The Privy Council confirms shareholders have a personal claim against a company for improper exercises of power

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The Judicial Committee of the Privy Council has handed down a landmark decision confirming the rights of shareholders, including minority shareholders, to prevent improper exercises of power and oppression by a company.

On 14 November 2024, the Judicial Committee of the Privy Council handed down its decision in *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36 (***Tianrui v China Shanshui***). It confirmed that a shareholder has a personal claim against a company when its directors exercise their powers for an improper purpose. More specifically, the Board found that such a claim may be brought by a minority shareholder in circumstances where the directors have allotted shares for the improper purpose of diluting that shareholder's voting power, so facilitating a takeover of the company.

The Board's decision in *Tianrui v China Shanshui* confirms a shareholder's ability to bring a personal claim against the company for declarations or injunctions to prevent conduct in breach of a company's articles of association, without the need for a derivative action under the rule in *Foss v Harbottle*. In doing so, the Board finally resolves what Professor Gower once described as "one of the most difficult problems in company law" (*Gower: Principles of Modern Company Law* (2nd edition, 1954) at 529).

Background to the shareholder dispute in *Tianrui v China Shanshui*

The background to the appeal involves a prolonged battle for control of the respondent, China Shanshui Cement Group Ltd (**China Shanshui**), which is a Cayman Islands exempted company whose shares are listed on the Hong Kong Stock Exchange. China Shanshui is engaged in the production, distribution and supply of cement and related construction products in the People's Republic of China (**PRC**).

The takeover battle in question was waged between three principal shareholders of China Shanshui. The appellant, Tianrui was on one side, and on the other was Asia Cement Corporation (**ACC**) and China National Building Materials Co Ltd (**CNBM**). China Shanshui, Tianrui, ACC and CNBM are all competitors in the cement production industry in the PRC.

In August and October 2018, without any prior notice, China Shanshui issued convertible bonds to six subscribers in two tranches. At a subsequent general meeting of China Shanshui, a majority of shareholders (including ACC and CNBM) passed a resolution permitting the directors to allot and issue new shares in China Shanshui to the holders of the convertible bonds.

Tianrui alleges that the bondholders are connected to ACC and CNBM by an undisclosed agreement or concert party to take over voting control of China Shanshui and the allotment was for the purpose of enabling ACC and CNBM to control China Shanshui by achieving a dilution of Tianrui's shareholding from 28.16% to 21.75%. This brought Tianrui's shareholding below 25%, preventing them from exercising "negative control" to block special resolutions of China Shanshui, including merger resolutions. As such, Tianrui argues that the issue of the convertible bonds and the allotment and issue of the new shares were an improper exercise of China Shanshui's power to allot and issue securities.

Tianrui issued writ proceedings against China Shanshui seeking a declaration that the exercise by its directors of the powers to (i) issue the convertible bonds, (ii) convert the bonds into shares, and (iii) issue the new shares; were each not a valid exercise of the relevant power. China Shanshui sought to strike out Tianrui's claim as an abuse of process on the basis that Tianrui did not have standing to sue China Shanshui for claims which are based on a breach of fiduciary duty by the directors. It argued that the claim ought to have been brought derivatively under the rule in *Foss v Harbottle*.

At first instance, Segal J concluded that Tianrui had standing to bring a personal claim against China Shanshui in respect of the improper dilution. However, the Cayman Islands Court of Appeal (**CICA**) allowed an appeal on the basis of the earlier Cayman decision of Kawaley J in *Gao v China Biologic Products Holdings, Inc* [2018 (2) CILR 591] which Segal J had declined to follow. CICA found that the proper plaintiff for the claim pleaded by Tianrui was the company and, therefore, the appropriate course was for Tianrui to bring a breach of duty claim on behalf of the company against the directors as a derivative action.

The Board's conclusions as to the availability of a direct shareholder claim

As the Board recognised, courts have long allowed shareholders to make personal claims against the company in which they are invested for a wrong done to them qua shareholder and to enforce those rights via a personal action (for example, claims to enforce personal rights to vote on

resolutions put to the company in general meeting). This includes cases where directors have exercised their powers improperly, such as *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71.

The limit to those cases was always thought to be whether or not the contravention of a shareholder's rights was capable of ratification by the company in general meeting. If it was, then in accordance with the rule in *Foss v Harbottle* (as applied in *McDougal v Gardiner* (1875) 1 Ch D 13, a case about general meetings conducted in breach of the articles of association), there would be no cause of action. That principle was always controversial, not least because similar direct claims were allowed in other cases such as *Pender v Lushington* (1877) 6 Ch D 70. In a seminal article in 1957, Professor Wedderburn suggested, on the basis of the House of Lords decision in *Quin & Axtens Limited v Salmon* [1909] AC 442, that a shareholder should always have a direct claim for breach of the articles, as if were a breach of contract. Such a breach was incapable of ratification by a simple majority of members because it would be tantamount to amendment of the articles. The question before the Board was more nuanced because it concerned the **improper** exercise of a power conferred by the articles, the exercise of which may, by its nature, be capable of shareholder approval.

