Bond Law Review

Volume 1 | Issue 1 Article 8

5-1-1989

Destiny of Company's Affairs : In Whose Control?

Kwai-Lian Liew
Bond University

Follow this and additional works at: http://epublications.bond.edu.au/blr

Recommended Citation
Liew, Kwai-Lian (1989) "Destiny of Company's Affairs : In Whose Control?," *Bond Law Review*: Vol. 1: Iss. 1, Article 8.
Available at: http://epublications.bond.edu.au/blr/vol1/iss1/8

This Commentary is brought to you by the Faculty of Law at ePublications@bond. It has been accepted for inclusion in Bond Law Review by an authorized administrator of ePublications@bond. For more information, please contact Bond University's Repository Coordinator.

Destiny of Company's Affairs : In Whose Control?

Abstract
This note examines the recent case of Paringa Mining & Exploration Co PLC v North Flinders Mines Ltd (hereinafter referred to as 'Paringa's case') which had shaken, at least at first instance, that respectable line of authority in company affairs. It is a case which has been of considerable interest not only to those concerned but also to those in the legal community at large.

Keywords
Paringa v North Flinders, companies, management, authority

This commentary is available in Bond Law Review: http://epublications.bond.edu.au/blr/vol1/iss1/8

DESTINY OF COMPANY'S AFFAIRS—IN WHOSE CONTROL?

Kwai-Lian Liew
Assistant Professor of Law,
Bond University.

Introduction

It is trite law that directors, delegated to manage the affairs of the company, must act 'in the best interests of the company'. As early as 1899, Lord Lindley in *Laguna Nitrate Co v Laguna Syndicate*[1] had opined that:

> As directors, I am not aware that there is any difference between their legal and their equitable duties. If directors act within their powers, if they act with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly *for the benefit of the company they represent* (my emphasis), they discharge both their equitable as well as their legal duty to the company.

His Lordship did not, however, elucidate precisely what he meant by 'for the benefit of the company they represent'. Who is 'the company'? Who can make the ultimate decision with regard to what is in the best interests of the company? Should the Court take an active part, if at all, in making this decision?

There is a line of authority, of which *Isle of Wight Rly Co v Tahourdin*[2] and *Harben V Phillips*[3] are just two examples, which stands for the proposition that the courts are extremely reluctant to interfere with the management of internal affairs of a company. The general view is that it is for the board of directors to establish corporate objectives, strategies and policies and generally carry out the managerial activities of the company. If shareholders are not satisfied that the powers granted to the directors have been exercised in their best interests, they can interfere by calling a general meeting.

This note examines the recent case of *Paringa Mining & Exploration Co PLC v North Flinders Mines Ltd*[4] (hereinafter referred to as *'Paringa's* case') which had shaken, at least at first instance, that respectable line

1 (1899) 2 Ch 392, 435.
2 (1883) 25 Ch D 320.
3 (1883) 23 Ch 14.
4 Unreported judgment No 1149 of the Supreme Court of South Australia, delivered on 24 November 1988. This case involved a number of issues including one in which the plaintiff successfully obtained, inter alia, special leave to appeal from a decision of a single judge of the Supreme Court to the Full Court of the High Court: see *Paringa Mining & Exploration Co PLC v North Flinders Mines Ltd* (1988) 62 ALR 852.

Published by ePublications@bond, 1989

of authority. It is a case which has been of considerable interest not only to those concerned but also to those in the legal community at large.

Paringa v North Flinders

In *Paringa's* case, the Full Court of the Supreme Court of South Australia reversed the decision of the judge at first instance and reinforced the long established principle that the ultimate power of control of a company reposes in the general meeting of members of that company. It was further held that members are entitled not only to a lawfully requisitioned general meeting, but also to decide at that meeting whether or not the directors are acting in their best interests and, should they so wish, to remove the directors from office—notwithstanding that litigation was in progress between the directors and those same members. Moreover, all three judges of the Full Court agreed that the court would only in exceptional circumstances interfere with the internal management of a company's affairs.

