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Departure of the Pakistani Courts from the Well-Established Rule of Majority in Corporate Law

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Abstract:
The common law practice of ancient times is that of majority rule, as enunciated in a well-known case called Foss Vs Harbottle. This case was based upon the proposition that the decisions and choices of the majority shareholders in the company should always prevail. It means if a person holds a greater number of shares in a company, then he should enjoy more privileges in comparison to a person who holds fewer shares. In such circumstances, the minority shareholders should accept the decision of the majority shareholders and they should not ask for a court interference because of the fact that the rule set down in Foss Vs Harbottle did not allow court interference if the majority of the members do not wish for such action by the court. Since this decision seems harsh and unjust, the court, in a subsequent decision, holds that in certain exceptional circumstances, the court can interfere in the internal affairs of the company. The exceptional circumstances may be Ultra Vires acts, where the act done by the members was that which requires a special number of members for its approval, like one third members etc.

Keywords: Corporate, Majority. Minority. Decision, Court, Rule, Shareholder, Precedent.

Introduction

There is no doubt that directors enjoy wide powers in respect of controlling. Directing and managing the affairs of the Company, but the ultimate control rests with the shareholders. Which can be exercised by them in the shareholders meetings'.[1] It is a cardinal principle of law that prima facie, the majority of the members exercise the powers of the company and in the absence of any provision. All the members are bound by the act passed by them."[2] The company itself is regarded as the best judge of its affairs, concerning internal management.[3] Majority shareholders, therefore, determine the state of the company. Such wide powers in their hands may be misused to exploit the minority and achieve personal benefits, even though the courts have no jurisdiction to interfere with the internal management of the company. Acting within its own powers. So, a proper balance of the rights of the majority and minority shareholders is essential for the smooth functioning of the company.

Lord Jenkin's View

[1] Majority Rule Khalid M. PULJ (Punjab University Law Journal} 1992 Page-80

[2] Bharat insurance Co. Vs Kanchana (1935) AIR Page792

[3] Palmer's Company law 20" Edition Page-492

The Rule in "Foss V Harbottle" prevents individual shareholders from suing for wrongs done to the company; only the company can sue. Thus Jenkins's, LJ said in Edward V Halliwell."[4] "The rule in Foss Vs Harbottle comes to no more than this, First, the proper plaintiff in an action, in respect of a wrong alleged to be done to a company or association of persons itself, secondly, where the alleged wrong is a transaction which might be made binding on the Company or Association an all its members by a simple majority. No individual member of the Company is allowed to maintain an action in respect of that matter for the single reason that, if a mere majority of the members of the Company or Associations is in favoring what has been done. So, the branches of the rule can be described as:

I. The proper plaintiff principle.

ii. The internal management principle.

The Rule in Foss Vs Harbotte

The minority shareholders in a company brought an action against the company's directors. Alleging that they were responsible for losses that had been incurred. "The action could not be brought by the minority shareholders. The wrong done to the company was one. Which could be ratified by the majority of the members. The companies was the proper plaintiff. The majority of the members should be left to decide whether to commence proceedings against directors?"

Cases Which Follow the Rule in Foss Vs Harbottle

1. In Mozley Vs Alston'. Bill was filled at the instance of two shareholders. Who stated procedural disapproval regarding the retirement of Directors. And prayed there in to restrain the twelve directors from acting as officers of the company.

The Chancellor held.

"The shareholders' action could not be sustained on the ground that a large majority of shareholders supported the plaintiff. The company filed bill in its corporate character to seek a remedy for the civil complaint of."

2. Lord Davey in Burland Vs Earle", Directors instead of pay projects to the shareholders, invested them in bank or other shares.

Held. "To redress a wrong done to the company. The action should be brought by the company itself and not by minority shareholders."

3. In Pavlides V Jensen[5] A minority shareholders brought an action for damages against three directors and against the company itself on the ground that they had been negligent in selling Asbestos mine owned by the company.

Reasons for the Rule of Non-Interference

There appear to be three reasons for the Court Policy of not hearing an action by a member concerning the affairs of the company.

(1) Refusal to be involved in disputes over business policy.

(2) Disputes among members should be settled by the members themselves in a general meeting where the "majority" should prevail.

(3) A fear of multiplicity of actions.

