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AHKA Seminar

Handling Shareholder Disputes in Listed and Private Companies

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Shareholder disputes

- Shareholder disputes arise when one or more shareholders feel aggrieved by the actions of other shareholders (not necessarily majority) or the directors.
- Different types of grievances are governed by different provisions of the CO and are resolved in different ways.
- Grievances have to be carefully classified
- Using the wrong provisions may result in the case being struck out. See **Chime Corporation Limited** FACV 6/2004; **Shun Tak Holdings Limited** HCMP 1377/2007
- Two broad categories:-
 - Wrongs done to the Company
 - Wrongs done to the Shareholders

Typical examples of Wrongs done to the Company:-

- Director sells assets to his 'friend' at undervalue/or purchases at overvalue
- Director manages company negligently
- Director diverting business opportunity away
- Director breaches fiduciary duty (accept bribe)
- Director hires mistress at inflated salary

Typical examples of Wrongs done to Shareholders:-

- Not declaring dividends but paying excessive salary to directors
- Excluding shareholder from management in “quasi-partnership” cases
- Not providing information to shareholders
- Issuing new shares for improper purpose


Hybrid cases:-

- Shareholders simply don't get along
- Shareholders do not cooperate – not attend meeting, not approve accounts, not file annual returns etc



Unless there is a shareholder agreement which contain provisions to the contrary, the general law and normal M&A provide that:-

- Management of the company is in the hands of board of directors (Article 3(1) of the new model articles)
- The board acts by simple majority (what about INEDs?)
- A simple majority shareholding could dictate the whole composition of the board

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- Minority (even 49%) has no right to management
 - Shareholders (whether maj or min) owe no fiduciary duty to the company and other shareholders
 - There's no mechanism for 'no-fault divorce' or 'withdrawal of capital'
 - A company is a separate legal entity. Its rights cannot be enforced directly by a shareholder. They can only be enforced by the company (i.e., the board)

The above are referred to as the Governing Principles.

The Governing Principles apply to both listed and private companies

- Case in point:
Sun Hung Kai Properties Limited (Stock code: 16) (CACV 145/2008)
- Alleged agreement between Walter Kwok and directors, in their own capacities and on the Company's behalf, that Walter Kwok would resume duties as Chairman and Chief Executive if certified to be medically fit.

Sun Hung Kai Properties Limited

- Court held it could not attribute to the Board an intention to enter into a binding agreement which would have the effect of fettering their discretion.
- Such agreement, even if exists is unenforceable as it sought to circumvent statutory requirement for any alteration of the articles to be by special resolution.



Another illustration: Grand Field Group Holdings Limited (Stock Code 115) (HCA 300/2009)

- The company was divided into two camps
- Tsang brothers v Chu and Huang, each holding about 20%
- The Tsangs were investigated by ICAC and shares were suspended for trading

Grand Field Group Holdings Limited

- When Tsangs resigned and undertook not to manage company, trading resumed, Chu and Huang controlled the board
- Company articles provide that company may by GM fix maximum number of directors (and it was previously fixed at 15)
- The Tsangs proposed (in their capacity as shareholders) to appoint 8 directors

Grand Field Group Holdings Limited

- Chu and Huang refused, and instead appointed 5 directors of their choice
- The 8 proposed by the Tsangs were subsequently voted into the board in a GM, making the total number of directors 19.
- The parties fought about the validity of the two resolutions to appoint directors – the board resolution v the GM resolution.

Grand Field Group Holdings Limited

➤ Who won?

- The above cases are resolved by the Governing Principles. However, the Governing Principles could be displaced if it is proved that there're some kind of understandings (even though not amounting to legally binding contract) amongst the shareholders which are inconsistent with the Governing Principles.

Legitimate Expectations overriding Governing Principles:-

Where a minority shareholder could establish legitimate expectations outside the articles or shareholder agreements, the court may intervene.

Golden Screen Limited v Village Cinemas Australia Pty Limited HCCW 368/2005

- Subsidiaries of Golden Harvest and Village Roadshow entered into joint venture agreement to develop cinema business across Asia.
- Village could appoint chairman to the board with casting vote.
- Golden complained that the CEO appointed to a subsidiary of the JV company was in gross dereliction of his duties.
- Village applied to strike out the petition on the ground that there's no scope of legitimate expectation as the detailed terms of cooperation were already set out in JV agreement.
- Court refused to strike out: JV agreement may not be exhaustive and there's scope for argument that Village's rights under the JV agreement had to be exercised in good faith.

