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Examiner - Professional 1 Stage Corporate Laws**

Shareholder rights and remedies

Introduction

This article reviews certain aspects of two of the consequences of owning shares in a company; shareholder rights and remedies. Of course there are other consequences, such as the duty to pay for those shares in full, on demand.

Nature of a Share

It is difficult to describe a share and impossible to show one! A share is personal property, as opposed to real property. A private company limited by shares must have a share capital and each shareholder owns at least one share of that capital. That does not mean that he owns a part of the company's assets and there is no direct connection between the "share" in the company and any particular assets. This was made clear in *Kerry Co-Op Creamery Ltd. v An Bord Bainne Co-op Ltd*¹ and in *AG v Jameson*² where the court held that "no shareholder has any right to any specific portion of the company's property".

The most important aspect of share ownership is that rights are conferred on the shareholder. The rights of shareholders are contractual rights by virtue of section 25 of the Companies Act, 1963 ("the 1963 Act"). That section provides that the memorandum and articles of association of the company are to be treated as if they were a deed duly signed and sealed by each shareholder. This elevates the memorandum and articles of association to the status of a binding contract between the shareholders.

A. Shareholder Rights – sources and samples

A shareholder has three main rights at common law;

- to receive a share of the company's distributable income in the form of dividend,
- to attend and (usually) to vote at meetings of the company, and
- to participate in the distribution of the assets of the company where it is wound up and its creditors have been paid in full.

The memorandum and articles of association may vary these common law rights and Statute does – for example, in the area of dividends. Section 45 of the Companies (Amendment) Act, 1983 provides that dividend may only be paid out of "profits available for distribution".

In other words, in addition to the common law rights, rights may arise under Statute or by virtue of the memorandum and articles of association.

¹ [1990] ILRM 664

² [1904] 2 IR 644

Shareholders statutory rights include rights to ;

- see the company's accounts - s.159 of the 1963 Act,
- receive notice of every general meeting - s.s 131 – 133 of the 1963 Act,
- inspect and get copies of general meeting minutes and resolutions - s. 143 of the 1963 Act,
- first refusal, or pre-emption rights, on a new issue of shares by the company, - s.23 of the 1963 Act, and
- petition the court pursuant to s.205 of the 1963 Act when treated in an oppressive manner.

Different Classes of Shares

Prima facie all shares are of equal status, unless otherwise stated. However, sometimes the memorandum and articles of association create classes of shares, often preference shares. The rights attaching to the classes of shares are dealt with in the articles of association.

A preference share, for example, usually gives its holder the right to a fixed dividend yield – 5% or 10%. The share might also give preferential rights to a return of capital available for distribution on a solvent winding up. Shares can be voting or non-voting, as in *Salomon v Salomon & Co. Ltd.*³ The non-preference shares are called ordinary shares and those two classes are the most common. So, to that extent shareholder rights may vary significantly depending on the class of shares they own.

Transferring your Shares – is it a right ?

It is essential that a company, to qualify as a private company limited by shares, have a share capital and have three provisions in its' articles of association. One of the provisions required to be contained in the articles is a restriction on the transfer of its' shares. That often takes the form of the directors having power to refuse registration of any transferee of shares. Obviously, that may impact substantially on a shareholder's ability to sell his shares in a private company. Where a shareholder wishes to sell his shares a two stage process is involved; a contract for the sale of the shares must be made and the transfer must be registered by the directors. Only then does the new "shareholder" become a member of the company and accrue any rights.

Table A, for example, provides that the directors may – in their absolute discretion – and without assigning any reason, decline to register any transfer of any share. Other sample restrictions are restrictions of transfers only to existing shareholders, family of existing shareholders or employees of the company.

Whatever the power of restriction is, it must be exercised by the directors bona fide and for the benefit of the company as a whole. Where the provision is that of Table A and no reasons need be given , the prospective transferee has few grounds on which to appeal a refusal unless they can show the directors have abused their powers and that the refusal was not bona fides. One effect of this is that the shareholders right to sell and transfer his shares is not an absolute right.

³ [1897] AC 22

*Re Smith and Fawcett Ltd.*⁴ concerned a provision similar to that in Table A and the Court of Appeal, in the judgment of Lord Greene M.R., upheld the broad discretion of the directors “to take into account any matter which they conceive to be in the interests of the company”. The court went on to say the directors could consider whether the transferee “would gain too great a weight in the councils of the company or might even perhaps obtain control”.

