FAIR PLAY IN OFFSHORE COMPANIES

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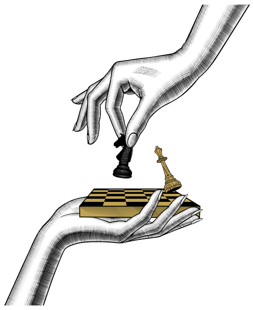
Abuse by directors

The directors of a company must manage the business of the company in accordance with the relevant statutory framework and the constitutional documents of the company. The directors also owe a number of duties (arising under statute or general law). On the whole, directors are entitled to manage the company as they think appropriate, provided they act within this framework. One of the key duties of directors is to act in the best interests of the company as a whole.

One challenging area is where the directors appear to act within the scope of their powers but against the interests of minority shareholders - for example, if the directors decide to take the company in a new direction against the wishes of minority shareholders.

Another key duty of a director is to exercise powers for a proper purpose. It is arguable that the courts are showing greater willingness to examine the purpose behind the use of powers by directors and to hold the directors to account if the purpose is improper. In this way, principles of fairness are being emphasised to enforce "fair play" when dealing with minority shareholders.



Abuse by shareholders

In addition, equitable constraints may also be imposed on the use of shareholder power. In normal situations, a shareholder may exercise voting rights purely to advance the interests of that shareholder. In other words, the shareholder can exercise voting rights to advance his or her own selfish interests without regard to the interests of others. However, there are circumstances where the courts will limit how a shareholder may act. Equitable considerations may be used to curtail an abuse of shareholder power.

Recent cases – motive and fairness

There have been a number of recent cases (both onshore and offshore) looking at what equitable constraints there may be on how a company is managed.

Re Virginia Solution

In the recent Cayman decision of Re Virginia Solution SPC Ltd (10 February 2022) concerning a petition for the just and equitable winding up of a Cayman company, issues of quasi-partnership, deadlock, and proper purpose were considered.

Virginia Solution was (from 2014 onwards) a two member captive insurance company, both shareholders being large US-based healthcare providers, Augusta and Valley Health.

In 2017, a dispute arose about the handling of a dividend and how it should be paid between the two shareholders. The dividend policy required the board of directors to declare dividends in accordance with the advice of the company's actuary, calculated according to a blended equity and claims experience formula. When dividends were proposed on this basis, Augusta repeatedly vetoed the dividends (as it technically had the right to do as a shareholder) unless Valley Health agreed that the dividends would be made on a basis more favourable to Augusta than the actuary had proposed.

Although a detailed discussion of the nature of quasi-partnerships is beyond the scope of this article, the important feature in this case is that a relationship of trust and confidence between the parties, giving rise to a quasi-partnership, was found despite the two shareholders being large community healthcare corporations. Augusta's argument that a quasi-partnership could not arise between two such impersonal entities failed, with the judge observing that, although this was novel, the courts should not be timorous in giving the words "just and equitable" full force.

The court further held that Augusta's position was in bad faith: their purpose in "slow-playing the dividends" and adopting the position they did was to force Valley Health to withdraw from the company entirely. If they did so, then Valley Health as the "last man standing" would obtain a significant windfall due to the complex nature of the way shareholders were rewarded in accordance with the company's constitutional documents.

Accordingly, whether on the basis of legitimate expectation (in a quasi-partnership context) or on the basis of a finding of bad faith, an order for the just and equitable winding up of the company was appropriate despite the solvency of the company.

Financial Technology Ventures v ETFS

In the Jersey case of Financial Technology Ventures v ETFS Capital Limited [2021] JCA 176, the court considered the doctrine of proper purpose in the context of an unfair prejudice petition.

This was a case where the managing director (also the majority shareholder) took the business of the company in a new direction against the wishes of a minority shareholder (who wanted to exit the company).

In the judgment, two principle director duties were considered:

a. A director owes a duty to exercise his or her powers honestly in what he or she believes to be the best interests of the company. This test is applied subjectively.

b. A director owes a duty to exercise his or her powers for the purposes for which they were given. Under this duty, the question is not whether the director acted in good faith. It is possible for a director to act in a way he or she genuinely believes to be in the best interests of the company, but nevertheless to act in breach of this duty to exercise powers for a proper purpose.

Although the decisions made by the managing director were within the scope of his power, the court found that the substantial purpose behind the exercise of his powers was to force the minority shareholder (who wanted to exit) to sell its shares in the company at a discount. This was found to be an improper purpose.

Onshore case law

The view can be taken that recent onshore cases show an increased scope to employ equitable principles in shareholder disputes.

In Pagden v Soho Square Capital LLP [2020] EWHC 944, the shareholders of a company were required to vote on whether or not the liquidators of a company should remain in office. The majority of the shareholders by value were defendants to proceedings which had been brought by the liquidators; they claimed the liquidators lacked independence and competence, and wished to replace them. The liquidators sought to argue that the majority decision, being solely designed to remove liquidators who were bringing a claim against them, was unfairly oppressive of the minority.

The High Court found that, when considering whether or not to intervene in the vote of shareholders of a company, "it should consider whether the majority decision has been brought about by unfair or improper means, fraud or illegality or is oppressive towards the shareholders who oppose it, and whether no reasonable person could consider that the member's vote was cast for the company's benefit". The High Court further considered that any operative oppression of the minority "must involve an element of abuse or unfair subjugation of the minority's will".

The starting principle is of course that shareholders can vote in their own interest. There have always been narrow exceptions to that principle, but it might be thought that the wording of the test quoted above may appear to involve an extension of those exceptions. On the facts of the case, the High Court decided that the circumstances of the vote were not sufficiently oppressive to justify intervention, because there was no basis on which to impugn the proposed replacement liquidators, who could consider the claims independently.

Another example is Re Compound Photonics Group Limited [2021] EWHC 787. This is an unfair prejudice case in which an express contractual obligation of good faith in a shareholders' agreement had a dramatic and wide-ranging effect on the outcome, placing onerous obligations on the parties to take into account the interests of their counterparties when making decisions, despite the commercial context in which the shareholders' agreement was drafted.

Conclusion

The equitable principles discussed in this article have always been broadly available to the courts of common law jurisdictions. Any development in this area is a question of nuance rather than any radical development of principle, but it is hard to escape the impression that the judiciary, both offshore and onshore, is becoming more open to making judgments based on motive and proper purpose in cases where they might not have previously interfered.

The tools available to a disgruntled shareholder are likely to focus on unfair prejudice claims and applications for a just and equitable winding up but the courts are increasingly looking at issues of motive and proper purpose when dealing with these claims.

Directors should be increasingly careful not to rely simply on their wide powers of management to justify their actions; they should be asking themselves not just whether they have the simple power to act, but also whether the power is being used appropriately.