Re H R Harmer Limited [1958] All ER 689

- Father was the founder of a stamp dealing business
- In 1947, when he was 77, he transferred his business to an incorporated company and allot shares to his sons and wife, who were appointed directors.
- However, he continued to run the company as if it were entirely his and disregard the provisions in the articles.
- Sons petition for relief
- Court found that father's "legitimate expectations" were contrary to law and articles and could not be sustained.
- He was ordered to sell his shares and remain in company as senior consultant with a salary of 2500 pounds per annum but could not interfere with the company's business.

Typical buy out order:-

- (1) The Respondent do purchase the shares in the capital of the company presently registered in the name of the Petitioner ('the Petitioner's Shares') at a price to be fixed by such valuer ('the Valuer') being a certified public accountant, as may within 14 days hereof be agreed upon by the Petitioner and the Respondent, or failing such agreement as may be appointed by the president for the time being of the Hong Kong Institute of Certified Public Accountants ('HKICPA') upon the application of either party with or without the consent of the other;
- (2) The Valuer is hereby directed to value the Petitioner's Shares by reference to the assets, profitability and future prospects of the Respondent as at [] (being the date of the Petition) and without discount for the fact that the Petitioner's shareholding is a minority holding

In the above cases, the legal armory available to the minority shareholder is the ‘unfair prejudice’ provisions in the Companies Ordinance (s.168A OCO, s.724 NCO)



s.168A OCO, s.724 NCO provides that:-

The Court may exercise the power under section 725(1)(a) and (2) if, on a petition by a member of a company, it considers that —

(a) the company's affairs are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of one or more members (including the member); or

(b) an actual or proposed act or omission of the company (including one done or made on behalf of the company) is or would be so prejudicial.

The concept of “legitimate expectation” (hence the applicability of the unfair prejudice petition) applies to listed companies as well.

C Y Foundation Group Limited (Stock Code 1182) (CACV 107/2012)

- The company’s bye-laws require a special resolution to remove a director, which was inconsistent with the Listing Rules.

C Y Foundation Group Limited

- The largest shareholder commenced a petition under section 168A [section 725 NCO] complaining against the other shareholders/directors' refusal to amend the bye-laws.
- Court held that company implicitly promised its shareholders to comply with the Listing Rules. Shareholders are bound by this promise. Failure on the part of the other shareholders to amend the bye-laws constituted unfair prejudice.

Another example:-

Some legitimate expectations are universal, e.g., directors are expected to exercise their power for a proper purpose

eSun Holdings Limited (Stock Code 571) (HCA 2722/2008)

- Company entered into placing agreement with CN Securities to issue 120m new shares to placees identified by CN at HK\$0.5 plus a warrant exercisable at same price

eSun Holdings Limited

- At that time the NAV of the company was around HK\$4.5 and there's no immediate need for cash
- The objective results of the placing were:-
 - An investment fund (Passport International) who recently acquired substantial shares would be diluted to below 25%
 - Peter Lam would maintain control of over 30%
 - The company would suffer a net loss of book profits from the placing

- Passport International sought an injunction to restrain the placing, arguing that the placees were not independent persons and the placing was for an ulterior motive (for Peter Lam to maintain control).
- Held:?

