BREACH OF DUTY: POWER OF SHAREHOLDERS TO RATIFY DIRECTORS FRAUDULENT DEALINGS

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Abstract

Company directors owe duty of loyalty to the company which prohibits them from fraudulent dealings in the course of conducting the affairs of the company. Although the shareholders could, in the exercise of their voting powers, grant relieves to the directors from liabilities arising from a breach of duty that amounts to fraud, the extent and capacity in which the shareholders could exercise such powers is confounded by the elusive attempts by the courts in defining fraud. The paper argues that without a definite meaning ascribed to fraud, the power and capacity in which the shareholders could ratify a breach of duty arising from self-dealing and expropriation of corporate opportunities by directors cannot be predetermined, but that each case would be based on the peculiarities of its own facts.

Keywords: Shareholders; Directors; Breach of duty; Fraud; Ratification

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Introduction

Directors as custodians of company's assets and powers owe duties of loyalty to the company. Loyalty demands total and unquestionable commitment by the director to the affairs of the company. It imposes fiduciary obligations on the directors demanding that they act with due care and skill, avoid self-dealing, and exercise utmost good faith and unscrupulous fairness in the conduct of the company's affairs in the best interests of the company.[1] The impact of the directors fiduciary duties are felt more stringently in recent times with the increasing statutory recognition and restatement, in various jurisdictions, of the scope, and the provision of guidelines for the enforcement of those duties.[2] The same statutes also recognise the humanness of the directors which is amenable to mistakes of business judgment and negligence in the discharge of their responsibilities, thus creating room for the shareholders to exonerate the directors from liabilities arising from a breach of duties through the process of ratification.

The classic form of ratification describes the situation where shareholders approve board action that, legally speaking, could be accomplished without any shareholder approval. It invokes a voluntary addition of an independent layer of shareholder approval in circumstances where shareholder approval is not legally required.[3] Classic ratification demands full and frank disclosure of the director's wrongdoing to enjoy the cleansing effect of the shareholders' votes.[4]

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[1] J. Robert Brown Jr, 'Speaking with Complete Candor: Shareholder Ratification and the Elimination of the Duty of Loyalty'(2002-2003) 54 *Hastings Law Journal* 641at 645.
[2] See for instance ss 76 & 77 of the South African Companies Act 71 of 2008, ss 170-178 of the UK Companies Act of 2006.
[3] See *In re Wheelabrator Technologies Inc, Shareholder Litigation* 663 A. 2d 1194, 1202 and n.4 (Del. Ch 1995). See also *Gentler v Stephens* 965 A 2d 695 (Del Supr. 2009) where the court approved the classic form of ratification and distinguished it from mere statutory shareholder approval. In *In re Santa Fe Pac. Corp. S'holder Litig*., 669 A.2d 59, 68 (Del.1995), the Delaware Supreme court held that the shareholders' approval of a merger is not the same as a ratification of a breach of duty.
[4] *Gentler v Stephens* 965 A 2d 695 (Del Supr. 2009) at 34.

It is however not settled on the extent to which classic ratification could exonerate the directors of wrongdoing arising from self-dealing and dishonest misappropriation of corporate opportunities and property in the course of conducting the company's affairs and in such a manner as would amount to defrauding of the company. Opinions are divided on whether, and in which circumstances, could the shareholders, in the exercising of their voting powers relieve the directors from liability arising from fraudulent transactions. The scope of the legal question, as observed by Worthington,[5] is not only whether a company may exonerate its defaulting director, but also how that exoneration must be effected if it is to bind dissenting shareholders and future controllers of the company. Judicial decisions on these issues are increasingly confounding, the same could also be said of the recent UK statutory provisions which are primarily geared at straightening the common law inconsistencies.

Fraudulent Conducts

One aspect of breach of duties by the directors which seems fairly well established as incapable of ratification by the majority of the shareholders is fraud.[6] The concept of fraud has, however, been subjected to various judicial definitions that it is now virtually impossible to determine which conduct of the director would escape judicial condemnation even after the shareholders have adopted the transaction.

The term 'fraud' is generally viewed from two perspectives, namely; actual fraud and equitable fraud. Actual fraud entails dishonesty which, as Millet LJ explained in *Armitage v Nurse*,[7] connotes at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interests of the beneficiaries or being recklessly indifferent whether it is contrary to their interests or not. A trustee is dishonest if he acts in a way which he does not honestly believe to be in the interests of the beneficiary. 'It does not matter whether he stands or thinks he stands to gain personally from his actions. A trustee who acts with the intention of benefiting persons who are not objects of the trust is not the less dishonest because he does not intend to benefit as a trustee'.[8]

The existence of dishonesty is ascertained objectively. This is borne by the judgment of the Privy Council in *Royal Brunei Airlines v Tan*[9] where Lord Nicholls stated that 'acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard'. The adoption of an objective approach in identifying dishonest conduct gives the courts a wider room to assess the conduct of the defendant. It would not depend on the defendant's 'conscious assessment of his own conduct, but on what a reasonable business man would have done, or how such conduct is seen judged by the normally acceptable standard'.[10] This would align

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[5] Sarah Worthington, 'Corporate governance: remedying and ratifying directors' breaches' available at http://eprints.lse.ac.uk/archive/00000235 accessed on 25/02/2014.

[6] And this is so whether the fraud is committed on the creditors or the minority shareholders. See Brenda Hannigan, *Company Law* 3rd ed (Oxford: Oxford University Press, 2012) at 247, 427-428. See also *Theatre Amusement Co v Stone* 1914 CanLII 40 (SCC), 50 SCR 32 at 37 where Anglin J observed that the changes in the dealings between the company and the partnership, after Stone had ceased to be a member of that partnership, whereby profits resulted to the partnership, was a fraudulent breach of trust on the part of the directors which no majority of the shareholders could render binding on the company.

[7] [1997] EWCA Civ 1279. See also *Newgate Stud Co & Anor v Penfold & Anor* [2004] EWHC 2993 (Ch) per Richards J para 249.

[8] *Armitage v Nurse* [1997] EWCA Civ 1279. See also *Gwembe Vally Development Co Ltd & Anor v Koshy & Ors* [2003] EWCA Civ 1048.

