THE DUTIES OF CONTROLLING SHAREHOLDERS - THE AGENDA FOR REFORM

Introduction

The High Level Finance Committee on Corporate Governance ("the Committee") in their Report[1] has reviewed and suggested some areas of reform in the area of corporate governance.[2] Among others, the Committee has proposed "to deem significant shareholders of a certain shareholding threshold and above as directors"[3] and that "the concept of 'a duty of fair dealing' be extended to include controlling shareholders in respect to vote in certain defined circumstances".[4]

The Committee explained that these proposals were made because of the controlling shareholders "control over the board and board decisions".[5] However, unlike directors, they are not fiduciaries; their right to vote is a proprietary right and not a fiduciary power.[6] Although these controlling shareholders may be a "shadow director" within the definition of director in section 4(1) of the Companies Act 1965,

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[1] Malaysian High Level Finance Committee on Corporate Governance, "Report on Corporate Governance" (1999).

[2] *Ibid*, Chapter 6.

[3] *Ibid*, pp. 132-134.

[4] *Ibid*, pp. 134-136. The Committee earlier stated in their introduction to the chapter on "Reform of Laws, Regulations and Rules" at p. 105 that this review for legislative reform "is required to bring them up-to-date with current commercial reality as well as with internationally accepted concepts on corporate governance".

[5] The Report, p. 132, para. 2.3.2.

[6] *Ibid*, para. 2.3.1. See also para. 2.3.13 at p. 134.

it is difficult to prove that the directors are accustomed to act under the directions and instructions of the controlling shareholders.[7]

The purpose of this article is to trace the development of the law relating to the duties of controlling shareholders and discuss whether there are justifications in the Committee's proposals for reform in this area.

The concept of control

Controlling shareholders are shareholders with the power to control and determine how a company and its business is being managed, be it on a day to day basis or the overall powers of management. To identify the category or categories of controlling shareholders, it will be necessary to first determine the meaning of control and secondly, the threshold of control.

Control may mean *de facto* control or *de jure* control. Shareholders may control a company, directly or indirectly, in a number of ways. First, by exercising their power to vote in a general meeting.[8] Secondly, through the appointment of directors in a general meeting.[9] Thirdly, it is possible that the shareholders themselves manage the company. Therefore, management powers are given to the shareholders and not the board of directors. Although under the law a company

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[7] *Ibid*, para. 2.3.3 at p. 132.

[8] Which is a common way to exert control in a company. For a list and discussion of powers vested in a general meeting, see L.S. Cheang, *Corporate Powers: Control, Remedies and Decision-making* (1996) at pp. 7-9.

[9] With respect to this power to elect directors, an issue may arise: the directors may be under the control of the shareholders nominating them. Although the law imposes fiduciary duties on directors, including nominee directors, to consider the best interests of the company, (see for example the case of *Berlei Hestei (NZ) Ltd. v Fernyhough* [1980] 2 NZLR 150), the practical realities may be different as the nominee directors may place their allegiance primarily to the shareholders nominating them. Also, a situation may arise where shareholders with majority votes may elect the whole board, and thus may deprive the minority of even a single board representative (although there may be some form of understanding or agreement between the shareholders to nominate directors in accordance with the proportion of their shareholding, usually by way of a shareholders agreement entered into by the shareholders. This is especially common in joint venture companies).

must have at least two directors,[10] there is presently no legal requirement that directors shall have exclusive management powers, although this is assumed to be the case in a great majority of cases, as reflected by the model articles of association.[11]

With regards to the threshold of control, it is necessary to distinguish between private and public companies. In order to obtain control over a private company, in many instances, a majority control of voting rights may be required. In public companies, the figure may be less. Control may also be achieved through other means – the use of interlocking shareholding is an example. Control may also be achieved through agreement by the shareholders or the use of proxies.

Berle and Means in their classic text, 'The Modern Corporation and Private Property',[12] discussed the concept of corporate control at length. In summary, the authors suggested five types of control, namely: (i) control through almost complete ownership, (ii) majority control, (iii) control through a legal device, (iv) minority control and (v) management control.[13] The first type of control, i.e. control through almost complete ownership, is found in private companies, where ownership and control are found in the same hands.[14] The second type of control, i.e. majority control, involves ownership of a majority of the shares. In this type of control, the interests of minority shareholders "run parallel to those of the controlling majority and are in the main protected by the self-interest of the latter."[15] In very large corporations, where majority control may not be possible, control is maintained with a relatively small proportion of ownership.[16] The third type of control is effected through a legal device, namely

[10]Companies Act 1965, section 122.

[11]Companies Act 1965, Table A, Regulation 73.

[12]Adolf Berle and Gardiner Means, Chapter 5, "The Evolution of Control" in *The Modern Corporation and Private Property* (1933). See also J. H. Farrar, "Ownership and Control of Listed Public Companies: Revising or Rejecting the Concept of Control" from *Company Law in Change* (ed. B. G. Pettet), London: Stevens & Sons (1987).

[13]*Ibid.*

[14]*Ibid*, p. 67.

[15]*Ibid*, p. 68.

