FRAUD ON MINORITY SHAREHOLDERS: THE PARADIGM UNDER ENGLISH LAW

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1. Introduction

A proper balance of the rights of the majority and minority shareholders is essential for the smooth functioning of a company. However, majority rule and its counter balance are dealt with under the general law suggesting that the wishes of the majority of the members normally prevail over those of the minority but the majority must not perpetrate a fraud on the minority. [1] Fraud on the minority, a kind of opportunistic conduct on the part of both the directors and majority shareholders, can be challenged in the court and be made to court review. The aim of this study is to show light into the issue that the rule of fraud on the minority shareholders does not follow any specific paradigm under English Law and has been developed through the decisions of the courts. The judiciary has made a discernible shift away from the traditional restrained approach to statutory interpretation in company law cases like other areas. Thus the English judges óver the years in different cases, as we will observe later on in this paper, have explained and widened this principle substantially and in a more purposive fashion into different aspects depending on the relevant facts of the cases. However, the action against fraud sometimes turns to be unsuccessful varying in certain degrees between the concerned parties.

2. Fraud on Minority

A company is a separate and distinct legal entity, the powers of which are in theory exercised by either the shareholders in general meeting or by the

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1 Charles worth & Cain, *Company Law*, 12th Ed. Geoffrey Morse, London, Stevens & Sons, 1983, at p. 397.

board of directors, by majority decision or vote. In the book, *Minority Shareholders' Remedies*, Elizabeth Boors describes the principle of majority rule, otherwise known as the rule in *Foss v Throttle*[2], as 'one of the pillars of company law'. However, this way of proceeding carries with it a risk of abuse of power, whereby those having control of the company might take advantage of their position to oppress the minority. The rule in *Foss v Throttle* is complex and has two closely related parts:

1. If a wrong is done to the company, the company is the 'proper plaintiff', so that only the company may sue and an individual shareholder (or group of shareholders) may not sue ('proper plaintiff rule'). As a result any legal proceedings seeking to redress a wrong done to the company must be brought by the company itself.

2. The internal management rule, which means that the court is reluctant to interfere with internal irregularities which can be cured by being ratified by ordinary resolution of the general meeting of members, e.g. improper appointments of directors, improper conduct of general meetings.

By denying individual members the opportunity to sue on behalf of a company, the *Foss* rule channels disputes away from the court room in favor of the internal governance mechanisms which exists within companies. However, this rule does not apply where the conduct of those in charge constitutes a fraud on the minority.[3] In such case of fraud, a minority of shareholders or even an individual shareholder may bring a derivative action[4] in the name of the company for their grievance and section 994 of the UK Companies Act 2006 (formerly Section 459 of the Companies Act 1985) deals with the provision more clearly. When an action is brought under this rule, where fraud on the minority plays the central role, the wrongdoers are usually both directors and controlling shareholders. But in this situation, a minority shareholder has to prove that the alleged wrongdoers have sufficient voting power to ensure that

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2 [1843] 2 Hare 461.

3 Brian R. Chef fins, *Company Law: Theory, Structure and Operation*, Clarendon Press. Oxford, 1997, at p. 465.

4 Section 260, UK Companies Act, 2006.

that if the matter arose at a general meeting the members would vote to terminate the litigation[5]. Besides the concept of "fraud on the minority" is doubly misleading. First, "fraud" in this context is not confined to common law fraud, i.e. deceit, but embraces a wider equitable meaning. Secondly, the fraud committed on the minority is not that much audible as on the company and is very difficult to prove.[6]

The exact meaning of the expression "fraud on minority" is not easy to determine. But at least it is clear that both "fraud" and "minority" are used somewhat loosely. There need not be any actual deceit; if there were, those on whom it was practiced would have a common law remedy against those who had willfully deceived them. "Fraud" here connotes an abuse of power analogous to its meaning in a court of equity to describe a misuse of a fiduciary position. Nor is it necessary that those who are injured should be a minority; indeed, the injured party will normally be the company itself, though sometimes those who have really suffered will be a class or section members, not necessarily a numerical minority, who are outvoted by the controllers.[7] Lord Dave in *Borland v. Earle*[8] says, it covers certain "acts of fraudulent character"- in the wider sense just described – of which "familiar examples are when the majority are endeavoring directly or indirectly to appropriate to themselves money, property or advantages which belong to the company or in which the other shareholders are entitled to participate.

