Directors' Powers of Management and Control: Division of Power Between Directors and General Meeting

Introduction

The most powerful 'organs' of the corporate body at law are the managing director(s), the board of directors and the general meeting (through which the will of the shareholders — the owners — is expressed). The Code itself says little of how power is to be divided among them. It does say that important matters such as alterations to the memorandum and articles, the removal of directors, and voluntary or court winding up of the company must be by general meeting. But there is no mention in the Code itself of who is to manage the company's affairs. A company is left to settle this in its own constitution.

The articles are most important. A sample set of the articles is presented in Table $A.^1$ The articles regulate the company's internal administration, including the relationship between the board and the shareholders. 'It is therefore within the legal power of the shareholders to dictate the details of this relationship.'

Invariably, the board of directors is made responsible for the management of the company. Usually a specific article — for example, reg 66(1) — will say this. Occasionally, the articles may preserve important policy decisions for the shareholders in general meeting. But it is rare for the directors' power to be curtailed in this way. Likewise, it is possible, although even rarer, for the articles to give the shareholders complete management power, or to retain powers of management in the general meeting and to provide that the general meeting can delegate its powers to directors. Under such an arrangement, the delegated powers could be withdrawn at will.

But under Table A the directors must manage the company. They are given control over most of the powers of the company. The members usually retain the power, for example, to set the directors' remuneration, to elect the directors, to fix a share qualification for them, and to declare dividends. But by comparison, their powers are few, as business efficacy demands.

Table A provides a model set of articles only. No company has to adopt them in whole
or part. But most modern companies adopt them or similar articles: see s 75 of the Code.
 Afterman, Company Directors and Controllers (The Law Book Company, 1970) at 12.

If directors are to manage their company efficiently they must, within broad limits, have a free hand to do what they consider best in the interests of the company.3

Constant reference to the body of shareholders for approval, with its attendant delays, would shackle corporate action. In the final analysis, though, the shareholders have two important powers: the power to appoint and fire directors and to change the articles themselves. The impact of these powers varies with the type and size of the company.

Under the articles, directors invariably are able to delegate their powers. Under reg 76(1) of Table A, for example, they may delegate 'any of their powers' to committees of directors. Under reg 81(1), a managing director may receive 'any of the powers exercisable' by the board. On policy grounds this should not mean that the directors can rid themselves of their responsibilities as well as their powers; they must at least retain the duty to supervise and, if necessary, to interfere in management matters. The directors are vested with final management power and should not be able to divest themselves of the duties attached to it. As we shall see, there is some concern that directors, especially of large, public companies, may pass over the real management of companies to senior, often non-board executives. Eisenberg reported in 1975: 'Indeed, the proposition that the board does not manage a corporation's business is not seriously controverted by any serious student of corporate practice.'4 There are reasons for this abdication: directors lack the time and the information to manage large, complex organisations and they are often beholden to the chief executive. Although it may be unrealistic to expect too much from directors, it is unhealthy for law and practice to be at odds in this way. One response may be to impose greater duties on those who truly manage, and the law already takes account of de facto directors. Another response may be to force directors to make the time to seek information by raising the standards expected of them, so that in practice, as well as in law, the board manages.

Realities of corporate power

The individual shareholder may have genuine power in small, proprietary companies. His vote may affect policy, help to elect the board, and thereby influence management. Often, such shareholders in proprietary companies are also directors. They get the rewards of their investment in the company through directors' remuneration, rather than as dividends and bonus issues of shares. Where a husband and wife (and perhaps the family lawyer or accountant) are the only members of the

3. The Jenkins Committee Report, Cmnd 1749 (1962) para 109.

^{4.} Eisenberg, 'Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants' (1975) 63 Calif LR 375 at 377. For an interesting account of the growth of institutional investment and its impact on control see Farrar and Russell, 'The Impact of Institutional Investment on Company Law' (1984) 5 Co Law 107.

board, ownership and management are the same. Everyone is a director and often everyone has a say in management. While dominant controllers are common enough in the family company, the members and board generally know what is going on and have time to devote to the management of company affairs. The controversial debates on corporate governance rarely touch the small company.

But in large, public, listed companies, individual shareholders can be virtually powerless. In transnational corporations, because of 'institutionalised' pressures and controls, even the directorates of 'branch' companies may have very limited control over the company's policies. Ownership, knowledge of the company's affairs, and control do not usually coincide where there are directors with comparatively few shares each and thousands of shareholders.

