

Royal Court considers shareholder intervention in management decisions

UPDATE

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On 17 October 2016, the Royal Court of Jersey handed down a judgment in proceedings arising out of a long standing deadlock between the members of the board of directors of a Jersey company, Galasys plc (the Company).

This judgment considers the power of shareholders to intervene in management decisions which would ordinarily rest in the hands of directors.

Factual background

Galasys plc was incorporated in Jersey in 2014 with shares listed on the AIM market of the London Stock Exchange. It is the holding company of a group which carries on business primarily in China and Malaysia. In compliance with AIM Rules, the company established three management sub-committees, including a 'Nomination Committee' which was responsible for considering the composition of the board and nominating new directors from time to time.

During the course of 2015, the three members of the Nomination Committee raised concerns over the governance of the Company and the performance of individual directors. A board meeting was convened to discuss these matters during which the Nomination Committee proposed a number of resolutions, including resolutions to terminate the positions of two of the Company's directors. Those resolutions were the subject of dispute amongst the parties.

The Nomination Committee maintained that the resolutions were validly passed as the meeting was quorate and sufficient votes were obtained in favour of the resolutions. The other directors disputed the validity of the resolutions on the basis that the meeting had been adjourned before a vote could be taken. They also contended that the attempt to remove the two directors was part of a plot by certain members of the Nomination Committee to gain control of the Company, in breach of the individual directors' duties to act in good faith in the best interests of the Company.

This situation created uncertainty as to the composition of the board and subsequent meetings became equally contentious as it was disputed which directors were in fact in office. Legal proceedings were commenced in Malaysia and England. The Malaysian proceedings concerned an attempt to get the dismissed directors back on the Board and the English proceedings were to block an attempt to call an EGM to reconstitute the Board, this being said to breach a relationship agreement entered into as part of the listing and preventing the largest shareholder from controlling the board.

Proceedings in the Royal Court

There was a dispute in the English proceedings as to which directors had authority to act in the name of the Company in bringing those proceedings. As such, pursuant to an undertaking given to the English High Court, two members of the Nomination Committee commenced proceedings in Jersey to determine whether the Nomination Committee had authority to take various steps in the name of the Company, including the ability to bring legal proceedings. This required the Court to consider the events of the

previous board meetings. The Jersey proceedings were therefore brought in the name of the two members of the Nomination Committee and the Company itself, and the respondents were the remaining directors who disputed the actions of the Nomination Committee.

The proceedings in Jersey commenced in January 2016 and were scheduled to be heard in April 2016 over eight days as a *cause de brève* (ie a speedy trial). However, the issues in the case expanded significantly and it was ultimately delayed to September 2016 for a three week trial. Shortly prior to the scheduled start of trial the respondent directors who remained in office purported to pass a directors' written resolution authorising the Company to bring the proceedings to an end. The validity of that resolution was, however, disputed by the Representors.

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The respondents did not, however, in the end press their reliance on the directors' resolution. Instead, the focus became a notice from two shareholders calling for an EGM. The resolutions to be put to a vote of the shareholders were drafted in similar terms to the resolutions purportedly passed by the directors' written resolution, and purported to give authority to one of the respondents to take steps on behalf of the Company to discontinue the proceedings in Jersey, England and Malaysia.

The shareholders passed the resolutions in due course and did so as ordinary resolutions.

Challenging the validity of the shareholder resolutions

In response to the events at the EGM, the Representors made an application to the Court to challenge the validity of the shareholder resolutions. The principal ground for that challenge was that management decisions must be made by the directors to whom the Company had delegated such responsibility, and shareholder intervention in management decisions can only be valid if passed in accordance with the Articles of Association of the Company, which required a special resolution (which in turn required 75 per cent in this case).

In determining this issue, the Court reviewed a long line of authorities in relation to the ability of shareholders to intervene in management decisions. It was argued on behalf of the Representors that decisions affecting the business must be taken by directors, as they are entrusted with the control of the business on behalf of shareholders (*Gramophone and Typewrite Limited v Stanley* [1908] 2 KB 89). However, the Court accepted that a departure from this rule can be permitted in circumstances where the board is unwilling or unable to act.

The circumstances envisaged by this exception were thoroughly examined. The Representors argued that this rule can only operate in the most limited circumstances and subject to the terms of the Articles. They drew the Court's attention to the Australian Court of Appeal decision in *Massey v Wales* [2003] NSW CA 212 in which the event of a deadlocked board was considered in depth. In that case, the court acknowledged the reserve power of shareholders to act in general meetings in situations where the directors could not act for some reason. However, it refused to give effect to the exercise of such power by shareholders when the issue preventing the directors from passing resolutions could be resolved by the appointment of additional directors to break a deadlock. The Jersey Court found in the present case, however, that because the appointment of new directors was arguably not possible due to an injunction in the English proceedings, the power of the shareholders to appoint additional directors contained in the Company's Articles did not provide a viable means to break the deadlock at board level. As such, the Court held that the shareholders could exercise the power and authorise the Respondents to seek to discontinue the proceedings on behalf of the Company. Having made that decision, the Court did not then need to determine whether, as the Representors contended, Jersey Law should follow the decision in *Massey* and only allow shareholders to exercise their residual power where the Articles did not provide for alternative means to deal with any impediment to the board acting. However, it stated *obiter* that, had it been required to decide the issue, it would have preferred the wider view, namely that shareholders always have a reserve power where the board is unable to act, and that such reserve power is not limited to appointing additional directors.

In considering whether such a power required an ordinary or special resolution, the Court held that in cases where the directors are unable to act that power must be exercisable by ordinary resolution, otherwise the position was no different from where the directors were able to act (it being well-established that shareholders may compel directors to act by resolution passed with the level of votes necessary to

amend the Articles and, in this case, there being a specific provision in the Articles allowing shareholders to issue directions to the board by special resolution).

A final issue that arose was that the directors were unable to act in this case because of conflicts of interest. The Articles provided a mechanism for shareholders to ratify decisions of the directors in conflict situations by way of ordinary resolution. However no specific disclosure of conflict of interest was made by the directors and the shareholders were not expressly asked to ratify the decision. Article 76 of the Companies (Jersey) Law 1991 requires a special resolution where there has been no disclosure of a relevant conflict. In this case, the Court was, however, satisfied that, notwithstanding the failure of the directors to disclose their personal interest in the outcome of the resolutions, this fact did not render the transaction voidable as the shareholders were sufficiently aware of the ongoing litigation which gave rise to the conflicts.

Conclusion

By its judgment, the Jersey court has confirmed that shareholders will only be allowed to interfere in management decisions delegated to the board in limited circumstances. Although the Court found that, in the circumstances of this case, the shareholders were able to exercise the relevant powers because the directors were unable to, it remains an open question whether the proper remit of such a residual power should be confined as per the Australian Court's decision in *Masse*, or whether the wider approach (that the Court stated *obiter* it preferred), should prevail.

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