Consequently the concept of fraud on a minority needs further examination. It was stated earlier that it is difficult to define. This is partly due to the coyness of the judiciary in what is obviously a difficult field.[9] The approach of Me Garry J., in *Stance (Kilmer House) Ltd v Greater*

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5 Birch v. Sullivan [1957] 1 W.L.R 1247 (Ch.D).

6 *Palmer's Company Law*, Clive M. Schmitt off (Editor), 24th Ed., Stevens & Sons, London, 1987, at p.983.

7 Gower, L.C.B, *The Principles of Modern Company Law*, 4th Ed., Stevens & Sons, London 1979, at p.616.

8 [1902] A.C. 83.

9 Pettit, Ben, *Company Law*, Pearson Education Limited, 2001, at p.231.

London Council[10]was pragmatic, but epitomizes the judicial unwillingness to develop the doctrine at a theoretical level:

> As, I have indicated, I do not consider that this is a suitable occasion on which to probe the intricacies of the rule in *Foss v Throttle* and its exceptions, or to attempt to discover and expound the principles to be found in the exceptions. All that I need say is that in my judgment the exception usually known as "Fraud on a minority "is wide enough to cover the present case, and if it is not, it should now be made wide enough.

In a broad and somewhat crude sense, fraud on the minority is conduct which the judges think is so bad that the majority should not be allowed to get away with it. More acceptable and juristic language can perhaps be found in Me Garry J's expression in *Stance* that it was conduct 'stultifying the purpose for which the company was formed.' The important point though, is to realize that if a type of act has been judicially categorized as a fraud on the minority then the majority rule or principle will cease to govern the situation. It will make no difference therefore if the act complained of has been 'ratified', that is, approved of, or forgiven, by the majority in general meeting. The ratification will be invalid, because the breach of duty was in law 'non-rectifiable'. What matters is not whether the breach of duty has been ratified, but whether the breach is regarded as rectifiable.[11]

Temple man J., in *Daniels v. Daniels*[12], laid down a wider definition of "fraud" as: "If minority shareholders can sue if there is fraud, I see no reason why they can not sue where the action of the majority and the directors, though without fraud, confers some benefit on those directors and majority shareholders themselves."

Thus the rule of fraud on minority has not gained any definite or fixed territorial limit or definition under English Law. Different case laws have

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[10] [1982] 1 All. ER 437 at pp. 447-448.

[11] Supra note 9, at p.232.

[12] [1978] 2 All E.R. 96.

developed over the years regarding this rule and have produced a gradual categorization of activities done by the controlling or the majority shareholders and also by the directors of the company to be treated as fraud on minority. In this context, the analysis of these case laws must be guarded after keeping into mind that each case will depend upon the respective facts of all the cases. The essence of fraud often also becomes impossible to prove and has to be judged from the facts of the cases.

In order for the plaintiff to have locus stand to bring a derivative action in case of fraud, he must be able to show that the alleged wrongdoers control the company. Otherwise, in the absence of such control, the general meeting of shareholders may safely be left to decide whether it is in the company's interests to embark upon litigation.[13] Accordingly, it has been held that a plaintiff in a derivative action arising out of fraud must specifically allege in his pleadings and be prepared to prove that those in control of the company would prevent the company from suing in its own name.[14] It has always been held that showing that the alleged wrongdoers own a majority of the shares conferring voting rights amounts to proof of control for these purposes, and that it is not necessary to go further and show that a demand was made of the wrongdoers to institute proceedings and they refused to do so.[15]

The question that has arisen is whether control can be established in the absence of proof of ownership of a majority of voting shares or the passage of a relevant resolution where the votes of the wrongdoers were an essential constituent of the majority. In *Prudential Assurance Co. Ltd. v. Newman Industries Ltd.*(No.2) Vine Lott J., at first instance[16] took the view that control was established where the wrongdoers were " able by any means of manipulation of their position in the company to ensure that the action is not brought by the company." It is not clear how far this broad

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[13] Supra note 6, at pp.984-985.

