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Expropriation of shares via the corporate constitution

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EXPROPRIATION OF SHARES VIA THE CORPORATE CONSTITUTION

Company constitutions sometimes include powers to effect compulsory share acquisitions from members. Where these are introduced into the constitution after incorporation, the amendment, like all constitutional alterations, must be able to satisfy the common law "*bona fide* test" in order to be valid. The content of this test has been much debated since the first cases a century ago, and differences in view have emerged from the English and Australian courts. While there is no local case law on such expropriations *per se*, the High Court recently confirmed for the first time the applicability in Singapore of the common law test for constitutional amendments. This article reviews the development of the test in relation to the introduction of compulsory acquisition powers and analyses the most recent cases in the UK courts, which have largely confirmed the traditional English approach.

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I. Introduction

1 The acquisition of shares in a company against the wishes of the shareholder is generally a controversial topic for obvious reasons. Shares are regarded as property in the hands of the shareholder[1] and a strong principle of property law requires any non-consensual interference with the owner's proprietary rights to be justified by clear legal authority. Usually, an express statutory power to acquire shares will be necessary, such as is found in the mandatory "squeeze-out" provisions found in many countries' companies legislation.[2] To prevent abuse, such statutory

1 See, *eg*, Ross Grantham, "The Doctrinal Basis of the Rights of Company Shareholders" (1998) 57 CLJ 554 at 555; and note s 121 of the Companies Act 1967 stating that shares are personal property.

2 For instance, in Singapore, s 215 of the Companies Act 1967 permits the compulsory acquisition, following a successful takeover, of up to 10% of the dissenting shares in the target company. Alternatively, in the context of a members' scheme of arrangement, s 210 of the Companies Act 1967 allows a similar acquisition of up
(cont'd on the next page)

procedures typically apply only in tightly-defined circumstances and must be strictly complied with.

2 However, expropriatory[3] powers contained in a company's constitution are in principle binding on shareholders, by reason of the constitution's status as a "statutory contract".[4] The advantages of using a constitutional power are that it can be tailored to the company's circumstances and no judicial process is in principle involved. A fairly common example is found where employees holding shares in a private company are constitutionally required to sell the shares upon cessation of their employment. Another is the "drag-along" clause which requires a minority to sell into an offer that the majority shareholders have accepted. The effectiveness of compulsory transfer powers when included in the constitution either from the company's inception,[5] or if not then by unanimous agreement,[6] has long been recognised. Shareholders are taken to accept the contents of the constitution when they become members. Further, a line of mainly English decisions has recognised the power of the majority shareholders, by means of a subsequent constitutional amendment, to force some shareholders to sell their shares in a variety of situations, provided that the amendment is passed "*bona fide* for the benefit of the company as a whole"[7] (hereinafter, the "*bona fide* test"). Although this does invoke a statutory power, *ie*, to amend the constitution, this power is stated in the most general terms with the main explicit safeguard for a minority being the need to attain a super-majority of votes.[8] The other contours of the power to amend are set by the common law *bona fide* test, whether the power is used to compulsorily acquire shares or for another purpose, as well as by the general statutory jurisdiction of the courts to respond to "oppressive" or "unfairly prejudicial" conduct.[9] While case law in Australia has rejected

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to 25% of the target's company's shares from dissenting shareholders, if the court's approval is obtained.

3 "Expropriation" is used in this article simply to mean an acquisition from a shareholder not requiring the latter's consent, including an acquisition for full value.

4 *Ie*, under s 39(1) of the Companies Act 1967. See, *eg*, *BTY v BUA* [2019] 3 SLR 786 at [83].

5 *Phillips v Manufacturers' Securities Ltd* (1917) 116 LT 290.

6 *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279.

7 *Eg*, *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154, relying on the principle stated in *Allen v Gold Reefs of West Africa Ltd* [1901] 1 Ch 656. For a general discussion of the principle in the latter, see Hans Tjio, Pearlie Koh & Lee Pey Woan, *Corporate Law* (Academy Publishing, 2015) ch 5, at para 5.047 *ff*.

8 In Singapore, this is stipulated by s 26 of the Companies Act 1967, requiring a special resolution, which must be passed by at least 75% of the votes cast at the general meeting. This power is subject to any entrenching provision covering the clause to be amended. However, such provisions, even if present, do not normally apply to entrench shareholdings as these are not typically stated in the constitution.