[9] [1995] 2 AC 378 at 386. Cf House of Lords decision in *Twinsectra v Yardley* [2002] UKHL 12 paras 27, 38 where Lord Hutton stated the test of dishonesty as being both objective and subjective in that honest person would not have acted in the same manner as the defendant, and that the defendant appreciated that his action would be considered as dishonest by honest and reasonable person. The cloud introduced by this decision on the test of dishonesty was cleared by a subsequent Privy Council decision in *Barlow v Clowes International Ltd (in Liquidation) v Eurotrust International Ltd* [2005] UKPC 37 which maintained an objective assessment of dishonesty, a position preferred by this writer as it enhances probity. The objective standard was adopted by the Court of Appeal in *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492. See generally Stephen Girvin, Sandra Frisby and Alastair Hudson, *Charlesworth's Company Law* 18th ed (London: Sweet & Maxwell, 2010) at 371-375 for analysis of the various decisions. See also John McGhee, *Snell's Equity* 31st ed (London: Sweet & Maxwell, 2005) paras 372-375.

[10] *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492.

dishonesty with the definition of fraud by Maugham J in *Re Patrick and Lyon Ltd*[11] as connoting 'real dishonesty involving, according to current notions of fair trading among commercial men at the present day, real moral blame'.

A dishonest transaction, even when not elevated to the status of criminality, could be denied legal validity on ground of public policy, notwithstanding shareholders' ratification. This would be the case where the ratified transaction does not further the interests of the company.[12] The existence of dishonesty, in whichever form manifested, strips the transaction of business judgment presumption[13] which ordinarily protects the directors from liability against decisions taken in good faith and in the best interests of the company.[14] The business judgment concept presumes in favour of the director that every transaction entered into on behalf of the company is executed bona fide and in the interests of the company. The real purpose is to allow the directors to run the affairs of the company without undue judicial interference. The proof of dishonesty, which is objectively ascertained, would however, compel such judicial intervention as the director would seem to be deviating from the company's goal in preference for personal gain.

The defining of equitable fraud invokes greater judicial flexibility than actual fraud. This flair of flexibility has invariably denied the concept 'fraud' of specific meaning by stretching its scope to any transactions by the directors which falls below the objective standard of fairness to the affected parties. In *Nocton v Ashburton*[15] Viscount Haldane explained equitable fraud as fraud that falls short of deceit, but imports breach of a duty to which equity has attached its sanction. The breach of a fiduciary duty by the directors could be deliberate or inadvertent, it may consist of an actual misappropriation or misapplication of the trust property or merely of an investment or other dealing which is outside the directors' powers; it may consist of a failure to carry out a positive obligation of the directors or merely of a want of skill and care on their part in the management of the trust property; it may be injurious to the interests of the beneficiaries or be actually to their benefit.[16]

It is not, however, every breach of duty that equity would ascribe the tag of fraud. If the directors act beyond their powers but in good faith and in the honest belief that they are acting in the interests of the company, such honesty of purpose would vitiate an inference of fraud,[17] and could be forgiven through shareholders ratification. But the honesty of the directors would not empower the shareholders to ratify transactions where the breach affects the interests of creditors. This is evident in the decision of the New South Wales Court of Appeal in *Kinsela v Russell Kinsela Pty Ltd*[18] where Street CJ said:

> It is in my view legally logical and acceptable to recognise that, where directors are involved in a breach of their duty to the company affecting the interests of shareholders, then shareholders

[11] [1933] Ch 786 at 790. See also *R* v *Grantham* (1984) 79 Cr App R 86, [1984] QB 675 (CA); *Re Sobam BV* [1996] 1 BCLC 446 (ChD); *Re A Company No 001418 of 1988* [1991] BCLC 197 (ChD); *Bernasconi* v *Nicholas Bennett & Co* [2000] BCC 921 (ChD); *Welham* v *DPP* [1961] AC 103 (HL); *Aktieselskabet Dansk Skibsfinansiering* v *Brother* [2001] 2 BCLC 324 (CFA HK). See generally, Alan Dignam and John Lowry, *Company Law*, 7th ed (Oxford: Oxford University Press, 2012) at 478. See generally Anthony O Nwafor, 'Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude' (2013) 42(4) *Common Law World Review* 297 at 307-311.

[12] *Madoff Securities International Ltd v Raven* [2011] EWHC 3102 (Comm), *Bowthorpe Holdings Ltd v Hills* [2003] 1 BCLC 226, *Cox v Cox* [2006] EWHC 1077 (Ch).

[13] *Gentler v Stephens* 965 A 2d 695 (Del Supr. 2009).

[14] *Ella M Kelly & Wyndham Inc v Bell* 266 A 2d 878 (Del 1970); *Maple Leaf Foods Inc. v Schneider Corp* 1998 CanLII 5121 (ON CA), (1998), 42 O.R. (3d) 177 (CA); *Kerr v. Danier Leather Inc.*, 2007 SCC 44 (CanLII), [2007] 3 SCR 331, 2007 SCC 44; *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69 (CanLII), [2008] 3 SCR 560 See generally Michael Follett, '*Gantler v Stephens*: Big Epiphany or Big Failure? A Look at the Current State of Officers' Fiduciary Duties and Advice for Potential Protection' (2010) 25 *Delaware Journal of Corporate Law* 563.

[15] [1914] AC 932. See also Supreme Court of Nigeria definition of fraud in *Yalaju Amaya v AREC Ltd* [1990] 4 NWLR (pt. 145) 422 as any act which may amount to an infraction of fair dealing, or abuse of confidence, or unconscionable conduct, or abuse of power as between a trustee and his shareholders in the management of a company.

[16] *Armitage v Nurse* [1997] EWCA Civ 1279.

[17] Ibid.

[18] (1986) 4 NSWLR 722 at 732.

> can either authorise that breach or ratify it in retrospect. Where, however the interests at risk are those of creditors I see no reason in law or logic to recognise that the shareholders can authorise the breach.

