one way under art. 108 and in another way under art. 120. The two articles did deal with the same subject matter—so far as that subject matter was the distribution of profits—in two different ways. In this sense the articles were inconsistent. But I agree with *Nicholas* J. that in a strictly legal sense they were not inconsistent. In the first place both articles could, upon any construction of them, be obeyed if all the shares were paid up to the same amount. The fact that the directors did not wish to call up further capital did not make the articles inconsistent. But further, the introductory words of art. 120, "Notwithstanding anything in any other article contained," do, in my opinion, exclude the application of art. 108 when a capitalization is effected under art. 120 even if that capitalization involves a real or a notional declaration of a dividend. I agree with what *Nicholas* J. says upon this matter. But, in my opinion, the circular should, in this respect, be regarded as expressing the views of the directors and not as laying down in absolute terms propositions of law guaranteed as correct. Even if those views were wrong, the action of the shareholders in passing the resolutions is not invalidated. As will be pointed out later, the shareholders heard the other side of the case, and made their decision after hearing both sides. There was reasonable ground upon which it could be believed that an obstacle to any capitalization of profits did exist. Even if a court should ultimately decide that such an obstacle did not exist, this fact would not deprive the shareholders of the right of so altering the articles as to express a meaning which they deliberately desired them to bear.

It was also objected that the directors did not give full, frank and fair information to the shareholders because the directors did not

tell the shareholders that there had been advice that art. 120 was an overriding article, that it conferred rights upon the fully paid shareholders, and that a capitalization could be carried out without altering the articles. The directors had been advised that art. 120 could be regarded as an overriding article, but that the matter was open to question. So also they had been advised that the partly paid shareholders had rights under art. 120 as it then existed, but they had also been advised that the company could (notwithstanding those rights) possibly bring about in a legal manner the desired distribution by using art. 36 without altering art. 120. The opinions disclosing the advice actually given to the directors were available to the shareholders.

The objections to the circular are objections which put the case against the proposals of the directors. They all raise fair matters for argument. The opinions of counsel obtained by the directors were not only available to the shareholders; they were actually inspected by the solicitor for the objecting shareholders on the day before the meeting was held. The opinions given by counsel were taken to the meeting and the chairman stated that, if the shareholders so desired, he would have them read. In my opinion the objections to the circular cannot be supported.

It is next objected that the statements made by the chairman and the solicitor for the company in the speeches which they made at the meeting were misleading. The objections to the speeches cover much the same ground as the objections to the circular. Complaint is made that the chairman and the solicitor to the company represented that the only way of carrying out the proposed capitalization was by adopting the proposals of the directors. In one sense that was true, for the reason that the directors were not prepared to recommend capitalization upon any other basis and probably art. 111 prevented the company from declaring any dividend not recommended by the directors. But the weight of the objection is that the speeches stated that it was legally impossible to bring about the desired capitalization by reason of inconsistency between arts. 108 and 120. Statements to this effect (more definite than those in the circular) were made in speeches by the chairman and by the company's solicitor. The company had in fact been so advised,

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but in my opinion the answer to these objections (as also to the objections against the circular) is that the whole matter was fully discussed and debated at the meeting. The directors put their views through the chairman and the company's solicitor. A solicitor and another speaker for the objectors contested the statements of the chairman and of the company's solicitor, contended that the proposed alteration would be unfair to the partly paid shareholders for reasons which have already been stated, stated (as was the fact) that counsel other than those consulted by the company had advised that arts. 108 and 120 were consistent and that the proposed alteration was, as one of the speakers put it, "unconstitutional and unbusinesslike," and that they had been advised that the issue of the new shares could only be made in accordance with the company's existing art. 120. They also said that the court would prevent the alteration desired, and went so far as to assert that art. 120 could not be altered except "with the consent of every individual contributing shareholder." Thus it appears to me that the whole matter was put before the shareholders. They were given quite full information. Any further information which they desired was available to them, including the opinions of counsel. No charge of fraud or of bad faith is made, or, if made, could on the evidence be supported. There is no evidence that the alteration was made with the object of oppressing a minority or to deprive a minority of its rights.

Whatever may be the true view of the relation between art. 108 and art. 120, there is no doubt that as it was not desired by any of those concerned to call up the uncalled capital the co-existence of the two articles was embarrassing to and created difficulties in the management of the company. Even if it should be held that some of the statements made in speeches at the meeting were inaccurate, it would, in my opinion, be a dangerous thing for a court to declare that such a circumstance invalidated a resolution passed at a meeting of the shareholders of the company. Whenever a controversy arises as to what is the wisest course to pursue, and particularly when the matter in issue involves the alteration of existing rights (real or supposed), statements will probably be made on each side which the other side regards as unfair or inaccurate and which may in fact be

unfair or inaccurate. There is, in my opinion, no authority to support the proposition that the fact that statements which are not true in fact were made at a shareholders' meeting has the effect of invalidating a decision reached at the meeting. If this were the law, then, as two inconsistent statements can never both be true, it would only be necessary for any dissentient shareholder to make a statement or series of statements which were plainly inconsistent with other statements made at the meeting in order to procure the invalidation of any resolution passed.

Evidence was given by a witness for the plaintiff who read the circular that he understood from the circular that arts. 108 and 120 were inconsistent and that "only by the passing of the" (special) "resolution could the action of the directors be made legal." I have already dealt with the question whether, in all the circumstances, it was proper to read the circular as stating such a proposition either at all or otherwise than as a matter of opinion which was submitted for discussion. With respect to this evidence, I desire to add that, in my opinion, an actual misapprehension of facts by one shareholder or by a number of shareholders, not induced by some relevant fraud or trickery, is not sufficient to invalidate a resolution of shareholders. In any meeting attended by a considerable number of people there will be some who misunderstand proposals submitted to the meeting and who vote upon an inaccurate view (or sometimes upon no view) of the facts that are really relevant. Such errors of understanding, of judgment, or of knowledge, not induced by improper means by persons who are subject to a duty in relation to the shareholders (as distinct from "outsiders"), do not afford grounds for setting aside resolutions passed by the meeting. A contrary view would place all proceedings at shareholders' meetings at the mercy of those present who possessed relatively low qualities of intelligence, business ability, and care.

