



Getting your fair share:

Statutory and common law obstacles to recovery
in shareholder litigation involving both foreign
and domestic companies

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Getting your fair share Part 1

Shareholder litigation involving foreign
companies

Background

- Alex had entered into joint venture with others
- The joint venture vehicle was a Cypriot company (“the Company”)
- Shareholders’ agreement imposed fiduciary duties
- Choice of law – English law
- Choice of jurisdiction – English courts
- Boris held himself out as CEO and diverted business away from the Company
- None of the parties had any connection with England



Instructions

- Boris had breached the Shareholders' Agreement
- The breach had caused Alex to suffer loss
- Alex wanted to sue Boris in the English courts for the breach of the Shareholders' Agreement



Reasons

- The loss suffered by Alex was reflective of the loss suffered by the Company
- The proper Claimant in such a claim is the Company



Principles of English Company Law

- The Rule in **Prudential v Newman** – a shareholder cannot recover loss that is merely reflective of the company's loss
- The Rule in **Foss v Harbottle** – When a wrong is done to a company, only the company may sue for redress (the Proper Claimant Principle)



Circumventing the rule in *Foss v Harbottle*

- Presenting an unfair prejudice petition under section 994 of the Companies Act 2006
- Making a derivative claim under Part 11 of the Companies Act 2006



Problems for Alex

- The problem for Alex is that sections 994 and 260 of the Companies Act 2006 only apply to companies registered under the Companies Act 2006 or its predecessors
- There is no provision that allows the English courts to apply these sections to foreign companies even if they are carrying on business in England



Questions to be addressed

- What law applies to the dispute and what is the effect of the choice of law clause
- Whether the English courts have jurisdiction to deal with the dispute and the effect of the choice of jurisdiction clause
- What cause of action can Alex pursue against Boris

WHAT LAW APPLIES TO THE DISPUTE?

Law of place of incorporation applies to the regulation and management of the company

- ***Konamaneni v Rolls Royce Industrial Power (India) Ltd [2002] 1 WLR 1269*** – Law of the place of incorporation determines whether shareholder could bring derivative action.
- ***Shaker v Al-Bedrawi [2003] Ch 350*** - The law of the place of incorporation governs the duties owed to the company by directors.
- ***Base Metal Trading Ltd v Shamurin [2005] 1 WLR 1157*** - The procedural aspects of a derivative action may be governed by the *lex fori* (the law of the forum)

Base Metal Trading Ltd v Shamurin

“In my judgment, the law of the place of incorporation applies to the duties inherent in the office of director and it is irrelevant that the alleged breach of duty was committed, or the loss incurred, in some other jurisdiction. Accordingly, these duties can only be modified by contract to the extent that the law of the place of incorporation allows. It is not open to the company and director to contend that they have contractually varied the liabilities imposed by the law of the place of incorporation by the terms of a contract for the appointment of the director governed by some other law, unless it is also shown that the law of the place of incorporation would allow this.”



Cypriot Law will govern

- The duties owed to the Company by directors
- Whether or not a derivative claim can be brought against a director
- Whether or not the Shareholders' Agreement can vary the duties owed by directors



DO THE ENGLISH COURTS HAVE JURISDICTION?

Konamaneni v Rolls Royce Industrial Power (India) Ltd *[2002] 1 WLR 1269*

- Inappropriate circumstances a derivative action can be brought in the English courts for the benefit of a foreign company
- However, the place of incorporation will almost invariably be the most appropriate forum

BAS Capital Funding Corporation v Medfinco Limited *[2004] 1 Lloyd's Rep 652*

"I am satisfied that it would require very strong grounds to override a choice of English jurisdiction, and that the normal forum conveniens factors have little or no role to play, especially where it could be inferred from the lack of other connections with England that the parties had chosen English forum as a neutral forum...

It would not be useful to speculate on what exceptional circumstances would justify the court in not accepting jurisdiction where the parties had conferred non-exclusive jurisdiction on the English court, but I accept that one feature which may be highly relevant is whether there are already proceedings in a foreign country which involve overlapping issues, especially if they have been commenced by the party which subsequently seeks to sue in England."

Lawrence Collins J



Implications of choice of jurisdiction clause

Provided proceedings in relation to overlapping issues are not on foot in some foreign court, the English court is very unlikely to decline jurisdiction where the parties have agreed to the jurisdiction of the English courts.



