Michaelmas Term
[2024] UKPC 36
Privy Council Appeal No 0002 of 2023

JUDGMENT

Tianrui (International) Holding Company Ltd (Appellant) *v* China Shanshui Cement Group Ltd (Respondent) (Cayman Islands)

From the Court of Appeal of the Cayman Islands

before

Lord Hodge
Lord Briggs
Lord Sales
Lord Leggatt
Lord Richards

JUDGMENT GIVEN ON
14 November 2024

Heard on 12 and 13 March 2024

Appellant
Thomas Lowe KC
Tara Taylor
Gemma Bellfield
Corey Byrne
(Instructed by Ogier (Cayman) LLP and Enyo Law LLP)

Respondent
Tom Smith KC
Paul Fradley
Adrian Davey
(Instructed by Maples and Calder (Cayman) LLP and Freshfields Bruckhaus Deringer LLP (London))

LORD HODGE AND LORD BRIGGS:

1. The issue on this appeal is whether a shareholder, including a minority shareholder, has a personal claim against a company when the directors of the company allot shares for an improper purpose. In particular, does the shareholder have a private right to sue the company for a declaration that the power of the company has been invalidly exercised by the board of directors on the company's behalf?

2. The allotment of shares can have the effect of altering the balance of voting power between shareholders within the company and the relative economic stakes they have in the company. The allegation in this case is that the allotment was made to reduce the appellant's stake in the company below 25 per cent, thereby removing its negative control so as to assist the other shareholders to consolidate their control over the company. The exercise of the power to issue and allot the shares is alleged to have been in breach of the directors' fiduciary duty owed to the company to exercise their powers for a proper purpose.

3. It has long been held in cases of high authority, by the Board, the UK Supreme Court, the High Court of Australia and other appellate courts, that in these circumstances proceedings may be brought by shareholders personally, rather than by derivative action on behalf of the company, to challenge such allotments, notwithstanding that the duty of directors to exercise their powers of allotting shares for proper purposes is owed not to shareholders personally but to the company alone. Although it has never previously been doubted that shareholders personally have standing to bring proceedings in these circumstances, the juridical basis for their standing has not been decided, and barely discussed, in most cases. In the present case, the Court of Appeal, reversing decision of the first instance judge, held that the claimant shareholders had no personal standing to bring the present claim.

4. For the reasons set out below, the Board concludes that a shareholder has a right of action against the company to challenge the allotment of shares by the board of directors on the basis that the allotment was made for an improper purpose in circumstances where the allotment will cause detriment to the shareholder.

5. The appeal comes before the Board against a successful strike out application by the company. The case has been decided in the courts below on assumed facts. The Board also addresses the appeal on the basis of assumed facts which may not be established at trial.

1. A summary of the factual background and the assumed facts

6. There has been a prolonged battle for control of the respondent company, China Shanshui Cement Group Ltd ("CSCGL"), which is a Cayman Islands exempted company that is also registered in Hong Kong as a non-Hong Kong company. CSCGL's shares are listed on the Hong Kong Stock Exchange ("HKSE"). CSCGL is a holding company of operating subsidiaries which are registered in Hong Kong and the People's Republic of China ("the PRC"). The group is principally engaged in the production, distribution and supply of cement and related construction products in the PRC. CSCGL's principal subsidiary, Shandong Shanshui Cement Group Co, is the sixth largest cement company in the PRC, measured by annual production capacity.

7. The principal shareholders in CSCGL are (i) the appellant ("Tianrui"), a company incorporated in the British Virgin Islands with a shareholding of 28.16%, (ii) Asia Cement Corporation ("ACC"), a company incorporated in Taiwan with a shareholding of 26.72%, (iii) China National Building Materials Co Ltd ("CNBM"), a company incorporated in the PRC with a shareholding of 16.67%, and (iv) China Shanshui Investment Company Ltd ("CSI"), a company incorporated in Hong Kong with a shareholding of 25.09%.

8. Each of CSCGL, Tianrui, ACC and CNBM are competitors in the cement production industry in the PRC.

9. As recorded in the agreed statement of facts and issues, CSCGL's shares were suspended from trading on the HKSE from April 2015 to 31 October 2018. On 23 October 2017, the HKSE gave notice that CSCGL would be delisted unless by 31 October 2018 (i) CSCGL restored its public float above the 25% minimum threshold required by a rule of the HKSE Main Board Listing Rules, and (ii) CSCGL addressed the facts that its auditors, KPMG, had issued a disclaimer of opinion on CSCGL's accounts on the financial years 2015 and 2016 and that the then board of CSCGL had not been able to publish their report for the financial year 2017.

10. On or about 23 May 2018 a majority of shareholders of CSCGL, including ACC, CNBM and CSI, voted at an extraordinary general meeting of CSCGL to reconstitute the board of directors. The reconstituted board comprised one director from CNBM (Chang Zhangli), one director from ACC (Wu Ling-Ling) and three independent non-executive directors.

11. Thereafter, CSCGL issued convertible bonds in two tranches. The first tranche, issued to one subscriber on or about 8 August 2018, involved bonds for a total value of US$210,900,000 at a conversion price of HK$6.29 per share. The second tranche was issued to seven subscribers on or about 3 September 2018 for a total of US$320,700,000 at a conversion price of HK$6.29 per share.

12. CSCGL claims that the proceeds of the bonds were primarily used to repay US$500 million loan notes that were repayable in March 2020 and were fully repaid on 28 November 2018.

13. After the first bond issue and before the second bond issue, on 30 August 2018, Tianrui filed in the Grand Court of the Cayman Islands a petition to wind up CSCGL on the ground that it would be just and equitable to do so. One of Tianrui's complaints was the improper issue of the shares described below. CSCGL's attempt to strike out that petition failed in the Court of Appeal, which, in a judgment dated 5 April 2019, held that, if Tianrui's allegations in the petition were true, they were capable of establishing that it would be just and equitable to wind up CSCGL.

14. On or about 6 October 2018 CSCGL (i) entered into deeds of amendment with each of the subscribers of the bonds to accelerate the conversion of US$456,600,000 in principal amount of the first and second bond issues into shares at a reduced "Early Conversion Price" of HK$4.20 per share, and (ii) agreed with the holders of bonds the allotment of 888,980,352 new shares in exchange for some of the bonds.

15. CSCGL held an adjourned annual general meeting and an extraordinary general meeting of shareholders on 30 October 2018. At the extraordinary general meeting a majority of the shareholders passed a resolution mandating the directors to allot and issue 1,067,830,759 shares, comprised of the new shares in para 14 above and a further 93,004,771 shares, representing shares relating to the bonds held by persons who had not already agreed to the share conversion referred to in para 14 above. The new shares were issued on 30 October 2018, and restored the public float of CSCGL to 25%. As a result, trading in CSCGL's shares on the HKSE resumed on the following day.