In the present case there is admittedly no fraud or trickery. As there is no evidence of oppression, and as the alteration cannot be described as extravagant, so that reasonable men could not regard it as a fair alteration to be made, the case of the plaintiff fails. I therefore think that the appeal should be allowed and that judgment should be entered for the defendant.

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RICH J. This suit was brought by and on behalf of holders of partly paid shares in the appellant company, which has met with great success in its business operations, to restrain the company from acting upon certain special resolutions for the alteration of the articles, and for a declaration that the special resolutions are void. The point at issue is whether upon a capitalization of profits a distribution of bonus shares shall be made according to the amount of capital paid up upon the shares or, if made at all, in proportion to the number of shares regardless of the amount paid up on the respective shares.

The share capital of the company, which is divided into shares of 14s. each, consists of a large number of fully paid shares and a smaller number of shares paid up to 4s. 8d. The existing articles of association contained a provision that cash dividends should be distributed in proportion to the amount of capital paid up on shares and a provision that under the authority of a general meeting profits might be distributed in the form of fully paid or partly paid shares in proportion to the number of shares held by the respective members. The introduction into the same set of articles of these two opposed ratios of distribution was probably due to thoughtlessness and not design. There is at least a want of symmetry about articles which require a distribution of ordinary dividends according to one proportion and allow a capitalization according to another. The purpose of the special resolutions was to alter art. 120, the article dealing with capitalization, so that when a capitalization of profits took place the distribution of shares should be in accordance with the amount paid up on the respective shares of the members participating. The alteration proposed formed the first step in a plan for the formation of a subsidiary operating company and the transfer of the assets to it in exchange for shares. Other resolutions directed to the carrying out of this plan formed part of the business of the same meeting, but it is unnecessary to describe the general scheme submitted for the shareholders' consideration. It would be only human for the holders of fully paid-up shares to object to a scheme of capitalization which would result in a diversion of some of the profits which holders of fully paid shares would receive on a cash distribution—a diversion from holders of fully paid shares to holders of partly paid shares

who, under the existing articles, would receive the paid-up shares representing them as the result of a capitalization. It is, therefore, problematical whether a scheme involving capitalization would be sanctioned if it was necessary to carry it out under the existing art. 120. On the other hand the holders of partly paid shares proved no less human. When the proposal was carried for an alteration of art. 120 depriving them of the chance of obtaining a larger proportion on a capitalization than they would on a cash distribution, they brought the suit out of which this appeal arises, asserting that the alteration had been resolved upon mala fide in order to deprive them of that to which they were entitled and to hand it over to the majority. The directors, who feared the Commissioner of Taxation more than they did any internecine conflict, had at an early stage invoked the aid of their legal and financial advisers Their legal advisers saw the complication created by what they called the inconsistency of the articles, and this caused a pause in the proposal for capitalization when it was first mooted. In the hope of finding wisdom the directors summoned a multitude of counsellors, who, with less variation of opinion than might have been expected, recommended a change in the articles. A circular explaining to the shareholders the purpose and nature of the proposed change was drawn up. It was drawn with much care and bears the evident marks of an attempt to give to an exposition of a complicated matter the not altogether compatible qualities of brevity, completeness, legalism and commercial intelligibility. Unfortunately, the prevailing thought among those who composed it was that the two articles were inconsistent because they prescribed different bases of distribution. For this reason it seems to have been considered that the co-existence of the articles made it impracticable to carry out the desires of the directors. The predominant argument of the circular presents some such view. I have not gone into the exact details of phraseology in which art. 120 is expressed, but it is sufficiently clumsy to admit of an argument that to capitalize under art. 120 would involve a violation of the article relating to dividends, art. 108. But notwithstanding this possible argument it is clear enough that the articles allowed the company to capitalize the profits according to one proportion and to distribute them according to

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another. As they constituted two courses between which the company could choose, it could not be correctly said that the articles were inconsistent one with another so as to produce an impasse. Where you are provided with a choice between two procedures you cannot take both, and, as it is only by combining them that the impossibility of them standing together is made manifest, it is not logical to say that the alternatives are inconsistent. Accordingly, the minority represented by the plaintiffs say that the circular was misleading. Their case is founded on the contention that either the majority was misled into voting for the amendment in order to bring the company out of an impasse or else they voted for their own aggrandisement. In aid of the first limb of this alternative argument the minority points to the proceedings at the meeting, which include strong statements by the solicitor of the company of the impossibility of carrying out the plan under the existing articles.

All this appears to me to be an artificial edifice of contention which would make impossible the ordinary administration of the affairs of a company, so far as they depend upon ill-considered and unsuitable articles of association. The plain fact was that the company had begun its life with an article of association relating to capitalization which ought not to have been found with an article requiring a distribution of profits according to the amount paid up on shares. Such articles ought not to have been found together because they are based on different conceptions of what is the just proportion for distributing gains and because they introduce an opposition of interest between the classes of shareholders when a question of capitalization of profits or distribution in cash is presented to them. The object of the proposals in the present case was to get over this want of harmony in the policy of the articles and resulting conflict of interests. Different ways of describing the situation would be adopted by different people. Many epithets or comments might fairly be used or made by directors or others in circulars or at meetings. Company law confers a power of alteration on a general meeting of shareholders requiring for any positive alteration a three-fourths majority. There is no other body to whom the question can be submitted. No rights given by articles of association can prevail against a three-fourths majority and it is well understood that

all are subject to it. It is true that the power of alteration must be exercised bona fide with a view to the advancement of the company considered as a whole and not with a view to the advancement of the interests of a majority of voters or of a section of the company only (*Richard Brady Franks Ltd.* v. *Price* (1); *Mills* v. *Mills* (2)). But in deciding what is for the interest of the company and what is bona fide, the constitution of the company, the condition and effect of the various articles of association and the extent to which rights are conferred upon different classes of shareholders are relevant and important. This seems to be the effect of *Allen* v. *Gold Reefs of West Africa Ltd.* (3), *British Murac Syndicate Ltd.* v. *Alperton Rubber Co. Ltd.* (4), *Sidebottom* v. *Kershaw, Leese & Co. Ltd.* (5) and *Shuttleworth* v. *Cox Brothers & Co. (Maidenhead) Ltd.* (6). Where the very problem which arises contains as inherent in itself all the elements of a conflict of interests between classes of shareholders these authorities do not mean that the power of alteration is paralysed, they mean only that the purpose of bringing forward the resolution must not be simply the enrichment of the majority at the expense of the minority. The resolution in the present case was brought forward to solve a difficulty and make possible a capitalization. It can hardly be supposed that the only solution of such a difficulty which can be lawfully adopted is that which gives the minority an advantage at the expense of the majority. In my opinion the case presents nothing but an ordinary example of an honest attempt on the part of the directors to clear up a difficulty by securing an alteration of the articles not unjust to any class of shareholders, but at the same time conserving the interests of the shareholders who form the great majority of the company. The facts that some of the arguments advanced were open to criticism does not make the case any less typical of the common course of company meetings.

