

36/84

ON APPEAL
FROM THE SUPREME COURT OF HONG KONG

BETWEEN :

SAMUEL TAK LEE

Appellant

- and -

- 1. CHOU WEN HSIEN
- 2. CHOW CHUNG KAI
- 3. ANN TSE KAI
- 4. GAW SIONG CHWAN
- 5. HSIN TING CHIA
- 6. HU CA FEE
- 7. CHENG WEI SHUE
- 8. OCEAN LAND DEVELOPMENT LIMITED

Respondents

CASE FOR THE APPELLANT

RECORD

1. This is an appeal from a judgment of the Court of Appeal of Hong Kong (CONS, ZIMMERN, JJA and HOOPER, J.), dated 9th July 1982 dismissing the Appellant's appeal from an order of FUAD J. in the Supreme Court of Hong Kong dated 20th May 1982, whereby he ordered inter alia that the general endorsement of the Plaintiff's Writ of Summons be struck out and the action be dismissed with costs.

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2. Article 73 of the New Articles of Association of the eighth Respondent, Ocean Land Development Ltd. ("the Company") provides inter alia as follows:-

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"DISQUALIFICATION OF DIRECTORS

73. The Office of an Ordinary Director shall be vacated:-

- (a) If he becomes bankrupt or insolvent or compounds with his creditors;
- (b) If he becomes of unsound mind;
- (c) If he be convicted of an indictable offence;

RECORD

- (d) If he is requested in writing by all his co-directors to resign; [emphasis added]
- (e) If he becomes prohibited from being a Director by reason of any order made under Section 223 or 275 of the Ordinance;
- (f) If he gives the Company one month's notice in writing that he resigns his office."

3. The substantial questions raised by this appeal are: 10

- (a) Whether the power conferred on the Directors of the Company by article 73(d) is a fiduciary power which can only be exercised by the directors bona fide in the best interests of the Company;
- (b) Whether a request purportedly made under article 73(d) is invalid unless made by each co-director acting bona fide in the best interests of the Company; and
- (c) whether, if the above questions are answered in the affirmative, an individual director of a Company can maintain a personal action against the other directors and/or the Company in respect thereof. 20

THE FACTS

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l.13
pp.19,1.9
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4. The Company is a public company incorporated in Hong Kong on 11th August 1972 and has an issued share capital of HK\$63,750,000. The Appellant, a practising architect, who in his own right is the registered holder of 248,000 shares in the Company, and the first seven Respondents have all been directors of the Company since its incorporation. The Appellant Plaintiff, Samuel Tak Lee in common with the other Directors, received a proportion of Directors emoluments shown in the annual accounts as follows:- 30

	y/e	Company	Group (inc Company)		
		HK\$	HK\$		
p.57	l.4	31. 3.77	45,000	45,000	
p.51	l.29	31. 3.78	45,000	45,000	40
p.71	l.10	31. 3.79	45,000	45,000	
p.71	l.10	31. 3.80	45,000	105,000	
p.85	l.26	31. 3.81		105,000	

p.11
LL.27-28,
37-38

The First Respondent is and at all material times was, the Chairman and Managing Director. The First and Second Respondent each hold approximately 20% of the issued share capital of the Company. The Company has several subsidiaries and interests in a

number of other companies which are described in its annual reports as "Trade Investments".

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11.18-20
pp.59,73,87

5. In early 1982 the Appellant began to be concerned about the way in which the business of the Company was being conducted. The detailed nature of his case was set out in a number of Affidavits and exhibits which were before the courts below. In summary form his concern was as follows:

