Chapter 9 – Members’ remedies

Helen, Tom and Joseph have, for ten years, run a small, but successful partnership. They decide to incorporate the business and a new company (JME Ltd) is created and the business is transferred to the new company. Helen, Tom and Joseph become directors and each take 300 shares in the company. A further 200 shares are issued and allotted to Dave, a local businessman. The Articles of JME Ltd provide that (i) no director can be removed without his or her prior consent, (ii) each director is to receive a salary of £150,000 per year, and (iii) any shareholder who wishes to sell his shares must first offer them to the directors.

After incorporation the company was successful but no dividends were paid as all the profits were ploughed back into the company, the directors drawing only their salaries of £150,000 each year.

In 2012 Joseph had an argument with Tom and Helen over matters of business policy. After this argument, Tom and Helen made all the business decisions in advance and outvoted Joseph at all the directors’ meetings. Joseph initially complained but has now lost interest and ceased attending meetings.

Recently, Tom and Helen have voted to remove Joseph as a director at a general meeting and also have voted to distribute the profits by increasing the directors’ salaries to £300,000 per annum.

Discuss whether or not JME Ltd has been run in a manner that is unfairly prejudicial, or whether any conduct has taken place that would justify winding up the company.

Introduction

- Note that the question requires you to discuss two shareholders’ remedies only, namely the unfair prejudice remedy, and a petition to wind up the company. Do not be tempted to discuss other remedies (e.g. derivative claims) – comply with the question’s instructions.
- It is important that you understand the relationship between the various shareholders’ remedies and to note that they are not mutually exclusive.

Payment of dividends

- The issue here is can non-payment of a dividend constitute unfairly prejudicial conduct. Where the directors decide to not issue dividends to an aggrieved petitioning shareholder, and instead issue the profits to themselves in the form of a salary, then this is indeed capable of constituting unfairly prejudicial conduct (Grace v Biagioli [2006] – it is important to note that in this case, the dividend had already been declared and the directors subsequently decided to not issue it based on the petitioner’s conduct).
Dave may therefore feel aggrieved that no dividend has been paid to him. Joseph, following his removal from the board, will also feel aggrieved (see the case of *Quinlan v Essex Hinge Co Ltd* [1996] for a case with similar facts to those of Joseph).

Point out that a finding of unfairly prejudicial conduct will more likely be established where no dividends are paid, even though the company has built up significant financial reserves. However, if the company’s financial performance is such that the payment of dividends is not justified, then it is highly likely that non-payment of dividends will not amount to unfairly prejudicial conduct (*Re Metropolis Motorcycles Ltd* [2007]).

**Removal of Joseph**

Many shareholder disputes involve cases where a member has been excluded from management. Depending on the type of company involved, exclusion from management may amount to unfairly prejudicial conduct and/or justify the winding up of the company.

**Unfairly prejudicial conduct**

Joseph has at first been excluded from management and then formally removed as a director. A substantial number of unfair prejudice petitions relate to situations where the petitioner has been excluded from management. It is worth noting at the outset that, in many types of company, the exclusion of a member from management will not amount to unfairly prejudicial conduct as the members will not expect to be involved in management. The type of case where this issue arises most commonly is where the company is small, the directors and members are the same persons and one of the directors is excluded from management. In other words, you will want to establish whether or not the company in question is a quasi-partnership (for guidance of what constitutes a quasi-partnership, see the case of *Ebrahimi v Westbourne Galleries Ltd* [1973]).

The courts have held on numerous occasions that the exclusion from management of a member of a quasi-partnership company is capable of amounting to unfairly prejudicial conduct, providing that it was understood by the other members that the petitioner would be involved in management (see e.g. *Brownlow v GH Marshall Ltd* [2000]). Accordingly, these cases must be viewed as a notable limitation on the ability to remove a director under the CA 2006, s 168.

However, it does not follow that such exclusion will always amount to unfairly prejudicial conduct (e.g. the petitioner’s conduct may justify his expulsion). Further, the courts are mindful of the fact that disagreements between members are common in the business world and a breakdown in relations may not, in itself, amount to unfairly prejudicial conduct (see *O’Neill v Phillips* [1999]).

**Winding up**

The courts have stated on numerous occasions that an order winding up a company will be appropriate where the company in question is a quasi-partnership and the petitioner has been excluded from participating in management, providing that he had a legitimate expectation that he would be involved in the company’s management.
• The classic case that you will need to discuss in some detail is *Ebrahimi v Westbourne Galleries Ltd* [1973]. This case is important for two reasons. First, it is a case involving the expulsion from management of a member. Second, the House laid down a series of guidelines to help determine whether or not a company is a quasi-partnership. This second factor is crucial as, outside of such companies, there will likely be no expectation to be involved in management and so a winding up will not be justified. Point out that, where the company is a quasi-partnership, the courts will often give effect to the legitimate expectations of the parties.

• You may also want to point out that, given Joseph’s expulsion will likely amount to unfairly prejudicial conduct, that a winding up is too drastic a remedy. You may also want to briefly discuss the relationship between the two remedies.

**Increase in salary**

• Can the payment of a seemingly exorbitant salary amount to unfairly prejudicial conduct? There is little doubt that, where the company has accrued substantial profits and distributes those profits to directors via excessive remuneration, then this can amount to unfairly prejudicial conduct, providing that there are members (who are not directors) who do not receive a share in the profits via a dividend (see e.g. *Re a Company (No 004415 of 1996)* [1997]).

• Accordingly, it is likely that the increase in Tom and Helen’s salary could amount to unfairly prejudicial conduct. A salary of £300,000 per annum would seem excessive given that the company is small. Further, the company has never paid out any dividends, so Dave and Joseph are likely to feel aggrieved if the company is distributing the profits to the directors via a salary increase. Such conduct will clearly unfairly prejudice members who are not directors.