16. Tianrui does not dispute this brief account of events which, on its face, may appear to be a rational response to the notice which the HKSE gave and which is referred to in para 9 above. But Tianrui says that that is not the whole story. Tianrui pleads in its writ in these proceedings that the bondholders were connected with ACC and CNBM by an undisclosed agreement or concert party to take over voting control of CSCGL. Tianrui pleads that the issue of the bonds and the allotment and issue of the new shares were an improper exercise of CSCGL's power to allot and issue securities. It is alleged that the shares were issued for the purpose of enabling ACC and CNBM to control CSCGL and achieving a dilution of Tianrui's shareholding to under 25% (in fact 21.85%) with the result that Tianrui could no longer block special resolutions. Mr Thomas Lowe KC for Tianrui submits that if the share issues are valid, Tianrui cannot prevent the merger of CSCGL with another company and it might have to have its shares bought out under section 238 of the Companies Act.

17. Tianrui's pleadings are made before discovery and before the administration of interrogatories. It explains that the PRC government had imposed restrictions on cement production capacity in 2014 with the result that cement producers could only expand their market shares through taking over other producers and that CSCGL had become a target for takeover. It asserts that in a series of meetings in person in 2015 attended by the directors of ACC and CNBM and telephone conversations it had been agreed that ACC and CNBM would form an alliance to take over CSCGL, that they would make a joint offer for CSCGL's shares and that they would oppose Tianrui's attempts to obtain a greater interest in CSCGL. ACC and CNBM then made a joint offer to purchase the shares of CSCGL on 12 August 2015. ACC, CNBM and CSI used their votes to requisition the extraordinary general meeting in May 2018 at which CSCGL's board was removed and replaced by a board entirely nominated by ACC. It avers that the bond issues and share conversion were concluded in secret, that they were not arm's length transactions and that the subscribers were connected with ACC and/or CNBM.

18. Tianrui describes the effect and purpose of the convertible bond and share issues in its statement of claim as follows:

> "56. As a result of having its shareholding reduced to under 25%, Tianrui is prejudiced as it can no longer block a special resolution in a general meeting of [CSCGL], which requires not less than 75% of the votes in general meeting.
>
> Improper Purpose
>
> 57. The Convertible Bonds were issued by the board of [CSCGL] to persons connected with and/or acting in concert with ACC and/or CNBM for the improper purposes of enabling ACC and CNBM by themselves or with others to control [CSCGL] as set out below.
>
> 58. ACC and CNBM entered into a secret or undisclosed voting agreement about how to exercise votes between ACC and CNBM and the Bond Subscribers and/or New Shareholders and/or each of them and/or reached an understanding with them and/or each of them."

19. Tianrui avers that the reconstituted board of CSCGL exercised their power to issue the convertible bonds and new shares for an improper purpose and that those transactions were invalid. Similarly, Tianrui avers that ACC, CNBM and CSI acted for an improper purpose in supporting the resolution at the extraordinary general meeting on 30 October 2018 to grant the specific mandate to issue the shares described in para 15 above.

20. Tianrui seeks as remedies declarations that the exercise by the directors of CSCGL of the powers (i) to issue the convertible bonds, (ii) to convert the bonds into shares, and (iii) to issue the new shares described in para 15above were each not a valid exercise of the relevant power.

21. The Board, like the courts below, is required to determine the strike out application on the basis that Tianrui's averments in paras 16-19 above are assumed to be true.

22. The court may strike out a statement of case if, among other grounds, the statement of case discloses no reasonable cause of action or is otherwise an abuse of the process of the court: Grand Court Rules, O18, r19.

2. The judgments of the Grand Court and the Court of Appeal

23. CSCGL sought to have both the winding up petition and the writ seeking declaratory relief struck out on various grounds. The Board is not concerned with the challenge to the winding up petition as it has earlier refused permission to appeal the Court of Appeal's judgment referred to in para 13 above. The only challenge to the writ proceedings made before Segal J in the Grand Court which is live before the Board is the challenge that the writ action is an abuse of process because Tianrui does not have standing to sue CSCGL for what are essentially claims arising out of breaches by the reconstituted board of the fiduciary duties which they owed to CSCGL.

24. In a detailed judgment delivered on 6 April 2020 Segal J rejected this challenge: 2020 (2) CILR 6. In so doing Segal J declined to follow a judgment of Kawaley J in the Grand Court in *Gao v China Biologic Products Holdings, Inc* 2018 (2) CILR 591 ("*Gao*") in which the court struck out the writ action by a minority shareholder challenging the exercise by a board of directors of the power to allot and issue shares on the ground that the plaintiff lacked standing to sue the company for a breach of fiduciary duty by the directors which was owed to the company and not to him. Segal J discussed various authorities, which the Board discusses below, and concluded that a minority shareholder had a personal claim against the company and that the appropriate remedy was a declaration, binding on the company, that the allotment and issue of the shares was unlawful. That is the remedy which Tianrui now seeks. He held that it followed from the characterisation of the shareholder's claim as a personal right against the company that the other shareholders could not ratify the acts of the directors. Segal J also rejected the argument that a shareholder did not have a personal claim because the shareholder could obtain redress by a derivative action.

25. CSCGL appealed that decision. In a judgment dated 1 July 2022 the Court of Appeal (Goldring P, and Field and Morrison JJA) held that an aggrieved shareholder had no personal right of action against the company for the diminution of his voting power

caused by the issue of shares in breach of a fiduciary duty owed to the company: 2022 (2) CILR 28. The Court of Appeal reasoned that the central question on the appeal was whether a minority shareholder had standing to sue the company in which it held shares in the face of two possible obstacles. The first was that it was trite law that directors owe their fiduciary duties to the company which appoints them and not to its shareholders. The second possible hurdle was the view that the damage suffered as a result of a breach of fiduciary duty by the directors is damage to the company and not to the shareholder whose voting power has been diminished by the issue of new shares.

26. Mr Tom Smith KC advanced on behalf of CSCGL the argument that it was the company that suffered the loss and not the aggrieved shareholder (ie the second obstacle). He relied on dicta in the judgment of Harman LJ in *Bamford v Bamford* [1970] Ch 212 and the judgment of the UK Supreme Court in *Marex Financial Ltd v Sevilleja* [2020] UKSC 31; [2021] AC 39. The Court of Appeal rejected that argument, holding that the shareholder's loss was separate and distinct from any loss suffered by the company. The argument has not been advanced again before the Board.

27. In addressing the first possible obstacle, the Court of Appeal considered several authorities which the Board will consider below. They were *Fraser v Whalley* (1864) 2 H & M 10; *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 ("*Howard Smith*"); *In re a Company (No 005136 of 1986)* [1987] BCLC 82 (aka *In re Sherborne Park Residents Co Ltd* ("*Sherborne Park*")); and the judgment of the Supreme Court of South Australia in *Residues Treatment & Trading Co Ltd v Southern Resources Ltd* (1988) 6 ACLC 1160 ("*Residues*"). The Court accepted Mr Smith's submissions that in *Sherborne Park* Hoffmann J had not explained why the shareholder had a personal right of action, in *Howard Smith* the House of Lords had not discussed how the shareholder could bring a personal claim, and in *Residues* King CJ, while referring to a shareholder's personal right "founded in equity" (p 1165), had failed to provide a principled basis for the conclusion that a shareholder had such a personal right. The Court of Appeal concluded (para 51) that "it remains the law of the Cayman Islands that the postulated aggrieved shareholder has no such personal right of action but must found his claim on a basis that is consistent with the rule in *Foss v Harbottle* or with the fraud on the minority exception to that rule."

