*Business Law: CIMA Year One*

# Corporate Management: Minority Shareholders

In general, when shareholders decide on aspects of company policy, decisions are taken by majority rule. If a director has committed a wrong against the company, the company must sue them – and for this to happen, a majority of shareholders must vote for the company to sue the director.

| Foss v Harbottle (1843)<br>H was a director of a company formed to buy land, F was a (minority) shareholder. H sold some of his own land (along with another director) to the company. F alleged that H had gained an excess profit from this sale, and tried to sue H. However, if H had acted wrongfully, it was against the company, and as such only the company could sue and not F. For the company to sue, a majority of shareholders were needed to agree, since otherwise a majority may ratify the decisions made. |
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Foss v Harbottle led to two general rules:

- The proper plaintiff rule: if a company has been wronged, then the company must be the claimant.
- The indoor management rule: if the act which is being claimed as wrong could be ratified by a vote in a general meeting, then the company is not allowed to sue. However, if the vote has already been carried out, responded negative, and the directors acted anyway, then court action is possible.

**Exceptions to majority rule**

There are some situations where a minority shareholder can sue the directors, either by forcing the company to sue or by suing as an individual.

*Derivative actions (case law)*

Derivative actions are so called since the shareholder's right to sue derives from the right of the company.

a) Any minority shareholder can sue for an injunction to prevent a proposed act which would be ultra vires the company. This is restricted, however, by the rights of third parties, and if the transaction has already been agreed by special resolution.

b) Directors may breach their fiduciary duties to commit 'fraud on the minority'. Fraud here is widely defined, and covers a breach of the duties of care and skill.
c) If the board attempts to do something which requires a special or an extraordinary resolution without obtaining such a resolution, it cannot be ratified by a simple majority. A large minority (over 25%) would be able to call for an injunction.
d) Any alterations to the Artcles of a company which are held to not be for the general good of the company allow for a minority to sue. For example, Brown v British Abrasive Wheel Co Ltd (1919) prevented a 98% majority from force through an amendment which would allow the majority to have a compulsory right to buy the shares of the minority.
e) Majority shareholders can owe duties of good faith; if these are breached then minority shareholders could sue (but they are more likely to do so as individuals).

*Personal wrongs (case law)*

Under the Companies Act 1985, the Memorandum and Articles form a contract between members. If one member does something to take away the rights of another member, the wronged party can seek a legal remedy. For example, if one member refused to count the votes of another member, that wronged member could go to court and force their votes to be counted, as in Pender v Lushington (1877).

*Unfairly prejudicial conduct (under the Companies Act 1985)*

Under s459 of the Companies Act 1985, any member may apply to the court for remedies on the grounds that the company's business is being conducted in a manner which is unfairly prejudiced against the shareholders generally, or against any subsection of shareholders (provided that subsection includes themselves).

For example:

- if directors paid themselves too high salaries, there would be no dividend for shareholders;
- directors could issue new shares to themselves on favourable terms;
- directors could minimise a dividend paid to non-cumulative preference shareholders; or
- a director may be unfairly removed from the board.

Re H R Harmer Ltd (1959)
H R Harmer founded a stamp business. In 1947, HRH formed a company to buy the business; at this time, HRH was 77. The initial directors of the company

were HRH and his sons Cyril H and Bernard H. The shareholders were HRH, CH, BH and HRH's wife. Together HRH and his wife had over 75% of the votes, and his wife always voted with HRH. HRH ran the business in an autocratic way: hiring and firing 'yes men', ignoring views of the other directors, opening a branch in Australia which folded and sold a successful branch in the US. The sons sued for unfair prejudicial conduct. The court ordered that HRH was to be employed as a 'senior stamp consultant' with a salary of £2500 per annum; HRH was not to interfere in any way with the running of the company; HRH was appointed as 'president for life' but with no powers; and the company was forced to buy his shares from HRH.

*Winding up on just and equitable grounds (under the Insolvency Act 1986)*

Under s122(g) of the Insolvency Act 1986, any shareholder may apply to have a company wound up on just and equitable grounds. There are three categories which apply here.

Where the object of the company has failed

Pirie v Stewart (1904)
A company was formed "to be shipowners and purchase charter and work ships". The company's only ship sank. P (with some other shareholders) petitioned to have the company would up. The courts agreed.

Where the company is formed to carry out a fraud

Re T E Brinsmead Ltd (1897)
A family company called J Brinsmead Ltd were piano makers. There was a family feud, and TEB and his sons left to set up TEB Ltd. There were several issues which arose.
Firstly, the prospectus stated that the business cost £76000, whereas in fact it cost £6000. The new company was using the name 'Brinsmead' to raise this, and shareholders sued to company for fraud.
Secondly, J Brinsmead got an injunction to stop the use of the name 'Brinsmead', since the courts agreed it was a case of passing off.
Finally, minority shareholders petitioned to have the company wound up.

In quasi-partnerships – related to the shareholder's right to manage the company

Ebrahimi v Westbourne Galleries (1973)
In 1945 W and Nazar formed a partnership (a Persian carpet business). In 1958 they formed a company – E and N were directors, each holding 500 £1 shares. G Nazar (the son of N) was later made the third director, and was give 100 shares by each of E and N. No dividends were paid to shareholders, and all profits went to directors' wages. In 1969, N and GN removed E as a director under s303 of

the Companies Act 1985. E had 400 shares but these were worthless since they paid no dividends. E petitioned to have the company wound up so he could get his fair share. The courts agreed, citing the partnership history as being important.

**Other rights of minority shareholders**

Certain proportions of shareholders have other rights:

- 25% or above can block any decision which needs to be passed by special or extraordinary resolution.
- 15% of a particular class of shareholders can petition against variation of class rights.
- 10% of shareholders can force directors to call an EGM.
- 5% of shareholders can force the directors to include a resolution on the agenda of the next general meeting.
- Articles may allow small numbers of members to demand polls at general meeting.