- 10 (a) there appeared to have been, a few years earlier, sales of shares in associated companies by the Company at gross under-valuations. The sales were to a private company owned by the First and Second Respondents, who had not disclosed their interest in breach of sections 129 D (3) (j) and 162 of the Hong Kong Companies Ordinance: 1975 Cap. 32. pp.108-113
- 20 (b) There was a substantial increase in the amounts due to the Company from its related companies in which the First and Second Respondents had interests: from HK\$6.8 million in 1980 to HK\$ 27.8 million in 1981, without the board of the Company being informed either as to the security for, or prospects of, those sums being repaid.
- 30 (c) There were unanswered questions relating to the management of the Company's Trade Investments, in particular mining companies in Malaysia (Pan-Land Development Limited) and Indonesia (Sea-Land Mining Limited) in each of which the Company had acquired a 50% holding. The First Respondent's interests in these companies were being probed by the Appellant, particularly since neither Company had made any profit.
- 40 (d) From March to May 1982, the Appellant sought to obtain further information about the affairs of the Company, its subsidiaries and Trade Investments, delivering written requests for copies of the reports and accounts of those companies. Those requests were made first to one Lam, the Executive Secretary of the Company, and secondly by solicitors instructed by the Appellant to solicitors acting for the First Respondent and the Company. Failure to supply the documents on Friday 7th May 1982 led the Appellant to exercise his right under Article 89 of the Company's Articles of Association to summon a meeting of the directors of the Company to take place on Tuesday 11th May to discuss the aforementioned failure to supply reports and to consider questions to be raised by him in respect of the pp.88-95 pp.40-41 pp.96-7
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100-101
11. 6-8

affairs of subsidiary and associate companies. To suit the convenience of the other directors the Appellant arranged with the said Lam to postpone the meeting until the morning of Monday 17th May 1982.

pp.101-2

6. Shortly after 10.00 a.m. on Saturday 15th May 1982, the Appellant was handed a written notice dated 12th May 1982, which purported to be a request by all the Appellant's co-directors to resign his office as a director of the Company pursuant to Article 73(d) of the Company's Articles of Association. The Appellant immediately sought legal advice that afternoon and the Writ herein was issued.

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pp.1-4

pp.4-5

7. On an ex parte summons heard by Sir Denys Roberts, C.J. at his home in the early evening of Saturday 15th May 1982, the Appellant obtained various injunctions in effect restraining the Respondents from interfering with the holding of the meeting of the directors of the Company which the Appellant had summoned to take place on 17th May 1982 and with the lawful discharge by the Appellant of his functions and duties as a director of the Company.

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pp.19-20

pp.102,
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8. In fact, the Appellant was the only director to attend the meeting of the Directors of the Company on 17th May 1982. He had notified the Company's auditors of the proposed meeting and of the agenda, but it subsequently became clear that the said Lam had deceived the auditors into believing that the meeting had been cancelled and that Lam misled the Appellant about the reason for the auditors' non-attendance at the meeting.

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120, 134
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pp.6-7

9. The return date for the hearing of the inter partes summons for interim relief had been fixed for 19th May 1982. On that date there were also before the Court two summonses issued by the First and Second Respondents and the Third to Eighth Respondents, both seeking an Order that the Appellant's Writ be struck out and his action dismissed on the grounds that:

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- (a) the action was irregularly constituted;
- (b) the Writ disclosed no reasonable cause of action; and
- (c) the action was frivolous, vexatious and was otherwise an abuse of the process of the Court.

All three summonses came on for hearing before Fuad, J. on 19th May 1982. The learned Judge proceeded

to hear the Respondents' summonses first, and on 20th May 1982 he made an Order striking out the Writ of Summons and dismissed the action with costs to the Respondents and discharging the interlocutory injunctions granted on 15th May 1982. On 9th July 1982, the Court of Appeal of Hong Kong dismissed the Appellant's appeal from the Order of Fuad, J.

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THE JUDGMENTS BELOW

10 10. Before Fuad J., the Respondents made two principal submissions:

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(a) that upon the happening of any of the six events specified in Article 73 of the Company's Articles of Association, the office of the Director concerned was ipso facto vacated and the matter was not capable of challenge in the courts.

20 (b) That even if there had been a breach of duty on the part of the Appellant's co-directors, the proceedings were improperly constituted and wholly misconceived since the duty was owed not to the shareholders or individual directors, but to the Company alone.

On behalf of the Appellant it was contended:

(a) that the power conferred on the directors by Article 73(d) was a fiduciary power which could only be exercised by the directors bona fide in the interests of the Company.

pp.23-4
138,128

30 (b) that a request to resign purportedly made under Article 73(d) was not valid if made by directors acting otherwise than bona fide in the best interests of the Company.

(c) that the Appellant was entitled to maintain an action to uphold his status as a director of the Company and for other relief.