9 See s 216 of the Companies Act 1967.

the *bona fide* test in favour of an alternative formulation, especially in the context of expropriation of shares and other proprietary rights, the UK courts have adhered to the traditional test. A Privy Council decision, *Staray Capital Ltd v Cha, Yang*[10] ("*Staray Capital*"), reaffirmed the English formulation in a clear case of compulsory acquisition, thus reinforcing the distinction between the English and Australian approaches. It is of note that the Singapore High Court has recently confirmed the *bona fide* test as generally applicable in Singapore,[11] albeit not specifically in the context of an expropriation of shares.

3 This article will first trace the development and key elements of the *bona fide* test before considering the two most recent cases involving compulsory transfer powers, *viz*, the English Court of Appeal decision in *Re Charterhouse Capital Ltd*[12] ("*Charterhouse Capital*") and the Privy Council's judgment in *Staray Capital*.

II. Development of the *bona fide* test in the UK

4 The application of the *bona fide* test has in the past caused difficulties, particularly in the compulsory transfer context. The classic formulation of the test is found in *Allen v Gold Reefs of West Africa Ltd*[13] ("*Allen v Gold Reefs*"), a decision of the English Court of Appeal. In that case, the amendment in question was in fact not to effect an expropriation of shares but to extend the company's lien on its shares for non-payment of calls beyond the usual case of partly-paid shares to the case of fully-paid shares. This alteration was challenged by the only shareholder who was affected by it (since he owned both types of shares). The amendment was upheld on the basis that the power to amend the articles of association included the power to modify the shareholder's existing rights to his detriment, even if only some of the shareholders were in practice affected by it.[14] Further, it was not to be regarded as retrospective as the extended lien could only be applied after the change, even though it could be enforced in respect of debts that existed before it came into effect.

10 [2017] UKPC 43.

11 *Gazelle Ventures Pte Ltd v Lim Yong Sim* [2023] SGHC 328 at [37] (discussed at para 34 below).

12 [2015] EWCA Civ 536.

13 [1901] 1 Ch 656. This decision was followed by the Privy Council on appeal from the Straits Settlements in *The Batu Pahat Bank Ltd v The Official Assignee of the Property of Tan Keng Tin* [1933] MLJ 237 on similar facts, *ie*, an amendment to extend a lien to fully paid shares.

14 *Allen v Gold Reefs of West Africa Ltd* [1901] 1 Ch 656 at 675.

5 In *Allen v Gold Reefs* there was, understandably, no real argument that on the facts the substance of the amendment could not be regarded as being for the company's benefit: the extended lien self-evidently ameliorated the company's ability to collect arrears on the partly paid shares. The issue of how the existence of benefit to the company should be determined was however later discussed in *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd*[15] ("*Shuttleworth*"). The amendment there empowered the board to remove any director, notwithstanding his status under the articles as a permanent director, by requesting him to resign. It had been passed following allegations, which were ultimately admitted, that the plaintiff (a director and employee) had failed to account for various payments received by him on the company's behalf. The court rejected the plaintiff's challenge to the amendment made on the ground that it had not been passed *bona fide* for the company's benefit. The test was whether the alteration was, in the honest opinion of the majority shareholders who voted in favour, in the company's interests, unless no reasonable shareholder could have considered it to be so. The latter proviso would apply if the amendment was so "oppressive" that it would cast doubt on whether the majority honestly held that opinion, or so "extravagant" that no reasonable person could consider it for the company's benefit.[16] Applying this standard to the facts, the court held that the amendment passed the *bona fide* test.

6 *Sidebottom v Kershaw, Leese & Co Ltd*[17] ("*Sidebottom*") was the first appellate decision on the test which involved a mandatory transfer of shares. The amendment enabled the directors to require the buy-out of any shareholder who carried on a business in direct competition with the company, at a price equal to the fair value of the shares. The plaintiff shareholder was admittedly engaged in a rival business, and the court upheld the validity of the article. While accepting that a motive for the acquisition to get a shareholder "out of the company only, without any reasonable ground and not for the benefit of the company" would be evidence of *mala fides*,[18] the existence of competition by the shareholder cast things in the opposite light. By contrast, two other cases decided by the English High Court just before *Sidebottom*, struck down constitutional amendments to insert powers of compulsory purchase of shares which were not expressly conditioned on any reason that protected the business. In *Brown v British Abrasive Wheel Co Ltd*[19] ("*Brown v British Abrasive*"), the majority shareholder's initial bid to acquire the minority's shares

15 [1927] 2 KB 9.
16 *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9 at 18–19.
17 [1920] 1 Ch 154.
18 *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154 at 161 and 172–173.
19 [1919] 1 Ch 290.

consensually had been rebuffed and was followed by a constitutional alteration. The court characterised the motive for the amendment as a desire to benefit the majority rather than the company. In *Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd*[20] ("*Dafen Tinplate*"), while the adoption of the expropriation power had arguably been motivated by fear of future competition from the shareholder, its scope was not restricted to that circumstance and it was also ruled invalid. However, the *Dafen Tinplate* reasoning was later criticised in *Shuttleworth*[21] on the basis that the judge had substituted his own view of the company's benefit for the majority's.

