

Samuel Tak Lee

Appellant

v.

Chou Wen Hsien and Others

Respondents

FROM

THE COURT OF APPEAL OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE
OF THE PRIVY COUNCIL, DELIVERED THE 31ST JULY 1984

Present at the Hearing:

LORD FRASER OF TULLYBELTON

LORD BRIDGE OF HARWICH

LORD BRIGHTMAN

LORD TEMPLEMAN

SIR ROBIN COOKE

[Delivered by Lord Brightman]

In this appeal Mr. Samuel Tak Lee, who became a director of Ocean-Land Development Limited upon its incorporation in 1972, seeks to retain his seat on the Board in the face of expulsion by his co-directors in purported pursuance of a power in the articles.

Ocean-Land Development Limited ("Ocean-Land") was incorporated in Hong Kong. It has an issued share capital of over HK\$60,000,000 divided into shares of one dollar each. The shares are quoted on the Hong Kong stock exchange. Mr. Lee is the registered holder of 248,000 shares. The company is principally a holding company, operating in shipping, real estate, mining and investments through some 23 subsidiary and associated companies. At the relevant time there were seven other directors. Under the articles of association a director, who needs no share qualification, is appointed by the company in general meeting. One third of the Board retires each year, being eligible for re-election. The company in general meeting has power by ordinary resolution to remove a director before the expiration of his period of office.

In earlier years a representative of the Hong Kong and Shanghai Banking Corporation served as a director. He resigned in September 1980 on his retirement from the Corporation. He was not replaced by another representative of the Corporation. Mr. Lee felt that Ocean-Land thereby lost someone whom he regarded as a wholly independent director. Until then harmony seems to have prevailed on the Board.

In March 1982 Mr. Lee started to entertain suspicions over the sale of Ocean-Land's holdings in certain subsidiary and associated companies. He began by asking the secretary of Ocean-Land for copies of the annual accounts of Forerunner Investment Limited, a 25% associated company, for the preceding nine years. Inspection of the accounts was offered, but not apparently a copy. Over the next four weeks Mr. Lee's requests extended to another 18 subsidiary and associated companies. His requests were not complied with. His misgivings stemmed from a re-consideration of the propriety of certain transactions in 1978/80. At that time Ocean-Land had substantial holdings in Clinton Investment Limited, Pentaland Investment Limited and Prat Development Limited, of which Mr. Lee and Mr. Chou Wen Hsien, the chairman and managing director of Ocean-land, were directors. Ocean-Land sold its holdings to Red Lake Investments Limited. Mr. Lee now claimed that these sales, or at any rate the sale of the share-holding in Prat Development Limited, was at an undervalue; furthermore he suspected that Mr. Chou and his brother, who is vice-chairman and deputy managing director of Ocean-Land, were the beneficial owners of the share capital of Red Lake Investments Limited.

Having failed to obtain from the secretary of Ocean-Land or from the company's solicitors the information he desired, Mr. Lee requested the secretary of Ocean-Land to convene a meeting of the Board for 11th May 1982, as he was entitled to do under the Articles. However, it turned out that this would not be a convenient date for his co-directors. Accordingly, on 9th May he asked for the meeting to be cancelled and reconvened for 17th May.

On 15th May there was delivered to Mr. Lee, without prior warning, by the hand of the chief accountant of Ocean-Land, a notice dated 12th May, addressed to Mr. Lee in the following terms:-

"Re: OCEAN-LAND DEVELOPMENT LTD.

We, the undersigned, being all the co-directors of the above company hereby give you notice that you are requested to resign your office as a director of the company with effect from the date of this notice. This notice is issued pursuant to Article 73(d) of the Memorandum and Articles of Ocean-Land Development Ltd. which states that the office shall be vacated if a director is requested in

writing by all his co-directors to resign."

This notice was signed by all Mr. Lee's co-directors.

Articles 73 is one of three articles under the cross-heading "Disqualification of Directors", and is in the following terms:-

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

But any act done in good faith by a director whose office is vacated as aforesaid shall be valid unless, prior to the doing of such act, written notice shall have been served upon the company or an entry shall have been made in the directors' minute book stating that such director has ceased to be a director of the company."

