Introduction

Although a company is a legal entity, it is merely an artificial person and has to act through the intermediary of humans. In a company, the board of directors and the members in general meeting are its primary decision-making bodies. It is a basic corporate structure for directors to manage or oversee the management of the company; while shareholders act as owners. This is often described as the doctrine of separation of ownership and control, and is common in most large public companies.

To determine how corporate power is allocated between these two bodies, it is necessary to have regard to the provisions of the Companies Ordinance (Cap.32) (CO) and the articles of association of the company¹. If there is any agreement entered into among the shareholders, the agreement may also set out the specific powers and rights held by them. In addition, common law principles such as the doctrine of residual management power may be relevant as well since it influences the scope of the management power that can be exercised by the general meeting when there is no board or when the board is ineffective. Generally, some functions are explicitly reserved to either the board or the members. For instance, only the general meeting has authority to alter the company’s objects, name or articles²; whereas the board is

² Companies Ordinance (Cap.32) sections 8, 13 and 22 respectively.
responsible for preparing annual accounts. In relation to the power of corporate management, Table A Regulation 82 of the Ordinance can be seen as the primary source since it is commonly adopted by companies. Nevertheless, despite over a century of judicial examination of the issue, there is still no consensus on the effect of the Regulation 82 concerning the relationship between directors and shareholders. As a result, upon the amendment made under the Companies (Amendment) Ordinance 2003, a new regulation came into force attempting to resolve the uncertainties. It is to be noted that although CO s11 stipulates that the regulations contained in Table A as at the date of incorporation would be applicable as the regulations of the company if the company has not registered its own articles, or if it has, the registered articles do not exclude or modify the regulations contained in Table A, companies incorporated prior to the amendment may choose to use the new regulation instead by altering their relevant articles. The emergence of this new provision, differing from what is expected, fails to eliminate all the existing uncertainties and ambiguities subsist.

In light of the above, this paper aims to examine both the former and present regulation 82 on the division of power between directors and shareholders, that is, the

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3 Companies Ordinance (Cap.32) s129D.
4 The Hong Kong Institute of Directors. *Guidelines on Corporate Governance for SMEs in Hong Kong.* November 2003, p.37.
5 Ord. No. 28 of 2003.
extent to which the board of directors can exercise management power without the interference of members in general meeting. To this end, the problems arising in construing the meaning of the wordings used in the respective provisions will be analyzed. It will be argued that under the former Regulation 82, the management power of the board of directors should be subject to ordinary resolutions passed by the general meeting. In relation to the current regulation, although it is clear that the shareholders can exercise control over the board by way of special resolution and they are only allowed to curtail future powers of the board, it is doubtful when an act of the board will be regarded as a prior act and in what degree such an act will be considered as being invalidated. It will be argued that any acts which have already been validly performed by the board of directors are prior acts and the general meeting is debarred from reversing them retrospectively. However, the general meeting should be allowed to direct the board in relation to future acts even though such directions are in substance in contravention of the previous acts of the board.

Last but not least, regardless of whether the power allocation provision gives any power to the general meeting for it to intervene in the management of the business of the company, the common law reserves the management power to the members in general meeting where there is no board or where an effective board is unavailable. In
this part, investigations will first be made to explore what circumstances will signify
that the board is ineffective. Then, the extent to which the general meeting can
exercise such reserve management power will be examined, and it will be argued that
the scope of this doctrine should be restricted in the sense that if there is a deadlock in
the board, the general meeting can only appoint additional directors or remove and
replace directors so as to make the board effective again but not usurp the powers of
the board by taking over all of them.

Courts’ Interpretation on the Former Regulation 82

Prior to the 2003 amendments, Regulation 82 of Table A7 was expressed in the
following terms:

The business of the company shall be managed by the directors, who may pay all
expenses incurred in promoting and registering the company, and may exercise
all such powers of the company as are not, by the Ordinance or by these
regulations, required to be exercised by the company in general meeting, subject,
nevertheless, to any of these regulations, to the provisions of the Ordinance and
to such regulations, being not inconsistent with the aforesaid regulations or
provisions, as may be prescribed by the company in general meeting; but no

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7 The corresponding provision in UK was the former Table A Regulation 80 in the Companies Act 1948.
regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made. (emphasis added)

This regulation entrusts the board of directors with the power to manage the business and affairs of the company which is not specifically bestowed upon the company in general meeting by the Ordinance or by the articles of association. However, the limiting words in the second half of the sentence attracted a heated debate as to whether the board of directors is subject to shareholders’ control and supervision in relation to the exercise of the management power as it appears to reserve power for the members in general meeting to prescribe “regulations” that binds the board. This question can be resolved by finding out what the proper interpretation is for the provision. Over the last century, there have been a great number of authorities examining this issue, and two schools of thought have evolved. The mainstream view holds the opinion that management power is vested exclusively in the board and the members in general meeting could not override management decisions made by the board or direct the board on how to exercise those power. In contrast, the other

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9 Automatic Self-Cleansing Filter Syndicate Co v Cuninghame [1906] 2 Ch 34; Salmon v Quin and Axtens Ltd; Quin and Axtens Ltd v Salmon [1909] 1 Ch 311(CA); [1909] AC 442 (HL); John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113; Breckland Holdings Ltd v London and Suffolk Properties Ltd [1989] BCLC 100; Paul L. Davies. *Gower and Davies’ Principles of Modern Company Law*, 7th
school contends that members in general meeting can in fact control the board by passing an ordinary resolution, provided that the resolution is not inconsistent with the Ordinance or the Articles. With regard to such conflict of views, it is important to analyze each line of cases in detail.