[16]*Ibid.*

"pyramiding".[17] Using this method, a company will own a majority of shares in another company, who will in turn own a majority share in a third company. This process is repeated a number of times. The result is that control can be achieved by the holding company through the holding of a small interest over the ultimate property. The fourth type of control is minority control, or working control, where an individual or a small group hold a sufficient shareholding to be in a position to dominate a company though the share interest.[18] The fifth type of control is management control. This type of control exists where the ownership is so widely distributed that no individual or small group has even a minority interest large enough to dominate the affairs of the company.[19]

It should therefore be recognised that there is no one hard and fast rule to determine and identify control, and therefore controlling shareholders.[20]

The Commission recognised that in companies with a huge shareholding base, 15% to 20% control over voting rights is sufficient for control.[21]

Shareholders' absolute powers?

It was once thought that shareholders of a company do not have any obligations towards the company and other shareholders. They may exercise their votes in general meeting to suit their interests; there is no need to consider the rights of fellow shareholders. A voting right is a proprietary interest, as well as an economic or financial interest. The majority rule applies in companies and therefore the wishes of the majority will prevail, whether with or without resistance from the minority. Jessel M.R. said in *Pender v Lushington*:[22]

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[17] *Ibid*, p. 69.

[18] *Ibid*, p. 75.

[19] *Ibid*, p. 78.

[20] For a discussion on the meaning of "controlling interest", see L. S. Cheang, *Corporate Powers: Control, Remedies and Decision-making* (1996) at pp. 184-185.

[21] The Report, p. 133, para. 2.3.8. However, the Report is only concerned with public companies.

[22] (1877) 6 Ch D 70, pp. 75-76.

> In all cases of this kind, where men exercise their rights of property, they exercise their rights from some form of motive adequate or inadequate, and I have always considered the law to be that those who have the rights of property are entitled to exercise them, whatever their motives may be for such exercise ... a man may be actuated in giving his vote by interests entirely adverse to the interests of the company as a whole. He may think it more for his particular interest that a certain course may be taken which may be in the opinion of others very adverse to the interests of the company as a whole, but he cannot be restrained from giving his vote in what way he pleases because he is influenced by that motive. There is ... no obligation on a shareholder of a company to give his vote merely with a view to what other persons may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interests.

Walton J. echoed this sentiment nearly a hundred years later in *Northern Counties Securities Ltd. v Jackson & Steeple Ltd*[23] when he said:

> When a shareholder is voting for or against a particular resolution, he is voting as a person owing no fiduciary duty to the company who is exercising his own right of property as he sees fit. The fact that the result of the voting at the meeting ... will bind the company cannot affect his position that, in voting, he is voting simply in exercise of his own personal rights.

This view was affirmed by the Malaysian Court of Appeal in *Tuan Haji Ishak bin Ismail v Leong Hup Holdings Bhd.*[24]

The established limitations on shareholders' rights

It is now the prevailing wisdom that the powers of shareholders in exercising their voting rights is not absolute. Farrar, in commenting on Jessel M.R.'s passage above, said that the judge "was wrong even in

[23] [1974] 1 WLR 1133, p. 1144.

[24] [1996] 1 MLJ 661.

1877."[25] English common law has recognised limitations on the voting rights of shareholders, based on an equitable principle, that is, the doctrine of "fraud" on the minority. "Fraud" in this context does not mean fraud as understood in common law, as a dishonest or immoral act. What it simply means is that "the power has been exercised [by the majority shareholders] for a purpose, or with the intention, beyond the scope of or not justified by an instrument creating the power".[26]

This equitable limitation on the shareholders' powers includes the use of voting powers by the controlling shareholders to confer upon themselves rights so as to enable that particular class of shareholders to secure an advantage to itself and to the detriment of the minority, or where the majority expropriates the company's property at the expense of the minority.[27] It may also involve cases where the shareholders confer upon themselves the right to enable them to compulsorily expropriate the shares of the minority.[28]

The test that has been applied to limit the controlling shareholders' powers is whether the power has been exercised "not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded".[29] What follows is a plethora of cases attempting to discover the meaning of the term "bona fide for the benefit of the company as a whole". Dixon J., for example, applied a "negative" test, i.e. the term "benefit as a whole" is "a very general expression negativing purposes foreign to the company's operations, affairs and organisations",[30] and involving "no op-

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[25] J. Farrar, "The Duties of Controlling Shareholders" in *Contemporary Issues in Company Law* in Farrar (ed.), p. 185.

[26] *Vatcher v Paull* [1915] AC 372, p. 378, per Lord Parker; *Abdul Rahim bin Aki v Krubong Industrial Park (Melaka) Sdn Bhd* [1995] 3 MLJ 417. See also the statement by Dixon J. in *Peters American Delicacy Co Ltd v Heath & Ors* (1938-39) 61 CLR 457, p. 505 that "the ground upon which the invalidity is placed is fraud, but what amounts to fraud has not been made the subject to definition". This statement holds true until today.

[27] See *Cook v Deeks* [1916] 1 AC 554; *Ngurli Ltd v McCann* (1953) 90 CLR 425.

[28] See, for example, *Brown v British Abrasive Wheel Co. Ltd.* [1919] 1 Ch 290; *Sidebottom v Kershaw Leese & Co Ltd* [1920] 1 Ch 154; *Gambotto v WCP* (1995) 16 ACSR 1.

[29] *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656, per Lindley MR.