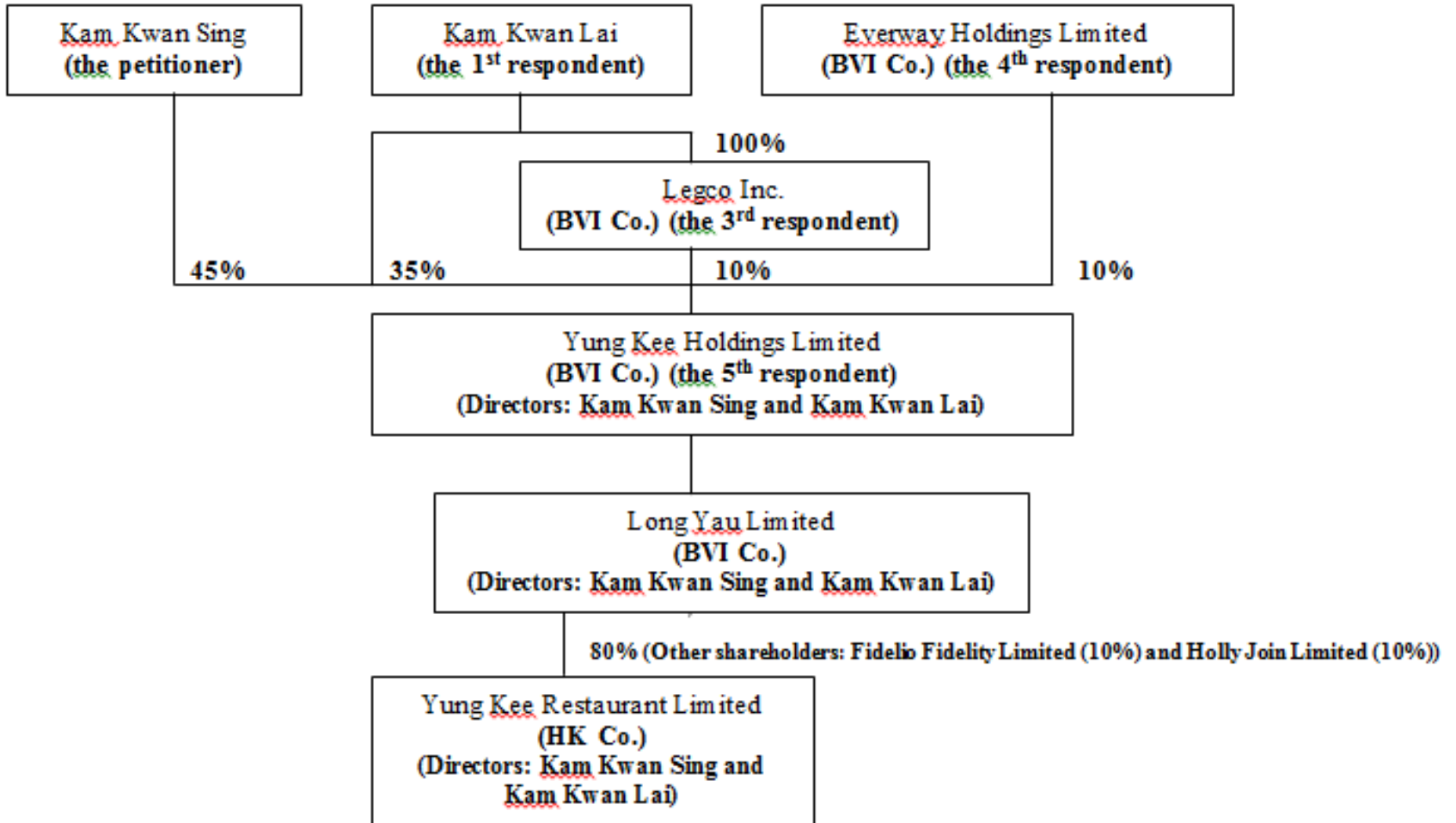
One more (failed) example of legitimate expectation

Yung Kee Restaurant (CACV 266/2012)

The elder brother Kwan Sing was alleging that the younger brother Kwan Lai was excluding him from management, appointing his own sons to take over management and not declaring dividends despite huge reserves.

How should Kwan Sing's allegations be assessed?

Yung Kee Restaurant



One further issue – jurisdiction

Does HK court have jurisdiction to grant relief under s.724 or the NCO or s.327(3)(c) of the OCO over a BVI company?

Unfair prejudice

- S.724 of NCO applies to non-Hong Kong company (S.722)
- Non-Hong Kong company is defined as:-
 - S.2(1) –
“Non-Hong Kong company means a company **incorporated outside Hong Kong** that—
(a) establishes a **place of business** in Hong Kong on or after the commencement date of Part 16; or
(b) has established a **place of business** in Hong Kong before that commencement date and continues to have a place of business in Hong Kong at that commencement date;”

Re Yung Kee Holdings Ltd

- Issue:
 - Whether or not the company had established a place of business in Hong Kong?
- Examples of a **place of business** from Court:
 - Holding companies of large groups
 - Listed on The Stock Exchange of Hong Kong
 - Carry out major activities, e.g. board of directors meet in Hong Kong, consider strategy, raise debt financing, access capital markets, form audit, remuneration and sub-committees, and approve public announcements
 - Normally registered under Part XI of CO

Re Yung Kee Holdings Ltd

- **Held: not established a place of business in Hong Kong and hence Hong Kong courts do not have jurisdiction**
- Relevant factors include but not limited to:
 - Yung Kee Holdings was an investment holding company incorporated in BVI
 - Only asset was shares in Long Yau Limited, another BVI company, which operated the Yung Kee business
 - It did not have a bank account, creditors and employees
 - It did not trade or run businesses in Hong Kong
 - It did not have income other than dividends from Long Yau

Just and equitable winding-up

- S.327(3)(c) of OCO provides that the court has a discretionary power to wind up an unregistered company if the court opines that it is **just and equitable** that the company should be wound up
 - Unregistered companies include foreign companies (S.326, *Yung Kee*)
- S.327(3)(c) is the equivalent of S.177(1)(f) which deals with Hong Kong companies