7 The 2007 decision in *Citco Banking Corp NV v Pusser's Ltd*[22] ("*Citco*") was not a compulsory share transfer case; but the alteration of articles had the effect of increasing the voting rights of the chairman and largest shareholder (then controlling 28%) so as to give him overall control of the company. The case is noteworthy for its recognition that the focus on the benefit to the company under the traditional formulation of the *bona fide* test was not necessarily appropriate for all possible types of constitutional amendment.[23] The Privy Council drew a distinction between amendments in which the company as an entity had an interest, and those in which it did not because the alteration only affected the rights of the shareholders between themselves – citing as an example of the latter the power to dispose of shares. For the first category the "benefit of the company" was a suitable criterion; but where the alteration did not affect the interests of the company as an entity, "some other test of validity is required". However, the court declined to express a view on the difficult "individual hypothetical member" formulation that had been put forward by the English Court of Appeal in *Greenhalgh v Arderne Cinemas Ltd*,[24] the facts of which appeared to fall into the second *Citco* category. It was unnecessary in *Citco* to formulate an alternative test for the second category as the court regarded the facts as falling within the first. The chairman argued that the company needed more debt and equity capital and there were reasonable prospects of securing both from financiers who insisted that the chairman was in control of the company; hence the amendments were in the company's interests. The court accepted that these arguments were honestly held by the chairman, and that reasonable shareholders could have accepted them. The *Shuttleworth* test was therefore satisfied.

20 [1920] 2 Ch 124.
21 *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9 at 23–24.
22 *Citco Banking Corp NV v Pusser's Ltd* [2007] Bus LR 960; [2007] UKPC 13.
23 A point which had been made in the Australian case of *Peters' American Delicacy Co Ltd v Heath* (1939) 6 CLR 457.
24 *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286.

8 *Citco* brought some clarity to a number of issues. It is authority that an amendment which falls within both categories may be assessed on the traditional test of benefit to the company.[25] This is significant because many alterations, while affecting the relative positions of different groups of shareholders (which would include expropriations of shares), can also be argued in particular cases to concern the company's commercial interests. The case further indicates that the required benefit does not have to result directly from the terms of the amendment; the increased voting power given to the chairman did not of itself assist the company as an entity, but it was a condition for obtaining the funding needed by the company. *Citco* also held that a shareholder who would particularly benefit from the amendment was entitled to vote on the resolution,[26] on the general principle that shareholders are free to vote in their own interests.

III. The Australian approach

9 The *bona fide* test is no longer accepted in Australia as the appropriate common law yardstick for reviewing constitutional amendments, particularly where it is used to introduce a power to expropriate shares – this was decided in 1995 in *Gambotto v WCP Ltd*[27] ("*Gambotto*"). In *Gambotto*, shareholders holding 99.7% of a listed company's shares procured the insertion into the articles of a compulsory transfer power, exercisable by a 90% shareholder at a price which was at a premium to the then market price. The amendment was motivated principally by substantial tax savings that would accrue to the company, and thus the ongoing shareholders, if the minority shareholdings were eliminated. Members holding 0.1% of the shares challenged the amendment, and the High Court of Australia upheld their objection.

10 The High Court rejected the English law test of "benefit to the company" for amendments which involved a conflict of interest between the majority and minority shareholders, on the basis that such test was "meaningless"[28] in that context. Further, the court emphasised that alterations authorising expropriations of shares required a specific test, by reason of the infringement of the shareholder's fundamental property

25 A similar approach was applied in *Faulkner v Bennett* [2011] EWHC 3702 at [72]–[77] and in *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536 at [96]–[97].

26 *Citco Banking Corp NV v Pusser's Ltd* [2007] Bus LR 960; [2007] UKPC 13 at [27], citing *Rights & Issues Investment Trust Ltd v Stylo Shoes Ltd* [1964] 3 WLR 1077 and *Burland v Earle* [1902] AC 83.

27 (1995) 127 ALR 417.