I agree with the view taken by the learned primary judge that the rejection by the chairman of the meeting of the amendment which is alleged to have been proposed did not invalidate the proceedings.

In my opinion the appeal should be allowed.

(1) (1937) 58 C.L.R. 112, at p. 138.
(2) (1938) 60 C.L.R., at pp. 169, 170.
(3) (1900) 1 Ch. 656.
(4) (1915) 2 Ch. 186.
(5) (1920) 1 Ch. 154.
(6) (1927) 2 K.B. 9.

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DIXON J. The decree from which this appeal is brought denies validity to certain special resolutions for the alteration of the articles of association of the appellant company. The special resolutions were carried at a meeting held on 14th September 1937. The decree declares that they were not validly passed and that the articles were not validly altered. The decree then restrains the appellant company from acting upon the resolutions. The alterations which it was intended to make in the articles relate to the capitalization of undistributed profits.

The articles, as they existed, contained clauses providing that the profits of the company should be divisible among the shareholders in proportion to the capital paid up on the shares held by them respectively; that a general meeting might declare a dividend to be paid to the members according to their rights and interests in the profits; that a general meeting might increase the capital by the creation of new shares; and that such a meeting might determine that the new shares should be offered to the members in proportion to the capital held by them or make any other provision as to the issue and allotment of such shares (arts. 108, 110, 111, 34 and 36).

The articles contained no provision as to the division of a surplus in a winding up. But they contained a clause (art. 120) specifically dealing with capitalization, and the purpose of the alterations was to overcome the effects which this clause produced. The meaning of the clause has been disputed, but I think that it clearly means that with the sanction of a general meeting undistributed profits might be capitalized by making a ratable distribution among the members of shares paid up in full or in part out of such profits. The article means that the ratable distribution shall be in proportion with the shares held by the members, not with the capital paid up thereon, and that the amount paid up on the bonus shares should be uniform and should not vary with the amount paid up on the existing shares of the respective members.

The issued capital of the company was in fact divided into fully paid and contributing shares. About three-fourths of the shares were paid up in full, and about one-fourth were paid up to one-third only of their amount. Large reserves of undistributed profits existed.

As the articles stood, the course taken by the company would determine the destination of these profits, or, rather, the proportions in which they or a title to them would be distributed to the shareholders. If they were distributed as a cash dividend, they would be divided in proportion with the amount of capital paid up by the respective members. If they were distributed in the form of paid-up shares under the authority of the specific clause in the articles, the division would be proportionate with the number of shares held, without regard to the amount paid thereon. If the company reconstructed by forming a new company to which it transferred the assets in consideration of shares and then wound up so that its members received the shares in the new company from the liquidator as contributories, the distribution would be upon still another basis. It would be necessary first to repay the capital paid up on the respective classes of shares, shares fully paid and shares partly paid, or in some other way to equalize the amount paid up and then to make a ratable distribution according to the number of shares held. A fourth possibility lies in the adoption of the indirect procedure for capitalization formerly in general use. By that procedure a cash dividend is declared and at that same time an intimation is made to every member that shares of a face value equal to the amount payable to him by way of dividend will be allotted to him on his signing some suitable authority under which the directors of the company will apply the dividend in satisfaction of the liability on the shares. This method of capitalization theoretically allows of the shareholder's taking the dividend in cash and declining the allotment of shares, but practically the contingency of his doing so is made negligible by taking care that only shares will be issued which have a market value well above par.

There appears to have been some doubt or difference of opinion among the company's advisers as to the competence of this method of capitalization. It was felt that perhaps the fact that one of the company's articles of association expressly authorized the direct method of capitalization of profits and directed that the distribution of shares should be according to capital subscribed as opposed to capital paid might be considered enough impliedly to exclude the indirect method. In my opinion it would not. The purpose of the

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article authorizing the direct method is to enable the company to make a distribution of shares paid up or partly paid up without allowing the shareholders the choice of taking cash and thus to empower the company to make an effective distribution of bonus shares even though the market value might not be so far above par as to ensure that the shares would be taken instead of a cash dividend, if one were payable and the choice were open, as would be the case under the older method. I agree in the view that the presence of such an express power supplies no sufficient reason for denying to the company in general meeting the right to exercise simultaneously the power of declaring a cash dividend and of offering a new issue of capital to the members in proportions corresponding with the amount of the cash dividend payable to them respectively. It is true that under the articles prima facie a new issue of shares must be offered to existing members in proportion with the capital they have respectively subscribed, not paid, but the proportion is, I think, subject to the direction of a general meeting (art. 36). The fact that under the article authorizing the direct method of capitalizing profits the ratio prescribed is proportionate with subscribed, and not paid-up, capital does not, in my opinion, give a foundation for the inference that other methods of capitalization must follow the same proportion. Doubtless the difference in the proportion fixed for that purpose and for the purpose of a cash dividend is in truth an accident such as often results from bringing together articles drawn from different precedents. But, however that may be, it can mean no more than that where shares are to be forced on the members without the option of a cash dividend the distribution is to be proportionate with subscribed capital.

It follows, therefore, that, as the articles stood, accumulations of profit, if distributed as a cash dividend or under the older indirect procedure for capitalization, would be distributed according to one proportion, viz., according to capital paid up ; if distributed directly as shares, according to another proportion, viz., according to capital subscribed ; and if distributed as upon a reconstruction through a liquidator, according to still a third method, viz., by first equalizing paid-up capital and then distributing according to shares held.