Commentators differentiate between the directors and the management of large, public companies — the former being those who are charged by the company's constitution with the task of management; the latter being those not on the board and not formally recognised in statute or articles, but loosely referred to as the 'senior executives'. These executives control and administer the day-to-day affairs of the company; they actually run the business. Many commentators now argue that not only are directors divorced from ownership but that, in the 'giant' corporations, 'management' has eclipsed the board.⁵ True management power, they argue, resides with the 'technostructure' of senior executives within the company. The board acts only to 'rubber stamp' decisions made lower down. The law permits it. Directors, as the law stands, can freely delegate to administrators, sub-committees and officers and can rely in good faith on reports from those officers. Providing that nothing occurs to put them on their guard, directors can rely on management's honesty and competence.

As we shall see, the lax duty of care required of directors does not discourage any director, especially a non-executive director, from sitting back, accepting a fee and playing no active part in the company's affairs. They do not yet need to inquire and supervise, to test the figures or to query the graphs. Their most weighty duties are to act honestly and in good faith in the company's best interests, duties which they can honour

 See, for example, Nader, Green and Seligman, Taming the Giant Corporation (Norton, 1976); Mace, Directors — Myth and Reality; Galbraith, The Age of Uncertainty (1977); Galbraith, The New Industrial State (1967). Galbraith, Age of Uncertainty (1977) at 278 offers a solution:

A better line of development would be to abolish boards of directors in the large firms now that they have no function. These would then be replaced with a board of public auditors, which would keep out of management decisions but ensure the enforcement of public laws and regulations, report on matters of public interest, otherwise keep management honest and ratify or, in the event of inadequacy or failure, order changes in the top management command.

You will ask who then would represent the stockholder. The answer is that no one does now. The shareholder in the modern large corporation is without power and without function. He (or she) is also obsolete.

perfectly well from an armchair. Or, more likely, the relatively low payments made to the prestigious and busy people who become outside directors (often of many major companies at the one time), mean that there is little time and incentive for them to immerse themselves sufficiently in every company's affairs. In some large enterprises it has become almost traditional for directors not to direct, despite the board's powers under legislation and the company's own constitution or articles. The chief executive dominates, with the expertise and assistance of the administrative sub-structure, the 'senior executives' of the company.6

Dominant figures on boards also control the company's purse. Contests for places on the company's board or over contentious issues may become proxy contests. Naturally, the company's money supports the line chosen by the company controllers. Further, the minor percentage of shareholders who make use of the proxy voting system normally allocate their votes as requested or advised by the company. Most shareholders have little interest in interfering in the company's affairs, so long as their investment proves profitable. Thus, it is rare indeed for 'rebel' candidates or resolutions to succeed. The costs of a rival campaign to attract the proxy vote are prohibitive for an individual shareholder. Whilst there are sound reasons for control by the management, the contest is uneven. Management also control corporate information and can defray their expenses from company funds. Not so the rebel candidate or share-holder. The control of litigation also rests with those who control the board. That, too, inhibits challenges to the status quo and a calling to account of defaulting directors.

Underlying the corporate law theory is the principle of responsibility to the owners, the shareholders. But

. . . the machinery provided by statute to make overriding shareholder control possible is rusty from lack of use and probably no longer appropriate for the larger quoted companies of the late twentieth century.7

Galbraith's tongue-in-cheek discussion of a large, mythical American company, 'UGE', raises the question of the ability of traditional corporate management law to deal with the large, modern, 'super' company and its true controllers.

In 1932, the two noted Columbia University professors, Adolf A. Berle and Gardiner C. Means, studied the control of the two hundred largest nonfinancial corporations in the United States. Nearly half, they discovered, were controlled by their management. No power remained with the owners to hire or fire the managers; the management appointed the directors who represented the stockholders. The directors did not appoint the managers. There would now be no question

7. Midgley (ed), Management Accountability and Corporate Governance (Macmillan, 1982) at

^{6.} A lively account of the apparent powerlessness of such boards is given by Nader, Green and Seligman, Taming the Giant Corporation (1976) Ch 4 at 75ff.