Just and equitable winding-up

- 3 requirements for court to assume jurisdiction to wind up a foreign company (Re Zhu Kuan Group Company Limited HCCW 874/2003):
 1. A sufficient connection with Hong Kong is established;
 2. There is a reasonable possibility that the winding up would benefit those applying for it; and
 3. That the Court is able to exercise jurisdiction over one or more persons in the distribution of the company's assets

Re Yung Kee Holdings Ltd

- Held: Insufficient connection with Hong Kong and hence Hong Kong courts do not have jurisdiction
 - Yung Kee Holdings did not even directly own the operating Hong Kong subsidiary which operated the business in Hong Kong.

Conclusion

- Both actions for a foreign company require a threshold of jurisdiction of the court:
 - Unfair prejudice §724
 - Major issue: Whether or not the company had established a place of business in Hong Kong?
 - Just and equitable winding-up §327(3)(c)
 - Major issue: Whether or not the company has sufficient connection with Hong Kong
- Judicial reluctance towards interference with internal matters of foreign companies
 - “Hong Kong law regards the domiciliary law of a company...as supplying the proper legal regime to control the vital questions of the company’s legal personality, status and continued existence as a legal person” (Yung Kee)

The above deals with Wrongs against the Shareholders. What about cases where the wrongs are done to the company but the board refuses to take action?

Derivative Actions

The Legal Armory Against the Abusive Majority

- Derivative Action
 - In a derivative action a Minority is suing the wrongdoer on behalf of the Company (form of action: XX suing on behalf of all shareholders of the Company except YY)
 - an action in the name of the Company
 - all recoveries go to the Company
 - but the Minority may bear the costs consequences of losing

Derivative Action

- a shareholder may apply to court for leave to commence the action (s.732)
- 14 days written notice has to be given to the Company (s.733(1)), could be dispensed with if urgency or secrecy justifies (s.733(5))
- The criteria for granting leave are (s.733(1)):-
 - prima facie in the interest of the Company
 - there is a serious question to be tried (i.e., an apparent case that a wrong has been done to the Company)


Derivative Action

- express provisions regarding the costs of proceedings (s.738)
 - court has power to order costs to be paid by the Company if the member bringing the action acts in good faith and has reasonable grounds for making the application
- more ancillary powers (s.737):-
 - interim orders (preservation of property, injunction)
 - appointment of investigator and costs thereof

Illustration:-

China Resources Power Holdings Company Limited (stock code 836) (HCMP 1655/2013)

- 6 minority shareholders applied for leave (under s.168BC of the OCO, s.732 of NCO) to enable them to commence action in the name of the Company against its 20 directors for negligence.
- All directors at the material times, including all INEDs (famous people like Elsie Leung, Raymond Chien) and the chairman Song Lin (now arrested for bribery)

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- The main allegation is that the directors caused the company to commit to over RMB6 billion to purchase several coal mines in Shanxi without doing sufficient due diligence and when it was later found that the coal mines were worthless, didn't enforce the company's rights against the seller.
 - Case withdrawn for the moment but may resume.

Myers Management Consultant Limited v Topix International Company Limited DCCJ 3051/2014

- P allegedly provided consulting services to D. D failed to pay and P obtained default judgment against D.
- Minority shareholder of D sought to intervene and apply to set aside default judgment.
- Minority alleged that the majority shareholder/director of D conspired with P to let default judgment be entered against D and then petitioned to wind-up D so as to cover up their wrongs (mis-appropriating assets of D).
- As the circumstances of entering the default judgment were suspicious and the majority shareholder/directors did not give any explanation, court allowed intervention and set aside default judgment.