The decision in Paringa is consistent with the words of Lord Wilberforce in *Howard Smith Ltd v Ampol Petroleum Ltd*,[5] where His Lordship said that directors, within their management powers, may make decisions against the wishes of the majority of shareholders who cannot control them in the exercise of those powers *while they remain in office.* The articles of association of the company usually provide that the management of the company's business be delegated to the board of directors, who are to act bona fide in the interests of the company. It would be extremely difficult if not impractical on a day-to-day basis to have those powers fettered constantly by reference to the directions and opinions of members who may or may not have the necessary experience and expertise to know what are in the best interests of the company as a whole. They are, however, entitled to decide whether or not to ratify a certain decision of the directors and, if they so wish, to remove those directors from office by a simple majority.[6] If shareholders, in whose best interests the directors claim they are acting, decide, in a manner recognised by law, that they do not consider the directors' plans and actions are in their interests and therefore should not be implemented, the directors cannot complain. Nor can any fault be found with them for they have merely performed their duty as directors of the company, representatives of the shareholders and custodians of their interests.

Factual background

The plaintiff, Paringa Mining & Exploration Company PLC ('Paringa'), a corporation incorporated in the United Kingdom, held 49.59% of the shares in the defendant company, North Flinders Mines Ltd ('North Flinders'), a listed company incorporated in the State of South Australia. Paringa therefore had effective control of North Flinders. Both are mining companies. The plaintiff's case is that the defendant directors of North Flinders were, on 19 September 1988 and in the events leading up to that date, in breach of their fiduciary obligation by failing to act in the

5 [1914] AC 821, 837.

6 See , for example, *John Shaw & Sons Ltd v Shaw* [1935] 2 KB 113; *Scott v Scott* [1943] 1 All ER 582.

best interests of the company and had contravened s 229 of the Companies (South Australia) Code (the 'Companies Code').

On 19 September 1988, the defendant directors resolved to implement a three-part proposal consisting of:—

(1) a Part C offer[7] by North Flinders for all the fully paid ordinary 10 cent shares in a listed public company called Australian Development Ltd ('ADL') for $2.75 per share, the offer to remain open for one month;

(2) in order to fund the offer, a non-renounceable share rights issue to shareholders of North Flinders consisting of the issue of two shares at $5.50 each with two attaching options at $1.00 each;

(3) a Part A offer[8] by North Flinders for all the issued capital of Paringa for two North Flinders shares for every seven Paringa shares, conditional on 51% acceptance.

(This three-part proposal shall hereinafter be referred to as 'the scheme'.)

Prior to 19 September 1988, on 9 September 1988, Paringa itself had undergone a change in shareholding. This occurred following an agreement between The Australian Gas Light Company ('AGL') and a group which, for ease of reference, is called 'The Hartogen Group' whereby AGL sold to The Hartogen Group its controlling interests in Paringa whose main asset was its majority shareholding in North Flinders. The new controllers of Paringa on 9 September 1988 requested certain changes from the board of North Flinders with regard to the composition of that board. This request, if acceded to, would have given control of North Flinders to Paringa.

Instead of dealing with Paringa's request, the directors passed the resolutions regarding the scheme, a scheme of which Paringa had no prior notice. On the same day, Paringa requisitioned a meeting of members pursuant to s 241 of the Companies Code to consider resolutions to reconstitute the board of North Flinders. The Code permits a maximum period of two months during which the board must convene the meeting. The board resolved that the meeting would be held on 18 November 1988, the last day permitted by the Code.[9]

On 23 September 1988, Paringa commenced proceedings in the Supreme Court of South Australia challenging the actions and the proposed scheme of North Flinders and its directors and seeking, inter alia, injunctions to

7 There is a general prohibition in the Companies (Acquisition of Shares) Code (the 'Takeovers Code') on acquisitions of shares beyond the 20% threshold (s 11). This prohibition does not apply to what is sometimes called an 'on-market bid' under s 17 of the Takeovers Code. This on-market bid is preceded by a takeover announcement which, in short, binds the bidder to buy, for a period of one month and at a specified price, all shares offered. Commercially, no sensible company would make a Part C offer for a company which had a majority shareholder unless the offeror company was certain in its own mind that the majority shareholder would accept the offer; otherwise the offeror company may be locked into the target company shareholding for which it has paid too much and which it does not have the ability to control.

8 Again, the general prohibition under s 11 of the Takeovers Code does not apply to acceptance of offers made under a takeover scheme (s 16). To qualify for the exemption, the offerer must make an offer to each person holding shares in the class of shares being acquired. Under the Takeovers Code, the offeror is required to serve a Part A statement (s 18) on the target company, together with a copy of the proposed offer.