For some years the directors had had the capitalization of profits under their consideration. They were alive, of course, to the danger that a capitalization might mean a distribution liable to income tax. In the course of seeking advice upon the subject their attention was drawn to the anomaly that under the articles a cash dividend was payable in proportion with the paid-up capital of the respective shareholders, while a distribution of bonus shares directly made under the specific authority of art. 120 must be in proportion with the shares held. The plan which the directors favoured involved the formation of a new company to carry on the business so far conducted by the appellant company, the transfer to that company of the assets of the business, including goodwill, and the holding by the appellant company of the shares in the new or operating company. Under the plan the value at which the goodwill would be transferred to the new company would produce a large profit which could be capitalized without danger of the distribution being taxable. But the fact that a capitalization of profits and a distribution of shares formed part of the plan brought the directors face to face with the question what should be the basis of the distribution among shareholders, that is, whether according to capital subscribed or capital paid up. After taking much advice the directors determined to deal with the question by proposing alterations of the articles which would enable a direct distribution of shares according to the amount of capital paid up by the respective shareholders upon their shares. The alterations designed to effect this result were proposed as special resolutions at an extraordinary general meeting of the company on 14th September 1937. The notice summoning the meeting stated that resolutions would be proposed for the necessary increase of capital and for authorizing the directors to carry out the proposed transaction and, also, if the resolutions altering the articles increasing the capital and approving of the transaction were passed, for the capitalization under the new articles of the profits arising from the sale of the goodwill. At the meeting the special resolutions were passed by the requisite majority. No poll was demanded. The remaining resolutions were then also carried.

If the capitalization of the profits arising from the sale of the goodwill had been carried out under the former article authorizing

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direct capitalization, those members of the company who hold contributing shares but hold no, or comparatively few, paid-up shares would have received a much larger number of new shares than under the altered article. The respondents, who are plaintiffs in the suit, represent the holders of partly paid shares. The decree declaring the attempted alteration of the articles to be invalid was made at their instance. They say that the object of the alteration was to deprive holders of partly paid-up shares of the right conferred by the existing articles to participate in a capitalization of profits on the same footing as holders of fully paid shares, i.e., according to the number of shares held, and that it amounted to an attempt on the part of the majority to appropriate what belonged to the minority. They also say that in a circular sent to shareholders with the notice of the meeting the directors misstated the situation under the existing articles and that at the meeting itself misstatements were made and an amendment moved in the interests of the minority was wrongly rejected.

The allegations that the circular and the statements at the meeting were misleading is not altogether independent of the attack upon the propriety of the purpose actuating the special resolutions for the alteration of the articles. For on behalf of the holders of partly paid shares the contention is put, by way of dilemma, that either the purpose of the resolutions was to deprive them of that to which the existing articles entitled them or else the purpose was supplied by the misleading statements contained in the circulars and made to the meeting. The judgment of *Nicholas* J., who made the decree under appeal, applies this form of reasoning to the facts.

The circular set out fully the two articles said to cause the difficulty, art. 108, which provided that profits should be divisible in proportion to the capital paid up, and art. 120, which provided that the proportion should be according to the shares held, when a direct capitalization of profits took place by a distribution of bonus shares. The circular stated that the articles were inconsistent. It is sufficient to quote one passage: "The two articles would only be consistent, when, as originally was the case, all the issued shares of the company had been paid up to the same amount, and would become inconsistent with one another when the issued shares are, as at present, paid up

to two different amounts ." The document emphasizes the need of setting off against the amount payable by a shareholder in respect of share capital issued to him an amount payable to him as a dividend in order to make such bonus shares fully paid.

It is, of course, indisputable that the liability upon shares issued by way of bonus distribution must be answered by some application of profits to the purpose. And it is difficult to deny that the word "inconsistent" might properly be used to describe the opposition between the principle or policy manifested in the article requiring cash dividends to be distributed according to capital paid up and that manifested in the article requiring a bonus-share distribution to be made according to the capital subscribed by members. But, when the requirement that in some way the liability upon the shares distributed shall be answered out of profits is described as a necessity that a dividend shall be declared in order to provide a set-off and this statement is brought into juxtaposition with the statement that the articles are inconsistent, it is apparent that an impression might readily be produced that under the existing articles a distribution of fully paid bonus shares was made quite impossible. Such an impression would have been incorrect. For, in my opinion, under art. 120 it would clearly have been lawful to distribute among members according to the number of shares respectively held by them bonus shares fully paid up out of profits.

How far the circular would actually produce such an impression it is not easy to say. A lawyer or accountant well acquainted with the principles upon which the capitalization of profits depends would not, I think, obtain it. A reader who was not informed upon such matters but who read the whole circular quite carefully and considered its total effect would probably understand it as meaning that the difference in the basis of distribution directed by the respective articles caused a difficulty, but not necessarily an impossibility, in carrying out the plan finding favour with the directors and that, if the alterations were not resolved upon by the shareholders, the plan would require reconsideration with a view of carrying it out by some other means. At the meeting, however, the company's solicitor clearly put a view which amounted to saying that it was impossible to act under art. 120 without contravening art. 108 and

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that on the existing articles a capitalization of profits could not be carried through unless by the indirect way of declaring a dividend and simultaneously offering shares of like amount to the members.

Another statement at the meeting upon which the respondents place some reliance was made by the chairman. He held a number of partly paid shares and, it is said, stated that he would for that reason be much better off financially if the proposals he recommended to the meeting were defeated. The statement is said to have been erroneous because he overlooked the effect, on the other side, produced by his holding certain fully paid shares.

In my opinion neither upon the ground that the resolutions were not carried bona fide for the ends allowed by the statutory power nor upon the ground that the passing of the resolutions was procured or affected by misleading statements nor upon a combination of or a dilemma between such grounds ought the alteration of the articles of association be held invalid.

The power of altering the articles of the company is now derived from sec. 20 of the *Companies Act* 1936 (N.S.W.), which is a general statutory provision. The section in terms empowers a company by special resolution to alter or add to its articles. No limitations or restrictions on the power are expressed, except that it is made subject to the provisions of the Act and the conditions contained in the memorandum of association. The section goes on to enact that any alteration or addition should be as valid as if originally contained in the articles.