as to UGE's membership on the management-controlled list. No individual stockholder owns as much as one percent of the stock of UGE. None of the directors owns more than the requisite qualifying shares. All the directors were selected by Harold McBehan and were voted in automatically by proxies returned for the management slate. McBehan's tests for selection were high standing in the financial world, past political service in Washington and a reputation for never interfering with management decisions. The average age of the directors was, until recently, sixty-seven. This has now been lowered slightly by the addition of a black, a consumer advocate and a nun. With the others they meet for two hours every two months and ratify decisions that have already been taken and which several of the board members do not understand. Two cannot remain awake. None has ever opposed management on any matter of more than cosmetic importance. All recognize the overwhelming advantage of those whose information is derived from day-to-day involvement with planning and operations. If UGE were losing money or moving into bankruptcy, the directors, prodded by the two bankers on the board, might well be led to question the quality of the management. Nothing short of this, or the suspicion of major fraud, would cause them to act. The board has confidence, on whole justified, in the honesty of UGE's management.8

One commentator wrote gloomily about the United States' position:

. . . all statutes described the board's function as managing the business and affairs of the corporation, but this description was almost totally fictional as applied to large corporations. . . . Monitoring has replaced management as a board function, but State law has rarely recognised the fact nor attempted to deal with the implications of the change.9

Not everyone is concerned by this. Fischel, for example, argues that there is no reason for shareholders to interfere in management once they have committed their capital to the enterprise in the expectation of making a profit. Shareholders, being inexpert, rely on managerial expertise and do not wish to be bothered with management.

The genius of the modern corporation, which the proponents of shareholder democracy overlook or misunderstand, is that it enables individuals who have wealth but lack managerial ability to invest while simultaneously allowing professional managers who lack personal wealth to run enterprises. Shareholders would be hurt rather than helped if they were given more power, which no doubt explains why they show no enthusiasm for the constant proposals to increase their role. 10

^{8.} Above n 5 at 268. Murphy J, in his dissenting judgment in FCT v Commonwealth Aluminium Corp (1980) 80 ATC 4371 at 4384-4385, spoke of aspects of corporate control. At issue was s 136 of the Income Tax Assessment Act 1936 — aimed at non-resident controllers and their manipulation of commodity prices to minimise taxation.

9. Schwartz, 'Federalism and Corporate Governance' (1984) 45 Ohio State LJ 545 at 556.

^{10.} Fischel, 'The Corporate Governance Movement' (1982) 35 Vand LR 1259 at 1276–1277.

Most commentators acknowledge shareholder 'apathy' and the reasons for it. While inactivity is the rule, however, shareholders who wish to intervene on important issues should not face unreasonable hurdles. And those charged by the law and the company's articles to manage should manage.

If directors do not do what they should do, it is, in large part, the fault of the law. Inadequate disclosure requirements and the lack of a meaningful duty of care are major problems. The difficulties of legal challenges by shareholders is another. But directors do have increasingly onerous responsibilities in law. The shackles are dropping from shareholders as their ability to litigate over corporate abuses improves. As noted in Chapter 1, there is a drive to introduce more independent or nonexecutive directors onto boards and to set up audit and nominating subcommittees. The legal liabilities of directors are greater than ever. Increasingly, directors will be asked to give an account of their stewardship. And, increasingly, 'director' will be seen as a distinct profession, one which demands appropriate skills and standards of care.

Much of our management law developed in the days of royal chartered corporations, joint stock partnership enterprises, deeds of settlement and the first stirrings of limited liability, when company acts were seen and dealt with more or less as the deeds of partners. Times and corporate enterprises have changed. Management law is adjusting. Sometimes, law and practice are at odds. But, although it retains the flavour of small company controls, the legislation, unfortunately complex in places, retains its central role in protecting the public and curbing abuses by management.

The 'management' article of association

The company usually entrusts complete managerial power to the board of directors. Regulation 66(1) of Table A reads:

Subject to the Act and to any other provision of these regulations, the business of the company shall be managed by the directors, who may pay all expenses incurred in promoting and forming the company, and may exercise all such powers of the company as are not, by the Act or by these regulations, required to be exercised by the company in general meeting.

This is a much improved redrafting of reg 73 of Table A in the UCA, which read:

The business of the company shall be managed by the directors, who . . . may exercise all such powers of the company as are not, by the Act or by these regulations, required to be exercised by the company in general meeting, subject, nevertheless, to any of these regulations, to the provisions of the Act, and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the

company in general meeting shall invalidate any prior act of the directors which could have been valid if that regulation had not been made [emphasis added].

