Legal protections for minority shareholders

Critically evaluate protections to minority shareholders and their effectiveness in protecting the smaller shareholders from the unfair dominance of the Majority.

Abstract

In order to adequately protect holders of minority interests of a corporate entity against oppressive shareholders whose actions might be at variance with the Company's Articles, there are several remedies and protection available to minority shareholders as members of the company. Some of these remedies are inclusive of, but not exclusive to, petition on the ground of unfair prejudice, just and equitable winding up and the derivative claim principle. The majority of these remedies are firmly rooted in the common law but recently, these rules have been codified under theCompanies Act 2006. For the purpose of this project, the protection afforded to minority shareholders will be critically evaluated and its effectiveness will be highlighted to portray the usefulness of the available remedies.

One of the major factors indirectly responsible for the destruction of a business or corporate enterprise due to loss of management time or excessive cost of litigation is shareholder disputes. 1The earliest remedies being afforded to minority shareholders dates back to the Cohen Committee Report where corporate bodies gave the court a broad jurisdiction to ascertain what actions of the majority would amount to oppression, and what could be the preliminary hurdles to bring a valid claim against unfair prejudice. 2The claims against majority shareholder oppression has been a long-serving legislative constant even before 1985 where the ability for a minority shareholder to bring an action against the majority was

encapsulated in the Companies Act (CA). 3Protecting the interest of the minority is mandated by law and it is part of the life of a corporate entity. 4This right however does not empower the minority to make decisions on the company's nor does it allow company policies to be set up exclusively by the majority. 5

The vast majority of disputes involves shareholders who are in a minority capacity who wish to seek redress because it will be unreasonable for the majority shareholders to bring an action since they could exercise their voting power to seek redress without court interference. 6Nevertheless, before an action could be brought against the majority, there must be elements of good faith on the part of the minorities because if the powers to bring a claim cannot be controlled, company stakeholders could face certain amount of oppression from frivolous law suits. 7In the case of *Re a Company* , 8Lord Hoffman stated that the provision of *s 75* CA9must be carefully applied so that it doesn't become a " means of oppression".

Petition on the ground of Unfair Prejudice

This is an important remedy which equips the minority shareholder to petition the Court for an order against the majority. This remedy is found in *s 994* CA 2006 which was formally *s 459* of the CA 1985. This action can furnish an allegation if it is found that the conduct of the majority are performed in an unfairly prejudicial manner against the interest of the stakeholders including the claimant, or that an act or proposed omission of the company is or would likely be prejudicial against the stakeholders by the company. 10The action will be against those in authority to act on its behalf and not just the conduct of a member acting in a personal capacity of a

shareholder. 11The acts complained of could be in relation to a breach of fiduciary duty between director and stakeholders, breach of legal bargain between shareholders as agreed in the Articles of Association, misappropriation of assets or breach of understanding. In *Re Leeds United Holdings plc* 12, the court rejected the petition which was saddled on the assertion that the shareholders did not dispose of their shares as to the manner agreed. The petition was quashed on the ground that the disposal of shares did not relate to the conduct of affairs of the company.

In most cases, this remedy having been upheld by the court after petitioning under *s 994* , the shares of the minority shareholder/petitioner will be purchased at a fair value. 13Since this remedy is relied on by the discretion of the Court, it could then be that the court could mandate the majority to remit their shares for a fair purchase by the minority depending on the seriousness of the breach. However, before resort to the courts, it is important that the petitioner is aware of the nature of fair offer made by respondents. If the respondents i. e. the majority shareholders have made a fair offer to the petitioner which entitles him to rights enjoyable under *s 994* CA 2006 but he refuses to accept, the court could strike off his petition. 14It is worth noting that only company members have a right to petition under this remedy. A case for petition could even be instituted by a nominee shareholder as seen in *Atlasview Ltd v Brightview Ltd.* 15

The Derivative Claim Principle

It is trite law that only the company excluding all stakeholders can bring an action *suo moto* . 16This common law principle is derived from the celebrated case of *Foss v Harbottle.* 17The two major principles enunciated

in this case are – any matter which negatively affects the company can only be commenced by the company, 18and only the simple majority of the members can bring a claim on behalf of the company. 19Part 11 CA 2006 governs the principles of derivative claims. 20A derivative action is normally for the benefit of the company which contrasts with *s 994* unfair prejudice remedy. 21If a shareholder brings a petition against the majority instead of a derivative action, the court will not set aside the claim *per incuriam* but will require the petitioner to bring a derivative action if the wrongdoing is against the company. 22