Refusal to Decide Business Policy

Judges have repeatedly said that a court determines questions of law not question of business policy. A court will not review the merits of a lawful decision of the members or directors of a

[4] ("950) 2 ALL(ER)Page-1064

[5] (1956) Ch-Page-565

company. As Latham CJ said[6], "It is not for a court to determine whether or not the directors were wise."

(1) Majority Rule

There is a long-standing opinion that membership of any kind of association involves an obligation to settle disputes within the association and to abide the majority decisions. Stuart, LC said in a case[7], the submission of the minority to the principle on which civil society is founded. It is a principle essential for that reasonable harmony which is necessary for the coherence of all societies. Great or small. Civil or religious."

(2) Multiplicity of Actions

Mellish LJ[8], Comment regarding the multiplicity of actions. "Looking at the nature of these companies. Looking at the way in which these articles are formed, and that they are not all lawyers who attend these meetings. Nothing can be more likely than that there should the something more or less irregular should be done at them. Some directors may irregularly appoint, some directors may have turned out, or something or other may have been done which ought not to have been done according to the proper constitution of the articles. Now. if that gives a right to every member of the company to file a bill to have the question decided, then if there happens to be one cantankerous member or one member who loves litigation, everything of this kind will be litigated. Whereas. If the bill must be filed in the name of the company. Then unless there is a majority who really want litigation. The litigation will not go on. Therefore, holding that such suits must be brought in the name of the company certainly greater tend to stop litigation.

Protection of Minority Shareholders (exception to the rule)

It is well established that it is the majority rule that prevails. But in order to prevent them from misusing this privilege and to protect the rights of minority shareholders, certain exceptions to Foss v Harbottle exist. Which are as follows:

1. Act or Resolution Illegal or Ultra Vires

It may be noted that the Rule in Foss V Harbottle will apply only when the acts done by the majority is one which the company is authorized by its memorandum to do. Any act done by the majority beyond the object laws is ultra vires, and it cannot be ratified even it every shareholder is willing to do so. In case of ultra vires acts, even a single shareholder can restrain the company from committing those illegal acts by the filling a suit of injunction, while creditor and debenture holders have no locus standi to object the resolution of the company on the ground that they are illegal or ultra vires[9]. Lord Cairns LJ[10], said "If any act of the company is illegal and any member of the company is dissent from it. He has a right to be protected against its effects. It is a well-established principle that majority has the right to determine everything connected with the management of the company. But we have a right and every individual has a right to enforce Articles."

(1) Rights of Shareholders to Enforce Articles

In Macdougall Vs Gardiner[11], the court held.

"There is a rule that the majority have a right to determine everything connected with the management of the company. But then we have a right, and every individual has a right to have a meeting held in the street in accordance with the Articles."

[6] Richard Brady I! ranks Lid Vs Price Page-136
[7] Copper V Gordon (1869) LR 8EQ Page-249
[8] Mac Dougall Vs Gardiner (1875) | Chapter-13 at Page-25
[9] Mills V Northern Railway of Buenos Ayres (1870) LRS Page-621
[10] Hole v Great Western Railway Co (1867) LR 3 Page- 262

[11] (1875) 1 Chapter D Page-13

Lord Jenkins[12]. Regarding enforcement of the articles by the shareholders observed as follows: So, where the Articles of a Company requires special majority in certain acts. The rule in Foss Vs Harbottle cannot be invoked to override these requirements by a resolution passed by a simple majority. If the requirements of special majority are not fulfilled. Any shareholder can Restrain the company from acting on the resolution.
Lord Hudson Jin Kraus VIG Lloyd (Pvt) Ltd[13]. Held. "The individual rights of the plaintiff as a member of the company have been invaded by the conduct of the defendants and that the rule in Foss Vs Harbottle presents no obstacles to her claim for relief in respect to such invasion".

(2) Fraud on the Minority (The Personal Action)
The rule in Foss V Harbottle will not apply to such acts of the majority. Which constitute a fraud on the minority. Majority powers should be exercised bona fide for the benefit of the company as a whole.
In Brown Vs British Abrasive Wheel co[14], the majority shareholders. Holding ninety eight percent of the shares were willing subscribe for the capital, which the company badly needed. but only if they were able to acquire the share holdings of the minority. They passed a special resolution to alter the Articles to enable them to purchase a minority share compulsorily on certain terms.
The plaintiff refused to sell its share and challenged the validity of the majority resolution; it was decided that.
"The alteration was not for the benefit of the company but for the benefit of the majority and accordingly an injunction was granted against the company prohibiting it from carrying out the Resolution."
In Sidebottom Vs Kershaw, Leese & Co Ltd[15]. Where the defendant company, passed a resolution to alter its Article of Association by providing that the director (who held the majority) should have power to require shareholders who carried on business in competition with the company to transfer these shares. at a fair value. To the directors. The plaintiff. a minority shareholder, brought an action for a declaration that the resolution was invalid.
The court declared the resolution illegal and hence failed.
In Dafen Yinplate Co Ltd V Llanelly Steel Co (1907) Ltd[16]. By altering its articles. The Company empowered the majority of shareholders to compel any member to sell his share at a price to be fixed by directors from time to time.
The court held, "the company could not confer such power on the majority"