40 (d) that the only evidence in the case at that stage was the uncontradicted evidence on affidavit of the Appellant, which disclosed a strong prima facie case of bad faith against the Respondents or some of them.

11. Fuad J. accepted the first of the Respondents' submissions and did not go on to consider their alternative submission. The learned judge said he did not think:

"it could reasonably be argued... that the Court is free to permit the directors who made the request to be examined as to their motives or reasons for taking the course that they did. No cases have been found directly

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11.20-26

RECORD

in point, but in my view the ordinary principle that directors must exercise their powers bona fide in what they believe to be in the interests of the Company cannot be prayed in aid to investigate the deliberations of the directors which led to the making of their decision..."

12. In the Court of Appeal, the leading judgment was delivered by Cons JA, with which Hooper J. agreed.

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pp.138-9

(a) Unlike Fuad J., Cons JA accepted the Appellant's contention that the power conferred by Article 73(d) had to be exercised by each co-director bona fide in the interests of the Company and on its true construction, the power was intended to cater for circumstances in which it was desirable for the sake of the Company that one director should relinquish his office but which might be so unusual or particular that the articles could not be expected to provide for them in advance. Such power was not to be exercised in the private interests of the individual directors. Accordingly, Cons JA said:

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"I would then agree with counsel for the Plaintiff that if any one of the directors could be shown in signing the letter to have acted from some private ulterior purpose the court would set the vacation aside, assuming of course that the action in which that was requested was properly brought."

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pp.135-142

(b) However, the Appellant's contention that a request made under Article 73(d) was invalid if actuated by bad faith was rejected by Cons JA who held that the Appellant had nevertheless ipso facto ceased to be a director of the Company with effect from 15th May 1982, the date on which he had received the purported request.

pp.137-8
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11.3-8

(c) Cons JA held that even if a power were exercised otherwise than in good faith, the injury or wrong had been done to the Company alone and not to the Appellant, whose injuries were coincidental by-products of that wrong in respect of which he had no cause of action. In support of his claim for personal relief, the Appellant had relied principally on the authorities of Pulbrook v. Richmond Consolidated Mining Co. (1878) 9 Ch D 610 and Hayes v. Bristol Plant Hire Ltd [1957] 1 WLR 499. Cons JA sought to distinguish those cases from the present case because in both, the Plaintiff had "his own personal cause of action - unlawful force", and so did not need to rely on a cause of action given to someone else.

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13. Zimmern JA delivered a short concurring judgment in which he expressed his agreement with the judgment of Cons JA save in relation to one matter: "the quality of the power, if any given to the co-directors under Article 73(d)." Zimmern JA agreed with Fuad J that the exercise of the power conferred by that article could not be challenged by an ousted director either personally or in a derivative action, save in instances of actual fraud:

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"The co-directors when exercising that power do not act collectively as a board nor do they act on behalf of the Company which in turn has no cause of action against the co-directors. I am of the opinion that the power is vested in each director personally to be exercised in that very limited way as he thinks fit without being tied by fiduciary duties owed to the Company. If it were otherwise there would be uncertainties about the composition of the board and this case is an example. Such uncertainties are rarely in the best interests of the Company."

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11.28-34

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THE SUBMISSIONS

14. The Appellant makes four principal submissions:

(I) The power conferred on the directors of the Company by Article 73(d) is a fiduciary power which can only be exercised by each of the directors bona fide in the best interests of the Company.

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(II) A request purportedly made under Article 73(d) has no effect if made by any of the directors acting otherwise than bona fide in the best interests of the Company.

(III) An individual director of a company can maintain an action in his own name against the other directors and the Company for an injunction to restrain them from wrongfully excluding him from acting as a director; and OTHER relief.

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(IV) The Appellant's claim is well founded in law, and contrary to the decision in the court below is not completely unarguable so as to be an appropriate one for the Court to exercise its power to strike out under O 18 r 19.