3. The issues raised in Tianrui's appeal

28. Tianrui now appeals to the Board against the striking out of its writ which followed upon this ruling.

29. In the Board's view, there are four principal questions that need to be addressed on this appeal. They are:

(i) Bearing in mind that the duty of the directors alleged to have been breached is owed to CSCGL and not to its shareholders, what, if anything, is the shareholder's cause of action?

(ii) What, if any, distinctive aspects of the shareholder's cause of action mean that it may be pursued notwithstanding the rule in *Foss v Harbottle*?

(iii) Was the impugned exercise of the board's power void or voidable?

(iv) Was the alleged breach of duty capable of being ratified by a majority of CSCGL's shareholders? If so, what is the consequence of the theoretical availability of ratification for the pursuit of the shareholder's claim in the meantime?

30. Before addressing the case law relating to a shareholder's personal right of action against a company, the Board summarises the relevant constitutional provisions relating to CSCGL in its memorandum and articles of association and in statute.

4. The relevant provisions of CSCGL's constitution

31. Unless the objects and business of a company are restricted in its memorandum of association, it has power to carry out any object not prohibited by law: Companies Act (2023 rev) ("CA"), section 7(4). When registered, a company's memorandum of association binds the company and its members as if each member had subscribed the memorandum and it contained a covenant on the part of the member, his heirs and administrators to observe all its conditions: CA section 12. Similarly, when registered the articles of association bind the company and its members as if each member had subscribed the articles and it contained a covenant on the part of the member, his heirs and administrators to conform to the regulations contained in the articles: CA section 25. There is, as the Board will explain below, a contract between the company and its members and between its members inter se that the company and its members will observe the conditions of the memorandum and the regulations of the articles of association, but the statutory contract is entered into on terms which are alterable by a 75% majority of the shareholders as vote at a general meeting, through the amendment of those articles by special resolution.

32. Clause 4 of CSCGL's memorandum of association empowers it to issue convertible bonds. CSCGL's amended and restated articles of association dated 16 May 2014, which were effective until 30 May 2019, gave the board power, in article 3.13, to allot or otherwise dispose of its unissued shares and, in article 11.2, to borrow and to grant securities for CSCGL's debts.

33. Tianrui in its statement of claim para 13, pleads that it is an implied term of the articles of association that the exercise of such powers of the board cannot result in the valid issue of securities if the exercise was materially affected by an improper motive or purpose.

5. The prior case law on the standing of the shareholder

34. Underpinning the challenge by CSCGL to the right of Tianrui to bring these proceedings is the so-called "rule in *Foss v Harbottle*" ((1843) 2 Hare 461). This "rule" is made up of two related principles.

35. The first, known as the "proper plaintiff" principle, is that where a wrong has been done to a company only the company, not an individual shareholder, can take action. A breach by a director or by the board of directors of a duty which is owed to the company is a wrong done to the company, and the general rule is that only the company has a remedy for that breach.

36. The second principle, which is known as the "majority rule" principle, is that the will of the majority of the shareholders of the company should, as a general rule, prevail in the running of the company's business. Thus, if a transaction can be made binding on the company by a simple majority of shareholders, and that majority does not want to take action against a director or directors for a breach of duty in relation to it, the majority can, as a general rule, waive the breach or ratify the irregular acts of the director or directors.

37. There is an exception to the operation of these principles where the wrongdoers are guilty of dishonest conduct or attempting to appropriate or have appropriated to themselves property or opportunities to which the company is entitled or in which other shareholders are entitled to participate, and the wrongdoers are themselves in control of the company. In that event, which is often called "fraud on the minority", the aggrieved shareholder or minority may bring a derivative action seeking relief on behalf of the company in whom the cause of action is vested.

38. The "rule" in *Foss v Harbottle* and the exception or exceptions to the "rule" are discussed in many authorities, including *Edwards v Halliwell* [1950] 2 All ER 1064, 1066-1069; and *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, 219-222.

39. The boundaries of the exception or exceptions to the "rule" are ill-defined. In many jurisdictions, the shareholder derivative action has been placed on a statutory basis in order to remove the uncertainties which remain within the common law. For example, in the United Kingdom Part 11 of the Companies Act 2006 has created a statutory derivative

action. The Cayman Islands has preserved the common law rules and the court exercises a degree of control over derivative actions under Order 15, rule 12A of the Grand Court Rules under which, if a defendant in a derivative action has given notice of an intention to defend, the plaintiff must apply to the court for leave to continue the action.

40. The "rule" in *Foss v Harbottle* is only part of the picture. The courts have long recognised that a shareholder has personal rights against a company which it can enforce by a personal action. For example, a shareholder has a personal right to vote on a resolution before a company in general meeting and, when his vote has been improperly rejected at a general meeting, is entitled to an injunction against the implementation of the irregularly obtained resolution: *Pender v Lushington* (1877) 6 Ch D 70, 80-81 per Jessel MR. This right of a shareholder personally to institute proceedings to assert or protect personal rights was the basis of the decision of the Court of Appeal in *Edwards v Halliwell*. In that case, a trade union had purported to increase the regular contributions payable by members without the resolution passed by a two-thirds majority required by the rules. Two members who were threatened with expulsion from the union for failure to pay the increased contributions were held to be entitled to bring proceedings personally for a declaration that the increases were invalid. Jenkins LJ said at p 1067, having discussed the rule in *Foss v Harbottle*:

> "In my judgment, this is a case of a kind which is not even within the general ambit of the rule. It is not a case where what is complained of is a wrong done to the union, a matter in respect of which the cause of action would primarily and properly belong to the union. It is a case in which certain members of a trade union complain that the union, acting through the delegate meeting and the executive council in breach of the rules by which the union and every member of the union are bound, has invaded the individual rights of the complainant members, who are entitled to maintain themselves in full membership with all the rights and privileges appertaining to that status so long as they pay contributions in accordance with the tables of contributions as they stood before the purported alterations of 1943, unless and until the scale of contributions is validly altered by the prescribed majority obtained on a ballot vote. Those rights, these members claim, have been invaded. The gist of the case is that the personal and individual rights of membership of each of them have been invaded by a purported, but invalid, alteration of the tables of contributions. In those circumstances, it seems to me the rule in *Foss v Harbottle* has no application at all, for the individual members who are suing sue, not in the right of the union, but in their own right to protect from invasion their own individual rights as members."