28 *Gambotto v WCP Ltd* (1995) 127 ALR 417 at 424, clearly referencing the use of that term by Dixon J in *Peters' American Delicacy Co Ltd v Heath* (1939) 6 CLR 457.

rights involved.[29] An expropriation would only be justified if, first, it was made for a proper purpose and, secondly, it was not oppressive to the minority. A proper purpose meant that the expropriation must be reasonably necessary to avoid significant harm to the company – *eg*, if the minority was competing with the company, or if their shareholdings endangered a regulatory licence needed to carry on the business. Conversely, merely advancing the company's interests was not a sufficient justification. The second element, *ie*, lack of oppression, required that the terms of the expropriation must be procedurally and substantively fair – the latter referring to the price and other terms of the buy-out. It is evident that these criteria are to be capable of review by the court, rather than assessed subjectively by reference to the shareholders' honesty. Further, given that, in the High Court's view, any expropriation was *prima facie* an infringement of rights, the burden of justifying it should be on the majority. On the facts in *Gambotto*, the expropriation failed the proper purpose element – obtaining a corporate tax benefit, even of a substantial amount, was insufficient justification for taking a shareholder's property.

11 The *Gambotto* approach was briefly considered in *Citco*. The Privy Council distinguished the Australian decision on the ground that *Citco* did not involve expropriation – a somewhat unconvincing point given that *Gambotto* addressed all amendments that involved a conflict of interest between shareholders (*ie*, which would fall into the second category identified in *Citco*). In addition, the Privy Council stated that the Australian approach had no support in English authority, which indicated a disagreement with the Australian court's revised balancing of the relevant interests.

12 While it remains the leading authority at common law in Australia, *Gambotto* has attracted much debate and some criticism there,[30] including on the basis that it could be used to facilitate opportunistic "greenmailing" by small shareholders in public companies. That risk was later addressed legislatively through a new statutory mechanism which enables a minority of less than 10% in a company to be compulsorily acquired in certain circumstances with court approval.[31]

29 *Gambotto v WCP Ltd* (1995) 127 ALR 417 at 425.

30 *Eg*, Gambotto v WCP Ltd: *Its Implications for Corporate Regulation* (Ian M Ramsay ed) (Centre for Corporate Law and Securities Regulation, 1996).

31 See Pt 6A.2 of the Corporations Act 2001 (Cth), entitled "General compulsory acquisitions and buy-outs".

IV. *Re Charterhouse Capital Ltd*

13 Prior to *Staray Capital*, the most recent English case was *Charterhouse Capital*,[32] which concerned an unfair prejudice action[33] brought by a retired partner in a private equity investment firm who still held 9% of the company's shares. The shareholders' agreement and the articles had always contained "drag-along" rights – *ie*, rights for an offeror who has acquired control of the company to require the remaining minority shareholders to sell their shares to the offeror at the same price – which are not unusual in the private equity industry.[34] Due to retirements, much of the company's equity came to be held by former partners rather than active ones, and the latter were concerned that there was an increasing "misalignment" in the shareholdings between the two groups, which could cause difficulties for raising new capital. Their proposed solution was, in essence, a sale of the shares pursuant to an offer by a vehicle for the continuing partners, which required some alterations to the scope of the drag-along articles. All the other retired partners agreed to the sale and to the related constitutional amendments, which were then used to acquire the plaintiff's shares.

14 The plaintiff argued that the transactions were unfairly prejudicial to him, in part because the amendments offended the common law *bona fide* test and facilitated the expropriation of his shares at an undervalue. The English Court of Appeal rejected the plaintiff's appeal, holding that there was no evidence of bad faith or improper motive by the proponents, and that the changes were not targeted at the plaintiff. Further, the misalignment issue was a genuine concern for the ongoing partners and the proposed solution was believed by a majority of the shareholders to be for the company's benefit. Overall, the changes to the articles could be characterised as a "tidying-up" exercise to bring them in line with the shareholders' agreement. The court also rejected the plaintiff's claim that the basis of valuing the shares was unfair, noting that the valuation model was one that reasonable shareholders could adopt in the circumstances.

32 *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536.

33 Under s 994 of the Companies Act 2006 (c 46) (UK), the equivalent of s 216 of the Companies Act 1967 (2020 Rev Ed).

34 Where such rights are included in the constitution it is usually from the outset; in the one English case challenging their subsequent introduction via amendment, the court had expressed some doubt about their validity but there was no final decision: see *Constable v Executive Connections Ltd* [2005] EWHC 3 (Ch). See also Brenda Hannigan, "Altering the Articles to Allow for Compulsory Transfer – Dragging Minority Shareholders to a Reluctant Exit" [2007] JBL 471.