(3) Fraud on the Minority (The Derivative Action)
Derivative action is a procedural device for enabling the court to do justice to a company controlled by miscreant directors or shareholders[17].
The court is entitled to examine the conduct of whoever intends to start such proceedings. he must be doing so for the benefit of the company. and not for the same other purpose i.e., he must be a proper person to bring a derivative action.
The minority shareholders can sue on behalf of themselves and all other shareholders accept those who are dependent. The form of action is always brought to minority shareholders on behalf of himself and other shareholders of the company, against the wrong doing directors and the company."[18]

[12] Edward V Halliwell (1980) 2 AHER Page-1064

[13] (1965) VR-232
[14] (1919) | Ch-290

[15] (1920) | Ch-154
[16] (1920) 2 Ch-124
[17] Nurcombe (1985) WLR 370
[18] "Barrett V Ducket" The times July 27, 1991

(4) Sale of Controle at a Premium

In Jones V Ahmanson & Co",[19] the Court Held, "Majority shareholders may not use their power to control corporate activity to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business."

Departure from the Rule by Courts in Pakistan

In Pakistan M. R. Kiyani CJ ignored the Foss Vs Harbottle in Maqbool Elahi Vs Khan Abdul Rahman Khan[20]. Where the Board meeting had been convened to consider the question of calling a General Meeting, but instead of discussing that. The chairman ordered the secretary to leave the room and declared that the petitioner and others had ceased to be directors by virtue of section 86 of the Companies Act, 1913. In their place, the proposal made by the chairman was opposed by two directors, while two were in favor. He would give his casting vote in favor of the proposal. The chairman proposed the suspension of the secretary. Kivani CJ examined the case carefully, where the court had discussed the minority actions and refused to interfere in the internal affairs of the companies. He placed special emphasis on Albert Mills Co Lid V Shiva.[21]To justify his departure from the rule in Foss V Harbottle

Kiyani Chief Justice. Seems to have taken advantage of the inconsistency in the difference in the rule. He remarked that the Authorities when considered collectively, will not be found to lay down any hard and fast rule. He finally discredited the Rule as unsuited to the circumstances in Pakistan. It is obvious that the rule in Foss Vs Harbottle was ignored because it is not practically suited to the conditions in Pakistan. In this respect, the decision of Kiyani CJ is of course, too sound to be questioned. The view of Mr. Kiyani CJ was affirmed by the Supreme Court of Pakistan.

Conclusion

This Rule does not suit the circumstances of Pakistan. In Pakistan, most of the public companies are, in fact, one-man companies. The majority shareholders exploit the minority shareholders with the help of this rule. In the case of private companies, this rule is widely misused.

The following suggestions are given regarding the circumstances in Pakistan.

1. Where it appears that the company appears or has been conducted with intent to defraud its members and creditors, the courts must interfere in the internal affairs of such a company. On the application of any shareholder or creditors.
2. Where it appears that the company is involved in fraudulent or illegal activities. The courts must interfere in the internal affairs of the company.
3. Where it appears that the promoters, directors, or persons engaged in the management of the company affairs have been guilty of fraud, misconduct or misfeasance which can be harmful for the minority shareholders. The courts may take immediate action.
4. Where it appears that the members and creditors of the company have not given true information with respect to its affairs, the courts must provide protection to those affected by ignoring the rule.
5. Statutory provisions should be incorporated to enable the Courts as well as SECP (Security and Exchange Commission of Pakistan) and other investigating agencies to interfere with the internal affairs of the company, in case of like circumstances."[22].

[19] 81 Cal rept-592 (1969)
[20] PLD (1958) Lahore Page-721
[21] (1872) AIR-438
[22] Principle of Majority Rule by Khalid M, PULJ (Punjab University Law Journal 1992 Page-87

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