Cook J had in an earlier New Zealand case of *Nicholson v Permakraft (NZ) Ltd*[19] held that the concurrence by the shareholders prevents any complaint by them, but compounds rather than excuses the breach as against creditors. Every conduct of the directors that could deprive creditors of timely recourse to the property which would otherwise be applied to their benefit is fraud,[20] the honesty of the directors in such a case is immaterial.[21]Thus, in *Re National Funds Assurance Co*[22] Jessel MR held that to say that something is done bona fide is not the same as merely to say that the actor had no intention to commit a fraud. The existence of fraud is determined by the effect which the conduct has on the affected party. This judicial stance was buttressed by the statement of Radcliffe LJ in *Welham v Director of Public Prosecutions*[23] that although generally the meaning of the word 'defraud' is invariably associated with the obtaining of an advantage for the person who commits the fraud, 'it is the effect upon the person who is the object of the fraud that ultimately determines its meaning'. Implicit in this statement is that every conduct of the directors which has adverse impact on the affected person constitutes fraud. This approach to defining fraud lend credence to the decision of Vinelott J in *Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2)*[24] where the judge held that fraud lies, not in the character of the act or transaction giving rise to the cause of action, but in the use of the voting power by the controlling shareholders/directors to ratify the transaction. The decision draws a line between the majority and the minority shareholders and locates fraud in a ratification process which places the minority shareholders at a disadvantage. This is not, however, suggesting that fraud cannot also be found on the character of a transaction. The expropriation of corporate opportunities and self-dealing by the directors are good instances of fraud founded on the character of the transaction.[25] Such transactions, when viewed from Lord Radcliffe's perspective in *Welham*, would have adverse impact on the shareholders who are not directors as they will bear the brunt of the retardation of corporate progress and the prospect of declaration of dividend which adds value to their shares.

Although it is accepted that the shareholders could ratify frauds arising from the directors breach of duty in certain circumstances, there is still an underlying controversy relating to the nature of the transaction and in what circumstances a ratification would be allowed. In *Cook v Deeks*,[26] for instance, three directors of the company had diverted to themselves property transactions which they had negotiated for the company. They procured the ratification at the general meeting of their breach of duty through the exercise of their controlling voting power. The Privy Council invalidated the ratification and held the directors liable as constructive trustees of the company for the profits they made. Lord Buckmaster said:

> If... the contract in question was entered into *under such circumstances that the directors could not retain the benefit of it for themselves*, then it belonged in equity to the company, and ought to have been dealt with as an asset of the company. Even supposing it to be not *ultra vires* of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow the majority to oppress the minority.[27]

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[19] [1985] 1 NZLR 242 at 250.
[20] *LIoyds Bank Ltd v Marcan & Others* [1973] 2 All ER 359.
[21] *Re Halt Garage* (*1964) Ltd* [1982] 3 All ER 1016 at 1046 per Oliver J who observed that although there was no intention to defraud anyone, the payment made to Mrs Charlesworth in excess of this weekly amount, however well intentioned, amounts to a disguised gift out of capital , and as such constitutes fraud on the creditors.
[22] (1878) 10 Ch D 118 at 128.
[23] [1961] AC 103 at 123(HL).
[24] [1980] 2 All ER 841.
[25] See 'Shareholder Ratification of Directors' Fraudulent Acts' (1940) 53(8) *Harvard Law Review* 1368. See also *Burland v Earle* [1902] AC 83 where Lord Davey referred to a transaction as being of fraudulent character.
[26] [1916] 1 AC 554 (PC), [1916] UKPC 10. See also *Re Halt Garage* (1964) Ltd [1982] All ER 1016, *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350.
[27] [1916] UKPC 10 at 23, emphasis added.

The expression used in the passage suggests that the door is not entirely shut against the majority of the shareholders to ratify transactions involving a breach of duty by the directors. Thus, the Lord Chancellor had earlier in the decision drawn a distinction between that case and cases of self-dealing involving the directors selling their property to the company and using their majority votes to ratify such transactions as witnessed in *North-West Transportation Co v Beatty*[28] and *Burland v Earle*.[29] Does this imply that while cases of expropriation of company's property may not be ratified, cases involving self-dealing are invariably ratifiable?

Lord Davey implicitly answered this question in the affirmative in *Burland v Earle* where he observed that the minority could maintain an action if the transaction is of fraudulent character, and this would occur 'where the majority are endeavouring directly or indirectly to appropriate to themselves money, property or advantages which belong to the company, or in which the other shareholders are entitled to participate'.[30] The affected transactions would presumably, as occurred in that case, not include the selling by the director of his own property to the company. But in *Theatre Amusement Co v Stone*[31] the Supreme Court of Canada warned that it would be absurd, and indeed constitutes a great danger to the corporate survival, to read the decision in *Burland* as authorising every self-dealing by directors. Idington J observed that such stance would encourage those holding the majority of the company's shares to use their power and opportunity to drain the company of all its sources of profit and render dividends impossible. The Judge cautioned that the sooner every legislative body can obliterate from its incorporating Acts the power of any shareholder by his own vote to help himself to sell his property to the company in which he is a shareholder, the better it will be for the business community. In *Regal (Hastings) Ltd v Gulliver*,[32] a case involving the expropriation of company's opportunity by the directors, Lord Russell of Killowen had suggested, in the judgment of the House of Lords, that the directors could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the shareholders in the general meeting. This creates the impression that even the expropriation of company's opportunity could be ratified.

These seeming inconsistencies in judicial opinions are rationalised by Davies, Worthington and Micheler by drawing a distinction between transactions involving expropriation of company's opportunity as in *Cook's case* and the making of incidental profit as in *Regal*. The authors suggested that while in *Cook* it was the duty of the directors to acquire the contract for the company, and accordingly when they themselves acquired them, they did so as constructive trustees of the company. On the other hand, in *Regal* the directors did not misappropriate company's property, but merely profited from information acquired as directors of the company and made use of an opportunity which the company might have availed itself.[33]

If the differences in the judicial opinions are founded merely on the perceived distinction between property and information, it would certainly be difficult to sustain as the predominant position is that every opportunity available to the company is as much a property of the company as the information that leads to the opportunity. Thus, Harman LJ had in *Bamford v Bamford*[34] described the information exploited by the directors in *Regal* as being in 'the nature of trust property of the company'. Roskill J's decision in *Industrial Development Consultant Ltd v Cooley*[35] further buttresses the fact that corporate information is not treated any differently from any other opportunity regarded as corporate property where he held that,

> when the defendant embarked on this course of conduct of getting information on 13 June, using that information and preparing those documents over the weekend of 14/15 June and sending them off on 17 June, he was guilty of putting himself into the position in which his duty to his employers, the plaintiffs, and his own private interests conflicted and conflicted

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[28] (1887) 12 App Cas 589 (PC), [1887] UKPC 39.
[29] [1902] AC 83 (PC).
[30] [1902] AC 83 (PC) at 93-94.
[31] 1914 CanLII 40 (SCC), 50 SCR 32 at 35-36.
[32] [1967] 2 AC 134n (HL).
[33] Paul L. Davies, Sarah Worthington and Eva Micheler, *Gower & Davies Principles of Modern Company Law* 9th ed (London: Sweet & Maxwell, 2012) at 625.
[34] [1970] Ch 212.
[35] [1972] 2 All ER 162.