The first and leading case supporting the prevailing view is *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame*\(^\text{11}\). In that case, members in general meeting passed a simple resolution ordering the board of directors to sell the whole of the company’s assets to a new company which was formed for the purpose of their acquisition. The directors thought that such sale was not for the benefit of the company. Thus, relying on an article similar to that of the former Regulation 82 in Table A but stated to be “subject nevertheless …… to such regulations …… as may from time to time be made by extraordinary resolution”, the directors refused to follow the direction. The members in general meeting argued that the board’s powers are subject to any instructions given by the general meeting since the directors are simply agents and they should obey what their principal (i.e. the shareholders) directs. The English Court of Appeal rejected these arguments, deciding that the direction given by the

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\(^{11}\) [1906] 2 Ch 34.
members was null and void and the directors should not be compelled to comply with the resolution. First, it was opined that the directors are not agents of the shareholders. Collins MR thought that even though for some purposes the directors are agents, they are agents of the company as a whole\textsuperscript{12}. As a result, it would be unfair if the directors are bound to obey any directions given by a simple majority as the minority is not taken into account\textsuperscript{13}. Moreover, Cozens-Hardy LJ was of the view that since it is the constitution which confers management powers on the board of directors, it would be more reasonable to regard the board as an organ of the company appointed to carry out the duties arranged rather than as an agent\textsuperscript{14}. Second, the shareholders have contractually agreed in the articles of association that the board will be responsible for managing the affairs of the company, so as long as there is no misconduct on the part of the board and the board is able to function, the members in general meeting must not have any rights to intervene unless they take back the powers from the directors by altering the relevant articles (which requires a special resolution), or alternatively, remove the directors from office.

However, three years after \textit{Cuninghame} was decided, a totally different approach was...
adopted in *Marshall's Valve Gear Co Ltd v Manning, Wardle & Co Ltd*\(^{15}\). In that case, the directors of the plaintiff company failed to pass board resolutions to institute legal proceedings against the defendant company for its infringement of the patent owned by the plaintiff company because three of the directors who were interested in the defendant company opposed the resolutions. A majority shareholder brought an action on behalf of the plaintiff company to sue the defendant. It was held that, under an article equivalent to the former Regulation 82, the majority shareholder had the right to bring such an action. Neville J stated in the judgment that although the board “may exercise all such powers of the company”, the members in general meeting could control the acts of the directors by way of an ordinary resolution and the board is bound by it, provided that such control does not contravene any provisions of the company’s articles or of the legislation. The case of *Cuninghame* was distinguished on the basis that in this case, the management power vested in the board was stated to be subject to the regulations prescribed by the general meeting; whist in *Cuninghame*, it was stated to be subject to an extraordinary resolution passed by the general meeting. Since no specific form of resolution is referred to in the provision, it appears that members in general meeting could direct the board of directors simply by an ordinary resolution.

\(^{15}\) [1909] 1 Ch 267.
In the same year though, the mainstream view was again followed. In *Salmon v Quin and Axtens Ltd*\(^{16}\); *Quin and Axtens Ltd v Salmon*\(^{17}\), the general power of management was conferred upon the board by Regulation 75 of the company’s articles which provided that “[t]he business of the company shall be managed by the board …….
The board may exercise all the powers of the company, subject, nevertheless, to the provisions of any Acts of Parliament or of these articles, and to such regulations (being not inconsistent with any such provisions of these articles) as may be prescribed by the company in general meeting”. The board passed resolutions to acquire and lease premises. However, Regulation 80 required that for a board resolution relating to the acquisition or disposal of premises to be valid, consent must be obtained from both managing directors. Since one of the managing directors dissented, the general meeting passed an ordinary resolution to the same effect as the board resolutions. The Court of Appeal held that the resolution of the company was inconsistent with Regulation 80 and thus of no effect. Further, applying the principle of *Cuninghame*, the board’s power under Regulation 75 would not be affected by the resolution anyway since the shareholders agreed in the article that the directors should manage the business of the company and such power should not be interfered with unnecessarily. Although the general meeting resolution might be seen as an attempt to

\(^{16}\) [1909] 1 Ch 311 (CA).
\(^{17}\) [1909] AC 442 (HL).
alter the terms of the article, it was not a special resolution and would therefore not be valid. This approach was later affirmed by the House of Lords.

The *Cuninghame* principle was also approved in *John Shaw & Sons (Salford) Ltd v Shaw*\(^\text{18}\) where a majority of the English Court of Appeal held that a special resolution of the members in general meeting directing the directors to discontinue legal proceedings which had been commenced by them was ineffective. Greer LJ expressed the view that the two corporate organs must be autonomous and cannot usurp each other’s power\(^\text{19}\). Since the board was properly exercising the powers of management vested in it by the articles, the general meeting has no right to intervene. Further, in *Breckland Holdings Ltd v London and Suffolk Properties Ltd*\(^\text{20}\), Harman J removed all the doubts that the general management power is vested exclusively in the board under an article similar to the former Regulation 82. In that case, no board resolution was passed to institute legal proceedings and a majority shareholder brought an action in the name of the company. It was held that the power to litigate was one of the general management powers vested solely in the board. Hence, the resolution of the members in general meeting authorizing the proceedings would not be valid. Harman J claimed that since the board of directors is the only organ of the company which

\(^{18}\) [1935] 2 KB 113; this is affirmed in *National Roads & Motorists’ Association v Parker* (1986) 2 ACLC 609.

\(^{19}\) [1935] 2 KB 113 at 134.

could commence legal proceedings, even if the directors failed to do so, the members still could not in general meeting pass a resolution allowing the raising of the action.

Since *Cuninghame*, there appears to be more commentators supporting the dominating and modern view compared with those agreeing with *Marshall’s Valve*.

