CHANCERY BAR ASSOCIATION

BERMUDA CONFERENCE

SHAREHOLDER DISPUTES PANEL

"I AM AN UNHAPPY SHAREHOLDER: WHAT SHOULD I DO?"

CHRIS HARRISON

4 STONE BUILDINGS

10 MAY 2019

WHAT DO YOU WANT?

1 The (obvious) starting point is to identify why you are unhappy and what you would like to do about it.

2 There will often be a tendency to think of a share buy-out as the natural panacea.

3 So your starting point may be:
"I have had enough of this company: Can I exit and recover my investment?"

4 This is indeed the remedy most often sought, and awarded, in minority shareholder actions in the UK. The Bermudian jurisdiction may be moving in this direction. But as yet the buy-out route has not obtained much traction with the courts (cf the *Kingboard* litigation) and has been found not to be straightforward.

5 This paper therefore considers and discusses the position more broadly. A buy-out of your shares is just one possible route; Bermudian law offers a range of other options.

6 So you may instead feel:
"Why should I be pushed out? Can I stay in and make sure the company is properly run and obtains redress for wrongs?"

7 Or even possibly (but rarely):

"Can I buy out the other shareholders, so that I can take control of the company?"

8 One or other of these routes may be more appropriate in particular circumstances.

9 As always, tactical considerations will be crucial. Which option will not only be most likely to achieve the result that you want, but also put maximum pressure on the other side to encourage a quick and sensible resolution?

10 This paper identifies pros and cons by reference to each scenario:

(i) ***I have had enough of this company: Can I exit and recover my investment?***

- Share buy-out: s.111 oppression/prejudice jurisdiction
- Winding-up: s.161(g) just and equitable jurisdiction

(ii) ***Why should I be pushed out? Can I stay in and make sure the company is properly run and obtains redress for wrongs?***

- Direct claim: personal rights
- Derivative action: common law jurisdiction
- Regulation of company: oppression/prejudice jurisdiction

(iii) ***Can I buy out the other shareholders, so that I can take control of the company?***

- Reverse share buy-out: oppression/prejudice jurisdiction

11 And adds in an additional factor.

"I would like to go to court, but there is an arbitration clause or ADR clause in the documentation. Is this a problem?"

EXITING THE COMPANY

12 These are the well-known jurisdictions under:

(i) Companies Act 1981, section 111

(ii) Companies Act 1981, section 161(g)

Section 111

13 Affairs of the company *"are being conducted or have been conducted"* in a manner *"oppressive or prejudicial to the interests of some part of the members, including [the petitioning member]"*.

14 Relief if facts would justify winding up on the *"just and equitable"* ground but winding up would *"unfairly prejudice"* the petitioning member.

15 Relief is *"such order as [the court] thinks fit",* eg *"regulating the conduct of the company's affairs"* or *"the purchase of the shares of any members"*.

16 Closely based on (and a hybrid of) the old UK provisions (UK Companies Act 1948, s.210) and the more recent UK provisions (now in UK Companies Act 2006, s.994 & 996).

17 In the UK, this is now a highly-developed jurisdiction with a wealth of caselaw, leading to considerable success for disgruntled minorities in achieving an exit. Bermudian law is likely to draw heavily on the UK caselaw, and is already doing so.

18 While therefore it may seem in principle that the Bermudian courts will readily be able to use the provision to help minority shareholders, there are factors which suggest that it may not be this straightforward.

19 Eg:

(i) The UK cases have often typically involved small closely-held companies, with informal arrangements between a small number of shareholders, often members of the same family or (until the inevitable falling-out) close friends. These are the so-called 'quasi-partnerships' – now a familiar term.

(ii) In such circumstances, the courts have been willing to find that a shareholder may have 'legitimate expectations' – such as to be involved in management – going beyond the specific rights set out in whatever documents there may be. The documentation may often be no more than the standard Model A Articles.

(iii) In contrast, the types of entities with which the Bermudian jurisdiction is concerned will usually be more sophisticated companies, set up with great care and with a raft of documentation, with detailed rights and obligations set out, and often listed on one of the international stock exchanges. The scope for arguing for 'expectations' beyond the documented rights will be limited, probably to the point of impossibility. See eg *Re Astec (BSR) plc* [1998] 2 BCLC 556.

(iv) Section 111 has the additional hurdle (derived from the old UK provision but not now present in the current UK provision) that the relevant conduct must be such as to justify a winding up on the just and equitable ground, but that a winding up would unfairly prejudice the petitioner.

(v) The recent experience in *Kingboard* – with the differences in view between the Supreme Court and the Court of Appeal – suggests that the Bermudian courts are feeling their way with caution.

20 **Pros**:

(i) If you really want to exit, this is the best (indeed, really the only effective) route.

(ii) It obtains a personal remedy for you; the derivative claim discussed below obtains a remedy for the company as a whole.

(iii) The test for 'prejudice' is quite broad.