The conditions expressed by the section itself make it clear that no alteration of the articles can validly operate to destroy or prejudice rights which the statute confers upon members of a company or which are lawfully fixed under provisions of the memorandum. But the power of altering articles of association now conferred by statute had its analogue, if not its source, in clauses found in deeds of settlement by which a specified majority of the members of companies constituted or regulated by such instruments were empowered to alter or add to their provisions. The mala-fide use or abuse of such powers would naturally fall under the jurisdiction of courts of equity, and from the time of the Act of 1856 (19 & 20 Vict. c. 47, secs. 33, 34 and 35), which included the statutory authority

to alter articles of association, it has never been conceded that the power is unrestrained. It is one thing, however, to say that such a power is not unlimited or uncontrolled and another to define the grounds upon which an ostensible exercise of the power should be considered invalid. At first an attempt was made to distinguish between matters which went to the foundation of a company's structure and matters which related only to the conduct and management of its affairs. Thus, in the course of his now overruled judgment in *Hutton* v. *Scarborough Cliff Hotel Co. (Ltd.)* (1) *Kindersley* V.C. said: "The question is whether the power given to a general meeting, by special resolution, to modify the regulations of the company is unlimited: clearly there must be some limit to the power; otherwise they might alter not only such as relate to the management of the company, but they might alter the very constitution and nature of the company." But the distinction was found untenable. It is the province of the memorandum of association to fix the constitution and nature of the company, and the power of altering the articles is subject to whatever restrictions it may contain. But no article as such could be made unalterable. It may be altered notwithstanding that it is expressed to be fundamental or part of the constitution of the company or unalterable, and a company cannot contract itself out of the power. In spite of what is said in *British Murac Syndicate Ltd.* v. *Alperton Rubber Co. Ltd.* (2), the better opinion still appears to be that the fact that to alter an article involves a breach of contract can be no more than an evidentiary consideration and does not in itself make the alteration invalid: See *Buckley* on *The Companies Acts*, 10th ed. (1924), pp. 24, 25; 11th ed. (1930) pp. 18, 19; *Law Quarterly Review*, vol. 31, p. 359. After the abandonment of the distinction between, on the one hand, matters of administration and management admittedly subject to the power of alteration and, on the other, matters going to the constitution of the company and said therefore to be outside the power, the courts sought for a limitation in the more general doctrine that a power must be exercised bona fide for the end for which the power is designed. Primarily a share in a company is a piece of property conferring rights in relation to

(1) (1865) 2 Drew. & Sm. 521, at pp. 524, 525; 62 E.R. 717, at p. 719.
(2) (1915) 2 Ch. 186.

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distributions of income and of capital. In many respects the proprietary rights are defined by the articles of association, and it is easy to see that a power of alteration might be used for the aggrandisement of a majority at the expense of a minority. For example, if there were no check upon the use of the power, it is conceivable that a three-fourths majority might adopt an article by which the shares which they alone held would participate, to the exclusion of other shares, in the surplus assets in winding up or even in distributions of profit by way of dividend. Again, authority might be obtained under an alteration so as to convert the assets or operations of a company into a source of profit not of the company but of persons forming part of or favoured by the majority. It has seemed incredible that alterations of such a nature could be made by the exercise of the power. But reliance upon the general doctrine that powers shall be exercised bona fide and for no bye or sinister purpose brings its own difficulties. The power of alteration is not fiduciary. The shareholders are not trustees for one another, and, unlike directors, they occupy no fiduciary position and are under no fiduciary duties. They vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage. No doubt the exercise of the right affects the interests of others too, and it may be that an analogy may be found in other powers which though given to protect the donee's own interests affect the property rights of others, as, for instance, does a mortgagee's power of sale. Some such analogy probably gave rise to the suggestion made in *Buckley* on *The Companies Acts* (10th ed. (1924), p. 26; 11th ed. (1930), p. 21) that the limitation on the power is that the alteration must not be such as to sacrifice the interests of the minority to those of a majority without any reasonable prospect of advantage to the company as a whole: Compare the expression in *Kennedy* v. *De Trafford* (1).

Apart altogether from altering articles of association, the voting strength of a majority of shareholders may be used in matters of management and administration to obtain for themselves advantages which otherwise would enure for the benefit of all the members of

(1) (1897) A.C. 180, at p. 185.

the company, and in some circumstances such an attempt on the part of the majority to secure advantages to the prejudice of the minority conflicts with ordinary notions of fair dealing and honesty. Often when this is done the thing attempted will be found by its nature to fall outside the power of the members in general meeting and even outside the corporate powers of the company. But this is not necessarily the case, and a thing not of its own nature *ultra vires* may be invalidated by the effect which it produces or is intended to produce in benefiting some shareholders at the expense of others or individuals at the expense of the company. The ground upon which the invalidity is placed is fraud, but what amounts to fraud has not been made the subject of definition; possibly under the influence of the tradition that "the court has never ventured to lay down, as a general proposition, what shall constitute fraud" (per Lord *Eldon*, *Mortlock* v. *Buller* (1)).

An example of a misuse of power on the part of shareholders constituting a majority in the administration of a company's affairs is the unjustifiable refusal to allow an action to be maintained in the name of the company to redress a wrong done to it by one of themselves. "The cases in which the minority can maintain such an action are," says Lord *Davey* in *Burland* v. *Earle* (2), "confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company. A similar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate." In *Dominion Cotton Mills Co. Ltd.* v. *Amyot* (3) Lord *Macnaghten* reduces the rule to a brief statement of general application:—"The principles applicable to cases where a dissentient minority of shareholders in a company seek redress against the action of the majority of their associates are well settled. . . . In order to succeed it is incumbent on the minority either to show that the action of the majority is *ultra vires* or to prove that the majority have abused their powers and are depriving the minority of their rights." In *Cook* v. *Deeks* (4) resolutions were in question which disclaimed

(1) (1804) 10 Ves. 292, at p. 306; 32 E.R. 857, at p. 862.
(2) (1902) A.C. 83, at p. 93.
(3) (1912) A.C. 546, at pp. 551, 552.
(4) (1916) 1 A.C. 554.

