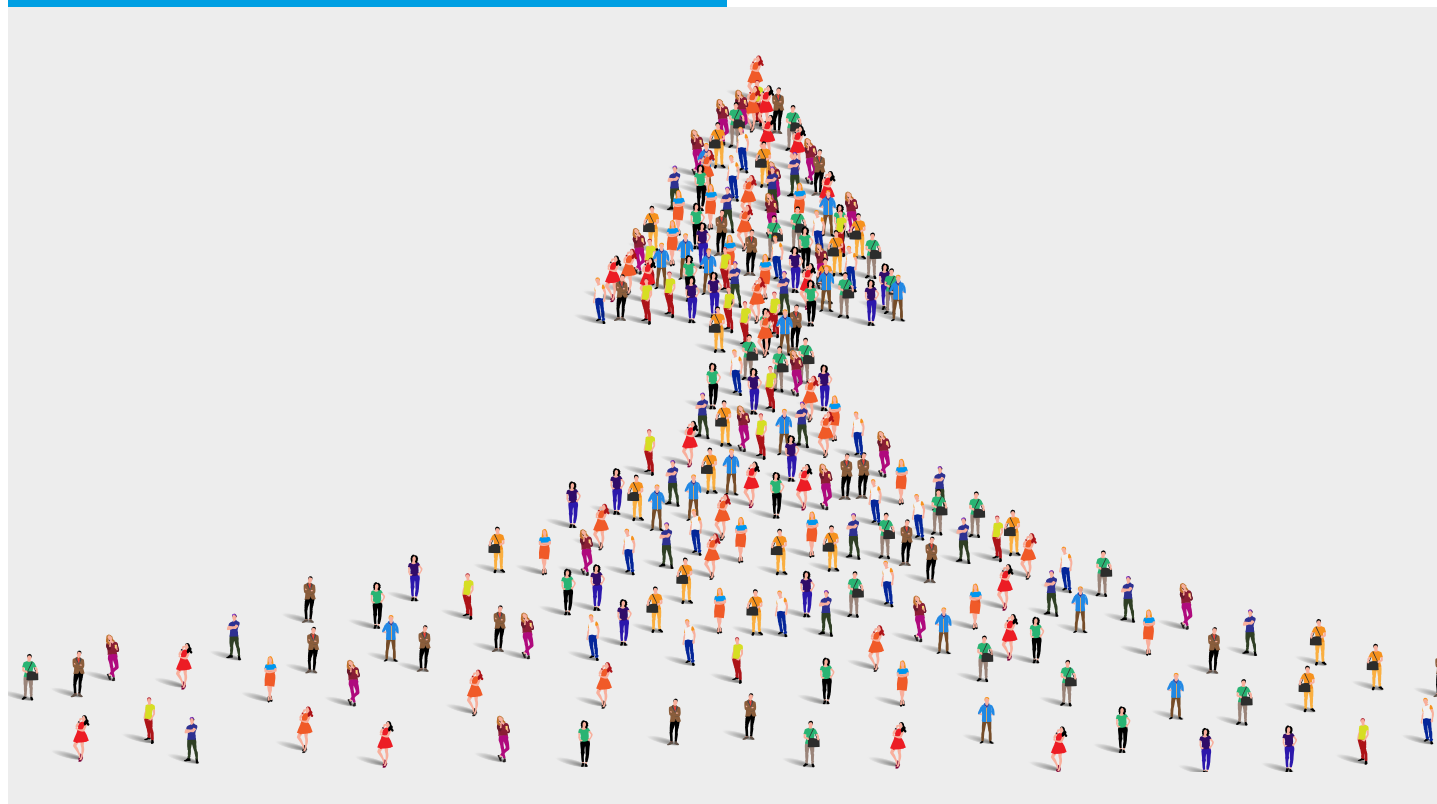


SHAREHOLDER DISPUTES

ARE THEY ON THE RISE?



Authored by: Katie Philipson - Stevens & Bolton LLP

For many businesses just surviving the pandemic could (and perhaps should) be hailed a huge achievement. However, as the bumpy economic climate looks set to continue for the foreseeable future, some fall outs between business owners and directors are inevitable and there is likely to be an upturn in allegations of unfair prejudice.

Here we give an overview of recent unfair prejudice cases – highlighting points of note, before outlining our predictions for the future and ways directors might avoid the pitfalls that lie ahead.



Stripping the standing to petition?