Some followers of *Cuninghame* had expressed their views on why it is more appropriate for the power of management to be vested exclusively on the board of directors. First, placing the managerial power on a particular group of people other than the shareholders is advantageous for the whole of the company. Since a company usually has a great number of shareholders, it is not feasible for shareholders to often hold meetings and pass resolutions in order to exercise day-to-day control over the business and affairs of the company. Moreover, directors are persons equipped with professional knowledge and skills which most shareholders do not possess, so they could make decisions in a more prompt and effective manner. Second, although it seems that directors could exercise management power free from any interference of members in general meeting, directors are somehow subject to the control of the members as well as the court. Other than the indirect control by members in general

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meeting through amendment of articles or removal of directors, the directors, while making decisions, have legal duties to act in good faith\textsuperscript{23}, in what they believe to be the best interests of the company\textsuperscript{24}, and in the appropriate level of care and skill\textsuperscript{25}, and they must exercise the power for the purposes for which they are given\textsuperscript{26}. Therefore, it may be presumed that the directors are already sufficiently accountable to the shareholders\textsuperscript{27}. However, does it necessarily follow that the mainstream view should be the correct approach whereas Marshall’s Valve is wrong?

**Which line of cases should Hong Kong Courts Adopt? Cuninghame or Marshall’s Valve?**

Despite the controversy between the two conflicting views in English authorities on how corporate powers should be allocated between the board of directors and the shareholders, Hong Kong courts have tended to follow the approach adopted in Cuninghame. First, it has been accepted at first instance in Broadview Commodities


that under an article drafted in similar terms to the former Regulation 82, the power to litigate should be conferred on the board of directors since the general management power is vested exclusively in the board. The board has the necessary authority to pass a resolution ratifying the institution of legal proceedings and the general meeting could not argue that the decision to sue should have been made by it instead. If the members in general meeting really wants to intervene in the management decisions, it could only limit the powers of the board by either not re-electing the directors whose acts it disapproved or altering the articles of association. Second, the principle of Cuninghame has been agreed in Miracle Chance Ltd v Ho Yuk Wah David though on an obiter dictum basis. The relevant article of the company conferring management power upon the directors largely adopted the wording of the former Regulation 82 but the power was stated to be “subject to such requirements as may be prescribed by a resolution of members”. It was held by Rogers J that in general terms, the general meeting could not usurp the powers of the board in managing the business of the company. However, since the word “requirements”, different from the word “regulations” in the common form provision, clearly suggested that the general meeting had power to exercise control over the board in relation to management issues, the general meeting should be allowed to do

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28 [1983] 2 HKC 578.
29 [1999] 3 HKC 811.
30 Ibid at 814.
so. As a result, the decision on the *Cuninghame* principle was merely *obiter*.

Although it seems that Hong Kong courts incline to favour the approach propounded in *Cuninghame*, the matter may not be entirely settled though under the law in Hong Kong as in *Tang Kam-Yip v Yau Kung School*[^31^], the Court of Appeal has supported the view of *Marshall’s Valve* instead. In that case, a company operated a school serving seven villages. Resolutions had been passed at its general meeting to ratify earlier resolutions passed by the board of directors to the effect that each village was to be represented by an equal number of members in the company. Later, the board of directors wished to admit more members to the company and accordingly passed a board resolution to achieve that purpose. Since that would result in an unequal distribution of membership from different villages, the resolution was clearly inconsistent with the previous resolutions of the general meeting. The issues here were whether the directors had power under the articles of association to admit members of the school and if so, whether the directors could hence override and replace the general meeting resolutions. It was held that under Article 30, which follows in great measure the wording of the former Regulation 82, the directors were only given powers in relation to management of the corporation. Since admission of members was not within the category of managerial power, the board of directors had

[^31^]: [1986] HKLR 448 (CA).
no authority to admit members *per se* and the board resolution was therefore invalid.

In *obiter*, the Court appeared to reject the judicial opinion on the autonomy of the board in exercising the management power and alleged that an ordinary resolution would be sufficient to bind the board.

Huggins VP first of all argued that the decisions supporting the dominant approach in the higher English courts are *obiter* only. His Honour thought that in *Cuninghame*, the division of power provision is materially different from the common form (in former Regulation 82) since it provided that the directors’ power of management is “subject nevertheless to the provisions of the statutes and of these presents, and to such regulations, not being inconsistent with these presents, as may from time to time be made by *extraordinary resolution*” (emphasis added). Besides, there was another article by which the directors were specifically empowered to sell or deal with any property to which the company may be entitled on such terms and conditions as they *may think fit* (emphasis added). It is because of the wordings in these two articles which make the general meeting unable to compel the directors in completing the sale but not necessarily because of the effect of the common form division of power provision. Hence, it is not appropriate to regard the case of *Cuninghame* as the

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authority for the proper interpretation of former Regulation 82 and this approach is supported by various commentators such as Goldberg\textsuperscript{33} and MacKenzie\textsuperscript{34}. Regarding \textit{Salmon v Quin and Axtens Ltd; Quin and Axtens Ltd v Salmon}, Huggins VP simply could not agree with the ruling of the English Court of Appeal that the general meeting resolutions were “absolutely inconsistent with Article 80” of the company in that case because the Article merely provided that “no resolution of a meeting of the directors ….. shall be valid or binding” unless both managing directors assented to it. The provision only refers to the resolution passed by the board but not that by the general meeting. It is questionable on how the Article would be applicable to the general meeting, making its resolutions invalid. Besides, Huggins VP felt that although the House of Lords affirmed the view of the Court of Appeal that the management powers of the board would not be affected by the general meeting resolutions anyway, it was not supported by analysis. Lord Loreburn, with the other lordships of the court concurred, simply said that “the directors should manage the business; and the company, therefore, are not to manage the business unless there is provision to that effect”\textsuperscript{35}. Huggins VP therefore concluded that he could not extract a \textit{ratio} from the decision and could only approach the question from first principles.

\textsuperscript{33} Ibid.
\textsuperscript{34} Judith-Anne MacKenzie. “’Who Controls the Company’ – the Interpretation of Table A”. 4(3) \textit{Company Lawyer} 99, p.99.
\textsuperscript{35} \textit{Quin and Axtens Ltd v Salmon} [1909] AC 442 (HL) at 443.
rather than on the basis of authority\textsuperscript{36}. As for \textit{John Shaw \& Sons (Salford) Ltd v Shaw}, Fuad JA, though cited the part of Greer LJ’s judgment which supported the \textit{Cuninghame} approach, shared the common view held by Goldberg\textsuperscript{37}, MacKenzie\textsuperscript{38} and Sullivan\textsuperscript{39} that the decision was based on a number of other provisions which granted specific power to the directors, rendering the article in the terms of the former Regulation 82 not prominent. Further, he also accorded with the view that each of the judges had decided the case on a different line of reasoning although the ultimate decision reached by them was the same. As a result, again the principle that the general management power is vested exclusively in the board could only be regarded as \textit{obiter}.