[14] Supra note. 5.

[15] Mason v. Harris [1879] 11 Ch.D. 97,108; Alexander v. Automatic Telephone Company [1900] 2 Ch. 56, 69.

[16] [1981] Ch. 257, 324-325.

and attractive proposition has survived the decision of the Court of Appeal in that case, but that court observed in a dictum[17], that control" embraces a wide spectrum extending from an overall absolute majority of votes at one end to a majority of votes at the other end made up of those likely to be cast by the delinquent himself plus those voting with as a result of influence or apathy."[18] Besides, a minority member would not be allowed to maintain an action on the company's behalf if the wrongdoer obtains no benefit for himself and this was decided in *Pelvises v Jensen*.[19]

The various activities of the directors or the majority shareholders as designated fraud on minority, though not exhaustive but distinct, under English Law mostly have the following appearances and in practical cases often overlap with each other.

2.1 Acts done not in good faith and for the benefit of the company

The separation of ownership and control is seen as one of the basic features of modern companies.[20] While the shareholders are said to be the owners of the corporation, the power to manage the corporation is delegated to the board of directors.[21] Under most circumstances, therefore, controlling shareholders dominate the company through their control over the board of directors.[22] In this way, the majority can express their power either as controlling shareholder or through the board.[23] The regulation of controlling shareholders is thus closely related with the regulation of directors.[24]

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[17] [1982] Ch. 204, 219.

[18] Supra note 6 , at p.985.

[19] [1956] 2 All ER 518.

[20] Kraakman, Reinier R.,*The Anatomy of Corporate Law*, Oxford University Press,2004, at pp.11-14.

[21] *Ibid*, at pp.33-34.

[22] Bainbridge, Stephen M, *Corporation Law and Economics*, Foundation Press, 2002, at p.513.

[23] Davies, Paul L, *Introduction to Company Law*, Oxford University Press, 2002, at p.217.

[24] Supra note 20,at p.13.

The directors or the majority shareholders are under a contractual obligation[25] to act bona fide for the benefit or for the best interest of the company. The test of "bona fide for the interest of the company " is actually more difficult to apply in practice than it first appears, especially in case of conflict of interest between the majority and minority shareholders.[26] This however, does not mean that they will ignore their own interests and raises a question on the relationship between fraud on the minority and acting bona fide in the interests of the company.[27] The conduct of majority shareholders can be impeached if it constitutes a fraud on minority though the meaning of this phrase is not very clear. Speaking very briefly it means a discriminatory action.[28] The shareholders can judge the action of the directors or the majority shareholders whether these actions are taken for the benefit of the company or not. The only restraint upon the majority powers, therefore, is that whatever the majority may decide, they must do so in good faith as reasonable businessmen.[29] Scrutiny, L.J. had taken this approach in *Shuttle worth v. Cox Bros. & Co.*[30]

> "When persons, honestly endeavoring to decide what will be for the benefit of the company, decide upon a particular course then, provided, there are grounds on which reasonable businessmen would come to the same conclusion, it does not matter whether the Court would or would not come to the same decision. It is not the business of the courts to interfere or to manage the affairs of the company. This is for the shareholders and directors. The absence of any reasonable grounds for deciding that a certain course of action is conducive to the benefit of the company may be a ground, for finding that the shareholders with the best

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[25] Section 33, UK Companies Act, 2006 (formerly Section 14 of the Companies Act 1985).

[26] Hollington Q.C, Robin, *Shareholders' Rights*, Sweet & Maxwell, 2004, at pp.44-48.

[27] Zahir, Dr. M., *Company and Securities Laws*, Revised and Updated Edition, The University Press Limited , 2005, at p. 190.

[28] Singh, Dr. Avatar ,"Majority Powers and Minority Rights," *Company Law*, 14th Ed, Eastern Book Company, Luck now, 2004, at p.463.

[29] *Ibid*, at p.465.

[30] [1927] 2 KB 9.