The tortuous and imprecise wording of reg 73 was adopted or copied by most companies. Its wording provoked debate over the respective powers of directors and the shareholders in general meeting. Argument centred on the meaning of 'regulations' (highlighted above) in its context. Does it mean articles of association of the company? Or does it mean resolutions passed by the general meeting? Most companies which were incorporated before 1981 still have this or a very similar 'management article'.

It was once thought that the shareholders in general meeting were 'the company' in essence, and that the directors were merely agents. It followed that ordinary resolutions should override board decisions. From the turn of this century opinion changed. The prevalent view became that under, or perhaps despite, reg 73 of the UCA (and like articles), once the power of management was vested by the articles in the directors, the general meeting could not, without other specific authority in the articles, interfere with or 'usurp' any of those powers. Needham J, in Turner v Berner, summarised:

There is no doubt that it has been established that, where a power is vested in the board of directors, a general meeting cannot exercise that power.11

Samuels J A, in Winthrop Investments Ltd v Winns Ltd, agreed:

The shareholders may have ultimate control, because they can alter the articles or remove the directors; but they cannot interfere in the conduct of the company business where management, as here, is vested in the board . . . they have no general power to transact the company's business, or to give effective directions about its management. 12

Three major cases cemented this conclusion into the law. In Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame, 13 an article, like reg 73 of Table A of the UCA, gave general management power to the directors. This power was 'subject to such regulations . . . as may from time to time be made by extraordinary resolutions'. Another article gave the board specific power to sell any property of the company on such terms as it thought fit.

A general meeting, by ordinary resolution, directed the board to sell company property. The directors refused to obey. They thought that the sale was not in the best interests of the company. They relied on the articles allocating the power of management to them. The Court of Appeal held that on a true construction of the articles, unless an extra-

^{11. [1978] 1} NSWLR 66 at 71.

^{12. [1975] 2} NSWLR 666 at 683.

^{13. [1906] 2} Ch 34.

ordinary resolution was passed by the general meeting (as called for in these articles), or unless the articles were lawfully altered by the members, it was not possible for the general meeting to ignore the statutory contract embodied in the articles and to override the directors or to usurp their function in this way. Here, the ordinary resolution of the members was insufficient.

The Court did not accept the master/servant analogy to describe the position of the company vis-à-vis the directors. Directors, the Court insisted, were part of the company: they were not servants in the true sense. Cuninghame's case signalled a new approach, although it was not immediately accepted by all courts.14

Similar decisions, in effect enforcing the contract embodied in the articles, were reached in Gramophone & Typewriter Ltd v Stanley15 and Quin & Axtens Ltd v Salmon. 16 In Quin & Axtens, the articles said that the directors were to manage the business of the company, but 'subject to such regulations (not being inconsistent with the provision of the articles) as may be prescribed by the company in general meeting'. 17 Another article said that two (named) managing directors had to agree to any board resolution to acquire or to let premises. In due course, the directors voted that the company acquire and let certain premises. But one of the named managing directors dissented. A simple majority of shareholders at a general meeting purported to confirm the board majority. Lord Loreburn LC pointed out that the articles contained the 'bargain' among the shareholders. Thus, while the directors had general powers of management, the articles also required the approval of both named directors before certain actions could be undertaken. Accordingly, the general meeting's resolutions were inconsistent with the articles. The company was restrained from acting on them.

Iohn Shaw & Sons (Salford) Ltd v Shaw,18 which concerned the board's power to institute litigation, produced a similar result. A reg 73 type article was again at issue. Greer J concluded:

If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders. 19

^{14.} See Dowse v Marks (1913) 13 SR (NSW) 332.

^{15. [1908] 2} KB 89 (CA).

^{16. [1909]} AC 442 (HL). See, recently, National Roads & Motorists' Assn v Parker (1986) 4 ACLC 609 at 613.

^{17.} Cf reg 73 of Table A of the UCA, above.

^{18. [1935] 2} KB 113.

^{19.} Ibid at 134.

A contrary interpretation of the management article arose in *Dowse v* Marks. 20 Article 103 (similar to reg 73) contained the words 'subject to any regulations from time to time made by the company in general meeting' (emphasis added). Again, did this mean that the general management power granted to the directors was subject only to changes in the articles themselves, or did it have a wider meaning (that is, subject to resolutions passed by simple majority at general meetings)? Under the latter interpretation, any board decision could be overthrown by ordinary resolution. Harvey I decided for the latter interpretation, namely:

that as to all powers delegated to the directors by force of this article, the company retains the power to control them by an ordinary majority at a general meeting. . . .