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on behalf of a company any interest in a contract made by persons who were directors of the company and who formed the majority of shareholders passing the resolutions. They were in fact constructive trustees of the benefit of the contract for the company, because they had made the contract in breach of their fiduciary duty as directors. Lord *Buckmaster* in giving the reasons of the Privy Council said: —"If, as their Lordships find on the facts, the contract in question was entered into under such circumstances that the directors could not retain the benefit of it for themselves, then it belonged in equity to the company and ought to have been dealt with as an asset of the company. Even supposing it be not *ultra vires* of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow a majority to oppress the minority. . . . In the same way, if directors have acquired for themselves property or rights which they must be regarded as holding on behalf of the company, a resolution that the rights of the company should be disregarded in the matter would amount to forfeiting the interest and property of the minority of shareholders in favour of the majority, and that by the votes of those who are interested in securing the property for themselves. Such use of voting power has never been sanctioned by the courts" (1).

In these formulations of general principle there is an assumption that vested in the company or in the minority of shareholders, as the case may be, is an independent title to property, to rights or to remedies, and the ground of the court's intervention is that by the course adopted by the majority, the company or the minority will be deprived of the enjoyment of that to which they are so entitled. The conduct of the majority is then given some dyslogistic description such as "fraudulent," "abuse of powers" or "oppression." A chief purpose of articles of association is to regulate the rights of shareholders *inter se*, and their relations to the profits and surplus assets of the company are governed by the provisions of the articles. A power to alter articles of association is necessarily a power to alter the rights of shareholders *inter se*, including their mutual rights in

(1) (1916) 1 A.C., at p. 564.

respect of profits and surplus assets. It is therefore evident that some difficulty must arise in applying to resolutions for the alteration of articles a statement of principle which assumes the independent existence of rights which should not be impaired or destroyed. Prima facie rights altogether dependent upon articles of association are not enduring and indefeasible but are liable to modification or destruction; that is, if and when it is resolved by a three-fourths majority that the articles should be altered. To attempt to distinguish between alterations which deserve the epithet fraudulent or oppressive or unjust and those deserving no moral censure without explaining the considerations upon which the distinction depends, is to leave the whole question to general notions of fairness and propriety. In *Sidebottom* v. *Kershaw, Leese & Co. Ltd.* (1), after expressing the opinion that a regularly passed resolution for the alteration of articles could be held bad only on the ground of mala fides, *Eve* J. referred to the question what is meant by mala fides in this connection and said :—" Speaking for myself, I do not think the solution of that question is assisted by the use of such phrases as 'the ordinary principles of justice,' 'just and equitable' or 'oppressive.' " To base the application of these descriptions to a particular resolution upon the fact that it involves a modification or defeasance of rights of a valuable or important nature, is in effect to go back to the discarded distinction between articles affecting the constitution and those affecting the administration of the company or to a distinction very like it. To base the application of the epithets upon the circumstance that the majority obtain a benefit by the change seems to involve some departure from the principle that the vote attached to a share is an incident of property which may be used as the shareholder's interests may dictate.

The considerations which I have mentioned all arise in attempting to discover and fasten upon some element the presence of which will always vitiate a resolution for the alteration of articles of association. But, whatever may constitute bad faith, it is evident that, if a resolution is regularly passed with the single aim of advancing the interests of a company considered as a corporate whole, it must fall within the scope of the statutory power to alter the articles and could never be

(1) (1920) 1 Ch., at p. 173.

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condemned as mala fides. A positive test was therefore available, conformity with which necessarily spelt validity. When the rejection of the doctrine of *Hutton* v. *Scarborough Cliff Hotel Co.* (*Ltd.*) (1) was made final by *Andrews* v. *Gas Meter Co.* (2), compliance with this positive test was declared to be all that was demanded, that is, besides consistency with the provisions of the statute and of the memorandum of association.

In *Allen* v. *Gold Reefs of West Africa Ltd.* (3) a majority of the Court of Appeal upheld as valid an amendment of a company's articles which had the effect of extending to the paid-up shares of members a lien which under the previous article was confined to partly paid shares. The lien secured all debts, obligations and liabilities of a member to the company and as a result of other provisions contained in the articles was enforceable by forfeiture of the shares. The occasion for adopting the amendment was the failure of the executors of a member who died holding a large number of vendor's fully paid shares and a smaller number of partly paid shares either to register themselves as shareholders or to pay the calls, the assets being insufficient. *Lindley* M.R. said that, wide as the statutory power of alteration was, it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. "It must be exercised not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded" (4). For the decision it was enough to say that an alteration which was made "bona fide for the benefit of the company as a whole" could not be invalid. And *Lindley* M.R. went on to say that if these conditions were complied with he could discover no ground for judicially putting any other restrictions on the power. But, as in literal terms it was expressed as a positive requirement which must be fulfilled and not merely negatived as a test compliance with which was enough, Lord *Lindley's* statement was taken in some subsequent cases as formulating the issue on which validity or invalidity depended absolutely, viz., whether "the power had been exercised bona fide for the benefit of the company as a whole."

(1) (1865) 2 Drew. & Sm. 521; 62 E.R. 717.
(2) (1897) 1 Ch. 361.
(3) (1900) 1 Ch. 656.
(4) (1900) 1 Ch., at p. 671.