Article 73(d) is not peculiar to Ocean-Land. It appears in the 1902 edition of Palmer's Company Precedents, and it has continued to appear down to the current edition published in 1956.

On the face of the record, the story does not seem a very attractive one. It is, however, fair to the respondents to say that the court proceedings which thereafter ensued were conducted with such exemplary speed that the respondents may not have had much opportunity to develop their side of the argument, nor indeed the occasion having regard to the form taken by the proceedings.

Later on the same day Mr. Lee caused a generally endorsed writ to be issued. Mr. Lee is named as the plaintiff in his personal capacity. He is not expressed as prosecuting a derivative action on behalf of Ocean-Land or the shareholders in that company. The defendants are his seven co-directors and Ocean-Land. The first two paragraphs of the relief claimed are in the following terms:-

- (1) A declaration that the notice of 12th May 1982 was "null, void and of no lawful force or effect".
- (2) A declaration "that the plaintiff is and remains a director of" Ocean-Land.

The remaining relief sought is purely consequential on those two paragraphs.

Mr. Chou and his brother responded on the same day by issuing a summons to strike out the writ and have the action dismissed on the ground that the action was irregularly constituted, that the writ disclosed no reasonable cause of action, and that the action was frivolous and vexatious and an abuse of the process of the court. This summons was returnable on 19th May.

On 17th May Mr. Lee issued a summons, also returnable on 19th May, seeking interlocutory relief, principally an injunction to restrain the defendants from interfering with the lawful discharge by him of his functions and duties as a director of Ocean-Land. He had earlier obtained ex parte relief.

On 19th May the remaining defendants fell into line by seeking the same relief as that sought by the Chou's.

In the outcome, the writ was struck out and the action dismissed by Fuad J, on the ground that the appellant had no arguable case; the event prescribed by Article 73(d) had happened and Mr. Lee's office as a director was therefore vacated. Mr. Lee appealed. The first judgment in the Court of Appeal was delivered by Cons J.A. who summarised the appellant's principal submissions as follows:-

- "(1) The power which Article 73(d) confers on the directors is a fiduciary power which can only be exercised bona fide in the best interests of the company;
- (2) a request made under that Article has no validity ipso facto and if activated by bad faith it has no validity at all;
- (3) ... the plaintiff has the right to claim relief as an individual director ... "

These three submissions were the essential three links in the chain of the appellant's arguments. If any of them failed, the appeal failed.

The learned Justice of Appeal began by addressing himself to the second submission, and observed as follows:-

"... it seems to me impossible to maintain that the request has not taken effect. The language of the article leaves no room for doubt or uncertainty. The office shall be vacated once any event therein mentioned occurs. That vacation must take place immediately. The position would otherwise be intolerable. No one would know who really constituted the board."

After considering the submissions in greater detail, he concluded by deciding that the appellant ceased to be a director of Ocean-Land as from 15th May.

Strictly speaking, no more needed to be said. The learned Justice of Appeal, however, also addressed himself to the first and third submissions of counsel. On the first submission he decided that the power in Article 73(d) had to be exercised in the interests of the company. He then said that the court would set aside the vacation of office if it could be shown that any one director had acted from some private ulterior purpose, assuming that the action was properly constituted. That assumption was implicit in counsel's third submission. That submission failed because "the wrong is not done to him, it is done to the company. His injuries are coincidental by-products of that wrong and for which he has no cause of action." Zimmern J.A. differed from Cons J. A. only to the extent that he did not accept that a director signing a notice of expulsion owed any fiduciary duty to the company. Hooper J. agreed with Cons J.A.

It is to be observed that in paragraph 14 of his printed case the appellant advances the same three submissions as he made to the Court of Appeal:-

- "(1) 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.
- (2) 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.
- (3) 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;"

adding, somewhat obscurely, after this last submission, the words "and other relief".