> grievously. There being the fiduciary relationship I have described it seems to me plain that it was his duty once he got this information to pass it to his employers and not to guard it for his own personal purposes and profit.[36]

This decision was reached with full consideration and application of some of the earlier decisions by the common law courts on the misappropriation of corporate opportunities and conflict of interests,[37] thus erasing doubts, if any, existing on the distinction between corporate information and corporate opportunity when dealing with the issues of director's breach of duty.

The preferred approach in rationalising the inconsistent decisions would be to consider the fairness of the transaction in which the directors have benefited as the basis for determining ratifiability, and invariably scrutinising the circumstances of the ratification. In *Regal's case*, for instance, Lord Russell of Killowen had alluded to the fact that the respondents 'in taking up these shares in Amalgamated… acted with bona fides, intending to act in the interest of Regal'. [38] This observation by Lord Russell which preceded the *obiter* suggesting that the directors could have absolved themselves from liability by obtaining the approval of the shareholders, cannot be divorced from the latter. The honesty of the directors seems to be the decisive factor. The same honesty of purpose was similarly emphasised by the Privy Council while approving the ratification of the self-dealing transaction in *North-West Transportation Co v Beatty*.[39] Their Lordships in that case had materially observed that,

> [i]t is proved by uncontradicted evidence, and is indeed now substantially admitted, that, at the date of the purchase, the acquisition of another steamer to supply the place of the "Asia" was essential to the efficient conduct of the Company's business; that the "United Empire" was well adapted for that purpose; that it was not within the power of the Company to acquire any other steamer equally well adapted for its business; and that the price agreed to be paid for the steamer was not excessive or unreasonable.[40]

Based on these prevailing circumstances, their Lordships agreed that any such dealing or engagement could be affirmed or adopted by the company. Similarly, in *Burland v Earle*[41] the Privy Council did not find the existence of fraud in the transaction in which the director had sold a property purchased by him to the company as the other directors were fully aware of the transaction and the price was fair. And more importantly, as found by the court, is that '[t]here is no evidence whatever of any commission or mandate to Burland to purchase on behalf of the Company or that he was in any sense a trustee for the Company of the purchased property'.

Such honesty of purpose was not evident in *Cook v Deeks*[42] both on the transaction and the process of ratification. The facts show that three directors, in that case, who had fallen out with the fourth director, procured in their name and subsequently formed a new company to execute a contract which was both in nature and substance the same as those previously executed by their jointly owned company. The three directors using their majority vote passed a resolution at the general meeting approving the sale of part of the assets of their joint company to the new company and procured a declaration that their jointly owned company had no interest in the contract. The judgment of the Privy Council, based on these facts, reflected the unfairness in, not just the deal, but also the subsequent ratification of the transaction. The Privy Council had referred to the observation of the trial judge that 'the sole and only object on the part of

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[36] [1972] 2 All ER 162 at 175.

[37] Such as *Keech v Sandford* (1726) [1558–1774] All ER Rep 230; *Aberdeen Railway Co v Blaikie Brothers* [1843–60] All ER Rep 249; *Bell v Lever Bros Ltd* [1932] AC 161, [1931] All ER Rep 1; *Boardman v Phipps* [1966] 3 All ER 721, [1967] 2 AC 46, [1966] 3 WLR 1009; Bray v Ford [1896] AC 44, [1895–99] All ER Rep 1009;*Imperial Mercantile Credit Association (Liquidators) v Coleman*(1871) 6 Ch App 558; *Parker v McKenna* (1874) 10 Ch App 96, [1874–80] All ER 443; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134n.

[38] [1967] 2 AC 134n (HL) at 143.

[39] (1887) 12 App Cas 589 (PC) (Can), [1887] UKPC 39.

[40] [1887] UKPC 39 at 43. See also *Newgate Stud Co & Anor v Penfold & Anor* [2004] EWHC 2993 (Ch) para 244 where Richards J accepted that self-dealing transactions could be ratified if it is fair, but warned that 'fairness is not equated with the lowest non-negligent valuation'.

[41] [1902] AC 83, [1901] UKPC 49 at 60.

[42] [1916] UKPC 10.

the defendants was to get rid of a business associate whom they deemed… unsatisfactory from a business standpoint'.[43] Such an exclusion of a co-director/shareholder in those circumstances bears the implication, as observed by the Privy Council, that the three directors had 'while entrusted with the conduct of the affairs of the company they deliberately designed to exclude, and used their influence and position to exclude, the company whose interest it was their first duty to protect'.[44] The Privy Council had while recognising that the directors should not be overburdened in the performance of their duties, emphasised that 'on the other hand, men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent'.[45] The unfairness in the acquisition and execution of the contract invariably extended to the ratification process which the Privy Council deprecated as follows:

> In same way, if the directors have acquired for themselves property or right which they must be regarded as holding on behalf of the company, a resolution that the rights of the company should be disregarded in the matter would amount to forfeiting the interest and property of the minority of shareholders in favour of the majority, and that by the votes of those who are interested in securing the property for themselves. Such use of voting power has never been sanctioned by the courts.[46]

The conduct of the directors in *Regal* was not as reprehensible as in *Cook*. The *Regal* directors' conduct was propelled by their belief, albeit misconceived, in their honesty of purpose. It was such honesty which vitiated the inference of fraud, at least in the actual sense, that compelled the suggestion by Lord Russell of Killowen that the directors could have sought ratification of the transaction by the shareholders. The differences in facts and circumstances of both cases lend credence to the suggestion by Dignam and Lowry that where a director has fraudulently expropriated a company's asset, the breach is non-ratifiable.[47] The emphasis is on fraudulent expropriation and not just the expropriation of company's opportunity as in *Regal.* Fraud in that sense is not simply embedded in the dishonesty of the directors, but would be reflected on the unfairness of the transaction or ratification on the affected persons.