Although it might be correct to interpret these decisions as mere \textit{obiter}, others might argue that they are in fact \textit{ratio}. However, if the principle laid down in these cases could be found to be wrong, it would then be a better view to say that they are \textit{obiter}.

In the following paragraphs, arguments would be put forward to support this latter view. First, the management power of the board should be qualified by the limiting words. Under the provision, there are two possible ways to read the whole provision,

\begin{itemize}
\item \textsuperscript{36} [1986] HKLR 448 (CA) at.455.
\item \textsuperscript{38} Judith-Anne MacKenzie. “‘Who Controls the Company’ – the Interpretation of Table A”. 4(3) \textit{Company Lawyer} 99, p.99.
\end{itemize}
either by one-part construction or by two-part construction. For one-part construction, the first two lines of the provision, that is, “[t]he business of the company shall be managed by the directors, who may pay all expenses incurred in promoting and registering the company”, will be read together with the limiting words and hence the management power of the directors would be qualified. On the contrary, for two-part construction, the above quoted text would be read separately from the limiting words, making the board’s management power unlimited. Huggins VP thought that the power of management held by the board should be qualified by the limiting words instead of being unfettered as opined by the mainstream line of authorities flowing from Cuninghame because ignoring the limiting words would contravene the fundamental rule of construction that “words shall not be treated as surplusage if a fair and reasonable meaning can be ascribed to them”40. Besides, Cons JA also agreed that the one-part construction is more reasonable because if otherwise, the draftsman would have expressed in a clearer way by separating the whole provision into two articles41.

There is no point in packing the management powers and all other powers of the company exercisable by the board in the same provision if the limiting words are not applicable to both as it is likely that the users of the provision would easily get confused with its proper meaning. In light of the above, since the principle that

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40 [1986] HKLR 448 (CA) at 453.
41 Ibid at 458; Judith-Anne MacKenzie. “‘Who Controls the Company’ – the Interpretation of Table A”, 4(3) Company Lawyer 99, p.100.
management power is vested exclusively in the board would only make sense in the two-part construction, the principle should in fact be incorrect.

Second, the “regulations” when referred to the second time in the limiting words must mean “resolutions” rather than “articles”. Common to the above three cases discussed, the courts have tried to interpret the limiting words, that is, “subject nevertheless to any of these regulations, to the provisions of the Ordinance and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting” (emphasis added). It was opined that the word “regulations” when referred to the second time means “articles”. However, if that is the case, the limiting words would be superfluous as CO s13 has already provided that the general meeting could alter the articles of association. Further, in the judgment, Huggins VP had commented that although the word “regulations” as it first appears in the quoted text clearly refers to “articles”, similarly where it is referred to the third time\textsuperscript{42}, the word “regulations” when used the second time must mean “resolutions” instead of “articles”\textsuperscript{43}. This view has strong grounds because firstly, if that reference to “regulations” means “articles”, then the reference will be redundant as it has already been stated at the beginning of the phrase that the power is subject to

\textsuperscript{42} [1986] HKLR 448 (CA) at 455.
\textsuperscript{43} Ibid.
any of these articles. Second, it is not possible to say that such “regulations” means “articles” newly made or amended by the general meeting since the “regulations” are required under the limiting words to be not inconsistent with the aforesaid articles. It is difficult to see how a new or amended article will not contravene existing articles. Moreover, Huggins VP took the view that the reference to “regulations” (when used the second time in the above quote) must refer to “ordinary resolutions”. This is because normally when the Ordinance only says “resolution” without specifying the form of it, it should be referred to as an ordinary resolution instead of a special resolution. As a result, the proper reading of the provision should be that the power of the directors in managing the business of the company is subject not only to any of the articles and provisions of the Ordinance, but also to such directions given by the general meeting through an ordinary resolution.

Third, during the process of interpretation, the court should not take into account any policy reasons. In Salmon v Quin & Axtens Ltd, Farwell LJ ruled that the board of directors should have the sole authority in managing the business of the company

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45 [1986] HKLR 448 (CA) at 456; Credit Development Pte Ltd v IMO Pte Ltd [1993] 2 SLR 370 at 378; Harvey J’s comment on the meaning of “regulation” in Dowse v Marks (1913) 13 SR (NSW) 332 at 340; the word “regulations” was interpreted wrongly as “articles” in Salmon v Quin and Axtens Ltd; Quin and Axtens Ltd v Salmon and John Shaw & Sons (Salford) Ltd v Shaw.
because “a business does require a head to look after it, and a head that shall not be interfered with unnecessarily”\(^\text{47}\). Nonetheless, if the provision has expressly conferred power on the general meeting for it to intervene in the management, there are no reasons why the general meeting is not allowed to exercise those power. Sticking to the policy reason during interpretation of the provision would risk making the whole construction inconsistent with its text. It must be noted that the members of the company are free to enter into any contracts that they think suitable. If the members intend to grant the general meeting the power to intervene in the management, the court should not interpret otherwise simply based on policy considerations. It should instead ascertain the intention of the contracting parties by following the rule of interpretation of the wording in the contract. Therefore, the conclusion drawn from these cases should not be the correct rule.