9 By then, the scheme, if uninterrupted, would have been implemented.

restrain the implementation of the scheme.[10] Paringa contended that the price offered for ADL shares was too high and that the main purpose of the scheme was to dilute its shareholding and thus control of Paringa in North Flinders.[11] The hearing of the action commenced on 11 October 1988 before Legoe J. On 7 November 1988, during the trial, North Flinders sought and succeeded in obtaining an order from Legoe J postponing the extraordinary general meeting of North Flinders convened for 18 November 1988. Paringa appealed against that order.

The hearing of the appeal before the Full Court took place on 24 November 1988 and an ex tempore judgment was given. King CJ gave the primary judgment with which both White and O'Loughlin JJ concurred.

Shareholders' right to general meetings

The Chief Justice did not doubt the Court's power to postpone transactions of business at a meeting by way of interlocutory order or to direct the adjournment of the meeting if:

(1) the exercise of that power is necessary to protect the rights of the parties pending the outcome of litigation before the Court; and

(2) it is otherwise fair and just to those parties and to any other parties who might be affected by the exercise of that power.

The main issue, said His Honour, was whether legal grounds existed before the Court to necessitate the exercise of its power.

Counsel for North Flinders proferred two grounds in support of Legoe J's order:

(1) It was argued that, but for the fact that North Flinders had been restrained by injunction from implementing its takeover and rights issue scheme, the board of North Flinders would have had almost two months from receiving the notice of requisition within which to implement the scheme before the requisitioned meeting. The combination of the injunctions and the length of the trial[12] had seriously altered the status quo to the threatened serious detriment of North Flinders. Thus, it was argued, to permit the hearing to proceed would be unfairly detrimental to the rights and interests of North Flinders pending the outcome of the trial.

(2) It was further argued that the order granted by Legoe J merely preserved the subject matter of the litigation (viz the right of the directors to proceed with the implementation of the

10 After some vicissitudes, Paringa's application for injunctions was successful: see *Paringa Mining & Exploration Co PLC v North Flinders Mines Ltd* (1988) 62 ALR 852.

11 The effect of the non-renounceable rights issue is as follows: if Paringa as the majority shareholder took all of the shares and options offered (in order to remain in control) it would have had to expend $80 million. If, on the other hand, it took none of the shares offered and the other shareholders took their entitlement, the percentage holding of Paringa would have been reduced to 37% on the allotment of the shares and to 29% on the exercise of the options.

12 At that stage, the trial was into its seventh week and was in fact continuing without disturbance during the hearing of this appeal.

scheme) pending the outcome of the trial with no detriment to Paringa.

This second ground of argument was quickly dismissed by the Chief Justice as 'a variant'[13] of the first argument and carried no substance. His Honour pointed out that the purpose of the litigation was to prevent the board of North Flinders from implementing the scheme which, Paringa alleged, was made for improper purposes. There was, therefore, no reason why the existence of the litigation should entitle the directors, who were themselves defendants in the action, to frustrate the right of the controlling shareholders to exercise its voting power at a general meeting—notwithstanding that the controlling shareholder was the plaintiff in the action, that it disapproved of the actions of the board, and that it wished to exercise its voting power for the purpose of electing new directors, the effect of which would be the abortion of the scheme.

In relation to the first argument, King CJ said:

> The injunction against North Flinders was granted to preserve the status quo, pending a decision of the action. If its incidental effect is to deprive the directors of time which they would otherwise have had to implement their plans against the wishes of the controlling shareholder, no wrong or injustice is thereby done to them, nor is there any infringement of their legal rights, still less does the injunction cause any wrong or injustice to or infringe the legal rights of the company, the controlling shareholder of which was opposed to the implementation of the directors' plan.[14]

King CJ noted further that s 241 of the Code requires the directors to 'forthwith' convene the meeting and the purpose of the two-month period is to allow the machinery of convening the meeting, such as the sending out of notices to shareholders, to take place. To appoint the last permissible day allowed so that the scheme could be implemented prior to the meeting, against the expressed wishes of its controlling shareholder, was therefore not a proper use of the two-month period and was an improper exercise of the directors' power under the Code.