To bring a claim on behalf of the minority shareholders of the company, the complainant must seek the leave of court before his claim can be entertained in court. 23It then means that an action against the majority shareholders can only be instituted under the company's name. Lord Denning MR while echoing the immortal words of Professor Gower, 24he states that where a derivative action is allowed, a minority shareholder is not suing in his own personal capacity as member of the company or on behalf of other members but solely on behalf of the company. 25The company is bestowed with the responsibility and authority to bring an action against the wrongdoers in its own personal capacity except if shareholders have been duly delegated such a right to bring a claim. 26

To institute a derivative action is quite a complicated exercise because the court is saddled with the responsibility of screening frivolous cases against the company which may threaten its daily operations, avoidance of multiplicity of individual actions which could be better brought jointly in one suit, etc. In the famous case of *Barrett v. Duckett* 27the House of Lords held

inter alia that there was a more favourable method of resolving shareholder disputes instead of a derivative action which could negatively affect the shareholders' relationship as members of the company.

The rule in *Foss v Harbottle* has gone a long way to ease the constraints the common law has over derivative claims. Some of the exceptions to the above common law rule are – a shareholder is permitted to bring an action against the majority which is *ultra vires* the Articles of association of the company, a shareholder may sue if he is denied his bona fide membership rights, a shareholder may sue the majority if certain element of fraudulent activities are committed against the minority shareholders and where a corporate decision is decided by simple majority when more than a simple majority is required. The ' fraud on the minority' provision tends to be the most popular of the common law exception because it is for the benefit of the company in contradistinction to the other three which seeks to ameliorate the personal rights of the minority shareholder. 28

To sum it up in regards to the provisions of Part 11 CA 2006, a derivative claim may be instituted in court against any member including ex-directors or shadow directors or any other person who is directly involved in the accused breach; 29it could be brought where there is negligence, default or breach of trust and duty by a director of the who failed to act in accordance with his duties. 30It then means that any breach of duty done knowingly or unknowingly will be actionable in court against such director. A derivative claim could also be institute by any company member however few the share capital he holds in the company. 31There is a feeling however that without any sort of restriction on the amount of shares held by a petitioner

before he can bring an action in this capacity, the tendency for it to be abused is present. Nonetheless, it will be more theoretical than real for a petitioner who has a single share in a company to bring a derivative action against the majority knowing fully well that he will pay cost as penalty if the law suit is rendered frivolous.

Just and Equitable Winding Up

TheInsolvency Act (IA) 1986provides shareholders with a statutory remedy in the form of a winding-up order on a just and equitable ground pursuant to certain provisions and rights inherent in the CA 2006. 32The aim of a petition via this remedy in the IA 1986 is to oblige the company to seek a validation order thereby putting pressure on the company if a petition for unfair prejudice has also been brought in tandem. 33However, the court has a certain level of discretion under the IA 1986 as to whether to allow a winding-up petition to be entertained. 34If there is a better alternative remedy apart from the just and equitable winding up such as the unfair prejudice claim, the court will most likely dismiss the former. 35

It seems quite unlikely that a petitioner will be satisfied with winding up a company where he possesses certain amount of shares as shareholder. As earlier discussed, it will be prudent for the petitioner to seek a quote on the remuneration of his shares and exit the company without the burden of pursuing a winding up order. From this standpoint, it can therefore be asserted that the just and equitable winding up remedy will most likely be useful only if *s 994* CA 2006 does not satisfactorily mend the wrongdoing complained of by the minority shareholders.

Conclusion

It has been recognised that certain discrepancies were inherent in the common law such as the fraud on the minority and majority rule which didn't suit the minority shareholders because of its uncertain nature as to whether they had the *locus standi* to sue and also the disadvantage of power concentration with the majority. Crucially, the advent of the 2006 CA has now filled the void which the common law failed to address adequately. The rigid exceptions in the common law have been relatively softened by the CA.