15 The English Court of Appeal set out[35] a seven-point summary of the principles to be drawn from the cases on the *bona fide* test. These explicitly reaffirm the primarily subjective nature of the test: the benefit to the company is to be judged by the shareholders rather than the court. However, the court will not be bound by the shareholders' view if *no* reasonable person could hold it.[36] Given the difficulty involved in proving a person's actual state of mind, meeting this rationality standard will suffice to withstand judicial scrutiny. In practice, the onus will fall on the challenger to disprove it. Further, if the benefit to the company flowing from the amendment is demonstrated on the foregoing basis, the fact that it adversely affects some of the shareholders or benefits others will not invalidate it.

16 One point of interest arising from the judgment is that the court went beyond the existing law in its (*obiter*) attempt to identify a test for the second *Citco* category, *ie*, where the alteration concerns a matter which affects only the relative positions of the shareholders because the company has no interest in it. Rejecting both the "benefit to the company" and "hypothetical member"[37] tests for that context, it preferred the "vitiating factors" approach espoused in *Peters' American Delicacy*.[38] That is, the amendment will be valid unless it amounts to "oppression or is otherwise unjust or outside the scope of the power" to amend.[39] Although *Charterhouse Capital* did not mention *Gambotto*,[40] it may be observed that in the latter case the High Court of Australia had been influenced by its earlier decision in *Peters' American Delicacy*. The vitiating factors route has objective elements and in that sense *Charterhouse Capital* may be seen as moving closer to the Australian approach. However, it should also be noted that, even if correct, this will probably have a limited effect as long as the UK test categorises amendments in which the company also has an interest as falling to be assessed under the *bona fide* test;[41] relatively few cases will end up only in the second category.

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35 *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536 at [90], *per* Sir Terence Etherton C.

36 "The test is not whether all reasonable people would have agreed that the amendment was in the best interests of the company. It is sufficient that a reasonable person could have thought [so] …": *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536 at [108].

37 *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286.

38 *Peters' American Delicacy Co Ltd v Heath* (1939) 6 CLR 457.

39 *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536 at [90(6)], as explained at [91]–[96].

40 The omission was perhaps unfortunate as *Gambotto v WCP Ltd* was not distinguishable on the basis used in *Citco Banking Corp NV v Pusser's Ltd*.

41 As was the case in *Citco Banking Corp NV v Pusser's Ltd*, and in *Staray Capital Ltd v Cha, Yang* (discussed at Part V below).

17 Overall, given that the existence of similar constitutional drag-along rights since the company's incorporation[42] was central to the court's reasoning, the result in *Charterhouse Capital* is not entirely surprising. It also means that the case does not represent a clear example of the application of the *bona fide* test to the introduction of expropriation powers. The facts of *Staray Capital*, on the other hand, squarely raised that situation.

V. *Staray Capital Ltd v Cha, Yang*

A. The facts and issues

18 The essential facts of the case were straightforward. In 2010, Mr Chen, a Chinese businessman, invited his acquaintance Mr Cha, a China-born lawyer with US citizenship, to invest together with him in a coal mining project in Canada. For this purpose, they formed a British Virgin Islands ("BVI") company, Staray Capital Ltd (the "Company"), with Mr Chen taking 80%, and Mr Cha 20%, of the shares; both were directors of the Company. It appeared that no shareholders' agreement was signed between them. In June 2011, the Company acquired a 5% stake in the mining project. When the project's prospects of success started to look rosier, Mr Chen began to express his interest in buying out Mr Cha's shareholding in the Company in whole or in part. After Mr Cha demurred, their relationship deteriorated. Mr Cha later alleged that Mr Chen had threatened that if he did not agree to sell, Mr Chen would use his majority voting power to achieve a buy-out compulsorily, although Mr Chen denied such a threat and the court made no finding on it.

19 Mr Chen claimed that during their negotiations leading to the formation of the Company, Mr Cha had made various false representations. These included that Mr Cha was a partner in a well-known law firm in China, and that he was qualified to practise law in China and the US. In late 2011, Mr Chen caused Mr Cha to be removed as a director of the Company. Shortly afterwards, as 80% shareholder he amended the Company's articles to insert a clause (Art 3.8) allowing the

42 See *Phillips v Manufacturers' Securities Ltd* (1917) 116 LT 290.

Company to redeem compulsorily the shares of any shareholder who had:[43]

> (a) made material misrepresentations (whether fraudulent or negligent) in acquiring his shares; or
>
> (b) committed any "act that may result in the Company incurring or suffering any pecuniary, legal, regulatory or administrative disadvantage or liability or negative publicity which the Company might not otherwise have incurred or suffered".

