Conyers Dill & Pearman

OFFSHORE CASES

MARCH 2017

BERMUDA

COURT OF APPEAL

Kingboard Chemical Holdings et al -v- Annuity & Life Re et al [2017] CA (Bda) 3 Civ (24 March 2017)

SHAREHOLDER DISPUTES - THE DUTY TO NEGOTIATE WITH SHAREHOLDERS - MINORITY OPPRESSION - SECTION 111 COMPANIES ACT, 1981

Minority shareholders angry with the conduct of their company have limited rights of redress other than to sell their shares. One of the weapons at their disposal is the minority oppression action which empowers the Court to issue buy-out orders (at a price set by the Court) where the minority has been unfairly prejudiced by the majority. This power is contained in Section 111 of the *Bermuda Companies Act, 1981* and Section 994 of the *English Companies Act, 2006*.

There are few instances of successful minority oppression actions even against private companies. Against listed companies, the number of successful petitions drops to zero. This is why the 2015 first instance decision in *Annity Re -v- Kingboard* [2015] SC (Bda) 76 Comm created a stir. It was the first known case anywhere of a minority oppression petition succeeding against a listed company. Further, the Bermuda Supreme Court had ruled that companies, and their majority shareholders, could have a duty to negotiate with the minority if the company was considering action which adversely impacted them. This was a potentially dramatic shift in power dynamics between shareholders and management.

In this Judgment, the Bermuda Court of Appeal overturned the first instance decision of the Bermuda Supreme Court and reasserted traditional notions of a company's relationship with shareholders.

Kingboard concerned a vertically integrated group of companies. One of those companies, Kingboard Copper Foil Holdings Limited (the "Company"), a company domiciled in Bermuda, but whose operations were in China, produced copper foil which was sold predominately to group companies. The Company was listed on the Singapore Stock Exchange (the "SGX"), but the majority of the shares were held by affiliated group companies. The ownership structure created an inherent conflict of interest: it was potentially in the interests of the group companies for the foil to be sold cheaply. This could benefit the majority shareholders, as purchasers of the copper foil, even though it was at the expense of the Company.

The minority shareholders, who had bought their shares on the SGX, believed that the Company was doing precisely this: selling copper foil too cheaply to benefit the majority shareholders. They claimed that, as a result, group companies were doing well, but the Company was doing badly. The minority had various remedies open to them – they could have complained to the SGX and they could have brought a minority oppression action in Bermuda on the issue. Instead, they took action themselves using powers granted to minorities under SGX rules. Under SGX rules, shareholders must approve all 'interested party transactions' and only non-interested shareholders can vote. This meant the minority could veto sales to group companies and this is what they did. Such a veto was the nuclear option: it effectively prevented the Company from operating. Having exercised the nuclear button, the minority waited for the Company to open negotiations.

The Company's response was unexpected. The Company licensed its entire operation to a third party for a monthly fee. The licensee then continued the copper foil production and the sales to group companies. This was an interim arrangement. The license was terminable on a month's notice. If the minority shareholders removed the veto, the Company could quickly resume normal operations. The Company invited the minority to

remove the veto and waited for the minority shareholders to surrender. However, rather than surrender, the minority issued a minority oppression petition in Bermuda alleging that: (a) the Company had been selling its copper foil too cheaply prior to the veto and (b) the new license arrangement was a sham designed to bypass the veto.

At first instance, the Chief Justice dismissed the claim of underpricing. He ruled that the Company had not been selling its copper foil too cheaply and that the pricing had been at arms-length. This was a comparatively simple analysis based on expert evidence. In regards the second ground, he ruled that the license arrangement was a genuine and commercial response to the veto, but nonetheless was oppressive because it improperly bypassed the minority shareholders' exercise of the veto. He ruled that there was prejudice because the licensing arrangement was less profitable than normal operations. The Chief Justice took the view that the Company's proper response, to these unusual circumstances, was to open up negotiations with the minority shareholders and seek a commercial solution. Any other response was improper.

The Bermuda's Court of Appeal unanimously allowed the Appeal. The Court of Appeal ruled that the Chief Justice was wrong to find any prejudice. The licensing arrangement had not caused prejudice because the correct comparison and the alternative to the license was the complete cessation of production. The Court of Appeal also disagreed with the Chief Justice on the question of a company's duty to negotiate with shareholders. The Company had not acted oppressively by failing to negotiate, because there was no duty to negotiate (at least in the circumstances of this case).

There was a subsidiary issue. An unusual aspect of litigation was the fact that the petitioner, while complaining about oppression, had all the while been increasing its stake in the Company. Both the Chief Justice and the Court of Appeal agreed that the petitioner could not claim in respect of shares bought after the date of the petition. Such claims were abusive, since self-inflicted.

The Kingboard first instance decision was the first successful minority oppression action against a listed company anywhere in the world. Further, it was potentially ground-breaking in positing a duty on companies to negotiate with their minority shareholders over issues which impacted the minority more than the majority. Such a duty was potentially far reaching in the context of vertically integrated groups of companies with cross shareholdings, and created a potential mine field. While the Court of Appeal refused to rule out the possibility of a duty (to negotiate) ever arising, it pointed out the difficulties inherent in such a duty. Minority shareholders are accordingly in the position they have always been in – passengers, not participants.