41. By contrast, in other cases, the rights of shareholders are invaded not because the company or its agents have acted contrary to the express terms of the articles of association or other constitutional documents but because the directors, acting as the company's agents, have exercised powers within the letter of their express terms but for improper purposes. All powers conferred on the directors are fiduciary in nature and they are required by equity to exercise such powers for proper purposes. An exercise of a fiduciary power for an improper purpose is a breach of the duty owed by the directors to the company. Although the duty is owed to the company, and not to shareholders personally, shareholders whose personal rights are adversely affected by the directors' exercise of the power have been held in the context of a range of different powers to be entitled to maintain a personal action against the company to remedy the wrong done to them.

42. The House of Lords in a Scottish appeal, *Hindle v John Cotton Ltd* (1919) 56 Sc LR 625, allowed an action by a shareholder against the company to proceed to proof (trial) in which the allegations by the shareholder were that the company's directors had acted in bad faith when, after dismissing him from office as managing director, they purported to exercise a power in the company's articles of association to acquire his shares at their nominal value. In *In Re Smith and Fawcett Ltd* [1942] Ch 304 an executor of a deceased shareholder of a private company, after the directors of the company refused to register him as a shareholder, applied to the court to have the register rectified. The application failed because the plaintiff had not shown that the directors had exercised their fiduciary powers other than in the interests of the company. More recently, in *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71; [2015] Bus LR 1395; [2016] 3 All ER 641, the UK Supreme Court gave a remedy to the beneficial owners of shares, which had asserted a personal right against the company in which they had invested, when the directors of the company had, in breach of their duty to exercise their powers for proper purposes, resolved to issue restriction notices suspending the right to vote at general meeting attached to the shares and to restrict the right to transfer the shares.

43. The issue at the heart of this appeal, namely the juridical basis of the individual shareholder's standing to bring proceedings to challenge the directors' exercise of a power for improper purpose, arose also in those cases. Given that in each case the shareholder's rights were directly affected by the relevant improper decision, they were obvious cases for intervention by the courts, but there still needs to be a proper legal basis - in short, a cause of action. As we discuss later in this judgment, we consider that, as an intrinsic feature of the contract constituted by the memorandum and articles of association, it is implicit that when exercising their powers on behalf of the company the directors will exercise them in accordance with their fiduciary duties, including the duty to exercise powers only for a proper purpose.

44. In each of the cases mentioned, the courts have recognised a shareholder's personal right to bring legal proceedings against the company when the directors act to appropriate the shares or to remove or restrict rights attached to them. The circumstances of this

appeal are different in the sense that it does not involve the removal or restriction of rights attached to shares. The appeal is concerned with the detriment to a shareholder's ability to exercise the proportionate voting power attached to its shares resulting from the allegedly improper allotment and issue of new shares to other parties. It is necessary to look more closely at the case law which is concerned with personal actions by a shareholder against a company which challenge the allotment and issue of new shares because CSCGL submits that the cases do not establish a proper jurisprudential basis for the recognition of such actions.

45. In the Cayman Islands, the courts have not accepted the standing of a shareholder to challenge the allotment and issue of shares to others. As the Board has mentioned in para 24 above, in *Gao* Kawaley J struck out a minority shareholder's action against the company on the ground that the shareholder lacked standing. The Court of Appeal has accepted his reasoning in this case in preference to that of Segal J who accepted that Tianrui had standing.

46. In the United Kingdom, the courts have for a long time recognised the right of a shareholder to challenge the allotment and issue of shares by a company's directors for an improper purpose, such as to alter the voting power of shareholders. In *Fraser v Whalley*, Sir William Page Wood V-C granted an injunction against the directors of a company to prevent them from invoking a prior resolution by shareholders to issue shares, which had been made for a superseded purpose, for another, improper purpose of gaining control of a forthcoming general meeting at which it was likely to be proposed that they be removed as directors. The Vice-Chancellor at p 29 concurred with the principle laid down in *Foss v Harbottle* but stated that the court will intervene when directors "clandestinely and at the last moment use a stale resolution for the express purpose of preventing the free action of the shareholders".

47. In *Punt v Symons & Co Ltd* [1903] 2 Ch 506 Byrne J followed *Fraser v Whalley* in granting an injunction against a company to restrain the holding of a general meeting of the company after the directors had issued shares for the improper purpose of gaining a sufficient majority of votes at that meeting to pass a special resolution to alter the company's articles of association. Byrne J stated (p 517):

> "If I find as I do that shares have been issued under the general and fiduciary power of the directors for the express purpose of acquiring an unfair majority for the purpose of altering the rights of parties under the articles, I think I ought to interfere."

48. Peterson J in *Piercy v S Mills & Co Ltd* [1920] 1 Ch 77 reached a similar decision in an action by a majority shareholder against the company and its directors when he granted a declaration that the allotment of shares which the directors had made for an

improper purpose was invalid and void. In that case, the plaintiff was a manager of the company who had acquired a majority of its shares and wished to use the voting power of those shares at general meeting to appoint himself and his two brothers as directors in face of opposition from the current directors. In response to his requisitioning of a general meeting, the directors on two occasions allotted shares to their friends to destroy his majority and thereby keep control over the management of the company. Referring to *Fraser v Whalley* and *Punt v Symons & Co Ltd* Peterson J stated, at p 84:

> "The basis of both cases is, as I understand, that directors are not entitled to use their powers of issuing shares merely for the purpose of maintaining their control or the control of themselves and their friends over the affairs of the company, or merely for the purpose of defeating the wishes of the existing majority of shareholders."

Holding that the majority shareholders were entitled to have their views prevail in accordance with the company's articles of association, Peterson J granted the declaration invalidating the allotments of the shares.

49. In *Hogg v Cramphorn Ltd* [1967] Ch 254 Buckley J addressed a scheme devised by the directors of a company, acting in good faith in what they believed to be the best interests of the company, to thwart a proposal by an investor from outside the company to acquire its whole share capital. The directors' scheme involved the issue of new preference shares with special voting rights of ten votes per share. Buckley J held that the company's articles of association did not give the directors power to issue shares with enhanced voting rights but recognised that the allottees might elect to accept the shares without the special voting rights attached. He then addressed the wider question of whether the allotment should be set aside, observing that it was common ground that the directors were not motivated by personal advantage but acted in the honest belief that their scheme to prevent the unwanted take-over was for the good of the company. He referred with approval to statements in *Fraser v Whalley*, *Punt v Symons & Co Ltd* and *Piercy v S Mills & Co Ltd* that it was not open to directors to use their power to issue shares in order to interfere with the right of a majority of shareholders to exercise their constitutional rights within the company. Nonetheless, he observed that a majority of the shareholders could have approved the issue of the contested shares and, had it done so, there could have been no force in the argument that the directors were attempting to deprive the majority of their constitutional rights. That being so, a majority in a general meeting of the company at which no votes were cast in respect of the contested shares could ratify the issue of those shares. Buckley J, therefore, rather than setting aside the allotment and issue of the contested shares, gave the company the opportunity in general meeting to decide whether it approved the issue of those shares, with the owners of the contested shares undertaking not to vote at the meeting in respect of those shares. As the report of the decision records, the shareholders thereafter ratified and approved the allotment of the shares, which had equal voting rights.