Such a redemption would be initiated by the Company giving a redemption notice, with the price being the fair market value of the shares, without any minority discount, as determined by a third-party valuer.

20 Mr Chen then caused the Company to give Mr Cha a redemption notice for his entire shareholding, citing both paragraphs (a) and (b) of Art 3.8. In response, Mr Cha brought an unfair prejudice application in the BVI against the Company and Mr Chen.[44] He alleged that the amendment to insert Art 3.8 amounted to "oppressive, unfairly discriminatory or unfairly prejudicial" conduct towards him as a shareholder, and sought the reversal of the amendment and an injunction against the redemption of his shares.

21 Mr Cha succeeded at first instance and in the BVI Court of Appeal, although not on all issues. Both courts upheld the validity of the constitutional amendment to insert the redemption power. However, the redemption notice issued by the Company pursuant to Art 3.8 was held to be invalid as neither of the pre-requisite grounds had been established on the facts. As regards paragraph (a), *ie*, the clause on material misrepresentation, although one of the statements in question was a misrepresentation, none of them had been material to Mr Chen's agreement to Mr Cha's participation. As regards paragraph (b), *ie*, the clause on potentially detrimental conduct, the lower courts found no evidence that the pleaded acts may have led to the kinds of detriment required under the article.[45]

22 The Judicial Committee of the Privy Council rejected the appeal brought by the Company and Mr Chen, essentially upholding the decisions of the courts below on both questions. Of most interest is

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43 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43 at [2].

44 Under s 184I of the Business Companies Act 2004 (No 16 of 2004) (BVI), which is *in pari materia* with s 216 of the Companies Act 1967 (2020 Rev Ed).

45 "Court of Appeal Sitting – Saint Lucia: 14th – 18th July 2014" *Eastern Caribbean Supreme Court* (14 July 2014) at paras 53–60 and 67–71 <https://www.eccourts.org/digest/14th-18th-july-2014> (accessed 3 January 2024).

the ruling on the first issue, concerning the validity of a constitutional amendment in the context of a compulsory acquisition of shares. The failure of the redemption notice turned on questions of fact (which, in the Privy Council, focused on paragraph (a) only) which do not require discussion here.

B. Validity of the amendment

23 The Privy Council's judgment[46] on the validity issue was rather laconic, finding no reason to disagree with the conclusion of the Court of Appeal that:[47]

> ... it was reasonable for a company to take the view that members who had acquired their shares by misrepresentation or who had committed acts which may result in the company suffering detriment should have their shares redeemed ...

However, that this was not simply due to the Privy Council's traditional reluctance to disturb concurrent factual findings of the courts below is shown by its description of such reasoning as "compelling".[48]

24 The court endorsed[49] the *Charterhouse Capital* summary[50] of the relevant legal principles. In particular, an amendment that does, and which is intended to, adversely affect one or more minority shareholders is nevertheless valid if it is made in good faith in the company's interests.

25 This is consistent with the previous case law that, although an amendment must not be discriminatory on its face (*ie*, by applying expressly to some shareholders only), it may be discriminatory in its effect. For instance, the extension of the lien to fully paid shares in *Allen v Gold Reefs* was valid even though in practice it affected only one shareholder. On the facts in *Staray Capital*, the amendment was obviously targeted at Mr Cha; there were no other shareholders to aim at. Mr Chen wanted him out of the Company and admitted as much.[51] The question is what motivated this wish. If his sole motive was to avoid sharing the fruits of the mining project, the amendment would not have been *bona fide* and would be invalid.[52] Mr Chen's earlier offer to buy Mr Cha out might

46 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43, delivered by Lords Mance and Carnwath (Lords Sumption, Hodge and Briggs agreeing).
47 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43 at [33].
48 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43 at [32]–[33] and [38].
49 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43 at [34].
50 *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536 at [90].
51 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43 at [31].
52 *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154 at 161.

seem to support that characterisation. However, Mr Chen claimed that the amendment was motivated by protecting the Company[53] (*ie*, against dissemblers). The law is that the majority shareholders' honest view of the benefit – rather than the court's – is the relevant one; but that he has no onus to prove that he genuinely held it, nor that it was justified on the facts. It is sufficient that a reasonable shareholder could have held that view. On the facts, all three courts decided that this was satisfied, hence the amendment was valid. Although the Privy Council regarded the result as a straightforward application of settled law, a number of points merit discussion.