If the _Cuninghame_ principle is wrong and the approach adopted in _Tang Kam Yip_ is correct, it would mean that the general meeting has power to give directions in relation to management decisions. In this circumstance, one may challenge that this should not be so because when the directors are exercising the management powers, they are subject to fiduciary duties but for the members in general meeting, they are not and they may act in their own favour which would be prejudicial to the interest of

\(^{47}\) [1909] 1 Ch 311 (CA) at 319.
the minority shareholders. However, the minority is not totally unprotected. Under the equitable doctrine of fraud on a power, the majority shareholder power would be restricted “if the power is exercised in bad faith or for purposes foreign to the power”48. For example, when there is fraud on the company or fraud on the minority, the common law allows the minority shareholders to bring a derivative action on behalf of the company as an exception to the rule in *Foss v Harbottle*49. Besides, CO s168A also protects the minority shareholders against any oppression or unfair prejudice. As a result, the interest of the minority shareholders should have been sufficiently protected. Furthermore, if the general meeting has made so many management decisions, they may even become *de facto* directors and fiduciary duties would then be attached to them. Hence, overall, the general meeting should not be obstructed from exercising management powers. The second possible criticism might be that if the directors are subject to the control of the general meeting, the directors will then do not really have powers. However, it should be reminded that such control is only directed as to future and not to any prior act, and as a practical matter, general meeting does not hold too often in a company. As a result, the directors still have

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48 *LGSS Pty Ltd v Egan* [2002] NSWSC 1171 (unreported, 4 December 2002, BC200207290) at [106]-[109].
49 *Burland v Earle* [1902] AC 83; Stefan Lo. “The Continuing Role of Equity in Restraining Majority Shareholder Power”. (2004) 16 *Australian Journal of Corporate Law* 96, p.105; Andrew Hicks & S H Goo. *Cases and Materials on Company Law*, 5th edn. Oxford: Oxford University Press, 2004, p.385; under the rule in *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189, if a wrong has been done against the company, the company would be the proper plaintiff to institute legal proceedings which would be done through its organs, namely the board of directors or the members in general meeting.
room to exercise their management powers.

In sum, under the law in Hong Kong, the view adopted in *Tang Kam Yip* should be correct and the Court of Final Appeal should adopt its approach despite the existing law is *Cuninghame* because of the analysis discussed above.

**Uncertainties in the Current Regulation 82**

As a result of the above difficulties in the interpretation of the former Regulation 82, the provision was amended in 2003. The current Regulation 82 reads as follows\(^{50}\):

Subject to the provisions of the Ordinance, the memorandum and articles and to any directions given by special resolution, the business and affairs of the company shall be managed by the directors, who may exercise all the powers of the company. No alteration of the memorandum or articles and no such direction shall invalidate any prior act of the directors which would have been valid if that alteration had not been made or that direction had not been given. The powers given by this regulation shall not be limited by any special power given to the directors by the articles, and a meeting of the directors at which a quorum is present may exercise all powers exercisable by the directors.

\(^{50}\) The corresponding provision in UK was the former Table A Regulation 70 in the Companies Act 1985; cf the model articles 2 and 3 in the Companies Act 2006.
Compared with the former regulation, this new provision clearly stipulates that the general meeting generally can direct the board by way of special resolution and the board is bound to follow. The intention for such a change is to help strengthen the power of shareholders as it provides means for the general meeting to control the board other than by removing directors from office. In consequence, the directorial autonomy rule established in the Cuninghame line of authorities on the construction of the former Regulation 82 can also be removed51. It is opined by Gower that such special resolution may be seen as the statutory requirement of altering the articles of association or it may merely be used to give directions52. Hence, in other words, when the general meeting disagrees with what the board has decided and thus wants to interfere with the future acts of the board, it has a choice of either amending the articles so that such particular power cannot be exercised by the directors in the long run, or passing a special resolution controlling what the directors can do in the future53.

Although this new provision successfully resolves the dispute as to whether the general meeting can control or restrict the acts or decisions of the board with respect

to its conduct of business of the company by ordinary resolution or by special resolution, the general meeting can only decide a matter in relation to future due to the phrase — “no such direction shall invalidate any prior act of the directors which would have been valid if …… that direction had not been given”. However, when is the cut-off time for an act to amount to a “prior act”? The word “prior act” refers to an act which has already existed before other acts happen. Take for an example, usually directors have to exercise their powers collectively by passing resolutions at directors’ meeting which may be formally or informally held unless the board of directors has delegated its powers to an individual director, a committee of directors or most commonly the managing director(s). In the situation where the board has resolved in a board meeting that a particular transaction should be entered into by the company, such board resolution will be regarded as a prior act since the directors have decided what to do next. It is not necessary to wait until the transaction has been entered into since this would be another act performed by the board.

The uncertainty in this phrase is the meaning of the word “invalidate”. In general usage, it means “to make something no longer valid” but this definition is not helpful at all as it fails to qualify the extent to which a matter will be considered as being

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54 Informal directors’ meeting could be found in Barron v Potter [1914] 1 Ch 895 and HL Bolton (Engineering) Co Ltd v TJ Graham and Sons Ltd [1956] 3 All ER 624.
55 Table A Regulation 104.
56 Table A Regulation 111.
invalidated. For instance, is it possible for the general meeting to discontinue the legal proceedings commenced by the board of directors if the shareholders think that it is not an appropriate decision to institute such proceedings? Further, in a situation where the directors have entered into a contract in the name of the company, is the general meeting permitted to pass a special resolution disallowing the company from performing the obligations agreed if it is of the view that the directors should not have entered into such a contract in the first place? These questions can be resolved by analyzing whether the general meeting has authority to give directions that effectively or in substance go against the original decisions of the board.

With regard to this issue, Gower has put forward the view that the general meeting is allowed to do so which can be explained by the following reasons: First, from the literal reading of the provision, the general meeting is refrained from giving any directions invalidating any prior act of the board which would have been valid if that direction had not been given. In the examples illustrated above, it cannot be seen how the discontinuance of the legal proceedings or the instruction which forbids the directors in acting upon the contract would render the prior act of the directors invalid because the act of the commencement of the litigation and the formation of the

contract would remain effective throughout. If a direction in substance contrary to the prior act of the board amounts to invalidation, the provision would have been drafted differently, clearly indicating that the directions given by the general meeting should not go counter to the spirit of the prior acts of the board. Since such intention could not be found reflected in any part of the provision, there are no reasons why the general meeting cannot give directions that go against the prior act of the board.