> motives, have not considered the matters which they ought to have considered ....If the resolution were such that no reasonable man could consider it for the benefit of the company as a whole, this might be a ground for finding lack of good faith."

Ever shed M.R. opined in *Greengage v. Arden Cinemas Ltd*,[31] that a special resolution would be liable to be impeached if it resulted in discrimination between the majority and minority shareholders and thus allowed the former to get an advantage of which the latter were deprived. In this case the majority shareholders passed a special resolution for the amendment of the articles of association which enabled the transfer of shares to an outsider ignoring the pre-emptive rights of a minority shareholder. The minority shareholders challenged the resolution on the ground of fraud on minority but the Court of Appeal rejected the claim. Ever shed M.R., also discussed what is meant by the phrase "bona fide for the benefit of the company as a whole", as

> "In the first place it is now plain that "bona fide for the benefit of the company as a whole " means not two things but one thing. It means that the shareholder must proceed on what, in his honest opinion, is for the benefit of the company as a whole. Second, the phrase, "the company as a whole", does not ... mean the company as a commercial entity as distinct from the corporations. It means the corporations as a general body. That is to say, you may take the case of an individual hypothetical member and ask whether what is proposed is, in the honest opinion of those who voted in its favor, for that person's benefit. I think the thing can, in practice, be more accurately and precisely stated by looking at the converse and by saying that a special resolution of this kind would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter were deprived. When the cases are examined where the resolution has been successfully attacked, it is on that ground. It is, therefore, not necessary to require that persons voting or a special resolution should, so to speak, dissociate themselves altogether from the prospect of personal benefit and consider whether the proposal is for the benefit of the company as a going concern. If, as

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[31] [1950] 2 All E.R. 1120.

> commonly happens, an outside person makes an offer to buy all the shares, prima facie, if the corporations think it is a fair offer and vote in favor of the resolution, it is no ground for impeaching the resolution because they are considering the position of themselves as individual persons."

However, Goodling J, in *Mutual Life v. Rank Organization,*[32]held that this did not mean that there could be no discrimination so long as the directors acted as between different shareholders. In this context, Parker J. in *Goodfellow v. Nelson Lines*[33] upheld the scheme which discriminated, though admittedly because discrimination was justified since a certain debenture-holder had special interests requiring special treatment. The court first observed that it might interfere not only when the voting was in bad faith but also where the resolution was unfair and oppressive. But later it stated that each debenture-holder might vote with a view to his individual interests though they might be peculiar to him. This view seems to be conflicting with that of Lord Ever shed.

In *British America Nickel Corn. v. O'Brien*[34] the passing of a resolution was attacked on the ground of acting not in good faith. Here an appeal from Canada to the Privy Council did not concern voting as members of a company but as members of a class of debentures to agree to a reconstruction scheme. The required majority would not have been obtained but for the vote of the holder of a number of debentures whose support had been obtained by the promise of a large block of ordinary stock-a promise not mentioned in the scheme. The court decided that the scheme to be enjoined as the debenture-holder had not treated the interest of the whole class as the dominant consideration. This decision has supported Lord Ever shed's formulation both in its subjective and objective forms as L.C.B Gower has mentioned in his book.

Thus Lord Ever shed has formulated two tests criteria to judge whether the acts done either by the directors or the majority shareholders are made

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[32] [1985] BCLC 11.

[33] [1912] 2 Ch.324.

[34] [1927] A.C. 369, P.C.

bona fide and for the benefit of the company. The principle of fraud on minority is made subject to (i) a subjective test (acting in bad faith) and (ii) an objective test (absence of "benefit to the company"). From the case laws it is conceived that these tests work in the manner that the failure to measure the act in light of objective test that the actions are taken for the benefit to the company affords evidence of subjective bad faith. On the other hand, it must be admitted that there is no clear authority supporting the actual formula of the subjective test. It is narrower than that apparently suggested by Lord Ever shed since a resolution cannot be avoided merely because the majority has failed to ask themselves whether it is beneficial to the hypothetical average member. It deliberately avoids the vague words "*male fides*", "*fraudulent*" and "*oppressive*", which are used in the cases, and which seem meaningless in this context, but seeks instead to define an ascertainable mental state analogous to malice in the law of conspiracy. And it is submitted that if such "malice" could be proved the court would avoid the resolution notwithstanding that it might reasonably be regarded as beneficial.[35]

Thus the development of this rule through case laws has tabulated some kinds of breach of director's duty as fraud on minority and non-rectifiable while others do not amount to fraud on minority and are rectifiable.