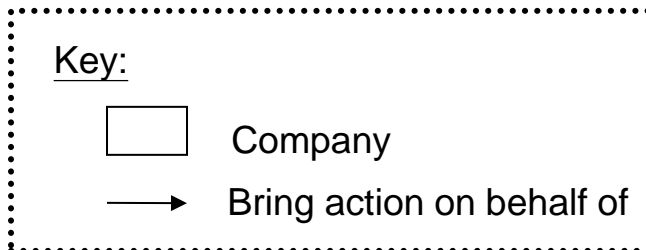
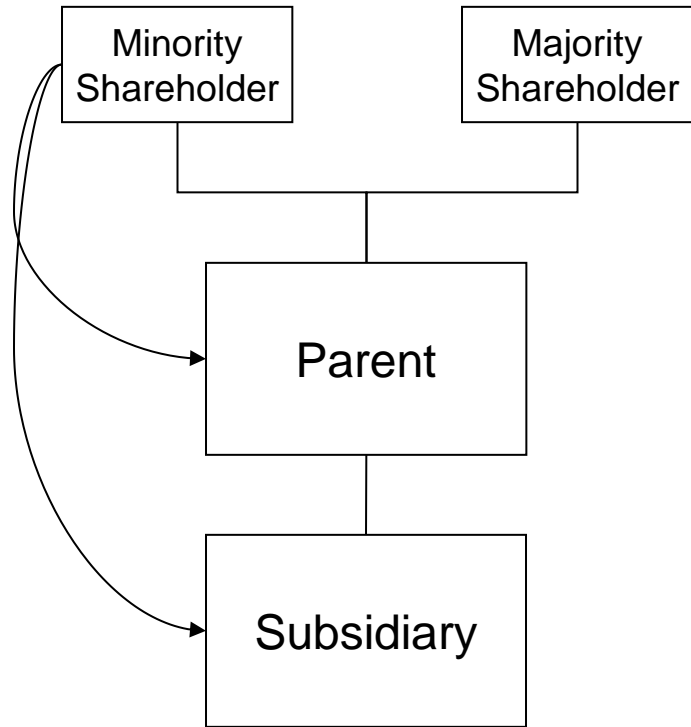


Issue:

What about if the wrong is committed against a subsidiary?

And what if the subsidiary is a BVI company?

Multiple Derivative Action (“MDA”)



An action through which minority shareholder of a parent company bring proceedings on behalf of both the holding company **and** its wholly owned subsidiary in respect of wrongdoings committed against the subsidiary

Position in Hong Kong under New Companies Ordinance (Cap. 622)

- **Statute**
 - Available to **associated companies**
 - S.732(1) : “If misconduct is committed against a company, a **member** of the company or of an **associated company** of the company may [...] bring proceedings in respect of the misconduct before the court on behalf of the company”
 - S.2(1): “**associated company**, in relation to a body corporate, means—
 - (a) a subsidiary of the body corporate;
 - (b) a holding company of the body corporate; or
 - (c) a subsidiary of such a holding company;”

Position in Hong Kong under New Companies Ordinance (Cap. 622)

- **Statute**
 - Available to non-Hong Kong companies
 - S.722 (1):
“In this Part (14) —
company includes a non-Hong Kong company.”
 - Multiple Derivative Action available to both Hong Kong and non-Hong Kong companies

Foreign Companies in Hong Kong

- ***Lex Incorporationis*** Availability of MDA is governed by law of the place of incorporation
 - “the Hong Kong Court will only entertain such derivative action if and only if an analogous action can be brought by the shareholder under the law of the place of the foreign company’s incorporation (Lawrence Collins J in *Konamaneni v Rolls Royce (India) Ltd*”
 - Reyes J in *East Asia Satellite Television (Holdings) Ltd v New Cotai, LLC & Others*
 - Reyes J held that MDA was not available under BVI law
 - Confirmed in CA – CACV 160/2010

Is MDA available in BVI?

Playmates Holdings Limited (stock code 635) HCA 3291/2003

- A minority shareholder took out an MDA against chairman Thomas Chan for causing an indirect subsidiary to sell assets at undervalue
- Thomas challenged that MDA should not be allowed.
- CFA ruled against him in 2008.
- However, at that time, no one paid attention to the fact that the indirect sub-sid is a BVI Co.
- After the decision of East Asia Satellite, Thomas was alerted of the issue.

Is MDA available in BVI?

- When the case was tried in 2013, Thomas raised the objection that BVI Co cannot have MDA.
- Judge said it was too late.
- However, judge went on to say if it were not too late, he would still hold (contrary to East Asia Satellite) that MDA is allowed in BVI.
- Thomas lost.



What about the position of the Majority?

The Position of the Majority

- Compulsory Buy-out of Minority – possible?
- **Re Nuneaton Borough AFC Ltd** [1990] BCLC 384)
- Court ordered compulsory buy out of the Majority by Minority on condition that the company pays off the loans advanced by Maj
- Maj not interested in running the club and neglected its duties

The Position of the Majority

- What can the majority do to pre-empt an unfair prejudice petition?
- The basic elements of a reasonable offer:-
 - To purchase share at a fair value
 - To be determined by a competent expert (jointly appointed)
 - Minority should be given access to company documents
 - Both sides should have the opportunity to make representations to the expert
 - Reasonable provision for costs



Thank you!





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Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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