Their Lordships are in agreement with the majority of the Court of Appeal that the power given by Article 73 to directors to expel one of their number from the Board is fiduciary, in the sense that each director concurring in the expulsion must act in accordance with what he believes to be the best interests of the company, and that he cannot properly concur for ulterior reasons of his own. It does not, however, follow that a notice will be void and of no effect, and that the director sought to be expelled will remain a director of the Board, because one or more of the requesting directors acted from an ulterior motive. Their Lordships have not been referred to any reported case directly in point. The decision of Farwell J. in *Re The Bodega Company Limited* [1904] 1 Ch. 276 provides the nearest analogy, but is only of limited assistance.

While it emphasises the automatic operation of an article similar to Article 73, the bona fides of the continuing directors was not there in issue.

To hold that bad faith on the part of any one director vitiates the notice to resign and leaves in office the director whose resignation is sought, would introduce into the management of the company a source of uncertainty which their Lordships consider is unlikely to have been intended by the signatories to the Articles and by others becoming shareholders in the company. In order to give business sense to the Article, it is necessary to construe the Article strictly in accordance with its terms without any qualification, and to treat the office of director as vacated if the specified event occurs. If this were not the case, and the expelled director challenged the bona fides of all or any of his co-directors, the management of the company's business might be at a standstill pending the resolution of the dispute by one means or another, in consequence of the doubt whether the expelled director ought or ought not properly to be treated as a member of the Board. Their Lordships therefore take the view that the appellant's claim, as spelt out in the endorsement on the writ, in argument before the Court of Appeal, and in his printed case, inevitably fails at this point.

It is not strictly necessary to deal with the appellant's third submission, to the effect that if Article 73(d) confers a fiduciary power and a request made in breach of that duty is of no effect, the wrongly expelled director is nevertheless entitled to maintain an action in his own name to restore himself to office and is not bound to sue, if at all, in a derivative action on behalf of the company to repair a wrong done to the company. Without developing the matter at length, their Lordships agree with the Court of Appeal that, on the two hypotheses stated, the ordinary principles of *Foss v. Harbottle* [1843] 2 Hare 461 would preclude such an action.

An unusual feature of this case is that the summons to strike out was heard in the absence of any pleading on the part of the plaintiff, and therefore without the Court having the benefit of a precise formulation of the plaintiff's case. For this reason their Lordships have paid particular attention to the appellant's submissions as recorded in the Judgment of Cons J. A. and in his printed case.

As already emphasised, the appellant's case has up to now been directed exclusively to his reinstatement in office on the ground that a valid request to resign had not been given. However, in order to save his action from failure in limine, the appellant sought before their Lordships to introduce into the case a further submission, namely, that the

appellant had an arguable case for damages or compensation on the basis that, on the true construction of Article 73(d), each director owed a duty to his co-directors, in addition to his duty to the company, not to sign a request for resignation save in pursuance of what the signatory believed to be the best interests of the company; and that an expelled director is entitled to damages or compensation from a co-director who signs a request in breach of that duty.

There was discussion before their Lordships as to whether such a right of action would be based on the breach of an implied contract between the Directors inter se to be spelt out of Article 73(d), or on breach of a fiduciary duty independently of contract, or perhaps in tort. Their Lordships did not invite the respondents' counsel to pursue a reply to this line of argument, because they took the view that it fell quite outside the relief claimed in the writ, which was solely directed to the restoration of the appellant's office as a director; nor is such a claim foreshadowed by any submission in the appellant's printed case, which again is directed solely to the appellant's re-instatement. It is conceivable that such a claim might have been introduced into a statement of claim had one been served, but possibly only after amendment of the relief claimed in the writ and possibly only after leave to amend had been obtained. The fact remains that no such claim is anticipated by the writ, nor is formulated in any statement of claim, nor is dealt with in any of the judgments, nor is to be found in the printed case. Their Lordships accordingly disregard such a claim for the purposes of this appeal, expressing no view upon it.

Their Lordships will humbly advise Her Majesty that this appeal should be dismissed. The appellant must pay the respondents' costs.