The finding of the existence of fraud either in the transaction or on the process of ratification should compel the directors to ensure that every transaction and ratification process in which they are involved meet the standard of 'entire fairness'.[48] Fairness, like dishonesty, must be ascertained by objective assessment of the entire process of expropriation and ratification. The assessment should be directed at what a person of sound business judgment would think of the process,[49] and not just the subjective belief and the implications of honesty of purpose on the part of the directors.

Who May Vote

Voting at the meeting is a property right of every shareholder. Shareholders acquire such right by virtue of their shareholding. A share is not a sum of money but is an interest measured by a sum of money and made up of various rights.[50] The nature of the interests conferred by 'share' was explained by Lord

[43] Ibid at 19-20.
[44] Ibid at 20.
[45] Ibid at 21.
[46] Ibid at 23.
[47] Dignam & Lowry above note 11 at 394.
[48] See Brown Jr, above note 1 at 647 where 'entire fairness' was described as showing fair price and fair procedure. Cf 'Shareholder Ratification of Directors' Fraudulent Acts' above note 25 at 1373 suggesting that where the value of the property sold more nearly approaches the consideration given, the deal is undoubtedly capable of ratification.
[49] *Solomon TRV v Armstrong* 747 A. 2d 1098, 1114-15 Del. Ch. 1999).
[50] *Borland's Trustee v Steel Brothers Co Ltd*[1901] 1 Ch 279 at 288(ChD). See also *Commissioner of Inland Revenue v Crossman* [1937] AC 26 at 66 (HL) per Lord Russel of Killowen; *Bradbury v English Sewing Cotton Co Ltd* [1923] AC 744 (HL) at 746 per Lord Wrenbury; *Cooper v Boyes* 1994 (4) SA 521 (C) at 535 per Van Zyl J. See generally Richard Jooste and Jacqueline Yeates, 'Shares, Securities and Transfers' in Farouk HI Cassim, Maleka Femida Cassim, Richard Jooste, Joanne Shev and Jacqueline

Russell of Killowen in *Commissioner of Inland Revenue v Crossman*[51] as 'being composed of rights and obligations which are defined by the Companies Act and by the memorandum and articles of association of the company'. It is not an interest in the property of the company as the company, being a juristic person, owns its own property.[52] The rights of the shareholders as conferred by the company's constitution include voting rights.[53] Any limitation on a shareholder's voting right is seen as an infringement on the property right which is inherent in share ownership.[54]

Shareholders, unlike directors, do not owe fiduciary duties to the company, and as such, could exercise their voting powers in any manner at the meetings of the company. Resolutions at such meetings which are unanimously passed where the company is solvent would rarely attract judicial condemnation in realisation of the fact that in such a company the proprietary interests of the shareholders are synonymous with those of the company.[55] A different consideration would, however, arise where there is a division between the majority and the minority shareholders and among the majority shareholders is also a director of the company.

There is no general rule at common law that prevents a shareholder who is also a director of the company from exercising his voting powers and in any manner he pleases at the general meetings of the company. Not even the personal interests of the shareholder/director in the transaction could exclude him/her from the meeting or prevent him/her from voting at such meeting.[56] Lord Davey in *Burland v Earle*[57] buttressed this common law position where he emphasised that '[u]less otherwise provided by the regulations of the company, a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having a particular interest in the subject-matter of the vote'.

But the harbouring of such interest by a director with a majority shareholding in a transaction approved with the aid of the controlling votes has always invoked the suspicion of fraud and consequently elicited close judicial scrutiny. In *Re Halt Garage (1964) Ltd*[58] Oliver J observed that '[f]raud opens all doors and the court will not uphold or permit the fraudulent exercise of a power'. In *North-West Transportation Company v Beatty*[59] the Privy Council had, while admitting that a director could as a shareholder, exercise his right of vote to ratify a transaction in which he is interested, cautioned that such affirmation or adoption must not be brought about by unfair or improper means, and should not be illegal or fraudulent or oppressive towards the minority shareholders. Vinelott J in *Prudential Assurance Co Ltd v Newman Industries Ltd & Others (No 2)*[60] found the existence of fraud, not in character of the act or transaction giving rise to the cause of action, but on the exercise, by the directors who are in control of the company, of their majority voting powers to prevent an action from being brought against them.[61] These cases buttress the judicial willingness at common law, even without denying the directors of their voting

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Yeats (eds) *Contemporary Company Law* (Claremont, JUTA & Co Ltd, 2011) at 197 for a discussion on the nature of shares.

[51] [1937] AC 26 at 66 (HL).

[52] See *Commissioners of Inland Revenue v Laird Group plc* [2003] UKHL 54 para 35 *per* Lord Nicholls of Birkenhead; *Short v Treasury Commissioners* [1948] 1 KB 116 at 122 (CA).

[53] See *Inland Revenue Commissioners v Joiner* [1975] 1 WLR 1701 at 1706-1707 (HL) *per* Lord Wilberforce.

[54] Worthington, above note 5 at 7.

[55] *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722, *West Mercia v Dodd* [1988] BCLC 250.

[56] Worthington above note 54.

[57] [1902] AC 83 at 93. See also *Eisenberg (formerly Walton) v Bank of Nova Scotia and Ridout et al* [1965] SCR 681 at 699.

[58] [1982] 33 All ER 1016 at 1037.

[59] (1887) 12 App Cas 589 at 594, [1887] UKPC 39 at 40. See also Donald J Zadeck, 'Corporations: Shareholder Ratification of Directors' Action' (1949) 10(1) *Louisiana Law Review* 82, who observed that in the absence of fraud or unfairness the interested directors may cast their votes as majority shareholders.

[60] [1980] 2 All ER 841 at 862.

[61] See also *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch) para 45 per Mr William Trower QC (sitting as a Deputy Judge of the High Court) who held that 'where the question of ratification arises in the context of an application to continue a derivative claim, the question which the court must still ask itself is whether the ratification has the effect that the claimant is being improperly prevented from bringing the claim on behalf of the company'.

rights as shareholders, to wade into any relief given to the directors from consequences of a breach of duty where the process is on its face unfair to all the shareholders.

