COLLAS CRILL

Managing and resolving shareholder disputes in Jersey

NOVEMBER 2020

The case of Sevilleja v Marex Financial Ltd (Marex) cast the spotlight firmly on what remedies are available to creditors and shareholders of a company. The Supreme Court's reversal of the Court of Appeal's decision in Marex unshackled creditors who are free to pursue claims without fear of the principle of reflective loss stifling their objective. Whilst shareholders remain caught by the principle of reflective loss, which the Supreme Court likened to 'ghastly legal Japanese knotweed', they still have a number of powerful tools at their disposal which can cause significant disruption and cost to a company, irrespective of the outcome.

Our earlier briefing note concerned the principle of reflective loss and remedies available to an aggrieved shareholder, namely the well-established pathways of:

1. an unfair prejudice claim under the Companies (Jersey) Law 1991 (as amended) (the **Companies Law**);
2. a common law derivative claim; or
3. an application to wind up the company under the Companies Law.

This briefing note looks in the opposite direction; namely, what tools are available to the directors of a company when managing and resolving a shareholder dispute.

Check the documentation

The starting point is to understand what rights the aggrieved shareholder has by reviewing the articles of association and any applicable shareholders' agreement. Consider where the balance of power lies and, in particular, where the approval of the shareholders is required.

The constitutional documents can also contain helpful provisions when it comes to the mechanics of resolving a dispute and might provide for the purchase of the aggrieved shareholder's shares in certain circumstances.

If the shareholder is also an employee, review the terms of his or her service agreement or employment contract but also bear in mind that even in the absence of this documentation the individual might still be classified as an employee under the Employment (Jersey) Law 2003 (as amended).

Directors' duties

Shareholders can try and place significant amounts of pressure on a board to bend to their will. Irrespective of the nature of the complaint or pressure, the board must remain fully cognisant of and comply with its statutory

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and fiduciary duties to act honestly and in the best interests of the company and, where the company is insolvent, its creditors.

In relation to this (and in addition to the ratification of acts or omissions by shareholders discussed below) the Royal Court of Jersey (the **Court**) is empowered to relieve an officer of a company in circumstances where a breach has occurred but that person has acted honestly and, having regard to all the circumstances of the case, he or she ought fairly to be excused pursuant to article 212 of the Companies Law. However, this is clearly very much a remedy of last resort.

Maintain clear records of meetings and decision making

The discovery (or disclosure) process, where documentation is exchanged between the parties is often the most crucial stage of legal proceedings. Making complete, clear and reasoned records of the board's decision-making is vital – it might be that these documents are reviewed by a court or regulatory body in the future.

Particular care should be taken discussing or reviewing legal advice to ensure that privilege over this advice is not inadvertently waived.

Communicate

Unless permitted by the constitutional documents, the board must not give preferential treatment to one shareholder over another, including when it comes to providing information. However, stonewalling the aggrieved shareholder is not advisable and unless the board understands the complaint, it cannot begin to deal with it effectively.

The board should make reasonable efforts to listen to and understand the shareholder's complaint. Depending on the approach of the shareholder, an initial meeting can often be helpful.

Check independence

Once the background to the complaint is understood, consider whether the board or certain members of the board are able to deal with the complaint objectively in the event that there is a potential conflict of interest.

It might be helpful (or perhaps necessary) to form a special committee or appoint an independent adviser to consider and deal with the complaint. This can also streamline and speed up the decision-making process.

Categorise the company

Does the company have the hallmarks of a quasi partnership? A quasi partnership might arise if one or more of the following elements are present: an association formed or continued on the basis of a personal relationship involving mutual confidence; an agreement or understanding that all or some of the shareholders would participate in the conduct of the business; and restriction on the transfer of the members' interest in the company.

If the company is a quasi partnership, equitable considerations come into play in addition to strict legal right.

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Categorise the complaint

Does the complaint relate to alleged mismanagement or alleged misconduct and what redress is being sought? These are important considerations which determine the nature of the proceedings that the shareholder would have to bring were it prepared to incur the cost of commencing legal proceedings.

If the complaint relates to alleged mismanagement, the company is typically facing an unfair prejudice application. If the complaint relates to alleged misconduct, the shareholder's options are likely limited to a derivative action. These are two very different processes that are accompanied by unique legal and factual considerations.

Focus on practicality

A careful evaluation of the shareholder's rights and remedies should be carried out at the earliest possible stage. However, a shareholder complaint can often be fuelled by emotion and principle. Deploying a practical and co-operative approach in the first instance instead of building a defensive wall of technicality and complexity can be an effective strategy.

Negotiate

Litigation can be time-consuming, expensive, uncertain and damaging to a company's reputation (and, consequently, its value). Try and find a way to resolve the shareholder's complaint outside of the court room and public eye but within the confines of the constitutional documents and in accordance with the duties imposed upon directors of Jersey companies.

The prospects of resolution might be increased by the use of an independent committee or individual who is not caught up in the complaint. Otherwise, a formal mediation process might be considered.

Consider calling a meeting of the company

A shareholder is able to force the board to call a meeting of the company by having one-tenth (or more) of the total voting shares. There might be a strategic and presentational upside in the board requisitioning the meeting first.

If negotiation has not proved effective, it might be that the shareholder's complaint can be dismissed or otherwise addressed by a shareholder vote. It is important that detailed and accurate information has been circulated to the shareholders in advance with the required period of notice.

It is also worth considering whether the other shareholders will be prepared to ratify the act or omission which is complained of pursuant to article 74 of the Companies Law.

Consider buying out the shareholder

Depending on what the constitutional documents state, it might be that that the aggrieved shareholder can be bought out by the company, another shareholder or a third party. If not, it might be that the nature of the

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shareholder's complaint and consequent cause of action before the Court could mean that a buyout of the shareholder is a likely outcome in any event.

If a buyout is to occur, consideration should be given to obtaining an independent valuation of the shareholding in issue unless the constitutional documents already provide for a value to be ascribed. It would be regrettable to have found an acceptable solution and then become embroiled in a valuation dispute.

Be prepared to litigate

Having taken legal advice, the board might form the view that if legal proceedings are issued, they should be defended, particularly when the complaint is considered to be unmeritorious or opportunistic so as to deter such a course of action by others in the future.

If this is the case, consider what can be done to secure the support of the other shareholders before the company embarks upon potentially costly and time-consuming litigation.

Just and equitable winding up

An application to wind up the company can be commenced by the company, a director or shareholder. However, it should be considered to be the 'nuclear' option and therefore requires careful consideration before launch.

The Court has said that the words just and equitable must be given a wide and flexible interpretation; therefore, it is not possible to give an exhaustive list of circumstances in which it will order a company be wound up on these grounds.

The traditional grounds on which successful applications have been brought, include:

- a deadlock arising in the management of the company as a result of which decisions cannot be made regarding the company's business;
- a justifiable loss of confidence in the management of a company due to fraud, dishonesty or serious mismanagement of the company's business by the directors or majority shareholders;
- a breach of an agreement in the company's articles of association and/or shareholders' agreement; or
- a breakdown in mutual trust and confidence between the shareholders where the company is properly characterised as a partnership, called a quasi partnership, despite its corporate form (by excluding a shareholder from participating in the company's management, for example).

Read our guide on key things you need to know about winding up a company on just and equitable grounds here.

Take legal advice early

Shareholder disputes turn on their own facts and can quickly become complicated and expensive. Taking early legal advice and having a clear and robust shareholders' agreement can often greatly assist with defusing an

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aggrieved shareholder’s complaint confidentially and at an early stage.

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