C. Scope of the amendment

26 The court upheld the validity of Art 3.8 as a whole, not merely the part on misrepresentation. The breadth of the Article is striking. While the effect of paragraph (a) may not be very different from the general law right to rescind a contract for material misrepresentation,[54] paragraph (b) is much wider. It covers any act that *potentially* results in *any* pecuniary, legal, regulatory or administrative disadvantage or liability *or* negative publicity for the Company that would not otherwise have occurred. Read literally, criticism expressed by a shareholder of the board's management performance at the annual general meeting which was reported in the media might render his shares liable to expropriation. That is quite a distance away from Messrs Sidebottom's direct competition with the company.[55] The potential chilling effect on minority shareholder behaviour might prove attractive to majority shareholders, even if they would have to prove that the facts fell within the paragraph.

27 Further, in *Staray Capital*, the article was inserted after the event and was obviously crafted with hindsight to target Mr Cha's alleged conduct before becoming a shareholder (the fact that the drafting turned out to be deficient in this case is not much comfort for minority shareholders generally). Yet, the plaintiff raised no argument based on retrospectivity, and it is unlikely that one would have succeeded. Since *Allen v Gold Reefs*,[56] amendments that operate with respect to facts which existed before the alteration took place have been upheld. Shareholders

53 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43 at [37].
54 Although that does raise the question why the Company did not simply pursue such right.
55 *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch 154 at 155–156.
56 [1901] 1 Ch 656 at 673 and 682.

have had to rely on extrinsic contracts to protect themselves from such effect.[57]

D. Bona fide *test and unfair prejudice or oppression*

28 A further point concerns the intersection between the common law *bona fide* test and the statutory unfair prejudice or oppression jurisdiction. A challenge based on the *bona fide* principle may be brought quite apart from the statutory jurisdiction.[58] However, in the two recent cases the actions were brought under the rubric of the latter but included claims based on the former. The first instance judge in *Charterhouse Capital* described the relationship thus:[59]

> Any resolution which offends the *Allen v Gold Reefs* principle will inevitably be unfair and prejudicial for the purposes of [the unfair prejudice] section, but an alteration of the articles does not have to offend the *Allen* principle in order to amount to unfair prejudice. Unfair prejudice is a wider concept, judged in accordance with an objective standard and gives rise to greater and more flexible remedies.

29 Subsuming such a challenge within the statutory jurisdiction may be advantageous from a remedial point of view, given the very broad powers that the court has to fashion an appropriate remedy, including by allowing the possibility of a buy-out order using a valuation approved by the court.[60] However, it does not appear that making use of the statutory jurisdiction has any effect on the substantive test: the standard applied to the validity of the amendments in both decisions was the common law "subjective" one articulated in *Shuttleworth*,[61] even though unfair prejudice is normally viewed through an objective lens. That is not to say that shareholders' might not sometimes have objectively assessed legitimate expectations in relation to the ease with which the constitution may be amended; however, they did not do so on the facts of the two recent cases.[62]

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57 See, *eg*, *Allen v Gold Reefs of West Africa Ltd* [1901] 1 Ch 656 at 673–674, citing *Swabey v Port Darwin Gold Mining Co* [1897] 2 Ch 469.

58 The common law principle pre-dates the introduction of the original unfair prejudice remedy in s 210 of the Companies Act 1948 (c 38) (UK).

59 *Re Charterhouse Capital Ltd* [2014] EWHC 1410 (Ch) at [237], *per* Asplin J.

60 See s 216(2) of the Companies Act 1967. A buy-out order was undoubtedly in the plaintiff's sights in *Re Charterhouse Capital Ltd*, although in *Staray Capital Ltd v Cha, Yang* the statutory buy-out right remedy would have been of little help to Mr Cha who presumably wanted to retain his interest as a valuation of the project may well have been speculative.

61 See para 5 above.

62 In *Re Charterhouse Capital Ltd* there were detailed agreements leaving little room for equitable considerations; in *Staray Capital Ltd v Cha, Yang* the trial judge found that the Company was not a quasi-partnership.

E. Mixed purposes

30 The Privy Council's judgment tantalises with a passing reference[63] to arguments based on improper purpose derived from *Eclairs Group Ltd v JKX Oil & Gas plc*[64] ("*Eclairs v JKX*"); however, it noted that these arguments were "realistically" not pursued by counsel. *Eclairs v JKX* concerned the *directors'* duty not to act for improper purposes, and discussed the applicable test where acts were motivated by both proper and improper purposes – whether a "predominant purpose" or "causative purpose" test should prevail. There is at one level a parallel with the *bona fide* test cases, where majority shareholders were arguably motivated both by the company's benefit and a wish to secure an advantage over the minority. This may prompt the question why the balance is drawn differently in the shareholder cases, where the courts require only a genuine and rational desire to benefit the company without weighing the relative effect of the purposes. The answer may, arguably, lie in the shareholders' role as owners rather than stewards of the company, and the consequent reluctance to subject their decisions to close review.