The interest that could influence the pattern of the director/shareholder's vote and which could invoke judicial intervention is not necessarily restricted to direct personal interest, but could extend to other relationships which the director could feel obliged to protect. Selbourne LJ had in *Exparte Forder*[62] emphasised that trustees are not allowed to exercise their powers for their own benefit or for the benefit of anyone so connected with them. Defining the boundaries of such connection as would impact on a director's interest has not been an easy one, not even with all the flexibilities of the courts of equity, as what a relationship may appear in form is not always same in substance. In *Newgate Stud Co & Anor v Penfold & Anor*[63] Richards J observed that 'if a director causes his company to enter into a transaction with a close relation, or a spouse or other partner, there is a significant risk that the director will be compromised by a desire to favour the other party'. In realisation of the propensity of the directors to protect such extended interests, equity throws its searchlight beneath the surface, and applies its doctrines to cases where, although in form a trustee has not sold to himself, in substance he has.[64] Beneath the surface scrutiny enables the courts to ascertain the validity of transactions in which the directors have used 'fronts'[65] to further their personal interests. Such transactions would usually appear fair on the surface, but the real interests involved are discovered with hard facts and evidence.

In matrimonial relationships, especially where the couple are married in community of property, it would reasonably be expected that such relationship would conclusively prove the existence of interest,[66] but, as in trust relationships, the courts are content to rely on suspicion raising a presumption that the transaction is for the benefit of the trustee and thereby shifting the onus on the trustee to dispel that impression.[67] Cogent reasons were proffered by Megarry VC in *Tito v Waddell (No 2)*[68] on why even such relationship cannot give rise to a conclusive inference of a director's interest in a transaction, where he said:

> If the question is asked: "Will a sale of trust property by the trustee to his wife be set aside?", nobody can answer it without being told more; for the question is asked in a conceptual form, and manifestly there are wives and wives. In one case the trustee may have sold privately to his wife with whom he was living in perfect amity; in another the property may have been knocked down at auction to the trustee's wife from whom he has been living separate and in enmity for a dozen years.

If a spouse's interest in a transaction cannot be firmly attached because of the realities of marriage, it would even be more difficult to identify or define other connections to a transaction which a director could have besides matrimonial relationships. Effort is now made by the parliament in the UK to set the scope and identify 'connected persons' who must not vote in transactions in which the directors have interest. Section 239(3)(4) of the UK Companies Act of 2006 provides as follows:

> (3) Where the resolution [for ratification] is proposed as a written resolution neither the director (if a member of the company) nor any *member connected with him* is an eligible member.
> (4) Where the resolution is proposed at a meeting, it is passed only if the necessary majority is obtained disregarding votes in favour of the resolution by the director (if a member of the company) and *any member connected with him*. This does not prevent the director or any such

[62] (1881) 25 Sol. Journ 720.
[63] [2004] EWHC 2993 (Ch) para 240.
[64] *Tito v Waddell (No 2)* [1977] Ch 106 at 240 per Sir Robert Megarry VC.
[65] 'Front' is defined by the Nigerian Court of Appeal in *Onyekwulunne v Ndulue* [1997] 7 NWLR (pt.513) 250 at 280 as the apparent or nominal leader behind whom the real powerful man works anonymously.
[66] See the s 253 of the UK Companies Act of 2006 which defines members of a director's family, for the purpose of exclusion of 'connected persons' from voting, as including the director's spouse or civil partner.
[67] See *Tanti v Carlson*[1948] VLR 401, *In re Douglas* [1928] 29 SR (NSW) 48, *Burrell v Burrell's Trustees* [1915] SC 333.
[68] [1977] Ch 106 at 240.

> member from attending, being counted towards the quorum and taking part in the proceedings at any meeting at which the decision is considered.[69]

The weight of the provision rests more on the outcome than on the procedure.[70] It would seem fair that the votes of 'connected persons' shall not be counted in determining the effectiveness of ratification. But it stops at that point. The fairness of the process of attending and conducting of the meeting are not covered. Indeed, the provision is unequivocal that 'connected persons' are not excluded from the quorum consideration and deliberations at the meeting. The exclusion of the votes of 'connected persons' is perhaps informed by the desire to prevent the recurrence of the most frequent incidences of fraud arising from self-dealing and expropriation of corporate opportunities by directors which are often ratified with the votes of the interested directors and their cronies. The exclusion of those votes, it is believed, would make it difficult, if not impossible, to secure the majority votes to ratify the transaction.[71] But the provision does not seem to have considered the influence which the interested directors could exert on the voting shareholders even when not present at the meeting, so much more with their presence, and perhaps presiding over the proceedings at the meeting. The real possibility of a provision such as this not being able to attain its purpose could be seen from the reflections by Brown on a similar provision under section 144 of the Delaware Corporate Code of 1967 which disqualifies interested directors from voting but permits their attendance and being counted on the quorum. Brown captured the futility of the provision where he observed:

> In general, disinterested shareholders will be influenced by the board of directors. It is the board that submits the matter to the shareholders. Management has the corporate treasury at its disposal and the attendant ability to spend conspicuous sum to obtain approval of the interested transaction. At the same time, shareholders suffer from collective action problems, making concerted opposition difficult. Moreover, disinterested opposition also risks retribution. Without the benefit of secret ballots, management will know the vote cast by each 'disinterested' shareholder.[72]

The threat of hostility by the directors to the dissenting shareholders is real and could be employed in different subtle ways such as failing to convene a meeting, or in the manner of conducting of meetings.

There is always the temptation to suggest that the solution lies in total exclusion of 'connected persons' from the meeting of the shareholders in which the transactions are being considered. In *D'Amore v*

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[69] Emphasis added. Connected persons are defined in section 252(2) as '(a) members of the director's family (see section 253); (b) a body corporate with which the director is connected (as defined in section 254); (c) a person acting in his capacity as trustee of a trust— (i) the beneficiaries of which include the director or a person who by virtue of paragraph (a) or (b) is connected with him, or (ii) the terms of which confer a power on the trustees that may be exercised for the benefit of the director or any such person, other than a trust for the purposes of an employees' share scheme or a pension scheme; (d) a person acting in his capacity as partner— (i) of the director, or (ii) of a person who, by virtue of paragraph (a), (b) or (c), is connected with that director; (e) a firm that is a legal person under the law by which it is governed and in which— (i) the director is a partner, (ii) a partner is a person who, by virtue of paragraph (a), (b) or (c) is connected with the director, or (iii) a partner is a firm in which the director is a partner or in which there is a partner who, by virtue of paragraph (a), (b) or (c), is connected with the director'.

[70] Cf Brown above note 48 at 642 where the writer observed that despite the importance of fairness to the duty of loyalty, the trend has been to eliminate any analysis of fairness, replacing substantive review with procedural safeguards.