Legoe J, in making the order to postpone the meeting, considered that he was merely preserving the status quo in the circumstances pending the outcome of the trial.[15] His Honour referred to a passage in the judgment of Lord Diplock in *Garden Cottage Foods Ltd v Milk Marketing Board*[16] where His Lordship made the following observation:

> In my opinion, the relevant status quo to which reference was made in the American Cyanamid Case is the state of affairs existing during the period immediately preceding the issue of the writ claiming the permanent injunction or, if there be unreasonable delay between the issue of the writ and the motion for an interlocutory injunction, the period immediately preceding the motion.[17]

According to Legoe J, the relevant status quo that had to be preserved was the period immediately prior to the application for an ex parte interim injunction. At that stage, the board of North Flinders had passed the impugned resolutions and, until restrained, would have proceeded with the implementation of the scheme until expiry or completion or

13 Ibid 9.
14 Ibid 8.
15 *Paringa Mining & Exploration Company PLC v North Flinders Mines Ltd*, unreported judgment No 1141, delivered on 23 November1988, Supreme Court of South Australia.
16 [1983] 2 All ER 770.
17 Ibid 774.

until the board withdrew the same within the permissible grounds of the Code.

On appeal, King CJ was of the opinion that, in deferring the requisitioned meeting and thereby denying Paringa the opportunity to exercise its legal right, forcing it to pursue legal action in order to bring about a result which it might otherwise be able to achieve indirectly by the exercise of its legal right at a general meeting, Legoe J was not protecting or preserving the status quo but rather disturbing it in radical respects.[18]

Given that Paringa was legally entitled under s 241 of the Companies Code to requisition a general meeting and had a clear right to exercise its voting power in the meeting to determine whether or not the actions of the directors could be implemented, it is a rather curious argument to say that the meeting must be postponed so that the subject matter of the litigation can be preserved. The directors had no legal right to have the position preserved pending the outcome of the trial. Further, the shareholders' statutory powers under the Companies Code and under the articles of the company would be denied if the meeting was postponed. These rights are independent of any dispute between Paringa as a shareholder of North Flinders and North Flinders itself as a company.

Court not to interfere with internal management of company

Another principle that has been reaffirmed by the South Australian Supreme Court in *Paringa* is the principle 'that the Court will not interfere with the internal management of a company except in so far as is necessary to prevent illegality or oppression or to secure the interests of justice'.[19]

This well established principle laid down clearly in *Hogg v Cramphorn*[20] was, curiously, overlooked by the Court of first instance. In that case, Buckley J said:

> Unless a majority in a company is acting oppressively towards the minority, the Court should not and will not itself interfere with the exercise by the majority of its constitutional rights or embark upon an enquiry into the respective merits of the views held or policies favoured by the majority and the minority.

This view was echoed by Street J (as he then was) in *Dominion Mining NL v Hill:*[21]

18 It is submitted that the difference between the opinions of the judges impinged largely on the fact that Legoe J did not take the view that the application by North Flinders to postpone the meeting was in the nature of an injunction whereas King CJ was of the view that it was. White and O'Loughlin JJ also proceeded on the basis that it was. The fact that it was an application for a mandatory injunction—ordering the Chairman of North Flinders to postpone the meeting—meant that the relevant status quo that was sought to be preserved would have included interlocutory orders made by consent by the Full Court on 31 October 1988 with the general meeting convened for 18 November 1988.

19 Ibid 112 per King CJ. See also *Hogg v Cramphorn* (1967) 1 Ch 254; *Dominion Mining N L v Hill* (1971) CLC 27-218; *Dominion Mining NL v Larbalastier* (1971) CLC 40-028; *Harben v Phillips* (1883) 23 Ch 14.

20 See above n 19 at 268.

21 See above n 19 at 27-219.

> The Court should not be astute to frustrate attempts by a large number of members holding a large proportion of shares in the company, to give voice to their wishes through the machinery of a meeting.

In *Hogg v Cramphorn*, the directors' exercise of the powers conferred on them by the company's articles in an attempt to defeat a threatening takeover was challenged on the ground that the use of their powers for such a purpose was improper. It was acknowledged that the directors had acted bona fide in what they considered to be in the best interests of their company. Special regard was given to the injurious effect which a takeover would have upon their staff and counsel's opinion had been sought which afforded further evidence of bona fides. The object of the directors was to see that their own policy views as to what was best for their company prevailed, even if the outside buyer secured sufficient shares that were available for purchase. Incidental to this object was that the directors could remain in control on the board.