[30] *Peters American Delicacy Co Ltd v Heath & Ors* (1938-39) 61 CLR 457, p. 512.

pression, no appropriation of an unjust or reprehensible nature and did not imply any purpose outside the scope of power";[31] and a "positive" one when he said: "if a resolution is regularly passed with the single aim of advancing the interests of a company considered as a corporate whole, it must fall within the scope of the statutory power ... and could never be condemned as mala fides".[32]

Another test was proposed by Bankes L.J. in *Shuttleworth v Cox Bros & Co. (Maidenhead) Ltd.*[33] which requires that the exercise of powers must not be "so oppressive as to cast suspicion on the honesty of persons responsible for it, or so extravagant that no reasonable men could really consider it for the benefit of the company".[34]

Yet another formulation was proposed by Evershed M.R. in *Greenhalgh v Ardene Cinemas Ltd.*[35] where his Lordship said:[36]

> In the first place, I think 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 upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase, "the company as a whole", does not ... mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body. That is to say, the case may be taken of an individual member and it may be asked whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit.

Despite the different tests and propositions forwarded by these judges, it is now accepted that, despite the proprietary nature of shares, controlling shareholders are not free to pursue their own self interests

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[31] *Ibid*, p. 513.

[32] *Ibid*, pp. 507-508.

[33] [1927] 2 KB 9.

[34] *Ibid*, at p. 18. It should be interesting to note that the legislature in England subsequently provides relief to members of a company where the affairs of the company have been conducted in a manner which is "oppressive" to members.

[35] [1951] Ch 286.

[36] *Ibid*, p. 291.

without any limitation. This limitation was introduced and based on the rules of equity. Jacobs J. commented:[37]

> It seems to me that the trust is that the courts in each generation or in each decade have set a line up to which shareholders have been allowed to go in affecting the rights of other shareholders by alterations of articles of association, but beyond which they have not been allowed to go. It seems to me that no amount of legal analysis or analytical reasoning can conceal the fact that the decision has in the past turned, and must turn ultimately, on a value judgement formed in respect of the conduct of the majority - a judgment formed not by any strict process of reasoning or bare principle of law but upon a view taken of the conduct.

The application of equity on controlling shareholders is not limited to the act of amending articles of association. It may also be applied in cases where the minority shareholders bring an action to wind up the company based on the "just and equitable" ground.[38] In the leading case of *Ebrahimi v Westbourne Galleries Ltd*,[39] the House of Lords approved the principle that where a petition is presented to wind up a company on the basis that such would be in the circumstances as "just and equitable", the courts will accede to the petition if the facts would have justified such an order had the company been a partnership. Lord Wilberforce stated that "just and equitable" enables the court to "subject the exercise of legal rights to equitable considerations". The court declined to define circumstances in which these equitable considerations may apply, but it may exist where one or more of the following elements exist: "(i) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some, (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the busi-

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[37] *Crumpton v Morrine Hall Pty Ltd* [1965] NSWR 240, p. 244.

[38] Pursuant to the Companies Act, section 218(1)(i). See also *Re Wondoflex Textiles Pty Ltd* [1951] VLR 458; *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360.

[39] *Ibid.*

ness; (iii) restriction upon the transfer of members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere."[40]

Lord Wilberforce cautioned against the use of equity in relation to companies when he said that "a company, however small, however domestic, is a company not a partnership, or even a quasi-partnership, and it is through the just and equitable clause that obligations common to partnership relations may come in".[41] This caution, however, was ignored by Foster J. in *Clemens v Clemens Bros Ltd.*[42]. In this case, the "equitable consideration" was further expanded to apply to shareholders. The facts of the case are as follows: the company had two shareholders, an aunt and her niece (the plaintiff). The aunt was a director of the company, but not the niece. The aunt also has controlling interests in the company, with 55% shareholding (and the balance 45% shares were held by the niece). The directors proposed to increase the share capital of the company, to be allotted to employees and directors. The niece claimed, among others, that the resolution's aim was to prejudice her by reducing her voting right to below 25%, therefore depriving her of veto rights on special resolutions. The court agreed with her, holding that the resolution to increase the company's share capital was intended to prejudice her by reducing her voting power to below 25%. The niece would therefore be deprived of the power to prevent the passage of a special resolution. Foster J. said:[43]

> [The aunt] is not entitled to exercise her majority vote in whatever way she pleases. The difficulty is in finding a principle, and obviously expressions such as "bona fide for the benefit of the company as a whole", "fraud on the minority" and "oppressive" do not assist in formulating a principle. I have come to the conclusion that it would be unwise to try to produce a principle, since the circumstances of each case are definitely varied. It would not, I think, assist

[40] *Ibid*, p. 379. These considerations are interesting, as it is somewhat similar to the definition of "close corporations" in the United States, which will be discussed later in this article.

[41] *Ibid*, p. 380.

[42] [1976] 2 All ER 268.

[43] *Ibid*, p. 282.

> to say more than that in my judgment [the aunt] is not entitled as of right to exercise her votes as an ordinary shareholder in any way she pleases. To use the phrase of Lord Wilberforce [in *Ebrahimi*], that right is "subject ... to equitable considerations ... which may make it unjust ... to exercise [it] in a particular way".

Clemens is a reflection of the difficulty the courts had, to somehow place a limit on the powers of controlling shareholders. The imposition of "equitable considerations" is a recognition that shares, by its very nature, are participating rights to the ultimate property, which are the assets of the company. The controlling shareholders, who have a right to a bigger portion of the assets (in a sense), are entitled to more say in the management of these assets. Therefore, the controlling shareholders have the power to control the assets, on their own behalf and on behalf of others. It has been said that the law imposes a fiduciary duty on anyone who has the power to control the property of another person,[44] and controlling shareholders are fiduciaries as they have the power to control the property of the other shareholders.[45] This may be used to explain the use of the phrases "the duty to act in the best interests of the company" and the "equitable considerations", without going so far as to impose a fiduciary duty on the controlling shareholders.