In the face of these cases I do not think I should be justified in confining the meaning of these words to a new article passed by special resolution . . . In the present articles the draftsman has uniformly used the term 'article,' or the expression 'these presents,' when referring to the articles. The term 'regulations,' as used in Article 101, no doubt includes the articles, but the word is, in my opinion, used in a wider sense, and includes any other regulations which may, consistently with the express provisions of the articles, be passed by the company by a simple majority in general meeting.21

Since Cuninghame's case in 1906, however, a division of powers between directors and shareholders has been enforced generally (although the division depends entirely on the construction of the articles at issue). The courts thus deprived much of reg 73 and similarly-worded articles (for example, the former UK reg 80, now reg 70) of meaning. Gower²² suggests that the favoured interpretation is that the word 'regulations', whenever used in the article (reg 73 of the UCA, the former UK reg 80), means 'articles', even though this renders tautologous the clause 'subject . . . to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting'. As Harvey J pointed out in Dowse v Marks, such an interpretation of 'regulations' renders the proviso unnecessary. It goes without saving that the general meeting can change the articles — 'that follows as a matter of course'. Why then were the words included in the article?

Goldberg²³ favoured Harvey J's view. The words, 'such regulations', he argued, must mean something other than 'such articles'. They could not mean articles already in existence. Nor could they mean new articles (that is, amendments to the articles) as 'such regulations' had to be 'not inconsistent with the aforesaid regulations'. And as no company can contract out of the right to amend its articles this could not be the

^{20.} Above n 14.

^{21.} Ibid at 340-341.

^{22.} Gower's Principles of Modern Company Law (4th ed) at 145 and n 46.

^{23. &#}x27;Article 80 of Table A of the Companies Act 1948' (1970) 33 MLR 177.

meaning of the words. Thus, he concludes, they could only mean resolutions passed by simple majority at a general meeting.24

The specific wording of reg 73 of the UCA supports this argument. Further, as Gower points out,25 it is odd that, while a mere ordinary resolution can remove directors from the board, the shareholders cannot take 'the less drastic step of over-riding them on a single issue'. However, the courts overwhelmingly adopted the other view — that management matters not specifically reserved to the shareholders in general meeting are in the absolute control of the directors. The shareholders, even if unanimous, cannot overrule the directors or interfere in their conduct of the affairs of the company, no matter how important those management matters may be. Of course, the shareholders can still alter the articles (or remove the directors). In the meantime, as Megarry J put it, 'while the directors are in the saddle, in the saddle they remain'.26

Regulation 66(1) of Table A removes the confusing wording. The regulation now specifically reserves management to the directors, subject only to powers required by the Code or the articles 'to be exercised by the company in general meeting'.27 Companies which adopt the new wording have an unambiguous statement. Most companies incorporated prior to the 1981 Code will retain either reg 73 of the UCA or a management article very like it. Study of the preceding cases is still necessary. Despite the interpretation difficulties offered by reg 73, the position is clear enough. It is now expressed in a more succinct and clear fashion in the new reg 66(1).

Regulation 66(1) says that the business of the company shall be 'managed' by the directors. Directors will usually find no further definition of 'managed' in the articles. And it is rare to have 'job descriptions' for directors.²⁸ But if the role of directors is to manage, that surely means more than offering advice or acting merely as a sounding board. The board should make decisions on substantial issues.

Business journals often attempt to define the director's role.²⁹ Mace summarises:

The business literature describing the classical functions of boards of directors typically includes three important roles: (1) establishing basic

- 24. Goldberg accepted limitations to the power of shareholders to interfere with the general management power of the directors; namely, where powers were specifically given to the directors in articles other than the equivalent of reg 73 of Table A, and where the directors were exercising their power to manage the day-to-day affairs of the company. In this way he attempted to reconcile most of the cases with his view, and to acknowledge the force to the opening words of reg 73 — 'The business of the company shall be managed by the directors'.
- 25. Above n 22 at 146.
- 26. Re Argentum Reductions (UK) Ltd [1975] 1 WLR 186 at 189. See also Samuels JA in Winthrop Investments Ltd v Winns Ltd [1975] 2 NSWLR 666 at 682-684.
- 27. See full text of reg 66(1) above.
- 28. See Mace, 'Directors: Myth and Reality Ten Years Later' (1979-1980) 32 Rutgers LR 293 at 305-307.
- 29. See, for example, Ch 1 above, n 4. See also Mace, Directors: Myth and Reality (1971) at 6-7; Mace, 'Directors: Myth and Reality — Ten Years Later', ibid at 305-307.