[71] Hannigan above note 6 at 429. Davies, Worthington and Micheler above note 33 at 626 similarly suggest that the provision, by depriving the directors in breach of the right to vote, avoids the result in *Cook v Deeks* where the wrongdoers held three-quarters of the votes in the company, but does so without the need to resort to the concept of 'non-ratifiable wrong. Victor Joffe QC, David Drake, Giles Richardson and Daniel Lightman, *Minority Shareholders Law, Practice, and Procedure* 3rd ed (New York, Oxford University Press Inc, 2008) at 19 observed that with the new trend in the legislation, ratification will be more difficult to achieve. See the reason for the provision as stated by Lord Goldsmith who said that the provision "seeks to exclude the votes of the wrongdoer and those persons most likely to be biased in favour of the director or under his influence- namely, the persons connected with him- and make it easier to identify those persons when the votes are counted."

[72] Brown Jr above note 70 at 642.

McDonald et al[73] Addy J of the Canadian Superior Court adopted a stance akin to this where he held that a director who is an interested party in any contract in which the company is interested must refrain from voting and cannot be counted to form a quorum. It could be argued in one extreme that the exclusion of the interested director/shareholder from the meeting and voting would amount to a deprivation of the right of property which every shareholder enjoys by his shareholding. But if that is the only prize to pay in order to ensure fairness in corporate transactions, it cannot be overburdening of the affected persons. On the other extreme is the argument that even such exclusion will not guarantee the desired fairness as the snares of proxy voting[74] which is apparently overlooked by the provision[75] still gives some leverage to the interested director who could be counted for the purpose of forming a quorum, and vote even when not a shareholder.

The safeguard against the deficiencies of section 239(4) is found in section 239(7) of the Act which provides as follows:

> This section does not affect any other enactment or rule of law imposing additional requirements for valid ratification or any rule of law as to acts that are incapable of being ratified by the company.

This provision preserves the common law principles on ratifiability of company transactions by the shareholders so that even with the exclusion of 'connected persons' from voting, the fairness of the transaction and ratification process are not free from judicial scrutiny. That provision should enable the courts to look beyond the surface of the transaction as it is done at common law and to examine the various interests involved in the ratification process.[76]

Effect of Ratification

The most potent weapon at the disposal of the minority shareholder in protecting the company against the incidences of abuse of power by the directors is the concept of derivative action. This concept is increasingly gaining recognition by the companies statutes in different jurisdictions. There is genuine concern on the prospect of depriving the minority shareholders of this invaluable weapon through the ratification by the majority of the directors' breach of duty. The need to guard against unjust deprivation of the minority shareholder of the benefit of derivative action is reflected in the decision of Mr William Trower QC (sitting as a Deputy Judge) in *Franbar Holdings Ltd v Patel*[77] who held that where the question of ratification arises in the context of an application to continue a derivative claim, the question which the court must still ask itself is whether the ratification has the effect that the claimant is being improperly prevented from bringing the claim on behalf of the company.

Seeking an answer to this question where issues of fraud arising from self-dealing or misappropriation of corporate opportunity are involved cannot be resolved with such an inquiry, as Knox J stated in *Smith v Croft (No 2)*,[78] as to whether it is an appropriate independent organ that is preventing the plaintiff from prosecuting the action. Transactions in which the directors have acted beyond their powers (*ultra vires*) or outside the confines of the statute as in *Smith's case*, bear different legal implications as such transactions may not bind the company until ratified or adopted by the shareholders. Such transactions do not necessarily confer benefits on the directors and could have been executed honestly by the directors for the benefit of the company. It is thus understandable if majority of the members are allowed to adopt or ratify the transactions. Transactions that fall within the legal connotations of fraud are more often than not

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[73] 1973 CanLII 759 (ON SC). See also *Garvie v Axmith et al* 1961 CanLII 154 (ON SC), *Transvaal Lands Co. v New Belgium (Transvaal) Land & Development Co*, [1914] 2 Ch 488.

[74] 'Shareholder Ratification of Directors' Fraudulent Acts' above note 48 at 1372.

[75] See Derek French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law* 30th ed (Oxford, Oxford University Press, 2013) at 520 where the authors observed that '[a]s s 239(4) disallows votes cast by a director 'if a member' rather than 'as a member', it would seem that votes cast by the director as proxy must not be counted if the director is a member, but must be counted if the director is not a member'.

[76] See *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch) where Mr William Trower QC (sitting as a Deputy Judge) applied the full force of that provision.

[77] [2008] EWHC 1534 (Ch) para 45.

[78] [1988] Ch 114 at 185.

executed to benefit the directors involved. In such cases, the mere ratification by the majority, even when seen as 'independent', would not *ipso facto* absolve the directors from liability without examining the propriety of the ratification. Ascertaining the propriety of the ratification requires close scrutiny of the ratification process which is implicitly approved by Vinelott J in *Prudential Assurance*[79] where he observed that there is something unconscionable in the conduct of the majority if they use their voting power in general meeting to prevent an action being brought against them. Going behind the veil of ratification could reveal, as Mr William Trower QC stated in *Franbar,* that company's assets are being diverted by the wrongdoer who is in control to 'unconnected persons' in the context of section 239(4) of the UK Companies Act.[80]

The realisation that fraud does not lie only on the character of the transaction, but could also be found on the ratification process,[81] compels the need to ascertain the extent of absolution which a director enjoys from liability for a breach of duty by the fact of ratification. Some writers hold the view that ratification by a company of a breach of duty by its directors destroys the cause of action against such directors and the company can no longer bring a claim based on that breach of duty.[82] That suggestion seems too generalised, it would require material qualifications to reflect the true effect of ratification. While a unanimous decision of the shareholders in a solvent company could have the effect of total absolution of directors from liability as in that situation the shareholders are seen as synonymous with the company,[83] ratification in other circumstances would certainly not have a similar effect.

The effective corporate operation requires that the interests of all shareholders be protected whether in the majority or in the minority. While the majority shareholders may have their way in corporate decisions, the minority shareholders must not be denied of their say, and which would ordinarily include recourse to the courts for a review of the decisions taken by the majority shareholders. It cannot be an answer to such challenge by the minority for the majority shareholders to assert that the transaction is ratified, even by 'disinterested' or 'unconnected' shareholders. This position is supported by the decision of the Privy Council in *North-West Transportation Company v Beatty*[84] where the court, though upholding the ratification in that instance, recognised that the ratification by majority shareholders could be challenged where it is brought about by unfair or improper means.