2.2. Expropriation of the company's property

If any resolution is passed permitting the expropriation of the company's property or member's shares, it results into the constitution of the fraud on minority. The concept of fraud on minority could be made clearer from the case *Meier v. Hooper's Telegraph Works,*[36]

Two companies A and B were in rivalry. The majority of the members of company A were also the members of company B. Company A had commenced an action against company B. At a meeting of the company A, the majority passed a resolution to compromise the action in a manner favorable to company B and unfavorable to company A. Thus they

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[35] Supra note 7, at pp.619, 622.

[36] [1874] 9 Ch. App. 350.

attempted to deprive the company of the benefits which could have been recovered from company B. Consequently, in an action by the minority, the resolution was held invalid. "It would be a shocking thing", the court observed, "if that could be done, because the majority have put something into their pockets at the expense of the minority."

This decision was later followed in the case *Cook v. Deems,*[37] where the directors had diverted to themselves contracts which they should have taken up on behalf of the company. It was held that the directors were holding the benefits of contract on trust of contract. The directors had ratified their action by the company in general meeting and yet were found to be holding the same for the benefits of the company for "directors holding a majority of votes would not be permitted to make a present to themselves."[38]

In *Regal (Hastings) Ltd. v. Gulliver*[39], however, the House of Lords commented that the directors would not have been liable to account for the profits if they had the transaction ratified in the general meeting. In this case the directors had taken the advantage of information which they acquired as directors of the company. But the resolution was passed for ratifying the transaction on the ground of company's interest. Thus the matter of passing resolution for ratifying the director's liabilities is quite controversial and this issue has been discussed later on in this paper.

2.3. Expropriation of the member's shares

Just as the majority or the controlling shareholders cannot exercise their power to appropriate and to deprive the company of its property, similarly, they are also not authorized to deprive the minority of their shares and interest in the company. In this case, however, the prohibition is not absolute and will not apply if such expropriation is for fair compensation and required in the interests of the company as a whole.[40]

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[37] [1916] 1 A.C.554, P.C.

[38] [1916] 1 A.C. at p.564.

[39] [1942] 1 All. E.R. 378.

[40] Supra note 7, at p.620.

The case of *Brown v. British Abrasive Wheel Co.*[41] provides the example regarding this.

A company was in great need of further capital. The majority representing 98% of the shares, were willing to provide this capital if they could buy up the 2% minority. Having failed to do this by agreement, they proposed to pass an article enabling them to purchase the minority shares compulsorily on certain terms. The plaintiff refused to surrender and brought an action to test the validity of the majority resolution. His action succeeded. The court here considered whether the proposed new article was "for the benefit of the company as a whole. As it was neither just nor equitable, nor for the benefit of the company as a whole to purchase the shares of the minority compulsorily," The resolution was held invalid and Asbury J. accordingly granted an injunction restraining the company from passing the resolution.

Likewise, in *Deafen Tinplate Co. v. Lamely Steel Co.*,[42] Peterson J held that the new resolution conferring on the majority an unrestricted and unlimited power to buy out any shareholder they might think proper went much further than was necessary for the protection of the company from conduct detrimental to its interests.

Here there was no power in the original articles of the defendant company for compulsory acquisition of a member's interest. A special resolution was passed enabling the majority of the shareholders to determine that the shares of any member may be offered for sale by the directors to such persons as they should think fit at the fair value to be fixed. The defendant company was formed with the object that all its shareholders were to take their tinplates from the company. The plaintiff company refused to do so and the defendant company resolved to acquire the plaintiff company's shares. The court struck down the resolution as this was found not to be in the interest of the company.

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[41] [1919] 1 Ch. 290.

[42] [1920] 2 Ch. 124.

