



The Rights of Shareholders – Including Oppression, Representative Actions, and Derivative Actions

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Preface

This memorandum provides a non-exhaustive summary of the rights of shareholders of exempted companies incorporated pursuant to the Bermuda Companies Act 1981, as amended (the “**Companies Act**”). The following discussion is intended to be very general in nature and no action should be taken in reliance upon the same without obtaining specific legal advice in respect of all relevant and applicable facts and circumstances.

Copies of the Companies Act 1981 have been prepared and are available on request.

This memorandum has been prepared on the basis of law and practice as at the date referred to below.

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1. RIGHTS OF SHAREHOLDERS

Under Bermuda law, shareholders are entitled to have the affairs of the company conducted in accordance with general law and in particular with the company's memorandum of association and bye-laws.

The company is required to hold an annual general meeting at least once in each calendar year unless such requirement is waived by resolution. At the annual general meeting it is usual to provide for the election or appointment of the directors. In addition, the directors may, whenever they see fit, convene a general meeting of the company, to be known as a special general meeting. All holders of voting shares are entitled to receive at least five days' notice of all general meetings of the company, unless all members entitled to attend and vote thereat agree to the meeting being called on shorter notice and, subject to the bye-laws, such holders are entitled to attend in person, by proxy or, in the case of a corporation, by an appointed representative.

When an election has been made to dispense with annual general meetings (whether for a specified number of years or indefinitely) any member can, by notice to the company given before 30 September, require that an annual general meeting be called in that calendar year. Once September passes, the member seeking an annual general meeting must wait until the following calendar year.

Unless all of the shareholders and all of the directors agree otherwise, the company must appoint an independent auditor. All members that are entitled to attend and vote at a general meeting of the company are entitled to receive the audited financial statements of the company at least five days before the date appointed for the annual general meeting (unless such members unanimously agree to receipt on shorter notice). A company whose shares are listed on an appointed stock exchange may circulate a summarised version of its financial statements to its members. In the case of a company that has waived the requirement to hold an annual general meeting, audited financial statements must, unless waived by all members and directors, be made available to members within 12 months of the company's financial year end.

Shareholders are also entitled to receive copies of the memorandum of association and bye-laws of the company and minutes of meetings of shareholders. Shareholders are not, however, generally entitled to inspect accounting records or minutes of meetings of the directors. The memorandum of association, register of shareholders and register of directors and officers of a company are public documents.

Shareholders of a company limited by shares will not be liable for the debts of the company except up to, and in so far as, any amount remains unpaid to the company in respect of the shares held by them. Exceptions to the general rule apply only in extreme circumstances involving, for instance, fraud or where the affairs of the shareholder and the company are so intertwined as to make the two indistinguishable.

2. SHAREHOLDER ACTIONS

2.1. General Rule

As a matter of Bermuda common law (following English common law), only a company itself can sue for loss caused to the company, or to redress a wrong done to the company. The legal rights of a company belong to the company as a separate person and not to its shareholders. As a result, shareholders do

not have standing to enforce the rights of the company by legal action. This is known as the rule in *Foss v Harbottle*¹, or the 'proper plaintiff' principle², and it follows from the fundamental and basic principle that a company is a legal person, separate and distinct from its shareholders³.

Under the rule in *Foss v Harbottle*, a court will generally refuse to interfere in the management of a company at the instance of a minority of its shareholders who are dissatisfied with the conduct of the company's affairs by the majority or by the board of directors. The fundamental proposition of law is that a minority shareholder cannot sue for a wrong done to the company or bring proceedings to rectify an internal irregularity in circumstances where the majority can lawfully ratify the same.

Every shareholder is, however, entitled to have the affairs of the company conducted properly according to law. As such, if those who control the company have persistently disregarded the requirements of company law or the provisions of the company's memorandum of association or bye-laws, the court will grant relief.

In general, the exceptions to the rule are as follows:

- (i) the act complained of is *ultra vires* or illegal and not capable for ratification by the majority;
- (ii) the act complained of constitutes a fraud on the minority where the wrongdoers control the company;
- (iii) the act complained of constitutes an infringement of individual rights of shareholders, such as the right to vote, pre-emption rights, etc; and
- (iv) where the company has not complied with provisions requiring that the relevant act be approved by a special or extraordinary majority of the shareholders.