Second, the intention of the Standing Committee on Company Law Reform in making the amendments to Regulation 82 is to give greater power to the shareholders and remove the rule that the directors can enjoy full autonomy while exercising their management powers. If the general meeting is not permitted to give directions which in substance go against the prior act of the board, the scope of the power given to the general meeting would be too narrow and this is inconsistent with the purpose of the amendment. Third, if the purpose of the requirement for not allowing invalidity of prior act of the board is to protect third party rights, it would be consistent with Gower’s allegation. For instance, in a situation where the board has agreed to sell goods to a company, property has passed and the company subsequently sold and delivered the goods to a third party. The third party holding the view that he has good title to sell re-sells the goods to someone else. If the general meeting is allowed to invalidate the formation of the contract, property would not pass to the company and
the third party would be in breach of implied warranty as to title. This purpose accords with the view that when the board has acted upon the board decision by entering into the contract and the general meeting is allowed to dictate the board not to perform the contract because in that case, property would not pass to the company at the beginning and neither to the third party. The third party would merely sue for breach of contract and would not face any other difficulties.

Nevertheless, the opponent to the above view may argue that the purpose of not allowing the general meeting to invalidate prior act of the board is to refrain it from overriding those prior act. If the general meeting can give directions that substantially defy the prior act of the board, the scope of the general meeting’s power in intervening the management would be too broad which would certainly cause the operation of the company coming to a halt and the restriction imposed under the provision having no room to operate. However, the view of Gower does not necessarily contravene this purpose. Taking again the example where the board of directors commenced litigation proceedings, despite the general meeting would discontinue the proceedings, the act of commencement would not be invalidated. Therefore, the restriction could still operate to a certain degree. Further, the opposing view fails to get around the argument concerning the intention to give more powers to
the shareholders because narrowing down the power of the general meeting would
clearly be inconsistent with such intention. Therefore, on the whole, it should be a
better view to say that the general meeting is allowed to control the board by giving
directions even though in substance they might go against the prior act of the board.

However, it should be noted that although in the situation where the board has decided
not to enter into a transaction but the general meeting is of the opinion that entering
into it is better for the company, the general meeting can pass a special resolution
forcing the directors to enter into the contract. This can only be done if it is still
practicable for the directors to do so\textsuperscript{58}. If the offer to entering into the transaction has
already been rejected by the directors and no new offers are standing, or the subject
matter of the contract is no longer available, the general meeting, though having
passed the required special resolution, could not coerce the directors to enter into the
transaction.

**Residual Management Power of Members in General Meeting**

Despite the fact that it is controversial as to whether members in general meeting can
control or direct the board of directors in making corporate decisions, it has been well
established in common law that in certain circumstances, the general meeting may

exercise residual or reserve management powers.

(1) When there is No Board of Directors

This situation may arise when members fail to hold annual general meetings and therefore unable to appoint directors in forming a board. In *Alexander Ward and Co Ltd v Samyang Navigation Co Ltd*[^59^], the power to litigate was vested in the board. However, no directors were appointed, so a member commenced litigation on behalf of the company. When the company subsequently entered into liquidation, the liquidator attempted to continue with the action by ratifying the proceedings. It was challenged that he lacked authority because since there was no board, the company did not have the capacity to commence litigation at the time. The House of Lords rejected this argument and held that although the power to initiate proceedings resided with the board, the members in general meeting have reserve powers to manage the company as presently there was no board which could act for the company. Another scenario may be where an effective quorum could not be obtained in board meetings as in *Foster v Foster*[^60^]. It was held that the general meeting can exercise management powers vested in the board until the board is properly constituted.

[^59^]: [1975] 1 WLR 673; [1975] 2 All ER 424; this was applied in *Dr Cheung Tse-Ming v Cheung Yuk May et al* (Unreported, 21 December 1995, HCA No 9995 of 1995).
[^60^]: [1916] 1 Ch 532.
(2) When the Board is Ineffective

The classic example of this scenario is the situation where the directors refuse to meet with each other and to pass board resolutions. In *Barron v Potter*\(^{61}\), an effective board meeting could not be held since there was a deadlock between the two directors and thus it was inquorate. A shareholder requisitioned a meeting appointing additional directors which originally is a specific power vested solely in the board. Such appointment was held valid on the ground that the general meeting has residual management powers. However, when will it be qualified as an ineffective board? In the case of *Marshall's Valve*, the board failed to make impartial decision, does it mean that the board is ineffective? **Prima facie**, the answer is negative because the meaning of an “ineffective board” can be explained as referring to the circumstance where the board is unable or unwilling to act. In order to amount to “unwilling to act”, the board must have refused to make any board decisions. In a situation where there is a functioning board which decides not to do something, the board is not “unwilling to act”. It is simply making a decision which it thinks best for the interests of the company. To decide otherwise would make the board only allowed to take positive actions for the company and it is not sensible. Similarly, failing to make unbiased decisions does not mean that the board is not functioning as it can still make decisions.

\(^{61}\) [1914] 1 Ch 895.
It is merely that the directors breach their duties to act in good faith, in the best interests of the company, and with the appropriate level of care and skills. For instance if the directors refuse to initiate proceedings because they are in breach of duties, an individual may launch an action against the directors on behalf of the company if an exception to the rule in *Foss v Harbottle* can be established or pursuant to the statutory derivative action.

Overall, as clearly reflected from the cases mentioned above, when there is no board of directors or when the board is ineffective, members in general meeting would have reserve powers to exercise the power of control of the company. However, it is questionable as to the limit of the scope of this doctrine.