Is there a case for imposing fiduciary duties on shareholders?

Whatever the test applied, a generally accepted proposition is that the "equitable considerations" applied in *Ebrahimi* and *Clemens* falls short

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[44] Z. Cohen, "Fiduciary Duties of Controlling Shareholders: A Comparative View" (1991) U. Pa. J. Int'l Bus. L. 379, p. 380, citing, among others, Davis, "Judicial Review of Fiduciary Decision-making: Some Theoretical Perspectives" (1985) 80 Nw. U.L. Rev. 1; L. S. Sealy, "Fiduciary Relationships" (1962) Cambridge L.J.; L. S. Sealy, *Some Principles of Fiduciary Obligations*, 1963.

[45] Z. Cohen, *ibid.*

of imposing a fiduciary duty on shareholders.[46] It is not difficult to understand the judiciary's reluctance to impose fiduciary duties on controlling shareholders, as ownership of shares is proprietary in nature.[47] As Dixon J. in *Peters' American Delicacy*[48] said, a shareholder's voting right "is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage".[49] Because of this, the shareholders "occupy no fiduciary position and are under no fiduciary duties"[50]. A fiduciary "is under an obligation not to promote his personal interest by making or pursuing a gain in circumstances in which there is a conflict or a real or substantial possibility of a conflict between his personal interests and those of the persons whom he is bound to protect".[51] Such an obligation is completely at odds with the proprietary nature of shares.

Nevertheless, there may still be a valid argument that controlling shareholders may be clothed, in certain circumstances, with fiduciary duties based on the relationship of the parties in a particular circumstance.

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[46] See J. H. Farrar, "The Duties of Controlling Shareholders" in Farrar (ed.) *Contemporary Issues in Company Law*, 185 at p. 189; B. A. K. Rider, "Partnership Law and Its Impact on 'Domestic Companies'" (1979) CLJ 148. Compare with Z. Cohen, "Fiduciary Duties of Controlling Shareholders: A Comparative View" (1991) U. Pa. J. Int'l Bus. L. 379, where the author, quoting Gower in *Gower's Principles of Modern Company Law* (4th ed.) (1980), argued that the limitation imposed on controlling shareholders in respect of alteration of articles, together with the "equitable considerations" in *Clemens* were a result of the breach of fiduciary duties of the shareholders.

[47] As was the view in *Pender v Lushington*, *supra*, *Northern Counties Securities Ltd v Jackson & Steeple Ltd*, *supra*, *Tuan Haji Ishak bin Ismail v Leong Hup Holdings Bhd*, *supra*, and *Peters' American Delicacy Co Ltd v Heath*, *supra*.

[48] *Supra*.

[49] *Supra*, at p. 504.

[50] *Supra*.

[51] Per Mason J. in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, p. 103.

Who are fiduciaries?

The traditionally accepted categories of persons who stand in a fiduciary position includes, among others, partners, agents, directors and solicitors.[52] These categories of fiduciaries are never closed[53]. This is where the difficulty lies, as there is no easy identification of a fiduciary. Perhaps a good starting point for discussion is the classical statement by Fletcher Moulton L.J. in *Re Coomber*:[54]

> Fiduciary obligations are of many different types: they extend from the relation of myself to an errand boy who is bound to bring me back my change, up to the most intimate and confidential relations which can possibly exist between one party and another, where the one is wholly in the hands of the other because of his infinite trust in him. All these are cases of fiduciary relations, and the courts have again and again, in cases where there has been a fiduciary relation, interfered and set aside acts which, between persons in a wholly independent position, would have been perfectly valid.

Two points should be noted from the above quotation: first, the presence of trust in the fiduciary and secondly, vulnerability of one party, resulting from the trust.

One writer, Finn[55] suggested two general characteristics of fiduciary relationships: first, the capacity one party has to affect the inter-

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[52]See, eg., *Tengku Abdullah ibni Sultan Abu Bakar & Ors v Mohd Latiff bin Shah Mohd & 2 Ors* [1996] 2 AMR 2633, pp. 2672-2673; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, p. 68.

[53]*Ibid.*

[54][1911] 1 Ch 723, pp. 728-729. For some other cases, see, eg., *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, *supra*; *Tengku Abdullah ibni Sultan Abu Bakar & Ors v Mohd Latiff bin Shah Mohd & 2 Ors, supra*, *Frame v Smith* (1987) 42 DLR (4th), 81. For articles, see eg. P. D. Finn, "Contract and Fiduciary Principle" (1989) 12 UNSW L.J. 76; J. M. Gill, "A Man Cannot Serve Two Masters: The Nature, Existence and Scope of Fiduciary Duties" (1989) Journal of Contract Law 115; B. H. McPherson J., "Fiduciaries: Who Are They?" (1998) ALJ 288 at p. 290.

[55]P. D. Finn, "Contract and Fiduciary Principle" (1989) 12 UNSW L.J. 76.

ests of the other and the corresponding vulnerability of the other[56], and secondly, the reliance one party has upon the other because of the trust or confidence reposed in him/her, or because of the influence or ascendancy enjoyed by, that other.[57] In another passage, Finn said:[58]

> What must be shown, in the writer's view, is that the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in the interests in and for the purposes of the relationship. Ascendancy, influence, vulnerability, trust, confidence or dependence doubtless will be of importance in making this out. But they will be important only to the extent that they evidence a relationship suggesting that entitlement. The critical matter in the end is the role that the alleged fiduciary has, or should be taken to have, in the relationship. It must so implicate that party in the other's affairs or so align him with the protection or advancement of that other's interests that foundation exists for the "fiduciary expectation".

