

The english rules on altering articles law company business partnership essay

Law



**ASSIGN
BUSTER**

PART A

2. The English rules on altering articles do not adequately protect minority shareholders. Discuss

The principal element of a company's constitution is the articles of association.[1]Every company must have articles of association, which form the rule book of the company.[2]They set out internal rules and regulations to govern the relationship between the members and the company.[3]Thus, the articles operate as a contract between the company and its members as well as between the members themselves.[4]Section 33(1) of the CA 2006 provides that " The provisions of a company's constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions." [5]Since the articles are concerned with the internal management of a company, they cannot remain static for all time. Thus, section 21(1) of the CA 2006 provides that " A company may amend its articles by a special resolution." The special resolution requires a 75 per cent majority. An agreement to deprive a company the power to amend the articles is invalid.[6]Subject to any provision for entrenchment, the articles may, thus, be amended by the members by a 75 per cent majority. It would appear that the contract formed by the articles is very unusual because its provisions may be amended by the majority of the contracting parties against the minority's wishes, subject to any entrenchment provision.[7]However, there is a limitation on the members, in that they must not exercise the company's power to amend the articles otherwise than bona fide for the benefit of the company as a whole. Thus, the majority may not vote as they please to amend the articles to the

detriment of the minority. In *Allen v Gold Reefs of West Africa Ltd*,^[8] the court stated that the power to amend the articles is limited by the statutory provisions and in the articles themselves. However, the power to alter the articles must be exercised in accordance with the general principle of law and equity which are applicable to the power conferred on the majority and enabling them to bind the minority.^[9] The court went on to state that the power must not only be exercised in accordance with the law, but also bona fide for the benefit of the company as whole and it must not be exceeded.^[10] However, this does not provide enough guidance as to the scope and the substance of bona fide for the benefit of the company as a whole. In *Shuttleworth v Cox Bothers and Co (Maidenhead) Ltd*,^[11] the court said it could not approve the alterations if it found them to be oppressive or extravagant. The test is whether a reasonable person would consider them not to be for the benefit of the company.^[12] The court, however, pointed out that it is the business of the members and directors, not of the court, to manage the company affairs.^[13] Where the alteration of the articles is likely to benefit a particular member, s/he may not abstain from voting.^[14] The test of the benefit of company may not be appropriate if the company does not have interest in the alteration. Therefore, courts have considered discrimination, hypothetical member and the proper tests as other ways of determining whether alteration by the majority should be overruled.^[15] However, the Company Law Steering Group recommended that the test of the benefit of the company as a whole is rooted in English law and should be retained.^[16] The court accepted this position of the Company Law Steering Group in *Constable v Executive Connections Ltd*.^[17] However, a

minority disputing an alteration of the articles may petition for a relief of unfairly prejudicial conduct rather than trying to prove that such alteration was not for the interest of the company as a whole or it was discriminatory. [18]Thus, the most common complaint is that the majority have unfairly prejudiced the minority.[19]The most common sought remedy is a court order for the majority to buy the minority's shares at a price proportionate to the company's value. In summary, the power conferred by section 21 of the CA 2006 to alter the articles by a special resolution may not be abused by the majority members so as to oppress the minority members. The minority may set aside a special resolution for fraud on the minority. The court will intervene where the majority have not acted bona fide for the interests of the company. An alternation which cannot stand because a reasonable person could not consider it for the benefit of the company is not alternation bona fide for the benefit of the company. However, the unfair prejudice is the best alternative which can be used to protect the minority if they have been unfairly prejudiced by alteration of the articles by the majority.

PART 2

These facts raise two major issues. The first issue is whether Baz has breached any directors' duties. A company's director has a duty to avoid conflicts of interest. Section 175 of the CA 2006 provides that a company's director " must avoid a situation in which he has, or can, have, a direct or indirect interest that conflict, or possibly may conflict, with the interests of the company." [20]It goes on to state that this " applies to the expropriation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or the

opportunity)."[21]Section 175 applies in the light of the corresponding common law rules and equitable principles.[22]A director exploits a conflict of interest for his/her personal advantage or where s/he he is in a situation of conflict or possible conflict, but does not seem to exploit it. Thus, liability under section 175 arises in a situation of conflict, or of possible conflict, with possible being limited to " whether a reasonable man looking at the relevant facts and circumstances would think that there is a real sensible possibility of conflict" with the interests of those who the fiduciary is bound to protect.