To illustrate, the differing approach adopted by Hong Kong courts and that of Australia will be analyzed — *Miracle Chance Ltd v Ho Yuk Wah David* and *Massey v Wales; Massey v Cooney* respectively. The issues in both cases are similar. They concern about the situation where the board of directors is ineffective, can the members in general meeting bring litigation proceedings on behalf of the company or ratify such an action, or is the general meeting only allowed to appoint additional directors in order to make the board effective again? In the case of *Miracle Chance*...

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there was a deadlock at board level. Since an effective board meeting could not
be convened to authorize institution of proceedings against one of the directors, the
general meeting decided to do so. The trial judge alleged that the action brought by
the general meeting had been commenced in the name of the company without
authority. Thus, the members in general meeting appealed to the Court of Appeal.
Rogers JA held unanimously with the other two appellant judges that the general
meeting can exercise residual management power when the board is in a state of
deadlock. Such residual power is not restricted in any sense. As long as the action in
question can be seen as falling within the category of management decisions, the
general meeting can exercise it. The reasoning behind this decision rests on the
opinion that when the board is ineffective, the power which in effect has been
delegated to the directors reverts back to the persons who delegated the power,
namely the company in general meeting\textsuperscript{63}.

However, the exercise of such residual power is very much confined in \textit{Massey v
Wales; Massey v Cooney}. In that case, the only two directors had fallen out with each
other. One of the directors held a purported directors’ meeting to appoint additional
directors without giving notice to the other. It is not in dispute that such an
appointment was invalid because the other director had not consented to it. The

\textsuperscript{63} [1999] 3 HKC 811 (CA) at 815.
directors (that is, one of the original directors together with the appointed director) instructed a firm of solicitors to commence legal proceedings in the name of the company and the general meeting later passed a resolution intending to ratify the institution and maintenance of those proceedings. It was held by Hodgson JA in the Supreme Court of New South Wales that the ratification was invalid. He rejected the common view that shareholders have unlimited reserve powers in respect of corporate management when the board is deadlocked. As a result, even though commencing legal proceedings is a kind of managerial power, the general meeting does not have reserve power to make such a decision. It is only permitted to appoint new directors in order to make the holding of board meetings possible and that the board is able to function again. His stance can be explained on the following grounds:

First, since the general power of management, as confirmed in higher court cases such as *Cuninghame* and *Salmon v Quin and Axtens Ltd; Quin and Axtens Ltd v Salmon*, lies exclusively with the board of directors, the members in general meeting are generally not given any power to intervene in the management. This principle applies to the ratification of the commencement of litigation proceedings. Although there is such a general principle, where the board is unable or unwilling to act, the general

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64 As in *Alexander Ward and Co Ltd v Samyang Navigation Co Ltd* [1975] 1 WLR 673; [1975] 2 All ER 424.
meeting does have some kind of reserve power which is founded on the basis of business efficacy or necessity. This ensures that there will not be a time where there are no authorized organs managing the business of the company and making the company becoming powerless. The general meeting should thus be able to exercise emergency powers “where an urgent decision is required and the members are unanimous, or where no-one ready, willing and able to accept an appointment as director, so as to resolve a deadlock, could be found”. Second, the company should be managed by the directors as they owe fiduciary duties to the company to act in the interests of the company as a whole but shareholders do not. It is risky for the members in general meeting to make management decisions as they might act in their own favour and thus potentially causes prejudice to minority shareholders. Third, since the constitution gives the general meeting power to appoint additional directors to resolve the deadlock, the general meeting should not simply take over all the powers of the board. If the constitution does not provide the general meeting such power, the power that the general meeting could remove and replace directors would

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68 Ibid at 11-12.
71 Ibid.
be sufficient for the deadlock to be removed\textsuperscript{72}. Fourth, since the reason for allowing
individual shareholders to take derivative actions is the general meeting’s inability to
authorize commencement of proceedings on the company’s behalf, the court should
decide that the general meeting is not given any power to commence legal
proceedings in order to be in line with such principle\textsuperscript{73}.

With regard to the first and second issues outlined above, it has already been
examined in earlier parts of this paper that the \textit{Cuninghame} principle, that is, the
management power is vested solely in the board and the general meeting has no
authority to intervene, is incorrect; and although in the absence of fiduciary duties
attached to the general meeting, the interest of the minority shareholders might be
prejudiced, they are sufficiently protected under the common law and the statute. In
relation to the reason for permitting individual shareholders to institute derivative
actions on the company’s behalf, it is not supported by any authorities that it is
because of the general meeting’s inability to authorize commencement of litigation
proceedings\textsuperscript{74}. Firstly, under the rule in \textit{Foss v Harbottle}, the general meeting is not
prevented from making litigation decisions for the company if the articles actually

\textsuperscript{72} Ibid.
\textsuperscript{73} Ibid at 18.
confer the relevant power on it. Second, the derivative actions would still be in use even if the majority shareholders are allowed to commence proceedings because there may be a time where they refused to exercise those power. As a result, the comments of Hodgson JA in the above area are not convincing.

However, despite the above rejections, the approach adopted in _Massey v Wales; Massey v Cooney_ is comparatively better than _Miracle Chance Ltd_. First, it is true that there should be an implied or presumed intention on the members of the company that when one organ of the company is incapable of functioning, the other should have some reserve power based on business efficacy or necessity. However, when the board is deadlocked, the main concern of the members is that the company would become powerless. Since this could be resolved by allowing the general meeting to appoint additional directors or remove and replace directors, there are no reasons why the general meeting should be given unrestricted management power. Second, in _Miracle Chance Ltd_, it is alleged that the general meeting has unlimited reserve management power when the board is ineffective because the management power reverts back from the board of directors to the delegating body, which is, the members.