The Court of Appeal has embarked on a similar quest in attempting to identify the general characteristics common to fiduciary relationships. In *Tengku Abdullah ibni Sultan Abu Bakar & Ors v Mohd Latiff bin Shah Mohd & 2 Ors*[59], one of the issues was whether promoters of a proprietary club were fiduciaries. The Court of Appeal answered the question in the affirmative. In reaching his decision, Gopal Sri Ram JCA quoted the general characteristics of fiduciary relationships proposed by Wilson J. in *Frame v Smith*[60]. These characteristics are:

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[56] Finn quoted *LAC Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) 14, a decision of the Supreme Court of Canada as an example of this proposition. In a more recent decision by the same court, *Hodgkinson v Sims* (1994) 117 DLR (4th), 161, the court discussed whether there was "substantial" or "total" reliance. The majority concluded that "substantial" reliance on the adviser is sufficient to confer a "fiduciary duty" on the adviser.

[57] *United Dominions Corp. Ltd v Brian Pty Ltd* (1985) 157 CLR 1 was among the cases cited.

[58] *The Fiduciary Principle* (1988), quoted with approval by La Forest J. in *LAC Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) 14, p. 29.

[59] [1996] 2 AMR 2633, pp. 2672-2673

[60] (1987) 42 DLR (4th) 81. See *Tengku Abdullah*, at p. 2671.

(1) the fiduciary has scope for the exercise of some discretion or power;
(2) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests;
(3) the beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

His Lordship concluded:

> A review of the authorities reveals that the characteristics referred to by Wilson J. [in *Frame v Smith*] are present in well established categories of relationships in which the duty has been held to arise. These include the relationships of spiritual adviser and penitent, doctor and patient, agent and principal, solicitor and client, company directors, partners and joint venturers.[61] It is noteworthy that the fiduciary doctrine has even been extended to those in negotiation for a partnership or a joint venture...

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[61] By way of a note, it may be worth noting that the Malaysian courts have consistently held that joint venturers owe a fiduciary duty to each other: see also the Supreme Court decision of *Newacres Sdn Bhd v Sri Alam Sdn Bhd* [1991] 3 MLJ 474 and the Court of Appeal in *Hartela Contractors Ltd v Hartecon JV Sdn Bhd* [1999] 2 MLJ 481. In *Newacres*, reliance for this proposition was based on, *inter alia*, the Supreme Court of New South Wales' case of *Brian Pty Ltd v United Dominions Corp Ltd* [1983] 1 NSWLR 490. In *Hartela Contractors Ltd*, the Court of Appeal cited *Newacres* as the authority that joint venturers owes fiduciary duties to one another. It should be noted that the defendant in *United Dominions Corp Ltd* had appealed against the Supreme Court's decision to the Australian High Court (see *United Dominions Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1). Although the Australian High Court affirmed the Supreme Court's decision, the Australian High Court holds that "whether or not the relationship between joint venturers is fiduciary will depend upon the form which the particular joint venture takes and upon the content of the obligations which the parties to it have undertaken" (at p. 11). In the light of the foregoing, it is difficult to understand the rationale behind the decisions to include joint venturers as one of the categories of relationships where a fiduciary relationship exists. An alternative approach is for the courts to look at the nature of the relationship and the obligations of the joint venturers to determine whether such a fiduciary relationship exists. For a more comprehensive treatment of the subject, see Nicolette Rogers and Gillian Nisbet, "Joint Ventures and Equity – Fiduciary Aspects" from *Joint Venture Law in Australia* (ed. W. D. Duncan) (1994).

> Ought the doctrine to made applicable to promoters of proprietary clubs? The appellants say it ought not. The [trial] judge held that it ought. With respect, we agree with the judge. In arriving at his conclusion, the learned judge was undoubtedly influenced by the decision of the House of Lords in *Erlanger (supra)* ... Suffice to say that we find the reliance he placed upon *Erlanger (supra)* to hold that the appellants, as promoters, were fiduciaries, to be a correct direction in law and to be entirely in keeping with the spirit and intendment of equity jurisprudence.

Based on the principles extracted above, it could well be argued that controlling shareholders may be fiduciaries, not as an accepted category of fiduciary relationship, but based on the actual relationship of the parties. In other words, a fiduciary relationship may exist because the general characteristics of the relationship between the controlling and minority shareholders reflect the accepted categories of persons who stand in a fiduciary position. The test to be applied is, first, the capacity the controlling shareholders have to affect the interests of the minority shareholders and the corresponding vulnerability of the minority shareholders, and secondly, the reliance the minority shareholders have upon the controlling shareholders because of the trust or confidence reposed in, or because of the influence or ascendancy enjoyed by the controlling shareholders.[62] Or alternatively, applying another test,[63] the questions to be answered are whether:

(1) the controlling shareholders have scope for the exercise of some discretion or power;
(2) the controlling shareholders can unilaterally exercise that power or discretion so as to affect the minority shareholders' legal or practical interests; and
(3) the minority shareholders are peculiarly vulnerable to or at the mercy of the controlling shareholders.