WHAT CAUSE OF ACTION?



Common Law Derivative Action

- Common law derivative action not abolished by Part 11 of the Companies Act 2006 and is still available for foreign companies
- Cypriot law would determine whether a derivative action can be brought by Alex on behalf of the Company
- The Rules in *Foss v Harbottle* and *Prudential v Newman* apply in Cyprus
- A common law derivative action can be brought within the fraud on the minority exception to the Rule in *Foss v Harbottle*



Remedy for Oppression - Section 202 of the Cypriot Companies Act

“Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself)...”



Conclusions

The English courts have jurisdiction to deal with claims relating to the internal management of foreign companies, but they raise complex conflicts of laws issues which require careful consideration and, in the absence of a choice of jurisdiction agreement, the English courts are likely to decline jurisdiction in favour of the courts of the place of incorporation.





Getting your fair share

Part 2

Shareholders who have been fraudulently induced to subscribe for shares by the company

Setting the Scene

- Incorporation of limited liability entity.
- Private equity fundraising rounds, each in respect of a different class of preferred share.
- Shareholders induced to subscribe by representations of company's CEO.
- Revised articles accompany each new class of shares.



- Articles designed to create 'last in/first out' system of priority between shareholder classes and provide for increased repayment on redemption/liquidation.
- Subsequently discovered representations inducing subscriptions were fraudulent.
- Company goes into liquidation (just and equitable winding up).
- If funds distributed according to articles, only class D preferred shareholders receive return.



Issue 1 - Rescind the subscription contract?



- A contract of subscription for shares cannot be rescinded after the commencement of winding up.
- *Oakes v Turquand* (1867) LR 2 HL 325.

Issue 2 – Equitable Avoidance of the Articles?



- Articles of association cannot be rectified: *Scott v Frank F Scott (London) Ltd* [1940] Ch 794 (CA).
- Articles are “*not defeasible on the grounds of misrepresentation, common law mistake in equity, undue influence or duress.*” *Bratton Seymour Service Co Ltd v Oxborough* [1992] BCC 471 (CA)
- No terms implied from surrounding circumstances.

Issue 3 – Damages Claims?



- Personal claim against director - if possible/worth it.
- Claiming or proving for damages in the liquidation: common law obstacle of *Houldsworth v City of Glasgow Bank* (1880) 5 App. Cas 317
- A shareholder who fails to rescind a subscription prior to the commencement of winding up cannot claim or prove for damages against the company.



Avoiding Houldsworth

- E&W: s.655 CA 2006 (s.111A CA 1985)
- Australia: *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1; s.247E Corporations Act 2001.
- Bermuda: *Re Televest* [1995] Bda LR 71; s.54A CA 1981
- BVI: ?
- Cayman Islands: ? (but watch this space)



Issue 4 – Priority of Claims

- S.74(2)(f) IA 1986

“a sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves.”

- *Soden v British Commonwealth Holdings Plc [1998] AC 298: “sums due to a member “in his character of a member” are only those sums the right to which is based by way of cause of action on the statutory contract.”*
- But (obiter): *“claims based upon having paid money to the company under the statutory contract which the member says that he is entitled to have refunded by way of compensation for misrepresentation or breach of contract. These, too, are claims necessarily made in his character as a member.”*



- *Sons of Gwalia v Margaretic* [2007] HCA 1 at [205]:
“if money is paid to the company to create the relationship of member (as will be the case when a person subscribes for shares) the company's obligation to pay damages for fraudulent misrepresentation inducing that subscription, or to pay damages because loss was occasioned by the company's misleading or deceptive conduct, will not, in the absence of specific legislative provision to the contrary, be an obligation whose foundation can be found in the legislative prescription of the rights and duties of members.”
- Cayman Islands: s.49(g) CA (currently under consideration).
- BVI: s.197 BVI IA 2003
- Remains a real risk that shareholder claims of this nature would be subordinated to the claims of third-party creditors.



Issue 5 – Article Waterfalls

- The articles may impose a waterfall.
- Relating to the return of capital to members.
- Possibly in relation to the priority of members' claims *inter se* which are subordinated to third-party creditor claims.