Thus majority shareholders often wish to act in ways that may disadvantage the minority. For example, it may be in the majority's interest to obtain complete control of a company by acquiring the minority's shares. The majority may wish, for example, to exclude the minority from participation in future rights issues. In these kinds of situations, however, there is likely to be considerable uncertainty as to the risks that the exercise of the majority's power will be open to challenge by the minority. In this respect the Australian case *Giancarlo Gambits and Aynor v WCP Limited and Aynor*,[43] which was handed down on 8 March 1995 can be referred. In a joint judgment Mason CJ, Brennan, Deane, and Dawson JJ allowed the appeal (as did McHugh J in a separate judgment) and set aside the orders made by the New South Wales Court of Appeal. This decision was based on the common law principle of fraud on the minority and not on oppression under section 260 of the *Corporations Law*. The judgments have largely reinstated the views underlying the three traditional British cases in this area, namely, *Brown v British Abrasive Wheel Co, Deafen Tinplate Co v Lamely Steel Co.* and *Sidebottom v Kershaw, Lease & Co.* that the elimination of minority shareholders could be caused for fair price and for the benefit of the company only.[44]

Moreover, section 996 of the UK Companies Act, 2006 provides that the court may, in case of an action brought by an individual, order for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly. This underlies the concept of expropriation of shares of the minority shareholders but such expropriation must be for fair price and for the benefit of the company as it has been mentioned earlier.

2.4. Alteration of Articles

A company may alter its articles of association by a special resolution.[45] But this may also result into fraud on minority if it is not done in good

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[43] [1995] 13 ACLC 342.

[44] <http://www.bond.edu.au/study-areas/law/publications/BLR/vol7.2/Mitchell7_2.pdf visited on 17.03.2009.

[45] Section 21, UK Companies Act, 2006.

faith and for the benefit of the company as a whole. This can be made more visible from the judgment of Lindley, M.R, given in *Allen v. Gold Reefs of West Africa*[46]as:

"The power of altering articles must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind the minorities. It must be exercised...bona fide for the benefit of the company as a whole..."

Observing this, it was held that a company could alter its articles so as to impose a lien on shares of existing holders in respect of existing debts.

Similar issue was also raised in the case of *Sidebottom v. Kershaw, Lease & Co.,*[47]

The plaintiffs who were in minority in the defendant company carried on a competing business. The majority of the shares were held by the directors who passed a special resolution altering the company's articles and introducing a power of the directors to require any shareholder who competed with the company's business to transfer his shares at their full value to nominees of the directors. The validity of this resolution was challenged on the ground that it was not for the benefit of the company as a whole." If the company as a whole means the whole body of corporations and every individual corporate, and if one of them has detriment occasioned to him by the alteration, it can not be for the benefit of the company as a whole."

The court held the view that it was very much for the benefit of the company to get rid of those members who were having competing business because the company's business secrets might have been exploited by such members.

3. Resolution for relieving the director's liabilities

The company has the jurisdiction to decide whether it will initiate litigation against the directors for the breach of their duty. It can also

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[46] [1900] 1 Ch. 656.

[47] [1920] 1 Ch. 154.

decide in the negative and forgive the directors for their transgressions. If the company is leaning in the direction of not taking legal action, that decision might express itself in a number of different ways, with different legal consequences. The company might want to go even further, so to speak, legitimate the breach of duty and, in so doing, deprive itself of the power in the future to bring litigation and give the potential defendants the comfort of knowing that their apparently wrongful conduct had been approved. Legitimization, usually called ratification, has the effect of expunging the wrong that the director has committed.[48]Besides, by this ratification the ratified transaction binds the company too. But there are clearly some limitations on the extent to which such a resolution can discharge the directors from the liability which would otherwise attach to them. Thus it does not extend to cases of misappropriation of the company's property by the directors. Nor does it apply if the directors have been fraudulent and here too "fraud" is used in a wider sense than actual deceit or dishonesty. [49]

Under section 239 of the UK Companies Act, 2006 which deals with the ratification of acts of directors amounting to negligence, default, breach of duty or breach of trust in relation to the company and such decision of the company to ratify such conduct must be made by resolution of the members of the company. The section also provides that where the resolution is proposed as a written resolution neither the director (if a member of the company) nor any member connected with him is an eligible member. Besides, where the resolution is proposed at a meeting, it is passed only if the necessary majority is obtained disregarding votes in favor of the resolution by the director (if a member of the company) and any member connected with him. This does not prevent the director or any such member from attending, being counted towards the quorum and taking part in the proceedings at any meeting at which the decision is considered.