Where the act complained of is not *ultra vires* or illegal then a shareholder cannot take action himself because it is an action which is capable of ratification by a majority of the shareholders. However, if the claim by the shareholders is that the directors have carried on an act which is *ultra vires* or illegal, then the shareholder has a right of action on behalf of himself and others to sue the directors with any damages awarded going to the company itself.

¹ The facts in *Foss v Harbottle* (1843) 2 Hare 461 were that the minority shareholders alleged the company had a claim in damages against some of the directors by reason of the fraudulent acts of those directors but at a general meeting the majority resolved that no action should be taken against them. Two of the minority shareholders took legal proceedings against the directors and others to compel them to make good the losses to the company. The court dismissed the action on the grounds that, as the acts of the directors were capable of confirmation by the majority of the shareholders, the court would not interfere. The court left the majority of shareholders to decide what was for the benefit of the company.

² The rule in *Foss v Harbottle* has been accepted as being applicable in Bermuda, for example in *Stena Finance BV and Temple Holdings Ltd v Sea Containers Ltd and others* [1989] Bda LR 71, and also in *Leamington Reinsurance v Lisa* [2006] Bda LR 82 at paragraph 39.

³ See, for example, *Salomon v Salomon* [1897] AC 22; *Clark v Energia Global Ltd* [2002] Bda LR 39.

Where the perpetrators of the act which constitutes the fraud against the minority are themselves in control of the company or where a resolution which requires a special or extraordinary majority has only been passed with a simple majority, it is open to the aggrieved shareholder to take an action in his own name. While it is generally for the company to bring action against its directors for wrong doing, it is recognised that the company may be prevented from doing so where the wrongdoers have effective control of the company.

As such, there are circumstances where a shareholder may be able to bring an action in his own name to address a wrong done to him in his capacity as a shareholder, and there are circumstances where the shareholder may be permitted to bring an action on behalf of the company, to address a wrong done to the company.

3. PERSONAL AND REPRESENTATIVE ACTIONS

3.1. Personal Actions

In a personal action, the shareholder complains in his own name and on his own behalf of a wrong done *to him as a shareholder* either by other shareholders or by the company. For example, a shareholder who is prevented from exercising his voting rights, or deprived of the benefit of a pre-emption clause, could bring a personal action against the company. Generally, the remedies available against the company in such circumstances would be a declaration or injunction to enforce the shareholder's rights.

Where a majority shareholder acts, or procures the company to act, in a manner oppressive to the minority shareholders, those minority shareholders may be able to bring an action against the majority shareholder (discussed further below). The remedies in an action against other shareholders may be much wider, and include damages, the right to have their shares purchased at a price set by the Court, or even the winding up of the company.

3.2. Representative Actions

Where a shareholder has a personal claim, and the legal and factual basis for the claim would apply equally to other shareholders, he may be able to obtain an order that he is appointed a representative of a class of shareholders. Order 15, rule 12 of the Rules of the Supreme Court provides that if a number of people have the same interest in legal proceedings, the proceedings may be begun and continued by or against one or more of them as representing all. Where representative action is taken, the individual shareholder does not bring an action in his own right alone, but on behalf of himself and all those shareholders who share a common interest and a common grievance. A representative suit is in order if the relief sought is in its nature beneficial to all whom the plaintiff proposes to represent. A judgement will bind all persons represented unless the plaintiff did not fairly fight the case or the other persons were not actually named as parties to the proceedings.

3.3. Winding Up

A shareholder is permitted to apply to the Court to wind up the company in certain circumstances. Section 161(g) of the Companies Act expressly stipulates that a company may be wound up by the court if the court is of the opinion that it is "just and equitable" to do so. In general, the basis of making a winding-up order under section 161(g) of the Companies Act has been held to include the following:

- (i) the substratum of the company has disappeared;
- (ii) there is deadlock or disagreement in the management of the company;
- (iii) there has been some fraud or illegality; and
- (iv) there has been mismanagement or misapplication of the company's funds.

An example of when it may be "just and equitable" to wind up a company is where the affairs of the company are being conducted or have been conducted in a manner oppressive or unfairly prejudicial (herein collectively referred to as "oppression") to the interests of a shareholder or some number of them.

The court may give relief from the oppressive conduct of the company's affairs or from any proposed oppressive act or omission, and a petition may succeed whether the complainant complains of a course of conduct or only isolated acts.