50. Another example of a personal action by shareholders to challenge an allotment of shares allegedly made for an improper purpose is the judgment of the Court of Appeal in *Bamford v Bamford* [1970] Ch 212. The directors of a public company allotted a significant block of shares in an attempt to block a take-over bid. Two minority shareholders in the company brought a personal action seeking a declaration that the allotment was invalid. In response, the directors gave notice convening a general meeting of the shareholders of the company to consider a resolution ratifying and approving the allotment. The two shareholders then issued a second writ challenging the validity of any resolution passed at the proposed general meeting. In the event, the resolution ratifying the allotment was passed by a substantial majority vote at the general meeting, the allotted shares not being voted. The two actions were consolidated, and a preliminary issue was tried as to whether the allotment was capable of being ratified and approved by a general meeting of the shareholders of the company. Plowman J answered the question in the affirmative, holding that as the allotment had been approved by a majority of the shareholders, it was validated, even if the directors had acted for an improper motive in making the allotment. The Court of Appeal upheld his conclusion, and approved Buckley J's judgment in *Hogg v Cramphorn Ltd*. It held that a majority of shareholders at the general meeting could waive and had waived any impropriety on the part of the directors. The allotment, if initially voidable, had been subsequently validated by the shareholders.

51. Harman LJ regarded the case as being "tolerably plain" (p 237). If the directors, by having regard to the exigencies of the take-over battle had not addressed the single question of the benefit of the company, the allotment would be voidable at the instance of the company because it was a wrong done to the company (p 238). The company in general meeting, which had the right to recall the allotment also had the right to approve it. Russell LJ, who gave the other substantive judgment on the appeal, stated (p 242):

> "It is true that the point before us is not an objection to the proceedings on *Foss v Harbottle* (1843) 2 Hare 461 grounds. But it seems to me to march in step with the principles that underlie the rule in that case. None of the factors that admit exceptions to that rule appear to exist here. The harm done by the assumed improperly-motivated allotment is a harm done to the company, of which only the company can complain. It would be for the company by ordinary resolution to decide whether or not to proceed against the directors for compensation for misfeasance."

The Board will return to this case in its discussion below. It is sufficient now to observe that in *Bamford v Bamford* the alleged wrong was not targeted at a shareholder or group of shareholders but was a wrong which affected all shareholders of the company. Russell LJ's dictum that only the company could complain of the harm done must be read in that context.

52. Before completing this survey of the case law from England and Wales, the Board turns to its judgment in an appeal from the Supreme Court of New South Wales in the well-known case of *Howard Smith*. The appeal concerned a struggle for the takeover of a company ("Millers") in which Howard Smith and Ampol were the rival parties. Another substantial shareholder in Millers, called Bulkships Ltd, was associated with Ampol and together they held about 55% of Millers' issued share capital. Millers needed more capital. The board of Millers recommended that Ampol's offer for the whole share capital of Millers be rejected as too low after Howard Smith had announced its intention to make a higher offer. Ampol and Bulkships announced their intention to act together in the future operations of Millers and to reject any offer for their shares. Howard Smith then applied to Millers for the allotment of 4.5 million shares and the directors of Millers by majority resolved to make the allotment and immediately issued the shares. The effect of the share issue was to give Millers much needed capital and to reduce Ampol's and Bulkships' combined shareholding to 36.6% of Miller's issued shares, thereby enabling Howard Smith to make an effective takeover offer.

53. Ampol brought an action against Howard Smith, Millers, 11 directors of Millers and a company which acted as Millers' registrar. Only Ampol and Howard Smith appeared in the appeal before the Board.

54. The question for the Board was whether the issue of the shares to Howard Smith was valid when the primary object of the directors was to alter the majority shareholding of the issued shares so as to procure the takeover offer by Howard Smith but the directors were not acting for their own personal advantage.

55. Lord Wilberforce, giving the judgment of the Board, stated (p 834) that the issue of the shares by the directors was intra vires but it was a fiduciary power whose exercise could be attacked on the ground that it was not exercised for the purpose for which it was granted. After referring to *Fraser v Whalley*, *Punt v Symons & Co Ltd*, *Piercy v S Mills & Co Ltd*, and *Hogg v Cramphorn Ltd*, which were cases in which the directors acted in their self-interest or at least to preserve their own control of management, he observed that the absence of self-interest is not enough to make a share issue valid and that a wider investigation must be made. He continued (p 837):

> "The purpose found by the judge is simply and solely to dilute the majority voting power held by Ampol and Bulkships so as to enable a then minority of shareholders to sell their shares more advantageously. So far as authority goes, an issue of shares purely for the purpose of creating voting power has repeatedly been condemned … In the leading Australian case of *Mills v Mills*, 60 CLR 150, it was accepted in the High Court that if the purpose of issuing shares was solely to alter the voting power the issue would be invalid. And, though the

> reported decisions, naturally enough, are expressed in terms of their own facts, there are clear considerations of principle which support the trend they establish. The constitution of a limited company normally provides for directors, with powers of management, and shareholders, with defined voting powers having power to appoint the directors, and to take, in general meeting, by majority vote, decisions on matters not reserved for management. Just as it is established that directors, within their management powers, may take decisions against the wishes of the majority of shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office …, so it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company's constitution which is separate from and set against their powers."

56. The Board therefore concluded that the power to allot and issue shares had been improperly exercised by the issue of shares to Howard Smith. The Board upheld Street J's order setting aside the allotment and ordering the rectification of the company's share register.

57. The Board observes, as CSCGL has emphasised on this appeal, that Lord Wilberforce recorded (at p 838) that it was not disputed in that case that Ampol as plaintiff had properly brought the action to set aside the allotment and rectify the register. The Board did not address any challenge to Ampol's standing. By contrast, Tianrui's standing to bring the proceedings in this case is the central issue on this appeal.

58. Returning to jurisprudence in England and Wales, in *Sherborne Park* Hoffmann J explained a jurisprudential basis for a personal action by a shareholder against the improper exercise by directors of the power to allot shares. The reported judgment is an ex tempore judgment in an ex parte application made, in a petition brought under section 459 of the Companies Act 1985, by the petitioner shareholder for an order that he be indemnified in advance by the company for his costs in the petition. The casus belli was a directors' resolution to issue and allot shares in the company alleged to have been motivated by an improper desire by the directors to alter the balance of voting power in the company. Entitlement to a costs indemnity depended upon the claim being properly constituted as a derivative action, rather than as a personal action by the claimant. In refusing the application, Hoffmann J drew a distinction between a derivative action in which a shareholder sues in his own name for a wrong done to the company, such as where the directors misappropriate the company's property, and a personal action for a

wrong done to a shareholder. A writ challenging an abuse by the directors of their fiduciary power in a wrongful share allotment was a personal action. He stated:

> "Although the alleged breach of fiduciary duty by the board is in theory a breach of its duty to the company, the wrong to the company is not the substance of the complaint. The company is not particularly concerned with who its shareholders are. The true basis of the action is an alleged infringement of the petitioner's individual rights as a shareholder. The allotment is alleged to be an improper and unlawful exercise of the powers granted to the board by the articles of association, which constitute a contract between the company and its members. These are fiduciary powers, not to be exercised for an improper purpose, and it is generally speaking improper -
>
> > "for the directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist."
>
> (see *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 All ER 1126 at 1136, [1974] AC 821 at 837). An abuse of these powers is an infringement of a member's contractual rights under the articles."

