

UPDATE

Improper exercises of Board power: Privy Council upholds shareholders' personal right of action against companies

Update prepared by Michael Popkin and Sharina Mahtani (Hong Kong)

On 14 November 2024, the Judicial Committee of the Privy Council delivered a landmark decision in *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36 confirming a shareholder's standing to bring a personal claim against a company for improper exercises of power by its directors.

The battle for control of China Shanshui

The decision arises from a prolonged battle for control of the respondent, China Shanshui Cement Group Ltd (**China Shanshui**), a Cayman Islands exempted company listed on the Hong Kong Stock Exchange (**HKSE**). China Shanshui is the holding entity for a group principally engaged in the production, distribution and supply of cement and related construction products in the PRC.

Following the issuance of two tranches of convertible bonds, a majority of China Shanshui's shareholders (including Asia Cement Corporation (**ACC**) and China National Building Materials Co Ltd (**CNBM**)) resolved at an extraordinary general meeting to direct the directors to allot and issue shares to the bondholders. The resultant share issuance diluted the appellant's (**Tianrui**) shareholding from 28.16 per cent to below 25 per cent. Tianrui contended that ACC, CNBM and the bondholders were acting in concert to seize voting control of China Shanshui. It claimed that the share allotment and issuance were intended to facilitate ACC and CNBM's control, dilute Tianrui's shareholding and thus eliminate its ability to block special resolutions (i.e. its negative control). It followed that the issue of the bonds and the share allotment constituted an improper exercise of China Shanshui's power to allot and issue securities.

Appeal background

Tianrui commenced proceedings in the Grand Court, seeking declarations that the directors' issuance of the convertible bonds and subsequent share allotment and issuance were invalid exercises of their powers. China Shanshui applied to strike out the proceedings, asserting that it constituted an abuse of process under the 'rule in *Foss v Harbottle*'.¹ It argued that Tianrui lacked standing to bring the claims as they were premised on breaches of fiduciary duties owed by the directors to China Shanshui itself, and not to Tianrui personally.

At first instance, Segal J dismissed China Shanshui's application,² concluding that a minority shareholder has standing to bring a personal claim against the company and that the appropriate remedy for Tianrui's share dilution was a declaration, binding on the company, that the allotment and issue of the shares was unlawful. In July 2022, the Court of Appeal allowed China Shanshui's appeal and held that a shareholder has no personal right of action in such cases and that the proper plaintiff is the company itself.³

¹ (1843) 2 Hare 461

² *Tianrui (International) Holding Company Limited v China Shanshui Cement Group Limited* 2020 (2) CILR 6 (Segal J)

³ *China Shanshui Cement Group Limited v Tianrui (International) Holding Company Limited* 2022 (2) CILR 28 (Goldring P, and Field and Morrison JJA)

Consideration of 'first principles'

The Board approached the challenge to Tianrui's standing from '*first principles*', noting the limited jurisprudential discussion in the authorities reviewed by the Board.⁴ It was determined that:

1. The basis of a shareholder's right to bring an action against the company to challenge an improper exercise of the directors' power to allot and issue shares is the contract between the shareholders and the company, constituted by its memorandum and articles. It is necessarily an implied term of that contract that the directors as the company's agents will exercise the power to allot and issue shares in accordance with their fiduciary duties.⁵
2. An improper exercise of such powers breaches the corporate contract between the company and its shareholders, notwithstanding that the relevant fiduciary duties breached by the directors are owed to the company, and not the shareholders directly.⁶
3. An improper allotment or issuance of shares is voidable (rather than void).⁷
4. The size of the aggrieved shareholder's shareholding is in principle irrelevant. What matters is that the aggrieved shareholder has suffered from an interference with their rights as shareholder brought about by the improper issue and allotment.⁸
5. The availability of an action by the company in respect of the same breach of duty by the directors does not exclude a shareholder's personal action against the company.⁹
6. The theoretical possibility that the invalid allotment could be ratified by a majority of shareholders is not sufficient to deprive the shareholder of their cause of action. There would need to be an actual ratification which would be constrained by the rule against oppression of the minority.¹⁰

Applying these principles, the Board allowed Tianrui's appeal. The Board regarded this as a '*strong case*' on the assumed facts for the availability of a personal shareholder's action and held that the dilution of Tianrui's shareholding (with the effect of depriving it of negative control) was an interference with its rights as shareholder.¹¹

Conclusion

This decision provides long-awaited clarity on an aggrieved shareholder's ability to directly pursue a personal claim against a Cayman Islands company when its directors improperly exercise their powers to dilute that shareholder's stake and voting power. In applicable circumstances, this may streamline an aggrieved shareholder's path to obtaining relief and reduce the need to rely on alternative remedies such as a derivative action (which, if contested, would require the shareholder to apply to the Grand Court to seek leave to continue with the action) or a just and equitable winding up of the company.

⁴ The Board noted that a challenge to a shareholder's standing has been addressed and rejected with principled reasons for doing so in only one of the cases reviewed by it (the decision of the Supreme Court of South Australia in *Residues Treatment & Trading Co Ltd v Southern Resources* (1988) 6 ACLC 1160). However, the Board commented that it '*does not entirely agree*' with the reasoning of King CJ in that case [65] – [66] of *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2024] UKPC 36

⁵ *Ibid.* [75] – [76]

⁶ *Ibid.* [72]

⁷ *Ibid.* [74]

⁸ *Ibid.* [78]

⁹ *Ibid.* [79]

¹⁰ *Ibid.* [82] – [84]

¹¹ *Ibid.* [85]

Contacts



Michael Popkin
Partner
Mourant Ozannes (Hong Kong) LLP
+852 3995 5769
michael.popkin@mourant.com



Nicholas Fox
Partner
Mourant Ozannes (Cayman) LLP
+1 345 814 9268
nicholas.fox@mourant.com



Simon Dickson
Partner
Mourant Ozannes (Cayman) LLP
+1 345 814 9110
simon.dickson@mourant.com



Sharina Mahtani
Senior Associate
Mourant Ozannes (Hong Kong) LLP
+852 3995 5737
sharina.mahtani@mourant.com

This update is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this update, please get in touch with one of your usual contacts. You can find out more about us, and access our legal and regulatory notices at [mourant.com](https://www.mourant.com). © 2024 MOURANT ALL RIGHTS RESERVED