"Oppression" takes its ordinary dictionary meaning of burdensome, harsh or wrongful. To establish a case of oppression, it has to be shown that those who are alleged to have acted oppressively acted at least unfairly. The kind of oppression which justifies the court in making an order may include fraudulent or oppressive conduct by majority shareholders, and breaches of fiduciary duty by controlling directors or promoters.

It is not enough to prove that those controlling the company have been unwise, inefficient and careless. Mere negligence, however damaging its consequences, does not amount to oppression. The oppression must involve an unconscionable use of the majority's power resulting, or likely to result, either in financial loss or in unfair or discriminatory treatment of the minority, and it must be more serious than a failure of the majority to act in the interest of the company as a whole. It is not necessary, however, for a petitioner for relief from oppression to show that the persons in control of the company acted malevolently or with a desire to obtain an improper advantage - shareholders may clearly be unfairly prejudiced by deliberate conduct which is not designed to cause them harm, but merely to gain some benefit for the person who acts improperly, or to enhance his power or position.

A minority shareholder's petition would not succeed if it was based solely on lack of business ability or inefficiency and carelessness in conducting the company's business on the part of the directors or the controlling shareholders. The court will not involve itself with questions of business policy or the soundness of business decisions. Isolated wrongful acts by a controlling director will not generally amount to oppression.

Where the court is satisfied that there has been oppression, it may order the winding-up of the company.

3.4. Oppression

Where the court has determined that the circumstances are such that it would 'just and equitable' to wind up the company, but to do so would unfairly prejudice the shareholders seeking the order, the court is given a wide discretion under section 111 of the Companies Act to make such alternative order as it thinks fit "whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any shareholders of the company by other shareholders of the company or by the company

and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise".

Section 111 therefore provides an alternative to a winding up order, and the Court is granted very wide powers. The relief granted on a successful section 111 petition may include ordering the majority shareholders to purchase the shares of the minority, or to sell their shares to the minority, at a price determined by the Court, or the payment of damages, or such other order as it may see fit in all of the circumstances.

4. DERIVATIVE ACTIONS

There is an exception to the rule in *Foss v Harbottle* where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue.⁴

A derivative action may be brought against third parties, where the wrongdoers are able to prevent the company from suing them in its own name, for example because they control a majority of the votes at a general meeting, or because they are otherwise able to prevent a general meeting from resolving that the company shall sue them.

The plaintiff can only sue if the company can sue itself - if the company has been dissolved or struck-off or if there was a valid waiver or exclusion of liability, no derivative action can be brought. The shareholder cannot do derivatively what the company could not do. The alleged wrongdoers are made the defendants in the action but the company itself is joined as a nominal defendant in order that it is bound by the judgement. In derivative actions, the judgement is given in favour of the company, so that the plaintiff obtains no personal benefit from the judgement directly.

The procedure for bringing a derivative action is set out in Order 15 Rule 12A of the Rules of the Supreme Court 1985, and require the shareholder bringing the action on behalf of the company to apply for leave of the Court to continue the action.

If the plaintiff can show that the legal action constituted "a reasonable and prudent course to take in the interest of the company" then he can apply to the court for an order that the company should indemnify the plaintiff against the costs of the action, whether or not the action succeeds (see Order 15 Rule 12A(13)).

Derivative actions have been permitted against directors for misappropriating the company's property or misapplying it in breach of company law in order to compel such directors to account to the company for profits made by appropriating for themselves a business opportunity which the company would otherwise have enjoyed; to rescind an allotment of shares made by such directors to themselves and their nominees in order to preserve their majority voting power at general meeting or to deprive the shareholders who

⁴ *Prudential Assurance Co. Ltd. v Newman Industries Ltd (No. 2)* [1982] Ch 204 at 210.

controlled the company of their power to control it in the future; and, to compel such directors to make a call on their own shares equal to a call which they had made on the shares of the other shareholders.

The derivative action is subject, however, to the doctrine of "clean hands". This principle has been applied in cases of acquiescence by the plaintiff shareholder in the wrongdoing of which he complains and in cases where the plaintiff has been regarded as a puppet of outsiders whose interests are opposed to those of the company - for instance, where the plaintiff's motive is to benefit a rival concern which has encouraged him to sue and has indemnified him against costs.[Appendix B Title]

This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.

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