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[62] Adopting the tests proposed by P. D. Finn in "Contract and Fiduciary Principle" (1989) 12 UNSW L.J. 76.

[63] As proposed in *Frame v Smith, supra*, and quoted with approval by the Court of Appeal in *Tengku Abdullah ibni Sultan Abu Bakar & Ors v Mohd Latiff bin Shah Mohd, supra.*

These tests may be answered in the affirmative especially where the company is a private company, and there is an intimate and personal relationship between the shareholders. It should be noted that in *Clemens*, the company was a small, private company with only two shareholders. The niece entrusted the aunt to manage the company. The niece herself was not a director. Therefore, this is a case where the aunt, as the controlling shareholder, has the capacity to affect the interests of the niece, the minority shareholder. There is also the trust element because the niece had entrusted the aunt to manage the company. To adopt the words of Fletcher Moulton LJ in *Re Coomber*,[64] "the [niece] is wholly in the hands of the [aunt] because of [the niece's] infinite trust in [the aunt]". It therefore seems likely that the "equitable considerations" in *Clemens* is fiduciary in nature.

Based on the foregoing it may perhaps be suggested that the proprietary nature of shares and the corresponding right of shareholders to vote in their own interests should not exclude the existence of fiduciary duties in appropriate circumstances.

The doctrine of fairness

The Companies Act 1965 provides for a statutory remedy for acts of the majority which may be considered "oppressive"[65] or "unfairly discriminatory or prejudicial"[66] against a member or in a manner that is contrary to the interests of the members as a whole.[67]

It is quite common for the courts to treat the term "oppressive" and "unfairly discriminatory or prejudicial" as having the same meaning. Even in the much cited case of *Re Kong Thai Sawmill (Miri) Sdn*

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[64] [1911] 1 Ch 723 at p. 728.

[65] Section 181(1)(a).

[66] Section 181(1)(b).

[67] The proposition that controlling shareholders have a duty to act "bona fide for the benefit of the company as a whole" when altering articles of association as devised by Lord Lindley in *Allen v Gold Reefs of West Africa Ltd*, *supra*, and further explored and explained by Dixon J. in *Peters' American Delicacy*, *supra*, was made at a time when there was no remedy provided by the law in relation to the abuse of power by the controlling shareholders. For a historical background of this remedy, see P. Redmond, *Companies and Securities Law* (1992) at p. 238.

Bhd[68], the Privy Council, having acknowledged the existence of relief based on "unfairly discriminatory or prejudicial" acts,[69] failed to spell out the difference between acts which are "unfairly discriminatory or prejudicial" and "oppressive".

Two cases where the court has attempted to distinguish the term "oppressive" and "unfairly discriminatory or prejudicial" are *Jaya Medical Consultants Sdn Bhd v Island & Peninsular Bhd & Ors*[70] and *Tuan Haji Ishak bin Ismail v Leong Hup Holdings Bhd*[71]. In *Jaya Medical Consultants Sdn Bhd*,[72] a group of 25 doctors incorporated a company as a vehicle to establish a private hospital. The doctors initially held 51% of the company's share capital, but was subsequently reduced to 21%. Due to a series of events, the project was being abandoned. The company was also unable to meet creditors' demands. The doctors brought an action against their venture partners pursuant to section 181(1)(a) and (b) of the Companies Act 1965 complaining that they had been misled, betrayed and cheated in that, *inter alia*, their legitimate expectation of getting a hospital had not been fulfilled.[73] Siti Norma Yaakob J. (as she then was) distinguished "oppression" and "unfairly discriminatory and prejudicial" acts when she said:[74]

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[68] [1978] 2 MLJ 227, at p. 229.

[69] Section 181(1)(b), which was not provided for under the corresponding United Kingdom provision, United Kingdom Companies Act 1948, section 210.

[70] [1994] 1 MLJ 520.

[71] [1996] 1 MLJ 661

[72] *Supra*.

[73] Although it is not clear from the judgment how a "legitimate expectation" on the part of the doctors could have arisen, it may be that the counsel argued that it applies on the basis that "equitable considerations" is a part of section 181. For this proposition of law, see e.g. *Ebrahimi v Westbourne Galleries* [1973] AC 360. Therefore, section 218(1) is imported into section 181. This contention is rejected by Siti Norma Yaakob J. when she said (at p. 535):

> ...I cannot accept the contention of ... senior counsel for the petitioner, that the just and equitable grounds form part and parcel of s 181, for unlike s 210 of the UK Companies Act 1948, our s 181 does not specify the winding-up of a company on the just and equitable ground. That provision would be more relevant if this petition had been presented under s 218(1)(i) of the Act.

[74] At pp. 536–537.

> Whilst the word 'oppression' connotes more serious or culpable behaviour, something less than oppression is required for conduct that is unfairly discriminatory or prejudicial to the petitioner as a member of the company. The essence of the wrong done to the minority member under s 181(1)(b) is the 'unfairness' of the discrimination or prejudice suffered by the member resulting from some act of the company in the advancement of its objectives. Mere discrimination against or prejudice to such member is insufficient to attract the court's jurisdiction to intervene. The question of unfairness is one of fact and degree which sub-s (1)(b) requires the court to determine. The test is aptly stated by Brennan J. in the Australian case *of Wayde & Anor v New South Wales Rugby League Ltd* (1985) 10 ACLR 87; (1985) 59 AJLR 798, to be as follows:
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> > The test of unfairness is objective ... and it assumes that reasonable directors weigh the furthering of the corporate object against the disadvantage, disability or burden which their decision will impose and address their minds to the question whether a proposed decision is unfair. The court must determine whether reasonable directors possessing any special skill, knowledge or acumen possessed by the directors and having in mind the importance of furthering the corporate object on one hand and the disadvantage, disability or burden which their decision will impose on a member on the other, would have decided that it was unfair to make that decision.
>
> It is this concept of unfair discrimination or prejudice that enables the court to take into consideration not only the rights of the members under the company's constitutions but also their legitimate expectations arising from agreements and understanding of the members among themselves. *Re Posgate & Denby (Agencies) Ltd* [1987] BCLC 8; [1987] PCC 1.