[23]The question is whether Baz being Future Tec Ltd's director attracts the application of the duty of no conflict of interest. Section 175(7) provides that a conflict of interest includes a conflict of interest and duty and a conflict of duties. Therefore, section 175 applies not only where there is a conflict between interests and duty, but also where there is a conflict or possible conflict between duties. Thus, this would include conflict between Baz's personal interests and his duty to promote Holly-Grain Ltd's interests and being a director of Holly-Grain Ltd and Future Tec Ltd and having separate duties to promote the interests of each company. There is no rule that Baz cannot be a director of both Holly-Grain Ltd and Future Tec Ltd.[24]However, there may be a potential conflict of interest bearing in mind that Holly-Grain Ltd is a customer of Future Tec Ltd. Disclosure and consent was important to this situation and, therefore, Baz is in breach of the obligation of undivided loyalty unless he secured the informed consent of both companies.[25]Even if he had informed consent, Baz would still have found it difficult to serve two masters without being in breach of his duties to one company or the other. [26]In this situation, resignation is the only possible course for Baz as it may

be difficult for him to maintain multiple directorships. In *Bhullar v Bhullar*, [27]*Cook v Deeks*[28]and *Industrial Development Consultants Ltd v Cooley*, [29]the courts found the directors in situations where their personal interests and their duties to the company conflicted such that now they would be in breach of section 175(1). Apart from his duty to promote Holly-Grain Ltd's success,[30]he was required to disclose the information to the company. [31]Baz must not only place himself in a position of conflict, but also that he must regularise or resign his position. However, resignation will not allow him to exploit the opportunity of which he became aware by virtue of being a director.[32]Since the duty is to avoid conflict of interest, the failure to disclose the conflict is itself a breach of duty.[33]In *Item Software (UK) Ltd v Fassihi*,[34]whilst the company was negotiating for the renewal of an important distribution contract, the director was also negotiating to secure the contract for his personal benefit. The Court of Appeal held that the director could not have fulfilled his duty of loyalty to the company except by disclosing his plans, including that he had set up his own company and planned to acquire the distribution contract for himself.[35]In effect, given that Baz did not disclose his plans, the disclosure requirements force him to resign as Holly-Grain Ltd's director. Baz was in a position to conflict. He had a conflict of interest for being the director of both Holly-Grain Ltd and Future Tec Ltd. Therefore, the duty not to exploit Holly-Grain Ltd's need of the 3D software to develop the holographic keyboard applied. He purchased the latest technology from Future Tec Ltd in the course of his management and in utilisation of the opportunity and special knowledge as a director of Holly-Gran Ltd. He is, thus, liable to account for any profit made from the

transaction. As a director of two companies, he was in a situation of conflict between his personal interests and his duty to Holly-Grain Ltd and he exploited the conflict to his own advantage. In such circumstances, the profiteer cannot escape the risk of being held accountable.[36]He is in breach of the duties of no conflict of interest and not to make profits and, thus, liable for breach of section 175(1) and (2) of the CA 2006. Baz may have also breached section 177 of the CA 2006 a company's director to declare his/her interest in a proposed transaction or arrangement to the board before s/he entered into it enabling the board to make a decision in the light of the information. In *Abeeden Rly v Blaikie Bros*,[37]a company was entitled to set aside a contract for the purchase of railway equipment entered into between it and a partnership when it was found that the chairman of its board of directors was also a managing partner of the partnership. This conflict of interest is obvious in Baz. He had a duty to act in Holly-Gram Ltd's interests to purchase the latest 3D animation software on behalf of the company at the lowest possible price. However, as the director of Future Tec Ltd, he sold the software to Holly-Gram Ltd at the highest price of £50, 000 more than the market price for the technology. Any fact that Baz is only one member of Future Tec Ltd will not affect the application of section 177. Holly-Gram Ltd may rescind the transaction on the basis that it is avoidable due to being in breach of director's fiduciary duty. Holly-Gram Ltd may also hold Baz to account for any profit he has made as a result of the transaction or require him to indemnify the company against any loss incurred. This position reflects the fact the duty to disclose imposed by section 177 is a fiduciary duty. The normal remedy for breach of fiduciary