objectives, corporate strategies, and broad policies; (2) asking discerning questions; and (3) selecting the president [chief executive]. 30

Mace found that, for various reasons, directors of large and mediumsize companies generally do not carry out these functions at all effectively. The same is not usually true of boards of the numerous small, family companies.31

The issues of whether the directors or the members hold a particular power and whether the power is a management power or not comes to a head at law on two occasions. These are when the company has been wronged and litigation is considered, and when the directors, especially of the smaller company, are unable or unwilling to act. We shall deal with these in turn.

Control of corporate litigation

As we shall see later, the courts have long said that if the company is wronged, then the company, and not individual shareholders or creditors, should initiate litigation.³² In the absence of an article specifically vesting the power to initiate, conduct and defend legal proceedings in the board (or in the general meeting), who decides for the company: the board using its general power of management, or the members in general meeting, or both?

It is not difficult to imagine circumstances in which the directors would resist initiating any action against a fellow director or themselves and yet the general meeting would be keen to sue. Do the directors control corporate litigation by their power to manage? Can the majority at general meeting override the board? This poses the wider question again — what is the relationship between reg 66(1) (the article which gives the directors the exclusive power of management) and the principle of majority control of companies?

Whether to sue or not is a management decision. Beck³³ echoed the Lawrence Committee³⁴ when he asserted: 'Nothing could be more central to the management of a company than the decision to sue, or not to sue, on the company's behalf.' The New Zealand Court of Appeal was quite certain: 'The proper persons to authorise an action on behalf of the company are the directors.'35 Certainly, ordinary day-to-day matters, such as the enforcement of trade debts owed to the company, are management matters. And the board is best placed to decide on whether or not liti-

^{30.} Ibid at 184.

^{31.} See discussion above under the heading, Realities of Corporate Power.

^{32.} See discussion of the rule in Foss v Harbottle, below, Ch 9.

^{33.} See 'An Analysis of Foss v Harbottle', in Ziegel (ed), Studies in Canadian Company Law, Ch 18 at 545, 553.

^{34.} Ontario Interim Report of the Select Committee on Company law, 1967, para 7.3.5.

^{35.} In Paramount Acceptance Co Ltd v Souster [1981] 2 NZLR 38 at 43, citing Gower's Modern Company Law (4th ed, 1979) at 643, and John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113. See also Mason Development Co Ltd v Gordon (1959) 19 DLR (2d) 465 at 471.

gation is wise. General meeting interference could be time-consuming and could hinder the fluid conduct of the company's affairs.

It seems to me to be neither desirable nor feasible for day-to-day decisions to be taken by the members in general meeting, for general meetings necessarily take time to be convened. The members must leave the directors to get on with the job. If they make a mess of it the remedy of the members is to sack the board and instal another that they can trust. And if the members are not prepared to entrust the board with the exercise of any particular powers (for example, borrowing in excess of a prescribed amount) these powers can be removed from the directors and vested on the general meeting by a provision to that effect in the Regulations either as originally framed or as altered . . . 36

As a general rule, this is fine. However, the situation should not exist that directors can, in effect, be judges in their own cause when there is the possibility of actions against themselves. It would be rare, indeed, for directors to sanction litigation against themselves. There should at least be an exception to the general rule when the directors are directly or indirectly 'interested' in, or likely to be the target of, the potential litigation.³⁷ The safeguard of possible interference by the general meeting is necessary and, in theory, it is justified. Beck argues:

The general meeting, through the articles, vests the power in the board. Surely if those to whom the power has been delegated refuse to act, or cannot act, or do not exercise their power validly, the power should revert to the place from which it came and where at law it normally resides — the general meeting.38

The exception may, however, already be in the law. If, indeed, the board has the right to initiate actions in the company's name, then the only method for the company to become a litigant is through a shareholder establishing one of the exceptions to the Rule in Foss v Harbottle. But Wedderburn³⁹ suggested that the board's refusal to bring an action when the majority of members asks may, in certain circumstances, itself be evidence of 'fraud on the minority' and may give standing to the members to sue on behalf of the company. 40 The rule in Foss v Harbottle itself is premised on the right of the general meeting to authorise suits,

^{36.} Gower in the Final Report on the Company Law of Ghana, 1961 at 108.

