

## Tianrui v China Shanshui: is it time for Foss v Harbottle to go?

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The recent Privy Council decision of *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36 will certainly have far-reaching implications for Cayman Islands company law.

In the latest decision in a long spate of litigation between China Shanshui Cement Group Ltd (**Company**) and its minority shareholder, Tianrui (International) Holding Company Ltd (**Tianrui**), the Privy Council confirmed that the shareholder of a Cayman Islands company has a personal claim against the company to challenge the allotment of shares where that the allotment was made for an improper purpose.

### Background

The dispute between the Company and Tianrui concerned the Company's allotment and issuance, by way of convertible bonds, of nearly 1 billion additional shares to third parties. This had the effect of reducing Tianrui's shareholding percentage below 25%, the practical implication of which was that Tianrui lost 'negative control', its ability to (partially) control the direction of the Company by blocking special resolutions.

The Company maintains that these steps were taken legitimately, to ensure compliance with the Hong Kong Stock Exchange's ongoing listing requirements. Tianrui, on the other hand, alleges that the shares were issued for an improper purpose, namely allowing two large shareholders and their affiliates to take over voting control in the Company.<sup>[1]</sup>

Tianrui issued a writ action seeking certain declaratory orders as to the unlawfulness of the directors' exercise of their powers in relation to the issuance of the convertible bonds and their conversion into shares (**Writ Proceedings**).

The Company applied for the Writ Proceedings to be struck out. In the strike-out application, the Company's position was that the Writ Proceedings were an abuse of process as Tianrui, as an individual shareholder, lacked standing to sue the Company because any alleged breaches by the directors were of duties owed to the Company, rather than to Tianrui as a shareholder.

It is this question of whether Tianrui had standing to bring such a claim that proceeded to the Privy Council, discussed further below.

### Quick recap: *Foss v Harbottle*

The foundational English case of *Foss v Harbottle*<sup>[2]</sup> is an (in)famous 1843 decision, which led to what is today known as 'the rule in *Foss v Harbottle*', comprising two key tenets: first, the 'proper plaintiff principle' stipulates that a company, not its

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shareholder, is the proper plaintiff to sue when harm has been caused to the company. Second, the 'majority rule principle' stipulates that the will of the majority of shareholders typically prevails in the administration of the company's affairs, unless there is a fraud on the minority.

## The Cayman position pre-*Tianrui*

Before *Tianrui*, the Cayman Islands position on direct shareholder claims was set out in the 2018 Grand Court decision of *Gao v China Biologic*.<sup>[3]</sup> The Grand Court held that, in accordance with the rule in *Foss v Harbottle*, a shareholder did not have standing to sue the company on the basis of an alleged breach of directors' duties in allotting and issuing shares. Such a claim concerned an alleged breach of duties owed to and enforceable by the company.

Interestingly, the position as set out in *Gao* is itself something of an outlier: whilst it abided by the rule in *Foss v Harbottle*, the position in respect of improper share allotment claims had diverged in other common law jurisdiction some 50 years ago.

In the 1970s Privy Council decision of *Howard Smith v Ampol*,<sup>[4]</sup> the Privy Council found that an improper allotment of shares by a company's directors affects the balance of voting power between the shareholders and thereby 'interfere[s] with that element of the company's constitution which is separate from and set against [the directors'] powers'.<sup>[5]</sup> As such, regardless of the rule in *Foss v Harbottle*, the shareholder enjoyed a direct claim to protect its personal interest in the shareholding proportion of the company.

## The Privy Council's *Tianrui* decision

Having reviewed the various authorities, the Privy Council noted that the courts of England and Australia, applying law 'not materially different to' <sup>[6]</sup> the law of the Cayman Islands, have repeatedly recognised a shareholder's personal action in these circumstances.

The Privy Council stated that both *Gao* and the decision below (which relied on *Gao*) were wrongly decided: Cayman Islands law recognises the right of a shareholder whose shareholding is diluted by an improper allotment of shares to bring a personal claim against the company to challenge that allotment.

The Privy Council's reasoning included the argument that a shareholder's 'active power' to vote and participate in the company is 'critically dependent upon' <sup>[7]</sup> the shareholder's relative holding. As such, dilution of that holding by an allotment of shares may alter the balance of power between shareholders. In addition, the Privy Council recognised that the cause of action is based on an implied term in the contract between the Company and *Tianrui* that the directors would exercise their powers to allot and issue shares in accordance with their fiduciary duties (that is to say, not for an improper purpose).

On this basis, the Privy Council held that the Court of Appeal had erred in allowing the Writ Proceedings to be struck out on the grounds of lack of standing, and allowed *Tianrui*'s appeal.

## Impact of this decision: start of the end of *Foss v Harbottle*?

This decision is of significance to shareholders in Cayman Islands companies because it clarifies that Cayman law is aligned with other common law jurisdictions as regards direct shareholder claims concerning improper share allotments.

That said, it is unlikely to deal a knockout blow to the nearly 200 years of juridical development represented by the rule in *Foss v Harbottle*. The *Tianrui* decision is specifically constrained to improper share issuances, which already enjoyed different treatment under the *Howard Smith* line of cases. It will certainly serve to bolster the arsenal available to minority shareholders in Cayman (and likely other jurisdictions that lack strong statutory shareholder protection regimes), and might well serve as a springboard from which other discrete shareholder claims are carved out of the general position.

However, at the end of the day, it is not only *Foss v Harbottle* that is responsible for the current state of the law: important considerations as to reflective loss, separate corporate personality and more all play a role, and are not easily defeated.

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[1] The appeal proceeded in the Courts below and in the Privy Council on the basis that Tianrui's averments as to the improper purpose of the share allotment and issuance were true; however, this remains an issue to be determined as a matter of fact in the next chapters of this saga.

[2] *Foss v Harbottle* (1843) 2 Hare 461.

[3] *Gao v China Biologic Products Holdings, Inc.* [2018] (2) CILR 591.

[4] *Howard Smith Limited v Ampol Petroleum Ltd* [1974] A.C. 821.

[5] *Howard Smith Limited v Ampol Petroleum Ltd* [1974] A.C. 821 at 837.

[6] *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36 at para 65.

[7] *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36 at para 68.

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