duty is a liability to account for any gain made or to indemnify any loss suffered by the company and this is not dependent on the company rescinding the contract.[38]A liability regardless of rescission of the contract would also be consistent with sections 195(3) and 213(3) of the CA 2006. The court may also award equitable compensation for any loss which is not compensated by the remedies of account or recession for breach of fiduciary duty.[39]The test of whether the loss was the result of the breach of duty is the "but for" test.[40]Future Tec Ltd may also be liable to account for profits made from the breach of duty, but it will not be jointly liable for the profits made by Baz.[41]The second issue is whether there are any steps which Tom and Jerry can take to remove Baz as a director. Section 168(1) of the CA 2006 provides that a company may by ordinary resolution remove a director before the expiration of his/her term in office regardless of any agreement between the company and the director. A special notice will be required for any resolution under section 168 to remove Baz,[42]a copy of which must be sent by Holly-Gram Ltd to him.[43]Baz will be entitled under section 169 to communicate to the other members in order to give them a notice of intention to propose a removal resolution. But Holly-Gram Ltd's articles cannot exclude Tom and Jerry's statutory right to remove Baz as director because of the principle that any provision of company's articles that is inconsistent with company law is void. However, Tom and Jerry may not be able to remove Baz as director because of the weighted voting clause in the articles that any resolution to remove him as a director he is entitled to two votes per share on a poll. A weighted voting provision provides for votes to be specially weighted in order to provide a director with a power to block a

special resolution to remove him/her as a director out of the proportion to his shareholding. A shareholder with a sufficient control of votes may prevent a special resolution from being adopted and may also prevent the articles from being amended. In *Bushell v Faith*,^[44] the company's 300 shares were held equality between the claimant, the defendant, and their sister, with the former two being the only directors. The company's articles weighted the voting rights attached to the shares from one per share to three per share where the issue before a general meeting was the removal of the director holding those shares. When the claimant and her sister wanted to remove the defendant as a director, the Court of Appeal and the House of Lords upheld the validity of the weighted voting rights. The resolution to remove the defendant was, therefore, defeated by 300 votes of the defendant's weighted votes to 200 of the claimant and her sister's combined un-weighted votes. In *Amalgamated Pest Control Pty v Ltd v McCarron*,^[45] the court said that it was not invalid for the company's articles to contain a provision giving a particular shareholder 26 per cent of the votes on any special resolution. Therefore, Tom and Jerry are may not remove Baz as director because the voting rights clause will have the effect of making a special resolution incapable of being passed if Baz exercises his voting rights against any proposed alteration of the clause. If the clause had provided that the articles could not be amended without Baz's consent, then that would have been contrary to section 21(1) of the CA 2006.^[46] However, the clause is entirely different because it provides for voting rights. Accordingly, Tom and Jerry are advised that a resolution to remove Baz from being a director will be defeated by Baz's 800 weighted votes to the combined Tom and

Jerry's 600 un-weighted votes. In summary, Baz has breached the duty to avoid conflicts interest contrary to section 175 and the duty to declare interest in the when he proposed for the contract a board meeting. In order for Tom and Jerry to protect their rights, Holly-Gram Ltd can rescind the contract for being avoidable. The company may take legal action to hold Baz accountable for any profit he has made as a result of the transaction. It can also take legal action to require him to indemnify the company against any loss incurred. The company may also request the court to award equitable compensation for any loss which cannot be compensated by the remedies of account or recession. The company may also take legal action against Future Tec Ltd to account for profits made from the breach of duty. However, Tom and Jerry may not be able to remove Baz as director because of the weighted voting rights clause in the articles which entitles him two votes per share on a poll.