^{37.} See same views expressed by Gower in his Final Report on the Company Law of Ghana, 1961 at 108, and Slutsky, The Duties and Powers of Management in the Company Law of Canada and England (unpublished PhD thesis, London School of Economics and Political Science, 1971) at 204-205 and 217.

^{38. &#}x27;An Analysis of Foss v Harbottle', in Ziegel (ed), Studies in Canadian Company Law (Butterworths, 1977) at 554. Note Beck's comments on Canadian 'letters patent' statute companies where the position differs to the Australian type of 'memorandum' companies.

^{39. &#}x27;The Rule in Foss v Harbottle' [1957] Camb LJ 194 at 202-203. See also Slutsky, above n 37 at 205-206.

^{40.} Cf Re Overton Holdings Pty Ltd (1984) 9 ACLR 225, where it was deemed 'oppressive' (within s 320 of the Code) for the company not to sue alleged wrongdoers where there was a reasonable cause of action on the facts.

but that line of authority has not been used in the Cuninghame - Quin & Axtens — John Shaw line of cases. 41

In Marshall's Valve Gear Co Ltd v Manning, Wardle & Co Ltd,42 three out of the four company directors refused to sanction legal proceedings against another company over a patent dispute. The fourth director, who owned a majority (but not three-quarters) of the shares in the company, commenced an action in the name of the company. The other three, who were 'interested' in the rival patent (they were proprietors of the rival patent), moved to strike out the name of the company as plaintiff and to dismiss the action on the ground that the company's name had been used without authority. Neville I refused. On an interpretation of the management article, he decided that the majority of the shareholders had the right to control the directors' action in the matter. 43 Neville J would not interfere with the action initiated by the one director 'because it is brought with the approval of the majority of the shareholders in the company, and, upon the decisions which I have referred to, they are the persons who are entitled to say, aye or no, whether the litigation shall proceed'.44 The key to the reconciliation of this decision with those in the mainstream of 'non-interference' cases is that here the directors who were trying to stop the litigation were 'interested' in the litigation: 'their duty and their interests are in direct conflict'. 45 In such circumstances, on traditional theory, it would be a fraud on the minority for the 'controlling' directors to refuse to sanction litigation when they were in such a position of breach of duty or 'fraud'.

Marshall impliedly clashes with John Shaw's case, where the permanent directors were held able to initiate legal actions against the other directors despite a general meeting's efforts to stop the action. Although it appears to run against the Cuninghame — John Shaw line of cases cited above, 46 Marshall is authoritative on the 'interested' directors situation. 47

A first instance dictum in Kraus v J G Lloyd Pty Ltd48 addresses the issue. There, two shareholders, together holding a majority of shares, were said to be unable

- 41. See discussion of the exceptions to Foss v Harbottle in Ch 9. See Foss v Harbottle 'line' and its conflict with Cuninghame 'line' discussed by Aickin, 'Division of Power Between Directors and General Meeting as a Matter of Law, and as a Matter of Fact and Policy' (1967) 5 Melb ULR 448.
- 42. [1909] 1 Ch 267.
- 43. He distinguished Cuninghame on the narrow basis that there a specific article, in addition to the management article, required an extraordinary resolution before shareholders could interfere in management. Such a resolution had not been passed.
- 44. Above n 42 at 273-274. Cf dictum of Hudson J in Kraus v JG Lloyd Pty Ltd [1965] VR 232 (see below).
- 45. Above n 42 at 271, per Neville J.
- 46. See also Scott v Scott [1943] 1 All ER 582.
- 47. See also Gower (4th ed) at 147; Wedderburn, 'Control of Corporate Litigation' (1976) 39 MLR 327. In Teck Corporation Ltd v Millar (1972) 33 DLR (3d) 288, a general meeting approved the bringing of an action by a shareholder. The court found that the Rule in Foss v Harbottle did not apply and that the court should hear the suit (292–293).
- 48. [1965] VR 232.