The Board reviewed a long line of English and Australian decisions of high authority on share issues, including *Fraser v Whalley* (1864) 2 H & M 10; *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Bamford v Bamford* [1970] Ch 212; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 and *Residues Treatment & Trading Co Ltd v Southern Resources Ltd* (1988) 6 ACLC 1160, in which the Courts recognised that shareholders may bring a personal claim in relation to improper share dilution. However, the Board noted that none of these cases explained the jurisprudential basis for a shareholder's standing to bring a personal claim. For instance, in the well known Privy Council decision of *Howard Smith Ltd v Ampol Petroleum Ltd*, the relevant question for the Board was whether the impugned share allotment was valid and there is no suggestion in the judgment that the standing of the minority shareholder plaintiff to bring the claim had been questioned. Outside of the Cayman Islands, a plaintiff's standing was challenged in only one case in *Residues Treatment & Trading Co Ltd v Southern Resources Ltd*, although the South Australian Supreme Court dismissed the challenge.

Given the lack of principled consideration in most of the cases, the Board ultimately approached the matter from "first principles" and found as follows:

- The availability of a direct action depended on the statutory contract constituted by the memorandum and articles of association. As an intrinsic feature of the contract between shareholders and the company, it is implicit that when directors are exercising their fiduciary powers on behalf of a company, they will be exercised for proper purposes
- The conferment upon directors of the power to allot and issue shares is an important part of that statutory contract. As a consequence, the power is subject to the constraint that it will be exercised for a proper purpose which is (at [72]):

> "as much a part of that corporate contract as if it had been spelt out word for word in the articles. It is a term of the corporate contract that, if the exercise of the power to allot and issue new shares by the directors as agents for the company is to be valid and binding as between the individual shareholder and the company, it should comply with all conditions necessary to make it a **proper** exercise. These include compliance with the directors' fiduciary duty owed to the company. This is a constraint implied by law as inherent in the relationship between the shareholder and the company"

- An allotment of shares which eliminates a shareholder's right of control or their right of "negative control" can have the effect of altering the balance of voting power between shareholders within the company and the relative economic stakes they have in the company. As such, where such an allotment is deliberately aimed at altering the balance of power, this constitutes the improper use of the power to issue and allot shares. Accordingly, the shareholder has a personal right to challenge the allotment based on a breach of an implied term of the corporate constitution
- Although the personal claim involves a breach of fiduciary duty by the directors which is, in theory a breach of its duty to the company, the wrong done to the company is not the substance of the complaint. The basis of the complaint is an alleged infringement of the plaintiff's rights as a shareholder under the articles and these two causes of action are not mutually exclusive and may co-exist together
- The right of the shareholder to sue the company is not dependent upon their status as a minority or majority shareholder. Although Tianrui was a minority shareholder, a majority shareholder may sue the company on the same basis, for instance, when shares are allotted by the company to a favoured outsider depriving that shareholder of majority control
- The fact that the offending exercise of power could theoretically be approved in advance or ratified by members in general meeting was not a sufficient rationale to deprive a shareholder of their cause of action. In particular, the Board noted that ratification by the general meeting is constrained by minority oppression principles and a breach by directors having an improper purpose of assisting an existing majority can hardly be ratified by the majority itself without falling foul of these principles

Based on the above considerations, the Board allowed the appeal and confirmed that the direct cause of action pleaded by Tianrui had a proper basis in law and there was a strong case on the assumed facts for the availability of such a claim.

Clarification of shareholder rights

Tianrui v China Shanshui is a watershed decision confirming the rights of shareholders in common law jurisdictions. The Board has clarified decades of judicial uncertainty regarding the circumstances in which shareholders can bring personal claims against a company for an improper

exercise of power.

Unlike most common law jurisdictions, the Cayman Islands has no statutory remedy for unfair prejudice or oppression and shareholder disputes involving such conduct are usually resolved via just and equitable winding up petitions or derivative actions, each of which present their own difficulties. Accordingly, the decision in *Tianrui v China Shanshui* is particularly significant for shareholders of Cayman Islands companies, providing them with an important remedy in cases where the directors of a company are exercising their powers improperly.

More broadly, even in jurisdictions where the statutory unfair prejudice or oppression remedy exists, the personal claim identified by the Board in *Tianrui v China Shanshui* is likely to apply more widely to improper exercises of power, including to the exercise of any other powers by directors which infringe a shareholder's rights. This provides disenfranchised shareholders with another important tool in their arsenal against majority oppression and unfair prejudice.

How Ogier can help?

Ogier, together with Tom Lowe KC and Tara Taylor of Wilberforce Chambers (who co-authored this article), acted on behalf of Tianrui, the successful appellant, in this matter.

Ogier's multi-jurisdictional Dispute Resolution team advises on technical, strategic and procedural aspects across the spectrum of contentious commercial issues and disputes, including shareholder disputes. For more information or to find out how Ogier can advise you in this area, contact one of the authors of this article.

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