In *Tuan Haji Ishak bin Ismail v Leong Hup Holdings Bhd*[75], the Court of Appeal found a similarity between sections 181(1)(b) and 218(1)(f) of the Companies Act 1965. Since one of the reliefs provided by section 181(2) is for an order that the company be wound up, the Court

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[75].[1996] 1 MLJ 661.

thought it appropriate to import the concepts of "legitimate expectation" and "equitable considerations" into section 181(1)(b).[76] Mahadev Shankar JCA said:[77]

> When we talk of legitimate expectations, we inevitably have to apply the equitable considerations that a court should take into account when dealing with a claim of a minority shareholder of oppression, or unfair prejudice. It is to be noted that whilst extending the scope of remedies available, s 181(2) provides that winding up shall be one of the remedies. Section 218(1) of our Act provides that the court may order the winding up if:
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> (f) the directors have acted in the affairs of the company in their own interests rather than the interests of the members as a whole, or in any manner whatsoever which appears to be unfair or unjust to other members;
>
> ...
>
> (i) the Court is of the opinion that it is just and equitable that the company be wound up.
>
> The words in (f) are somewhat different, but the effect is very similar if not the same. Self-interest, unfair or unjust conduct could also amount to oppression, unfair discrimination or conduct which is unfairly prejudicial to minority interests.

The approach taken by the Court of Appeal contrasted with the approach of the High Court in *Jaya Medical Consultants Sdn Bhd v Island & Peninsular Bhd, supra*. Notwithstanding these two different approaches, they yield the same result: "legitimate expectation" and "equitable considerations" may be imported into section 181. How-

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[76] *Ibid*, at pp. 684–692, relying on passages from the text *Company Law* by Farrar (3rd Edition, 1991) at pp. 464-465, *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 and a few other authorities. However, the court concluded that based on the facts, there was no legitimate expectation which may be enforced against the respondent company.

[77] *Ibid*, at pp. 684–685.

ever, one might be inclined to think that as the term "fairness" allows the courts to directly import "legitimate expectation" or "equitable considerations" into section 181, there should be no reason why the courts should introduce these "legitimate expectations" or "equitable considerations" through the back door, i.e. by merging the "just and equitable" ground in section 218 into section 181.

Notwithstanding the two different approaches taken by the courts above, it should by now be clear that minority shareholders would have a valid complaint if they are not being treated fairly. The concept of fairness is not limited to actions brought to wind up a company based on "just and equitable" grounds.

The term "fairness" has been further explained in *Thomas v HW Thomas*[78] where Richardson J. said:[79]

> Fairness cannot be assessed in a vacuum or simply from one member's point of view. It will often depend on weighing conflicting interests of different groups within the company. It is a matter of balancing all the interests involved in terms of the policies underlying the companies legislation in general and [section 181] in particular: thus to have regard to the principles governing the duties of a director in the conduct of the affairs of a company and the rights and duties of a majority shareholder in relation to the minority; but to recognise that [section 181] is a remedial provision designed to allow the Court to intervene where there is visible departure from the standards of fair dealing; and in the light of the history and structure of the particular company and the reasonable expectations of the members to determine whether the detriment occasioned to the complaining member's interests arising from the acts or conduct of the company in that way is justifiable.

The position in the United States compared

The courts in the United States have always been prepared to hold shareholders responsible in appropriate circumstances, to the extent

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[78] [1984] 2 ACLC 610.

[79] *Ibid*, p. 618.

that their duties may be equated to those of directors. In an important decision, *Pepper v Litton*,[80] the Supreme Court said:

> A director is a fiduciary ... so is a dominant or controlling stockholder or group of stockholders ... Their powers are powers in trust.... Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation are challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show inherent fairness of the transaction from the viewpoint of the corporation and those interested therein.

In the United States there is no statutory provision comparable with section 181 of the Companies Act. Most actions taken by minority shareholders are premised on claims of breach of fiduciary duties by the controlling shareholder as it was generally accepted that controlling shareholders owe fiduciary duties to the minority and the corporation.[81] In the leading case of *Southern Pacific Co. v Bogert*,[82] the United States Supreme Court held that the controlling shareholder in control of the voting rights of a company must act fairly towards the minority and is subject to a fiduciary duty. The majority will also not be allowed to 'squeeze-out' or 'freeze-out' the minority, i.e. where the majority employ the various techniques to eliminate the minority shareholders.[83] If the minority is being oppressed by the majority, in some cases the court will not hesitate to impose very strict fiduciary duties on the majority. If there is a written agreement entered into by the shareholders, the court will defer to the contractual arrangement. In the absence of a contract, the court must decide what the parties would have agreed to had they written a contract resolving all contingencies.[84]

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[80] 308 U.S. 295, p. 306.