The plans of the directors triumphed in *Hogg v Cramphorn*, as the trial judge held that the scheme was capable of ratification by the shareholders in general meeting, and this the shareholders duly did after the case was adjourned to allow the vote to be taken.

The interesting fact in *Paringa's* case is that Paringa, the majority shareholder, was the minority on the board. There was, therefore, an attempt by the minority shareholders, who were in a position to control the board, to implement a scheme which the majority shareholders clearly did not consider to be in the best interests of the company. Those very same minority shareholders/directors were determined to postpone the holding of the general meeting because they knew that their scheme would not be ratified and that the board would be reconstituted. If the court had allowed the order postponing the meeting, it would have involved itself in boardroom battles and power struggles which it had always sought to avoid. It is perhaps at this point that the words of Buckley J in *Hogg v Cramphorn* should be noted:

> Nor will this Court permit directors to exercise powers, which have been delegated to them by the company in circumstances which put the directors in a fiduciary position when exercising those powers, in such a way as to interfere with the exercise by the majority of its constitutional rights; and in such a case of this kind also, in my judgment, the court should not investigate the rival merits of the views or policies of the parties.[22]

Conclusion

This note began by posing the questions: what is meant by the phrase 'in the best interests of the company' and 'who can ultimately decide whether certain plans and actions taken by the company are in its best interests'?

Paringa stands for the proposition that shareholders of a company are legally entitled to requisition a general meeting of members to decide whether or not certain actions taken by their representatives, the board of directors, were in *their* best interests, without interference by the court. This is consistent with the decision in *Hogg v Cramphorn* and also with

22 See above n 19 at 268.

decisions such as *John Shaw & Sons Ltd v Shaw*[23] and *Automatic Self-Cleaning Filter Syndicate Co v Cunninghame*,[24] which established the principle that, where the management of a company is delegated to directors, shareholders cannot interfere with the exercise of the management *but* they can, however, remove directors from office or amend the articles of the company so as to withdraw the authority delegated to these very directors. Similarly, although shareholders cannot interfere with the management activities carried out by the directors, they could decide whether or not to ratify a decision by the board which has been made, for instance, for an improper purpose,[25] unless it would amount to fraud on the minority.[26]

In giving the ultimate control of the company's affairs to the shareholders at general meeting, it may be a legitimate concern that those who are alleged to be acting *not* in the best interests of the company *are* the majority shareholders. Those minority shareholders who are not in a position to influence the outcome of the general meeting may therefore be at a serious disadvantage. However, s 320 of the Companies Code is enacted to protect them. Its purpose is to protect the minority in a company against those who are conducting the affairs of the company in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members of the company, or contrary to the interests of members as a whole. Although it is beyond the scope of this paper to discuss this protection that is available to those in a company who are not in a position to influence the decision of the board, suffice it to say that the protection is there for the minority shareholders to avail themselves of and therefore, in general, the ultimate control of a company should be vested in the shareholders at general meeting.

As far as the management of the company's internal affairs is concerned, both shareholders and those who manage the business of the company should be in a position to control the destiny of their company at general meetings without interference from the judiciary. As Bowen L J succinctly stated in the case of *Harben v Phillips*:[27]

> No-one can doubt that the court ought not to interfere in the conduct of the company's business further than is absolutely necessary. A meeting of shareholders is at once looked to as the source from which help can come. People ought to be allowed as far as possible to manage their own affairs without interference by a court of law.

It is neither commercially realistic nor desirable to have interference from the judiciary, except in special circumstances, into the affairs of a company. The court cannot be expected to be familiar with every aspect of the business or commercial concern (eg mining developments) that the case before it involves. Its function is to determine and protect, not to interfere with, legal rights.

---

23 See above n 6.

24 [1906] 2 Ch 34.

25 See, for example, *Winthrop Investments Ltd v Winns Ltd (No 1)* 1 ACLR 219; *Bamford v Bamford* [1970] Ch 212; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; *Russell Kinsela Pty Ltd v Kinsela* (1983) 8 ACLR 384.

26 *Foss v Harbottle* (1843) 2 Hare 461, 67 ER 189.

27 See above n 3 at 36-37.