Such a resolution can ratify an act by the directors in excess of their powers conferred on them or resolve not to sue in respect of a breach of

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[48] Supra note 23, at p.192.

[49] Supra note 7, at p.619.

their duties care and skill.[50] It seems to cover all cases in which they have not acted on good faith or in the belief that what they believe to be in the best interest of the company. If they have acted dishonestly, a resolution in general meeting will not protect them.[51] Moreover, where the ratification results into a fraud on the minority, the court will be able to let the derivative action continue. Where the wrong can be effectively ratified, the court will be able to adjourn the case to enable a meeting to be held.

In other words, the distinction seems to be this: consent in general meeting can remove the objective restraints on the directors' acts but it can not relieve them from their subjective duties to act in what they believe to be the best interests of the company and exercise their power accordingly.[52] This not only means that a director who committed fraud on the minority can not be forgiven by shareholder ratification but also that a majority shareholder can not use his\ her power to ratify to misappropriate company asset. Such a use of majority power in itself would be fraud on the minority and can not bind the company.

4. Conclusion

It has been suggested that a general rule for establishing fraud on the minority can be culled from the study of relevant case law. In determining what amounts to a fraud on the minority for the purpose of allowing derivative actions, it appears that the courts tend to allow for a more generous interpretation as compared with fraud at common law, including within its ambit fraud in the equitable sense (e.g. where there is an abuse of power — *Stance (Kilmer House) Ltd v. Greater London Council* [1982] (1 All ER 437). Furthermore, it appears from the study of relevant case law that fraud on the minority would exist where the majority uses their voting power in a manner that the law regards as illegitimate to cause some injury or loss to the company or to the minority members. This is weighed against the countervailing principle that a member has a right to vote as he

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[50] Pelvises v Jensen [1956] 2 All ER 518.

[51] Supra note 48.

[52] Ibid.

pleases; which dictates that where the majority votes to excuse a breach or waive a right, the minority is bound by that vote and may not sue in defiance of the majority's decision. The balance is struck where fraud is being perpetrated on the minority — in such cases, the power of the majority to pass resolutions is necessarily circumscribed and the decision of the majority will not be binding on the minority.[53]

Another important issue about the efficiency of judicial review based on the establishment of the substantive standard is the most effective way for fighting against the controlling shareholder opportunism and the fraud on the minority. From a practical perspective, judicial check has its strong as well as weak points and need to co-function with other strategies, such as the so-called decision right strategy, to achieve an efficient outcome.[54] But this issue of co-functioning is not dealt with in this paper and needs another detailed study.[55]

The present trend is towards a principle that any breach of duty which causes loss to the company should be regarded as a fraud on the minority.[56] In the case of *Daniels v. Daniels*, the sale of a company's property below its natural market value was held to be a fraud. Welcoming this decision, it has been observed that "in view of the inactivity of the legislature in the area of minority protection, it is welcome that the courts have taken it upon themselves to extend that area and to enable minorities more frequently than before to have their grievances ventilated in court."[57]

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[53] "Minority Shareholders and Derivative Actions," <http://www.lawgazette.com.sg/2000-10/Oct00-focus3.htm, visited on 16.03.2009.

[54] "Challenging Controlling Shareholders in UK Courts: The Substantive standard of Review," <http:// www.rechten.eldoc.ub.rug.nl/ FILES/ root/ GGSL/ promovendicngres200/ chalcoshi/ Paper_Chunyan_Fan.pdf> visited on 12.03.2009.

[55] For detail, see Davies, Paul L, supra note 23, at pp.217-224.

[56] Supra note 28, at p.467.

[57] [1976] JBL 347.