[81] See, eg. *Donahue v Rodd Electrotype Company of New England Inc.* 328 NE 2d 505 (1975).

[82] 250 U.S. 483 (1919).

[83] See O'Neal and Thompson, *O'Neal's Oppression of Minority Shareholders* (2nd. ed.) (1985); Jennifer Hill, "Protecting Minority Shareholders and Reasonable Expectations" (1992) 10 C & SLJ 86 at pp. 88-89.

[84] O'Neil and Thompson, *ibid*, p. 245.

The courts in the United States have also accorded special recognition of a fiduciary duty of majority shareholders in the context of a close corporation.[85] This was established in *Helms v Duckworth.*[86] In a more recent case, *Donahue v Rodd Electrotype Company of New England Inc.*,[87] the corporation bought shares from it's long standing manager (Rodd) at a certain price, but refused to pay the same price to the plaintiffs, the reason given was lack of funds. The court held that the shareholders in a closely held corporation owe each other a duty of utmost good faith and loyalty. This duty requires that the controlling shareholders who use their position to confer benefits on themselves to do the same for all other shareholders. In not doing so, the controlling shareholders have breached their fiduciary duties, which is analogous to fiduciary duties of partners in a partnership. The court explained:

> Because of fundamental resemblance of the close corporation to the partnership, the trust and confidence which are essential to this scale and manner of enterprise, and the inherent danger to minority interests to the close corporation, we hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another. ... the standard of duty owed by partners to one another as the 'utmost good faith and loyalty'. Stockholders in close corporations must discharge their management and stockholders responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation [references omitted].

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[85] A close corporation is a private company and is typified by: (1) small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation: *Donahue v Rodd Electrotype Company of New England Inc* 328 NE 2d 505 at p. 508 (1975). It is interesting to note the similarity in the characteristics of close corporations to those companies where "equitable considerations" were thought to apply as stated by Lord Wilberforce in *Ebrahimi.*

[86] 249 F.2d 482 (1957).

[87] *Donahue, supra,* at p. 512.

Adopting the partnership relationship, the fundamental principles of partnership law should apply, such as equal sharing rules, automatic buyout rights and strict fiduciary duties.[88]

Conclusion

Based on current legal principles which have been developed by both the legislature and the courts, controlling shareholders are not free to do as they wish without any limitations, but are required to consider the interests of minority shareholders. This duty to consider the interests of other shareholders has been differently described as a "duty to act in the best interests of the company as a whole", "a duty to act fairly", "equitable considerations" and even "fiduciary duty". Although section 181 of the Companies Act 1965 offers much potential as a way to formulate a comprehensive set of duties of controlling shareholders[89], it has yet to be fully explored and utilised by aggrieved shareholders and the courts. Otherwise, to rely on a finding of a fiduciary relationship by the courts, although this should not be discounted, would simply promote uncertainty. Even if one general principle for the identification of fiduciaries may be formulated by the courts in the years to come, a limitation of shareholders' powers can only be imposed on the special facts and circumstances of a particular case. Also, to impose fiduciary duties on controlling shareholders as a new category of fiduciary relationship is incompatible with the proprietary nature of shares and its all-important incidental right - voting power. Nonetheless, a recognition of the concept of close corporations as found in the case law and legislation of the United States may be useful, both by the legislature, for the purpose of law reform, and the

[88] See Frank H Easterbrook and Daniel R Fischer, "Close Corporations", Chapter 9 in *The Economic Structure Of Corporate Law* (1991).

[89] Although the provision may require an update, as has been done to corresponding companies legislation in Australia, New Zealand, Canada and the United Kingdom.

courts, for the purpose of identifying the "actual circumstances of a relationship".[90]

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[90]To quote P. D. Finn in *The Fiduciary Principle* (1988).

* The author is grateful to Professor Judith Sihombing of the University of Hong Kong for her comments on the earlier draft of this article. All errors remain mine alone.

APPEAL FROM THE HIGH COURT TO THE COURT OF APPEAL AGAINST A BAIL DECISION : *DATO' SERI ANWAR BIN IBRAHIM V PUBLIC PROSECUTOR*

In the case of *Dato' Seri Anwar bin Ibrahim v Public Prosecutor,*[1] three major points were discussed. The first was in relation to the question of whether a bail decision by the High Court is appealable to the Court of Appeal.

Section 307(1) of the Criminal Procedure Code (CPC) allows any person to appeal to the High Court against a judgment, sentence or order of a lower court. The word 'judgment' has been defined as: 'The official and authentic decision of a court of justice upon the respective rights and claims of the parties to an action or suit therein litigated and submitted to its determination. The final decision of the court resolving the dispute and determining the rights and obligations of the parties'[2] whilst the word 'sentence' has been defined as: 'The judgment formally pronounced by the court or judge upon the defendant after his conviction in a criminal prosecution, imposing the punishment to be inflicted'.[3] It is clear therefore that an acquittal or a conviction may be appealed against. Similarly, a sentence may be appealed against if either the prosecutor or the accused is dissatisfied with it. What about the 'order' then?

According to *Black's Law Dictionary*, an 'order' means 'a mandate; precept; command or direction authoritatively given, rule or regulation ... Direction of a court or judge made or entered in writing,

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[1] [1999] 1 MLJ 321.

[2] *Black's Law Dictionary,* (6th. ed.), 841-842.

[3] *Op.cit.* 1362.