15. In relation to (I), the Appellant relies on the decision of the majority of the Court of Appeal that in the exercise of their powers the directors of a company are under a duty to act bona fide in the best interests of the Company and that this principle

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11.30-32

applies to the exercise by the directors of the Company of the power conferred by Article 73(d). While the Appellant accepts that the nature of the power of the directors of a Company depends in each case on the true construction of the article, in the present case there was no justification for Zimmern JA seeking to construe the power conferred by Article 73(d) otherwise than as a power conferred on the directors for the benefit of the public Company as a whole, and that Zimmern JA was wrong in his opinion that "the power is vested in each director personally to be exercised.... as he thinks fit without being tied by fiduciary duties owed to the Company." So to hold is to expose a Company to risk by deterring a director who suspects wrongdoing by his fellow directors from doing his duty.

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16. In relation to (II), in support of the conclusion that the request to resign was valid even if actuated by bad faith, the Court of Appeal relied principally on the decision of Farwell J in Re The Bodega Company Limited [1904] 1 Ch. 276. The relevant article in that case provided that "the office of any director shall be vacated if he becomes bankrupt, if he becomes lunatic... or if he be concerned in or participate in the profits of any contract with the Company not disclosed to and authorised by the board." It was the latter situation that occurred, Farwell J finding that there had been a conspiracy to defraud the company between its chairman and a solicitor. Cons JA relied on the following passage from the judgment of Farwell J at page 283:

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"In my opinion it is quite plain on the words of the article that he ipso facto, or automatically, vacates his office on the act being done; there is no distinction between this and the other events mentioned in the article, e.g. bankruptcy, and in none of them is there any locus poenitentiae for him, or any means by which the directors can condone the offence or the act which causes the vacation. The office is vacated automatically..."

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The learned judge did not deal with the following observations of Farwell J. which were relied on by the Appellant:

"The directors have nothing to do with the vacation of the office by an event over which they have no control, and with which they have nothing to do except to satisfy themselves that the fact has happened, if this fact be put in issue. In this case, there is no dispute of fact, because it is admitted that the director was concerned in the contract."

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In the present case, unlike Re The Bodega Company Limited, the request of the Appellant to resign was an event caused by the acts of the directors, who had initiated the situation by requesting the Appellant to resign. The Appellant respectfully submits that since the power conferred on the directors by Article 73(d) can only be exercised bona fide in the interest of the company, a request made otherwise than in good faith has no effect and certainly no effect ipso facto. Cons JA also relied on the dictum of Megarry J. in Gaiman and Others v. National Association for Mental Health [1971] Ch. 317 at page 330, that an act in breach of trust gives rise to complaint but is not a nullity. It is respectfully submitted that the dicta of Megarry J., cited by Cons JA, have no application to the present case in which the rights of third parties arising from a breach of duty are not involved. The Appellant is entitled to his own right to maintain an action against his co-directors and the Company. It is respectfully submitted that the principle set out in Estmanco (Kilner House) Ltd. v. GLC [1982] 1 AER 437 that the exception to the rule that a member of a company cannot maintain an action on behalf of the company for a wrong done to the company which permits a member to sue where there is a fraud on a minority of shareholders extends beyond fraud at common law and includes an abuse or misuse of power by the majority whether acting as directors or shareholders, is correct. As Sir Robert Megarry V.C. said at p.445 d:

"'Fraud' in the phrase 'fraud on a minority' seems to be being used as comprising not only fraud at common law but also fraud in the wider equitable sense of that term, as in the equitable concept of a fraud on a power."

It is also respectfully submitted that Templeman, J. (as he then was) was correct in Daniels v. Daniels [1978] Ch 406, when he said, at 414:

"A minority shareholder who has no other remedy may sue where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company"

and that this proposition is equally applicable whether the proposed plaintiff be merely a shareholder or whether he be a director.

Moreover, the exercise of a fiduciary power made with a purpose that is ulterior and not a purpose for which the power was intended can be set aside by the court: See Punt v. Symons & Co. Ltd.

/1903/ 2 Ch. 506, 515 per Byrne J, cited in Hogg v. Cramphorn Ltd. /1967/ Ch. 254, 267 per Buckley J. both being cited in Gaiman's case (supra) at page 330 D-F.