. . . to secure by resolution of a general meeting of the company a valid authority to bring an action against the defendants in the name of the company. The power to decide whether such an action should be brought rests with the directors of the company under art. 67 and this cannot be overriden by an ordinary resolution of the shareholders in general meeting: Quin & Axtens v Salmon. 49

Hudson I did not consider Marshall. His Honour also did not turn his attention to the situation of the 'fraudulent' or 'interested' director. The court was speaking of the general position, there being no fraud on the minority but rather a breach of individual membership rights.

The members in general meeting should be able to initiate corporate ligitation, at least when the directors are personally interested in the decision to litigate or not. The directors should not have exclusive control. Several cases support this view. But legislation would put the issue beyond doubt. The enactment of a provision similar to Gower's s 137 of the Ghanaian Code would enable a balance to be struck between the need for the management to run the company unfettered by trivial concerns and the members' need to control self-interested behaviour by directors. 50

Directors unwilling or unable to act

What, however, is the position when the board of directors either cannot or will not exercise the powers vested in it? Can the general meeting then exercise management powers?

In Alexander Ward and Co Ltd v Samyang Navigation Co Ltd,⁵¹ two individuals, who had no authority to use the company's name, issued a

- 49. Per Hudson J, ibid at 236-237.
- 50. '(1) A company shall act through its members in general meeting or its board of directors or through officers or agents, appointed by, or under authority derived from, the members in general meeting or the board of directors.
 - (2) Subject to the provisions of this Code, the respective powers of the members in general meeting and the board of directors shall be determined by the company's
 - (3) Except as otherwise provided in the company's Regulations the business of the company shall be managed by the board of directors who may exercise all such powers of the company as are not by this Code or the Regulations required to be exercised by the members in general meeting.
 - (4) Unless the Regulations shall otherwise provide, the board of directors when acting within the powers conferred upon them by this Code or the Regulations shall not be bound to obey the directions or instructions of the members in general meeting.
 - (5) Notwithstanding the provisions of subsection (3) of this section, the members in general meeting may -
 - (a) act in any matter if the members of the board of directors are disqualified or are unable to act because of a deadlock on the board or otherwise;
 - (b) institute legal proceedings in the name and on behalf of the company if the board of directors refuse or neglect to do so;
 - (c) ratify or confirm any action taken by the board of directors; or
 - (d) make recommendations to the board of directors regarding action to be taken by the board.
 - (6) No alteration of the Regulations shall invalidate any prior act of the board of directors which would have been valid if that alteration had not been made."
- 51. [1975] 2 All ER 424 (HL).

summons in its name. It had not yet appointed any directors. The company went into liquidation before the specific point at issue could be litigated. But the liquidator did, in the company's name, ratify the action of the individuals. Lord Kilbrandon noted that, while 'the directors, and no one else, are responsible for the management of the company, except in the matters specifically allotted to the company in general meeting, this does 'not mean that no act of management, such as instructing the company's solicitor, can validly be performed without the personal and explicit authority of the directors themselves'.52

Likewise, when there is deadlock on the board, it seems that the general meeting may take action.53 So, also, if an effective quorum is absent at a board meeting.54 Samuels JA summarised in Winthrop Investments Ltd v Winns:

Certainly, I would suppose that, if the directors for some reason refuse to act, so that, to borrow the words of Cotton LJ in Isle of Wight Railway Co v Tahourdin, 'the business of the company' is at a deadlock, the shareholders should themselves intervene. 55

Gower concludes:

These exceptions are convenient, but difficult to reconcile in principle with the strict theory of a division of powers. Their exact limits are not entirely clear There must, it is submitted, normally be a failure by the directors validly to exercise their discretion; only then will their discretionary powers revert to the members.⁵⁶

It is well established that directors may refer matters to the general meeting for ratification or perhaps even to seek guidance as to what course of action to follow. If the directors exceed their powers under the articles or breach their duties, generally the shareholders may sanction their actions retrospectively. This will be discussed below.⁵⁷

^{52.} Ibid at 432.

^{53.} See Barron v Potter [1914] 1 Ch 895.

^{54.} See where two of the three directors were interested in the proposed contract and thus prohibited from voting in respect of the contract: Foster v Foster [1916] 1 Ch 532 at 551, applying Barron v Potter, ibid.

^{55.} Above n 12 at 683.

^{56.} Above n 22 at 147-148.

^{57.} See Bamford v Bamford [1970] Ch 212 and other authorities (discussed later at Ch 6).