Vaughan-Williams L.J., who dissented, did so on the ground " that the resolution was not passed in good faith, being really passed merely to defeat the existing rights of an individual shareholder " (1). He took good faith as the test and added that an alteration involving oppression of the shareholder would not be made in good faith. But the opening words of his judgment (2) show that he regarded these standards as the same as those formulated by *Lindley* M.R. Nevertheless, not only have the latter's words been sometimes received as embodying an exclusive and conclusive test, but through repetition they tended to become almost a formula. Their meaning was sometimes questioned but more often assumed. In *Brown* v. *British Abrasive Wheel Co. Ltd.* (3) *Astbury* J. appears to have read the words as distinguishing into separate matters the good faith of the alteration and its tendency to benefit the company as a whole. The company in that case was faced with liquidation unless it could obtain further capital, which a majority holding ninety-eight per cent of the shares was ready to supply, provided the remaining two per cent of the share capital was placed under the same control. An alteration of the articles was proposed by which a transfer of the shares might be compelled at a value fixed by a method prescribed by the existing articles for the case of compulsory sale. *Astbury* J., after quoting the statement of *Lindley* M.R., said: " The question therefore is whether the enforcement of the proposed alteration on the minority is within the ordinary principles of justice and whether it is for the benefit of the company as a whole " (4). Stating the issue in this way, he concluded that to expropriate a minority was unjust and for the benefit not of the company but of the majority. But shortly afterwards, in *Sidebottom* v. *Kershaw, Leese & Co. Ltd.* (5), an alteration was upheld as valid by the Court of Appeal though it provided for the expropriation at a value of the shares of any member carrying on business in direct competition with that of the company or being a director of another company so doing. Lord *Sterndale* M.R. (6) and *Warrington* L.J. (7), as he then was, both made it clear that in their opinion *Astbury* J. in *Brown* v. *British Abrasive Wheel Co. Ltd.* (3) had been wrong in treating bona fides and benefit of the company

(1) (1900) 1 Ch., at p. 677.
(2) (1900) 1 Ch., at pp. 676, 677.
(3) (1919) 1 Ch. 290.
(4) (1919) 1 Ch., at p. 295.
(5) (1920) 1 Ch. 154.
(6) (1920) 1 Ch., at p. 167.
(7) (1920) 1 Ch., at p. 172.

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as separate conceptions, and the justification, if any, for his decision lay in a finding of fact that the majority had acted entirely for their own benefit. But the members of the Court of Appeal relied upon the same passage from the judgment of *Lindley* M.R., which *Eve* J. (1) restated in the form of a question: "Was the resolution adopted, or was the resolution made for the benefit of the company or for the benefit of some section of the company, without reference to the benefit of the company as a whole?" Yet within a few months of the decision of the Court of Appeal *Peterson* J. decided the validity of an alteration of articles as upon an issue whether in fact it could "properly be said to be for the benefit of the company" (*Dafen Tinplate Co. Ltd.* v. *Llanelly Steel Co.* (*1907*) *Ltd.* (2)). The article adopted, though apparently not directed against any shareholder in particular, conferred an arbitrary power to compel the transfer of shares exercisable without cause and upon grounds unspecified and not expressly limited. But, whatever may be said as to the validity of such a provision, it could not depend on the opinion of the court that as an alteration it did or it did not operate for the benefit of the company considered as a whole. The view taken by *Peterson* J. was corrected by the Court of Appeal in *Shuttleworth* v. *Cox Brothers & Co.* (*Maidenhead*) *Ltd.* (3), where the validity of an alteration was upheld which provided that any one of a board of directors appointed for life should lose office if his fellow-directors requested in writing that he should resign. The alteration was directed at a particular director whose conduct had not been satisfactory. The words of *Lindley* M.R., "exercised bona fide for the benefit of the company" (*Allen* v. *Gold Reefs of West Africa Ltd.* (4)), were again interpreted as stating one condition only, a condition which *Scrutton* L.J. understood "as meaning that the shareholders must act honestly having regard to and endeavouring to act for the benefit of the company" (5). *Bankes* L.J., after saying that the test is whether the alteration was, in the opinion of the shareholders, for the benefit of the company, continued:—"By what criterion is the court to ascertain the opinion of the shareholders upon this question? The alteration may be so oppressive as to cast suspicion on the honesty of the persons responsible for it, or so

(1) (1920) 1 Ch., at p. 173.
(2) (1920) 2 Ch., at p. 141.
(3) (1927) 2 K.B. 9.
(4) (1900) 1 Ch., at p. 671.
(5) (1927) 2 K.B., at p. 23.

extravagant that no reasonable men could really consider it for the benefit of the company" (1). *Atkin* L.J. (as he then was) made a significant but very natural remark :—" But neither this court nor any other court should consider itself fettered by the form of words, as if it were a phrase in an Act of Parliament which must be accepted and construed as it stands. We must study what its real meaning is by the light of the principles which were being laid down by the Master of the Rolls when he used the phrase" (2). In *British Equitable Assurance Co. Ltd.* v. *Baily* (3) Lord *Lindley* said : " Of course, the powers of altering by-laws, like other powers, must be exercised bona fide, and having regard to the purposes for which they are created, and to the rights of persons affected by them." I imagine that in *Allen* v. *Gold Reefs of West Africa Ltd.* (4) Lord *Lindley* meant no more.

If no restraint were laid upon the power of altering articles of association, it would be possible for a shareholder controlling the necessary voting power so to mould the regulations of a company that its operations would be conducted or its property used so that he would profit either in some other capacity than that of member of the company or, if as member, in a special and peculiar way inconsistent with conceptions of honesty so widely held or professed that departure from them is described, without further analysis, as fraud. For example, it would be possible to adopt articles requiring that the company should supply him with goods below cost or pay him ninety-nine per cent of its profits for some real or imaginary services or submit to his own determination the question whether he was liable to account to the company for secret profits as a director.

The chief reason for denying an unlimited effect to widely expressed powers such as that of altering a company's articles is the fear or knowledge that an apparently regular exercise of the power may in truth be but a means of securing some personal or particular gain, whether pecuniary or otherwise, which does not fairly arise out of the subjects dealt with by the power and is outside and even inconsistent with the contemplated objects of the power. It is to exclude the purpose of securing such ulterior special and particular advantages

(1) (1927) 2 K.B., at p. 18.
(2) (1927) 2 K.B., at p. 26.
(3) (1906) A.C. 35, at p. 42.
(4) (1900) 1 Ch., at p. 671.