59. Turning to Australian jurisprudence, in *Mills v Mills* (1938) 60 CLR 150, which Lord Wilberforce cited in *Howard Smith*, the High Court of Australia addressed what was in substance a dispute in a family company between two directors, one of whom was the managing director, and the other, his nephew. The uncle's interest was mainly in ordinary shares which carried one vote per share, while the nephew's interest was mainly in preference shares which carried three votes per share. The nephew challenged the resolution of the directors to issue new ordinary fully paid up shares to the holders of ordinary shares. No new shares were issued to the holders of preference shares. This share issue not only altered the balance of voting power of the shareholders in favour of the holders of ordinary shares but also improved the position of ordinary shareholders if a winding up should take place as the preference shares ranked equally with the ordinary shares. The nephew and two other shareholders brought an action on their own behalf and on behalf of the shareholders of the company against the company, the uncle and another director seeking a declaration that the share issue was invalid. The action failed as it was not established that the resolution of the directors was passed in bad faith; the mere fact that the uncle derived some benefit from the passing of the resolution was not sufficient ground for invalidating the share issue when it was not established that the resolution was passed for an improper purpose.

60. The High Court of Australia rejected a challenge to the right of minority shareholders to seek an order invalidating the exercise by directors of their fiduciary power to allot shares in *Ngurli Ltd v McCann* (1953) 90 CLR 425 ("*Ngurli*"). The case involved identical transactions in four companies. Simplifying the facts, shares were issued at par for the improper purpose of giving a director and shareholder controlling voting power at meetings of a company and no shares were issued to minority shareholders. The judge at first instance, Mayo J, held that there had been a breach of fiduciary duty by the controlling director but that the wrong had been done to the company and it alone was the proper plaintiff. The Supreme Court of South Australia set aside his order and declared that the allotment and issue of the shares were invalid. The High Court (Williams ACJ, Fullagar and Kitto JJ) dismissed an appeal against that order. They held (p 447) that the controlling director in failing to take into account the interests of the minority shareholders when deciding to issue the new shares had acted in breach of his fiduciary duty to consider the interests of the company as a whole and that in those circumstances "the plaintiffs have a clear right to sue in their own names to remedy the breach of trust."

61. The Supreme Court of South Australia rejected a similar challenge to the standing of a minority shareholder to seek an order invalidating the allotment of shares by directors of a company for an allegedly improper purpose in *Residues*, to which the Board has referred in para 27 above. In the leading judgment of King CJ, with whom Matheson J agreed, the court recognised that the exercise by directors of a power to allot shares for an improper purpose was a breach of their fiduciary duty to the company and that such an allotment was voidable "in the sense that it is valid unless and until disavowed by the company in general meeting or declared invalid by a court in a properly constituted action" (p 1163). The court recognised that to establish standing the statement of claim must raise a cause of action based upon an infringement of the plaintiff's personal rights. King CJ referred to several cases in which a shareholder had successfully challenged allotments of shares made by directors for an improper purpose, including *Ngurli*, *Howard Smith*, and *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285. The cases, he stated, contained "strong indications … of the recognition of a personal right in a shareholder to be protected against dilution of his voting rights in the company by improper action on the part of the directors." He considered that the principle applied not only to an improper allotment that converted a majority into a minority but also to an improper allotment which "reduces the aggrieved shareholder's voice in the company." (p 1164)

62. King CJ explained the jurisprudential basis for the personal right in these terms (p 1165):

> "The personal right of a shareholder to which I refer is founded, in my opinion, upon general equitable considerations referred to in the cases cited above arising out of membership of a body whose management is in the hands of directors having fiduciary

> obligations. It is fortified by the nature of the contract between the company and the members constituted by the memorandum and articles of association and given statutory force by section 78(1) of the Companies Code. I do not mean that the relevant right of a shareholder is founded in contract or that his remedies for infringement are remedies for breach of contract. The shareholder's right is founded in equity and is a right to have the say in the company which accrues to him by virtue of the voting rights which are attached to his shares by his contract with the company, preserved against improper actions by the company or the directors who manage its affairs."

The improper allotment of shares which diminished a shareholder's effective voting power was "a wrong done to the shareholder by the company acting through its agents" and therefore the rule in *Foss v Harbottle* did not apply. He drew support for his conclusion from Hoffmann J's judgment in *Sherborne Park*.

63. King CJ expressed the view that any potential for ratification of the exercise of the power at general meeting would not deprive the plaintiff of standing while the infringement exists. The Board addresses the Company's argument on the potential for ratification in paras 80 – 84 below.

64. Bollen J in a short judgment concurred and referred to Hoffmann J's "carefully considered dicta" in *Sherborne Park* as giving strong support for his conclusion (p 1168).

6. The legal basis of the shareholder's personal action

65. The series of English and Australian cases reviewed above shows that courts, applying principles of company law which are not materially different to those in force in the Cayman Islands, have repeatedly recognised the right of one or more shareholders of a company to bring a personal action in their own names against the company (rather than a derivative action on behalf of the company) by way of challenge to the validity of an allotment of shares made on behalf of the company by its directors, based upon the allegation that the directors acted for an improper purpose. In only one (Australian) case, the *Residues* case, has a challenge to the shareholders' standing been addressed and rejected with principled reasons for doing so. Yet in two Cayman cases, *Gao* and the decision of the Court of Appeal in this case, that right to bring such an action has been asserted but denied. At the heart of each of those decisions was the reasoning that shareholders could not bring a claim in their own right in respect of a breach of fiduciary duty owed by the directors solely to the company. The company was the only proper claimant, and shareholders could only assert the company's claim by way of a derivative

action, where the law permitted such an action to be brought and where leave of the court to do so was obtained in accordance with the rules.

66. The Board's opinion is that *Gao* was wrongly decided, and that the Court of Appeal was wrong to follow it in the present case. A shareholder whose holding is diluted by an improper allotment of shares by the directors may bring a personal claim against the company challenging the validity of that allotment, although in certain circumstances (not applicable here) the claim may be defeated by ratification of the allotment by a majority of the shareholders (other than the allottees) at a general meeting. Since the Board does not entirely agree with the reasoning of King CJ in the *Residues* case for reaching that conclusion, the Board will set out its own reasons. They require the matter to be approached from first principles.