If the courts decide to condone a liberal attitude, the company will be subjected to unnecessary and trivial claims while if it adopts a strict procedure, the minority will be parachuted to the pre-2006 CA situation where the rules where quite restrictive. Nevertheless, the most important objective is to protect the minority from majority shareholder abuse, at the same time, uphold the needs of the majority.

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2Committee Report on Company Law Amendment, 1945, Cmnd. 6659, para. 60, hereinafter “ The Cohen Report”.

3Companies Act 1985, s 459. The provisions of minority shareholder protection under the new Companies Act 2006 is contained under Part 30, hereinafter CA.

4Anupam Chander, ‘ Minorities, Shareholder and Otherwise’ [2003] 113 Yale L. J. 119, 127.

5Ibid.

6See *Re Baltic Real Estates Ltd* (No 2) [1993] BCLC 503.

7See *Re Bird Precision Bellows Ltd* [1984] Ch. 419; [1984] 2 W. L. R. 869; [1984] 3 All E. R. 444.

8See *Re a Company* (No. 007623 of 1984) [1986] 2 BCLC 99191, 99196. " But the very width of the jurisdiction means that unless carefully controlled it can become a means of oppression. The threat of such proceedings by a dissident and possibly legally-aided shareholder in a small company can be used to bring pressure upon a majority to accept the price he demands for his shares." – *Per* Lord Hoffmann.

9Companies Act 1980, then became *s 459 – 461* Companies Act 1985, now repealed pursuant to the Companies Act 2006.

10See s. 994 (1) CA 2006. Also, see generally Victor Joffe, David Drake & Others, *Minority Shareholders* (3rd edn OUP, USA 2008), Chs 5, 6.

11See Re Unisoft Group Ltd (No 3) [1994] 1 BCLC 609.

12[1996] 2 BCLC 545. See also *Arrow Nominees Inc. v Blackledge* [2000] 2 BCLC 167.

13S 996 (2) (e) CA 2006.

14 *O'Neill v Phillips* [1999] 2 BCLC 1. In addition, the Court's decision to strike off a petitioner's action for his refusal of a reasonable offer gives more credence to the claim that company shareholders should resolve their actions out of court. An alternative dispute resolution may suffice for the purpose of severance compensation.

15[2004] BCLC 191.

16 *Salomon v Salomon* [1897] AC 22 (HL).

17[1843] 67 ER 189; 2 Hare 461 (Ch. D).

18See *Prudential Assurance Co. Ltd v Newman's Industries Ltd* [1982] Ch. 204.

19C *arlen v Drury* [1812] 1 V & B 154; 158. This position was also affirmed in *MacDougall v Gardiner* [1875-76] L. R. 1; Ch. D 13 *per* Mellish LJ where he was posited that if the act complained of is the responsibility of the majority of the company to correct or if the act which is performed irregularly is being required to be rectified, or if an act is done illegally but could be done in a legally, then individual litigation is of no use.

20A derivative claim is defined under CA 2006, *sec 260 (1)* .

21An example of an unfair prejudice against the minority is a breach of director's duty against the members and not the company. See Atlasview Ltd v Brightview Ltd [2004] 2 BCLC 191, 207. Derivative claims are mostly aligned with protecting the assets of a company company's and violation of majority shareholder rights. See *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 W. L. R. 2 ; [1982] 1 All E. R. 437.

22See *Lowe v Fahey* [1996] 1 BCLC 262.

23See *Cooke v Cooke* [1997] 2 BCLC 28; [1997] BCC 17.

24Laurence C. B. Gower, Principles of Modern Company Law (3rd edn Stevens & Sons Ltd, London 1969) p 587.

25See *Wallerstainer v Moir* (No. 2) [1975] QB 373, 391.

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27[1995] 1 BCLC 243.

28See *Burland v Earle* [1902] AC 84, 93.

29CA 2006. *s 260 (5) (a)* .

30Ibid.

31CA 2006. *s 261 (1)* . See *Portfolios of Distinction Ltd v Laird* [2004] 2 BCLC 741.

32The CA 2006 has no statutory power to make winding up orders but *s 122 (1) (g)* IA 1986 has provisions for a just and equitable winding up.

33Brenda Hannigan, *Company Law* (2nd edn OUP, USA 2009) para. 17-103.

34IA 1986, s 125 (2).

35See *Re a Company* (No 001363 of 1988) [1989] BCLC 579.