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that Lord *Lindley* used the phrase "bona fide for the benefit of the company as a whole." The reference to "benefit as a whole" is but a very general expression negativing purposes foreign to the company's operations, affairs and organizations. But unfortunately, as appears from the foregoing discussion, the use of the phrase has tended to cause misapprehension. If the challenged alteration relates to an article which does or may affect an individual, as, for instance, a director appointed for life or a shareholder whom it is desired to expropriate, or to an article affecting the mutual rights and liabilities *inter se* of shareholders or different classes or descriptions of shareholders, the very subject matter involves a conflict of interests and advantages. To say that the shareholders forming the majority must consider the advantage of the company as a whole in relation to such a question seems inappropriate, if not meaningless, and at all events starts an impossible inquiry. The "company as a whole" is a corporate entity consisting of all the shareholders. If the proposal put forward is for a revision of any of the articles regulating the rights *inter se* of shareholders or classes of shareholders, the primary question must be how conflicting interests are to be adjusted, and the adjustment is left by law to the determination of those whose interests conflict, subject, however, to the condition that the existing provision can be altered only by a three-fourths majority. Whether the matter be voting rights, the basis of distributing profits, the basis of dividing surplus assets on a winding up, preferential rights in relation to profits or to surplus assets, or any other question affecting mutual interests, it is apparent that though the subject matter is among the most conspicuous of those governed by articles and therefore of those to which the statutory power is directed, yet it involves little if anything more than the redetermination of the rights and interests of those to whom the power is committed. No-one supposes that in voting each shareholder is to assume an inhuman altruism and consider only the intangible notion of the benefit of the vague abstraction called by Lord *Robertson* in *Baily's Case* (1) "the company as an institution." An investigation of the thoughts and motives of each shareholder voting with the majority would be an impossible proceeding. When the purpose of a resolution is spoken

(1) (1906) A.C., at p. 39.

of, a phrase is used which refers rather to some characteristic implicit in the resolution in virtue of the circumstances or of some larger transaction of which it formed a part or step. It is not far removed from what Lord *Sumner* called " one of those so-called intentions which the law imputes . . . the legal construction put on something done in fact " (*Inland Revenue Commissioners* v. *Blott* (1)). But, when the very question to be determined is a conflict of interests, unless the subject matter is held outside the power, the purpose of the resolution, as distinguished from the motives of the individuals, often must be to resolve the conflict in favour of one and against the other interest.

In my opinion it was within the scope and purpose of the power of alteration for a three-fourths majority to decide the basis of distributing shares issued for the purpose of capitalizing accumulated profits or profits arising from the sale of goodwill, and in voting for the resolution shareholders were not bound to disregard their own interests. I am far from saying that the resolution for the alteration of the articles would have been bad if the existing articles had been uniform and clear in requiring that, however the " capitalization " was effected, the basis of distribution should be the number of shares respectively subscribed for by members. But the facts of the case were that by one method, the older indirect method, a capitalization might have been effected which would mean a distribution according to capital paid up. Doubts were felt about the propriety of adopting this course, and doubts were agitated as to the meaning of the article providing for the direct method. If there were no capitalization, the accumulated profits would not be distributed in proportion with capital subscribed. In these circumstances the holders of partly paid shares had no " right " to receive the profits in proportion with capital paid up. As the articles stood they were entitled only to receive shares in that proportion if and when issued by way of direct capitalization. That event would never be likely to occur ; for the holders of fully paid shares were perfectly entitled to prevent it and would no doubt do so. In these circumstances it appears to me that the resolution involved no oppression, no appropriation of an unjust or reprehensible nature and did not imply any purpose outside the scope of the power.

(1) (1921) 2 A.C., at p. 218.

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The statements contained in the circular and made at the meeting do not, in my opinion, invalidate the resolutions nor affect the conclusion I have just stated. It is true that the circular is capable of conveying a view of the situation arising under the articles which was not the correct legal result. The articles were, however, fully set out in the notice and in the circular. It can hardly be denied that they created a complicated if not confused position and a difficult situation. I agree that the circular was not likely to make the operation of the existing articles appear less difficult. But the fact that a description honestly made of the exact legal result arising from the existing articles is thought by the court to be capable of conveying an incorrect impression is no sufficient ground for treating as void special resolutions duly notified, proposed and passed.

The argument of the solicitor at the meeting was clearer in its error, but a bad argument to a shareholders' meeting has not the same effect upon their resolutions as a misdirection upon a jury's verdict. This observation is sufficient to dispose of the contention founded on the chairman's mistaken statement as to where his own pecuniary interest lay.

The view taken by *Nicholas* J. of the facts was in effect that, if the circular determined the action of the shareholders, they voted to remove an illusory difficulty and, if it did not, they voted to deprive the majority of their rights. His Honour's conclusions may be stated thus :—First, the shareholders voted under a misapprehension (i) of the true relationship of the respective articles, and, therefore, also (ii) of the purpose of the resolution. Secondly, none of the following propositions could be maintained, viz., (i) that the object of the resolution was the benefit of the company, (ii) that the action of the shareholders was capable of being considered for the benefit of the shareholders, (iii) that the shareholders did not consider matters which they ought not to have considered. It is evident from his Honour's reasons that his view of the facts, worked out in this manner, represents a carefully considered opinion as to the operation of the circular and the true effect of the articles. Its legal basis is found in Lord *Lindley's* reference to the benefit of the company as a whole and the repetitions and discussions of that expression in the later decisions. It is for that reason that I have

dealt so fully with the somewhat vague and unsatisfactory test to be applied when what is in question is the validity of an alteration of an article dealing with such a subject as that in the present case. Ultimately my reason for upholding the resolution is that I find no vitiating element present. His Honour, on the other hand, approaching the matter somewhat differently, I think, sought and did not find any sufficient ground for the positive conclusion that the resolution fell within the standard of validity which he regarded as laid down by authority.

There remains the question whether the resolution was invalidated by the chairman's refusal of an amendment. I shall not restate the facts affecting this question, which is of no general importance. It is enough to say that I think that the amendment, which was not formally proposed, consisted of two parts, one of which directly negatived the motion and the other of which fell outside the scope of the notice, which made the proposal of the only resolution to which the amendment was relevant contingent on the passage of that which the amendment negatived. I therefore think that a rejection by the chairman of the intended amendment would not have been irregular.

In my opinion the appeal should be allowed. The decree of the Supreme Court should be discharged. The suit should be dismissed with costs, including the costs of the amendments mentioned in the decree. The respondents should pay the costs of the appeal.

McTIERNAN J. In my opinion the appeal should be allowed. I agree with the judgment of the Chief Justice.

Appeal allowed. Suit dismissed.

Solicitors for the appellant, *McDonell & Moffitt.*

Solicitors for the respondents, *Thompson, Bradfield & Fincham.*

J. B.