In *Re Hafner*⁵ Black J. upheld the rule on the absence of reasons being given by directors. The judge stated that while the directors power must not be exercised “arbitrarily, capriciously or corruptly. They are not bound to assign their reasons, and the court is not entitled to infer merely from their omission to do so that their reasons were not legitimate.” The absence of a requirement to give reasons becomes irrelevant where an invalid reason for declining to register is proved to the satisfaction of the court. On the facts of this case the court accepted that the directors refusal to register the transfer was designed to force the transferee/nephew to sell his shares to them at an undervalue and to prevent him questioning the directors voting themselves large remuneration packages. The acceptance by the court of this allegation of improper motive was therefore enough to allow the court draw an inference from the directors silence.

In *Tangney v. The Clarence Hotels Co. Ltd.*⁶ the articles of association gave the directors discretion to refuse to register a transfer of shares to a person they thought was not a “desirable person to admit to membership”. The plaintiff had been a shareholder and member of the company for many years. He bought more shares in the company but the directors relied on the discretion described above when refusing to register those additional shares in his name. Johnston J. held that the discretion related to “strangers proposing to come into the family, as it were” and could not be relied upon in respect of an existing member applying for registration of additional shares.

B.

Shareholder Remedies

There are many rights available to shareholders and a number of possible sources of those rights. At common law, shareholder remedies and protection for minority shareholders were envisaged by the exceptions to the rule in *Foss v Harbottle*⁷. These are limited in their applicability and statute provides far greater protections. The protections offered, for example, by section 205 of the 1963 Act are far more significant and widely known. However, the 1963 Act also provides other remedies and some of those are reviewed below.

1. Petition the Court for an order to wind up the company

Section 213 of the Companies Act 1963 provides various grounds on which the court may order the winding up of a company. The relief is discretionary. Section 213 (f) provides that the court may order the winding up of a company where it is of the opinion that “it is just and equitable” to do so.

⁴ [1942] 1 Ch. P.304

⁵ [1947] IR p.426

⁶ [1933] IR p.51

⁷ (1843) 2 Hare 461

There was a view that sub-section (f) was to be read in connection with, and with reference to, the preceding subsections of section 213, applying the *ejusdem generis* principle of interpretation. That view has now been dispelled and the broader interpretation, giving the courts greater discretion, has been confirmed. Section 213 (f) can therefore be a very useful tool for resolving situations of corporate dysfunction, where s.205 oppression can not be shown.

In the *Re Murphs Restaurants*⁸ case Gannon J. referred to the *quasi partnership* nature of the company concerned and focussed on the breakdown of the relationship of confidence, mutuality and partnership. The judgment acknowledged that while there might be a power in company law to remove a director from the board, the exercise of that power may render it “just and equitable” to wind up a company. This would be the case where the character of the company was so close and so mutual that there is a special underlying obligation on shareholders to allow fellow shareholders participate in the management of the company.

Relief will also be granted where there is a *deadlock in corporate management*. This often arises where the voting power in the company is evenly divided between two people or groups who are at loggerheads. In *Bluzwed Metals Ltd. v Transworld Metals SA*⁹ the High Court exercised its power to wind up because the company’s activities were “effectively paralysed to the detriment of both the members and creditors”. Another example exists in *Re Vehicle Buildings and Insulations Ltd.*¹⁰ In ordering the winding up of that company Murphy J. referred to the “complete unwillingness of each party to co-operate with each other”.

The two more important categories of cases of winding up on “just and equitable” grounds are quasi partnership and deadlock in corporate management.

2. Miscellaneous statutory remedies.

This category give rise to shareholder rights where the majority agree to serious organisational /constitutional change and there is a dissenting shareholder(s).

Express statutory provisions providing relief to the dissenter(s) exist in respect of ;

- Proposed alterations to the objects clause – section 10(2) allows the dissenting shareholder make an application to court and section 10(6) provides wide discretion to the courts in terms of relief, including the power to order the purchase of dissident shareholders’ shares.
- Variations of class rights – section 78 provides a power for a dissenting minority of holders of shares in a particular class to have a variation of their class rights cancelled by the court.

C. Conclusion

The incorporation of a business has many consequences, not least for the shareholders in the resulting company. The resulting contract is a complex one and statutory provisions add to the complexity of the contract in many ways. Many of these however operate to the advantage of the shareholders, particularly when they find themselves in a minority.

⁸ [1979] ILRM 141

⁹ (9 May, 2001 unrep.)

¹⁰ [1986] ILRM 239