67. The registration of a person as a shareholder in a company brings with it a bundle of rights. Subject to any special class rights or restrictions, the rights include a proportionate share in the distributed profits of the company and in any distribution of capital. The value per share of the shareholding will follow the fortunes of the company. That which benefits or harms the company will correspondingly increase or reduce the value of the shares.

68. Subject again to any class restrictions, shares will carry the right to attend and vote at general meetings of the company, and thereby play a part in the exercise of the shareholders' collective power to influence or control the general direction of its affairs. The active power of a shareholder is critically dependent upon the proportion which the shares (of an individual shareholder or group of shareholders acting together) bear to the shares in the company (or the relevant class) as a whole. In companies which are controlled by the majority vote of ordinary shareholders, the possession of a majority of the shares confers control (critically through the power to appoint and remove directors), while possession of more than 25% of the shares confers what is sometimes called negative control, through the ability to block certain steps requiring a special resolution, including the power to alter the articles of association. The value per share of such a block is critically sensitive to dilution, where in particular its percentage falls below 50% or 25% of the whole. The exercise of (or ability to exercise) those rights by individual shareholders or groups of shareholders is how power over the company's affairs is maintained, and dilution of those shareholding proportions by the allotment and issue of new shares may critically affect the balance of power between shareholders.

69. The power to issue shares is conferred upon CSCGL by its memorandum of association, but the power to cause the company to allot and issue shares is conferred upon the directors, acting as fiduciaries, by the articles of association. The power is therefore necessarily a fiduciary power and must therefore only be exercised for proper purposes. The proper purposes for the exercise of the power to allot and issue shares include the raising of new capital where that is genuinely considered by the directors to

be in the best interests of the company, but there can be other legitimate purposes. No part of those proper purposes includes deliberately altering the balance of power between shareholders. But, of course, an allotment and issue of new shares will frequently have that effect, save where the allotment is made to, and taken up by, all existing shareholders in strict proportion to their existing holdings. Equally, an allotment to the whole of one class of shareholders may alter that balance of power, as is illustrated by the facts of *Mills v Mills*, as explained by Latham CJ at pp 159-160.

70. The conferment upon the directors of that fiduciary power to allot and issue shares is an important part of the contract between shareholders and the company, constituted by its memorandum and articles: see sections 12 and 25 of the Companies Act (para 31 above). The inevitable consequence of the conferral of a power upon fiduciaries is that it must be exercised for proper purposes: see again *Mills v Mills,* per Dixon J, at pp 185-186, followed in *Howard Smith* at pp 835-836 and more recently *Eclairs*, at paras 15ff. Where such a power is conferred by the articles upon fiduciaries, this constraint upon its exercise is as much a part of that corporate contract as if it had been spelt out word for word in the articles. It is a term of the corporate contract that, if the exercise of the power to allot and issue new shares by the directors as agents for the company is to be valid and binding as between the individual shareholder and the company, it should comply with all conditions necessary to make it a proper exercise. These include compliance with the directors' fiduciary duty owed to the company. This is a constraint implied by law as inherent in the relationship between the shareholder and the company.

71. It is not, of course, any part of the corporate contract that a shareholder's holding will not be diluted, or that nothing will be done by the directors which alters the balance of power between shareholders. The Board may for example perfectly legitimately decide to issue shares for proper business purposes to new shareholders and that issue, while diluting all existing shareholders' holdings in equal proportions, incidentally alters the balance of power by depriving a shareholder or group of majority control, or of negative control. But it is part of the corporate contract that, if this is to happen, it is done only by a proper exercise of the power, ie one that is exercised bona fide for the benefit of the company as a whole and exercised for the purposes for which the power was conferred. This will necessarily exclude, for example, an allotment and issue of shares which is deliberately aimed at altering the balance of power between shareholders, so as to advance the power of one (or one group) at the expense of another.

72. This is, in the Board's view, the basis of the shareholder's right to bring an action against the company to challenge an improper exercise of the directors' power to allot and issue shares. It is implicit in the contract constituted by the articles of association that the company's power to allot and issue new shares, delegated by the articles to the directors, will be exercised properly, which is to say by the directors on behalf of the company in accordance with their fiduciary duties. The harmful consequence to the shareholder is the alteration (adverse to him) in the balance of power between the company's shareholders and the particular harm which that does to the value of the rights

embedded in his shares. It is an actionable harm because the impropriety in the exercise of the power contravenes the corporate contract binding him and the company, even though the relevant fiduciary duty breached by the directors is not owed to him.

73. It is precisely in the identification of the corporate contract as the basis of the shareholder's claim against the company that the Board respectfully differs from the otherwise compelling reasoning of King CJ in the *Residues* case in the quotation in para 62 above.

74. It is correct to say that the constraint which requires the directors to exercise their power to allot and issue shares only for proper purposes is of equitable origin, because it is an aspect of the conduct which equity requires of directors as fiduciaries. This is for example the reason why the exercise of the directors' power to allot and issue shares is only rendered voidable (rather than void) by an equitable impropriety in its exercise, and why a challenge to its exercise may be ineffective against a bona fide purchaser of the issued shares without notice of the impropriety: see again *Residues*, at pp 1162-1163. But the Board does not consider that the breach of an equitable restraint upon the exercise of a power gives rise automatically and without more to an equity to set it aside enjoyed by someone, such as a shareholder, who is neither the donor nor the beneficiary of the power. What gives the shareholder that right is the corporate contract binding between the shareholder and the company, in which this right not to have his say in the company adversely affected by an improper exercise of the power is embedded.

75. In that respect the Board prefers the analysis of Hoffmann J in *Sherborne Park* which the Board has quoted in para 58 above. Although this was an ex tempore judgment refusing an ex parte application for a costs indemnity at the outset of an unfair prejudice petition, it is nonetheless compelling and consistent with principle. It chimes with Lord Wilberforce's emphasis in *Howard Smith* on the contractual constitution of a company in the passage which the Board has set out in para 55 above. The Board agrees with Hoffmann J's pithy analysis of the essential nature of the shareholder's personal action to challenge an improper allotment and issue of shares by directors. Although the action is founded upon the fact of the commission of a breach of fiduciary duty by the directors, the cause of action is that the contract between the shareholder and the company contains the implied term that, in exercising the power to allot and issue shares, the directors as the company's agents will do so in accordance with their fiduciary duties.

76. In the Board's view this term falls to be implied into the contract between the shareholder and the company and between the shareholders inter se and it arises out of the nature of the contractual constitution of the company. It is a term which is implied as a result of the nature of the contract and the relationship thereby created between the parties to that contract. This involves implication in the sense that the House of Lords discussed in *Liverpool City Council v Irwin* [1977] AC 239, see especially Lord Wilberforce at p 254 and Lord Fraser of Tullybelton at p 270. It is a necessary legal

incident of the relationship between a shareholder and a company, and between the shareholders inter se.