The September 2021 judgment in *Re Motion Picture Capital Ltd* [2021] EWHC 2504 (Ch) serves as a useful reminder that an unfair prejudice petition cannot be avoided simply by transferring the petitioner's shares! Here the petitioner was seeking the purchase of his shares at a price that fairly reflected the value of the company following the unfairly prejudicial conduct of the respondents. Thwarted in their attempts to dismiss the petition, the respondents simply exercised the company's entitlement to transfer the petitioner's shares to themselves as nominees for the company and thus removed the petitioner as a member. However, the respondents failed to appreciate that this did not automatically strip the petitioner of standing to continue the petition.

Section 994(2) contains a requirement for a petitioner to be a member at the time a petition is presented. There is no continuing obligation to remain a member. In assessing whether to allow a petition to continue the court will look at whether there is a continuing interest in pursuing the petition. Unless there is a continuing interest a petition will be struck out. However, given the court's wide discretion under section 996 when considering remedies for unfairly prejudicial conduct, a respondent will rightly face an uphill struggle to show that a petition should be struck out for lack of continuing interest.



It's all about the remedy...

The wide discretion found in section 996 warrants careful consideration. The unwary might assume that a buyout order is automatic enabling the petitioning shareholder to be bought out. However, disgruntled petitioners may seek an order to buyout the respondent(s) as an alternative to exiting the business themselves.

Furthermore, as was demonstrated in *Macom GmbH v Bozeat* [2021] EWHC 1661 (Ch) in June 2021 even though unfairly prejudicial conduct had taken place, there was no financial loss suffered by the petitioner. When considering what remedy was appropriate the court felt it disproportionate to order the buyout of the petitioner's shares. Instead, the court used its discretion and made an order regulating the future conduct of the company's affairs. In every case the court will look to the over-arching requirement of section 996 so that it makes such order as it thinks fit for "giving relief in respect of the matters complained of".



The impact of good faith clauses

The final case in this overview is *Faulkner v Vollin Holdings Ltd* [2021] EWHC 787 (Ch) (subject to an outstanding appeal). This case serves to highlight the significant effect the inclusion of express good faith

obligations can have on the outcome of shareholder disputes. Here it was held that minority shareholders had been unfairly prejudiced by the actions of the majority shareholder investors who had, amongst other things, excluded the two founding directors from the management of the company. This was despite the Shareholders' Agreement and Articles of Association including specific clauses designed to protect the founding directors' interests and position on the board.

The impact of good faith clauses is a key consideration when setting up a business venture, or taking new shareholders into an existing business. There can be advantages and disadvantages to expressly including a good faith obligation to underpin contractual rights. For those who are subject to agreements containing such an obligation, they breach it at their peril.



Predictions for the future

Directors face a tough time ahead balancing the interests of the business, their shareholders and other stakeholders. We're expecting an uptick in allegations of unfair prejudice as shareholders continue to expect a return on their investment whilst many businesses will be struggling with the economic and social impact of the last 20 months.

Shareholders are increasingly looking to see that their investments are (at least to an extent) ethical. The media focus firstly on corporate social responsibility (CSR) and then the shift to environmental, social and governance (ESG) issues has led to significantly higher expectations amongst shareholders. Not only do directors have to operate business profitably, they must do so whilst satisfying the social mores of their shareholders, employees and other stakeholders. Setting a realistic strategy and delivering on it is much more likely to keep stakeholders happy than failing

to deliver on an overly ambitious plan.

Whilst majority director shareholders may think that where discontent arises the solution is to ease out the disgruntled minority or dilute their control, this must be executed with care. Undoubtedly the valuation of many businesses will be lower now than prior to the pandemic. This perhaps gives rise to:

- **The possible buy out of a minority at a price which the majority could not otherwise afford. However, forced buyouts are fraught with risk (even if achievable) as the minority may prefer to hold the shares and await the recovery of the share price.**
- **A need for additional capital through an Open Offer. This can operate to dilute a shareholding if the shareholder declines to participate.**

In both of these areas though the price / valuation is fundamental. It must be a fair value otherwise it will be susceptible to challenge. It is also imperative in an Open Offer scenario to ensure that the directors are acting in the best interests of the company, in accordance with its constitution and any shareholder agreements (including any good faith obligations). It is also necessary to ensure that the directors have the ability to allot new shares.

A failure to carefully analyse intended courses of actions can lead to unintended consequences which open up routes to allegations of breach of contract, breach of duty and/or unfair prejudice.