F. Australian comparison

31 Finally, although *Gambotto* was not mentioned in *Staray Capital*, it is of interest to consider briefly how the Australian approach might have applied, particularly to Art 3.8(b). While that paragraph is expressed in terms of various detriments suffered by the company, it is perhaps doubtful that the formulation would be sufficient to engage the "proper purpose" standard required under the first limb of the *Gambotto* test for expropriations. This would require protecting the company from "significant harm", as exemplified by competition or serious regulatory problems,[65] and it will be recalled that the onus in Australia is placed on the majority shareholders.

VI. Conclusion

32 Despite the doubts previously expressed in Australia, *Staray Capital* continues the approach that the English courts have followed in the century since *Shuttleworth* was decided.[66] While the stated objective of that approach is to limit the power conferred by statute on a 75% majority

63 *Staray Capital Ltd v Cha, Yang* [2017] UKPC 43 at [19].

64 [2015] Bus LR 1395.

65 See para 10 above.

66 The English Court of Appeal has recently reaffirmed the approach taken in *Citco Banking Corp NV v Pusser's Ltd*, in *Re Compound Photonics Group Ltd* [2022] EWCA Civ 1371 at [200].

to amend the constitution, the elements of the English test heavily favour the majority. The subjective manner of assessment, the mere rationality standard of review, the irrelevance of discriminatory effect where the corporate interest is involved, and the location of the onus on the challenger, in combination result in relatively weak protection for the minority against the acquisition itself. The latest decision, which is the first since *Sidebottom* to present a clear upholding of share expropriation through constitutional amendment, cements the position (and in so doing strengthens the validity of introducing drag-along rights after incorporation by this method).

33 A minority challenge will have a better chance of success either where it can be shown that no plausible reason is required to be given for the expropriation,[67] or where the price payable is so inadequate as to be oppressive. The latter is illustrated by *Assenagon Asset Management SA v Irish Bank Resolution Corporation Ltd*,[68] a decision from a creditor context. In connection with a restructuring of bonds, as an incentive to vote for the proposals, the restructuring mechanism provided that the bonds of bondholders who voted against would be acquired by the issuer for nominal consideration. Citing the *Greenhalgh* formulation of the *bona fide* test,[69] the court held this negative inducement to be oppressive and an abuse of the power to bind the minority. The amendment in *Staray Capital* avoided this pitfall by providing straightforwardly for a fair market value via an independent valuer. The complex facts of *Charterhouse Capital* made the issue of adequacy of value much more difficult but ultimately the challenge on this point failed to meet the burden of proof.

34 By way of footnote, the Singapore High Court recently approved the *Allen v Gold Reefs* principle for the first time, describing it as "settled law".[70] The issue in the case involved the tort of causing loss by unlawful means, and in that context the court discussed whether a constitutional amendment which failed the *bona fide* test could amount to unlawful means. The putative amendment did not involve any expropriation of

67 As in *Dafen Tinplate Co Ltd v Llanelly Steel Co (1907) Ltd* [1920] 2 Ch 124.

68 [2013] Bus LR 266 at [73]–[86], *per* Briggs J, who as Lord Briggs also sat in *Staray Capital Ltd v Cha, Yang*.

69 Although, as discussed, the formulation in *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 has not found favour in the recent constitution cases, in a *creditor* context there is no distinction to be drawn between the company as a commercial entity and as a body of shareholders.

70 *Gazelle Ventures Pte Ltd v Lim Yong Sim* [2023] SGHC 328 at [37]. Interestingly, the court also paraphrased from *Greenhalgh v Arderne Cinemas Ltd* the reference to the "company as a whole" as meaning the general body of members rather than the commercial entity, without adverting to *Citco Banking Corp NV v Pusser's Ltd* – although there was no necessity to do so.

shares and so is outside the scope of the present article.[71] While confirming the relevance of the *bona fide* test in Singapore, the case did not require any discussion of whether the English or Australian approaches should be preferred, which therefore remains an open issue locally.

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71 However, the discussion raises an interesting point whether the *bona fide* test amounts to a "duty" on shareholders – or whether it is, as traditionally framed, simply a requirement for the validity of the amendment.