77. The Board would add that the right of the shareholder to sue the company is not dependent upon the alteration in the balance of power being adverse only to a minority of shareholders (although it was on the assumed facts of this case). Directors may seek deliberately to deprive a single existing shareholder (or group) of majority control by allotting shares to a favoured outsider. That is what happened in *Howard Smith,* but the claimant, which was one of a pair of shareholders which together held 55% of the company's shares, nonetheless succeeded. There the majority were determined to resist a take-over bid, and the directors improperly allotted sufficient shares to the bidder to destroy that majority, so as to facilitate the bid. In both *Hogg v Cramphorn Ltd* and *Bamford* v *Bamford* the directors feared that the majority would succumb to an unwelcome take-over bid. In neither case did this render the shareholders' personal actions improperly constituted. As explained below, the claimants ultimately failed in both cases because the improper issue and allotment of shares by the directors was ratified in general meeting.

78. Nor by contrast is the personal right to sue dependent upon the claiming shareholders being, or being part of, a majority, as was submitted by Mr Smith, even though that was in fact the position in a number of the cases where a personal claim succeeded. The Board considers that the size of the claimant's shareholding is in principle irrelevant. The Board agrees with the following extract from the judgment of Barwick CJ in *Ashburton Oil NL v Alpha Minerals NL* (1971) 123 CLR 614 ("*Ashburton*") at p 620:

> "The remaining basis of the appellants' claim was that their majority shareholding itself gave them a right to relief in each action which they had commenced. But, in my opinion, the extent of that shareholding in itself gave the appellants no equity to any of the relief sought in either action. Of course, that shareholding because of its extent might enable the appellants to carry resolutions at general meetings of the company, but always subject to the absence of any relevant oppression of the minority. Though the appellants have the equity of a shareholder to which I have referred, they have, in my opinion, no greater and no differing right because their shareholding is a numerical majority of the issued shares of the company."

What matters is that the claiming shareholder, together in an appropriate case with those other shareholders he claims to represent, have suffered from an interference with their rights as shareholders brought about by the improper issue and allotment.

79. It is also in principle irrelevant whether or not the company itself has a cause of action against the directors for the breach of the fiduciary duty owed to it. Usually it will, because the right of the beneficiary to challenge the improper exercise of a fiduciary power, and to seek to set aside the resulting transaction, is not dependent upon proof of loss or damage. To that extent, if the dicta of Hoffmann J in *Sherborne Park* might be thought to suggest that the two types of action are mutually exclusive, the Board respectfully disagrees, even if they may have been on the facts of that case. The Board agrees with the analysis of Professor Gower in his *Principles of Company Law*, 4th ed (1979) at pp 653-654 that a shareholder's action against the company may coexist with an action by the company in respect of the same breach of duty by the directors, so that the availability of the latter by no means excludes the former.

80. A major plank in Mr Smith's submissions was that one thing which prohibited a shareholder's action against the company was the ever-present theoretical possibility that the offending exercise of power by the directors could be ratified by the members in general meeting. The Board has already acknowledged that, in certain circumstances, ratification may defeat the shareholder's personal claim. It is necessary again to start from first principles. The shareholders of a solvent company may, acting unanimously, ratify any action taken by the directors which falls within the corporate capacity of the company itself. The thing done becomes the act of the company: see *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258.

81. But if the shareholders seek to use their power to act by a majority, then they are constrained by the equitable principle that they may not do so by way of oppression of the dissenting minority: see *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656, Lindley MR at pp 671-672; *Cook v Deeks* [1916] 1 AC 554, Lord Buckmaster LC at pp 563-565; *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, Evershed MR at p 291; *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 ("*Peters*"), Latham CJ at pp 480-482; *Ashburton*, Barwick CJ at p 620. That constraint is inherent in the power of the majority of a class to bind the minority. Whether it is actionable by the minority having a mere equity of their own to set the majority action aside, or because that constraint is also embedded in the corporate contract, may be a matter for debate, but it makes no practical difference for present purposes.

82. There have been, and will always be, cases where a personal claim by a shareholder may be defeated by ratification, both before and after proceedings have been begun or even tried. *Hogg v Cramphorn Ltd* and *Bamford v Bamford* are well known examples of such cases. In the former the allotment by the directors was ratified at a general meeting held after the case had been tried and judgment given in the claimant's favour, during an adjournment granted for the purpose, before any final order was made. In *Bamford* the impugned allotment had been ratified shortly after the issue of the writ challenging the allotment. The ratification was then challenged by a second writ, and the two were consolidated and heard together. In neither case was the ratification held to have involved oppression of a minority. In such cases (unless ratification has occurred before the

commencement of proceedings) it may be said that the shareholder has a defeasible claim, but it will rarely be open to the company to say that the claim is demurrable merely because of the theoretical possibility of ratification in the future. The court may well stay a claim as a matter of good case management (as in *Hogg v Cramphorn Ltd*) to see whether ratification occurs.

83. There will also be cases where the nature of the breach of duty by the directors is such that ratification will be seen to be impossible, either because it has been attempted without success or because any attempt in the future would be bound to fail. For example, a breach constituted by the directors having the improper purpose of assisting an existing majority to oppress a minority could hardly be ratified by the majority, without itself falling foul of the constraint against majority oppression: see in *Residues* at p 1167, King CJ's doubt whether the share allotment in that case could be ratified. As Dixon J explained in *Peters,* pp 504ff and especially pp 511-513, the power of the shareholders in general meeting to alter the articles of association must be exercised in a manner which is both within the power and consistent with the contemplated purpose of the power.

84. No part of this analysis supports Mr Smith's submission that the mere theoretical possibility of ratification is sufficient to deprive the claimant shareholder of a cause of action. If that were so, then there would have been no need for a trial in *Hogg v Cramphorn Ltd,* still less an adjournment to see whether ratification would succeed. Nor, in *Bamford*, would there have been any need for a second writ. The possibility of ratification would have been enough to defeat the claim made by the first writ.

7. The Law Applied to the Assumed Facts

85. The Board regards this as a strong case, on the assumed facts, for the availability of a personal shareholder's action, such as is pursued by Tianrui's writ. It is alleged that the disputed share issue was allotted to outsiders who were acting in concert with the majority shareholder group and the directors to consolidate their control over CSCGL, and that the allotment was ratified by the same majority in general meeting. The effect of the dilution of Tianrui's shareholding was to deprive it of negative control of CSCGL. It was an interference with Tianrui's rights as shareholder to have a say in the collective control of CSCGL's affairs by the shareholders.

86. It is plain that, if the assumed facts are proved to be true, the directors acted for an improper purpose in the issue and allotment of the disputed shares, and that the purported ratification of their actions was itself vitiated by the intent of the majority to oppress Tianrui as a minority shareholder. It is equally plain, if the assumed concert party between the majority and the recipients of the shares is proved, that the recipients, once identified by discovery and joined as defendants, would be unlikely to be able to resist the setting

aside of the allotments on the basis that they are bona fide purchasers without notice of the impropriety.

8. Conclusion

87. It follows that the writ should not have been struck out by the Court of Appeal. The Board will therefore humbly advise His Majesty that this appeal be allowed.