(iv) The conduct of the affairs of a subsidiary may in appropriate circumstances be taken to be conduct of the affairs of the holding company: see *Re Neath Rugby Ltd; Hawkes v Cuddy (No 2)* [2009] EWCA Civ 291. This will be important where, as often, the Bermudian company is a holding company and the complaint is in relation to the operations of the subsidiary that carries on the business.

(v) You do not need permission to bring the claim.

(vi) The claim is not subject to strict limitation periods, although in some case the broader principle of laches may be operative.

(vii) In some circumstances it may enable you to achieve a pro rata value for your shares, rather than the discounted value that you would be likely to obtain if you were to sell to a third party.

21 **Cons**:

(i) Expensive. These claims are notoriously costly to fight as they will often involve trawling through a substantial part of the company's history.

(ii) Slow. The claims can take a long time to come to trial. (Contrast the derivative action discussed below, which has an 'early hit' by the permission application.)

(iii) Uncertain, at least while the principles are being worked out by the Bermudian courts.

Section 161(g)

22 The court may wind up the company if the Court *"is of the opinion that it is just and equitable that the company should be wound up"*.

23 But the court has a natural reluctance to close down a company that is carrying on a thriving business, albeit a business tainted by wrongdoing. The court will generally consider that the petitioner should instead seek some other remedy, most usually a section 111 buy-out.

24 Broadly, the court is likely to entertain a just and equitable winding up only in two situations. First, where the company's business has come to an end, such that the company is no longer performing any useful function. Second, where the company's business has become deadlocked, eg where rival factions have equal powers and cannot agree anything, and the deadlock cannot be resolved.

25 Neither of these situations is likely to apply to the typical Bermudian company. These will usually be long-term businesses. While there may indeed be rival factions, it is rare for the balance of power to be evenly weighted.

26 **Pros**:

(i) Not many. It may exert a little additional pressure on the other side, but not much. It would be a brave petitioner who relied on this as the only claim, without the back-up of a section 111 claim as well.

27 **Cons**:

(i) Even if successful, the claim is unlikely to lead to full recovery of the share value. The winding up itself will be expensive, and will damage the business's value.

STAYING IN THE COMPANY, WITH REDRESS FOR WRONGS

28 This is an avenue that could usefully be explored more often.

29 In the typical Bermudian company, a shareholder will often have intended to invest for the long term. The better response to wrongdoing may often be to ensure that the wrongdoing is corrected, while remaining as a shareholder to reap the expected long-term profits.

30 How to do this? Broadly 3 routes:

(i) Direct claim: personal rights
(ii) Derivative action: common law jurisdiction
(iii) Regulation of company: oppression/prejudice jurisdiction

Direct claim

31 This is a straightforward matter. You may have a direct personal right, eg under the Articles or a shareholders' agreement, which has been infringed. Eg a right to vote or to receive a preferential dividend. Other examples are attempts to strike down resolutions, changes to Articles, operation of pre-emption rights and drag/tag rights. It can also be a

route to challenge rights issues, eg *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

32 You can bring a claim to vindicate the right and to recover damages and to ensure compliance in the future.

33 **Pros**:

(i) Straightforward and therefore relatively quick and cheap.

(ii) A surgical strike.

(iii) Available in a wide variety of situations as mentioned above.

(iv) The claim may lend itself to interim injunctive relief at the outset, which will be useful in putting pressure on the other side.

34 **Cons**:

(i) None in particular, assuming that this relief is really all that you want.

Derivative action

35 As is well-known, this is where a shareholder is permitted to bring a claim on behalf of the company. It is an exception to the usual fundamental principle that any claims belonging to the company are to be brought by the company, not by a shareholder, because the company is a separate legal entity and the claims belong to it, not to the shareholders.

36 The exception arises where the wrongdoers – ie the people against whom the company would bring the claim – are themselves in control of the company and so are able to prevent the company from suing them. In such circumstances, a shareholder may bring the claim on behalf of the company, so that the wrong may be righted and redress obtained.

37 When used properly and carefully, it is a powerful weapon in a shareholder's artillery.

38 Crucially – because the claim is being brought for the company's benefit – the court is able to order at the outset of the claim that the company is to indemnify the plaintiff against its costs. You can therefore argue that you should not have to fund the costs from your own pocket; the company should pick up the tab. See eg *Wallersteiner v Moir (No 2)* [1975] QB 373. However, in the UK the courts are exercising the power with care, and may be reluctant to grant a full indemnity at the outset, particularly where the claim is really a dispute between two rival factions of shareholders and a 'prejudice' petition may seem more appropriate – eg *Bhullar v Bhullar* [2015] EWHC 1943 (Ch).

39 Here, in Bermuda, the claim arises at common law. In the UK, derivative claims have now been put on a statutory footing by the UK Companies Act 2006, section 260. This is not yet the case here in Bermuda, although there have been calls to introduce a similar statutory basis.

40 The absence of a statutory basis does not, however, matter too much, as the common law position will be adequate if carefully used.