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in general meeting. This conceptualization of delegation is a mistaken belief. It is unsafe and misleading to assert that there is such a delegation because in doing so, the board of directors will be regarded as mere agent. In Cuninghame, the English court has made it clear that the constitution of the company is the source of the power for the general meeting and the board of directors. Both bodies are separate organs of the company and therefore are not in a relationship of principal and agent\(^78\). This view has also been generally accepted in Salmon v Quin and Axtens Ltd; Quin and Axtens Ltd v Salmon and John Shaw & Sons (Salford) Ltd v Shaw. Although Gower has argued that in principle, it is possible to say that the general management power is delegated from the shareholders since they have control over the adoption and amendment of the articles\(^79\), this argument is quite weak because the shareholders enjoy such rights simply because the Act or the Ordinance confers on them the relevant power but not on the directors. It is unreasonable to draw the conclusion from this observation that the shareholders must have delegated the management power to the directors. Hence, the basis of the decision in Miracle Chance Ltd is without support. Third, although there may be dispute on the use of the suggested method in resolving deadlock because in Massey v Wales; Massey v Cooney, the articles specifically confer the power to appoint additional directors on the company in

\(^78\) [1906] 2 Ch 34 at 42, 43 and 45.

general meeting, even if it has not, the general meeting would still be authorized to do so since the company would retain such power as reserve management power when the board is ineffective as demonstrated in *Barron v Potter*. Fourth, the argument put forward by Qu questioning the usefulness of the ruling is weak. Qu had used the case of *Marshall’s Valve* to illustrate that if the scope of the general meeting’s power to make management decisions is too narrow, the problems arisen in that case could not be resolved. He argued that if the general meeting can only exercise emergency powers where (i) an urgent decision is required and the members are unanimous, or where (ii) no-one ready, willing and able to accept an appointment as director, so as to resolve the deadlock, can be found, the company’s interest in the patent cannot be protected since the fact of the case does not fall within any of the two conditions. However, the company’s interest would have protected by the article similar in terms to the former Regulation 82 since it was examined before that the general meeting has power to intervene in the management by an ordinary resolution. Even if this principle is not agreed and the constitution in fact does not give any power to the general meeting at all, the general meeting could still remove the directors under CO s157B(1) which simply requires an ordinary resolution. Further, it cannot be seen how the case of *Marshall’s Valve* relate to the principle laid down in *Massey v Wales; Massey v* 

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Cooney because in Marshall’s Valve, the board of directors simply failed to make impartial decisions. It has been explained earlier in this paper that failing to make impartial decisions does not mean that the board is ineffective because the board is still functioning and there is no authority saying otherwise. Since Qu did not give any reasons as to the connection of these two cases, his arguments are doubtful.

Hence, with reference to the arguments and analysis discussed above, it is better for the extent of residual management power exercisable by the general meeting to be restricted.

Conclusion

To sum up, the extent to which the members in general meeting can exercise control over the board of directors in relation to matters of management has been examined in this paper with regard to the model articles of association contained in Table A and the common law doctrine of residual management power. In essence, this issue depends much on the way in which the terms of the relevant article are to be construed. It has been argued that under the former Regulation 82, the general meeting could control the board by way of an ordinary resolution because the opposite view demonstrated in the English authorities such as Cuninghame, Salmon v Quin and Axtens Ltd; Quin and Axtens Ltd v Salmon and John Shaw & Sons (Salford) Ltd v Shaw are obiter only and
the common principle laid down in these cases is even wrong. Since there is nothing preventing the members in general meeting from exercising the management power, they should be allowed to do so. In relation to the current Regulation 82, it has been argued that the requirement of not allowing the invalidity of prior act of the board does not restrict the general meeting in giving directions which in substance go against the prior act because this intention is not reflected in the text of the provision and to interpret otherwise would contravene the purpose of amending the provision and the purpose of imposing such requirement. Therefore, the general meeting is permitted to make management decisions to a large extent. However, in the situation where there is no board or where the board is ineffective, the scope of the general meeting’s power to make management decisions should be limited since the reason for giving the general meeting the reserve power is on the ground of business efficacy or necessity. So long as a board can be formed or the deadlock can be resolved, there is no point in giving the members in general meeting other powers.
List of Legislation

_England:_

Companies Act 1948

   Table A Regulation 80

Companies Act 1985

   Table A Regulation 70

Companies Act 2006 Model Articles

   Articles 2 and 3

_Hong Kong:_

Companies (Amendment) Ordinance 2003 (Order No. 28 of 2003)

Companies Ordinance (Cap.32):

   Sections 8, 11, 13, 22, 129D, 157B(1) and 168A

   Table A Regulations 82, 104 and 111
List of Cases


Automatic Self-Cleansing Filter Syndicate Co v Cuninghame [1906] 2 Ch 34

Barron v Potter [1914] 1 Ch 895

Breckland Holdings Ltd v London and Suffolk Properties Ltd [1989] BCLC 100

Broadview Commodities Pte Ltd v Broadview Finance Ltd [1983] 2 HKC 578

Burland v Earle [1902] AC 83

Credit Development Pte Ltd v IMO Pte Ltd [1993] 2 SLR 370

Dowse v Marks (1913) 13 SR (NSW) 332

Dr Cheung Tse-Ming v Cheung Yuk May et al (Unreported, 21 December 1995, HCA No 9995 of 1995)

Foss v Harbottle (1843) 2 Hare 461; 67 ER 189

Foster v Foster [1916] 1 Ch 532

HL Bolton (Engineering) Co Ltd v TJ Graham and Sons Ltd [1956] 3 All ER 624

John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113

LGSS Pty Ltd v Egan [2002] NSWSC 1171 (unreported, 4 December 2002, BC200207290)

Mashall’s Valve Gear Co Ltd v Manning, Wardle & Co Ltd [1909] 1 Ch 267
Massey v Wales; Massey v Cooney (2004) 47 ACSR 1

Miracle Chance Ltd v Ho Yuk Wah David [1999] 3 HKC 811

National Roads & Motorists’ Association v Parker (1986) 2 ACLC 609

Salmon v Quin and Axtens Ltd; Quin and Axtens Ltd v Salmon [1909] 1 Ch 311

(CA); [1909] AC 442 (HL)

Tang Kam-Yip v Yau Kung School [1986] HKLR 448 (CA)
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