17. In relation to (III), the Appellant respectfully contends that the present case is indistinguishable in principle from Pulbrook's case (supra) and Hayes' case (supra), which should have been followed. In Pulbrook's case, Jessel MR upheld the right of a director to an injunction to restrain his co-directors from interfering with his right to act as a director, saying at page 612:

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"Now it appears to me that this is an individual wrong, or a wrong that has been done to an individual. It is a deprivation of his legal rights for which the directors are personally and individually liable. He has a right by the constitution of the company to take part in its management, to be present, and to vote at the meetings of the board of directors. He has a perfect right to know what is going on at these meetings.... It appears to me that for the injury or wrong done to him by preventing him from attending board meetings by force, he has a right to sue. He has what is commonly called a right of action, and those decisions which say that, where a wrong is done to the company by the exclusion of a director from board meetings, the company may sue and must sue for that wrong, do not apply to the case of a wrong done simply to an individual."

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The Appellant respectfully submits that Cons JA was in error when he stated that in neither Pulbrook's case nor in Hayes' case did the plaintiff need to rely on a cause of action given to somebody else whilst the Appellant in the present case did. Moreover, the use of force to prevent Pulbrook attending board meetings was not the basis of the decision in the case, but rather a narrative description of the particular circumstances in which Pulbrook was excluded. His cause of action was not in trespass to the person. Hayes' case was not dependent on the use of force either. The Appellant submits that his cause of action here is not dependent on his first attempting to attend board meetings and being by force prevented therefrom. A director of a company can maintain an action in his own name against his co-directors inter alia for an injunction to restrain them from wrongfully excluding him from acting as a director, whether by simple force or an abuse of power exercised for a dishonest and ulterior motive, since such wrongful exclusion constitutes an injury to the individual

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director himself. As Wynn-Parry, J said in Hayes'
case at p.504:

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"it would be really a denial of justice to prevent a person in the position of this plaintiff from pursuing what otherwise is a proper right of action..."

10 Reduced to its essentials, the position of a director where there are Articles such as the present, is that he has a contract with the company on the terms of the Articles. He and each of his co-directors, on the true construction of Article 73(d), is entitled to remain in office on the terms of the Articles unless Article 73(d) is put into operation bona fide by each co-director in the best interests of the Company. If Article 73(d) is abused the Appellant (a director victim of the breach) is entitled to contractual relief against his co-directors and/or the Company in whose name and on whose behalf they purported to act.

20 18. In relation to (IV), the Appellant respectfully contends that it was, in any event, inappropriate for the Court to take the Draconian step in the circumstances of the case in striking out his Writ in limine and dismissing his action with costs, a fortiori as Cons JA expressed the view that:

30 "there seems to me to be considerable force in (counsel for the Appellant's) argument that in this respect the judge did omit to consider what was put forward as the history and background of the events." pp.108-113

19. Accordingly, the Appellant humbly submits that the judgment of the Court of Appeal was wrong and ought to be reversed and that this appeal ought to be allowed with costs, for the following, amongst other,

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11.3-5

R E A S O N S

- 40 1. BECAUSE the power conferred on the Company by Article 73(d) is a fiduciary power which can only validly be exercised by the directors bona fide in the best interests of the Company.
2. BECAUSE a request made under Article 73(d) has no effect if made by the directors acting otherwise than bona fide in the best interests of the Company.
3. BECAUSE if, as Cons JA stated, a power such as that conferred by Article 73(d) exists to "cater for circumstances in which it is desirable

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for the sake of the Company that one director should relinquish his office but which may be so unusual or particular that the articles cannot be expected to provide for them in advance", it is not in the public interest for it to be used as a method of attempting to silence a director of a public company who has reason to suspect that shareholders have been, or may have been, misled or that the assets of the company may have been improperly dealt with, or to prevent him exercising his right to inspect the records of the Company.

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4. BECAUSE an individual director can maintain an action in his own name against his co-directors and the company for inter alia an injunction to restrain them from wrongfully excluding him from acting as a director.

5. BECAUSE the Appellant's claim is well founded in law, and contrary to the decision in the court below, is not completely unarguable so as to be an appropriate one for the court to exercise its power to strike out under O 18 r 19.

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IN THE PRIVY COUNCIL

O N A P P E A L
FROM THE SUPREME COURT OFF HONG KONG

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LIMITED Respondents

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