41 Bermudian law has recently introduced a requirement for leave, following the position in the UK and other jurisdictions. This is addressed in Anna Markham's paper on 'Derivative Actions: A topical review' delivered at this conference. The UK experience suggests that the requirement should not represent a particularly onerous hurdle, and so should not prevent any proper claims from going ahead.

42 The provisions of the Bermudian Order 15 rule 12A which introduced the leave requirement have confirmed the plaintiff's ability to apply for a costs indemnity from the company, at r.12A(13): "*The plaintiff may include in an application under paragraph (2) an application for an indemnity out of the assets of the company in respect of costs incurred or to be incurred in the action, and the Court may grant such indemnity upon such terms as may in the circumstances be appropriate".*

43 **Pros**:

(i) A very effective weapon for a shareholder who wants to stay in the company while ensuring that wrongs are righted.

(ii) Particularly useful where there may be hidden future value, eg *Airey v Cordell* [2006] EWHC 2728 (Ch).

(iii) May be the only route where relief is sought for and on behalf of the company and an oppression/prejudice claim might not be permitted.

(iv) May be the only route in certain circumstances, eg overseas company with assets and defendants within the jurisdiction and conduct within the jurisdiction.

(v) The requirement for leave can operate well in the shareholder's favour. When leave is obtained, the wrongdoers will know they are facing a claim that has received judicial approval. If the merits are strong, this can be powerful pressure for an early settlement.

(vi) Good where the majority are desperate to buy you out and your position as a 'thorn in their side' might exert tactical pressure.

(vii) The costs indemnity.

44 **Cons**:

(i) No direct benefit for the shareholder, as any damages recovered are paid to the company. But this does not matter much, where the shareholder is in the company for the long term. The share value will increase correspondingly.

(ii) The relationship has broken down and litigation is unlikely to improve it. A divorce by a share buy-out may be the better way.

(iii) Front loading of costs at permission stage; no guarantee you will obtain permission.

Regulation of company

45 You may wish to remain in the company but ensure that some misconduct in its affairs is remedied, separately from pursuing a claim on the company's behalf of the kind that would be appropriate for a derivative action.

46 Eg, the company may have been refusing to pay dividends, while at the same time paying inflated salaries to its directors who are the majority shareholders. The majority would thereby obtain a return on their investment by that route, while you the minority would obtain nothing at all.

47 While in such circumstances there may be grounds for a derivative action (as a result of the breaches of fiduciary duties in paying the inflated salaries), you may prefer to obtain a remedy for yourself, requiring dividends to be paid and regulating the position for the future.

48 The route for this is again the section 111 oppression/prejudice jurisdiction discussed above. But this time the jurisdiction is being used to obtain a remedy while staying in the company, rather than to exit the company.

49 **Pros**:

(i) A useful route if there is some discrete matter to be addressed. But it is rare for matters to be so discrete and compartmentalised, and there may be a risk of the claim morphing into a wider-ranging dispute.

50 **Cons**:

(i) As above, uncertain, at least while the principles are being worked out by the Bermudian courts.

TAKING CONTROL

51 Can you claim that you should be able to buy out the wrongdoers, so that you can wrest ownership and control of the company from them?

52 In principle, yes. Eg, *Oak Investment v Boughtwood* [2009] EWHC 176 (Ch) affirmed [2010] EWCA Civ 23. It is likely to be a rare case where the court will permit this to happen. But if you can show that you invested for the long term and that the majority have

been deliberately trying to squeeze you out, why should the majority be allowed to succeed in their aim by forcing you to exit?

ARBITRATION / ADR

53 As discussed above, Bermudian companies are likely to be set up with a raft of paperwork. A shareholders' agreement, or the Articles, or a joint venture agreement, may provide that disputes between the shareholders are to be referred to arbitration and that the court's jurisdiction is ousted and/or that the parties should go through ADR procedures before litigating the dispute.

54 Are these clauses effective?

55 The UK experience is: yes, to some extent.

56 Arbitration clauses are usually widely drafted, requiring 'all disputes' to be arbitrated. After a period of some uncertainty on the English authorities, the Court of Appeal has come down in favour of upholding such clauses in relation to shareholder disputes: see *Fulham Football Club (1987) Ltd v Richards* [2011] EWCA Civ 855.

57 Therefore even though the right to bring an 'unfair prejudice' claim is a creature of statute (UK Companies Act 2006, section 994), a shareholder's right to litigate the matter in court may be ousted by an arbitration clause.

58 However, an arbitration is a dispute purely between the arbitrating parties. Where the relief that the shareholder seeks may have an effect on third parties, it may still be necessary for the court to become involved. In such circumstances the *Fulham* case envisages that the arbitrators will make the relevant factual findings and then give directions for the shareholder to apply to court for the appropriate relief under section 994.

59 Similarly, if the shareholder seeks a winding up order on the just and equitable ground, the arbitrators would have to refer the matter to court as the arbitrators themselves could not grant such relief.

60 Clauses requiring the parties to go through some form of ADR, before resorting to litigation or arbitration, are also increasingly likely to be upheld.

Chris Harrison

4 Stone Buildings

10 May 2019