Ratification could be unfair or improper, not just because it favours one group of shareholders and not the others, but also because the transaction that is ratified does not serve the interest of the company. The realities of these situations would demand that the effect of ratification on the transaction be restricted. Such restriction is found in *Solomon TRV v Armstrong*[85] where the court described the true effect of ratification as merely conferring a cleansing effect on transaction but does not extinguish the claim for a breach of duty.

The courts should entertain any action brought by the minority shareholder that contests the effectiveness of ratification. It is only by subjecting the ratification to judicial scrutiny that the process through which the ratification is attained would be known. A ratification which is fraudulently procured by the majority even with the exclusion of the 'connected persons' should not receive judicial approval.[86]

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[79] [1980]2 All ER 841 at 862.
[80] [2008] EWHC 1534 (Ch) para 45.
[81] See *Prudential Assurance's case supra* where Vinelott J held that 'fraud lies in their use of their voting power, not in the character of the act or transaction giving rise to the cause of action'.
[82] See French, Mayson & Ryan above note 75 at 520.
[83] See *Multinational Gas v Multinational Services* [1983] Ch 258 at 288G where Dillon LJ held that so long as the company is solvent, the shareholders are in substance the company. Lawton LJ at 258E-H observed that when the oil companies, as shareholders, approved what the plaintiffs as directors had done there was no cause of action because at that time there was no damage. What the oil companies were doing was adopting the directors' acts and as shareholders, in agreement with each other, making those acts the plaintiff's acts. See also *Attorney-General for Canada v Standard Trust Co of New York* [1911] AC 498; *In re Express Engineering Works Ltd.* [1920] 1 Ch 466; *In re Horsley & Weight Ltd* [1982] Ch 442; *Kinsela v Russell Kinsela* Pty Ltd (1986) 4 NSWLR 722; *West Mercia v Dodd* [1988] BCLC 250; *Madoff Securities International Limited v Raven & Others* [2011] EWHC 3102 (Comm).
[84] (1887) 12 App Cas 589, [1887] UKPC 39.
[85] *Solomon TRV v Armstrong* 747 A. 2d 1098, 1114-15 Del. Ch. 1999).
[86] *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016 at 1037.

Shareholders unanimous resolutions ratifying directors breach of duties are not necessarily immune from judicial scrutiny. Such resolutions could be challenged by the liquidators of the company. The challenge would invariably be predicated on the effect of the ratification on the interest of the company's creditors. It is incumbent on the courts upon such challenge to ascertain whether the company is insolvent or on the verge of insolvency at the time of the ratification, a position which would materially impact on the effectiveness of the ratification. Street CJ in *Kinsela v Russell Kinsela Pty Ltd*[87] reflected on the effect of insolvency on the company as follows:

> [W]here a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency or the imposition of some alternative administration.

Shareholders cannot in a company's state of insolvency relieve directors from liability arising from a breach of duty. Any ratification contrived in such circumstances is a fraud on the creditors which lacks legal validity and will not survive judicial scrutiny. The inference from the analysis is that the actual effect of ratification, whether made by a unanimous resolution or majority shareholders decision, is not definite until it is tested and pronounced upon by the court.

Conclusion

The concept of fraud has never received a precise definition either in equity or at common law. It would be safe to ascertain the existence of fraud in the context of ratification of breach of duty by the director by examining the transaction and the ratification process. Fraud could be found either in the character of the transaction or in the ratification process. The unfairness of the transaction or ratification on any of the affected persons, which could be objectively ascertained, could imply the existence of fraud.

In considering the ratifiability of a transaction in which the existence of fraud is indicated, the honesty of the director is material but not a decisive factor as any transaction that adversely affects the interests of the creditors cannot be ratified even by a unanimous resolution of the shareholders. There is no valid distinction in the ratification process relating to the nature of corporate property expropriated by the directors. Whether corporate opportunity or corporate information, or issues of self-dealing, all have the same effect. What is material is the fairness of the transaction and the ratification process on the affected persons.

The directors are at common law not generally prohibited from voting as shareholders for ratification of transactions in which they have personal interests. This judicial position is justified by the fact that shares are personal property of the shareholder which confers voting rights on the shareholder. The shareholders as such do not owe fiduciary duty to the company and would not be restricted in the manner of exercising of their voting powers. However, where the shareholder is also a director holding majority of the shares and is seen to have employed his controlling votes to ratify transactions in which he has interest, the courts have increasingly shown a disposition in such situation to scrutinize the transaction and the ratification process to be satisfied that there is no fraud involved.

The parliament in the UK has modified the extant common law position by enacting provisions in section 239(3)(4) of the Companies Act of 2006 which disqualify the interested director and 'connected persons' from voting at meetings in which ratification of a breach of duty is being considered. The scope of 'connected persons' as defined by the Act is commendably wide enough to affect those with latent interests in the transaction. But the provision does not excluding the interested director and 'connected persons' from attending and being counted for the purpose of forming a quorum at the meeting. The effect of this is that the interested director and 'connected persons' could still exert influence on the voting shareholders and in that manner circumvent the purpose of the provision which is geared at

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[87] (1986) 4 NSWLR 722 at 732. See also *Re Horsley & Weight Ltd* [1982] Ch 442 (CA); *Rolled Steel Ltd v British Steel Corp* [1986] Ch 246 (CA); *Bowthorpe Holdings Ltd v Hills* [2003] 1 BCLC 226; *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA); *Aveling Barford v Perion Ltd* [1989] BCLC 626.

ensuring fairness in the ratification process. The panacea lies in section 239(7) of the Act which preserves the common law principles on determining the validity of ratification.

The effect of ratification, as held in *Solomon TRV v Armstrong*[88] is merely to confer cleansing effect on the transaction, it does not extinguish the claim for a breach of duty. The resolution to ratify, even when passed by a unanimous decision of the shareholders, could be challenged by the liquidator where it infringes on the rights of the creditors. Similarly, ratification is not immune from challenge by the minority shareholders merely because it is seen as the expression of the will of the majority of the shareholders. The courts have shown the disposition, and are in fact under a positive duty, in an action by the minority shareholders, to review the ratification process and be satisfied that it is fair to all the interested parties.

[88] 747 A. 2d 1098, 1114-15 Del. Ch. 1999).