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Shareholder Disputes

Introduction

Disputes between shareholders arise for a number of reasons. One of the most common reasons is where a previously good relationship turns sour. There may be a dissident shareholder who refuses to co-operate in the running of the business and who hampers the decision – making process. A shareholder or a group of shareholders may want to expel such a shareholder in order to resume the smooth running of the company. This article will outline the options available to members when attempting to resolve a dispute and examine the various remedies available to minority shareholders.

It is always advisable for members to have a shareholders agreement to clarify issues that may arise and make provision for dispute resolution. However, it is not uncommon for companies to overlook the need for such an agreement.

Possible remedies

Where a dispute arises, the shareholders should attempt to negotiate a solution. For example, the members can offer to buy out the dissenting shareholder. However, where negotiation fails, shareholders do have other options. The first step would be to seek legal advice on how to proceed. If the dissenting shareholder is also a director of the company, the second step would be removing them from the board. The third step would be to determine how best to remove them as member of the company.

The power of a shareholder or a group of shareholders when making decisions depends on how many shares they hold. A special resolution requires a 75% majority of members present and voting. If the dissenting shareholder holds more than 25% of the share capital, the other shareholders may seek to reduce the dissenting shareholder's shareholding to below 25% by passing a special resolution but this may not be possible and will likely be opposed. Alternatively, as a last resort, the shareholders should consider winding up the company on the basis that there has been an irretrievable breakdown of a business relationship between shareholders.

Majority shareholders must act with caution as there are rules under common law and under Gibraltar legislation that protect minority shareholders (a shareholder holding less than 50% of the total shareholding).

Minority shareholder protections

Cancellation of a change of rights

Where provision is made by the company's core documents for authorising the change of rights attached to any class of shares, the holders of not less than 15% of the issued shares of that class are entitled to apply to court to have the change cancelled. The court will not allow the change if it is satisfied that it would unfairly prejudice the shareholders of the class (section 111 Companies Act). The following conduct may be classified as "unfairly prejudicial":

- Exclusion from management (*Ebrahimi v Westbourne Galleries Ltd*);
- Allotting shares in breach of pre-emption rights (*Re DR Chemicals (1989) 5 BCC 39*);
- Making a rights issue in certain circumstances (*Re a Company No 007623 of 1984 (1986) 2 BCC 99 191*);
- Providing misleading information to a company's share-holders (*Re a Company No 008699 of 1985 [1986] BCLC 382*);
- Proposing to sell the company's business at a substantial undervaluation to connected persons (*Re Posgate & Denby (Agencies) Ltd [1987] BCLC 8*); and
- Using the company's assets for the benefit of the company's controlling shareholders and family (*Re Elgindata [1991] BCLC 959*).

An act of the company requiring the confirmation or authorization of the court

Minority shareholders have a right to be heard in the court where an act of the company requires the confirmation or authorization of the court. Thus, if a decision has been made for reducing the company's capital under the Companies Act and the company requests the court to confirm the reduction under said Act, a shareholder is entitled to be represented on the application to oppose the reduction (*Scottish Insurance Corporation Limited v. Vilsons and Clyde Coal Co Limited [1949] AC 462*);

Common law derivative claim

A derivative claim is a claim brought by an individual shareholder in his own name but on behalf of the company. Minority shareholders have the right to bring a derivative action against wrongdoers who have committed a fraud on the minority if the wrongdoers are in control of the company (control simply means having a majority of the shares conferring voting rights). A resolution constitutes a fraud if it is not passed "bona fide for the benefit of the company as a whole", or if its effect is to discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter were deprived" (*Estmanco (Kilner House)) Ltd v. Greater London Council [1982] 1 WLR 2*). The appropriation of assets or advantages belonging to the company by the majority may also constitute fraud (*Cook v. Deeks [1916] 1 AC 554*).

Just and equitable winding up of the company

Minority shareholders have the right to request a compulsory winding-up on just and reasonable ground. For example, a minority shareholder may petition for winding-up on the ground that he has a "justifiable lack of confidence in the conduct and management of the company's affairs" (*Loch v John Blackwood Limited [1924] AC 783, 788*). Note that the court is unlikely to make such an order if the petitioner has, or is thought to have, another remedy (*Re Professional etc. Building Society (1871) 6 Ch. App 856*);

English case law shows the courts reluctance to rule in favour of majority shareholders to the detriment of the minority. In the case of *Re Legal Costs Negotiators Ltd [1998] All ER (D) 244*, there was a falling out of the members of the company. The respondent failed to carry out his accounting responsibilities. As a result the respondent ceased to be employed and resigned as a director. He held 25% of the shares in the company. The petitioners offered to acquire the respondent's shares but did not agree terms. The petitioners presented a petition seeking an order that the respondent be ordered to transfer or sell his shares in the company to the petitioners. The latter argued that the company's affairs were being conducted in a manner which is unfairly prejudicial to their interests because they (the three petitioners holding 75%) were now working for the benefit of all the shareholders (the 100%). The court held that the petitioners were able to remedy the problem by bringing the respondents employment to an end and producing his resignation as a director. As a result, the court decided against forcing the respondent to sell his shares.

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